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ERRATA

The table below corrects for printing errors in Lily L. Batchelder, *Taxing the Poor: Income Averaging Reconsidered*, 40 HARV. J. ON LEGIS. 395, 447, tbl. 3 (2003). The online versions of the Article will be updated with this corrected table.

TABLE 3. INCOME VOLATILITY REGRESSIONS, FAMILIES WITH HEADS AGED 44–49

(Dependent Variable: Standard Deviation of Log Income as Percentage of Average Log Income)				
Regression	1		2	3
2d Decile	**–0.019**** 0.007	Time	**0.002**** 0.001	**0.003** 0.003
3d Decile	**–0.026***** 0.008	2d Quartile	**–0.016***** 0.002	**–0.022***** 0.004
4th Decile	**–0.015**** 0.008	3d Quartile	**–0.021***** 0.002	**–0.022***** 0.004
5th Decile	**–0.030***** 0.008	4th Quartile	**–0.021***** 0.002	**–0.021***** 0.004
6th Decile	**–0.030***** 0.008	HS Grad.	**0.002** 0.002	**0.001** 0.003
7th Decile	**–0.031***** 0.008	Some College	**0.004**** 0.002	**0.000** 0.004
8th Decile	**–0.034***** 0.008	College Grad.	**0.001** 0.003	**–0.006** 0.004
9th Decile	**–0.037***** 0.008	Black	**0.000** 0.003	**0.010**** 0.004
10th Decile	**–0.026***** 0.008	Single Parent	**0.006*** 0.003	**–0.004** 0.006
HS Graduate	**0.008**** 0.004	Married Parent	**0.001** 0.002	**–0.005*** 0.003
Some College	**0.006** 0.004	Never Rcv'd AFDC as Adult	**–0.006*** 0.003	**0.004** 0.006

TABLE 3 (CONT.)

College Graduate	**0.006** 0.005	Time * 2d Q.		**0.004**** 0.002
Black	**–0.014**** 0.006	Time *3d Q.		**0.002** 0.002
Single Parent	**0.017***** 0.006	Time *4th Q.		**0.001** 0.002
Married Parent	**0.006*** 0.003	Time *HS Grad.		**0.001** 0.002
Never Rcv'd AFDC as Adult	**–0.025***** 0.007	Time * Some College		**0.002** 0.002
Constant	**0.066***** 0.009	Time * College Grad.		**0.004*** 0.002
		Time * Black		**–0.008***** 0.003
		Time * Single Parent		**0.006**** 0.003
		Time * Married Parent		**0.004**** 0.001
		Time * Never Rcv'd AFDC as Adult		**–0.007**** 0.003
		Constant	**0.039***** 0.004	**0.036***** 0.007
Obs.	366		1495	1495
Time period	1987–92		1968–92	1968–92

OLS regression, 1968 weights. Coefficients are indicated in bold, robust standard errors in normal script.

*** denotes p-values at the 1% level or lower; ** denotes 5% level; * denotes 10% level.

POLICY ESSAY

SMALL BUSINESS HEALTH PLANS: A CRITICAL STEP IN SOLVING THE SMALL BUSINESS HEALTH CARE CRISIS

SENATOR OLYMPIA J. SNOWE*

In this Policy Essay, Senator Olympia J. Snowe argues that passage of Small Business Health Plan (SBHP) legislation will address the critical health insurance needs of small business employees by fueling a more competitive market for coverage. Senator Snowe highlights the legislation's provisions, debunks common criticisms of SBHPs, and recommends the enactment of SBHP legislation as a means to ameliorate the lack of affordable health insurance coverage for small business employees.

Across the country, the number one issue I hear, time and time again, is how soaring costs have moved health care far beyond the reach of the average American citizen. Issues like Supreme Court confirmations and the war against terrorism dominate headlines. But a far more pressing policy concern—one that has not received much attention by the mainstream media—is the rising number of uninsured Americans, in particular those who work for small businesses.

The American people have consistently and overwhelmingly told Congress that action is needed to address access to affordable health insurance and the explosive growth in premiums. In four of the past five years, health insurance costs have increased by double-digit percentages.[1] Health insurance costs are on pace to become the largest share of employers' total benefit packages, surpassing total retirement benefits.[2] According to a December 2004 study by the Employee Benefit Research Institute ("EBRI"), health care spending in 2004 constituted 43.2% of employers' total benefit spending, up from 36.3% in 1990.[3]

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* Member, United States Senate (R-Me.). Senator Snowe serves as chair of the Senate Committee on Small Business & Entrepreneurship. Member, United States House of Representatives, 1978–94; Member, Maine State Legislature, 1973–78. I would like to thank Alexander N. Hecht, J.D., LL.M., Regulatory Counsel for the Senate Committee on Small Business & Entrepreneurship, for his research assistance on this Policy Essay.

[1] *See* Press Release, Kaiser Family Found., Survey Shows Private Health Insurance Premiums Rose 11.2% in 2004 (Sept. 9, 2004), *available at* http://www/kff.org/insurance/chcm090904nr.cfm; *see also* KAISER FAMILY FOUND., EMPLOYER HEALTH BENEFITS 2005 ANNUAL SURVEY 1 (2005), *available at* http://www.kff.org/insurance/7315/upload/7315.pdf.

[2] Michael W. Wyland, *Health Care Costs on Track to Become Largest Portion of Employer's Benefit Costs*, BNA DAILY REPORT FOR EXECUTIVES, Jan. 3, 2006, at A-6 (citing Ken McDonnell, *Finances of Employee Benefits: Health Costs Driving Changing Trends*, EBRI NOTES, Dec. 2005, at 2).

[3] *See id.* at A-5.

Further compounding the problem, small businesses are trapped in dysfunctional small group insurance markets lacking meaningful competition, in which only a handful of larger insurers offer few coverage choices. Unfortunately, the United States Senate has failed to pass legislation to confront this deepening national crisis that continues to harm small businesses' ability to create jobs and compete in today's global economy.

One critical solution to the small business health care crisis is Small Business Health Plan ("SBHP") legislation. In February 2005, I introduced the Small Business Health Fairness Act of 2005,[4] a bill that would allow small businesses to band together in SBHPs, offered through professional associations. These SBHPs would allow small businesses to offer quality health insurance to their employees across state lines with uniform benefits packages and at lower costs. Touted by President George W. Bush and supported by a coalition representing over twelve million employers and eighty million employees, SBHPs represent a fair, fiscally sound, and tested approach to reducing the number of uninsured Americans at nominal cost to the federal government.[5]

In this Policy Essay, I examine the plight of America's uninsured, with a specific focus on the deepening health insurance crisis that now confronts small businesses. I argue that the small group insurance market reforms in the Health Insurance Portability and Accountability Act ("HIPAA") of 1996[6] have failed to produce meaningful competition among insurers and choices for small businesses. Finally, I advocate for SBHP legislation, a critical component to solving the small business health insurance crisis, and dispel myths and untruths about SBHPs that have persisted for the past decade.

I. REDUCING THE NUMBER OF UNINSURED AMERICANS

A. Negative Coverage Trends for Small Business

The plight of the uninsured continues to be one of America's most pressing domestic problems. According to the United States Census Bureau, there are now 45.8 million uninsured Americans.[7] This number has

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[4] S. 406, 109th Cong. (2005).

[5] In April 2005, the Congressional Budget Office ("CBO") issued a formal cost estimate of the House version of Senate Bill 406 (H.R. 525, 109th Cong. (2005)). The CBO estimated that Senate Bill 406 would cost $4 million in 2006; $55 million over the 2006–2010 period; and $136 million from 2006 to 2015. They further predicted that the Department of Labor ("DOL") would need to hire 150 workers over the next three years to certify and regulate SBHPs. *See* CONG. BUDGET OFFICE, COST ESTIMATE, H.R. 525: SMALL BUSINESS HEALTH FAIRNESS ACT OF 2005 2 (2005), *available at* http://www.cbo.gov/ftpdocs/62xx/doc6265/hrs2s.pdf.

[6] Pub. L. No. 104-191, 110 Stat. 1936 (codified as amended in scattered sections of 29 U.S.C., 42 U.S.C., 18 U.S.C., and 26 U.S.C.).

[7] *See* U.S. CENSUS BUREAU, U.S. DEP'T OF COMMERCE, INCOME, POVERTY, AND HEALTH INSURANCE COVERAGE IN THE UNITED STATES: 2004, 16 (2005).

risen dramatically this decade, increasing 800,000 since 2003[8] and over 4,000,000 since 2001.[9] In my home state of Maine, 130,000 people lacked health insurance in 2004.[10] According to the Congressional Research Service ("CRS"), the number of uninsured has risen almost every year since 1989 and is expected to continue rising into the future.[11]

The increasing number of uninsured Americans is just one in a series of alarming trends in our nation's health care crisis. Approximately fifty-two percent of the nation's 23.7 million uninsured citizens work for a small business with fewer than 100 employees or are dependent on someone who does.[12] According to an October 2005 study by EBRI, individuals without health insurance are more likely to be from families whose family head works for a small firm rather than a large one.[13] Furthermore, individuals with a family head working in a firm with fewer than 10 workers have a 30.9% probability of being uninsured.[14]

Clearly, the size of an employer plays a pivotal role in whether that employer will offer health insurance as a workplace benefit. Small employers are far less likely than larger employers to provide health insurance to their workers.[15] The 2005 Kaiser Family Foundation Survey of Employer Health Benefits found that only 59% of all small firms (defined as firms with 3 to 199 employees) provide health insurance.[16] Insurance is provided in a meager 47% of companies with 3 to 9 employees; 72% of companies with 10 to 24 workers; 87% of companies with 25 to 49 workers; and 93% of companies with 50 to 199 employees.[17] In contrast, health insurance is nearly universally offered as an employer-provided benefit in larger firms (200 or more employees), which offer insurance to 98% of their employees.[18]

Further compounding matters, these numbers are moving in the wrong direction. This is particularly true in my home state of Maine. The Maine Center for Economic Policy ("MECEP") recently surveyed 1254 small

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[8] *See id.*

[9] *See* U.S. CENSUS BUREAU, U.S. DEP'T OF COMMERCE, HEALTH INSURANCE COVERAGE: 2001, 1 (2002).

[10] *See* CONG. RESEARCH SERV., HEALTH INSURANCE: UNINSURED BY STATE, 2004, 5 (2005).

[11] *See* CONG. RESEARCH SERV., ASSOCIATION HEALTH PLANS, HEALTH MARTS AND THE SMALL GROUP MARKET FOR HEALTH INSURANCE 1 (2005).

[12] *See* CONG. RESEARCH SERV., *supra* note 10, at 4.

[13] *See* PAUL FRONTSTIN, EMPLOYEE BENEFIT RESEARCH INST., UNINSURED UNCHANGED IN 2004, BUT EMPLOYMENT-BASED HEALTH COVERAGE DECLINED, EBRI NOTES 3 (2005).

[14] *See id.*

[15] *See* KAISER FAMILY FOUND. AND HEALTH RESEARCH AND EDUC. TRUST, EMPLOYER HEALTH BENEFITS: 2005 ANNUAL SURVEY 4 (2005) (reporting that only 47% of small businesses, with 3 to 9 employees, currently provide health insurance to their employees, down from 52% in 2004 and 58% in 2002).

[16] *See id.*

[17] *See id.*

[18] *See id.*

business owners in Maine.[19] Over the past five years, the rate of coverage offered by small businesses with 2 to 10 employees has dropped from 62% to 43%.[20] The MECEP survey reported that Maine small businesses have experienced an average annual premium increase of 15% over the past three years.[21] To cope with this escalating health insurance inflation small business have done three things: 28% of Maine small businesses have reduced health benefits;[22] at their last insurance renewal, over 25% have delayed pay raises to their employees in order to pay for health insurance;[23] and 8% have dropped health insurance coverage entirely.[24]

With each passing year that Congress fails to address the small business health insurance crisis, fewer and fewer small businesses are able to offer health insurance as a workplace benefit. This is simply unconscionable. Access to affordable health insurance is the number one issue facing small businesses,[25] and it is one that my colleagues and I hear time and time again. Small businesses are the engine that drives America's economy, generating between 60% and 80% of net new jobs each year for the past decade.[26] And yet, when it comes to securing quality, affordable health insurance, small businesses are treated like the pariahs of the insurance market. Congress should consider and pass SBHP legislation this year to help resolve the burgeoning small business health insurance crisis.

B. Small Businesses Bear a Disproportionate Burden of Health Care Cost Increases

Escalating cost is the primary reason that small businesses do not offer health benefits. A study by the Small Business Administration's Office of Advocacy ("Office of Advocacy") found that "price is the major factor affecting small firms' ability to offer health insurance for [their] employees."[27] In four of the past five years, small businesses have experienced double-digit premium increases that far outpaced wage gains and inflation. Health insurance premiums increased by 10.9% in 2001, 12.9% in 2002,

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[19] *See* FRANK O'HARA & LISA POHLMANN, MAINE CENTER FOR ECONOMIC POLICY, MAINE SMALL BUSINESS HEALTH INSURANCE: A 2004 SURVEY 1 (2005).

[20] *See id.*

[21] *See id.* at 12 (stating that even the "good news" of an 11% average premium increase in 2003–2004 "remains well over the general rate of inflation, and is a burden for small businesses").

[22] *See id.* at 13.

[23] *See id.*

[24] *See id.* at 1.

[25] NATIONAL FEDERATION OF INDEPENDENT BUSINESS (NFIB), HEALTH CARE: COST VERSUS VALUE—CHOICE VERSUS CHANGE: SMALL BUSINESS OWNERS CONSIDER THE FUTURE OF HEALTH CARE 3 (2003), *available at* http://ahps.ion.nfib.com/object/IO16330.html ("Health care costs have been NFIB members' number one priority since 1986.").

[26] OFFICE OF ADVOCACY, SMALL BUS. ADMIN., Small Business Frequently Asked Questions, http://www.app1.sba.gov/faqs/faqindex.cfm?areaID=24 (last visited Apr. 15, 2006).

[27] OFFICE OF ADVOCACY, SMALL BUS. ADMIN., STUDY OF ADMINISTRATIVE COSTS AND ACTUARIAL VALUES OF SMALL HEALTH PLANS 1 (2003).

13.9% in 2003, 11.2% in 2004, and 9.2% in 2005.[28] The smallest firms (three to twenty-four employees) saw their premiums increase by 13.6% in 2004.[29] Subsequently, a 2004 Kaiser survey questioned whether "smaller firms will continue to support family coverage for their employees as costs continue to rise."[30]

The Office of Advocacy has found that small businesses typically spend much more than larger businesses for the same benefits.[31] According to an Office of Advocacy study, "administrative costs of some benefits are almost fourteen times more for the smallest firms than for their largest counterparts."[32] When small firms pay the same amount for coverage as larger firms pay, the coverage for these small firms is less generous than for larger businesses.[33]

In addition, employees in smaller firms must absorb a greater portion of their plan's administrative costs due to the smaller number of employees in their purchasing group. According to the Government Accountability Office ("GAO"), "[f]rom twenty to twenty-five percent of small employers' premiums typically go toward expenses other than benefits, compared with about ten percent for large employers."[34] The Office of Advocacy found that, "for the same claims per covered employee or enrollee, small group plans pay up to twenty to thirty percent more in total premiums than larger health plans. Administrative expenses for small group plans are three to seven times higher as a percentage of claims."[35] Thus, small businesses generally bear a much higher cost burden than large businesses in providing health insurance for their employees.

C. HIPAA's Small Group Market Reform Has Failed To Help Small Businesses

The Health Insurance Portability and Accountability Act of 1996 ("HIPAA") is a comprehensive federal statute addressing the portability of employer health plans and ensuring the privacy and security of patient

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[28] *See* KAISER FAMILY FOUND. AND HEALTH RESEARCH AND EDUC. TRUST, *supra* note 15, at 1.

[29] *See id.* at 18.

[30] *Id.* at 8.

[31] *See* OFFICE OF ADVOCACY, *supra* note 27, at 1 ("Small health plans have higher administrative expenses than larger employers in the form of higher broker commissions, underwriting expenses and other expenses related to operating a health plan.").

[32] OFFICE OF ADVOCACY, SMALL BUS. ADMIN., COST OF EMPLOYEE BENEFITS IN SMALL AND LARGE BUSINESSES 35 (2005).

[33] *See* OFFICE OF ADVOCACY, *supra* note 27, at 43 ("The largest firms, firms with union employees, and firms with higher percentage of workers with high wages had more generous health plans while the smallest firms and construction firms had less generous health plans.").

[34] U.S. GEN. ACCOUNTING OFFICE, PRIVATE HEALTH INSURANCE: SMALL EMPLOYERS CONTINUE TO FACE CHALLENGES IN PROVIDING COVERAGE 3 (2001).

[35] OFFICE OF ADVOCACY, SMALL BUS. ADMIN., STUDY OF ADMINISTRATIVE COSTS AND ACTUARIAL VALUES OF SMALL HEALTH PLANS 31 (2003).

health information.[36] It was also created in part with the purpose of reforming the small employer, or small group, insurance market.[37] However, it has utterly failed to spur competition and choices in the small group market.

Before HIPAA provided a federal framework for employee health insurance, many states enacted regulations in the early 1990s to make health insurance easier to purchase when moving from job to job.[38] Many states also enforced similar provisions for small group market reform.[39] Thirty-eight states had varying guaranteed issue laws, which typically precluded health insurance companies from denying coverage to any individual who applied for insurance in the small group market.[40] Forty-three states had guaranteed renewal requirements, such as health insurance policies that once in place must be renewed at the request of the insured, may not be canceled so long as premiums are paid, and must be renewed without discrimination at the same rate.[41] However, roughly half of the states with guaranteed issue laws prior to HIPAA's enactment applied them only to insurance plans with standardized benefits that were designed for higher risk subscribers.[42]

The enactment of HIPAA in 1996 changed these inconsistencies by imposing a universal guaranteed issue requirement in state small group markets.[43] Each health insurance issuer that offers health insurance in the small group market must accept every small employer that applies for coverage, regardless of the employer's claim history or health status; must accept under such coverage every eligible individual who applies for enrollment; and may not place any restrictions inconsistent with these requirements on an employee being a participant or beneficiary.[44] By allow-

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[36] Joy L. Pritts, *Altered States: State Health Privacy Laws and the Impact of the Federal Health Privacy Rule*, 2 YALE J. HEALTH POL'Y L. & ETHICS 325, 341 (2002).

[37] Mark A. Hall, *The Competitive Impact of Small Group Health Insurance Reform Laws*, 32 U. MICH. J. L. REFORM 685, 691 (1999) (stating that all insurance policies offered in a state small group market must be "guaranteed issue," or made available to all small businesses in the state).

[38] *See* Timothy S. Jost, *Private or Public Approaches to Insuring the Uninsured: Lessons from International Experience with Private Insurance*, 76 N.Y.U. L. REV. 419, 465 (2001).

[39] *See id.*

[40] CONRAD F. MEIER, DESTROYING INSURANCE MARKETS: HOW GUARANTEED ISSUE AND COMMUNITY RATING DESTROYED THE INDIVIDUAL HEALTH INSURANCE MARKET IN EIGHT STATES 8 (2005).

[41] *See id.* (*citing* GAIL A. JENSEN & MICHAEL A. MORRISEY, MANDATED BENEFIT LAWS AND EMPLOYER-SPONSORED HEALTH INSURANCE 4 (1999)); *see also* Mark A. Rothstein, *Genetic Privacy and Confidentiality: Why They Are So Hard To Protect?*, 26 J. L. MED. & ETHICS 198, 199 (1998).

[42] *See* Mark A. Hall, *HIPAA's Small-Group Access Laws: Win, Loss, or Draw?*, 22 CATO J. 71 (2002).

[43] *See* Pub. L. No. 104-191, 110 Stat. 1936 (codified as amended in scattered sections of 29 U.S.C., 42 U.S.C., 18 U.S.C., and 26 U.S.C.).

[44] *See* GRETA E. COWART, HIPAA NONDISCRIMINATION AND PORTABILITY UPDATED AND EXPANDED 4 (2005); *see also* Hall, *supra* note 37, at 691.

ing higher risk purchasers to choose any of an insurer's offerings in the small group market, HIPAA supporters argue that it "took what existed in most states and made it universal."[45]

HIPAA defines the small group market as covering businesses that have employed an average of two to fifty employees during the preceding calendar year and have employed at least two employees on the first day of the plan year.[46] As discussed above, HIPAA's enactment marked a significant change in how insurance companies provide health insurance products in the small group markets.[47] Unlike the individual and large group markets, which are not subject to a federal guaranteed issue requirement, the small group market reform under HIPAA meant that any small business that fit the two to fifty employee definition under HIPAA would provide guaranteed access to whatever policies that insurance companies offered in the small group market.[48] The success of this policy goal, of course, relied on the assumption that insurance companies would in fact offer a range of affordable, quality coverage options after HIPAA's enactment.[49]

Unfortunately, the HIPAA small group market reform has provided little assistance in helping small businesses that are seeking more affordable health insurance options.[50] Skeptics point out that HIPAA's small group market reform is fraught with hidden costs, including the foreclosure of market innovations and the creation of new administrative burdens on the state level.[51] They also argue that HIPAA has actually driven health care costs up in the small group market, because it incentivizes healthy groups to wait until one of their employees becomes sick before buying insurance.[52] This holds true because under HIPAA's guaranteed issue requirement, any small business with two to fifty employees would be automatically eligible to participate in any health insurance products offered in the small group market, regardless of how sick or old their employees may be.[53] Rather than offering health insurance to younger, healthier workers, small businesses could wait until these employees grow older or become sicker and thus increase the cost of providing insurance overall via insurance premium hikes.[54]

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[45] Hall, *supra* note 42, at 71.

[46] 42 U.S.C. § 300gg-11 (2000).

[47] *See* Hall, *supra* note 37, at 691.

[48] *Id.*

[49] *See* Hall, *supra* note 42, at 72.

[50] *See* Tom Miller, *The Health Insurance Portability and Accountability Act: More Than We Bargained for, and Less*, 22 CATO J. 1 (2002).

[51] *See* Hall, *supra* note 42, at 72.

[52] *See generally* MEIER, *supra* note 40 (detailing how guaranteed issue and community ratings have sometimes adversely affected private insurance markets in various states).

[53] Hall, *supra* note 37, at 691.

[54] *See* Ann Hilton Fisher, *Small Employers and the Health Insurance Needs of Employees with High Health Care Costs*, 8 EMPL. RTS. & EMPLOY. POL'Y J. 53, 53–55 (2004) (indicating that strong incentives exist to drop the insurance of those employees whose medi-

Further compounding this problem is a simple business reality: small businesses have limited resources and operating budgets.[55] In my experience as Chair of the Senate Committee on Small Business and Entrepreneurship, most small businesses desperately want to provide health insurance to their employees. Health insurance is a critically important component to attracting quality workers and remaining competitive with larger businesses.[56] And yet, rising costs have moved the accessibility of health care far beyond the reach of our nation's smallest businesses.[57] As a result, I have witnessed these "micro" small employers, especially those with fewer than ten employees, often wait until one of their employees needs coverage before obtaining it. When employers with healthy employees take their money out of the system and sit on the market sidelines, health insurance premiums increase, forcing other small employers to drop coverage. When small businesses finally decide to purchase health insurance, they find themselves trapped in dysfunctional state small group markets that are dominated by a small handful of larger insurers who offer very few affordable coverage options.[58]

D. HIPAA's Guaranteed Issue Mandate Has Contributed to the Lack of Competition in the Small Group Insurance Market

HIPAA's guaranteed issue mandate has suppressed competition in the small group market. In addition, some states, including Maine, have enacted modified community rating laws that limit the factors by which an insurance company can modify health insurance premiums.[59] With their profit potential being threatened, many insurance companies have pulled

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cal needs increase health care costs).

[55] Amy Bushaw, *Small Business, Local Culture and Global Society: Some Examples from the United States*, 5 J. SMALL & EMERGING BUS. L. 223, 223–25 (2001) (stating that due to economies of scale, small businesses face many financial challenges that larger businesses do not face).

[56] *See* Dayna Bowen Matthew, *Controlling the Reverse Agency Costs of Employment-Based Health Insurance: Of Markets, Courts, and a Regulatory Quagmire*, 31 WAKE FOREST L. REV. 1037, 1039 (1996); *see also* Jodie Snyder, *Small Business Juggles Health Plan Options* (Jan. 17, 2006), *available at* http://www.azcentral.com/health/news/articles/0117HCR-cereus17.html

[57] Ronald Wilson, *Federal Tax Policy: The Political Influence of American Small Business*, 37 S. TEX. L. REV 15, 37 (1996) (indicating that a lack of affordable health plans is the most common reason why small businesses do not provide health insurance coverage for their employees).

[58] *See* U.S. GEN. ACCOUNTING OFFICE, PRIVATE HEALTH INSURANCE: NUMBER AND MARKET SHARE OF CARRIERS IN THE SMALL GROUP HEALTH INSURANCE MARKET, GAO-02-536Ra, at 2 (2002), http://www.gao.gov/new.items/d02536r.pdf (stating that five or fewer insurers control at least three-quarters of the small group market in most states, and this lack of competition contributes to double-digit rate increases for many small businesses).

[59] Ann Hilton Fisher, *Small Employers and the Health Insurance Needs of Employees with High Health Care Costs: A Need for Better Models*, 8 EMPL. RTS. & EMPLOY. POL'Y J. 53, 77–78 (2004) (stating that nineteen states have adopted some type of community rating including Maine, New York, New Jersey, Massachusetts, and Vermont).

out of the small group market.[60] Further exacerbating the problem, HIPAA contains an exclusion clause barring an insurer that has pulled out of the small group market from re-entering the market for six months.[61]

In May 2005, along with Senators Christopher "Kit" Bond (R-Mo.) and Jim Talent (R-Mo.), I requested that the GAO research the competitiveness of small group health insurance markets in every state.[62] For each state, I requested that the GAO determine the total number of licensed health insurance carriers; the largest carrier and its market share; the combined market share of the five largest carriers; and the rank of the largest Blue Cross/Blue Shield ("BCBS") carrier, as well as the combined market share of all BCBS carriers.[63]

The GAO report, released in October 2005, revealed that a handful of large insurance carriers dominate the small group market, leaving small businesses with few, if any, choices when it comes to securing affordable, quality health insurance for their employees. More specifically, the GAO discovered that the median market share of the largest small group carrier was about 43% in 2005, compared to 33% in 2002; when combined, the five largest carriers in the small group market represent 75% or more of the market in 26 of the 34 states that supplied information, up from 19 states in 2002; and the median market share of all BCBS carriers was about 44%, up from 34% in 2002.[64]

There are simply too few health insurance carriers competing in the small group market. This lack of competition has contributed to higher prices for the handful of products that do exist in the small group market.[65] According to a recent report jointly issued by the Federal Trade Commission and the Department of Justice, "competition generally results in lower prices and, thus, broader access to health care products and services . . . . Vigorous competition promotes the delivery of high-quality, cost-effective health care."[66] Thus, the lack of competition amongst carriers

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[60] Susan Adler Channick, *Come the Revolution: Are We Finally Ready for Universal Health Insurance?*, 39 CAL. W. L. REV. 303, 307–08 (2003) (arguing that to compete profitably, health plans "began experience rating their insurance pools, i.e., rating on the basis of risk experience, rather than using community rating").

[61] *See* 42 U.S.C. § 300gg-11(c)(2) (2000).

[62] *See* Letter from Olympia J. Snowe, Christopher Bond & Jim Talent, U.S. Senators, to Kathryn G. Allen, Director, U.S. Gov. Accountability Office (May 9, 2005) (on file with author). This letter followed up on a prior request made in 2002 by Senator Bond. *See* U.S. GEN. ACCOUNTING OFFICE, *supra* note 58, at 1–2.

[63] *See* Letter from Olympia J. Snowe, Christopher Bond & Jim Talent to Kathryn Allen, *supra* note 62.

[64] *See* GOV. ACCOUNTABILITY OFFICE, PRIVATE HEALTH INSURANCE: NUMBER AND MARKET SHARE OF CARRIERS IN THE SMALL GROUP HEALTH INSURANCE MARKET IN 2004 2 (2005).

[65] Bushaw, *supra* note 55, at 223–25.

[66] FED. TRADE COMM'N & DEP'T OF JUSTICE, IMPROVING HEALTH CARE: A DOSE OF COMPETITION 4 (2004).

in the small group market has contributed to rising health care costs and has narrowed available options for employees.[67]

In this way, small businesses are being trapped in stagnant, dysfunctional health insurance markets, in which prices are spiraling out of control and viable coverage options have moved far beyond their budgetary reach.[68] In Maine, BCBS now controls 63% of the small group market, while the five largest carriers dominate 98% of the market.[69] I recently met with representatives from the Maine Association of Realtors, who explained to me how the only "affordable" coverage option in their insurance market is "catastrophic coverage." On top of already expensive premiums, the realtors pay deductibles ranging from $5,000 to $15,000 for policies that fail to offer basic health insurance coverage. This situation is unacceptable, and Congress must take immediate action to address the problem.

II. SOLUTION: SMALL BUSINESS HEALTH PLAN LEGISLATION

One effective solution that Congress could adopt is SBHP legislation. In February 2005, I introduced "The Small Business Health Fairness Act of 2005."[70] My bill offers a fair, common-sense solution to the problem of rising health care costs. It unleashes the power of the competitive market to provide small businesses with more choices when it comes to securing affordable, quality insurance coverage. Just like larger businesses and unions, small businesses should have the option to purchase health plans across state lines with uniform benefits packages.

SBHPs were originally conceived in the mid 1990s as a response to the Clinton Administration's effort to overhaul the nation's health care system with a delivery/payment system to be run by the federal government.[71] SBHPs allow small businesses to purchase cheaper employee health insurance by joining together, or "pooling," in order to increase their bargaining power and reduce administrative costs. A recent Small Business Administration's Office of Advocacy ("Office of Advocacy") report validates the potential savings inherent in SBHPs: "Allowing small firms greater access to methods of pooling risk and administrative costs in both pension plans and health insurance may also encourage a wider offering of

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[67] *See supra* note 58 and accompanying text.

[68] Jeffrey Ralph Pettit, *Help! We've Fallen and We Can't Get Up: The Problems Families Face Because of Employment-Based Health Insurance*, 46 VAND. L. REV. 779, 799 (1993) ("Small businesses are unable to absorb rising insurance premiums that derive from astronomical increases in health care costs, and are forced to limit or to discontinue employee health benefit plans.").

[69] GOV. ACCOUNTABILITY OFFICE, *supra* note 62, at 2.

[70] S. 406, 109th Cong. (2005).

[71] Tiana Velez, *Small Business Insurance Groups Likely*, ARIZ. DAILY STAR, Apr. 3, 2006, *available at* http://www.azstarnet.com/business/122750 (providing a detailed time line of the political path traveled by SBHP legislation, which dates back to 1995).

those benefits."[72] The National Federation of Independent Business further concluded that "[t]he administrative costs of SBHPs are lower, on average, than those achieved by other small health plans, for-profit Medicaid plans, and not-for-profit Medicaid plans."[73]

Thus, SBHP legislation would spur competition in stagnant insurance markets in which small businesses have few viable coverage choices. It would allow small businesses to shop for quality health insurance plans with much lower administrative costs, while at the same time shrinking the ranks of the nearly forty-six million uninsured Americans at virtually no cost to the federal government.

SBHPs have been widely supported both by President Bush as well as a coalition of more than 190 associations representing twelve million employers and eighty million employees.[74] In July 2005, the House of Representatives overwhelmingly passed SBHP legislation[75] for the eighth consecutive time.[76] In the Senate, SBHPs have received unprecedented attention. On April 20, 2005, I chaired a hearing in the Senate Committee on Small Business and Entrepreneurship, which focused on SBHPs.[77] On the following day, the Senate Health, Education, Labor and Pensions (HELP) Committee held a hearing also focused on SBHPs.[78]

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[72] OFFICE OF ADVOCACY, SMALL BUS. ADMIN., COST OF EMPLOYEE BENEFITS IN SMALL AND LARGE BUSINESSES 2 (2005).

[73] ANTHONY C. RUCKS, A STUDY OF THE ADMINISTRATIVE COSTS ACCRUING TO ASSOCIATION HEALTH PLANS 12 (2005) (asserting that the lower administrative costs of SBHPs have been achieved by lower marketing expenses; skillful outsourcing of administrative functions; and plan participants being the primary stakeholders of SBHPs).

[74] Trade associations strongly supporting Senate Bill 406 (S. 406, 109th Cong. (2005)) include the National Federation of Independent Business; the National Association of Realtors; the U.S. Chamber of Commerce; Associated Builders and Contractors; International Franchise Association; National Association of Home Builders; National Association of Manufacturers; National Retail Federation; the National Restaurant Association; and the National Association of Wholesaler-Distributors. *See* Coalition Supporting Access & Choice Through Small Business Health Plans, About Us, http://www.SBHPsNow.com/page/SBHPsNowAboutUs (last visited Mar. 17, 2006).

[75] H.R. 525, 109th Cong. (2005). On July 26, 2005, SBHP legislation passed in the House of Representatives by a vote of 263-165. *See* 103 Cong. Rec. H6478–84 (daily ed. July 26, 2005).

[76] In the 104th Congress, Representative Harris Fawell (R-Ill.) introduced the ERISA Targeted Health Insurance Reform Act of 1996. H.R. 995, 104th Cong. The bill was included in the House version of HIPAA, but was subsequently stripped out of the final version of the bill in conference committee. Since that initial bill, SBHP legislation has successfully passed the House on eight consecutive votes. *See* H.R. 4279, 108th Cong. (2004); Small Business Health Fairness Act of 2004, H.R. 4281, 108th Cong. (2004); Small Business Health Fairness Act of 2003, H.R. 660, 108th Cong. (2003); H. Amdt. 302, 107th Cong. (2001); Patient's Bill of Rights Plus Act, H.R. 2990, 106th Cong. (1999); H.R. Res. 348, 106th Cong. (1999); H.R. Res. 323, 106th Cong. (1999); Health Care Consumer Empowerment Act of 1998, H.R. 4250, 105th Cong. § 2201 (1998).

[77] *Solving the Small Business Health Care Crisis: Alternatives for Lowering Costs and Covering the Uninsured: Hearing on S. 406 Before the S. Comm. on Small Bus. and Entrepreneurship*, 109th Cong. (2005) [hereinafter *Senate Hearing on the Uninsured*].

[78] *Small Businesses and Health Insurance: Easing Costs and Expanding Access: Hearing Before the S. Comm. on Health, Educ., Labor and Pensions*, 109th Cong. (2005).

Senate Majority Leader Bill Frist (R-Tenn.) recently stated that he intends to bring SBHP legislation to the Senate floor "in the near future."[79] If the Senate fails to pass SBHP legislation, the national small business health insurance crisis will only worsen, and more people will join the ranks of the uninsured.

A. Specific Provisions of SBHP Legislation

Below is a summary of the provisions included in the Small Business Health Fairness Act of 2005.

1. Eligibility Requirements

SBHP legislation would amend the Employee Retirement and Income Security Act (ERISA)[80] to include sections on the certification and regulation of SBHPs. The legislation would expand ERISA to allow small businesses, via bona fide trade, industry, and professional associations, to operate health plans under uniform rules similar to those governing plans sponsored by large corporations and unions.[81] In order to be eligible, these associations must have been established for substantial purposes other than providing health insurance for at least three years.[82] Sponsoring associations may not condition membership plan coverage on employee and dependent health status or related factors.[83] These provisions are designed to ensure that only legitimate, pre-existing member-driven associations offer SBHPs as opposed to opening the flood gates to potentially fraudulent entities that spring up solely to provide "insurance."

SBHP legislation defines an "association health plan" as a group health plan that offers fully insured and/or self-insured medical benefits, has been certified, and is operated by a board of trustees with complete fiscal control and responsibility for all SBHP operations.[84] To be certified, a "self-insured" SBHP must have at least 1000 participants or beneficiaries.[85] This minimum "covered lives" requirement, coupled with the solvency and surplus requirements in the bill, would help to ensure the viability of self-insured SBHPs and to prevent fraud. One way for self-insured SBHPs to

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[79] Press Release, Bill Frist, *Frist Praises HELP Committee Action to Protect Working Families' Access to Health Care* (Mar. 15, 2006), http://frist.senate.gov/index.cfm?useAction=PressReleases.Detail&PressRelease_id=2304.

[80] 29 U.S.C. §§ 1001–1461 (2000).

[81] *See* S. 406, 109th Cong. § 801(b)(1) (2005). Senate Bill 406 contains most of its substantive provisions within Section Two of the bill. To be more informative, the author has cited the bill, which adds a new part to subtitle B of title I of ERISA, by referring directly to the new part's provisions.

[82] *See id.* §§ 801(b)(1), 803(a).

[83] *See id.* § 803(b)(3).

[84] *See id.* § 803(b).

[85] *See id.* § 805(a)(3).

be certified is if coverage is available on the date of enactment.[86] Self-insured SBHPs already in existence on the date of S. 406's enactment would be "grandfathered" in and would not have to satisfy all of the bill's certification requirements.[87] Another means of certification is if the SBHP represents a broad cross-section of trades, typically by being a "federation" type of an association, such as a chamber of commerce with a membership that is open to many different types of businesses.[88] The third and final means of certification is if the SBHP represents one or more trades with average or above average health insurance risk.[89]

2. Participation and Coverage Requirements

SBHP legislation requires that all employers participating in the SBHP must be members or affiliated members of the sponsor.[90] All individuals under the plan must be active or retired employees, owners, officers, directors, partners, or their beneficiaries.[91] SBHP legislation prohibits discrimination by requiring that all employers who are association members be eligible for participation; all geographically available coverage options are made available upon request to eligible employers; eligible individuals cannot be excluded from enrolling because of health status; and premium contribution rates for any particular small employer cannot be based on the health status or claims experience of plan participants or beneficiaries, or on the type of business or industry in which the employer is engaged.[92] Finally, state-licensed health insurance agents must be used to distribute health insurance coverage provided to small employers under a fully insured SBHP.[93]

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[86] *See* S. 406, 109th Cong. § 802(f)(1) (2005).

[87] *See id.*

[88] *See id.* § 802(f)(2).

[89] *See id.* § 802(f)(3). The bill specifically lists a number of industries with average or above average risk, including agriculture; equipment and automobile dealerships; barbering and cosmetology; certified public accounting practices; child care; construction; dance, theatrical, and orchestra productions; disinfecting and pest control; financial services; fishing; food-service establishments; hospitals; mining; medical laboratories; professional consulting; sanitary services; transportation; warehousing; and wholesaling/distributing. *See id.* § 802(f)(3). Furthermore, the bill would cover any industry not specifically listed that has been indicated as having average or above average risk or health claims experience through state rate filings, denials of coverage, proposed premium rate levels, or other demonstrated means. The intent of this provision is to serve as a broad "catch all" that would encompass the overwhelming majority of small businesses. *See id.* § 802(f)(3).

[90] *See id.* § 804(a)(1).

[91] *See id.* § 802(a)(2).

[92] *See* S. 406, 109th Cong. § 805(a)(2) (2005).

[93] *See id.* § 805(a)(4)(A).

3. Reserve Requirements and New Provisions for Solvency

SBHP legislation also contains new solvency provisions that will increase consumer protections for small businesses who purchase insurance through a "self-insuring" SBHP that chooses to bear its own risk in providing health insurance rather than purchasing insurance through a traditional insurance company. These new provisions require claims reserves certified by a qualified actuary,[94] minimum surplus reserves,[95] both specific and aggregate stop-loss insurance,[96] and indemnification insurance to ensure that all claims are paid.[97]

Self-insured SBHPs must be sufficiently funded for unearned contributions, benefit liabilities, administrative costs, or any other obligations.[98] Self-insured SBHPs must also make annual payments to a Small Business Health Plan Fund to guarantee that indemnification insurance is always available.[99] Issuers of stop-loss and indemnification insurance for self-insured SBHPs must notify the Secretary of Labor if the SBHP fails to make a payment that would result in the cancellation of the insurance policy.[100]

4. Preemption from Mandated State Benefits

One of the primary purposes of SBHP legislation is to provide small businesses with relief from the confusing and complex web of state insurance regulations. Over the past twenty years, we have seen a significant increase in the number of mandated benefits at the state level.[101] Under current law, insurance companies offering fully insured SBHPs must comply with the mandated benefit laws in each and every state in which their plans operate, even though the laws cover the same benefit at widely varying eligibility levels.[102] The administrative cost of complying with these state regulations consumes a far greater percentage of the premium dollar

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[94] *See id.* § 806(a)(2)(A).

[95] *See id.* § 806(b). A self-insuring SBHP must maintain reserves between $500,000 and $2 million, depending on the level of stop-loss coverage and other factors. *See id.* § 806(b)(1).

[96] *See id.* § 806(a)(2)(B).

[97] *See id.* § 806(a)(2)(B)(iii). The Secretary of Labor may require additional indemnification insurance for SBHPs when he or she deems it necessary *See id.* § 806(c).

[98] *See* S. 406, 109th Cong. § 806(a)(2)(A)(i)–(iv) (2005).

[99] *See id.* § 806(f).

[100] *See id.* § 806(a).

[101] *Senate Hearing on the Uninsured, supra* note 77, at 110 (statement of Tom Haynes, Executive Director, Coca-Cola Bottlers' Association (CCBA)) (asserting that the CCBA offered an SBHP to its members for ninety years until it was forced to disband in 2000 due to the overwhelming complexity of state small group reform laws and regulations).

[102] *See id.* at 110 ("These well-meaning but counter-productive laws eliminated virtually all insurance companies from participating in multi-state arrangements due to their reluctance to navigate the myriad individual state premium and coverage requirements for small employers.").

for small businesses than for larger ones, a major reason why most SBHPs have been forced to shut down in recent years.[103]

SBHP legislation seeks to level the playing field between small and large businesses by preempting varying and duplicative state benefit mandates.[104] Certified fully insured SBHPs would be exempt from state health insurance laws and regulations in the state where the SBHP insurance policy is filed and approved, except those that prohibit the exclusion of specific diseases.[105] Self-insuring SBHPs would fall under the regulatory purview of the Employee Retirement and Income Security Act (ERISA), which currently preempts any state laws related to regulation of insurance for employers who choose to self-insure.[106] In either case, SBHPs would be able to offer uniform benefit plans across state lines with lower administrative costs.

SBHP legislation is ultimately a matter of fairness: small businesses ought to receive the same advantages under the law as larger businesses. Small businesses should be able to provide their hard working employees with the same type of quality insurance that employees at larger businesses receive. SBHP legislation would enable us to do this at virtually no cost to the American taxpayer.

5. Strong Enforcement

Finally, SBHP legislation does not require a new bureaucracy to ensure that existing and new SBHPs are properly regulated. The Department of Labor ("DOL") would regulate self-insured SBHPs in the same manner it regulates over 300,000 self-insured health plans covering seventy-eight million people.[107] Within one year of enactment of SBHP legislation, DOL would promulgate implementing regulation detailing how the agency would conduct certification and oversight, safeguard the public against insolvency, and provide strong enforcement against potential fraudulent actors.[108] To discourage any corrupt exploitation of SBHPs, SBHP legislation provides for criminal penalties for employers that willfully misrepresent themselves as exempt SBHPs[109] and establishes a procedure for the

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[103] *See id.* at 112 ("Many associations have had to close down their health plans because health insurance companies cannot afford the cost of compliance in multiple states.").

[104] *See id.* at 38 (statement of Elaine L. Chao, Secretary, U.S. Department of Labor) (stating that fully insured SBHPs "will be able to offer a uniform benefits package nationwide, making it possible for employees to receive the same benefits regardless of where they live").

[105] *See* S. 406, 109th Cong. § 812(b)(3)(c)(iii) (2005).

[106] *See Senate Hearing on the Uninsured*, *supra* note 77, at 38 (statement of Elaine L. Chao, Secretary, U.S. Department of Labor).

[107] *See id.* at 30–31.

[108] *See* S. 406, § 6(a); *Senate Hearing on the Uninsured*, *supra* note 77, at 40–43 (statement of Elaine L. Chao, Secretary, U.S. Department of Labor).

[109] *See* S. 406, § 4(a).

Secretary of Labor to petition a U.S. District Court for a cease activity order against fraudulent health plans.[110]

B. Myths and Realities About SBHPs

As SBHP legislation has meandered through Congress over the past decade, a number of myths have been perpetuated. These myths were generated by critics vigorously opposed to SBHP legislation, including those who comprise the BCBS,[111] the National Governors Association,[112] and the National Association of Insurance Commissioners.[113]

While each of these groups has substantive objections, at the heart of their opposition is a threat to their competitive standing. As discussed in Part II.C, the GAO report that I requested reveals the powerful market lock BCBS and a handful of other large insurers possess over the small group market. When no competition exists, larger insurers have no incentive to offer a range of insurance plans with varying benefit levels at reduced cost. Similarly, governors and insurance commissioners are resistant to ceding regulatory control to the federal government and thereby losing any associated tax revenues.[114] Below, I discuss the myths and realities that have persisted about SBHP legislation. By examining the provisions of the legislation, the erroneous nature of the myths regarding cherrypicking, stripped benefits, consumer vulnerability, and potential for fraud will be unveiled. SBHPs will not only guard against these unwanted consequences but also reduce the size of the uninsured population, as well as reduce administrative costs.

One prevalent myth about SBHPs is that they will encourage risk selection and reduce risk pooling through "cherry picking." Opponents contend that SBHPs would design benefit packages that will be relatively unattractive to older and less-healthy populations and that SBHPs would be able to "simultaneously attract a higher proportion of younger and healthier individuals in their pools, thereby driving down their expected claims costs, and thus their premiums."[115]

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[110] *See id.* § 4(b).

[111] *See* Press Release, Blue Cross Blue Shield Association, Federal AHPs Would Eliminate Critical State Laws and Oversight That Protect Consumers (May 12, 2005), http://www.carefirst.com/media/InTheNewsDetails/InTheNewsDetails_20050512.html (last visited Mar. 20, 2006).

[112] *See* Press Release, National Governors Association, NGA Opposes Association Health Plans (Apr. 1, 2004), *available at* http://www.nga.org (follow "News Releases").

[113] *See* National Association of Insurance Commissioners (NAIC), Consumer Alert: Association Health Plans are Bad for Consumers, http://www.naic.org/documents/consumer_alert_ahps.pdf (last visited Apr. 15, 2006).

[114] Susan Randall, *Insurance Regulation in the United States: Regulatory Federalism and the National Association of Insurance Commissioners*, 26 FLA. ST. U. L. REV. 625, 634 (1999) (acknowledging that states enjoy tax authority over the insurance industry).

[115] *Senate Hearing on the Uninsured*, *supra* note 77, at 145 (statement of William N. Lindsay, former Chair, National Small Business Association).

However, in reality, SBHPs are specifically prohibited from being able to cherry pick.[116] First, the language of the SBHP bill clearly states that bona fide associations must provide all interested employers (regardless of employee health status, etc.) with information regarding all coverage options available under the plan.[117] Second, under HIPAA, an employer cannot deny coverage based on a preexisting health status or claims experience.[118] As "group health plans," SBHPs would thus be subject to the preexisting condition, portability, nondiscrimination, special enrollment and renewability provisions established under HIPAA.[119] Third, the SBHP legislation clearly stipulates that any member of an association who is eligible for membership benefits be furnished with information regarding all coverage options available under the plan and may not be excluded from enrolling in the plan because of health status.[120] Finally, SBHP legislation requires that the contribution rates for any particular employer be nondiscriminatory,[121] meaning that contribution rates for employers cannot vary on the basis of any employee health status factors or on the type of business or industry in which the employer is engaged.[122] This holds true unless the state in which that small employer is located would specifically allow such a variation and, in such a case, this variation remains limited.[123]

A second myth about SBHPs is that, because they will be exempt from state benefit mandates, they will only offer stripped-down benefits intended to appeal solely to the young and healthy in order to increase their profit margins. Similar to the "cherry-picking" myth discussed above, opponents contend that SBHPs would offer low-cost health plans that fail to provide any meaningful health coverage.[124]

However, in reality, professional associations are driven by their members. SBHPs must constantly justify their worth to dues-paying members.[125] It is simply not realistic to assume that SBHPs will offer access to a health insurance product that does not meet the needs and demands of its members. Small businesses will demand that their SBHPs offer generous benefits, because they have to compete with larger companies already offering generous benefits to their employees. Moreover, the increased flexibility that SBHPs gain from receiving preemption from mandated state benefits

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[116] *See* United States Chamber of Commerce, Myths vs. Facts Regarding SBHPs, http://www.uschamber.com/issues/index/health/0603_ahps_mythsvsfacts.htm (last visited Mar. 20, 2006).

[117] *See* S. 406, 109th Cong. § 804(d)(1) (2005).

[118] *See* Hall, *supra* note 42, at 71.

[119] *Senate Hearing on the Uninsured*, *supra* note 77, at 42 (statement of Elaine L. Chao, Secretary, U.S. Department of Labor).

[120] *See* S. 406 § 804(d)(2).

[121] *Id.* § 805(a)(2).

[122] *Id.* § 805(a)(2)(A).

[123] *Id.* § 805(a)(2)(B)(ii).

[124] *See* United States Chamber of Commerce, *supra* note 116.

[125] ARLENE FARBER SIRKIN, KEEPING MEMBERS: THE MYTHS AND REALITIES: CEO STRATEGIES FOR 21ST CENTURY SUCCESS 13 (1995).

will allow associations to narrowly tailor their insurance plans to meet the specific needs of their members' employees.[126] The reduced administrative expenses resulting from having centralized requirements will allow more resources to be devoted to providing benefits.[127] Finally, the competition amongst the different associations for members will ensure that these plans offer competitive benefits at attractive rates.

A third myth about SBHP legislation is that it would preempt important consumer protections that are currently provided through state regulation of insurance. These protections include prompt pay requirements, external and internal review mechanisms, and rate form filings.[128]

However, fully insured SBHPs must actually continue to meet consumer protections, such as third-party external reviews, as well as solvency requirements set forth by the states.[129] Because it operates in the interest of its members, an SBHP will readily cover benefits demonstrated to be cost-effective, such as childhood immunization, prenatal care, and cancer screenings.[130] However, the well-intentioned, yet excessive coverage mandates that drive up the cost of health coverage and leave small businesses unable to afford coverage will be eradicated.[131]

With respect to self-insured SBHPs, the SBHP legislation establishes strict and explicit solvency requirements.[132] In self-insured SBHPs, trustees who are fiduciaries are responsible for both the financial and operational integrity of the plan and provide the necessary oversight.[133] This fiduciary duty of oversight of the SBHP on behalf of its members is a key factor in assuring and maintaining the solvency and credibility of SBHPs in the long-term. In addition to the solvency standards and requirements for self-insured SBHPs and the fiduciary obligation, the patient protections included in the SBHP legislation are also more stringent than those now required under ERISA for self-insured plans.[134]

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[126] *Senate Hearing on the Uninsured, supra* note 77, at 38–39 (statement of Elaine L. Chao, Secretary, U.S. Department of Labor).

[127] *Id.* at 51 (statement of Hector V. Barreto, Administrator, U.S. Small Business Administration).

[128] *See* William Hammond, *Prompt Pay: Getting Paid Gets Easier for Michigan's Health Care Providers*, 81 MICH. BAR J. 24, 24–25 (2002); *see also* Danielle F. Waterfield, *Insurers Jump on Train for Federal Insurance Regulation: Is It Really What They Want or Need?*, 9 CONN. INS. L.J. 283, 320 (2003).

[129] *Senate Hearing on the Uninsured, supra* note 77, at 41 (statement of Elaine L. Chao, Secretary, U.S. Department of Labor).

[130] *See* Sara Rosenbaum, *Rationing Without Justice: Children and the American Health System*, 140 U. PA. L. REV. 1859, 1865 (1992); *see also* E. Haavi Morreim, *Diverse and Perverse Incentives of Managed Care: Will the Last One out of the Artesian Well Please Put on the Lid*, 1 WIDENER L. SYMP. J. 89, 108 (1996).

[131] *Senate Hearing on the Uninsured, supra* note 77, at 36 (detailing a study that reported that mandates raise premiums by 4% to 13% and that up to one-quarter of uninsured Americans lack health insurance due to state mandates).

[132] *See id.* at 41 (statement of Elaine L. Chao, Secretary, U.S. Department of Labor).

[133] S. 406, 109th Cong. § 805(a)(1)(A) (2005).

[134] *Senate Hearing on the Uninsured, supra* note 77, at 339 (statement of Elaine L. Chao, Secretary, U.S. Department of Labor) (asserting that self-insured SBHPs "will be

A fourth myth about self-insured SBHPs is that they will lack adequate solvency protections because of a lack of state regulation. However, SBHP legislation actually contains extensive requirements for solvency. First, SBHPs will only be certified if they have been in business for more than three years for a reason other than selling health insurance.[135] SBHPs must establish and maintain reserves in the amount recommended by the qualified actuary that would be sufficient for unearned contributions; benefit liabilities that have been incurred but not satisfied and their expected administrative costs; any other obligations of the plan; and a margin of error and other fluctuations that take into account specific circumstances of the plan.[136] The SBHP must also secure aggregate excess stop loss insurance for the plan with an attachment point not greater than 125% of the expected gross annual claim as well as specific excess stop loss insurance for the plan with an attachment point at least equal to an amount recommended by the plan's qualified actuary.[137] Finally, the self-insured SBHP must secure indemnification insurance[138] and maintain claims reserves in an amount between $500,000 and $2,000,000.[139] These measures will work in concert to guard against potential insolvency.

A fifth myth about self-insured SBHPs is that the DOL will not be able to effectively regulate them because they can provide their members with their own insurance as opposed to solely relying upon outside insurers. The DOL already effectively regulates 300,000 self-funded employer plans covering seventy-eight million people and can handle the additional workload from SBHPs.[140] DOL has a strong record of enforcement and protecting workers, retirees, and their families in health plans. As of December 2005, DOL has initiated 684 civil and 142 criminal investigations and has recovered over $165 million in enforcement actions against fraudulent and failed multiple employer welfare arrangements (MEWAs).[141]

A sixth myth about SBHPs is that they will not significantly reduce the number of uninsured in this country due to their sole focus on providing health insurance for employees of small businesses. Yet the majority of the uninsured work for a small business or are dependent on someone who works for a small business.[142] If we make it easier for small businesses to get health insurance for their employees, we will be able to substantially

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required to meet strong solvency requirements that are not required of self-insured employer and union-sponsored group health plans today").

[135] *See* S. 406, § 803(a).

[136] *See id.* §§ 806(a)(2)(A)(i)–(iv).

[137] *Id.* § 806(a)(2)(B)(i)–(ii).

[138] *Id.* § 806(a)(2)(B)(iii).

[139] *Id.* § 806(b)(1)–(2).

[140] *See Senate Hearing on the Uninsured*, *supra* note 77, at 30–31.

[141] *See* EMPLOYEE BENEFITS SECURITY ADMINISTRATION, U.S. DEP'T OF LABOR, FACT SHEET: MEWA ENFORCEMENT (2006), http://www.dol.gov/ebsa/Newsroom/fsMEWA enforcement. html.

[142] CONG. RESEARCH SERV., *supra* note 10, at 4.

reduce the number of uninsured Americans. The Congressional Budget Office ("CBO") has conservatively estimated that at least 620,000 uninsured individuals would become newly insured if SBHPs were passed,[143] and other studies have stated that as many as 8.5 million people may gain health insurance through SBHPs.[144]

A seventh myth about SBHPs is that they would increase the incidence of insurance fraud occurring now under multiple employer welfare associations (MEWAs) because small business may confuse SBHPs with these MEWAs.

Small businesses are so desperate to find access to health care benefits that they are increasingly turning to organizations that are created overnight to purchase health coverage that is often insecure. These plans, called MEWAs, are supposed to be regulated by states.[145] Unfortunately, however, state insurance departments are often unable to prevent fraud and abuse by unscrupulous operators.[146] MEWAs are often "front" organizations for insurance companies or insurance agencies to sell insurance, leading to adverse selection and fraud.[147] Often, no certification process is required before MEWAs can begin providing health benefits to workers, and MEWAs have no federal solvency standards, which has led to further fraud and abuse.[148]

SBHPs are fundamentally different from MEWAs.[149] Specifically, SBHP legislation provides that the sponsor of an SBHP must be a bona fide professional trade organization organized and maintained in good faith, with a constitution and bylaws specifically stating its purpose and providing annual meetings.[150] Furthermore, sponsors must be in existence for at least three years for purposes other than obtaining or providing health coverage.[151] Sponsoring associations must set up a separate trust administered by trustees who become fiduciaries under the plan and are subject to the same ERISA responsibilities as fiduciaries of corporate and union health plans.[152] These trustees must set up a financial and operational strategy for the trust and plan, assuring the active and ongoing involvement of

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[143] *See* CONG. BUDGET OFFICE, *supra* note 5, at 4.

[144] CONSAD RESEARCH CORPORATION, THE PROJECTED IMPACTS OF THE EXPANDED PORTABILITY AND HEALTH INSURANCE COVERAGE ACT ON HEALTH INSURANCE COVERAGE 2 (1998), *available at* http://www.consad.com/reports/healthinsport.pdf

[145] *See Senate Hearing on the Uninsured*, *supra* note 77, at 36 (statement of Elaine L. Chao, Secretary, U.S. Department of Labor).

[146] *See id.*

[147] *See id.*

[148] *See id.*

[149] *See id.*

[150] *See Senate Hearing on the Uninsured*, *supra* note 77, at 36 (statement of Elaine L. Chao, Secretary, U.S. Department of Labor); S. 406, 109th Cong. § 801(a)(1) (2005).

[151] *See* S. 406, § 803(a).

[152] *See id.* § 805(a)(1)(A); *see also Senate Hearing on the Uninsured*, *supra* note 77, at 42 (statement of Elaine L. Chao, Secretary, U.S. Department of Labor).

the trustees in the plan's operation.[153] The SBHP must also file for certification with the DOL.[154] Finally, the continued oversight of the association on behalf of its members is a key factor in assuring and maintaining the solvency and credibility of SBHPs in the long term.[155] In order to be successful and retain participation in the plan, associations that offer SBHPs will have to offer benefits equal to or superior to traditionally regulated insurance plans in order to attract employers and their employees.[156] The regulation of these SBHPs will distinguish them from MEWAs. Small businesses will be able to safeguard themselves against fraud by looking toward these requirements and checking these entities for the appropriate DOL certification. Precluding small businesses from securing health insurance by deferring to the present status quo, which is void of affordable options, only exacerbates the likelihood that small businesses will experience fraud with MEWAs.

An eighth myth about SBHPs is that they will not succeed in reducing administrative expenses because it enlarges the infrastructure through which health insurance is provided.

In fact, uniformity provides for lower administrative costs. While smaller employers today are saddled with administrative costs that are typically 20% to 25% of their premium, self-funded large employers typically pay only 5% to 10% in administrative costs.[157]

Several associations with experience offering SBHPs confirm the savings in administrative costs that SBHPs can achieve. For example, since 1965, the American Council of Engineering Companies ("ACEC") has offered a national SBHP that provides health benefits to over 1550 firms and 41,000 employees and their families.[158] ACEC's SBHP provides its participating members with approximately 100 different medical benefit plans with a wide range of deductibles—while efficiently delivering these benefits to small businesses, with administrative costs of only 9.5%.[159] However, ACEC contends that "[t]he proliferation of mandates and regulations imposed on a state-by-state basis is the greatest concern. These mandates have vastly increased the degree of complexity of administration and have resulted in a host of compliance and regulatory initiatives that have added a significant burden to the administration of the plan."[160]

Thus, only practice can reveal the level of savings that SBHPs under the Small Business Health Fairness Act can deliver. Membership in an SBHP would be voluntary, and other insurance options currently available would

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[153] *See* United States Chamber of Commerce, *supra* note 116.

[154] *See* S. 406, § 802; United States Chamber of Commerce, *supra* note 116.

[155] *See* United States Chamber of Commerce, *supra* note 116.

[156] *See id.*

[157] *See* OFFICE OF ADVOCACY, *supra* note 27, at 2; *see also* U.S. GEN. ACCOUNTING OFFICE, *supra* note 34, at 3.

[158] *Senate Hearing on the Uninsured*, *supra* note 77, at 203.

[159] *Id.*

[160] *Id.*

not be disturbed. Ultimately, if SBHPs cannot deliver significant savings, they will not gain traction in the market.

III. Conclusion

Small businesses desperately need relief from the crisis of sharply rising health care costs and the lack of coverage options in the small group market. I believe SBHP legislation is a critical solution to the small business health insurance crisis. SBHPs represent a common-sense, targeted approach to providing coverage to a sector of society that desperately needs it at nominal cost to the federal government, without inflicting a systemic shock to the health care system,. For far too long, Congress has failed to provide relief to small businesses. I will continue to work with my colleagues in the Senate and various stakeholders on both sides of the issue in order to move SBHP legislation to the Senate floor and achieve its passage.

POLICY ESSAY

UNDERSTANDING RURAL HEALTH CARE NEEDS AND CHALLENGES: WHY ACCESS MATTERS TO RURAL AMERICANS

SENATOR CRAIG THOMAS*

In this Policy Essay, Senator Craig Thomas discusses the challenges currently facing rural health care, including a large uninsured population and a growing scarcity of providers. Senator Thomas examines how geographic and demographic factors impair rural health and proposes a number of practical solutions, including collaborative health care networks, greater equity between rural and urban areas for Medicare reimbursement, and direct incentives to physicians and other providers to practice in rural areas. After explaining why the Medicare Prescription Drug Modernization and Improvement Act of 2003 was an important first step toward achieving many of these solutions, Senator Thomas argues that there is still much that needs to be done to revitalize and strengthen rural health.

As I travel throughout Wyoming, almost everyone I talk to—patients, doctors, hospital administrators, and small businessmen—agrees that the health care system in the United States is broken. Health care costs continue to grow nationwide,[1] as does the number of uninsured Americans.[2] In rural areas, an increasingly small number of health providers[3] struggle to keep up with low levels of reimbursement[4] and the unique but varied health needs of rural citizens. It is essential for our nation, and particularly our rural

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[1] *See* U.S. DEP'T OF HEALTH AND HUMAN SERVS., EFFECTS OF HEALTH CARE SPENDING ON THE U.S. ECONOMY 1 (2005), *available at* http://aspe.hhs.gov/health/costgrowth/report.pdf.

[2] Data released by the Census Bureau in August of 2005 indicate that the number of uninsured Americans has risen from 39.8 million in 2000 to 45.8 million in 2004. Press Release, Ctr. on Budget and Policy Priorities, The Number of Uninsured Americans Continued to Rise in 2004 (Aug. 30, 2005), *available at* http://www.cbpp.org/8-30-05health.htm.

[3] *See* NAT'L RURAL HEALTH ASS'N, HEALTH CARE WORKFORCE DISTRIBUTION AND SHORTAGE ISSUES IN RURAL AMERICA 1 (Mar. 2003), *available at* http://www.nrharural.org/advocacy/sub/policybriefs/WorkforceBrief.pdf.

[4] *See* COMM. ON THE FUTURE OF RURAL HEALTH CARE, INST. OF MED. OF THE NAT'L ACADS., QUALITY THROUGH COLLABORATION: THE FUTURE OF RURAL HEALTH 126–42 (2005).

citizens, that we reverse these alarming trends.

After first describing the relationship between rural health and health care nationally, I will then discuss the aspects of rural health that have created its unique problems. Next I will address some of the flaws in existing health policies as they relate to the needs of rural citizens and communities. I will then outline some of the health care measures I have recently promoted in Congress. These measures will assist with the revitalization of fragile rural health networks by improving equity between rural and urban health care resources and reducing medical liability costs. Finally, I will consider some potential steps Congress might take to improve health care, both in rural areas like Wyoming and throughout the nation.

I. HEALTH CARE NATIONALLY

Health care costs continue to grow unchecked. National health expenditures rose 7.9% in 2004.[5] While that percentage is slower than the 8.2% growth experienced in 2003,[6] this number is still unacceptably high. The portion of the nation's Gross Domestic Product spent on health care grew to 16% in 2004—up from 14.9% only two years before.[7] Furthermore, our health care system faces challenges beyond reining in costs.

We have one of the most advanced economies on earth,[8] and yet there are still many Americans who lack access to quality health care.[9] Nationwide, it is essential that we improve our underlying health care infrastructure, as rising costs affect us all.[10] While our nation's hospitals struggle to collect revenues because of low public and private insurance reimbursement rates,[11] providers cost-shift to those with private insurance.[12]

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[5] Press Release, Ctrs. For Medicare & Medicaid Servs., Healthcare Spending Growth Rate Continues to Decline in 2004 (Jan. 10, 2006), *available at* http://www.cms.hhs.gov/apps/media/press/release.asp?counter=1750.

[6] *Id.*

[7] *Id.*

[8] In 2004, the U.S. had the third highest Gross National Income ("GNI") in the world when controlling for local prices of goods and services. *See* WORLD BANK, GNI PER CAPITA 2004, ATLAS METHOD AND PPP 1–4 (2005), *available at* http://siteresources.worldbank.org/DATASTATISTICS/Resources/GNIPC.pdf.

[9] *See* COMM. ON THE FUTURE OF RURAL HEALTH CARE, *supra* note 4, at 31–37.

[10] The costs of health care for the uninsured are not only borne out of pocket by the uninsured themselves, but also by insurers, physicians, government, and taxpayers. *See* COMM. ON THE CONSEQUENCES OF UNINSURANCE, INST. OF MED. OF THE NAT'L ACADS., HIDDEN COSTS, VALUE LOST: UNINSURANCE IN AMERICA 38–39, 46–49, 53–58 (2003).

[11] *See, e.g.*, PHILANTHROPIC COLLABORATIVE FOR A HEALTHY GEORGIA, IMPROVING RURAL HEALTH: AN ISSUE PAPER 3 (2002), *available at* http://www2.gsu.edu/~wwwghp/publications/pchg/RHbriefjan02.pdf ("It is often difficult for rural hospitals to remain open because of decreases in payments from Medicare, Medicaid, and private insurance companies.").

[12] *See* Michael A. Morrisey, *Cost Shifting: New Myths, Old Confusion, and Enduring Reality*, HEALTH AFFAIRS: THE POLICY JOURNAL OF THE HEALTH SPHERE, Oct. 8, 2003, W3-491, http://content.healthaffairs.org/cgi/reprint/hlthaff.w3.489v1 (follow "begin manual download" hyperlink).

Uninsured Americans increasingly visit emergency rooms for primary care services,[13] resulting in high costs for taxpayers.[14] Worldwide, Americans continue to pay the highest prices for prescription drugs[15] and shoulder nearly half of global research and development costs.[16] Meanwhile, doctors waste billions of dollars on unnecessary tests for fear of being sued,[17] and businesses and their employees are quickly being priced out of the health insurance market.[18] The public and private sectors must identify common-sense solutions to fix the system and, most importantly, individuals must take personal responsibility for their health.

II. RURAL HEALTH CARE

Rural counties are the backbone of America, consisting of a considerable number of citizens living on a large portion of the nation's land.[19] Because many of those individuals without access to quality health care live in rural areas,[20] rural health issues are a pressing part of the nation's current health care dilemmas.

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[13] *See Emergency Room Visits Reach Record High*, MSNBC, May 26, 2005, http://www.msnbc.msn.com/id/7995137 ("Emergency departments are a safety net and often the place of first resort for health care for America's poor and uninsured.").

[14] *See id.* (stating that "Medicaid patients were four times more likely to seek treatment in an ER than people with private insurance.").

[15] Gardiner Harris, *The Nation: Prescriptions Filled; If Americans Want to Pay Less for Drugs, They Will*, N.Y. TIMES, Nov. 16, 2003, at D4.

[16] *See* Ian M. Cockburn, Professor of Finance and Economics in the School of Management at Boston University, Remarks before the Task Force on Drug Importation (Apr. 27, 2004), *available at* http://www.hhs.gov/importtaskforce/session4/presentations/CockburnTestimony.doc ("Worldwide R&D expenditures by pharmaceutical and biotechnology companies now likely exceed $70 billion per year, over $35 billion in the US alone.").

[17] BRUCE BARTLETT, NAT'L CTR. FOR POLICY ANALYSIS, TOTAL COSTS ADD TO MANUFACTURING'S WOES (2003), *available at* http://www.ncpa.org/edo/bb/2003/bb-20031215.html ("[I]t is thought that $50 billion to $100 billion is wasted each year on unnecessary medical tests doctors order just to protect themselves from a lawsuit.").

[18] THE KAISER FAMILY FOUNDATION, EMPLOYER HEALTH BENEFITS: 2005 SUMMARY OF FINDINGS 1 (2005), *available at* http://www.kff.org/insurance/7315/sections/upload/7316.pdf. While employer-based health care premiums rose by 13.9%, 11.2%, and 9.2% during the years of 2003 to 2005, respectively, inflation rose by only 2.2%, 2.3%, and 3.5% during those same years. Meanwhile, from 2000 to 2005, the percentage of firms offering health benefits decreased from 69% to 60%. *Id.*

[19] All of the rural counties in the United States together comprise a land area equivalent to the eighteenth largest nation in the world. *See* Thomas C. Ricketts, *Arguing for Rural Health in Medicare: A Progressive Rhetoric for Rural America* 1 (N.C. Rural Health Research and Policy Analysis Ctr., Working Paper No. 75, 2002), *available at* http://www.shepscenter.unc.edu/research_programs/rural_program/wp75.pdf. The U.S. Census Bureau reported in 2000 that 59 million people, or 21% of the U.S. population, live in rural areas. See U.S. Census Bureau, Urban/Rural and Metropolitan/Nonmetropolitan Population: 2000 (2000), *available at* http://factfinder.census.gov/servlet/SAFFPeople?_submenuId=people_1&_sse=on (follow "Urban/Rural and Metropolitan/Nonmetropolitan Population: 2000" hyperlink).

[20] *See* THE KAISER FOUNDATION ON MEDICAID AND THE UNINSURED, THE UNINSURED IN RURAL AMERICA 1 (2003), *available at* http://www.kff.org/uninsured/upload/The-Uninsured-in-Rural-America-Update-PDF.pdf ("Among the 41 million uninsured in the United States, nearly one in five live in rural areas.").

Despite similarities between the rural and urban poor, what works in New York City will not necessarily work in Newcastle, Wyoming. Rural populations suffer from a distinct lack of insurance,[21] high transportation costs,[22] and demographic challenges.[23] There are also significant barriers in rural health to obstetrical services,[24] oral health,[25] mental health,[26] substance abuse recovery services,[27] and many other types of care.[28] Furthermore, rural areas face higher rates of obesity,[29] depression,[30] and suicide.[31]

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[21] *See* BARBARA A. ORMAND ET AL, THE URBAN INST., RURAL/URBAN DIFFERENCE IN HEALTH CARE ARE NOT UNIFORM ACROSS STATES 2, fig.2 (2000), *available at* http://www.urban.org/UploadedPDF/b11.pdf (demonstrating that 14.3% of urban residents, 17.5% of rural residents living adjacent to urban areas, and 21.9 % of rural residents not living adjacent to urban areas are uninsured.).

[22] Katherine Porter, *Going Broke the Hard Way: The Economics of Rural Failure*, WIS. L. REV. 969, 1008 (2005) (stating that "the average rural household spent nearly $1,000 more for transportation in 2001 than the average urban household . . . because their geographic distances to jobs, schools, and services increase the need for a vehicle, and thus gas and maintenance expenses.").

[23] For example, rural patients tend to be older. As of the 2000 census, approximately one in four seniors lived in a rural area. *See* ECON. RESEARCH SERV., U.S. DEP'T OF AGRIC., BRIEFING ROOM—RURAL POPULATION AND MIGRATION: RURAL OLDER POPULATION (2005), *available at* http://www.ers.usda.gov/briefing/population/older; *see also* U.S. CENSUS BUREAU, POPULATION PROJECTIONS FOR STATES BY AGE, RACE, AND HISPANIC ORIGIN 12 (1996), *available at* http://www.census.gov/population/www/projections/ppl47.html ("The population 65 plus is expected to double in the top seven States with the fastest-growing elderly population. The States with the fastest growth of the elderly population in rank order are: Alaska, Utah, Idaho, Colorado, Nevada, Wyoming, and Washington.").

[24] At least five Wyoming cities have already suffered the loss of OB-GYN care, and the scarcity of these services means that some pregnant women must travel distances of thirty to ninety miles to receive care or deliver their babies. *See* Wyo. Med. Soc'y, Will Care Be There? Wyoming's Medical Liability Crisis Grows More Severe (May 2005), http://www.wyomed.org/pli_prob_areas.htm (last visited Apr. 30, 2006).

[25] *See* COMM. ON THE FUTURE OF RURAL HEALTH CARE, *supra* note 4, at 239 (stating that "rural areas are marked by a lack of access to dental services resulting from an inadequate supply of dentists.").

[26] *See* Rural Assistance Center Guide to Mental Health, http://www.raconline.org/info_guides/mental_health (last visited Apr. 4, 2006) ("[I]t is well documented that rural America still lags behind its urban counterparts in mental health care.").

[27] *See* COMM. ON THE FUTURE OF RURAL HEALTH CARE, *supra* note 4, at 53. ("Health care systems in rural areas tend to be financially fragile with some services, such as . . . substance abuse, being critically underfunded."). Substance abuse services are of particular importance given the recent rise in methamphetamine abuse in rural areas. In 2003, 9385 methamphetamine labs were reported in rural areas nationwide, an increase from the 949 that were reported in 1998. NPR.com, *Meth a Growing Menace in Rural America*, http://www.npr.org/templates/story/story.php?storyId=3805074 (last visited Apr. 4, 2006).

[28] Wyoming is now considered a "red crisis state." Many doctors are either trimming their services or ending them all together. The most threatened and depleted resources for Wyoming residents are mental health care providers, surgical services, OB/GYN care, opthalmology, primary care, and many more specialized medical practices. *See* Wyo. Med. Soc'y, *supra* note 24.

[29] Rural Assistance Center Guide to Obesity and Weight Control, http://www.raconline.org/info_guides/obesity (last visited Apr. 4, 2006) ("Rural communities are now experiencing higher rates of obesity . . . than urban areas.").

[30] "The prevalence of mental illness, in particular depression, in rural areas is high." Rural Assistance Center, Mental Health, http://www.raconline.org/info_guides/mental_health (last visited Apr. 4, 2006).

[31] In 2001, Wyoming was ranked fourth in suicide rates amongst fifteen- to twenty-

Perhaps most importantly, rural areas face an unprecedented challenge in ensuring that they have an adequate number of health care professionals to serve patients.[32] Physicians and other allied health professionals are retained at lower rates than ever before,[33] and our young people are not choosing careers in the health field as often as they used to.[34] As a result, hospital vacancy rates for registered nurses, radiology technicians, and pharmacists are each greater than 10%.[35] One in seven hospitals faces a severe nursing shortage and more than 20% of nursing positions remain vacant.[36]

While many of the differences between urban and rural health are material, economic, and geographic, there are also differences of attitude as well. In rural communities, individuals are likely to define health as a person's ability to work.[37] For reasons related to culture, transportation difficulties, and health literacy, rural individuals are more likely to delay seeking medical treatment until a condition has become severe or until multiple conditions exist.[38] This mentality of the underserved exists side-by-side with those who not only have access, but arguably have too much access to medical services. Because these latter individuals are insured and have more immediate access, doctors frequently encourage them to run a gamut of expensive and repetitive testing simply because insurance covers it and there is no shared record of previous testing.[39] Neither of these two extremes promotes personal or professional responsibility in regard to health and both are costly in terms of health and medical costs.

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four-year-olds. A Wyoming youth is twice as likely to commit suicide as the national youth average. In 2002 the rate was 20.35 per 100,000 youths in Wyoming as compared with 9.9 per 100,000 youths nationally. WYO. DEP'T OF HEALTH, MATERNAL AND CHILD HEALTH NEEDS ASSESSMENT: ISSUE PAPER 2 (2004), *available at* http://wdh.state.wy.us/mchepi/pdf/briefs/Suicidissue.pdf.

[32] *See* COMM. ON THE FUTURE OF RURAL HEALTH CARE, *supra* note 4, at 79 ("[F]or decades, rural and frontier communities have struggled to attract and retain an adequate supply of . . . various health care professionals.").

[33] *See* NAT'L RURAL HEALTH ASS'N., *supra* note 3, at 1.

[34] *See* Press Release, U.S. Dep't of Health and Human Servs., Bush Administration Promotes Careers in Nursing: Survey Shows Critical Shortage of Nurses (Feb. 22, 2002), *available at* http://newsroom.hrsa.gov/releases/2002releases/nursesevent2withpics.htm.

[35] FIRST CONSULTING GROUP, THE HEALTHCARE WORKFORCE SHORTAGE AND ITS IMPLICATIONS FOR AMERICA'S HOSPITALS 4 (2001), *available at* http://www.hospitalconnect.com/aha/key_issues/workforce/resources/content/FcgWorkforceReport.pdf.

[36] *Id.*

[37] K. A. Long, *The Concept of Health*, 28 RURAL NURSING 123, 123–30 (1993).

[38] Felecia G. Wood, *Health Literacy in a Rural Clinic*, 5 ONLINE JOURNAL OF RURAL NURSING AND HEALTH CARE (2005), http://www.rno.org/journal/issues/Vol-5/issue-1/Wood_article.htm.

[39] *See, e.g.*, Press Release, Agency for Healthcare Research and Quality, AHRQ Awards Over $22.3 Million in Health Information Technology Implementation Grants (Oct. 6, 2005), *available at* http://www.ahrq.gov/news/press/pr2005/hitimppr.htm (stating that some information technology grants will be used to "ensure safer patient transitions between health care settings, as well as reducing medication errors and duplicative and unnecessary testing").

Skyrocketing medical liability premiums[40] are also crippling the rural health care system.[41] Obstetrics and gynecological services have been especially impacted by medical liability premiums.[42] Two Wyoming areas, Wheatland and Douglas, recently lost their only OB-GYNs—doctors who had previously delivered babies in three counties—as a result of rising malpractice costs.[43] In order to address this issue, we need to set reasonable limits on non-economic damages, provide for a quicker review of liability claims, ensure that claims are filed within a reasonable time limit, and educate people to help them understand that frivolous lawsuits only add to the overall cost of health care for everyone.

In an effort to meet these challenges, the Senate Finance Committee, of which I am a member, has been meeting regularly to discuss ways to increase health insurance access and affordability.[44] There are many competing proposals to accomplish this goal including tax credits,[45] reducing paperwork and costly regulations,[46] expanding safety net programs,[47] improving Health Savings Accounts ("HSAs"),[48] and implementing medical

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[40] For example, the most substantially affected states saw premiums for specialty physicians increase between 36% and 113% in 2002. *See* OFFICE OF THE ASSISTANT SEC'Y FOR PLANNING AND EVALUATION, U.S. DEP'T OF HEALTH AND HUMAN SERVS., SPECIAL UPDATE ON MEDICAL LIABILITY CRISIS (2002), *available at* http://aspe.hhs.gov/daltcp/reports/mlupd1.htm.

[41] *See* NAT'L RURAL HEALTH ASS'N, PROFESSIONAL LIABILITY REFORM 1 (2003), *available at* http://www.nrharural.org/advocacy/sub/policybriefs/LiabilityReformPolicyBrief.pdf ("In rural and underserved communities, where access to quality care is already in jeopardy, rising liability costs are creating a crisis situation.").

[42] *See* Donald J. Palmisano, Statement of the Am. Med. Ass'n to the Comm. on Small Business of the U.S. House of Rep. 3 (Feb. 17, 2005), *available at* http://www.legalreforminthenews.com/Reports/AMA%20Testimony%20Congress%202-17-05.pdf ("[P]atients' access to care may be in jeopardy as increased medical liability costs force physicians to restrict the services they provide, especially high-risk specialists in neurosurgery, orthopedic surgery, obstetrics, and general surgery.").

[43] After twenty-three years of practice, OB-GYN Willard Woods was unable to obtain liability insurance and was forced to end his obstetrics practice. *See* Wyo. Med. Soc'y, *supra* note 24. (providing further examples of doctors whose practices have been threatened by rising malpractice insurance costs).

[44] *See, e.g., Health Care Coverage for Small Businesses: Challenges and Opportunities: Hearing Before the S. Comm. on Finance*, 109th Cong. (2006); *Improving Quality in Medicare: The Role of Value-Based Purchasing: Hearing Before the S. Comm. on Finance*, 109th Cong. (2005).

[45] *See* Equity for Our Nation's Self Employed Act of 2005, S. 663, 109th Cong. (2005) (allowing the self-employed to deduct the amount they pay for health insurance from their calculation of payroll taxes).

[46] *See* Healthy America Act of 2005, S. 4, 109th Cong. (2005) (proposing in section 102 to achieve increased efficiency through new technology and greater coordination among various parties); *see also* Better Healthcare through Information Technology Act, S. 1355, 109th Cong. (2005) (providing for increased efficiencies through application of technology).

[47] *See* Seniors Mental Health Access Improvement Act of 2005, S. 784, 109th Cong. (2005) (focusing on improving seniors' access to mental health support); Medicare Rural Home Health Payment Fairness Act of 2005, S. 300, 109th Cong. (2005) (extending a rural home health bonus provision).

[48] *See* Personal Responsibility and Individual Development for Everyone Act, S. REP. NO. 109-051, at 266–67 (2005) (providing for the establishment of deductions for health savings plans).

liability reform.[49] Although I remain committed to working in a bipartisan manner with my Senate colleagues to find solutions to the looming health care crisis, this piecemeal approach to legislation still leaves hard working families living in rural areas without quality health care.

III. FLAWS IN THE EXISTING POLICIES

National health care policies have placed additional burdens on rural citizens and health providers beyond those that already exist due to the intrinsic characteristics of rural areas. For years, Medicare has underpaid rural providers and hospitals.[50] The underpayments include those to clinics and allied health professionals and result from the unfortunate assumption that rural health care, by nature, costs less.[51] In reality, rural Americans experience escalating costs that their urban counterparts do not. This is because of factors such as the alarming 45.7% of Wyoming births paid for by Medicaid,[52] a rapidly aging population,[53] high chronic illness,[54] decreasing access to providers,[55] transportation issues,[56] and low patient volumes.[57]

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[49] *See* Help Efficient, Accessible, Low-Cost, Timely Healthcare (HEALTH) Act of 2005, S. 354, 109th Cong. (2005) (seeking to reduce the burden the liability system places on health care delivery networks); *see also* S. 4 (proposing in sections 101–112 to "implement reasonable, comprehensive, and effective health care liability reforms.").

[50] *See* COMM. ON THE FUTURE OF RURAL HEALTH CARE, *supra* note 4, at 12 ("Although significant steps have been taken to correct historical underpayment of rural providers under Medicare, the operating margins of many rural hospitals are still low, and concerns about the equity of physician payments persist.").

[51] *Finding the Funds for Rural Health*, RURAL HEALTH NEWS (Rural Info. Ctr. Health Serv.) Spring 2001, at 1, *available at* http://www.raconline.org/newsletter/pdf/spring01_vol8-1.pdf ("Medicare reimbursement policies . . . pay rural providers lower rates than urban providers for the same services, based on the arguably incorrect assumption that everything costs less in rural areas.").

[52] BRENT SHERARD, WYO. DEP'T OF HEALTH, COMPREHENSIVE ASSESSMENT OF MATERNAL AND CHILD HEALTH NEEDS 2006–2010, at 12 (2005), *available at* http://wdh.state.wy.us/mch/pdf/Final Needs Assessment.pdf.

[53] *See supra* note 23 and accompanying text.

[54] A recent study found that 30.5% of Wyoming's adult population reported being diagnosed with high blood cholesterol; 37% were overweight; 4.5% reported being diagnosed with diabetes; and 24.6% were smokers. CTRS. FOR DISEASE CONTROL AND PREVENTION, PROFILING THE LEADING CAUSES OF DEATH IN THE UNITED STATES: WYOMING 4 (2005), *available at* http://www.cdc.gov/nccdphp/publications/factsheets/chronicdisease/pdfs/wyoming.pdf. The numbers were even higher for Wyoming's Native American Population, whose death rates from both diabetes and liver disease both exceeded national Native American averages. They were also, on average, more overweight (41%) and more likely to smoke (39%) than their Caucasian counterparts. *Id.*

[55] *See supra* notes 32–36 and accompanying text.

[56] *See* Porter *supra* note 22 and accompanying text.

[57] *See, e.g.*, COMM. ON THE FUTURE OF RURAL HEALTH CARE, *supra* note 4, at 98 ("[L]ow volume of patients make it difficult for rural hospitals to hire specialists in emergency medicine and muster the financial resources to adequately support an EMS system.").

An additional problem is the lack of statistical data to support rural health programs as well as policy changes.[58] While some states have compiled their own statistics to support their rural health needs,[59] the U.S. Department of Health and Human Services' ("HHS") Office of Rural Health Policy ("ORHP")[60] is under tight budget constraints for its rural health priorities.[61] While the ORHP has produced some good data for rural areas given its limited funding,[62] HHS needs to look more closely at rural populations' specific health care concerns and respond in concrete, fiscal terms to the rural health crisis.

Another complication is the very definition of the term "rural population." Currently, there are several definitions for rural, frontier, and rural-urban populations—each with different criteria.[63] The lack of clarity and cohesiveness created by these overlapping definitions serves to neglect particular rural areas.[64] It also simultaneously oversimplifies the continuum of rural and urban areas by overlooking the existence of neighboring urban and rural counties into consideration.[65] This is likely to result in the wasteful distribution of resources to areas without truly rural needs.

IV. RURAL HEALTH NETWORKS

One reason for the lack of health care professionals willing to work full time in rural areas,[66] and hence for the resulting shortage of medical

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[58] *See, e.g.*, *id.*, at 111 ("Current workforce programs are hampered by a lack of data and information to target resources effectively."); *id.* at 226 ("Efforts to evaluate the quality, status, and utilization of emergency services in specific terms have been hampered by the overall lack of data.").

[59] *See, e.g.*, The Colorado Rural Health Ctr. Library, http://www.coruralhealth.org/crhc/resources/library.php (last visited Apr. 16, 2006); Idaho Dep't of Health & Welfare Health Statistics Webpage, http://healthandwelfare.idaho.gov/site/3457/default.aspx (last visited Apr. 16, 2006); JOHN PACKHAM, NEVADA OFFICE OF RURAL HEALTH, NEVADA RURAL AND FRONTIER HEALTH DATA BOOK–2004 EDITION (2004), *available at* http://www.unr.edu/med/dept/CEHSO/Documents/DataBook2004.pdf.

[60] The ORHP is part of the Health Resource Services Administration ("HRSA"). Rural Health Policy Homepage, http://ruralhealth.hrsa.gov (last visited Feb. 23, 2006).

[61] The President requested only $27 million for rural health in the proposed 2007 HRSA budget, down from the $145 million earmarked for rural health programs in 2005. *See* U.S. DEP'T OF HEALTH AND HUMAN SERVS., BUDGET IN BRIEF: FISCAL YEAR 2007, at 20 (2006) *available at* http://www.hhs.gov/budget/07budget/2007BudgetInBrief.pdf.

[62] *See generally, e.g.*, VICTORIA FREEMAN ET AL., INTENSIVE CARE IN CRITICAL ACCESS HOSPITALS (2005), *available at* http://www.shepscenter.unc.edu/research_programs/rural_program/WP81.pdf; ERIKA C. ZILLER & ANDREW F. COBURN, HEALTH INSURANCE COVERAGE OF THE RURAL AND URBAN NEAR ELDERLY (Maine Rural Health Research Center, Working Paper No. 27, 2003), *available at* http://muskie.usm.maine.edu/Publications/rural/wp27.pdf.

[63] *See* COMM. ON THE FUTURE OF RURAL HEALTH CARE, *supra* note 4, at 200–04.

[64] *See* THOMAS C. RICKETS ET AL., DEFINITIONS OF RURAL: A HANDBOOK FOR HEALTH POLICY MAKERS AND RESEARCHERS 6 (1998), *available at* http://www.schsr.unc.edu/research_programs/rural_program/ruralit.pdf.

[65] *See id.* at 8.

[66] *See supra* notes 32–36 and accompanying text.

care, is the isolation that many rural physicians face.[67] An innovative solution to some rural health problems, including that of physician isolation, is rural health networks.[68] By using the information technologies to create a network of co-worker collaboration between sparsely located hospitals and rural care providers within which communication about care plans for specific patients can occur, we can improve the effectiveness of rural care and reduce the isolation faced by rural providers. Furthermore, because shared information about patients reduces the need for repetitive tests, the care can also be less expensive for both the provider and the patient.[69] Existing networks need to stretch federal dollars to serve as many people as possible. Communities need the tools and resources to build meaningful and collaborative health networks to support rural communities on a regional level.

Another complication in addressing rural health care is the lack of data to support rural health networks and similar collaborative programs.[70] Under its 2002 Rural Initiative, HHS established the Rural Assistance Center ("RAC") as a rural health and human services information portal.[71] The RAC "helps rural communities and other rural stakeholders access the full range of available programs, funding, and research that can enable them to provide quality health and human services to rural residents."[72] The ORHP also assists in promoting rural health networks by "maintaining a national information clearinghouse."[73]

Although the efforts of the RAC and ORHP have brought some improvements to rural health,[74] there is much that remains to be done. We can start by improving upon the existing communication and collaborative capabilities of rural health clinic systems already in place in Wyoming

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[67] *See* AM. MED. STUDENT ASS'N, HEALTH CARE DELIVERY: RURAL VS. URBAN COMMUNITIES (2006), http://www.amsa.org/programs/gpit/ruralurban.cfm.

[68] A rural health network is defined as "[a] formal organizational arrangement among rural health care providers (and possibly insurers and social service providers) that uses the resources of more than one existing organization and specifies the objectives and methods by which various collaborative functions are achieved." AGENCY FOR HEALTH CARE POLICY AND RESEARCH, STRENGTHENING THE RURAL HEALTH INFRASTRUCTURE: NETWORKING DEVELOPMENT AND MANAGED CARE STRATEGIES (1997), *available at* http://www.ahrq.gov/news/ulp/ulpstren.htm.

[69] *See* MICHAEL E. SAMUELS & SHELLY TEN NAPEL, NAT'L RURAL HEALTH ASS'N, COLLABORATION: MODERN RELATIONSHIPS BETWEEN RURAL COMMUNITY HEALTH CENTERS AND HOSPITALS 2–8 (2005), *available at* http://www.nrharural.org/quality/collaboration.pdf.

[70] *See supra* notes 58–61 and accompanying text.

[71] *See generally* Rural Assistance Center Homepage, http://www.raconline.org (last visited Apr. 14, 2006).

[72] What is the Rural Assistance Center?, http://www.raconline.org/about (last visited Apr. 14, 2006).

[73] Rural Health Policy Homepage, *supra* note 60.

[74] *See generally* OFFICE OF RURAL HEALTH POLICY, DEP'T OF HEALTH AND HUMAN SERVS., A HISTORY OF THE RURAL HEALTH CARE SERVICES OUTREACH PROGRAM (2004), *available at* http://ruralhealth.hrsa.gov/funding/outreachhistory.asp (providing a history of the Department's efforts to improve rural health and discussing some of the ORHP's recent success stories).

and other rural states. This effort must begin by increasing funding for critical access hospitals, community hospitals, community health centers, and tribal health services. It should also involve improvements in resource equity for rural programs and providers[75] and reductions in liability for rural health providers.[76]

V. THE MMA AND RURAL PROVIDER EQUITY ACT

Rural health was not on the radar screen in the 1980s. But the growing concerns about the status of rural health prompted key senators from rural states to begin working in a bipartisan fashion to effect change. During the late 1990s, Congress enacted rural-friendly health legislation in response to data indicating the inadequacies of payment systems and poor health status of rural Americans. Some of those pieces of legislation include the Balanced Budget Act of 1997 ("BBA"),[77] the Balanced Budget Refinement Act of 1999 ("BBRA"),[78] the Medicare, Medicaid, and SCHIP Benefits Improvement and Protection Act of 2000 ("BIPA"),[79] and the Medicare Prescription Drug Modernization and Improvement Act of 2003 ("MMA").[80]

The MMA[81] in particular includes many provisions that begin to address rural health concerns, the most important of which relate to Medicare equity.[82] Medicare should prioritize rural health,[83] not only because

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[75] *See supra* notes 50–51 and accompanying text.

[76] *See supra* notes 40–43 and accompanying text.

[77] Balanced Budget Act of 1997, Pub. L. No. 105-33, §§ 4201–4207, 111 Stat. 251, 369–81 (1997) (codified as amended in scattered sections of U.S.C.). This Act attempted to reduce Medicare spending by $116.4 billion between 1998 and 2002. JENNIFER O'SULLIVAN ET AL., CONG. RESEARCH SERV., RL30347—MEDICARE, MEDICAID, AND STATE CHILDREN'S HEALTH INSURANCE PROGRAM (SCHIP): CHANGES TO BALANCED BUDGET ACT OF 1997 (BBA 97, P.L. 105-33) PROVISIONS 1 (1999), *available at* http://www.house.gov/moore/rl30347.pdf.

[78] Balanced Budget Refinement Act of 1999, Pub. L. No. 106-113, §§ 401–413, 113 Stat. 1501, 1501A-369 to -378 (1999) (codified as amended in scattered sections of U.S.C.). This legislation was intended to mitigate the impact of the BBA on Medicare payments and access to care. *See* O'SULLIVAN ET AL., *supra* note 77, at 1–2, 4–5.

[79] Medicare, Medicaid, and SCHIP Benefits Improvement and Protection Act of 2000 (BIPA), Pub. L. No. 106-554, § 1(a)(6), 114 Stat. 2763 (2000) (codified as amended in scattered sections of 42 U.S.C.). *See generally* HINDA CHAIKIN ET AL., CONG. RESEARCH SERV., RL30707—MEDICARE PROVISIONS IN THE MEDICARE, MEDICAID, AND SCHIP BENEFITS IMPROVEMENT AND PROTECTION ACT OF 2000 (2001), *available at* http://digital.library.unt.edu/govdocs/crs/data/2001/upl-meta-crs-1363/RL30707_2001May24.pdf (discussing the legislation's effects on Medicare).

[80] Medicare Prescription Drug, Improvement and Modernization Act of 2003, Pub. L. No. 108-173, 117 Stat. 2066 (2003) (codified as amended in scattered sections of 26 & 42 U.S.C.).

[81] Medicare Prescription Drug, Improvement and Modernization Act, 42 U.S.C.A. § 1395 (West Supp. 2005).

[82] *See infra* notes 90–95, 99–99, 101–104 and accompanying text.

[83] Medicare is essential to rural health, since it may account for up to 70% of the total revenue for many rural providers. *See* Keith Mueller, Ph.D., Nat'l Rural Health Ass'n, Testimony before the Nat'l Bipartisan Comm'n on the Future of Medicare (Sept. 8, 1998),

of the unique needs and characteristics of rural populations,[84] but also because Medicare's complex funding formula currently favors urban providers.[85] The Senate Rural Health Caucus has worked long and hard to address the current rural inequities of the Medicare program.[86] The fact that the MMA contains the largest rural health package to date—approximately $25 billion for rural providers, including $40 million for Wyoming providers over the next ten years[87]—is an indication that the Caucus has begun to succeed in that endeavor.

The package makes the equalization of the standardized base payment amount permanent in all states and territories.[88] The MMA addressed the payment disparities in Medicare between rural and urban health providers for hospitals, physicians, ambulances, and home health agencies.[89]

For hospitals, the MMA extends the equalization of in-patient base payments,[90] making permanent what would have otherwise been a temporary elimination of disparities between hospitals in large urban areas and hospitals in rural and small urban areas.[91] In addition, the MMA equalizes Medicare disproportionate share payments[92] to Disproportionate Share Hospitals (DSHs), rural hospitals, rural referral centers, and Sole Community Hospitals (SCHs).[93] These payments are meant to improve services for a large number of uninsured, poverty-stricken, and indigent patients. The MMA package also creates a ceiling of 62% for the labor-related share of

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available at http://thomas.loc.gov/medicare/muellertest.html.

[84] *See supra* Part II.

[85] *See supra* notes 50–51 and accompanying text.

[86] *See, e.g.*, Letter from Senate Rural Health Caucus to Senate Finance Comm. and House Comm. on Ways and Means (July 15, 2005), *available at* http://hospitalconnect.com/aha/advocacy-grassroots/advocacy/hillletters/content/030725senruralhlthlet.pdf.

[87] *See* Fact Sheet, U.S. Dep't of Health and Human Servs., HHS Programs to Protect and Enhance Rural Health (Jan. 13, 2006) *available at* http://www.hhs.gov/news/factsheet/rural.html; Press Release, Craig Thomas, U.S. Senator (R-Wyo.), Thomas Attends Medical Bill Signing (Dec. 9, 2003), *available at* http://thomas.senate.gov/index.cfm?FuseAction=PressReleases.Detail&PressRelease_id=165&Month=12&Year=2003.

[88] As of April 1, 2004, urban and rural standardized amounts (under PPS) were permanently equalized through a single base payment for all hospitals. *MMA—Medicare Prescription Drug, Improvement and Modernization Act of 2003: Information for Medicare Rural Health Providers, Suppliers, and Physicians*, MEDLEARN MATTERS: INFO. FOR MEDICARE PROVIDERS. (Ctrs. for Medicare & Medicaid Servs., Baltimore, Md), Dec. 14, 2004, at 1, *available at* http://www.cms.hhs.gov/medlearnmattersarticles/downloads/SE0450.pdf [hereinafter *Information for Providers*].

[89] *See infra* notes 90–95, 99–99, 101–104 and accompanying text.

[90] Medicare Prescription Drug, Improvement and Modernization Act, § 401, 42 U.S.C.A. § 1395ww(d)(3)(A) (West Supp. 2005).

[91] *See id.*; JENNIFER O'SULLIVAN ET AL., CONG. RESERACH SERV., RL31966—OVERVIEW OF THE MEDICARE PRESCRIPTION DRUG, IMPROVEMENT, AND MODERNIZATION ACT OF 2003, at 18 (2003), *available at* http://www.nachc.com/advocacy/files/CRSMedicareRxSummary.pdf.

[92] Disproportionate share payments are payments made to providers that "serve[ ] a significantly disproportionate number of low-income patients." 42 U.S.C.A. § 1395ww(d)(5)(F)(i)(I).

[93] 42 U.S.C.A. § 1395ww(d)(5)(F).

the wage index in low-wage areas,[94] which will further boost payments to rural hospitals.[95]

The effort also extends the current "hold harmless" provisions for rural hospitals from the Outpatient Prospective Payment System.[96] This assures that isolated rural hospitals with less than 100 beds are protected from payment decreases.[97] Hospitals with fewer than 800 annual discharges will receive up to a 25% increase in inpatient payments.[98] This creates a new low-volume payment system to recognize the different economies of scale of rural hospitals. Finally, the MMA provided a 5% bonus payment for rural home health agencies[99] as well as an increase in payments for ground and air ambulance transportation.[100]

For physicians, the MMA establishes a floor for the downward adjustment of payments based upon geographical regions and their relative cost differences so that the value of rural physicians' time and effort is not minimized in comparison to their urban counterparts.[101] The MMA also increases payments for all physicians by turning planned cuts in Medicare physician fees into 1.5% pay increases in 2004 and 2005.[102] Furthermore, the MMA improves the Medicare Incentive Payment Program (MIPP) by creating a new 5% bonus payment program based upon physician scarcity.[103] These provisions create incentives for doctors to practice in areas where there are physician shortages, many of which are rural.[104]

Finally, the MMA strengthens the Critical Access Hospital (CAH) program through provisions to increase the qualifying bed limit from 15 to 25, to provide flexibility within the 25-bed limit for acute care,[105] as well as to increase reimbursement by basing its calculation on 80% of 101% instead of 80% of 100% of reasonable costs for CAHs.[106] The MMA also provides additional funding and flexibility by authorizing periodic interim payments;[107] paying the costs of more emergency room on-call

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[94] 42 U.S.C.A. § 1395ww(d)(3)(E).

[95] *See* H.R. REP. No. 108-391, at 610 (2003) (Conf. Rep.) ("Decreasing [the] labor-related share . . . increase[s] Medicare payments to hospitals in areas with wage indices below one."); Kathleen Dalton et al, *Rural Hospital Wages and the Area Wage Index*, 24 HEALTH CARE FINANCING REVIEW 164, fig.3 (2002) (demonstrating a correlation between rural areas and lower relative wages).

[96] 42 U.S.C.A. § 1395l(t)(7)(D).

[97] *See* O'SULLIVAN ET AL., *supra* note 91, at 18.

[98] 42 U.S.C.A. § 1395ww(d)(12).

[99] 42 U.S.C.A. § 1395fff ("[T]he Secretary shall increase the payment amount . . . for [home health] services by 5 percent.").

[100] 42 U.S.C.A. § 1395m(l).

[101] 42 U.S.C.A. § 1395l(u).

[102] 42 U.S.C.A. § 1395w-4(d)(5).

[103] 42 U.S.C.A. § 1395(u)(B).

[104] *See supra* notes 32–36 and accompanying text.

[105] 42 U.S.C.A. § 1395i-4(c)(2)(B).

[106] 42 U.S.C.A. §§ 1395f(l), m(g)(1), tt(a)(3).

[107] 42 U.S.C.A. § 1395g(e)(2).

providers;[108] permitting distinct units for psychiatric and rehabilitation;[109] and providing four additional years of special grant funding.[110] The CAH program has been essential to keeping some Wyoming hospitals open, and there are now at least fourteen CAHs in the state, including those in Basin, Worland, Thermopolis, Newcastle, Douglas, Wheatland, and Torrington.[111]

The substantive changes in CAH and other rural health programs are a reasonable short-term solution for rural health needs. In the long-term, however, either reimbursement policies need to change or the entire system must become market-driven and lose its basis in an artificially overpriced insurance-reimbursement system that does not adequately inform buyers of what they are purchasing. If we are to improve upon the efforts that the Senate Rural Health Caucus has begun over the past decade, then Congress must place the tremendous needs of rural health care at the top of its agenda.

VI. CONCLUSION

We must continue the fight for rural health care access and affordability. The task before Congress may be Herculean, but it is important to focus on the steps we can take for the greater good of rural health. There is momentum in 2006 for efforts involving Health Savings Accounts.[112] With so many Americans changing jobs,[113] we need to give some "portability" to our health care system. This may also help us develop a system where we "shop" for our health care needs, knowing that we have a finite amount of money to use. While the creation of a more market-driven health care system should control costs, it would not fully address rural health needs.

I will continue efforts to shore up rural health networks through collaboration and fair and equitable payment policies. I will also work to provide more access to mental health and substance abuse programs, which are desperately needed in many rural areas and have become a growing concern in Wyoming.[114] Another focus must be the needs of rural America's

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[108] 42 U.S.C.A. § 1395m(g)(5).

[109] 42 U.S.C.A. § 1395i-4(c)(2).

[110] 42 U.S.C.A. § 1395i-4(j).

[111] *See* Flex Monitoring Team, A Complete List of Critical Access Hospitals (Feb. 28, 2006), http://flexmonitoring.org/documents/CAHlist_current.xls.

[112] *See* Personal Responsibility and Individual Development For Everyone Act, S. REP. No. 109-051, at § 223 (2005) (providing for the establishment of deductions for health savings plans).

[113] *See* Ronald Bird, Chief Economist, Employment Policy Foundation, Testimony to U.S. Senate Comm. on Appropriations (May 4, 2004), *available at* http://appropriations.senate.gov/hearmarkups/record.cfm?id=221090 ("In 1938, most workers expected to stay with a single employer for his or her working life. Today, average job tenure is under five years and declining.").

[114] Press Release, University of Wyoming, College of Health Sciences, UW Program to Improve Access to Wyoming Primary Mental Health Care (Aug. 9, 2005), *available at* http://

aging population.[115] We must also remain steadfast in encouraging providers to practice in designated physician-shortage areas. Finally, throughout this looming health care debate, we need to remember to be creative and to help Americans help themselves. As we shape health policy for all Americans, we need to work collaboratively with federal, state, and private interests and in concert with associations and providers, to find common-sense solutions to rural health care needs.

uwadmnweb.uwyo.edu/hs/showrelease.asp?id=961 ("[Wyoming] has the second highest rate of suicide per 100,000 people in the nation. . . . Wyoming also has the fourth highest rate of substance abuse.").

[115] *See* ECON. RESEARCH SERV., *supra* note 23.

POLICY ESSAY

WHY IMMIGRATION REFORM REQUIRES A COMPREHENSIVE APPROACH THAT INCLUDES BOTH LEGALIZATION PROGRAMS AND PROVISIONS TO SECURE THE BORDER

REPRESENTATIVE SHEILA JACKSON LEE*

As many as eleven million undocumented immigrants are living and working in the United States today, and the number is only growing. This Policy Essay addresses the problems resulting from the presence of so many undocumented workers in this country and presents two key legislative proposals to help solve the current crisis. In particular, it confronts two crucial weaknesses in immigration policy today: effectively managing the undocumented workers already in the United States and preventing a new population of undocumented immigrants from replacing the one we have now. The Essay contends that the Bush Administration's legislative proposal would establish a guest worker program that only temporarily addresses the former issue and completely ignores the national border security problems causing the latter issue. Instead, the Essay concludes that the federal government should present a means for undocumented workers presently residing in this country to gain legal permanent resident status and should provide for a more reliably secured national border.

United States immigration policy presents one of the most pressing national concerns on two fronts: the growing undocumented immigrant population and the security of national borders. I believe it is in the best interests of our country to offer honest, hard-working undocumented immigrants access to legal permanent resident status. Moreover, our citizens deserve a reliably secured border provided by the federal government.

The Bush administration's current immigration proposal does not adequately address either the issue of undocumented immigrant population growth or that of national border security.[1] It attempts to solve the undocumented immigrant problem by establishing a guest worker program, but such a program is predicated on the unrealistic expectation that participants will leave when their guest worker status expires.[2] The proposal also inadequately addresses the crucial concern of inadequate border security.[3] For

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[1] *See* Press Release, President George W. Bush, Fact Sheet: Fair and Secure Immigration Reform (Jan. 7, 2004), *available at* http://www.whitehouse.gov/news/releases/2004/01/20040107-1.html.

[2] *See id.*

[3] *See id.*

example, it does not attempt to shield our nation from violent criminals, drug traffickers, and human traffickers, many of whom have crossed the U.S.-Mexico border as a result of inadequate border protection.[4] State governors have attempted to manage border security through the use of sporadic State of Emergency declarations, a strategy that has proven both makeshift and ineffectual.[5]

In order to provide a context for the existing immigration problems we face, this Policy Essay begins in Part I by discussing the history of immigration policy. Part II then gives an overview of the state of this policy today. Part III summarizes President Bush's current immigration proposal, followed in Part IV by a comparison of this proposal to two pending pieces of legislation I recently proposed (H.R. 2092 and H.R. 4044)[6] that address the issues of undocumented worker growth and national border security, respectively. Other legislative proposals have been made, but it is too soon to predict their viability. Nevertheless, the Policy Essay provides a roadmap for our country to achieve effective immigration policy reform.

I. HISTORY

A. The Evolution of a Restrictive Immigration Policy

During our first 100 years of nationhood, the influx of new settlers was essential to our survival, and the government allowed immigrants relatively unfettered access.[7] This policy paid rich dividends, as immigrants and their descendants contributed heavily to the growth of the country.[8] It was during this time that Emma Lazarus wrote the poem that is now enshrined on the Statute of Liberty: "Give me your tired, your poor, your huddled masses yearning to breathe free, the wretched refuse of your teeming shore, send these, the homeless, tempest-tossed, to me: I lift my lamp beside the golden door."[9]

At the beginning of our country's history, popular sentiment favored immigration even when policymakers did not. The Alien Act of 1798,[10] which authorized the President to deport any alien viewed as dangerous, was extremely unpopular and was not renewed at the end of its two-year

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[4] *See, e.g.*, Ginger Thompson, *Drug Violence Paralyzes a City, and Chills the Border*, N.Y. TIMES, Mar. 24, 2005, at A4; Ginger Thompson, *In the Border Brutality, Discerning a Bright Side*, N.Y. TIMES, Oct. 26, 2005, at A4.

[5] *See* Ralph Blumenthal, *Citing Border Violence, 2 States Declare a Crisis*, N.Y. TIMES, Aug. 17, 2005, at A14; Ruben J. Garcia, *Labor's Fragile Freedom of Association Post-9/11*, 8 U. PA. J. LAB. & EMP. L. 283, 349 (2006).

[6] *See* H.R. 2092, 109th Cong. (2005); H.R. 4044 109th Cong. (2005).

[7] *See generally* Gerald L. Neuman, *The Lost Century of American Immigration Law (1776–1875)*, 93 COLUM. L. REV. 1833 (1993).

[8] *See* 1 CHARLES GORDON ET AL., IMMIGRATION LAW AND PROCEDURE § 2.02[1] (2005).

[9] EMMA LAZARUS, *The New Colossus*, *in* SELECTED POEMS 58 (John Hollander ed., 2005).

[10] Ch. 58, 1 Stat. 570, 570–72.

term.[11] As late as 1864, Congress continued to enact legislation encouraging immigration, and several states had programs actively promoting it.[12]

This trend began to change in 1875 when Congress passed a statute barring convicts and prostitutes from entering the country.[13] The first immigration restrictions became law soon afterwards in 1882 when immigrants had to pay a fifty cent head tax in order to enter the United States and lunatics, convicts, and paupers were prohibited from immigrating.[14] In 1885 and 1887, Congress passed more laws to restrict the influx of foreign low-wage workers and to protect the domestic labor market.[15] General immigration laws codified in 1891 excluded additional classes of people, including "idiots" and diseased persons, and authorized the deportation of aliens who had entered the country illegally.[16]

In 1921, the Emergency Quota Act[17] established quotas proportional to the number of foreign-born residents of each nationality living in the United States at the time of the 1910 census. Three years later, Congress enacted a more complex quota system under the Immigration Act of 1924,[18] which used the 1890 census as its baseline for national origin, thereby limiting the number of southern and eastern European immigrants.[19] In 1952, Congress passed the Immigration and Nationality Act (INA),[20] which remains the basis for modern immigration law. INA modified immigration quotas by basing them on the 1920 census, while at the same time removing all racial restrictions from the code.[21]

Today, immigration quotas are primarily divided into three broad categories: immediate relatives of immigrants, family-based immigration, and employment-based immigration.[22] The first group faces no quotas and consists of spouses, unmarried minor children below the age of twenty-one, and parents of U.S. citizens.[23] The second group is limited to 226,000 immigrants per year and is selected from the remaining children, siblings, and spouses of citizens as well as unmarried adult children of green card holders.[24] Finally, members of the third group immigrate to work in this coun-

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[11] *See* GORDON, *supra* note 8, § 2.02[1].

[12] *See id.*

[13] Act of Mar. 3, 1875, ch. 141, 18 Stat. 477.

[14] *See* Act of Aug. 3, 1882, ch. 376, 22 Stat. 214, 214–15.

[15] *See* Act of Feb. 23, 1887, ch. 220, 24 Stat. 414, 414–15; Act of Feb. 26, 1885, ch. 164, 23 Stat. 332, 332–33.

[16] *See* Act of Mar. 3, 1891, ch. 551, 26 Stat. 1084, 1084–86.

[17] Ch. 8, 42 Stat. 5, 5–7.

[18] Ch. 190, 43 Stat. 153, 153–169.

[19] *See* E. P. HUTCHINSON, LEGISLATIVE HISTORY OF AMERICAN IMMIGRATION POLICY 1798–1965 484 (1981).

[20] *See* Pub. L. No. 82-414, 66 Stat. 163 (1952) (codified as amended in scattered sections of 8 U.S.C. and 18 U.S.C. § 1429).

[21] *See id.*

[22] *See* Kevin Keane, *The U.S. Immigration Quota System*, Feb. 21, 2006, http://www.kkeane.com/quota-faq.shtml.

[23] *See id.*

[24] *See id.*

try and are limited to 140,000 immigrants per year, of which no more than 9800 may be from any one country.[25]

B. History of the U.S. Border Patrol

The same desire to control immigration into the United States that led to immigration quotas also resulted in the creation of the U.S. Border Patrol.[26] As early as 1904, Mounted Guards patrolled the border between the United States and Mexico in an effort to prevent illegal crossings.[27] However, limited resources did not allow them to consistently protect the expansive border.[28] In an effort to help, Mounted Inspectors and Texas Rangers were assigned to patrol the border in the 1910s, but available workforce similarly limited their ability to prevent illegal crossings.[29]

The need for more stringent border patrol became more pronounced in 1920 with the advent of Prohibition, when preventing the illegal importation of alcohol became a high national priority.[30] However, the efforts of customs and immigration agencies were undermined by a lack of border enforcement between inspection stations.[31] In addition, requiring literacy and payment of a higher head tax in order to enter the United States prompted more people to attempt to enter without documentation.[32]

The INA legislation passed in 1952 further expanded the power of the Border Patrol to prevent undocumented immigration.[33] For the first time, agents could board and search vehicles for undocumented immigrants anywhere in the United States, and undocumented entrants traveling within the country were subject to arrest.[34] Repatriation efforts to return mass numbers of undocumented aliens to Mexico commenced, but many deportees simply turned around and re-crossed the under-protected border.[35] Because such repatriation programs proved both extremely expensive and ineffective, they were phased out within two years.[36]

During the 1980s and 1990s, the United States saw a rapid increase in undocumented immigration.[37] In response, the Border Patrol increased its

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[25] *See* IMMIHELP.COM, EMPLOYMENT BASED GREEN CARD (2006), http://www.immihelp.com/gc/employment/greencard.html (last visited Mar. 16, 2006).

[26] *See* U.S. Customs and Border Protection, U.S. Border Patrol History (July 15, 2003), http://www.cbp.gov/xp/cgov/border_security/border_patrol/history.xml.

[27] *See id.*

[28] *See id.*

[29] *See id.*

[30] *See id.*

[31] *See* U.S. Customs and Border Protection, *supra* note 26.

[32] *See id.*

[33] *See id.*; Pub. L. No. 82-414, 66 Stat. 163 (1952) (codified as amended in scattered sections of 8 U.S.C. and 18 U.S.C. § 1429).

[34] *See id.*

[35] *See id.*

[36] *See id.*

[37] *See* U.S. Customs and Border Protection, *supra* note 26.

work force and utilized modern military technology, including infrared night-vision scopes and seismic sensors, to help locate, apprehend, and process those entering the United States without documentation.[38] The increased concentration of agents and military technology in specific areas along the border, such as San Diego, California, which accounted for more than half of undocumented entries, provided a "show of force" that proved successful over the next few years in stemming undocumented immigration.[39]

With the September 11th attacks shedding light on the vulnerability of our nation, even more attention has been placed on securing our national borders.[40] The sheer ineffectiveness of our present militarized tactics to prevent undocumented immigration is startling. Over ten million undocumented workers presently reside in our country, and approximately 700,000 have entered annually between 2000 and 2004.[41]

II. DEFINING THE PROBLEM

A. Immigration Policy and Its Effects

As established in Part I, the U.S. government employs a military-style patrol of our border with Mexico. However, security holes in that border as well as the federal government's dependence on state efforts to guard the borders have permitted millions of undocumented immigrants to enter the country.[42] Presently, nine to eleven million undocumented immigrants live in the United States, further feeding the growing undocumented workforce.[43]

Approximately seventy percent of Americans are concerned about undocumented immigration, and more than fifty percent think the government should do more to prevent undocumented immigrants from coming into the country.[44] Having such a large undocumented immigrant population in our country poses a large national security threat, because it minimizes

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[38] *See id.*

[39] *See id.*

[40] *See id.* at 1759.

[41] *See* JEFFREY S. PASSEL, PEW HISPANIC CENTER, UNAUTHORIZED MIGRANTS: NUMBERS AND STATISTICS 3 (2005), *available at* http://pewhispanic.org/files/reports/46.pdf.

[42] Currently, only 11,000 Border Patrol agents are available to patrol the over 8000 miles of U.S. Borders. *See* U.S. Customs and Border Protection, CBP Border Patrol Overview (Jan. 11, 2006), http://www.cbp.gov/xp/cgov/border_security/border_patrol/overview. xml.

[43] *See* Mike Madden, *New Border Chief Maps Strategy*, ARIZ. REPUBLIC, Feb. 15, 2006, *available at* http://www.azcentral.com/arizonarepublic/news/articles/0215ice-qa0215.html. This number has risen from 10.3 million unauthorized migrants in 2004 and 9 million unauthorized migrants in 2003. *See* PASSEL, *supra* note 41, at 3; MIGRATION POLICY INSTITUTE, UNAUTHORIZED IMMIGRATION TO THE UNITED STATES 1 (2003), http://www.migrationpolicy.org/pubs/two_unauthorized_immigration_us.pdf#search='undocmented%20immigrant%20population.

[44] *See* National Public Radio, *Public Immigration Concerns Contrast with Policy*, Oct. 7, 2004, http://www.npr.org/templates/story/story.php?storyID=4075602.

the need for potential terrorists to forge documents in order to avoid detection.[45] Furthermore, without documentation, there exists no paper trail that authorities can use to track suspected terrorists.[46] Many immigrants also suffer, living in constant fear of deportation and thereby being unable to fully participate in or contribute to their communities.[47] While undocumented aliens usually pay taxes like other workers, they participate only minimally in entitlement programs and frequently do not vote.[48]

The exploitation of undocumented workers by American employers in the United States also creates economic strains. A recent Harvard University study estimated that this exploitation, from 1980 to 2000, reduced the earnings of native-born U.S. workers by three to four percent, with the brunt of the negative impact being felt by the less educated.[49] However, another study argues that this level of reduction in earnings is really only seen in cities with large immigrant populations, such as Miami and Los Angeles, with effects in other locations being considerably smaller.[50]

Congress has attempted to address the undocumented worker problem by prohibiting the employment of undocumented aliens, but these efforts have been largely ineffective in disincentivizing undocumented immigration. The Immigration Reform and Control Act of 1986 (IRCA)[51] made it unlawful for employers to hire aliens who are not authorized to work in the United States and established penalties for violations.[52] While IRCA has been anecdotally effective in curtailing the employment of some

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[45] *See Terrorist Threats to the United States: Hearing Before the Subcomm. on Immigration and Claims of the House Comm. on the Judiciary*, 106th Cong. 34 (2000) (statement of Steven Emerson, Executive Director, Terrorism Newswire).

[46] *See id.*

[47] *See* Thomas J. Walsh, *Hoffman Plastic Compounds, Inc. v. NLRB: How the Supreme Court Eroded Labor Law and Workers Rights in the Name of Immigration Policy*, 21 LAW & INEQ. J. 313, 317 (2003). *But see* Qianwei Fu, Note, Eldred v. Ashcroft*: Failure in Balancing Incentives and Access*, 38 U.C. DAVIS L. REV. 701, 717 (2005) (arguing that undocumented immigrants have the capacity to have the same community ties that documented ones have, including family, employment, participation in community organizations, and an intention to make the United States a permanent home, but that they lack the official recognition of those ties through a visa).

[48] *See* Alan O. Sykes, *The Welfare Economics of Immigration Law*, *in* JUSTICE IN IMMIGRATION 158, 159, 161 (Warren F. Schwartz ed., 1995).

[49] *See* George J. Borjas & Lawrence F. Katz, *The Evolution of the Mexican-Born Workforce in the United States* 37–38 (Nat'l Bureau of Econ. Research, Working Paper No. 11,1281, 2005).

[50] *See* David Card, *Immigrant Inflows, Native Outflows, and the Local Labor Market Impacts of Higher Immigration*, 19 J. LAB. ECON. 22, 57 (2001).

[51] *See* Pub. L. No. 99-603, 100 Stat. 3359 (1986) (codified as amended in scattered sections of 8 U.S.C.).

[52] *See* 8 U.S.C. § 1324a (2000). For employment purposes, an "unauthorized alien" is one who is not either lawfully admitted for permanent residence or authorized to be so employed by law or by the Attorney General. *See id.* § 1324a(h)(3) (2000). Thus, the term covers illegal aliens as well as aliens here temporarily whose status does not permit them to work, such as tourists.

undocumented workers,[53] its overall effect during the past twenty years has been insignificant.[54]

Some advocates endorse deportation as the only solution to the problem of undocumented immigration,[55] but this view is both impractical and xenophobic. The immigration judicial system simply lacks the resources to move such a large number of people through removal proceedings. All of the eight to eleven million undocumented immigrants currently living in the United States would be entitled to removal hearings before an immigration judge as well as the right to appeal adverse decisions to the Board of Immigration Appeals.[56] Currently, the Board is able to adjudicate 3000 appeals per month.[57] If the Board were to continue adjudicating appeals at this rate, it would take centuries to deport the undocumented immigrants currently in the country, not to mention those who would undoubtedly enter during that time. Furthermore, the already strained immigration budget would make streamlining this process economically difficult.

B. Border Security

In its efforts to control undocumented immigration, the United States must not only deal with the millions of undocumented workers who currently reside within the country but also must work to prevent the present undocumented population from being replaced by a new one in the future. This should be the job of the federal government, but due to the inadequacy of federal border security, the burden of securing our national borders has fallen upon the southwestern border states, which have had to resort to extreme measures to do so. For example, on August 12, 2005, New Mexico Governor Bill Richardson issued an executive order declaring a state of emergency along New Mexico's border with Mexico, citing "the ravages and terror of human smuggling, drug smuggling, kidnapping, murder, destruction of property and the death of livestock" that had been inflicted upon the state's southern region.[58] He concluded that these

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[53] In 2005, Wal-Mart agreed to pay Immigration and Customs Enforcement (ICE) $11 million to settle charges that the store had contracted with cleaning companies that hired undocumented immigrants. *See* Madden, *supra* note 43.

[54] *See* JAMES R. EDWARDS, CENTER FOR IMMIGRATION STUDIES, TWO SIDES OF THE SAME COIN: THE CONNECTION BETWEEN LEGAL AND ILLEGAL IMMIGRATION (2006), *available at* http://www.cis.org/articles/2006/back106.html (noting that the estimated illegal immigration population has tripled since 1980, in spite of the adoption of IRCA in 1986).

[55] *See, e.g.*, MICHELLE MALKIN, INVASION: HOW AMERICA STILL WELCOMES TERRORISTS, CRIMINALS, AND OTHER FOREIGN MENACES TO OUR SHORES (2002).

[56] *See* U.S. DEP'T OF JUSTICE EXECUTIVE OFFICE OF IMMIGRATION REVIEW, ADJUDICATING REQUESTS FOR STAYS AT THE BIA, http://www.usdoj.gov/eoir/bia/stays.htm (last visited Apr. 4, 2006).

[57] *See* THE AM. BAR ASS'N COMM'N ON IMMIGRATION POLICY, PRACTICE AND PRO BONO, BOARD OF IMMIGRATION APPEALS: PROCEDURAL REFORMS TO IMPROVE CASE MANAGEMENT app. 9 (2003).

[58] *See* Exec. Order No. 2005-040 (Aug. 12, 2005), *available at* http://www.governor.state.nm.us/orders/2005/EO_2005_040.pdf (declaring a disaster in Hidalgo, Luna, Dona

conditions constituted an emergency situation with potentially catastrophic consequences.[59]

Three days later, Arizona Governor Janet Napolitano took similar action, declaring a state of emergency along the Arizona-Mexico border.[60] According to Governor Napolitano, the three million border crossings into her state each year have threatened public health and safety from gangs and others engaged in dangerous criminal activities along the Arizona-Mexico border.[61] She concluded that the massive increase in unauthorized border crossings and the related increases in death, crime, and property damage justified a declaration of a state of emergency.[62]

Finally, on October 12, 2005, Texas Governor Rick Perry announced a comprehensive security plan for the Texas-Mexico border region.[63] Governor Perry stated that "Al Qaeda and other terrorists and criminal organizations view the porous Texas-Mexico border as an opportunity to import terror, illegal narcotics, and weapons of mass destruction. Gangs . . . have begun operating on both sides of the Texas border . . . with confirmed reports of kidnapping, rape, and murder on the rise."[64] The Governor praised recent federal efforts providing one thousand new Border Patrol agents, but insisted that Congress must do much more.[65]

State governors should not have to resort to declaring such states of emergency to protect citizens from the consequences of a porous border. These emergency declarations reflect the existence of an unfair and underfunded responsibility forced upon the states by the failure of the federal government to respond to the crisis at our border.

Unfortunately, Congress has not acted to address border control needs. The Border Patrol stated in a recent report that its primary goals are to (1) apprehend terrorists who attempt to enter the United States; (2) deter undocumented entries; (3) deter and capture contraband smugglers; (4) effectively utilize "Smart Border" technology; and (5) reduce crime and improve life and economic vitality in border communities.[66] While these objectives are noble and far-reaching, they will be difficult to achieve without adequate funding and attention from the federal government.

Ana, and Grant Counties due to border security concerns).

[59] *See id.*

[60] *See* Exec. Order, Gov. Janet Napolitano, Declaration of Emergency: Arizona/Mexico International Border Security Emergency (Aug. 16, 2005), *available at* http://www.governor.state.az.us/press/2005/0508/DE%7E081605%7EAZMEXBorderSecurity.pdf.

[61] *See id.*

[62] *See id.*

[63] *See* Press Release, Gov. Rick Perry, Perry Announces Comprehensive Border Security Plan for Texas (Oct. 12, 2005), *available at* http://www.governor.state.tx.us/divisions/press/pressreleases/PressRelease.2005-10-12.2500.

[64] *Id.*

[65] *See id.*

[66] *See* THE OFFICE OF BORDER PATROL, NATIONAL BORDER PATROL STRATEGY 2 (2004), *available at* http://www.cbp.gov/linkhandler/cgov/border_security/border_patrol/national_bp_strategy.ctt/national_bp_strategy.pdf.

Addressing the issues of border security and undocumented worker population growth must be the dual goals of our immigration policy. The ways in which this country has chosen to react to undocumented immigration have proven ineffective and wasteful of the decidedly scarce available resources. Federal surveillance both intrudes upon the lives of many legal residents and does not effectively enforce our immigration laws.[67] Mandatory detention policies create a situation in which peaceful asylum-seekers without documentation must be detained, using prison space and resources that could otherwise be used to detain more dangerous undocumented immigrants.[68] Furthermore, while Julie Myers, the Director of Immigration and Customs Enforcement (ICE), has asserted that ICE's key priorities are to establish clear guidelines for companies in terms of hiring undocumented workers and to punish violators harshly, no clear plan for such enforcement has emerged.[69] Articulating vague policies without any plan for implementation and making token additions to the border patrol does little to deal with undocumented immigrants already in the country or to prevent future undocumented immigration.[70]

III. THE ADMINISTRATION'S PROPOSAL

To address the problem of undocumented immigration, the Bush administration has proposed a temporary worker program that purportedly benefits the American economy by employing undocumented workers while also keeping the homeland safe. The major tenets of the action are as follows:

A. Temporary Worker Program

The administration would institute a guest worker program in which undocumented immigrants would be permitted to enter or remain in this country legally for a limited period of time, provided that they paid a registration fee and worked for a willing U.S. employer.[71] In coordination with this program, federal authorities would intensify their efforts in punishing U.S. employers that hire undocumented workers.[72]

Furthermore, the administration would impose significant limits on their guest worker program. After an initial period of time, only persons out-

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[67] *See* Gabriela A. Gallegos, *Redefining the National Interest in U.S.-Mexico Immigration and Trade Policy*, 92 CAL. L. REV. 1729, 1757–58 (2004).

[68] *See* TIMOTHY H. EDGAR, AMERICAN CIVIL LIBERTIES UNION, ACLU MEMO TO INTERESTED PERSONS REGARDING CONCERNS IN H.R. 4437, THE "BORDER PROTECTION, ANTITERRORISM, AND ILLEGAL IMMIGRATION CONTROL ACT OF 2005" (Dec. 7, 2005), *available at* http://www.aclu.org/natsec/gen/22371leg20051207.html.

[69] *See* Madden, *supra* note 43.

[70] *See* Press Release, President Bush, *supra* note 1.

[71] *See id.*

[72] *See id.*

side the United States would be eligible for guest worker status, not undocumented immigrants currently in the country.[73] Temporary workers would be able to renew their status once, but after their temporary status elapsed, they would have to return to their countries of origin.[74] Moreover, before hiring a guest worker, a U.S. employer would have to make every reasonable effort to find a U.S. citizen to fill the job in question first.[75]

B. Homeland Security and Border Enforcement

While President Bush's current proposal does not address the issue of border security, the administration has allocated more resources to border security in recent years. Between September 11, 2001, and December 2003, the Border Patrol increased in size by more than ten percent.[76] The number of agents assigned to the northern border has tripled to more than 1000.[77] Furthermore, the Border Patrol is using technology to extend its capabilities beyond the physical reach of its agents.[78]

More broadly, the administration has sought to ensure greater compliance with immigration laws through enforcement initiatives. The administration instituted Operation Tarmac to monitor immigration law compliance among businesses and employees in secure areas of airports.[79] Since September 11th, this operation has resulted in more than 3640 audits by the Department of Homeland Security and at least 774 individual indictments.[80]

The administration has also emphasized the importance of technology in tracking visitors to the United States. Through the Internet-based Student and Exchange Visitor Information System (SEVIS), authorities have been able to monitor over 870,000 foreigners on student and exchange visas.[81] SEVIS has led to at least 71 arrests based on 285 field investigations.[82] Furthermore, the United States has started collecting biometric identifying information from aliens entering the country through the US-VISIT program.[83] Maintaining a database of this information should facilitate future visa enforcement.[84]

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[73] *See id.*
[74] *See id.*
[75] *See* Press Release, President Bush, *supra* note 1.
[76] *See id.*
[77] *See id.*
[78] *See id.*
[79] *See id.*
[80] *See* Press Release, President Bush, *supra* note 1.
[81] *See id.*
[82] *See id.*
[83] *See id.*
[84] *See id.*

C. Analysis of the Proposal

President Bush's proposal presents a superficial solution to undocumented immigration. The President endorses a guest worker program that would provide temporary legal status for a substantial portion of the country's undocumented immigrants, but he opposes the extension of lawful permanent resident status.[85] The participants in this program who are not able to remain employed would therefore be required to leave the country.[86] Given the unpredictable nature of the low-wage job market, the administration's proposal threatens to attract immigrants with promises of guest worker status, only to force them out of the country a few years later when they lose their jobs.[87]

Furthermore, President Bush's guest worker program would only provide lawful status to undocumented immigrants for approximately three years, and, after at most one chance to reapply for three more years, our "guests" would be required to leave the country.[88] The temporary nature of this program provides little incentive for undocumented immigrants to emerge from the shadows, especially those who have raised American-born children and have established deep ties to their communities.

The administration's approach is essentially a "flat Earth" program: the White House expects undocumented workers to fall off the edge of the Earth and disappear when their guest worker status expires. The central problem with this tactic is that it unrealistically expects individuals who have risked their lives to immigrate without documentation and currently live underground to stand up, be counted, and then depart when their new visas expire.

Such a program admittedly may have some benefits, especially for citizens of Mexico and other countries who depend on the money they receive from family members working in the United States.[89] It may even help domestic employers who need low-wage labor by providing a steady stream of workers.[90] However, it does not solve the problem of having

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[85] *See* Press Release, President George W. Bush, President Bush Proposes New Temporary Worker Program (Jan. 7, 2004), *available at* http://www.whitehouse.gov/news/releases/2004/01/20040107-3.html.

[86] *See id.*

[87] *See generally* Frank W. Munger, *Social Citizen as "Guest Worker": A Comment on Identities of Immigrants and the Working Poor*, 49 N.Y.L. SCH. L. REV. 665, 668–74 (2004) (discussing the plight of low-wage and immigrant workers).

[88] *See* Julia Gelatt, *Bush Puts Immigration Reform Back on Agenda, Approves Funding for DHS*, MIGRATION POLICY INST., Nov. 1, 2005, http://www.migrationinformation.org/USfocus/display.cfm?id=346.

[89] Remittances to Latin America and the Caribbean totaled more than $53 billion in 2005, exceeding both foreign direct investment in and international aid to those countries. *See* Richard Lapper, *Home Economies Helped by $54bn Migrant Cheques*, FIN. TIMES, Mar. 30, 2006, at 12.

[90] *See, e.g.*, Patrice Hill, *Industries Back Illegals Plan*, WASH. TIMES, Mar. 11, 2004, at A1.

millions of undocumented immigrants living outside mainstream society. While offering guest worker status to undocumented workers would initially reduce the number of people residing in the country without documentation, it would likely be followed by a regrowth in the undocumented population as the status period expires. Since the United States is so inefficient at policing immigration,[91] these newly undocumented workers would have no incentive to return to their home countries.

Moreover, a guest worker program could be detrimental to American workers. The rapid growth of a supply of legal guest workers willing to accept low wages and few benefits for fear of losing their jobs—and thus their legal status—would threaten wages and employment benefits for American workers.[92] President Bush's proposal does not seek to strengthen protections for wages, benefits, and other workers' rights.[93] While the administration claims that there would be effective employment protections in the program,[94] the government's record of enforcing such protections is historically spotty at best.[95]

Not only does the administration's proposal inadequately address the problems presented by the vast number of undocumented workers currently residing in the United States, but it also fails to deal effectively with the crucial need for improved border security in order to deter undocumented immigration in the first place. It does not even include a provision for additional border agents.[96] Such a reactive approach to undocumented immigration has proven ineffective in the past, as witnessed by the millions of

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[91] *See, e.g.*, Thomas J. Espenshade, *Does the Threat of Border Apprehension Deter Undocumented US Immigration?*, 20 POPULATION & DEV. REV. 871, 872 (1994) ("[T]he typical undocumented migrant who is already established in the United States faces an annual probability of being apprehended of 1–2 percent."); Alberto Dávila et al., *The Short-Term and Long-Term Deterrence Effects of INS Border and Interior Enforcement on Undocumented Immigration*, 49 J. ECON. BEHAV. & ORG. 459, 462 (2002) ("[I]ncreases in INS enforcement resources do not appear to be a significant long-term deterrent to Mexican attempted illegal immigration.").

[92] *See* Brian DeBose, *Immigrant Competition Shown to Depress Wages*, WASH. TIMES, May 5, 2004, at A3; *cf.* Walsh, *supra* note 47, at 313.

[93] *Cf.* Press Release, President Bush, *supra* note 1 (describing only strengthened enforcement of existing laws as a component of President Bush's proposal).

[94] *See* Press Release, President Bush, *supra* note 85.

[95] *See, e.g.*, CAL. HERITAGE PROJECT, THE BRACERO PROGRAM: LEGAL TEMPORARY FARMWORKERS FROM MEXICO, 1942–1964, http://sunsite.berkeley.edu/CalHeritage/latinos/braceros.html (last modified May 17, 2004) (describing how the United States failed to provide the benefits originally promised to Mexican workers temporarily doing agricultural work in the United States through the Bracero Program); Michael Holley, *Disadvantaged by Design: How the Law Inhibits Agricultural Guest Workers from Enforcing Their Rights*, 18 HOFSTRA LAB. & EMP. L.J. 575, 583–85 (2001) ("If [a bracero] complained [about poor conditions], he would be fired without any practical recourse, blacklisted and sent home with debts still owing."); Kristi L. Morgan, *Evaluating Guest Worker Programs in the U.S.: A Comparison of the Bracero Program and President Bush's Proposed Immigration Reform Plan*, 15 LA RAZA L.J. 125 (2004).

[96] *See* Press Release, President Bush, *supra* note 1 (listing policy proposals and failing to include such an increase).

undocumented aliens currently living in the United States.[97] Clearly, President Bush's proposal is ill-equipped to address the root of the U.S. immigration dilemma.

IV. The Solution to the Undocumented Worker Problem: The Save America Comprehensive Immigration Act

Due to the inadequacies in current immigration policy, the United States is in need of comprehensive immigration reform. I have introduced the Save America Comprehensive Immigration Act (SACIA)[98] to address the undocumented worker population growth problem. The bill includes the proposed reforms described immediately below. I expect many of its provisions to be adopted when Congress enacts a comprehensive immigration bill.

A. Earned Access to Legalization

SACIA emphasizes an earned access to legalization on the part of undocumented immigrants that would promote domestic economic stability. Unlike the Bush administration's proposal, which provides temporary legalized status for undocumented workers who have lived in the United States for any length of time,[99] SACIA would only provide access for undocumented immigrants who have lived in the United States for more than five years.[100] Furthermore, it would amend the registry provision of the INA, making permanent legal status available to undocumented immigrants who have lived in the United States since 1986,[101] up from the current cutoff year of 1972.[102] The rationale behind this registry provision is that people develop roots when they live in the United States for a long period of time, making it unconscionable to force them to leave.[103] I believe that two decades is a long enough period of time to establish such roots and that this change to 1986 is both reasonable and politically realistic.[104]

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[97] *See* Passel, *supra* note 41, at 3.

[98] H.R. 2092, 109th Cong. (2005).

[99] *See* Press Release, President Bush, *supra* note 85 (making program available to "undocumented men and women now employed in the United States").

[100] *See* H.R. 2092, 109th Cong. § 201 (2005).

[101] *See id.* § 203.

[102] *See* 8 U.S.C. § 1259 (2000).

[103] *See* 131 Cong. Rec. E936 (Mar. 19, 1985) (statement of Sen. Kindness) ("[O]ver time[,] many [immigrants] make their home here, raise their children here, and ultimately become taxpaying contributors to American pluralism.").

[104] The registry provision cutoff year was amended to 1972 in 1986. *See* Pub. L. No. 99-603, § 203, 100 Stat. 3359 (1986) (current version at 8 U.S.C. § 1259 (2000)). Since a fourteen-year residency period was acceptable in the 1986 amendments, a twenty-year period should be reasonable now.

Furthermore, President Bush's proposal would establish a relatively easy renewal of temporary legal status, which would encourage guest workers to simply recycle their temporary status.[105] In contrast, SACIA would more easily allow undocumented immigrants to gain permanent legal status,[106] thereby promoting stability in the lives of these workers as well as within the U.S. economy.[107]

B. Employee Protections

SACIA addresses the roots of undocumented worker exploitation: lack of power on the part of these workers and lack of government regulation. Under constant threat of government expulsion, illegal immigrants are being forced to accept reduced wages and benefits.[108] The administration's proposal erroneously presumes that a "compassionate" work environment for employees will naturally emerge as a result of offering illegal immigrants temporary guest worker status.[109] In contrast, SACIA would confront the reality of exploitation by requiring the Secretary of Labor to conduct a national study on such exploitation of undocumented workers by employers.[110] The results of such a study would enable the government to determine the extent and nature of this problem and, therefore, to tackle it more effectively.

Furthermore, SACIA would empower employees, both domestic and immigrant, to benefit from the collective power of worker unions. Greater numbers of undocumented workers increase employer exploitation of laborers willing to work at extremely low wages or else face deportation.[111] In turn, this decreases the ability of all employees, American and not, to organize, collectively bargain, and negotiate contracts and benefits. Unfortunately, this problem would persist even if undocumented workers gained guest worker status, as employers would still maintain their power by threatening to fire them and terminate their guest worker status.[112] Therefore, President Bush's proposal would allow employers to maintain their upper hand over employees, while still abiding by Immigration Reform and Control Act (IRCA) requirements not to hire undocumented workers.[113] Only when workers have full legal status and can assert their rights

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[105] Although the Bush proposal technically allows only one renewal, preventing workers from falsifying information on their applications in order to illegally secure additional renewals would be a significant concern.

[106] *See* H.R. 2092, 109th Cong. § 201 (2005).

[107] *Cf. supra* notes 90–95 and accompanying text.

[108] *See* Walsh, *supra* note 47, at 317.

[109] *See* Press Release, President Bush, *supra* note 1.

[110] *See* H.R. 2092, 109th Cong. § 402 (2000).

[111] *See supra* note 92 and accompanying text.

[112] *Cf.* Press Release, President Bush, *supra* note 1 (noting that guest workers must "return home after their period of work expires").

[113] *See* Pub. L. No. 99-603, 100 Stat. 3359 (1986) (codified as amended in scattered sections of 8 U.S.C.).

free of employer intimidation, as I propose in SACIA, can they protect themselves and join their non-immigrant co-workers in improving working conditions.

To further help domestic workers, SACIA would require the Secretary of Homeland Security to impose a ten percent surcharge on fees collected for employment-based permanent resident status petitions.[114] The funds raised would be used to establish employment-training programs for Americans in lines of work especially affected by undocumented worker growth.[115] The money would also be used to establish an Office to Preserve American Jobs in the Department of Labor, whose purpose would be to ensure that the qualified Americans graduating from these training programs are employed before foreign workers.[116]

C. Family Reunification

Another goal of SACIA is family reunification. While Bush's proposal ignores this issue,[117] SACIA provides solutions for two barriers to family reunification caused by current immigration law. First, it revises the INA[118] to allow the waiver of grounds for removal of undocumented aliens, such as minor criminal offenses and technical violations of the INA, in order to promote family unity.[119] Second, SACIA establishes a solution to the backlog of applications for entry by family members of legal residents that currently plagues the Immigration and Naturalization Service, such as visa petitions and naturalization applications.[120] It would expand the K-1 Visitor's Visa, which currently allows an applicant to enter the United States to marry an American citizen,[121] in order to make it possible for relatives of permanent residents to enter the United States and await the processing of a visa petition here.[122] It is simply unfair to make lawful permanent residents endure family separation that is not required of citizens, especially when their foreign relative is already on track to becoming a permanent resident as well.

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[114] *See* H.R. 2092, 109th Cong. § 403 (2005).

[115] *Id.*

[116] *See id.*

[117] *See* Tisha R. Tallman, *Liberty, Justice, and Equality: An Examination of Past, Present, and Proposed Immigration Policy Reform Legislation*, 30 N.C.J. INT'L L. & COM. REG. 869, 888 (2005).

[118] *See* Pub. L. No. 82-414, 66 Stat. 163 (1952) (waiver sections codified as 8 U.S.C. §§ 1101, 1182(d)-(i)).

[119] *See* H.R. 2092, 109th Cong. tit. V (2000).

[120] *See* 151 CONG. REC. H6081 (July 19, 2005) (statement of Rep. Jackson Lee).

[121] *See* U.S. Customs and Immigration Serv., How Do I Bring My Fiancé(e) to the United States?, http://uscis.gov/graphics/howdoi/fiance.htm (last visited Jan. 20, 2006).

[122] *See* H.R. 2092, 109th Cong. § 103 (2005).

D. Diversity Visas and Haitian Parity

SACIA addresses head on the discriminatory effects of immigration policy head on, another vital issue inadequately addressed by President Bush's proposal. The Department of State currently administers a Diversity Immigrant Visa Program under which it issues 55,000 permanent resident Diversity Visas each year to people who meet certain stringent requirements and come from countries with low rates of immigration to the United States.[123] This program seeks to provide a counterbalance to the concentration of immigration from particular source countries that results from family and employment-based immigration.[124] It also creates an avenue for legal immigration for those without pre-existing family or employment relationships in the United States.[125] In an effort to further promote diversity in U.S. immigration, SACIA would double the number of Diversity Visas offered annually from 55,000 to 110,000.[126]

From the 1960s to the present, hundreds of thousands of Cuban refugees have been allowed into the United States and permitted to adjust automatically to permanent resident status after one year under the Cuban Adjustment Act.[127] In contrast, Haitian refugees have been required to pass a "credible fear" screening before being granted asylum into the United States.[128] Unable to meet this stringent requirement, two-thirds of them have been forced to return to Haiti.[129] To address this problem, SACIA would establish a Haitian version of the Cuban Adjustment Act, offering Haitian refugees automatic permanent resident status after one year of residence in this country.[130]

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[123] *See* 8 U.S.C. § 1153(c) (2000) (requiring that applicants for diversity visas not hail from a country from which the United States admitted more than 50,000 natives in the previous year and that they have completed at least the equivalent of a high school education or two years of work experience).

[124] *See id.*

[125] This program marks the first time in our history that Africans have been able to immigrate by choice in significant numbers. *See* Andowah A. Newton, *Injecting Diversity into U.S. Immigration Policy: The Diversity Visa Program and the Missing Discourse on its Impact on African Immigration to the United States*, 38 CORNELL INT'L L.J. 1049, 1077 (2005). Furthermore, the program has allowed immigration to resume from the Warsaw Pact countries, which had previously prohibited its citizens from emigrating during the Cold War. *See* Paul J. Smith, *Geography and the Boundaries of Confidence: Military Responses to the Global Migration Crisis: A Glimpse of Things to Come?*, 23 FLETCHER F. WORLD AFF. 77, 78–79 (1999) (discussing the rise in immigration from the former Soviet countries); *see also* Francis A Gabor, *Reflections on the Freedom of Movement in Light of the Dismantled "Iron Curtain,"* 65 TUL. L. REV. 849, 853 (1991) (discussing America's hostile response to the Soviet Union's curtailing its citizens' right to freedom of movement).

[126] *See* H.R. 2092, 109th Cong. § 701 (2000).

[127] Pub. L. No. 89-732, 80 Stat. 1161 (codified as amended at 8 U.S.C. § 1255 (2000)).

[128] *See* Omnibus Consolidated and Emergency Supplemental Appropriations Act of 1999, 105 Pub. L. No. 277 § 902(b), 112 Stat. 2681-539 (codified as amended at 8 U.S.C. § 1255 (2000)).

[129] *See* Bill Frelick, Letter to the Editor, *Most Favored Refugees?*, WASH. POST, Apr. 20, 1998, at A18.

[130] *See* Cuban Adjustment Act § 1.

By adopting SACIA, the United States would be able to counteract the discrimination currently encouraged by U.S. immigration policy, thereby improving our relationships with other countries and generating international goodwill.[131] All of this would open doors to foreigners who wish to immigrate through legal channels without creating any new incentives to immigrate without documentation.[132]

E. Fairness in Asylum and Refugee Proceedings

Unlike the Bush administration's proposal, which fails to exhibit any compassion for refugees hoping to escape deplorable homeland conditions,[133] SACIA directly confronts the problems created by this country's stringent asylum requirements. Currently, the Attorney General can remove any asylum seeker from the United States to a "safe third country" and must automatically deny refugee status to anyone who has previously been denied asylum.[134] Asylum applicants must apply for asylum within one year of their arrival into the United States or else be able to justify a delay on the basis of extraordinary circumstances.[135]

However, many immigrants lack documentation that proves they have been in the country for less than a year[136] and cannot establish the extraordinary circumstances required for an exception, even though they remain in desperate need of asylum in order to avoid being returned to countries where they face persecution. SACIA would eliminate the one-year application requirement and thereby facilitate the legal immigration of many refugees looking to flee persecution in their home countries.[137]

F. Local Policing Reform

SACIA would also address the inability of local law enforcement to enforce immigration policy due to overstretched state resources, a problem completely ignored by the Bush plan.[138] Currently, the INA allows the

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[131] *See, e.g.*, John N. Paden & Peter W. Singer, *America Slams the Door (On Its Foot): Washington's Destructive New Visa Policies*, FOREIGN AFF., May–June 2003, at 8–14.

[132] *See Diversity Visa Program: Hearing Before the Subcomm. on Immigration, Border Security, and Claims of the H. Comm. on the Judiciary*, 109th Cong. 4–8 (2005) (statement of Bruce A. Morrison, Chairman, Morrison Public Affairs Group).

[133] *See* Karen C. Tumlin, *Suspect First: How Terrorism Policy Is Reshaping Immigration Policy*, 92 CAL. L. REV. 1173, 1179, 1190, 1228 (2004) (describing the transfer of immigration oversight from the INS to the Department of Homeland Security, which adversely impacted refugees; the creation of Operation Liberty Shield, which requires immediate detainment of asylum seekers from 34 "Al Qaeda" nations; and the freezing of refugee admissions following September 11th).

[134] *See* 8 U.S.C. § 1158 (2000).

[135] *See id.*

[136] *See* Cara D. Cutler, *The U.S.-Canada Safe Third Country Agreement: Slamming the Door on Refugees*, 11 ILSA J. INT'L & COMP. L. 121, 142 n.79 (2004).

[137] *See* H.R. 2092, 109th Cong. § 1003 (2005).

[138] *See* Jodi Wilgoren, *Traces of Terror: Domestic Security; U.S. Terror Alert Led to No*

Attorney General to enter into agreements with state and local governments to have immigration enforcement handled by local police.[139] However, local police are simply not equipped to enforce the non-criminal provisions of the INA, as they are not trained as immigration officers. Furthermore, such agreements take them away from handling other crucial police functions. In contrast, SACIA would repeal the INA section allowing these agreements between the Attorney General and local law enforcement,[140] forcing the federal government to utilize available federal power and resources to enforce immigration policy more effectively.

V. THE SOLUTION TO THE BORDER SECURITY PROBLEM: THE RAPID RESPONSE BORDER PROTECTION ACT

While addressing the undocumented worker population is integral to immigration policy reform, securing our national border with Mexico is just as important. In order to prevent our undocumented immigrant population from continuing to grow exponentially, the United States must secure our border. This goal would be achieved through the enactment of the Rapid Response Border Protection Act (RRBPA).[141]

President Bush's current proposal offers no new solutions to our pressing border security problems. It merely refers to efforts already taken by the administration in the aftermath of September 11 to devote more resources to securing our nation's border.[142] In February 2006, President Bush asked Congress for funding for about 200 additional Immigration and Customs Enforcement (ICE) agents to investigate undocumented immigrant employment violations.[143] Immigration experts, however, point out that this number is much too low to find the estimated eleven million undocumented immigrants already living in the United States.[144] Moreover, these efforts are merely reacting to the reality that our borders are insecure and do nothing to fix the root of the problem.

Unlike President Bush's plan, RRBPA would address the urgent crisis at our border by providing the Border Patrol with the personnel, resources, and equipment it needs to secure the border. The bill would add 15,000 new Border Patrol agents over the next five years, increasing the number of agents from 11,000 to 26,000.[145] It would authorize the Secretary of Homeland Security to respond rapidly to border crises by deploying up

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Change in States' Security, N.Y. TIMES, May 25, 2002, at A1.

[139] *See* Pub. L. No. 82-414 § 287(g), 66 Stat. 163 (1952).

[140] *See* H.R. 2092, 109th Cong. § 1202 (2005).

[141] *See* H.R. 4044, 109th Cong. (2005).

[142] *See* Press Release, President Bush, *supra* note 1.

[143] *See* Madden, *supra* note 43.

[144] *See id.*

[145] *See* H.R. 4044, 109th Cong. § 301 (2005).

to 1000 additional Border Patrol agents to a state when its governor declares a border security emergency.[146]

Furthermore, RRBPA would crack down on the use of fraudulent documents to enter or to remain in the country by adding specialized enforcement agents to address this issue[147] and by establishing cooperative mechanisms with state and local law enforcement agencies.[148] It would also provide critical equipment and infrastructure improvements, including helicopters, power boats, land-based vehicles, portable computers, reliable radio communications systems, hand-held GPS devices, body armor, and night-vision equipment.[149] Supplying this equipment would enhance the Border Patrol's ability to detect those attempting to immigrate without documentation before they join the millions of undocumented workers who live here already.

Moreover, RRBPA would provide personnel benefits to ensure that the Bureau of Customs and Border Protection is able to attract highly qualified personnel to enforce our immigration and customs laws along the borders.[150] The bill would also add 100,000 more detention beds to ensure that those apprehended entering the United States without documentation can be detained and not released into our communities.[151]

RRBPA has the support of many organizations integrally involved in immigration policy enforcement. It is strongly endorsed by the National Border Patrol Council and the National Homeland Security Council, which both represent enforcement officials serving on the front line.[152] It is also backed by the 9/11 Families for a Secure America, a multi-ethnic coalition of native-born and naturalized Americans contending that the problems of open borders, illegal immigration, and terrorism are inextricably linked.[153]

CONCLUSION

Our nation is currently home to eight to eleven million undocumented workers, and this number will only increase if we cannot secure our borders from illegal entry. Despite the strong language contained in the Bush administration's recent immigration reform proposal,[154] it presents no real solutions to our nation's undocumented worker and border security prob-

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[146] *See id.* § 101.

[147] *See id.* § 403.

[148] *See id.* § 404.

[149] *See id.* §§ 103, 105–110.

[150] *See* H.R. 4044, 109th Cong. §§ 305–307, 310, 313, 315–316 (2005).

[151] *See id.* § 201.

[152] *See New Bill Would Bolster CBP*, FEDERAL DAILY, Oct. 18, 2005, http://www.clubfed.com/federaldaily/archive/2005/10/FD101805.htm.

[153] *See Rep. Sheila Jackson Lee Introduces Major Immigration Enforcement Bill*, NEWSLETTER (9/11 Families for a Secure Am., Staten Island, N.Y.), Oct. 14, 2005, http://www.911fsa.org/newsletters/news2005oct15.pdf.

[154] *See* Press Release, President Bush, *supra* note 1.

lems. While the guest worker status program would initially legalize current undocumented workers, these workers would likely remain in the United States illegally after their temporary status expired. Thus, President Bush's proposal would worsen the very immigration problems it purports to resolve. Unlike the administration's proposal, the two bills that I have proposed, SACIA and RRPBA,[155] will collectively resolve the undocumented immigration issues we face. First, they will address the large presence of undocumented workers by making citizenship rights more accessible. Second, they will more effectively prevent the entry of undocumented immigrants in the first place.

The United States is a nation of immigrants, but our present immigration system is sadly dysfunctional and outdated. In a debate often dominated by fear-mongering and xenophobia, it is time for practical solutions to this serious challenge. Congress must create a secure and controlled immigration system that will keep us safe and fulfill the promise of liberty and economic opportunity that America continues to represent to its current and future citizens. The two bills that I have proposed, the Save America Comprehensive Immigration Act and the Rapid Response Border Protection Act, will help our nation accomplish that goal.

[155] *See* H.R. 2092, 109th Cong. (2005); H.R. 4044 109th Cong. (2005).

ARTICLE

POST-KATRINA RECONSTRUCTION LIABILITY: EXPOSING THE INFERIOR RISK-BEARER

STEVEN L. SCHOONER*
ERIN SIUDA-PFEFFER**

This Article takes a critical look at the Gulf Coast Recovery Act (GCRA), a United States Senate bill that would provide liability protection to government contractors engaged in disaster relief work in the areas devastated by Hurricane Katrina, as well as in future disaster areas. The Article discusses the traditional government contractor defense and explains how GCRA differs from it in significant ways. The Article then argues that efficiency or fairness concerns cannot justify those differences because GCRA merely places the cost of accidents on disaster area residents and relief workers. Also, even if GCRA's protection might be justified by a hypothetical market failure, no empirical evidence indicates that government contractors experienced such failure in Katrina's wake. Finally, after outlining alternative measures that can provide GCRA-like protection without placing the cost of accidents on disaster victims, the Article concludes that GCRA is an undesirable measure that violates basic good government principles.

I. INTRODUCTION: EXPOSING THIRD PARTIES TO HARM

In this young century, both the September 11, 2001, terrorist attacks and Hurricane Katrina have graphically reminded Americans that they do not live in a perfect world. The aftermath of both events continues to weigh heavily upon the public and dramatically affect the nation's fiscal outlook. Moreover, the two events demonstrate that unanticipated crises such as these—and the responses to them—can cause unimaginable destruction

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and injury[1] as well as impose tremendous financial burdens on society.[2] As all levels of government in the United States increasingly rely on the private sector to provide essential services to the public,[3] post-disaster recovery efforts have come to involve a progressively larger pool of contractual arrangements,[4] many hastily drafted and poorly managed.[5] As was graphi-

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[1] *See, e.g.*, GOV'T ACCOUNTABILITY OFFICE, GAO-04-1068T, SEPTEMBER 11: HEALTH EFFECTS IN THE AFTERMATH OF THE WORLD TRADE CENTER ATTACK 1 (2004), *available at* http://www.gao.gov/new.items/d041068t.pdf [hereinafter GAO, WTC HEALTH EFFECTS] ("When the [World Trade Center] buildings collapsed on [September 11], nearly 3,000 people died and an estimated 250,000 to 400,000 people were immediately exposed to a mixture of dust, debris, smoke, and various chemicals."); GOV'T ACCOUNTABILITY OFFICE, GAO-05-1053T, HURRICANE KATRINA: PROVIDING OVERSIGHT OF THE NATION'S PREPAREDNESS, RESPONSE, AND RECOVERY ACTIVITIES 1 (2005), *available at* http://www.gao.gov/new.items/d051053t.pdf ("[Hurricane Katrina] affected over a half million people .... [S]tanding water and high temperatures have created a breeding ground for disease .... Hurricane Katrina also resulted in environmental challenges, such as water and sediment contamination from toxic materials released into the floodwaters.").

[2] *See, e.g.*, GOV'T ACCOUNTABILITY OFFICE, GAO-06-461R, AGENCY MANAGEMENT OF CONTRACTORS RESPONDING TO HURRICANES KATRINA AND RITA 1 (2006), *available at* http://www.gao.gov/new.items/d06461r.pdf [hereinafter GAO, AGENCY MANAGEMENT OF KATRINA CONTRACTORS] ("Congress has appropriated over $62 billion as an initial commitment ... to the Gulf Coast states impacted by the ... hurricanes."). These costs are dwarfed by the costs associated—directly and indirectly—with the September 11 attacks on New York City and Washington, D.C. Congress initially appropriated $40 billion to assist with disaster recovery. 2001 Emergency Supplemental Appropriations Act for Recovery from and Response to Terrorist Attacks on the United States, Pub. L. No. 107-38, 115 Stat. 220. Shortly thereafter, it supplemented this amount with an open-ended appropriation for the establishment of the Victim Compensation Fund. *See* September 11th Victim Compensation Fund of 2001, Pub. L. No. 107-42 § 406(b), 115 Stat. 230, 240 (codified at 49 U.S.C. § 40101 note (Supp. II 2002)). Indirect costs include, among other things, forgone federal taxes, *see* Victims of Terrorism Tax Relief Act of 2001, Pub. L. No. 107-134, 115 Stat. 2427 (codified in scattered sections of 26 U.S.C. and other titles), and lost state and city revenue, *see* GOV'T ACCOUNTABILITY OFFICE, GAO-05-269, SEPTEMBER 11: RECENT ESTIMATES OF FISCAL IMPACT OF 2001 TERRORIST ATTACK ON NEW YORK (2005), *available at* http://www.gao.gov/new.items/d05269.pdf.

[3] New Public Management (NPM), which gained hold in the United States in the mid-1990s under the moniker "reinventing government," is a movement to transform the public sector. For the two works that are largely responsible for popularizing "reinvention" principles in this country, see generally AL GORE & NAT'L PERFORMANCE REVIEW, FROM RED TAPE TO RESULTS: CREATING A GOVERNMENT THAT WORKS BETTER & COSTS LESS (1993), and DAVID OSBORNE & TED GAEBLER, REINVENTING GOVERNMENT: HOW THE ENTREPRENEURIAL SPIRIT IS TRANSFORMING THE PUBLIC SECTOR FROM SCHOOLHOUSE TO STATE HOUSE, CITY HALL TO PENTAGON (1992). NPM seeks to apply traditionally private sector business techniques to the provision of public services and to thereby enable government to provide such services with greater productivity and efficiency. *See* Jamil E. Jreisat, *The New Public Management and Reform*, *in* HANDBOOK OF PUBLIC MANAGEMENT PRACTICE AND REFORM 539, 541–42 (Kuotsai Tom Liou ed., 2001). Proponents of NPM advocate increased privatization and the "contracting out" of government services. *See* GRAEME A. HODGE, PRIVATIZATION: AN INTERNATIONAL REVIEW OF PERFORMANCE 40 (1999); *see also* Robert B. Denhardt & Janet Vinaznt Denhardt, *The New Public Service: Serving Rather Than Steering*, 60 PUB. ADMIN. REV. 549, 550–52 (2000); E. S. Savas, *Privatization and the New Public Management*, 28 FORDHAM URB. L.J. 1731, 1731–32 (2001) (providing several examples of privatization—both domestic and international—ranging from the protection of North Atlantic salmon to the renovation of military housing).

[4] *See* GAO, AGENCY MANAGEMENT OF KATRINA CONTRACTORS, *supra* note 2, at 1 ("The private sector is an important partner with the government in responding to and re-

cally demonstrated at Ground Zero of the World Trade Center attacks, when the government and its contractors rush to respond, those who physically carry out the response bear the consequences of their haste. Many individuals who selflessly assisted at the World Trade Center site were badly injured.[6] Many anticipate that relief workers will be subjected to a similar level of harm in the wake of Hurricane Katrina.[7]

The risks faced by disaster area residents and relief workers can only be exacerbated when the parties who can best alleviate such risks fail to act responsibly and when the law fails to otherwise hold them accountable. The doctrine of sovereign immunity limits the *government's* legal liability for harms related to disaster relief,[8] and, through the government contractor defense, its contractors have been able to enjoy some of that immunity.[9] As contractors assume a greater portion of the government's duties, they are increasingly voicing their desire for increased legal protec-

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covering from natural disasters . . . . [S]uch partnerships increasingly underlie critical government operations.").

[5] *See id.* at 2–4 (reporting that government contracts awarded in the wake of Hurricanes Katrina and Rita suffered from inadequate planning, did not clearly communicate responsibilities, and did not sufficiently utilize oversight personnel).

[6] *See generally* Ctrs. for Disease Control & Prevention, *Physical Health Status of World Trade Center Rescue and Recovery Workers and Volunteers—New York City, July 2002–August 2004*, 53 MORBIDITY & MORTALITY WKLY. REP. 807 (2004), *available at* http://www.cdc.gov/mmwr/PDF/wk/mm5335.pdf [hereinafter *MMWR Report*].

[7] *See, e.g.*, 151 CONG. REC. H10235, 40–42 (daily ed. Nov. 16, 2005) (statement of Rep. Major Owens, and Letter from the National Council for Occupational Safety and Health (Oct. 6, 2005)); Michelle Chen, *Relief Workers May Be Next Wave of Katrina Victims*, NEW-STANDARD, Sept. 23, 2005, http://newstandardnews.net/content/index.cfm/items/2395. The Centers for Disease Control and Prevention has published guidelines and recommendations for Hurricane Katrina relief workers in an effort to address health and safety issues preemptively. *See* Ctrs. for Disease Control & Prevention, Hurricane Information for Response and Cleanup Workers, http://www.bt.cdc.gov/disasters/hurricanes/workers.asp (last visited Apr. 15, 2006).

[8] The doctrine of sovereign immunity is a relic of royalty—originating from the English common law premise that the King could do no wrong—and its continued life under American jurisprudence is not easily justified. *See* United States v. Lee, 106 U.S. 196, 207 (1882) ("[W]hile the exemption of the United States . . . from being subjected . . . to ordinary actions in the courts has . . . been repeatedly asserted here, the principle has never been discussed or the reasons for it given, but it has always been treated as an established doctrine."); ALFRED C. AMAN, JR., & WILLIAM T. MAYTON, ADMINISTRATIVE LAW § 12.1, at 342–43 (1993) (citations omitted). *But see* Kawananakoa v. Polyblank, 205 U.S. 349, 353 (1907) ("A sovereign is exempt from suit, not because of any formal conception or obsolete theory, but on the logical and practical ground that there can be no legal right as against the authority that makes the law on which the right depends."); AMAN & MAYTON, *supra*, § 14.1.3, at 532 (suggesting a functionalist justification for the doctrine of sovereign immunity, namely, that the doctrine insulates the government's official actions from undue influence) (citations omitted). Indeed, many academics have expressed dissatisfaction with the doctrine of sovereign immunity. *See, e.g.*, Erwin Chemerinsky, *Against Sovereign Immunity*, 53 STAN. L. REV. 1201, 1202 (2001) ("Sovereign immunity is inconsistent with a central maxim of American government: no one, not even the government, is above the law."); David P. Currie, *Ex Parte Young After Seminole Tribe*, 72 N.Y.U. L. REV. 547, 548 (1997) ("Sovereign immunity is a rotten idea. If states commit wrongs, they should be accountable for them.").

[9] *See infra* text accompanying notes 55–65.

tion[10] where the government, shielded by sovereign immunity, would not face liability for negligent harms.

In the wake of Hurricane Katrina, Congress is currently considering legislation intended to provide insulation against liability for contractors involved in disaster relief and reconstruction. The Gulf Coast Recovery Act (GCRA)[11] would broadly apply the government contractor defense and thereby forestall private tort litigation arising from contractors' work in the wake of Hurricane Katrina and other similar disasters.[12] Not surprisingly, the GCRA enjoys strong support amongst contractors.[13] Cognizant of the government's current (and future) fiscal crisis,[14] deficit hawks are reluctant to pursue any alternative program in which the government would indemnify contractors.[15] Additionally, critics of the plaintiffs' and class-action bars support such situational immunity for contractors as a logical step toward tort reform.[16]

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[10] *See* Press Release, Associated Gen. Contractors of Am., Senate Bill Would Limit Contractors' Risk of Law Suits for Aiding in Rescue and Recovery Efforts in Gulf Coast (Sept. 22, 2005), *available at* http://www.agc.org/galleries/pr/05-094.doc [hereinafter AGC Press Release].

[11] S. 1761, 109th Cong. (2005).

[12] *See id.* § 5.

[13] *See* AGC Press Release, *supra* note 10.

[14] *See* Gov't Accountability Office, Our Nation's Fiscal Outlook: The Federal Government's Long-Term Budget Imbalance, http://www.gao.gov/special.pubs/longterm (last visited Apr. 15, 2006) ("Absent policy change, a growing imbalance between expected federal spending and tax revenues will mean escalating and ultimately unsustainable federal deficits and debt."); PETER G. PETERSON, RUNNING ON EMPTY 9–10 (2004) ("[I]n just three years [(2001 to 2003)] U.S. voters witnessed a negative swing of over $10 trillion in the ten-year federal deficit outlook. By the year 2014, that will amount to $90,000 in additional federal debt for every household."); Rudolph G. Penner & Alice M. Rivlin, *Dimensions of the Budget Problem*, *in* RESTORING FISCAL SANITY 2005: MEETING THE LONG-RUN CHALLENGE 17, 17–34 (Alice M. Rivlin & Isabel Sawhill eds., 2005).

[15] Deficit hawks, who place great emphasis on keeping the federal budget under control and the federal deficit low, have become increasingly alarmed at the rate of government spending in the wake of Hurricane Katrina. *See* Donald Lambro & Amy Fagan, *Defer Drug Benefit to Offset Katrina, Deficit Hawks Urge*, WASH. TIMES, Sept. 20, 2005, at A2 ("Deficit hawks both inside and outside of Congress say adding the cost of recovery and rebuilding to the deficit is a bad idea."). If the government were to provide contractors with indemnification, it would essentially be insuring its contractors against liabilities they incur to individuals injured by the contractors' negligence, resulting in further government expenditures after national disasters. *See infra* notes 173–175 and accompanying text (discussing indemnification for unusually hazardous risks). Under the GCRA, however, the government would bear no economic responsibility for harm resulting from contractors' negligent acts.

[16] The Senate hearing on the GCRA included frank disparagement of the plaintiffs' bar. *See infra* text accompanying notes 132, 136–138. This is to be expected in light of the political leanings of the GCRA's sponsor (Sen. John Thune (R-S.D.)) and co-sponsors (Sen. Jim DeMint (R-S.C.); Sen. Michael B. Enzi (R-Wyo.); Sen. James M. Inhofe (R-Okla.); Sen. Trent Lott (R-Miss.); Sen. Lisa Murkowski (R-Alaska); Sen. Rick Santorum (R-Pa.); Sen. Ted Stevens (R-Alaska); and Sen. David Vitter (R-La.)). *See* 151 CONG. REC. S10378 (2005); 151 CONG. REC. S10514, 10515 (2005); 151 CONG. REC. S10594, 10596 (2005); 151 CONG. REC. S11130, 11131 (2005). *See generally* REPUBLICAN NAT'L COMM., 2004 REPUBLICAN PARTY PLATFORM: A SAFER WORLD AND A MORE HOPEFUL AMERICA (2004), *available at* http://www.gop.com/media/2004platform.pdf ("America's litigation system is broken. Junk and frivolous lawsuits are driving up the cost of doing business in America by

This Article, however, asserts that the GCRA grossly misses the mark when judged against two commonly suggested normative goals of tort law: the GCRA neither serves the ends of justice and fairness by compensating victims, nor does it minimize the costs of harm by deterring contractors from acting negligently.[17] This Article first criticizes the GCRA's doctrinal structure, which is primarily founded upon an improper use of the government contractor defense. By jettisoning the traditional predicate to the defense, that a government contractor has explicitly followed government direction to its detriment, the GCRA unmoors the defense from its logical underpinnings—the insulation of the discretionary functions of government from liability.[18]

This Article further bemoans the economic inefficiencies likely to result from this distortion of the government contractor defense. First, the GCRA fails to allocate the risks of disaster relief efforts to the parties who can best access information about the potential risks associated with such work and can most effectively avoid or protect themselves against these risks.[19] Instead, it shifts these risks to individuals who lack the opportunity to assess, avoid, or insure against them.[20] Second, by alleviating contractors' accountability for negligent actions, the GCRA creates a moral hazard, diminishing the incentives for responsible contractor behavior and potentially increasing the incidence of harmful behavior.[21] This Article advocates allocating the risks of disaster relief work to those parties who can most effectively minimize the costs of these activities or who can best bear the risks inherent in such work,[22] a solution superior to that embodied by

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forcing companies to pay excessive legal expenses to fight off or settle often baseless lawsuits . . . ."); Nathaniel L. Bach, Note, *Trial Lawyer on the Ticket: Electoral Rhetoric and the Depiction of Lawyers in the 2004 Presidential Campaign*, 19 GEO. J. LEGAL ETHICS 317, 319–36 (2006) (analyzing the tort reform "cornerstone" of the Bush-Cheney domestic policy agenda during the 2004 presidential election).

[17] *See* GUIDO CALABRESI, THE COSTS OF ACCIDENTS: A LEGAL AND ECONOMIC ANALYSIS 24 (1970). This is not, of course, to suggest that the GCRA's only flaw is its failure to address the principle goals of tort law. *See infra* note 79 (discussing the GCRA's encroachment upon states' rights). Such problems, however, are beyond the scope of this Article.

[18] *See* Boyle v. United Techs. Corp., 487 U.S. 500, 511–12 (1988). For a more extensive discussion of the government contractor defense, see *infra* Part III.A.

[19] *See infra* text accompanying notes 113–119.

[20] As discussed *infra* Part III.B, the GCRA does not preserve the possibility of victim compensation by either diluting the government's sovereign immunity or mandating that the government indemnify its contractors. It merely leaves individuals without a remedy if they are injured by the tortious acts of contractors involved in, among other things, debris removal or reconstruction work in disaster zones.

[21] *See infra* notes 121–124 and accompanying text.

[22] The law and economics literature suggests the desirability of allocating risk to the party who can most effectively reduce the costs of harm or who can best bear the risk. *See* Guido Calabresi & Jon T. Hirschoff, *Toward a Test for Strict Liability in Torts*, 81 YALE L.J. 1055, 1060 (1972) (proposing that liability should rest with the party best positioned "to make the cost-benefit analysis between accident costs and accident avoidance costs, and to act on the decision once made"); *see also* Richard A. Posner & Andrew M. Rosenfield, *Impossibility and Related Doctrines in Contract Law: An Economic Analysis*, 6 J. LEGAL STUD. 83, 88–92 (1977) (analyzing risk allocation in the context of contract impossibility).

the GCRA. In other words, Congress should allocate these risks to the party in the best position to understand, anticipate, assess, avoid, mitigate, insure against, or, ultimately, bear the potential loss.[23]

Finally, this Article proposes that the GCRA is undesirable absent empirical evidence of either (1) a dearth of qualified companies willing to compete for the government's business, or (2) a market failure in the insurance industry. This Article concedes that contractors involved in disaster relief may face risks for which sufficient insurance is unavailable. Nonetheless, among all alternative solutions, the GCRA is one of the least appropriate; in all likelihood, it would compound the effects of the devastation it was intended to address. Congress does not lack for more appropriate solutions to deal with whatever risks arise in post-catastrophe clean-up. For example, the government could model risk management on the third-party liability provisions of the Federal Acquisition Regulations (FAR)[24]; or the hazardous risk indemnification allowed by Public Law 85-804,[25] which permits contractual relief under extraordinary circumstances such as high-risk research and development involving nuclear power or highly volatile missile fuels.[26] Alternatively, the government could establish a victim compensation fund, drawing upon models such as the September 11 captive insurance fund[27] or the Vaccine Injury Compensation Program.[28] Each of these options is preferable to the GCRA's unnecessary, inefficient, and unfair

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See generally RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW (5th ed. 1998); Richard A. Posner, *A Theory of Negligence*, 1 J. LEGAL STUD. 29 (1972).

[23] Guido Calabresi's categorization of accident cost reduction efforts into three tiers of "subgoals" is instructive. *See* CALABRESI, *supra* note 17, at 26–31. "Primary" cost reduction encompasses efforts to reduce the number and severity of accidents. *Id.* at 26–27. "Secondary" cost reduction addresses the societal costs that indirectly result from the accident, such as rehabilitation and care of the injured. *Id.* at 27–28. Societal costs may be reduced, and possibly minimized, by spreading accident losses—shifting the risk of these costs from individuals (i.e., potential injurers and victims) to society in the aggregate. *See id.* at 39–42. Finally, tertiary cost reduction involves managing the transactional costs of the administrative or market machinery that is used to achieve primary and secondary cost reduction. *Id.* at 64–66. From this, Calabresi persuasively argues that the party best equipped to reduce the costs of the accident should bear those costs. *Id.* at 40–42.

[24] 48 C.F.R. § 52.228-7 (2005). The FAR "is established for the codification and publication of uniform policies and procedures for acquisition by all executive agencies." *Id.* § 1.101.

[25] Act of Aug. 28, 1958, Pub. L. No. 85-804, 72 Stat. 972 (codified as amended at 50 U.S.C. §§ 1431–1435 (2000)); *see also* 48 C.F.R. §§ 50.403-1 to -3 (2005).

[26] *See* Patrick E. Tolan, Jr., *Environmental Liability Under Public Law 85-804: Keeping the Ordinary Out of Extraordinary Contractual Relief*, 32 PUB. CONT. L.J. 215, 260–61 (2003) (explaining that the legislative history of Public Law 85-804 indicates that indemnification should be limited to research, development, and production in the fields of nuclear power or highly volatile missile fuels); Michael Abramowicz, *Predictive Decisionmaking*, 92 VA. L. REV. 69, 108–13 (2006) (suggesting nuclear safety regulation as a candidate for "predictive decisionmaking," as an alternative to the limited liability model found in, for example, the Price-Anderson Act, 42 U.S.C. § 2210 (2000)).

[27] Consolidated Appropriations Resolution, 2003, Pub. L. No. 108-7, div. K, tit. III, 117 Stat. 11, 517–18 (2003).

[28] 42 U.S.C. §§ 300aa-10 to -34 (2000).

allocation of risk to the residents of disaster areas and the relief workers who come to their aid.

II. OPPORTUNISTIC POST-CRISIS BEHAVIOR

Congress intended the GCRA to protect contractors.[29] While the GCRA would do so, it does not serve the public interest.[30] Specifically, it seeks to capitalize upon Hurricane Katrina's devastation to obtain, for the contractor community, long-sought after, and long-denied, insulation from liability in post-crisis situations.[31] Unfortunately, this legislative initiative reflects a broader, disconcerting trend of seemingly opportunistic post-crisis behavior. Under the guise of exigency, both the Bush administration and Congress have utilized Hurricane Katrina to effectuate public policies that are unnecessary and untenable, and thus might not otherwise have survived debate or scrutiny.

For example, in its $51.8 billion post-Katrina emergency supplemental appropriation, Congress hastily raised the "micro-purchase threshold" (which, in effect, serves as the government charge card purchase cap)[32] to $250,000 for purchases relating to relief and recovery from Hurricane Katrina.[33] That hundredfold increase on the existing $2,500 limit[34] far

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[29] Section two of the GCRA lists the congressional findings supporting the bill's proposed relief. These findings emphasize that government contractors provide vital assistance in responding to national disasters and that fears of future litigation may discourage this assistance. *See* S. 1761, 109th Cong. § 2 (2005). The GCRA is thus intended "to ensure that . . . contractors continue to answer the governmental requests for assistance in times of great need." *Id.* § 2(12)(a).

[30] *See* Richard S. Markovits, *Liberalism and Tort Law: On the Content of the Corrective-Justice-Securing Tort Law of a Liberal, Rights-Based Society*, 2006 U. ILL. L. REV. 243, 249, 287 (2006) (arguing that governments of "rights-based [s]tates" are obligated to "maximize the rights-related interests" of their citizens, and thus should have "legally enforceable . . . duties" to (1) avoid committing torts against their citizens, (2) reduce the occurrence of torts between citizens, and (3) provide victims of tortious conduct with appropriate opportunities to seek redress). Markovits concludes that "government officials can promulgate goal-oriented tort legislation if, but only if . . . the legislation in question does not on balance disserve the rights-related interests of the relevant society's members and participants." *Id.* at 250; *see also id.* at 283–85. Responsible government should focus on serving the public interest. *See* Mark Seidenfeld, *A Civic Republican Justification for the Bureaucratic State*, 105 HARV. L. REV. 1511, 1514 (1992) ("[G]overnment's primary responsibility is to enable the citizenry to deliberate about altering preferences and to reach consensus on the common good.").

[31] *See infra* notes 128 and 135 (discussing bills to reduce contractor liability proposed in the mid-1980s).

[32] *See* 48 C.F.R. § 13.201(b) (2005) (making government purchase cards the "preferred method" for micro-purchases).

[33] Second Emergency Supplemental Appropriations Act to Meet Immediate Needs Arising from the Consequences of Hurricane Katrina, 2005, Pub. L. No. 109-62, § 101(2), 119 Stat. 1990, 1992. Although government purchase cards were first used during the Reagan administration in the late 1980s, their use gained momentum in the early 1990s with former Vice President Al Gore's National Performance Review, which strongly urged agencies to increase their reliance on government purchase cards. *See* Neil S. Whiteman, *Charging Ahead: Has the Government Purchase Card Exceeded Its Limit?*, 30 PUB. CONT. L.J. 403, 407–11

exceeded the already flexible $15,000 ceiling Congress had previously made available during contingencies and emergencies.[35] While pressure quickly forced the administration to bar further use of this authority,[36] the fact that the $250,000 threshold became law at all, without meaningful discussion, is shocking.[37] At the time of the threshold increase, more than 300,000 government purchase cards were in circulation,[38] and a mountain of Inspector General reports, Government Accountability Office studies, and congressional hearings had demonstrated that the government's management of its charge cards was abysmal.[39] Not only does the temptation of poorly supervised purchase cards encourage fraudulent behavior,[40] but such pro-

(2001). The 1994 enactment of the Federal Acquisition Streamlining Act, Pub. L. No. 103-355, 108 Stat. 3243 (codified in scattered sections of 10 U.S.C. and 41 U.S.C.), fueled government purchase card activity by (1) creating a $2500 "micropurchase" threshold (and thereby exempting purchases under that threshold from many of the onerous regulations that govern most procurements), *see* 41 U.S.C. § 428(b), (f) (2000), and (2) allowing agencies' procurement organizations to delegate purchasing authority to nonprocurement cardholding personnel, *see id.* § 428(c); *see also* Whiteman, *supra*, at 411–12.

[34] 41 U.S.C. § 428(f); 48 C.F.R. § 2.101 (2005).

[35] After the attacks of September 11, 2001, the micro-purchase threshold for supplies or services acquired by the Department of Defense for the purpose of defending the United States against terrorist attacks was increased to $15,000. Federal Acquisition Regulation; Temporary Emergency Procurement Authority, 67 Fed. Reg. 56,120–21 (Aug. 30, 2002) (codified in scattered sections of 48 C.F.R.).

[36] *See* Memorandum from Clay Johnson III, Deputy Dir. for Mgmt., Office of Mgmt. & Budget, Executive Office of the President, Limitation on Use of Special Micro-purchase Threshold Authority for Hurricane Katrina Rescue and Relief Operations (Oct. 3, 2005), *available at* http://63.161.169.137/omb/procurement/micro-purchase_guidance_10-03-05.pdf (requesting that agencies not use the increased micro-purchase authority unless there are "exceptional circumstances"). Nonetheless, purchase card usage appears robust. The Inspector General of the Department of Homeland Security estimated the value of Katrina-related purchase card transactions, as of December 30, 2005, at approximately $50.9 million. *See* PRESIDENT'S COUNCIL ON INTEGRITY AND EFFICIENCY, PCIE 12-17-05 TO 12-30-05 BIWEEKLY REPORTING PERIOD: HURRICANE KATRINA AGENCY DATA, *available at* http://www.dhs.gov/interweb/assetlibrary/OIG_PCIE_123005.pdf [hereinafter HURRICANE KATRINA AGENCY DATA].

[37] *See* Bill Marsh, *Here Is Your New Federal Credit Card, Here Is Your New Purchase Limit*, N.Y. TIMES, Sept. 18, 2005, § 4, at 14; Steven L. Schooner, *Fiscal Waste? Priceless*, L.A. TIMES, Sept. 14, 2005, at B13.

[38] FED. PROCUREMENT DATA CTR., U.S. GEN. SERVS. ADMIN., FEDERAL PROCUREMENT REPORT FY 2003 § 1, at 13 (2003), *available at* http://www.fpdsng.com/downloads/FPR_Reports/FPR2003a.pdf.

[39] *See generally The Use and Abuse of Government Purchase Cards: Hearing Before the H. Subcomm. on Governmental Efficiency, Financial Management and Intergovernmental Relations of the H. Comm. on Governmental Affairs*, 107th Cong. (2002); OFFICE OF THE INSPECTOR GEN., DEP'T OF DEF., REP. NO. D-2002-029, DOD PURCHASE CARD PROGRAM AUDIT COVERAGE (2001), *available at* http://www.ignet.gov/randp/cards/dod-D-2002-029.pdf; GEN. ACCOUNTING OFFICE, GAO-02-676T, GOVERNMENT PURCHASE CARDS: CONTROL WEAKNESSES EXPOSE AGENCIES TO FRAUD AND ABUSE (2002), *available at* http://www.gao.gov/new.items/d02676t.pdf; GEN. ACCOUNTING OFFICE, GAO-04-717T, PURCHASE CARDS: INCREASED MANAGEMENT OVERSIGHT AND CONTROL COULD SAVE HUNDREDS OF MILLIONS OF DOLLARS (2004), *available at* http://www.gao.gov/new.items/d04717t.pdf.

[40] For a lengthy discussion of the purchase card program's fundamental flaws, which lead to widespread abuse and fraud, see Jessica Tillipman, *The Breakdown of the United States Government Purchase Card Program and Proposals for Reform*, 2003 PUB. PROCUREMENT L. REV. 229, 234–41 (2003).

grams also run counter to the fundamental procurement principles of transparency, integrity, and competition.[41] In August 2005, the White House recognized these systemic problems and issued long overdue (and slow to be implemented) purchase card guidance, mandating fundamental training and risk management policies.[42] Not only would the micro-purchase increase have exacerbated the existing purchase card management debacle, but it would have devastated many small businesses,[43] which receive approximately two-thirds of all federal procurement dollars awarded through contracts under $250,000.[44]

Similarly, the Bush administration capitalized on the post-Katrina sense of urgency by suspending the Davis-Bacon Act in the counties damaged by the hurricane.[45] The Davis-Bacon Act is a pro-labor compensation regime which requires that federal construction workers be paid no less than prevailing wage rates.[46] Thus, prolonged suspension of the Davis-Bacon Act would have permitted contractors to profit from the massive reconstruction effort without ensuring that their workers receive wages sufficient for entry into the ranks of the lower middle class. The administration's putative explanation—that the suspension would save taxpayers' money and guarantee a sufficient supply of labor[47]—proved unpersuasive. After widespread criticism,[48] the administration reversed the suspension.[49]

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[41] *See* Steven L. Schooner & Neil S. Whiteman, *Purchase Cards and Micro-Purchases: Sacrificing Traditional United States Procurement Policies at the Altar of Efficiency*, 2000 PUB. PROCUREMENT L. REV. 148, 158–64 (2000); Whiteman, *supra* note 33, at 442–55. *But see* Jeff P. MacHarg, Note, *Doing More With Less—Continued Expansion of the Government Purchase Card Program by Increasing the Micropurchase Threshold: A Response to Recent Articles Criticizing the Government Purchase Card Program*, 31 PUB. CONT. L.J. 293, 305–11 (2002).

[42] *See* OFFICE OF MGMT. & BUDGET, EXECUTIVE OFFICE OF THE PRESIDENT, CIRCULAR NO. A-123, MANAGEMENT'S RESPONSIBILITY FOR INTERNAL CONTROL app. B, at 6–13 (2005), *available at* http://www.whitehouse.gov/omb/circulars/a123/a123_appendix_b.pdf.

[43] Typically, government purchases between $2500 and $250,000 would be set aside for small businesses. *See* 48 C.F.R. §§ 19.501, .502-1(b), .502-2(a), .502-2(b) (2005); *see also* Schooner, *supra* note 37, at B13 ("Anecdotal information and experience suggests that the lion's share of purchase card transactions benefit large businesses. That's not surprising, given the convenience offered by stores such as Wal-Mart, Staples, Home Depot and Best Buy."); Whiteman, *supra* note 33, at 456 ("The Government makes the bulk of its purchase card transactions from large businesses.").

[44] Telephone Interview with Paul Murphy, President, Eagle Eye, in Fairfax, Va. (Sept. 9, 2005). Eagle Eye is a commercial service that processes and repackages government procurement data. *See* Eagle Eye, Inc., About Eagle Eye, http://www.eagleeyeinc.com/Search.FPC?pg=10 (last visited Apr. 15, 2006).

[45] Proclamation No. 7924, 70 Fed. Reg. 54,227 (Sept. 8, 2005), *available at* http://www.whitehouse.gov/news/releases/2005/09/20050908-5.html.

[46] 40 U.S.C. § 3142 (Supp. II 2002). To be clear, the Davis-Bacon Act does not mandate that firms employ only union workers: it merely requires that firms pay "prevailing" wage rates and benefits, which typically correlate with those enjoyed by union workers. *See id.*

[47] *See* Proclamation No. 7924, 70 Fed. Reg. at 54,227 ("The wage rates imposed by [the Davis-Bacon Act] increase the cost . . . of providing Federal assistance to [areas affected by Hurricane Katrina] . . . . Suspension of [the Davis-Bacon Act] will result in greater assistance to these devastated communities and will permit the employment of thousands of additional individuals."); *see also* News Release, Congressman Charlie Norwood, Ad-

In both of these examples, reason ultimately overcame opportunistic encroachments upon established procurement policies. Hopefully, reason also will prevail over the GCRA. It may well be that contractors engaged in post-disaster work struggle and sometimes fail to obtain sufficient insurance. Nonetheless, prospectively releasing contractors from commonly anticipated liabilities allocates the risk of harms caused by contractor negligence to the victims harmed by such negligence.[50] That cannot be the optimal solution. If the liability insurance market truly fails, the government—as the party best able to assess the risk; avoid, mitigate, or insure against harm; and, should it be necessary, bear the costs of harm—may ultimately need to indemnify its contractors, or otherwise finance the compensation of victims.[51] Katrina's devastated communities, however, should not bear the brunt a second time.

III. PRIVATE VERSUS PUBLIC INTEREST

A. Distorting the Government Contractor Defense

The GCRA, which would grant virtually unprecedented liability protection to a contractor's recovery work in disaster zones,[52] is as inconsiderately drafted as it is misguided. Its most startling (and, ultimately, problematic) provision extends a rebuttable presumption that the government contractor defense applies to contractors certified as "necessary for the recovery of a disaster zone."[53] This solution disregards the premise that government direction serves as the touchstone for the government con-

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ministration Grants Norwood Request for Temporary Suspension of Davis-Bacon Act Restrictions on Rebuilding After Katrina (Sept. 8, 2005), *available at* http://www.house.gov/apps/list/press/ga09_norwood/DavisBacon.html.

[48] *See, e.g.*, Editorial, *A Shameful Proclamation*, N.Y. TIMES, Sept. 10, 2005, at A16; Thomas B. Edsall, *Bush Suspends Pay Act in Areas Hit by Storm*, WASH. POST, Sept. 9, 2005, at D3; Susan Jones, *Democrats, Unions Blast Bush Over Federal Rebuilding Effort*, CNSNews.com, Sept. 9, 2005, http://www.cnsnews.com/Politics/Archive/200509/POL20050909a.html.

[49] Proclamation No. 7959, 70 Fed. Reg. 67,899 (Nov. 3, 2005), *available at* http://www.whitehouse.gov/news/releases/2005/11/20051103-9.html.

[50] *See infra* Part III.B.

[51] "[I]ndividual moral rights holders whose tort-related rights have been sacrificed by [their] government['s] failure[ ] [to secure these rights by legislation] will have a moral right to receive compensation from the government . . . ." Markovits, *supra* note 30, at 291.

[52] Similar liability protection can be found in the Support Anti-Terrorism by Fostering Effective Technologies Act of 2002 (SAFETY Act), 6 U.S.C. §§ 441–444 (Supp. II 2002). As discussed *infra* Part III.A.3, however, the GCRA is vastly different from the SAFETY Act, chiefly because the SAFETY Act applies only to extraordinarily risky and evolving technologies. Although the SAFETY Act was a unique approach to liability protection when passed in 2002, Congress has indicated its intention to use the SAFETY Act as a model for other private sector industries not only through the proposal of the GCRA, but also through the Public Readiness and Emergency Preparedness Act (PREP Act), Pub. L. 109-148, div. C, 119 Stat. 2680, 2818–32 (2005) (to be codified at 42 U.S.C. §§ 247d-6d to -6e), discussed *infra* Part III.A.3.

[53] S. 1761, 109th Cong. § 5(d) (2005).

tractor defense.[54] Moreover, the formulaic certification process provided by the GCRA, coupled with the federal government's increasingly unstructured and chaotic contracting practices, renders this alteration of the defense particularly pernicious.

1. Ignoring the History of the Government Contract Defense

The GCRA misuses the government contractor defense and, in so doing, damages its viability. Although its roots trace to the 1940s,[55] the modern government contractor defense grew out of the Federal Tort Claims Act (FTCA)[56] and later found solid footing with *In re "Agent Orange" Product Liability Litigation.*[57] *Agent Orange* required that contractors manufacturing products for the government prove three elements to successfully assert the government contractor defense: that (1) the government

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[54] *See infra* note 62 (discussing of the importance of government direction, and consequent lack of contractor discretion, in the application of the government contractor defense).

[55] In *Yearsley v. W.A. Ross Construction Co.*, 309 U.S. 18, 20–22 (1940), the Supreme Court refused to hold a public works contractor liable for erosion of the plaintiff's property allegedly caused by construction performed under a federal government contract, applying agency principles to extend the government's sovereign immunity to the contractor. After *Yearsley*, lower courts struggled to apply the defense to a wider range of cases, specifically to those involving products manufactured according to government specifications. *See* Randal R. Craft, Jr., *The Government Contractor Defense: Evolution and Evaluation*, *in* THE GOVERNMENT CONTRACTOR DEFENSE: A FAIR DEFENSE OR THE CONTRACTOR'S SHIELD? 3, 7–9 (Juanita M. Madole ed., 1986) (discussing relevant opinions between 1940 and 1980).

[56] Enacted in 1946, the FTCA, ch. 753, §§ 401–424, 60 Stat. 812, 842–47 (codified as amended in scattered sections of 28 U.S.C.), initially exposed the military to liability. *See, e.g.*, Brooks v. United States, 337 U.S. 49, 50–52 (1949) (holding that service members can pursue negligence claims against the government for injuries not incident to service). Soon after passage of the FTCA, however, the Supreme Court ruled that the government is not liable under the FTCA when service members' injuries "arise out of or are in the course of activity incident to service." Feres v. United States, 340 U.S. 135, 146 (1950). After *Feres*, defense supply contractors became the target of choice in product liability suits because the government was no longer an available defendant. That situation proved unfair, because contractors, compelled to execute clear government directives, did not exercise independent discretion. The Court further complicated the legal treatment of military contractors in *Stencel Aero Engineering Corp. v. United States*, 431 U.S. 666 (1977), a case in which malfunctions in a government-specified, contractor-manufactured, aircraft ejection system injured a serviceman. When the serviceman alleged negligence against both the contractor and the United States, the contractor cross-claimed seeking indemnity from the government, alleging that "any malfunction . . . was due to faulty specifications, requirements, and components provided by the United States." *Id.* at 667–68. The Court relied on *Feres* to dismiss both the serviceman's claim against the government and the contractor's request for indemnification. *See id.* at 669, 673–74. *Feres* and *Stencel* thus placed military contractors in a bind. *See* R. Todd Johnson, Comment, *In Defense of the Government Contractor Defense*, 36 CATH. U. L. REV. 219, 227 (1986) ("The Feres-Stencel doctrine created an insurmountable dilemma . . . by excusing the government both from suit by serviceman and from indemnification actions brought by the contractor."). Their only option was to assert the still-developing government contractor defense discussed in this section. *See, e.g., id.* at 224–27; Kateryna Rakowsky, Note, *Military Contractors & Civil Liability*, 2 STAN. J. C.R. & C.L. (forthcoming 2006).

[57] 534 F. Supp. 1046 (E.D.N.Y. 1982), *aff'd*, 818 F.2d 187 (2d Cir. 1987).

established the product specifications, (2) the product met the specifications in all material respects and (3) the government knew as much or more than the contractor about the hazards associated with the product.[58] In *Boyle v. United Technologies Corp.*,[59] the Supreme Court modified and clarified these elements.[60] Contractors may assert the affirmative defense when (1) the United States approved reasonably precise design specifications, (2) the equipment conformed to those specifications and (3) the contractor warned the government about relevant dangers known to it, but not the government.[61] The first two elements "assure that the suit is within the area where the policy of the 'discretionary function' would be frustrated—i.e., they assure that the design feature in question was considered by a Government officer, and not merely by the contractor itself."[62] Although

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[58] *Id.* at 1055. The court elaborated on the third element by explaining that a contractor was required to inform the government of information known to it, but unknown to the government, regarding the hazards of the product. *Id.* at 1057. The *Agent Orange* approach was adopted in large part by the Ninth Circuit in *McKay v. Rockwell International Corp.*, 704 F.2d 444, 451 (9th Cir. 1983), which modified the first prong to allow the defense where the government either established or approved reasonably precise design specifications. Thereafter, most courts followed the *McKay* formulation of the government contractor defense. *See* Craft, *supra* note 55, at 14–25. However, the Eleventh Circuit remained a notable exception. *See* Shaw v. Grumman Aerospace Corp., 778 F.2d 736, 740, 745–46 (11th Cir. 1985) (allowing use of the defense only if the contractor either participated only minimally in design specifications or warned the government of all known risks and disclosed known alternative designs).

[59] 487 U.S. 500 (1988). *Boyle* involved the death of a serviceman who drowned when he was unable to release the escape hatch of a submerged helicopter. *Id.* at 502. The plaintiff sued the contractor that supplied the military with the helicopter, alleging, among other things, that the escape hatch was defectively designed to be outward-opening, which made it impossible for his son to release the hatch when subject to water pressure. *Id.* at 503.

[60] *Id.* at 511–12.

[61] *Id.* at 512.

[62] *Id.* Focusing on the discretionary function exception to the FTCA, the Court reasoned that it makes little sense to subject a contractor to state tort suits for manufacturing products that conform to designs fashioned or approved by a federal official when the federal official would enjoy immunity from similar suits. Although the FTCA waives the government's sovereign immunity for negligent or wrongful acts or omissions, 28 U.S.C. § 2674 (2000), it expressly exempts matters in which the government exercises a discretionary function, *id.* § 2680(a). In an earlier case, *Berkovitz v. United States*, 486 U.S. 531 (1988), the Supreme Court elaborated on the requirements that must be met before the discretionary function exemption may be applied. First, a mandatory statute or regulation prescribing a specific course of action must not have constrained the government decision being challenged. *Id.* at 536. Second, the government decision, when not so constrained, must have been grounded in social, economic, or political policy. *Id.* at 536–37. Thus under the FTCA's discretionary function exemption, the government's right to assert sovereign immunity is most likely to be engaged when a government official exercises discretion. In contrast, the protection offered by the government contractor defense as established in *Boyle* will most often be engaged when the contractor demonstrates its lack of discretion. Because such a lack of contractor discretion necessarily implies the presence of discretion on the part of government officials, the government contractor defense ensures that contractors are afforded liability protection only in those cases where the government itself would receive such protection under the FTCA's discretionary function exemption. *See* Peter C. Brown, *Blowing the Lid Off Pandora's Box: A Look at the Effect of the Design-Build Contract on the Government Contractor Defense*, CONSTRUCTION LAW., July 1997, at 17, 17. *Sanner v. Ford Motor Co.*, 364 A.2d 43 (N.J. Super. Ct. Law Div. 1976), decided before *Boyle*, illus-

Boyle addressed a military product (or supply), lower courts have extended its application to nonmilitary products.[63] Today, lower courts increasingly allow contractors to assert the defense with regard to service contracts[64] in addition to product or supply contracts.[65]

While the GCRA purports to apply the government contractor defense in the context of disaster relief with only a procedural variation, the GCRA effectively eviscerates the substantive legal underpinnings of the defense. For certified contractors, the GCRA would create a "rebuttable presumption that . . . all elements of the government contractor defense are satisfied; and . . . the government contractor defense applies in the lawsuit."[66] This ignores the first requirement of *Boyle*—that the government approve, in a reasonably precise manner, the scope of the work. Again, the ordinary government contractor defense protects contractors who explic-

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trates the importance of establishing the element of government discretion in any assertion of the government contractor defense. In *Sanner*, a passenger, who sustained injuries after being thrown out of a vehicle manufactured by Ford for the military, alleged that the company negligently failed to install safety belts. *Id.* at 43–44. Prior to manufacturing the vehicle, Ford offered the Army a design that included safety belts, which the Army rejected, "because occupants could be compromised due to deterred egress and escape in tactical situations as well as enhancing injuries in the event of a roll-over." *Id.* at 44–46. The court accepted the government contractor defense, finding that "Ford had no discretion to exercise with respect to installation of seat belts, roll bars or other restraints. The decision was that of the . . . Army[, which] specifically rejected the installation of these so-called safety devices." *Id.* at 47.

[63] *See, e.g.*, Carley v. Wheeled Coach, 991 F.2d 1117, 1123–28 (3d Cir. 1993) (civilian ambulance manufacturer); Yeroshefsky v. Unisys Corp., 962 F. Supp. 710, 717, 719–21 (D. Md. 1997) (manufacturer of keyboard equipment for the United States Postal Service); Andrew v. Unisys Corp., 936 F. Supp. 821, 829–32 (W.D. Okl. 1996) (manufacturer of letter sorting machines for the United States Postal Service); Lamb v. Martin Marietta Energy Sys., Inc., 835 F. Supp. 959, 966–68 (W.D. Ky. 1993) (company in charge of operating a nuclear facility for the Department of Energy). *But see, e.g.*, *In re* Haw. Fed. Asbestos Cases, 960 F.2d 806, 810–12 (9th Cir. 1992) (precluding insulation supplier from asserting the government contractor defense because its products were not military equipment).

[64] The FAR distinguishes contracts for services (from custodial to clerical and medical) from those for supplies (end items or widgets, from furniture to fighter aircraft) and construction (building, repairing, or renovating structures or improving real estate). Service contracts "directly engage[ ] the time and effort of a contractor whose primary purpose is to perform an identifiable task rather than to furnish an end item of supply." 48 C.F.R. § 37.101 (2005).

[65] *See, e.g.*, Hudgens v. Bell Helicopter/Textron, 328 F.3d 1329, 1334–45 (11th Cir. 2003) (accepting government contractor defense of a company providing helicopter maintenance to the Army); Richland-Lexington Airport Dist. v. Atlas Props., Inc., 854 F. Supp. 400, 421–24 (D.S.C. 1994) (applying the defense to a company supplying decontamination services to the Environmental Protection Agency). In the context of a service contract, the *Boyle* test remains essentially the same: (1) the government must have approved reasonably precise procedures to be followed in providing the service, (2) the contractor's performance must have conformed to those procedures and, (3) the contractor must have warned the government about dangers in those procedures that were known to it, but not to the government. *See Hudgens*, 328 F.3d at 1335. This test continues to focus on the "overriding question of who, the government or the contractor, ultimately had the most significant discretion in controlling the end result." Paul M. Laurenza & Michael W. Clancy, *The Government Contractor Defense: Post-Boyle Expansion and the SAFETY Act*, 80 FED. CONTRACTS REP. 477, 481 (2003).

[66] S. 1761, 109th Cong. § 5(d)(1) (2005).

itly follow government direction to their detriment.[67] Although the government need not create the specifications or otherwise withhold all discretion from the contractor,[68] some sort of meaningful government choice or decision is required before the defense can come into play.[69] To the extent that contractors exercise significant amounts of discretion in the performance of their contracts, however, the defense has not protected them.[70] As summarized by Ralph Nash and John Cibinic,

> [T]he Supreme Court has given a set of straightforward requirements—the most important of which is the Government approval requirement. . . . [W]here the Government agency is a full participant in the design process, the defense can be predicted to be a winner. In contrast, if the Government has not participated in design the contractor will find it very hard to use the defense.[71]

Thus, without a governmental act of discretion, there is little legal or policy justification for extending the government's sovereign immunity to the contractor.

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[67] *See Boyle*, 487 U.S. at 512.

[68] *See Carley*, 991 F.2d at 1125 ("[I]t is necessary only that the government approve, rather than create, the specifications . . . .").

[69] *See* Trevino v. Gen. Dynamics Corp., 865 F.2d 1474, 1480 (5th Cir. 1989) ("The mere signature of a government employee on the 'approval line' . . . , without more, does not establish the government contractor defense."). Guidelines for contractors regarding the successful assertion of the defense emphasize the need to ensure that the government actually approved precise specifications or procedures. For example, one author has advised that to assert a successful government contractor defense,

> [T]he actual approving authority . . . should prepare to discuss not only what the Government wanted in terms of design, but the level of expertise among the government design approval team, and how dependent the approval officials were on the contractor's designers for purposes of contract review . . . . [T]he Government should also provide a record of communications between the contractor and the Government, documenting the "give and take" in the design process that shows conscious government approval of every design suggestion and change.

John J. Michels, Jr., *The Government Contractor Defense: The Limits of Immunity After* Boyle, 33 A.F. L. REV. 147, 160 (1990); *see also* Carl L. Vacketta et al., *The "Government Contractor Defense" in Environmental Actions*, BRIEFING PAPERS, Dec. 1989, at 7 (advising government contractors to "do whatever [they] can to facilitate Govt [sic] review and inspection of every aspect of [their] contract work"). Conversely, plaintiffs are advised that their "best line of attack" in response to a defendant's assertion of the government contractor defense is to argue that the government did not exercise the requisite discretion over specifications. *See* Charles E. Cantu & Randy W. Young, *The Government Contractor Defense: Breaking the Boyle Barrier*, 62 ALB. L. REV. 403, 420–22 (1998).

[70] *See, e.g.*, Raymond B. Biagini & Ray M. Aragon, *The Government Contractor Defense: Limiting Product Liability in the New Procurement Environment*, 39 GOV'T CONTRACTOR ¶ 169, at 3 (1997) ("[Only] the contractor that proves 'the Government made me do it' can share in the Government's sovereign immunity.").

[71] Ralph C. Nash & John Cibinic, *Postscript: The Circuit Court View of the Government Contractor Defense*, 4 NASH & CIBINIC REP. ¶ 52 (1990).

2. Violating the Spirit and Intent of the Government Contractor Defense

The GCRA's supporters assert that the legislation "implements the requirements already set forth by the Supreme Court,"[72] thereby avoiding costly litigation involving the *Boyle* elements and increasing certainty and uniformity.[73] The argument that the certification requirement fulfills *Boyle*'s first element,[74] however, rings hollow, because the purely perfunctory certification process fails to consider the amount of discretion enjoyed by the contractor in performing the work.

Contractors seeking certification would submit a request to the Corps of Engineers.[75] To issue the certification, the chief of engineers need only conclude that (1) the work takes place in a disaster zone[76] and (2) at least one-half of the work falls within specified categories, including routine activities such as debris removal, reconstruction work, and search and rescue operations.[77] Unlike the judicial predicate for applying the government contractor defense, the chief of engineers need not consider the amount of discretion the contractor enjoyed in performing the work.[78] Moreover, certification would control federal, state, or local government contracts.[79] If certification involved a comprehensive review of the discretion

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[72] *Oversight Hearing on the Impact of Certain Governmental Contractor Liability Proposals on Environmental Laws: Hearing on S. 1761 Before the Subcomm. on Superfund and Waste Management of the S. Comm. on Environment and Public Works*, 109th Cong. 79 (2005) [hereinafter *Hearing*] (statement of Craig S. King, government contracts attorney). Craig King has further argued that "[u]nder Supreme Court standards, the Government contractor defense would apply to disaster relief efforts without S. 1761." *Id.* at 75.

[73] *See id.* (written statement of Craig S. King).

[74] *See id.* at 78 (statement of Craig S. King).

[75] S. 1761, 109th Cong. § 5(d)(4)(B) (2005) (referring to "the submission of a request for a certification"). The GCRA would encompass both past performance and future performance. *See id.* (defining certification as a determination that "a government contract *was or will be* necessary for the recovery of a disaster zone," and focusing the certification inquiry in part upon "the scope of work that the government contract *does or will require*") (emphasis added). Because the language of the GCRA does not specify the source of the submission, it leaves open the possibility that a request could be submitted either by the government, a contractor, or another entity, such as an insurance company. *See id.* § 5(d)(4)(A) (providing that the Chief of Engineers is responsible for reviewing "any government contract that any person or entity, including any governmental entity, claims to be necessary for the recovery of a disaster zone from a disaster for the purpose of establishing a government contractor defense").

[76] Pursuant to the GCRA, the term "disaster zone" includes those geographical areas affected by Hurricane Katrina as well as any other region affected by a major disaster requiring federal assistance exceeding $15 billion. *Id.* § 3(1).

[77] *Id.* § 5(a)(1), (d)(4).

[78] *See id.* § 5(d)(4)(c); *cf. supra* text accompanying notes 67–71 (emphasizing that the ordinary government contractor defense only protects contractors who explicitly follow government direction and limit their own exercise of discretion).

[79] S. 1761 § 3(2)(A)(ii) (defining "government contract" to include contracts entered into by federal, state, and local governments). In other words, the Corps certification would override negotiated or legislated allocations of risk in state, local, or municipal contracts, even if the federal government was not a party to those contracts. This is not an isolated

retained by the government or delegated to the contractor, it might appear reasonable to presume that the elements of the government contractor defense would be satisfied. The GCRA certification process, however, ignores the presence or absence of governmental approval of either the contractor's methods or means of contract performance. Whereas the sort of liability protection provided by the GCRA is usually reserved for government entities and those acting under their discretion, the GCRA extends this protection to parties whose decisions cannot be attributed in any way to the government.

The GCRA would not only provide inappropriately broad access to the government contractor defense, but it would leave little procedural room for a plaintiff to defeat its preclusive force. Once granted a certificate of need under the GCRA, contractors and subcontractors could raise the government contractor defense to defeat claims brought by a negligently injured party. Specifically, the GCRA would entitle the contractor to a "rebuttable presumption" that all the elements of the government contractor defense were satisfied and that the government contractor defense applied to the lawsuit.[80] Yet the presumption offered by the GCRA hardly seems rebuttable on its merits; if anything, the GCRA's presumption is more analogous to a government official's defense of qualified immunity.[81]

Typically, a rebuttable presumption merely shifts the burden of proof to one challenging the presumption, who may then attempt to rebut the

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intrusion on state authority; the GCRA establishes exclusive federal jurisdiction for lawsuits arising out of the performance of a contract in a disaster zone. *See id.* § 5(a). Thus, in the unlikely event that a contractor has not been granted certification (meaning that the government contractor defense would not insulate it from liability), a negligently harmed individual can assert state tort claims only in *federal* court. Moreover, individuals injured by a Corps-certified state or local government contractor are denied recourse in a wide range of federal causes of action. The GCRA expressly prohibits any action against a contractor engaged in disaster-recovery work (whether certified or not) under federal laws or regulations that are administered by the Secretary of the Army, the Secretary of Transportation, or the Administrator of the Environmental Protection Agency. *Id.* § 4(a). This means that individuals cannot hold contractors accountable for violations of, for example, the Clean Water Act, 33 U.S.C. §§ 1251–1387 (2000), which is administered by the Environmental Protection Agency, *see id.* § 1251(d). The propriety and constitutionality of these encroachments upon states' rights, however, are beyond the scope of this Article.

[80] S. 1761 § 5(d)(1), (2).

[81] The defense of qualified immunity protects "government officials [as opposed to private parties such as contractors] . . . from liability for civil damages insofar as their conduct does not violate clearly established statutory or constitutional rights of which a reasonable person would have known." Harlow v. Fitzgerald, 457 U.S. 800, 818 (1982). An official's qualified immunity is overcome only by showing that the government official knew or should have know that his or her actions would cause injury to the plaintiff. *See id.* at 818–19. Similarly, the showing required to overcome the GCRA's rebuttable presumption is quite taxing. *See* S. 1761 § 5(d)(3). However, qualified immunity operates somewhat differently than a "mere defense to liability" of the sort provided by the GCRA; qualified immunity is "an entitlement not to stand trial under certain circumstances" and may be "effectively lost if a case is erroneously permitted to go to trial." Mitchell v. Forsyth, 472 U.S. 511, 512 (1985); *see also* Karen M. Blum, *Qualified Immunity: A User's Manual*, 26 IND. L. REV. 187, 190 (1993).

presumption by producing evidence to the contrary.[82] Here, however, no effect would be given to even the production of specific, unequivocal evidence demonstrating the lack of those conditions traditionally requisite to the success of a government contractor defense. The only way to overcome the GCRA's presumption is through evidence that the entity seeking certification acted fraudulently or with willful misconduct in submitting information to the Corps of Engineers.[83] Logically, a statutory certification system should be subject to reasonable constraints on the legal consequences of certification, informed by the substance of the threshold requirements for certification. The pro forma certification provided for in the GCRA, however, violates such expectations; it offers no more than a procedural rubber stamp with a nearly indelible ink.

Advocates of the GCRA suggest that the second element of *Boyle*—that the contractor performed in accordance with the approved scope of the work—is met because the GCRA only protects a contractor for work done within the scope of its contract.[84] But reality belies this theory as well. Post–September 11 experience has demonstrated that, particularly in emergency contracting, the government loosely describes its contractors' work, if the work is defined at all.[85] Contractors concede that this norm—including oral agreements and handshake deals[86]—pervades the post-Katrina recovery efforts.[87] When a skeletal, overcommitted government acquisition workforce

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[82] *See* BLACK'S LAW DICTIONARY 1224 (8th ed. 2004) (defining a rebuttable presumption as "[a]n inference drawn from certain facts that establish a prima facie case, which may be overcome by the introduction of contrary evidence") (citations omitted).

[83] S. 1761 § 5(d)(3).

[84] *See, e.g.*, *Hearing*, *supra* note 72, at 78–79 (statement of Craig S. King).

[85] *See* GAO, AGENCY MANAGEMENT OF KATRINA CONTRACTORS, *supra* note 2, at 1 ("The [hurricane] response efforts . . . suffered from [i]nadequate planning and preparation . . . [and i]nsufficient numbers and inadequate deployment of personnel to provide for effective contractor oversight."); *see also* GOV'T ACCOUNTABILITY OFFICE, GAO-05-274, CONTRACT MANAGEMENT: OPPORTUNITIES TO IMPROVE SURVEILLANCE ON DEPARTMENT OF DEFENSE SERVICE CONTRACTS 2 (2005), *available at* http://www.gao.gov/new.items/d05274.pdf (finding that twenty-six out of ninety contracts reviewed suffered from insufficient quality assurance surveillance); GOV'T ACCOUNTABILITY OFFICE, GAO-04-605, REBUILDING IRAQ: FISCAL YEAR 2003 CONTRACT AWARD PROCEDURES AND MANAGEMENT CHALLENGES 5 (2004), *available at* http://www.gao.gov/new.items/d04605.pdf ("The agencies encountered various contract administration challenges . . . stemming in part from . . . lack of clearly defined roles and responsibilities . . . . [D]efining key terms and conditions of the contracts remain[s a] major concern[ ].")

[86] "A letter contract is a written preliminary contractual instrument that authorizes a contractor to begin . . . manufacturing supplies or performing services." 48 C.F.R. § 16.603-1 (2005). Because letter contracts permit work to proceed before the contracting parties achieve a meeting of the minds, they offer a recipe for disaster. Although Congress permits use of these "undefinitized contractual actions," "[t]he general policy has been to greatly restrict the use of such transactions because they are open-ended arrangements that place the risk of excessive costs largely on the Government." JOHN CIBINIC, JR., & RALPH C. NASH, JR., FORMATION OF GOVERNMENT CONTRACTS 1073–74 (1998); *see also* 48 C.F.R. § 16.603-3 (2005) (imposing procedural limitations on letter contracts).

[87] Anthony Zelenka, president of Bertucci Contracting Corporation, explained that his company went to work on an oral agreement to execute a written contract. *Hearing*, *supra* note 72, at 24 (statement of Anthony Zelenka). Warren Perkins, vice-president of Boh Brothers

rushes to identify contractors, hastily drafts contracts (or relies upon open-ended, vague statements of work), and fails to manage contract performance, the government essentially delegates any exercise of discretion to contractors.[88] Such open-ended arrangements fail to provide the specific direction or approval historically required for application of the government contractor defense.[89]

Construction Company, indicated that his company was doing work "on little more than a handshake. . . . We did not demand the time we would normally take to scrutinize contractual terms and conditions." *Id.* at 36 (statement of Warren Perkins). Further, Mr. Perkins stated that "the work that was asked of us had no specifications, had nothing to rely on, no design specifications, no specifications whatsoever." *Id.* at 44. Mr. Perkins expressed doubt in the government's ability to adequately direct disaster relief efforts. *See id.* at 22 ("[T]he contracting agencies have to guide and direct the recovery effort. . . . [But] we cannot be sure that the agencies are in charge."). This open-ended style of contracting is not unique to post-Katrina recovery efforts. Sweeping changes in the procurement environment emphasizing outcome over process have made the government more akin to a commercial purchaser; this trend has minimized government's involvement in, and control over, product design. *See* Steven L. Schooner, *Fear of Oversight: The Fundamental Failure of Businesslike Government*, 50 AM. U. L. REV. 627, 630–31 (2001) [hereinafter Schooner, *Fear of Oversight*] (explaining that, at a macro level, the reinvented procurement system is (1) defined by greater purchaser discretion, (2) less encumbered by bureaucratic constraint and internal oversight, and (3) more businesslike). *See generally* Steven L. Schooner, *Commercial Purchasing: The Chasm Between the United States Government's Evolving Policy and Practice*, *in* PUBLIC PROCUREMENT: THE CONTINUING REVOLUTION 137 (Sue Arrowsmith & Martin Trybus eds., 2003) [hereinafter Schooner, *Commercial Purchasing*]. As the government delegates more discretion to contractors, "the new regime . . . casts doubt on contractors' ability to enjoy the Government contractor defense's protection." Biagini & Aragon, *supra* note 70, at 3.

[88] The lack of competition utilized in awarding contracts, although an inexact proxy, gives credence to the disturbing picture of Katrina-related contracting practices derived from anecdotes. Despite the competition mandates of the Competition in Contracting Act (CICA) of 1984, Pub. L. No. 98-369, §§ 2701–2753, 98 Stat. 494, 1175–1203 (codified as amended in scattered sections of 10 U.S.C., 31 U.S.C. and 41 U.S.C.), that pervade the federal acquisition system, competitive contract awards have been the exception, not the rule. *See generally* 48 C.F.R. pt. 6 (2005). As of December 30, 2005, of the 579 contracts in excess of $500,000 awarded by the Department of Homeland Security for Katrina relief, only 115 (or just under 20%) employed full and open competition. HURRICANE KATRINA AGENCY DATA, *supra* note 36; *see also* 48 C.F.R. § 6.102 (2005) (listing "[t]he competitive procedures available for use in fulfilling the requirement for full and open competition"). In contrast, 378 (65%) of those contracts were awarded "no bid/sole source." HURRICANE KATRINA AGENCY DATA, *supra* note 36. Government-wide, a similar trend emerges: of the 905 contracts in excess of $500,000, only 246 (just over 25%) employed full and open competition, while 542 (approximately 60%) were awarded "no bid/sole source." *Id.*

[89] Over time, contrary to Congress's intent to reduce litigation, the GCRA might provoke *increased* litigation *against the government* pursuant to the FTCA. The GCRA would insulate *contractors* from liability even when the government aggressively outsources disaster-area work without giving proper attention to contract drafting or engaging in any meaningful oversight. Under the GCRA, a negligently injured individual in need of compensation would have only one option remaining—to sue the government. The FTCA waives the government's sovereign immunity and permits a suit in tort absent an exercise of discretion. Here, an injured party might assert that the government delegated the exercise of discretion to its contractor. This could be perceived to be an abdication, rather than an exercise, of discretion. In other words, the discretionary function exemption might not apply when the government did not, for example, provide the contractor with clear guidance or ongoing oversight. Thus, the government might find itself being held directly liable for the individual's injury.

The government's failure to provide contractors engaged in post-Katrina clean-up work with an appropriate level of direction for invocation of the government contractor defense is due, in large part, to its current dearth of contracting or acquisition personnel. Congress was quick to authorize more auditors and inspectors general to scrutinize Hurricane Katrina-related contracting,[90] but made no corresponding call for more contracting experts to perform the functions necessary for the procurement system to operate efficiently.[91] Sadly, the government's acquisition workforce has been strained to the breaking point.[92] Nor has the Bush administration suggested any reason for optimism that the issue will be addressed in the foreseeable future.[93]

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[90] Charles R. Babcock, *600 People Monitoring Hurricane Contracts*, WASH. POST, Jan. 13, 2006, at D2 ("The federal government has sent nearly 600 auditors and investigators to the Gulf Coast region to monitor $8.3 billion in contracts awarded to help victims of last year's hurricanes, according to year-end figures released by the Department of Homeland Security.").

[91] *See* Steven Kelman & Steven L. Schooner, *Scandal or Solution?*, CONT. MGMT., Jan. 2006, at 62, 62. The contracting workforce has desperately required a dramatic recapitalization after the bipartisan, post–Cold War, 1990s initiative to reduce the contracting workforce. *See generally* GEN. ACCOUNTING OFFICE, GAO-03-443, FEDERAL PROCUREMENT: SPENDING AND WORKFORCE TRENDS (2003), *available at* http://www.gao.gov/new.items/d03443.pdf; OFFICE OF THE INSPECTOR GEN., DEP'T OF DEF., REP. NO. D-2000-088, DOD ACQUISITION WORKFORCE REDUCTION TRENDS AND IMPACTS (2000), *available at* http://www.dodig.osd.mil/audit/reports/fy00/00-088.pdf; Schooner, *Fear of Oversight*, *supra* note 87, at 671–72.

[92] The 1990s workforce reductions left the government woefully unprepared for the dramatic increase in procurement spending since September 11 and Hurricane Katrina. In the last four years, after years of stagnation, government contracting dollars have increased dramatically, with yearly rates of growth between 6.5% and 22.1%. *See* FED. PROCUREMENT DATA CTR., U.S. GEN. SERVS. ADMIN., TRENDING ANALYSIS REPORT FOR THE LAST 5 YEARS, http://www.fpdsng.com/downloads/top_requests/FPDSNG5YearViewOnTotals.xls (last visited Apr. 15, 2006). However, these increased expenditures on government contracts have not been accompanied by a corresponding increase in the workforce. *See supra* note 91. *See generally* Steven L. Schooner, *Feature Comment: Empty Promise for the Acquisition Workforce*, 47 GOV'T CONTRACTOR ¶ 203 (2005), *available at* http://ssrn.com/abstract= 719685; Griff Witte & Robert O'Harrow, Jr., *Short-Staffed FEMA Farms Out Procurement*, WASH. POST, Sept. 17, 2005, at D01. At some level, this problem is exacerbated by pressure from the current administration to outsource. Outsourcing, or its more palatable pseudonym, "competitive sourcing," has been one of five government-wide initiatives in the Bush management agenda. *See, e.g.*, OFFICE OF MGMT. & BUDGET, EXECUTIVE OFFICE OF THE PRESIDENT, THE PRESIDENT'S MANAGEMENT AGENDA, FISCAL YEAR 2002 17–18 (2002), *available at* http://www.whitehouse.gov/omb/budget/fy2002/mgmt.pdf; Dru Stevenson, *Privatization of Welfare Services: Delegation by Commercial Contract*, 45 ARIZ. L. REV. 83, 83 (2003) ("President Bush is a major advocate of . . . hiring private firms to do the government's work.") (citing David J. Kennedy, *Due Process in a Privatized Welfare System*, 64 BROOK. L. REV. 231, 232 (1998)); *see also* Matthew Diller, *Form and Substance in the Privatization of Property Programs*, 49 UCLA L. REV. 1739, 1763 (2002) ("Governor Bush sought to hand administration of the state's welfare system over to . . . Lockheed Martin . . . and Electronic Data Systems.").

[93] David Safavian, while serving as administrator for federal procurement policy under the Bush administration, made clear that the administration had no plans to invest in a recapitalization of the acquisition workforce. *See* David H. Safavian, *Feature Comment: Delivering Results for the Acquisition Workforce*, 47 GOV'T CONTRACTOR ¶ 267 (2005) (responding to Schooner, *supra* note 92, by claiming that "[a]n across-the-board call for more

The government needs a massive influx of experienced professionals to identify and select quality suppliers, ensure fair prices, draft contracts, manage and evaluate contractor performance, and provide proper oversight.[94] The negative ramifications of poorly planned, vaguely written, and ill-managed contracts in this context are obvious: they allow contractors to weigh, among other things, haste versus caution, or, to some extent, profits versus care. For example, in removing debris from New Orleans a contractor might face significant economic choices with regard to (1) the experience of its personnel (drivers with spotless safety records might demand higher wages), (2) the quality and maintenance of its equipment (newer, better maintained trucks likely cost more to purchase or lease), (3) the means of performance (minimally acceptable environmental practices likely cost less than the most modern, clean, and safe technologies), and (4) time management (truck drivers might save time and money by transporting hazardous waste through, rather than around, residential communities). Responsible governance would not entail ceding such decisions to contractors.[95] Also, without an indication of true necessity, the government should not insulate its contractors against suits by parties injured as a result of the contractors' negligent actions. To do so would unnecessarily expose residents and relief workers in disaster areas to the detriments

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billets is an overly simplistic approach to a complex and challenging issue. . . . OMB does not support an increase in billets merely to establish an arbitrary level for the acquisition corps."). Sadly, Safavian's indictment for obstructing investigations and making false statements during his prior position at the General Services Administration set back, and may have crippled, serious procurement reform for the remainder of the Bush administration. Press Release, U.S. Dep't of Justice, Former GSA Chief of Staff David H. Safavian Indicted for Obstruction of Proceedings and False Statements (Oct. 5, 2005), *available at* http://www.usdoj.gov/opa/pr/2005/October/05_crm_521.htm.

[94] A simple "lesson learned" in Iraq was that, if the government relies heavily upon contractors, the government must maintain, invest in, and apply appropriate professional resources to select, direct, and manage those contractors. Unfortunately, insufficient contract management resources were applied. *See, e.g.*, *Hearing on Contracting Issues in Iraq: Hearing Before the Subcomm. on Readiness and Management Support of the S. Comm. on Armed Services*, 109th Cong. 2 (2006) (statement of Stuart W. Bowen, Jr., Special Inspector General for Iraq Reconstruction), *available at* http://www.sigir.mil/reports/pdf/testimony/SIGIR_Testimony_06-001T.pdf ("[T]he important lesson is that oversight works . . . . But, it works more efficiently the earlier it is put in place. Provisions for formal oversight of Iraq reconstruction should have been established at the very beginning of the endeavor."); Major Gen. George R. Fay, *AR 15-6 Investigation of the Abu Ghraib Detention Facility and 205th Military Intelligence Brigade*, *in* INVESTIGATION OF INTELLIGENCE ACTIVITIES AT ABU GHRAIB 1, 52 (2005), *available at* http://www.defenselink.mil/news/Aug2004/d20040825fay.pdf ("[T]here was no credible exercise of appropriate oversight of contract performance at Abu Ghraib."). *See generally* Steven L. Schooner, *Contractor Atrocities at Abu Ghraib: Compromised Accountability in a Streamlined, Outsourced Government*, 16 STAN. L. & POL'Y REV. 549 (2005). Indeed, this problem exists across the entire spectrum of government contracts. *See* Steven Kelman, *Strategic Contracting Management*, *in* MARKET BASED GOVERNANCE: SUPPLY SIDE, DEMAND SIDE, UPSIDE, AND DOWNSIDE 88, 89–90, 93 (John D. Donahue & Joseph S. Nye, Jr. eds., 2002) ("[T]he administration of contracts[,] once they have been signed, has been the neglected stepchild of [the procurement system reform] effort[ ].").

[95] *See* Seidenfeld, *supra* note 30, at 1514.

of contractor decisions unconstrained by democratically accountable government.

3. Form over Substance: Misuse of the SAFETY Act Model

The GCRA makes more sense if considered in the context of the model upon which it is based,[96] the Support Anti-Terrorism by Fostering Effective Technologies Act of 2002 (SAFETY Act).[97] The SAFETY Act, a post-September 11, 2001 initiative, encourages the development and protects the use of new or evolving (and, implicitly, unproven) technologies. Once the Under Secretary of the Department of Homeland Security (DHS) certifies a technology as a qualified anti-terrorism technology (QUATT), a rebuttable presumption of the government contractor defense applies to lawsuits "arising out of, relating to, or resulting from an act of terrorism" when the QUATT has been deployed in defense against, in response to, or in recovery from the terrorist act.[98] The SAFETY Act's underlying assumption is that, without insulation from liability, contractors might not otherwise permit the government to deploy these QUATTs to combat terrorism.[99] These contracts involve unusual types of work or technologies, or unusual uses of technologies, that are perceived as extraordinarily risky.[100]

Recently, Congress also borrowed from the SAFETY Act model to create the Public Readiness and Emergency Preparedness Act (PREP Act),[101]

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[96] *Hearing*, *supra* note 72, at 95 (statement of Craig S. King, government contract attorney) ("There is no doubt on earth this statute is patterned after the SAFETY Act.").

[97] 6 U.S.C. §§ 441–444 (Supp. II 2002). *See generally* Alison M. Levin, Note, *The SAFETY Act of 2003: Implications for the Government Contractor Defense*, 34 PUB. CONT. L.J. 175 (2004).

[98] 6 U.S.C. § 442(d)(1). Note that there is a difference between designation as a QUATT and certification as a QUATT. *Compare* 6 C.F.R. §§ 25.3, 25.5 (2005) (contemplating QUATT designation), *with id.* §§ 25.6, 25.7 (contemplating QUATT certification). Although a QUATT designation triggers certain liability limitations, the rebuttable presumption of the government contractor defense only applies to a technology that has received QUATT certification. *See id.* § 25.6. QUATT certification is only available once a technology has been designated a QUATT. *See id.* § 25.7(f). It entails a further level of government review than that required for QUATT designation. *Compare id.* § 25.3(b) (listing the criteria to be considered for designation), *with id.* § 25.6(a) (listing the additional criteria to be considered for certification).

[99] For a discussion of the SAFETY Act's purpose and legislative history, see Levin, *supra* note 97, at 176–78; *see also* Laurenza & Clancy, *supra* note 65, at 482 ("[P]rotection for contractors against the potential extraordinary liability that may result from an act of terrorism is essential if the federal government is to be able to work effectively with the private sector in the development and procurement of anti-terrorism technologies.").

[100] This point cannot be overemphasized. For a cogent articulation of this principle (in the context of indemnification), see, for example, Tolan, *supra* note 26, at 260–61 (emphasizing the unique and extraordinary nature of the contractual requirements, particularly in research and development, that proved uninsurable because they involved, for example, nuclear power or highly volatile missile fuels).

[101] Pub. L. 109-148, div. C, 119 Stat. 2680, 2818–32 (2005) (to be codified at 42 U.S.C. §§ 247d-6d to -6e).

which provides broad legal protection to parties involved in the production and distribution of covered "countermeasures,"[102] when the Secretary of Health and Human Services identifies their countermeasure in a public health emergency declaration.[103] Unlike the PREP Act, the GCRA would apply the unique SAFETY Act model to far more common, if not mundane, tasks.[104] Although they are clearly important, the contracts that the GCRA would cover by and large involve routine tasks such as search and rescue; demolition and repair; debris removal; and dewatering of flooded property.[105] For services such as these, it seems far less reasonable to shield contractors from liability for all but the most egregiously wrongful actions. These are not the types of work that can only be performed by an extremely limited pool of contractors or that require the use of unique facilities.

Contrast the private sector's virtually unlimited capacity to provide, for example, demolition and repair services with its extremely limited capacity to develop the type of technologies certified under the SAFETY Act, such as "lamp-based infrared countermeasure missile-jamming systems that can be deployed on fixed-wing aircraft to defeat . . . heat-seeking . . . missiles" or "a computer network that screens and validates, using biometric screening techniques, the identity of persons entering or leaving the United States."[106] Although certified SAFETY Act technologies may involve "the normal work that [the companies producing the technologies] do,"[107] they are not widely available in the commercial marketplace. Thus, while it may be "normal" for the specialized firms to produce these technologies, nothing suggests that a significant capacity exists for the private sector to produce them.

As discussed above, the GCRA process through which contractors would be able to obtain liability protection—certification by the Chief of Engineers—lacks any substantive inquiry into the circumstances surround-

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[102] PREP Act sec. 2, § 319F-3(a)(1), 119 Stat. at 2818 (to be codified at 42 U.S.C. § 247d-6d(a)(1)). The PREP Act includes a rather confusing definition of "covered countermeasure." *See id.* sec. 2, § 319F-3(i)(1), 119 Stat. at 2827–28 (to be codified at 42 U.S.C. § 247d-6d(i)(1)). Essentially, the term encompasses drugs, biological products, or devices that are authorized for use in diagnosing, mitigating, preventing, treating, or curing a pandemic or epidemic.

[103] *Id.* sec. 2, § 319F-3(b)(1), 119 Stat. at 2819–20 (to be codified at 42 U.S.C. § 247d-6d(b)(1)). Like the SAFETY Act and the GCRA, the PREP Act makes an exception for willful misconduct. *Id.* sec. 2, § 319F-3(d), 119 Stat. at 2824 (to be codified at 42 U.S.C. § 247d-6d(d)).

[104] *See* S. 1761, 109th Cong. § 5(a)(1) (2005).

[105] *See id.* While the scope of Hurricane Katrina's destruction may be unprecedented, describing the work as routine reflects the nature of the work, rather than the importance of the work.

[106] Both the missile-jamming systems, produced by BAE Systems Information and Electronic Systems Integration, and the computer network, produced by Accenture, have been certified as QUATTs. Dep't of Homeland Security, Recent SAFETY Act Designations/Certifications, https://www.safetyact.gov/dhs/sacthome.nsf/Awards?OpenForm (last visited Apr. 15, 2006).

[107] *Hearing*, *supra* note 72, at 96 (statement of Craig S. King).

ing contractual performance.[108] This process bears little resemblance to the highly judgmental and discretionary decisions to be made by the DHS Under Security under the SAFETY Act.[109] Specifically, the SAFETY Act employs seven criteria,[110] most of which are absent in the GCRA. For example, it is difficult to imagine a scenario in which there would be a "[s]ubstantial likelihood that [for example, debris removal] technology will not be deployed unless protections under [the GCRA, as opposed to the SAFETY Act] are extended."[111] Furthermore, QUATT certification is only granted after the DHS Under Secretary conducts a "comprehensive review" to determine whether the technology will perform as intended, conform to the seller's specifications, and be safe for use as intended,[112] while the GCRA requires no analogous review. Thus, the SAFETY Act certification involves a significant, meaningful act of governmental discretion and thereby approximates the judicial inquiry applied to the government contractor defense. By forgoing such scrutiny, however, the GCRA abandons this traditional limitation on the liability protection provided to government contractors—a limitation without which the extension of such protection loses its ordinary doctrinal justification.

B. Misallocating Risk

As a policy matter, the GCRA is unfair, inefficient, and unwise. The GCRA improperly allocates risk of harm between negligently injured parties, contractors, and the government.[113] As a matter of policy, a better solu-

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[108] *See supra* Part III.A.2.

[109] *But see Hearing*, *supra* note 72, at 95 (statement of Craig S. King) ("Basically all the same types of protections that we are talking about [in the SAFETY Act] would be [in S. 1761]. There would be a certification process, the whole sort of thing.").

[110] The criteria are (1) prior United States Government use or demonstrated substantial utility and effectiveness, (2) availability of the technology for immediate deployment in public and private settings, (3) existence of extraordinarily large or unquantifiable potential third-party liability risk exposure to seller (or another provider of the technology), (4) substantial likelihood that the technology will not be deployed unless SAFETY Act protections are extended, (5) magnitude of risk exposure to the public if the technology is not deployed, (6) evaluation of all scientific studies that can be feasibly conducted to assess the capability of the technology to substantially reduce risks of harm, and (7) whether the technology would be effective in facilitating the defense against acts of terrorism. 6 U.S.C. § 441(b) (Supp II 2002).

[111] *See id.* § 441(b)(4); *infra* notes 130–135 and accompanying text (discussing the lack of empirical evidence that threats of liability will significantly inhibit the market for the disaster relief activities covered by the GCRA).

[112] 6 U.S.C. § 442(d)(2).

[113] Generally, the government expects contractors to purchase insurance and, accordingly, the government willingly pays contractors to obtain that insurance. Prospective indemnification is employed only under extraordinary circumstances (for example, in the nuclear industry) in which contractors either cannot obtain insurance for a certain risk or cannot afford prohibitively priced premiums. *See, e.g.*, Act of Aug. 28, 1958, Pub. L. No. 85-804, 72 Stat. 972 (1958) (codified as amended at 50 U.S.C. §§ 1431–1435 (2000)); 48 C.F.R. §§ 50.403-1 to -3 (2005) (allowing government indemnification of contractors for unusually hazardous or nuclear risks). Thus, indemnification—through which the govern-

tion allocates risk to the superior risk bearer or, alternatively, the least cost risk avoider.[114] For most every activity that would be covered by the GCRA, it is apparent that pursuit of either policy goal would require either the government or its contractors to bear the risk of their negligent decisions or actions.

The superior risk bearer is the party best positioned to (1) appraise, in advance, the likelihood that the risk will occur and the magnitude of the harm if it does occur, (2) insure against the risk, either through self-insurance or market insurance, and (3) bear the cost of the harm.[115] In the unique context of post-disaster clean-up and reconstruction, the party harmed by negligent contractor behavior typically is less able to anticipate, assess, insure against, or avoid contractor negligence.[116] Both the con-

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ment, in effect, directly insures contractors rather than reimbursing the contractor for its insurance costs—derives from a market failure in the insurance industry. *See generally* Ralph C. Nash & John Cibinic, *Risk of Catastrophic Loss: How to Cope*, 2 NASH & CIBINIC REP. ¶ 44 (1988). Bear in mind, however, that the indemnification debate focuses upon prospective allocation of risk between the government and its contractors—it does not suggest that members of the public, if injured, should have no remedy.

[114] In addition to fairness, economic efficiency also appears to dictate that the costs incurred as a result of accidents be allocated to "the party or activity which can most cheaply avoid them." *See* Guido Calabresi & A. Douglas Melamed, *Property Rules, Liability Rules, and Inalienability: One View at the Cathedral*, 85 HARV. L. REV. 1089, 1096–97 (1972); *see also* Posner & Rosenfield, *supra* note 22, at 88–92. *But see* Gillian Hadfield, *Of Sovereignty and Contract: Damages for Breach of Contract by Government*, 8 S. CAL. INTERDISC. L.J. 467, 515–18 (1999) (suggesting that the allocation of risk to the party best able to bear the risk is less appropriate when the government is one of the contracting parties). Hadfield asserts that private sector assumptions of efficiency fail when transported to the public sector because "[t]o the extent that government has superior risk-bearing capacity, it does not act in order to profit from this characteristic." *Id.* at 516. In other words, the government transfers risk for reasons other than efficiency. *See id.*

[115] Posner and Rosenfield defined the superior risk-bearer as the party better able to insure against the risk, which is determined by its (1) ability to determine, in advance, the probability that the risk will occur and the magnitude of the loss if the risk does in fact occur, and (2) ability to diversify the risk away by pooling it with other uncertain events. Posner & Rosenfield, *supra* note 22, at 90–92. Economist Christopher Bruce has similarly focused on the parties' abilities to mitigate damages resulting from the occurrence of the risk through insurance. *See* Christopher J. Bruce, *An Economic Analysis of the Impossibility Doctrine*, 11 J. LEGAL STUD. 311, 322–23 (1982).

[116] In *Dalehite v. United States*, 346 U.S. 15, 24 (1953), the Supreme Court held that the FTCA prohibited a claim against the government by victims of the explosion of ammonium nitrate fertilizer stored in a ship at the docks in Texas City. A negligence suit was filed against the government because the fertilizer involved "had been produced and distributed at the instance, according to the specifications and under the control of the United States." *Id.* at 18. Although *Dalehite* involved the issue of government liability rather than contractor liability, the dissenting opinion of Justices Jackson, Black, and Frankfurter emphasized the irrationality of imposing the cost of harm on the injured parties who quite obviously were the inferior risk bearers:

> The disaster was caused by forces set in motion by the Government, completely controlled or controllable by it. Its causative factors were *far beyond the knowledge or control of the victims*; they were not only incapable of contributing to it, but could not even take shelter or flight from it.

Id. at 48 (Jackson, J., dissenting) (emphasis added). For additional information on the Texas

tractor—through market-supplied insurance—and the government—through indemnification, should market-supplied insurance not be available—are far better positioned than the potential victims of contractor negligence to insure against the risk of such accidents and to thereby bear the cost of this risk. Nonetheless, by expanding the liability protection of the government contractor defense beyond its ordinary bounds,[117] the GCRA imposes the cost solely on the negligently injured individual.

Similarly, the least cost risk avoider is the party best positioned to take steps to avoid or minimize the harm.[118] Even when a harm is nearly inevitable, a party may be able to either reduce the probability that the harm will occur or decrease the harm's magnitude.[119] For example, consider a contractor hired to demolish private homes in the New Orleans area that the government has deemed damaged beyond repair.[120] Imagine that the contractor destroys the wrong house—i.e., a house that poses no danger and was capable of being restored—because either (1) the government was ambiguous when it designated the houses for destruction and the contractor did not seek clarification, or (2) the contractor was negligent in its communications with the government about which houses were slated for demolition. Whereas the contractor could have avoided a costly accident with the exercise of reasonable care, the homeowner would not even know of a need to take precautions that would have reduced the risk of the home's destruction. Yet under the GCRA, the homeowner would bear this loss.

In so doing, the GCRA would reduce the contractor's incentive to adopt prudent risk avoidance strategies (e.g., to inquire or confirm whether the house must be destroyed) when faced with such an ambiguity.[121] Un-

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City disaster, see generally HUGH W. STEPHENS, THE TEXAS CITY DISASTER 1947 (1997); Samuel B. Kent, *The Texas City Disaster, 1947, Hugh W. Stephens*, 28 J. MAR. L. & COM. 675, 677 (1997) (book review); Local 1259, Int'l Ass'n of Fire Fighters, The Texas City Disaster: April 16, 1947, http://www.local1259iaff.org/disaster.html (last visited Apr. 15, 2006) (detailing the events of the tragic day through an historical account, pictures, and personal stories).

[117] *See supra* Part III.A.1.

[118] The least cost risk avoider is often conflated with the superior risk bearer. For example, Posner and Rosenfield perceive that the superior risk bearer is not only better able to insure against the risk, but is also better able to prevent the risk from materializing in the first place. *See* Posner & Rosenfield, *supra* note 22, at 90.

[119] *See* Robert Cooter, *Unity in Tort, Contract, and Property: The Model of Precaution*, 73 CAL. L. REV. 1, 3 (1985) ("Even when necessary or unavoidable, an accident . . . causes harm. The affected parties, however, can usually take steps to reduce the probability or magnitude of the harm. The parties to a tortious accident can take precautions to reduce the frequency or destructiveness of accidents.").

[120] Certification under the GCRA would most likely be granted in this case: the majority of the contractor's work was the performance of demolition activities in a declared disaster zone. *See* S. 1761, 109th Cong. §§ 5(a)(1), 5(d)(4) (2005); *supra* text accompanying notes 77–81.

[121] *See Hearing*, *supra* note 72, at 31 (statement of Dr. Beverly Wright, Director, Deep South Center for Environmental Justice, Xavier University) ("If contractors no longer fear legitimate legal liability, where is the incentive to do good work?"); *id.* at 55 (statement of Dr. Joel Shufro, Executive Director, New York Committee for Occupational Health and

der the GCRA, contractors could only be held liable for negligent actions if they engaged in reckless or willful misconduct.[122] By thus lowering the bar, the GCRA creates a moral hazard,[123] increasing the possibility that third parties will suffer harm as a result of contractor behavior.[124]

From a policy perspective, protection of the public from harm—rather than protection of contractors' economic interests—must come first.[125] Senator Barbara Boxer (D-Cal.) explained that the government "should be on the side of the people that get hurt directly, and [it] shouldn't be in a situation where [it is] trying to make it more difficult for them to receive compensation[.]"[126] Senator James Jeffords (Ind-Vt.) also warned that

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Safety) ("What S. 1761 does is to shift the costs of personal injuries and property damage from the government contractors to the workers and/or the residents in the disaster areas."); *id.* at 10 (statement of Sen. Barbara Boxer) ("[The GCRA] sends a . . . message . . . to the contractors, well, do your best, because if you make a mistake, if you burn toxics, if you do some other things, you know, you won't be held responsible.").

[122] At the Hearing, Senator Thune emphasized that the GCRA "would not in any way limit any contractor's liability for recklessness or willful misconduct." *Hearing*, *supra* note 72, at 4 (statement of Sen. John Thune). However, by limiting contractors' liability for negligent acts, the GCRA insulates contractors from the consequences of a significant portion of their activities.

[123] "'[M]oral hazard' refers to the tendency for insurance against loss to reduce incentives to prevent or minimize the cost of loss." Tom Baker, *On the Genealogy of Moral Hazard*, 75 TEX. L. REV. 237, 239 (1996) (citing Joseph E. Stiglitz, *Risk, Incentives and Insurance: The Pure Theory of Moral Hazard*, 8 GENEVA PAPERS ON RISK & INS. 4 (1983) ("[T]he more and better insurance that is provided against some contingency, the less incentive individuals have to avoid the insured event, because the less they bear the full consequences of their actions.")); *see also* Kenneth J. Arrow, *The Economics of Moral Hazard: Further Comment*, 58 AM. ECON. REV. 537, 537–38 (1968); Kenneth J. Arrow, *Uncertainty and the Welfare Economics of Medical Care*, 53 AM. ECON. REV. 941, 961–62 (1963); Mark V. Pauly, *The Economics of Moral Hazard: Comment*, 58 AM. ECON. REV. 531, 535 (1968). Baker also explained that "economists' models demonstrate[ ] . . . that insurance inevitably increases the occurrence, magnitude, or cost of that which is insured against." Baker, *supra*, at 241. In other words, "[c]ontrol of moral hazard is essential to prevent . . . dissipat[ion of] any deterrent force that the tort system possesses." Seth J. Chandler, *The Interaction of the Tort System and Liability Insurance Regulation: Understanding Moral Hazard*, 2 CONN. INS. L.J. 91 (1996). In the context of contracting activities, moral hazard can result when a contractor is insulated from liability for negligent behavior during the course of performance and thus has a reduced incentive to take reasonable precautions against risky activities. *See* Samir B. Mehta, *Additional Insured Status in Construction Contracts and Moral Hazard*, 3 CONN. INS. L.J. 169, 182 (1996). In *Dalehite v. United States*, 346 U.S. 15 (1953), not only did the dissenting Justices point out the irrationality of imposing harm on the inferior risk bearer, *see id.* at 24, but they also quite reasonably anticipated the moral hazard problem that results when parties are insulated from liability, *see id.* at 50 (Jackson, J., dissenting) ("It is our fear that the Court's adoption of the Government's view in this case may inaugurate an unfortunate trend toward relaxation of private as well as official responsibility.").

[124] *See* Ronald A. Cass & Clayton P. Gillette, *The Government Contractor Defense: Contractual Allocation of Public Risk*, 77 VA. L. REV. 257, 260 (1991) ("[T]he immediate effect of the [government contractor] defense is to place the full cost of mishaps on injured parties who, but for government involvement, would be able to shift that cost to the contractors.") (citations omitted).

[125] "The most important objective . . . is the assurance of prompt and adequate compensation of the public." A. J. ROSENTHAL ET AL., CATASTROPHIC ACCIDENTS IN GOVERNMENT PROGRAMS 12, 72–76 (1963).

[126] *Hearing*, *supra* note 72, at 9 (statement of Sen. Barbara Boxer).

"[n]ow, more than ever, our government's role should be to ensure that citizens are protected from faulty cleanup efforts."[127] Instead of pursuing either of these goals, the GCRA legislation would create a regime in which (1) the parties harmed by the negligence of contractors would bear risks that they could not effectively reduce and (2) neither the government nor its contractors would bear responsibility for harm inflicted through accidents that could have been insured against or averted with reasonable precautionary efforts. Again, these line-drawing questions regarding contractor liability are not new.[128] But the solution offered by the GCRA—that negligently injured parties, rather than the government or its contractors, should bear the risk of loss inherent in ordinary disaster relief work—is as novel as it is unappealing.[129]

C. Absence of Empirical Necessity

The GCRA's drafters asserted that "well-founded fears of future litigation and liability under existing law discourage contractors from assisting in times of disaster."[130] Such fears apparently derived from the volume and size of post–September 11 litigation filed against contractors.[131] That anxiety has been fueled by the contracting community, particularly

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[127] *Id.* at 6 (statement of Sen. James Jeffords).

[128] The Department of Justice (DOJ) objected to a 1985 bill that would have reduced the liability of contractors, because it did not "believe that government indemnification of contractor losses is the appropriate way to solve the problems faced by government contractors because of changing tort liability." *Indemnification of Government Contractors: Hearing on S. 1254 Before the S. Comm. on the Judiciary*, 99th Cong. 21 (1985) (statement of Richard K. Willard, Acting Assistant Attorney General, Civil Division, Department of Justice). Indeed, "[i]n the . . . few years [before 1985], the efforts of government contractors to transfer their product liability exposure to the government [had] increased dramatically." *Id.* at 22. Although DOJ acknowledged "that the changes in the tort system have created problems for contractors, [it did] not believe that indemnification [was] an appropriate response, and certainly it [would not have corrected] the underlying reasons for these problems." *Id.* at 25.

[129] While some QUATT certifications no doubt shift risk to negligently injured individuals, the underlying policy is that the social good enjoyed by the public derived from individual QUATTs employed in combating terrorism outweighs the risks borne by potential victims. This is analogous to the nuclear industry, which might prove unsustainable without protection from potential liability. *See infra* text accompanying notes 173–174. But, as discussed *infra* Part III.C, no empirical evidence suggests any such market failure in, for example, debris removal.

[130] S. 1761, 109th Cong. § 2(10) (2005).

[131] Senator John Thune (R-S.D.), who introduced S. 1761, explained:

> [B]ecause of the ongoing multi-billion dollar class action cases filed against the contractors who assisted the Government in the cleanup of the World Trade Center, I have concerns that other major disaster cleanups, including Hurricane Katrina, may be stymied due to the potential for future lawsuits being brought against contractors who carry out major disaster cleanups on behalf of the Government.

Hearing, *supra* note 72, at 3 (statement of Sen. John Thune); *see also id.* at 8 (statement of Sen. David Vitter).

by contractors that pursued post-Katrina government contracts without liability protection beyond that afforded by existing law.[132] From this public showing of anxiety, the GCRA's drafters concluded that contractors would not compete for government contracts in times of disaster without extraordinary liability protection, that disaster recovery efforts would consequently prove inadequate, and that the public would suffer. Senator John Thune (R.-S.D.) emphasized that the government would be unable to adequately respond to major disasters without contractor assistance.[133] The authors readily concede this point. The relevant issue is whether contractors can, or will, function without the liability protection afforded by the GCRA.

Experience suggests, however, that the GCRA drafters' premise is hyperbolic or simply incorrect.[134] No evidence suggests that a significant number of the nation's (or the world's) best contractors have been discouraged from seeking the United States Government's business in the past. The absence of empirical data or concrete information supporting this assertion by the GCRA's proponents is stark, but in light of history, it is not surprising.[135]

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[132] *See, e.g., id.* at 38 (statement of Warren Perkins) ("I can assure you that responsible contractors throughout the Country are paying close attention. . . . They are aware of the litigation that followed [the September 11 attacks]. . . . [T]hey are deeply concerned."); *id.* at 25 (statement of Anthony Zelenka) ("Take a look at what happened [to contractors] in New York after the terrorists on 9/11. . . . I believe passing the [GCRA] is necessary to ensure that contractors like me will be there to do the work in the future without fear of reprisals.").

[133] *See id.* at 12 (statement of Sen. John Thune).

[134] At the hearing, Dr. Beverly Wright called this premise a "complete fabrication," citing local contractors' dissatisfaction with their lack of opportunity to compete for no-bid contracts for post-Katrina work. Dr. Wright discussed how local contractors were ready and willing to accept the work and the corresponding liability. *See Hearing*, *supra* note 72, at 32–33 (statement of Dr. Beverly Wright).

[135] At similar hearings twenty years ago, Senator Charles Grassley (R-Iowa) asked the Aerospace Industries Association (AIA) whether *any* members of its association "no longer bid on government contracts because of the fear of liability suits." *Indemnification of Government Contractors: Hearing on S. 1254 Before the S. Comm. on the Judiciary*, 99th Cong. 88–89 (1985). AIA asserted that it lacked sufficient information to respond at the hearing and, in a subsequent written response, was no more convincing. Even responding "on a non-attribution basis," AIA failed to identify a single firm, and instead merely asserted that "[t]he consequences of unusually hazardous or nuclear risks arising under government contract . . . influence the business decision process." *Id.* at 96 (Letter from Lloyd R. Kuhn, Vice President of Legislative Affairs, AIA to Sen. Charles E. Grassley, Member, Senate Comm. on the Judiciary (June 28, 1985)). Similarly, one year earlier, when Representative Sam Hall (D-Tex.) requested an estimate of the number of contractors who had restricted their bidding for government contracts due to liability concerns, the National Association of Manufacturers was unable to give him "reliable data," stating merely that "we do feel that there are clearly contractors who will not bid for certain types of contracts, and that there are certain types of contractors who will not seek this type of business." *Government Contractors' Product Liability and Indemnification Acts: Hearing on H.R. 4083 and H.R. 4199 Before the Subcomm. on Administrative Law and Governmental Relations of the H. Comm. on the Judiciary*, 98th Cong. 39 (1984) (statement of T. Richard Brown, Vice President, Law Department, Electronics and Defense Sector of TRW Inc., on behalf of the National Association of Manufacturers). When Representative Hall revisited the issue with John M. Geaghan of Raytheon Company, Mr. Geaghan admitted

While they have thus far failed to put forth empirical proof, GCRA proponents have invoked the familiar critiques of opportunistic trial lawyers,[136] emboldened by a popular anecdote involving a failed suit.[137] This storyline has been enriched by rhetorical flourishes regarding the putative dichotomy between patriots and trial attorneys.[138] The GCRA's supporters thus focus on the costs imposed by future lawsuits and class actions while neglecting to identify any ex ante disincentives created by those costs. This mere fact that government contractors experience an ex post aversion to lawsuits is an insufficient policy predicate for legislation extending them liability protection.[139] Although empirical evidence *could* someday validate the GCRA proponents' argument,[140] the threat of liability has yet to result in a dearth of available contractors.[141]

Despite the post-disaster hysteria, the current procurement regime contains sufficient flexibility for the government to meet its contracting requirements in times of crisis.[142] In awarding post-Katrina recovery contracts, the Army Corps of Engineers has relied on several FAR procedures

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that he knew of no instance when the company refused to pursue a government contract due to liability concerns. *Id.* at 161.

[136] *See Hearing*, *supra* note 72, at 25 (statement of Anthony Zelenka) ("[T]here are people out there who want to capitalize on this tragedy and others like it. Lawsuits have been filed against contractors who have performed the types of rescue and recovery work my firm has been doing in New Orleans."). Of course, the GCRA's advocates deny any animosity toward the plaintiff's bar. *See id.* at 38 (statement of Warren Perkins) ("I am not here to bash plaintiff attorneys.").

[137] Government contractors have identified a lawsuit filed against Boh Brothers Construction Company as a sign that "[t]he madness has already started in Louisiana." *See id.* at 26 (statement of Anthony Zelenka). The lawsuit accused Boh Brothers of performing faulty bridge repair work which was apparently performed by an entirely different contractor, and the suit was dismissed, of course. *See id.* at 26 (statement of Anthony Zelenka); *id.* at 33 (statement of Warren Perkins).

[138] One contractor beseeched the Senate "not [to] let the trial lawyers penalize the contractors like me who report for duty." *Id.* at 27 (statement of Anthony Zelenka).

[139] *See supra* notes 128, 131 (discussing Congress's rejection of proposed bills to reduce contractor liability in the 1980s); *see also supra* note 129 (contrasting the mere desire to avoid ex post liability with the social necessity of averting real market failures in the provision of essential or crucial technologies or services).

[140] *See infra* Part IV.A.

[141] *See infra* notes 134–135 and accompanying text.

[142] *See* Stan Soloway, *Baghdad's Lessons for New Orleans*, GOV. EXEC., Oct. 1, 2005, at 44–45, *available at* http://www.govexec.com/features/1005-01/1005-01advp2.htm ("[M]any of the flexibilities contained in the [FAR] . . . are poorly understood . . . includ[ing] limited as opposed to full and open competition, higher levels under which purchases can be made instantly, and more. . . . [T]hese flexibilities enable[ ] us to meet the demands for speed and agility integral to any recovery effort."); J. Catherine Kunzsee, *Pre-Disaster Contracting: The Use of Indefinite-Delivery/Indefinite-Quantity Contracts*, ANDREWS GOV'T CONT. LITIG. REP., Feb. 27, 2006, at 13 (discussing the importance of indefinite-delivery/indefinite-quantity contracts in responding to national disasters); *see also* OFFICE OF FED. PROCUREMENT POLICY, EMERGENCY PROCUREMENT FLEXIBILITIES: A FRAMEWORK FOR RESPONSIVE CONTRACTING & GUIDELINES FOR USING SIMPLIFIED ACQUISITION PROCEDURES (2003), *available at* http://www.whitehouse.gov/omb/procurement/emergency_procurement_flexibilities.pdf.

that have allowed for increased flexibility in responding to the disaster.[143] Shortly after Hurricane Katrina, the Corps advertised four contracts for large debris removal: twenty-two contractors—eighteen more than the number required—responded.[144] Although the response rates for other contracts were not as high, General Riley could not name a single contract that exhibited insufficient contractor interest.[145]

IV. FIRST, DO NO HARM

Nonetheless, in performing government contracts, certain contractors may indeed require protection. It is not surprising that Congress has sought to fashion a remedy to this limited problem. The challenge, however, is for Congress to adopt an appropriate solution, rather than an approach that has the potential to harm disaster area residents and relief workers without fixing the putative problem.

A. Protection Without Moral Hazard

This Article does not dispute the premise that certain contractors, involved in certain types of disaster relief, may find themselves unable to obtain adequate insurance to cover their potential liability. Insurance is based on assessing, quantifying, mitigating, and transferring risks.[146] In emergencies, however, a lack of certainty about site conditions and contracting requirements turns the consideration of such elements into an exercise in futility.[147] If insurers are unable to quantify contractors' risks,

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[143] *See Hearing*, *supra* note 72, at 17 (statement of Major General Don T. Riley, U.S. Army Corps of Engineers). For example, contracts were awarded under shortened time periods under the unusual and compelling urgency exception to the CICA, 10 U.S.C. § 2304(c)(2) (2000); 41 U.S.C. § 253(c)(2) (2000), and on the basis of verbal and letter contracts as authorized by the FAR, 48 C.F.R. § 6.302-2 (2005). *See Hearing*, *supra* note 72, at 17.

[144] *Hearing*, *supra* note 72, at 40 (statement of Major General Don T. Riley).

[145] While General Riley testified that during the few weeks before November 2004, several contracts attracted only between one and five bidders, he did not identify any contracts that failed to attract a single bid. *See id.* (statement of Major General Don T. Riley). General Riley also acknowledged that there may be other reasons, unrelated to liability concerns, to explain the low level of interest in these particular contracts. *See id.* While there may be some indications that the level of competitive bidding for Katrina relief contracts is occasionally less than optimal, there is no evidence of a total incapacity to attract bids and no reason to believe that fear of liability is the primary cause of any deficiencies in contractor interest. *See infra* text accompanying notes 130–135.

[146] *See Hearing*, *supra* note 72, at 86 (statement of Paul Becker, President, Willis Construction Practice); ROBERT E. KEETON, INSURANCE LAW: BASIC TEXT § 1.2 (1971) ("Insurance is an arrangement for transferring and distributing risk."); *see also* KENNETH S. ABRAHAM, DISTRIBUTING RISK: INSURANCE, LEGAL THEORY, AND PUBLIC POLICY 64–66 (1986) (discussing the importance of accurate assessment and classification of risks).

[147] *See* KEETON, *supra* note 146 ("As one understands a greater percentage of the relevant facts, the element of guessing in his description of risk is reduced, and his prediction is more reliable."). Insurance companies have expressed concerns about underwriting contractors working in disaster zones for several reasons: uncertain site conditions; unusual

they may not be willing to provide sufficient coverage for those risks.[148] The contractors working at Ground Zero apparently faced this situation.[149]

Moreover, contractors employed in emergency circumstances face a legitimate threat of litigation. The inherently uncertain and unstable nature of disaster zones naturally leads to significant property loss, physical injury, or death.[150] Regardless of whether contractor fault causes these injuries, lawsuits are likely to be filed against them.[151] Even unwarranted or frivolous lawsuits can be devastating without adequate insurance. These risks loom large for construction and debris contractors, which tend to be particularly small firms with thin profit margins. Once more, the September 11 experience is instructive. Some five thousand claims are currently pending against contractors who assisted with disaster recovery at the World Trade Center site.[152] Even for those contractors facing meritless suits or those that can overcome a negligence standard, litigation defense absorbs significant resources that can threaten firms' survival.[153]

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and unknown health hazards; questions regarding chemicals released during clean-up; the limited nature of tools available to assess environmental factors; varying local, state, and federal standards; the fast track nature of the work to be done; and unclear contractual provisions. *See id.* at 86–87 (statement of Paul Becker).

[148] "[I]f insurance companies do not or can not [sic] understand the risks they are being asked to insure, they have a very difficult time providing the risk financing which allows companies to operate." *Id.* (written statement of Paul Becker).

[149] The Executive Vice President of Bovis, a contractor involved in the post–September 11 clean-up, testified that "given the dangerous conditions, the retroactive nature and the unknown aspects of [the post-September 11] unprecedented effort, commercial insurance companies would not provide the coverage needed and ultimately only limited liability coverage was obtained." *Hearing*, *supra* note 72, at 51 (statement of Michael Feigin, Executive Vice President, Chief Administrative Officer, Bovis Lend Lease Holdings, Inc.). The President of Willis, a global insurance broker, testified that his company was only able to secure limited insurance coverage for contractors working at Ground Zero. *Id.* at 85 (statement of Paul Becker); *see also* Steven Greenhouse, *Contractors at Ground Zero Denied Insurance for Cleanup*, N.Y. TIMES, Jan. 18, 2002, at B1.

[150] *See* SIERRA CLUB, POLLUTION AND DECEPTION AT GROUND ZERO REVISITED: WHY IT COULD HAPPEN AGAIN 14 (2005), *available at* http://www.sierraclub.org/groundzero/report2005.pdf ("Any emergency involving the destruction of a large building is likely to cause a release of hazardous substances."). The New Orleans area stored massive amounts of toxic chemicals. *See Hearing*, *supra* note 72 (written statement of Dr. Beverly Wright) ("Dozens of toxic time bombs along Louisiana's Mississippi River petrochemical corridor, the 85-mile stretch from Baton Rouge to New Orleans, make the region a major environmental justice battleground. The corridor is commonly referred to as Cancer Alley.").

[151] Some injured parties sue the contractors simply because they "are the only [people] in there that can be sued." *Id.* at 56 (statement of Anthony Zelenka); *see also supra* notes 56, 62 (describing the scope of the government's sovereign immunity under the FTCA). *But see supra* note 89 (arguing that the government's sovereign immunity may be limited when it abdicates its discretionary function).

[152] *Id.* at 48 (statement of Michael Feigin); *see also id.* at 8 (statement of Sen. David Vitter) ("We know from true, recent experience after 9/11 that there could well be a flurry of class action lawsuits to try to profit from the emergency measures that needed to be taken [after Hurricane Katrina] . . . ."); *id.* at 25–26 (statement of Anthony Zelenka) ("Hundreds of lawsuits were filed against contractors for the heroic work they did to clean up Ground Zero in a short amount of time at the express direction of the Federal, State, and local authorities.").

[153] *Id.* at 48 (statement of Michael Feigin) ("[T]he problem isn't that we don't believe

Thus, contractors' desire for financial protection when working in disaster zones under emergency circumstances is understandable. But that desire can be fulfilled in ways other than the dilution of tort law. Broadly eliminating contractor tort liability is patently unfair to parties sustaining property loss or bodily injury as a result of negligent actions. Individuals living and working in disaster zones have suffered, and will continue to suffer, both financially and physically because of contractor irresponsibility and negligence. The continuing negative health effects suffered by Ground Zero workers and lower Manhattan residents are widely recognized,[154] and a "Katrina cough" appears frequently in the New Orleans

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that we can sustain a standard of negligence. We believe that we've done nothing wrong. . . . But the legal fees alone could put a company like ours . . . out of business."). In response to pressure from the contracting community, Congress eventually appropriated $1 billion to fund an insurance program covering injuries to workers incurred during clean-up of the World Trade Center site. *See* Consolidated Appropriations Resolution, 2003, Pub. L. No. 108-7, div. K, tit. III, 117 Stat. 11, 517–18 (2003); Jeffrey H. Birnbaum, *Clients' Rewards Keep K Street Lobbyists Thriving*, WASH. POST, Feb. 14, 2006, at A1 ("The [General Contractors Association of New York] paid Carmen [Group Inc.] $500,000 to persuade the federal government to cover its members' insurance premiums for cleanup work at Ground Zero after the terrorist attacks of Sept. 11, 2001. After three years of lobbying, the government agreed . . . ."). The government also appropriated separate funds to ease the burden September 11–based claims would have on New York's workers' compensation system. Pub. L. No. 107-117, div. B, ch. 8, 115 Stat. 2230, 2312–13 (2002). *See generally* GOV'T ACCOUNTABILITY OFFICE, GAO-04-1013T, SEPTEMBER 11: FEDERAL ASSISTANCE FOR NEW YORK WORKERS' COMPENSATION COSTS (2004), *available at* http://www.gao.gov/new.items/d041013t.pdf.

[154] Joel Shufro, executive director of the New York Committee for Occupational Safety and Health, testified about these health problems at the Hearing:

> Unfortunately, four years following the devastating attacks on the World Trade Center, respiratory illness, psychological distress and financial devastation have become a new way of life for many of the responders . . . . Many of the workers are disabled by chronic pulmonary problems. Some are unable to work. Many have also suffered substantial economic disruption . . . and do not have health insurance and are unable to pay for treatment or needed medicine. . . . [T]here are grave concerns about the potential for workers developing slower starting diseases, such as cancer, in the future.

Hearing, *supra* note 72, at 54; *see also* GAO, WTC HEALTH EFFECTS, *supra* note 1, at 7–15; *MMWR Report*, *supra* note 6, at 808 (finding that of those Ground Zero workers who participated in a Centers for Disease Control and Prevention study, 60% suffered from lower respiratory symptoms and 74% suffered from upper respiratory symptoms); Greg Sargent, *Zero for Heroes*, NEW YORK MAG., Oct. 27, 2003, at 28, *available at* http://www.newyorkmetro.com/nymetro/news/politics/columns/citypolitic/n_9384/ (discussing a severe pulmonary disease, and consequent financial stresses, suffered by a contractor employee). Some of these health problems may have directly resulted from contractor negligence. For example, according to a Centers for Disease Control and Prevention study, on the three days following September 11, when exposure was greatest, only 21% of the participants reported using respiratory protection. *MMWR Report*, *supra* note 6, at 808. On any given day after that, nearly 50% of the workers were not wearing respiratory protection, something Mr. Shufro attributed to "a management problem." *Hearing*, *supra* note 72, at 66 (statement of Dr. Joel Shufro). Although some workers had protection and decided not to wear it, "Ground Zero workers—lacking proper training and accurate official safety information—had little incentive to wear the 'uncomfortable and unmanageable' respiratory gear." Michelle Chen, *Ground Zero: The Most Dangerous Workplace*, NEWSTANDARD, Jan.

area.[155] Nothing suggests that the injured and suffering individuals should, as a matter of course, be denied compensation. As Senator Hillary Clinton (D-N.Y.) explained, the solution provided by the GCRA "ignores and misapplies the lessons of September 11th."[156]

B. Superior Alternatives

Experience offers superior alternatives to the GCRA that do not sacrifice the interests of negligently injured parties or contractor personnel. The alternatives discussed below represent examples of the government's prior efforts to solve insurance marketplace failures without denying a recovery to negligently injured individuals.

1. Remedy-Granting Clauses

Ordinarily, parties to government contracts use standardized remedy-granting clauses[157] to allocate the risk of anticipated and unforeseen contingencies[158] between the parties. The implicit premise of these clauses is

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24, 2005, http://newstandardnews.net/content/index.cfm/items/1402. Furthermore, some workers received no more than a paper mask. *Id.*; *Hearing*, *supra* note 72, at 60 (statement of Dr. Joel Shufro).

[155] *See* Scott Gold & Ann M. Simmons, *"Katrina Cough" Floats Around*, L.A. TIMES, Nov. 4, 2005, at A10.

[156] *Hearing*, *supra* note 72, at 14 (statement of Sen. Hillary Clinton); *see also* Press Release, Office of Commc'ns, New York City Dep't of Health and Mental Hygiene, Most WTC Health Registry Enrollees Reported New or Worsened Respiratory Symptoms After 9/11/01 (Nov. 22, 2004), *available at* http://www.nyc.gov/html/doh/html/press_archive04/pr151-1122.shtml.

[157] *See, e.g.*, Differing Site Conditions Clause, 48 C.F.R. § 52.236-1 (2005) (anticipating subsurface or latent physical conditions that differ from the contract or unknown and unusual site conditions); Changes Clause, 48 C.F.R. § 52.243-1 (2005) (anticipating of potential changes within the scope of the contract); Government Furnished Property Clause, 48 C.F.R. § 52.245-2(a)(3)–(4) (2005) (anticipating potentially defective, or late delivery of, government-furnished property); Termination for Convenience Clause, 48 C.F.R. § 52.249-2 (2005) (anticipating the government's need to end contracts for a host of noncontractual reasons). All of these clauses include a similar remedy for the occurrence of unanticipated contingencies: reimbursement of all allowable costs, plus an allowance for profit. *See* Joshua I. Schwartz, *Liability for Sovereign Acts: Congruence and Exceptionalism in Government Contracts Law*, 64 GEO. WASH. L. REV. 633, 695–97 (1996) (discussing the use of standardized clauses to anticipate unforeseeable contingencies in government contracts).

[158] The FAR define a contingency as "a possible future event or condition arising from presently known or unknown causes, the outcome of which is indeterminable at the present time." 48 C.F.R. § 31.205-7(a) (2005).

> [Contingencies] that may arise from presently known or unknown conditions, the effect of which cannot be measured so precisely as to provide equitable results to the contractor and to the Government . . . are to be excluded from cost estimates, but should be disclosed separately . . . to facilitate the negotiation of appropriate contractual coverage.

Id. § 31.205-7(c)(2); *see also* Foster Constr. C.A. v. United States, 435 F.2d 873, 887 (Ct. Cl. 1970) (noting the "long-standing, deliberately adopted procurement policy" that bid-

that they (1) dissuade contractors from padding their bids, offers, or proposals when competing for government business, and (2) reassure those contractors that the government will equitably adjust contracts to reimburse for unforeseen contingencies.[159] This "contingency promise" essentially provides that in exchange for the contractor's willingness not to inflate its contract price to insulate itself against certain potential, although unknown, liabilities, the government agrees to make the contractor whole when such liabilities are incurred.[160]

During the performance of government contracts, if an unanticipated contingency arises that requires the contractor to incur additional costs, the parties have a number of options.[161] The contracting officer[162] and the contractor can agree upon compensation and bilaterally modify their contract.[163] Alternatively, the contracting officer can unilaterally determine the additional compensation to be paid.[164] If the contractor is dissatisfied with the amount of compensation, it can file a claim, which commences the disputes process.[165] This orchestrated response to unforeseen liability in government contracts is a far cry from the GCRA's insulation of contractors from liability. Rather than providing the contractor and the government with several alternative methods by which they may allocate between themselves the costs arising from an unanticipated liability, the GCRA simply imposes these costs upon the negligently injured individual.[166]

Generally, the government considers contractor insurance a cost of doing business. Indeed for some contracts, the government requires contractors to maintain a certain amount of insurance and permits reimbursement of the contractors' insurance costs.[167] Further, the government may

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ders "need not consider how large a contingency should be added to the bid to cover the risk"); Richard J. Kendall, *Changed Conditions as Misrepresentations in Government Construction Contracts*, 35 GEO. WASH. L. REV. 978, 979–82 (1967).

[159] Contingency planning strikes at the core of federal procurement policy. *See* Ralph C. Nash, Jr., *Risk Allocation in Government Contracts*, 34 GEO. WASH. L. REV. 693, 698–700 (1966) (["T]erms and conditions . . . are an attempt . . . to define the remedies of the parties for most foreseeable contingencies that may occur . . . . [T]hese standard terms and conditions represent a relatively thorough statement of intended risk allocation.").

[160] *See* Schooner, *Fear of Oversight*, *supra* note 87, at 695–96.

[161] In addition to these options, the contractor may choose to absorb the additional costs and continue performance. For example, the contractor may forego making a claim if its assessment of the 1990s reforms—such as the evaluation of past performance—persuades it that the opportunity cost of pursuing the claim outweighs the value of the claim against the government. *See* Schooner, *supra* note 94, at 697–98.

[162] A contracting officer is a government employee with actual, legal authority to bind the government in contract. *See* 48 C.F.R. § 1.602-1 (2005) (providing that contracting officers have authority to enter into, administer, or terminate contracts and make related determinations and findings); *see also* RALPH C. NASH, JR., STEVEN L. SCHOONER & KAREN R. O'BRIAN, THE GOVERNMENT CONTRACTS REFERENCE BOOK: A COMPREHENSIVE GUIDE TO THE LANGUAGE OF PROCUREMENT 127 (2d ed. 1998).

[163] 48 C.F.R. § 43.103(a).

[164] *Id.* §§ 43.103(b), .201.

[165] *Id.* §§ 33.206, 52.233-1; *see also* 41 U.S.C. §§ 601–613 (2000).

[166] *See supra* text accompanying notes 113–120.

[167] 48 C.F.R. § 52.228-7(a), (c)(1) (2005); *see also id.* §§ 28.301, 31.205-19 (2005)

indemnify a contractor for certain liabilities to third parties (and expenses incidental to such liabilities) above and beyond those covered by insurance when the liabilities arise out of the performance of the contract.[168] The former mechanism allocates the responsibility of procuring adequate insurance to the contractor, after which the government reimburses the contractor for the costs of obtaining such protection against risk; the latter directly gives contractors an extra layer of insurance.

The FAR's third-party liability provisions could serve as a model for government indemnification of contractors engaged in disaster relief.[169] They would, however, need to be modified in at least two respects. First, construction and engineering contracts, both of which are prevalent in disaster recovery efforts, currently are exempted from agreements of this nature.[170] Second, and more problematic, liability protection is subject to the availability of appropriated funds at the time the contingency occurs.[171] As discussed below, however, once insurance becomes either unattainable or so expensive that the government is no longer willing to pay for it, the government should be willing to indemnify its contractors.

2. *Extraordinary Protection for Extraordinary Risks*

With few exceptions,[172] when commercial insurance becomes unavailable or inordinately expensive, the government historically has indemnified contractors and, in effect, become a direct insurer of its contractors.[173] Under Public Law 85-804, the President may delegate authority to various agencies

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(providing a policy prescription and cost principles regarding insurance of government contractors).

[168] *Id.* § 52.228-7(c)(2). The government limits its assumption of liability to claims based on death, bodily injury, or property damage arising out of performance of the contract. *Id.* It disallows indemnification for liabilities that, under the terms of the contract, were the responsibility of the contractor or that were attributable to the contractor's "willful misconduct or lack of good faith." *Id.* § 52.228-7(e).

[169] *See* 48 C.F.R. § 52.228-7(a), (c). Under the indemnification provision, contractors are only reimbursed for "final judgments or settlements approved in writing by the Government." *Id.* § 52.228-7(c)(2). Therefore, contractors do not necessarily avoid the up-front costs associated with litigation through this type of contractual agreement. *See Hearing*, *supra* note 72, at 76 (statement of Craig S. King). Note, however, that when a contractor is facing a third-party suit that may be reimbursable under the FAR, the government is given the option to "settle or defend the claim and to represent the Contractor in or to take charge of any litigation." 48 C.F.R. § 52.228-7(g)(3) (2005). In the event that the government chooses to exercise this right, the contractor is able to avoid litigation expenses.

[170] 48 C.F.R. § 28.311-1 (2005).

[171] 48 C.F.R. § 52.228-7(d). In the context of disaster recovery, the potential liability is significant. Thus, it is unlikely that the government would have appropriated sufficient funds, thereby leaving contractors with a large amount of residual liability. *See* Richard A. Smith, *Indemnification of Government Contractors*, BRIEFING PAPERS, Oct. 1982, at 1 (discussing the application of the Antideficiency Act, Pub. L. No. 97-258, 96 Stat. 877 (1982) (codified as amended in scattered sections of 31 U.S.C.)).

[172] *See supra* Part III.A.3 (discussing the SAFETY Act and the PREP Act).

[173] *See, e.g.*, H.R. REP. No. 2232 (2d Sess. 1958) (indicating Congress's intent to authorize the use of indemnification where commercial insurance was unavailable).

to provide extraordinary relief for contracts in connection with the national defense.[174] This relief includes indemnification in those extraordinary circumstances when contracts involve "unusually hazardous or nuclear risks" for which commercial insurance is unavailable or insufficient.[175] Granted, this statutory vehicle is a tool of last resort, reserved for truly extraordinary circumstances when the private sector market fails.[176] Also, like the FAR third-party liability clauses, Public Law 85-804 neither avoids the government's current fiscal crisis[177] nor allows contractors to escape the litigation process. Litigation expenses, however, are reimbursable.[178] Furthermore, indemnification under this statute is not constrained by congressional appropriations.[179] Given the potential magnitude of third-party claims arising out of disaster recovery work, this would prove especially helpful to contractors engaged in post-Katrina clean-up.[180]

Although Public Law 85-804 currently applies only to national security situations, Congress easily could expand it to cover other circumstances

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[174] Pub. L. No. 85-804, 72 Stat. 972 (1958) (codified at 50 U.S.C. §§ 1431–1435 (2000)). *See generally* Kevin P. Mullen, *Extraordinary Contractual Relief: Public Law 85-804 in the Homeland Security Era*, PROCUREMENT LAW., Summer 2002, at 1 (providing a comprehensive overview of the history and substance of Public Law 85-804). Other examples of statutory indemnification authority also exist. *See* 10 U.S.C. § 2354 (2000) (allowing the military to indemnify research and development contractors for "unusually hazardous risks"); 42 U.S.C. § 241(a)(7) (2000) (allowing the Department of Health and Human Services to indemnify contractors under the same terms as the military as outlined in 10 U.S.C. § 2354); 42 U.S.C. § 2458(b) (2000) (allowing the National Aeronautics and Space Administration to indemnify users of space vehicles).

[175] 48 C.F.R. § 50.403-1 (2005); *see also id.* § 52.250-1 (providing a clause to be inserted in contracts that have been approved for indemnification). Like the FAR third-party liability provisions, the government's liability under Public Law 85-804 does not extend to claims that arise from contractors' willful misconduct or lack of good faith. *Compare* 48 C.F.R. § 52.250-1(d) *with id.* § 52.228-7(e). Thus far, thirteen major agencies have been granted indemnification authority: the Atomic Energy Commission; Department of Agriculture; Department of Commerce; Department of Defense; Department of Health and Human Services; Department of the Interior; Department of Transportation; Department of the Treasury; Federal Emergency Management Agency; General Services Administration; National Aeronautics and Space Administration; Tennessee Valley Authority; and Government Printing Office. Exec. Order No. 10,789, 23 Fed. Reg. 8897 § 21 (Nov. 14, 1958), *as amended by* Exec. Order No. 11,051, 27 Fed. Reg. 9683 (Sept. 27, 1962); Exec. Order No. 11,382, 32 Fed. Reg. 16,247 (Nov. 28, 1967); Exec. Order No. 11,610, 36 Fed. Reg. 13,755 (July 22, 1971); Exec. Order No. 12,148, 44 Fed. Reg. 43,239 (July 20, 1979); Exec. Order No. 13,232, 66 Fed. Reg. 53,941 (Oct. 20, 2001).

[176] The FAR directs agencies not to use their authority under Public Law 85-804 "when other adequate legal authority exists." 48 C.F.R. § 50.102(a). The FAR also warns agencies to avoid granting indemnification "in a manner that encourages carelessness and laxity on the part of persons engaged in the defense effort." *Id.*

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

[178] 48 C.F.R. § 52.250-1(b) ("[T]he Government shall . . . indemnify the Contractor against . . . [c]laims (including reasonable expenses of litigation or settlement) by third persons (including employees of the Contractor) for death; personal injury; or loss of, damage to, or loss of use of property.").

[179] Exec. Order No. 11,610, 36 Fed. Reg. 13,755 (July 22, 1971); *cf.* 48 C.F.R. § 52.228-7(d) (subjecting the FAR third party liability provisions to the availability of appropriated funds at the time a contingency occurs).

[180] *See supra* note 171 and accompanying text.

where contractors might not be able to obtain sufficient insurance, such as disaster relief. Indemnification is preferable to the GCRA not only because it protects contractors from potentially devastating liabilities, but also because it helps negligently injured individuals receive compensation.[181] Contractors "should not be penalized for showing up," nor should negligently injured individuals be left without a remedy. The Public Law 85-804 model would satisfy both of these admirable goals.

3. Funds

Another indemnification model is the $1 billion liability insurance fund created by Congress to protect contractors and the State and City of New York against claims related to debris removal after the terrorist attacks of September 11, 2001.[182] Contractors that began work at Ground Zero immediately after the terrorist attacks subsequently failed to obtain sufficient liability insurance due to the uncertain nature of the risks and the potentially large number of liability claims.[183] Therefore, the Federal Emergency Management Agency (FEMA) used congressionally appropriated funds to facilitate the creation of an insurance company by the State of New York to provide $1 billion in third-party liability coverage for a period of twenty-five years.[184] The City of New York is the named insured on the fund, with approximately 140 of the city's contractors and subcontractors as additional named insureds.[185] The captive insurance program is

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[181] *See* ROSENTHAL, *supra* note 125, at 97–108 (discussing the benefits and shortcomings of government indemnification of contractors for catastrophic accidents).

[182] Consolidated Appropriations Resolution, 2003, div. K, tit. III, 117 Stat 11, 517–18 (2003) ("[FEMA] is directed to provide . . . up to $1,000,000,000 to establish a captive insurance company or other appropriate insurance mechanism for claims arising from debris removal . . . ."); *see also* U.S. GEN. SERVS. ADMIN., CATALOG OF FEDERAL DOMESTIC ASSISTANCE 1749–50 (2005), *available at* http://12.46.245.173/CFDA/pdf/catalog.pdf (detailing the history, objectives, and application process for the creation of the captive insurance company); Act of July 22, 2003, 2003 N.Y. Sess. Laws 839–41 (McKinney) (codified at N.Y. INS. LAW §§ 7001–7012 (McKinney 2003)) (authorizing formation of a captive insurance company for liability arising out of disaster relief at the World Trade Center after September 11).

[183] *See* U.S. GEN. ACCOUNTING OFFICE, GAO-03-926, DISASTER ASSISTANCE: INFORMATION ON FEMA'S POST 9/11 PUBLIC ASSISTANCE TO THE NEW YORK CITY AREA 16 (2003) [hereinafter GAO, FEMA's 9/11 ASSISTANCE]; U.S. GEN. ACCOUNTING OFFICE, GAO-04-72, SEPTEMBER 11: OVERVIEW OF FEDERAL DISASTER ASSISTANCE TO THE NEW YORK CITY AREA 26 (2004) [hereinafter GAO, 9/11 FEDERAL ASSISTANCE]; Steven Greenhouse, *Contractors at Ground Zero Denied Insurance for Cleanup*, N.Y. TIMES, Jan. 18, 2002, at B1.

[184] GAO, FEMA's 9/11 ASSISTANCE, *supra* note 183, at 15–16; GAO, 9/11 FEDERAL ASSISTANCE, *supra* note 183, at 26–27. Although FEMA initially indicated that the insurance fund would be limited to claims for injuries occurring after September 29, 2001, when the rescue work officially ended, it subsequently backed off from that position. Jennifer Steinhauer, *City May Bear $350 Million in 9/11 Claims*, N.Y. TIMES, Apr. 9, 2004, at B1; Mike McIntire, *New York and FEMA End Dispute Over 9/11 Medical Claims*, N.Y. TIMES, Apr. 13, 2004, at B3.

[185] *Hearing*, *supra* note 72, at 48 (statement of Michael Feigin).

currently defending New York City and its contractors in several lawsuits arising from their debris removal efforts.[186] The indemnification provided by the fund is more forward-looking than that granted by Public Law 85-804. Although it was created subsequent to many of the covered injuries, plenty of injuries encompassed by the fund came to light after its creation and, indeed, are continuing to arise today.[187] Because the captive insurance fund has proven to be extremely useful to contractors facing liability from their involvement in clean-up after September 11,[188] it frequently is cited as an alternative to the GCRA.[189]

The fund was unprecedented[190] and is imperfect. A frequent complaint is that the pool is capped at $1 billion.[191] Injuries continue to mount, and, in all likelihood, will continue to be discovered for years to come.[192] The amount of litigation stemming from contractors' Ground Zero work continues to grow.[193] Thus, it is unclear whether $1 billion will be sufficient to cover all third-party liability claims. The amount set aside for the fund, however, was arbitrary, and, should it prove insufficient, the government can increase its size.

Any program modeled on the September 11 insurance fund should, to the extent possible, address the shortcomings with its establishment and administration.[194] Nonetheless, the fund is preferable to the GCRA because

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[186] *See id.* at 51 (statement of Michael Feigin); Complaint, DiVirgilio v. Silverstein Properties, 04-CV-07239 (S.D.N.Y. Sept. 10, 2004) (initiating a class action lawsuit on behalf of approximately 800 people involved in the clean-up and rescue efforts at Ground Zero against, *inter alia*, the four government contractors that led the clean-up: Turner Construction; AMEC Construction; Tully Construction; and Bovis Lend Lease).

[187] Concern about the potential long-term health effects of September 11 is widespread and has led to the creation of the World Trade Center Health Registry. *See* World Trade Center Health Registry, http://www.nyc.gov/html/doh/html/wtc/index.html (last visited Apr. 15, 2006); *see also* Kirk Johnson, *Inquiry Opens Into Effects of 9/11 Dust*, N.Y. TIMES, Sept. 6, 2003, at B1. Any future negative health effects could give rise to lawsuits against the city or its contractors that would be covered by the captive fund.

[188] *See Hearing*, *supra* note 72, at 51 (statement of Michel Feigin) ("But for the WTC Captive [fund] . . . expenses for lawyers and consultants would have exceeded any fees made in a matter of months. . . . In short, absent the captive [fund], responding to a disaster when called would have . . . put us out of business.").

[189] *See, e.g.*, *id.* at 16 (statement of Sen. Hillary Clinton (D-N.Y.)); *id.* at 69 (statement of Dr. Beverly Wright).

[190] *See* GAO, FEMA's 9/11 ASSISTANCE, *supra* note 183, at 30.

[191] *Hearing*, *supra* note 72, at 49 (statement of Michael Feigin).

[192] *See* Devlin Barrett, *Sept. 11-Related Cancers May Not Appear for Decades, Doctors Say*, BIOTERRORISM WK., Sept. 27, 2004, at 11.

[193] *See Hearing*, *supra* note 72, at 85 (statement of Paul Becker, President).

[194] For example, the PREP Act, unlike the GCRA or the SAFETY Act, provides for the establishment of a fund to compensate individuals negligently injured by covered countermeasures. *See* Pub. L. 109-148, div. C, 119 Stat. 2680, 2829–32 (2005) (to be codified at 42 U.S.C. § 247d-6e). This use of a fund suggests that Congress looked for guidance on how to manage risk from other prior endeavors besides the SAFETY Act, perhaps to one of the victim compensation funds. To date, however, Congress has appropriated no money for the fund, *see id.* § 257d-6e(a), leading some to question its effectiveness. *See* Press Release, Sen. Edward Kennedy, Sen. Tom Harkin & Sen. Christopher Dodd, Kennedy, Harkin and Dodd Protest Frist Liability Giveaway (Dec. 21, 2005), *available at* http://kennedy.senate.

it recognizes, to a certain extent, government responsibility for certain third-party injuries incurred during post-disaster clean-up,[195] extends liability protection to contractors assisting the government and ensures their survival,[196] and protects individuals negligently harmed by those contractors.

A different fund model can be found in the Vaccine Injury Compensation Program (VICP),[197] created by Congress in 1988 to stabilize the supply of vaccines and establish a streamlined compensation process for vaccine-related injuries.[198] Under the VICP, the government assumes liability for vaccine-related injuries and deaths through a no-fault alternative to the tort system.[199] VICP compensation is paid out of the Vaccine Injury Compensation Trust Fund, which is financed by a seventy-five cent tax on certain vaccines.[200]

Congress intended the VICP to provide compensation "quickly, easily, and with certainty and generosity."[201] Like the September 11 fund, how-

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gov/~kennedy/statements/05/12/2005C22413.html ("Without a real compensation program, the liability protection in the defense bill provides a Christmas present to the drug industry and a bag of coal to everyday Americans."). Nonetheless, in the PREP Act, Congress recognized the fundamental unfairness of denying injured individuals any compensation, while the GCRA contains no such acknowledgement.

[195] *See generally* SIERRA CLUB, *supra* note 150 (discussing the federal government's failure to adequately warn, protect, account for, and treat individuals living and working in lower Manhattan after September 11).

[196] Michael Feigin of Bovis Lend Lease claimed that the "current World Trade Center related litigation demonstrates the need for additional clarity, not only to protect contractors from liability, but also to eliminate or discourage the costly and time consuming process of the litigation itself." *Hearing*, *supra* note 72, at 52 (statement of Michael Feigin). Earlier, however, he had admitted that Bovis had received compensation for its work at Ground Zero and had fewer litigation expenses and potential liabilities due to the September 11 captive insurance program. *See id.* at 31. Thus, a program based on the September 11 fund would recognize and address the financial threats contractors face when they assist the government in disaster relief.

[197] 42 U.S.C. §§ 300aa-10 to -34 (2000). *See generally* DEP'T OF HEALTH AND HUMAN SERVS., HEALTH RES. AND SERVS. ADMIN., NATIONAL VACCINE INJURY COMPENSATION PROGRAM FACT SHEET (2004), http://www.hrsa.gov/vaccinecompensation/fact_sheet.htm [hereinafter VICP FACT SHEET].

[198] *See* VICP FACT SHEET, *supra* note 197; GEN. ACCOUNTING OFFICE, GAO/HEHS-00-8, VACCINE INJURY COMPENSATION: PROGRAM CHALLENGED TO SETTLE CLAIMS QUICKLY AND EASILY 4–5 (1999), *available at* http://www.gao.gov/new.items/he00008.pdf [hereinafter GAO, VACCINE INJURY COMPENSATION]. Prior to the creation of the VICP, the threat of litigation faced by vaccine manufacturers resulted in serious vaccine shortages which, in turn, decreased the rate of child immunization. *See Compensating Vaccine Injuries: Are Reforms Needed?: Hearing Before the H. Subcomm. on Criminal Justice, Drug Policy, and Human Resources of the H. Comm. on Gov't Reform*, 106th Cong. 106 (1999) (statement of Thomas E. Balbier, Jr., Director, National Vaccine Injury Program).

[199] The Secretary of Health and Human Services is the designated respondent in lawsuits filed under the VICP. VICP FACT SHEET, *supra* note 197. The vaccine manufacturer and administrator are not involved in the proceedings. 42 U.S.C. § 300aa-11(a)(3).

[200] 42 U.S.C. § 300aa-15(i)(2); 26 U.S.C. § 9510 (2000). The fund, however, is available to compensate for vaccine-related injuries that occurred both before and after its establishment. 42 U.S.C. § 300aa-15(i).

[201] H.R. REP. No. 99-908, pt. 1, at 3 (1986); *see also* GAO/HHES-00-8, *supra* note 198, at 5 ("VICP features designed to expedite the process include a relaxation of the rules of evidence, discovery, and other legal procedures that can prolong cases in the legal sys-

ever, the VICP has not pleased everyone.[202] Any indemnification regime based on previously established funds should, of course, incorporate the lessons learned from its predecessors. Although neither fund is perfect, both the September 11 captive insurance company and the VICP are more responsible and equitable approaches to the alleviation of crushing liabilities than the GCRA.

V. CONCLUSION: OF JUSTICE AND EFFICIENCY

As the World Trade Center attacks and Hurricane Katrina violently demonstrated, the government heavily relies upon the private sector's expertise, and its nearly limitless capacity, after national disasters to provide emergency services, restore order, and begin the reconstruction process. Contractors—drawn both by altruistic interests and profit motives—promptly answer the government's call. Experience suggests that, in their haste, neither the government nor its contractors obtain sufficient information to assess and avoid the risks associated with critical tasks, such as rescue operations and debris removal. To the extent that haste breeds an absence of, or reduction in, caution, the potential for negligent injury increases.

A legal regime in which injured parties alone bear the costs of contractor negligence is untenable. Accordingly, the government mandates, and reimburses the costs of, contractor insurance. If, due to the immensity of destruction following a disaster or inadequate information in light of a crisis, the insurance industry fails to offer economically feasible protection to contractors, the government must fill the void. The government—armed with sovereign immunity and able to, on the one hand, widely disperse the burden to the taxpaying public and, on the other hand, incur and carry debt—may choose to directly insure its contractors. But in no event can the government's recognition that it must provide meaningful protection for its contractors result in unmitigated risk to potential victims of contractor negligence. Legislative solutions must consider the interests of the government, the contractors upon which the government depends, and the public. Governmental indemnification, on an ad hoc basis, has proven effective. Similarly, where the insurance industry cannot provide a market so-

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tem.").

[202] Concerns raised include the VICP's processing time, the adversarial nature of the process, the imbalance between the resources available to the opposing parties, and the fund balance. *See Compensating Vaccine Injuries: Are Reforms Needed?: Hearing Before the Subcomm. on Criminal Justice, Drug Policy, and Human Resources of the H. Comm. on Government Reform*, 106th Cong. 32–34 (1999) (statement of Linda Mulhauser, a petitioner of the VICP fund); *id.* at 58–59 (statement of Marcel Kinsbourne, pediatric neurologist); *id.* at 79–91 (statement of Clifford J. Shoemaker, Senior Partner, Shoemaker & Horn); GAO, VACCINE INJURY COMPENSATION, *supra* note 198, at 19 ("While VICP was expected to provide compensation for vaccine-related injuries quickly and easily, these expectations have often not been met."); *id.* at 7–11, 16.

lution, the government, in large part successfully, has experimented with captive funds or pools.

In the end, any legislative solution should endeavor to achieve two potentially synergistic ends: deterring, to the optimal degree, contractors from causing harm and, when harm does result, compensating the victims. Because the two ends are not entirely identical, balance is required. Forcing contractors to internalize all of the costs of harm imposed upon victims—particularly where there is a failure of the insurance market—could result in excessively risk averse behavior. Such behavior could impede and potentially frustrate recovery efforts or dramatically increase the government's costs. Conversely, unnecessary or excessive protection might encourage irresponsible behavior or, at a minimum, discourage firms from undertaking a socially desirable level of care. For example, creating a government-financed litigation fund without a cap may prove effective for compensating victims, but it would not serve to deter potential tortfeasors. On the other hand, such a cap likely would result in either victims or contractors bearing some portion of the cost of the harms caused.

The sponsors of the Gulf Coast Recovery Act do not appear to have grappled with these thorny issues. Rather, the GCRA smacks of opportunism, and accordingly, merits attention and scrutiny. As a matter of law, it distorts the government contractor defense beyond recognition. As a matter of policy, the breadth and scope of Hurricane Katrina's devastation fail to justify capitulation to the unsubstantiated and oft-rebuffed contractor demands for insulation from liability. No empirical case proves that the insurance market has failed or that broad insulation of disaster-area contractors is necessary. Moreover, the GCRA would not encourage responsible contractor behavior; instead it creates a moral hazard, exposing potential victims to physical injury and financial ruin. Any solution that potentially *increases* the risk of negligent injuries is fundamentally flawed. It also violates basic principles of justice and fairness, particularly after the devastation already caused by Hurricane Katrina. The Gulf Coast Recovery Act's effort to capitalize upon national disasters is not only ill-conceived and inefficient, but harms the credibility of the federal government's procurement process. Congress should examine its own legislative repertoire more fully before going down this perilous path.

ARTICLE

THE KATRINA FUND: REPAIRING BREACHES IN GULF COAST INSURANCE LEVEES

MITCHELL F. CRUSTO*

This Article proposes the Katrina Homeowners Compensation Fund, a policy solution to the residential property crisis following Hurricane Katrina. In the wake of massive property damage, a heated legal battle has emerged on the issue of whether homeowners property insurance covers damage resulting from flooding due to the breaking of levees. This Article examines recently filed class action lawsuits and various congressional proposals, concluding that both current judicial and legislative remedies are inadequate in providing immediate, full relief to homeowners in devastated areas. The Article then proposes the Katrina Homeowners Compensation Fund, modeled after the September 11th Fund, which would constitute a federal bailout program to compensate uninsured and under-insured homeowners. It concludes that this Fund best serves the immediate needs of those affected by Katrina while preserving the integrity of the insurance market.

I. INTRODUCTION: HURRICANE KATRINA'S SECOND WAVE BRINGS FINANCIAL DEVASTATION AND LITIGATION OVER WIND VERSUS FLOOD PROPERTY INSURANCE COVERAGE

Recently, the City of New Orleans, as well as communities along the Mississippi and Alabama Gulf Coasts, received international attention following the loss of lives and property devastation from Hurricane Katrina (Katrina).[1] Katrina caused substantial property losses from both wind and

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[1] Hurricane Katrina was a major part of the most volatile Atlantic Hurricane season on record, which included Hurricanes Katrina, Rita, Wilma, and Beta. For purposes of this Article, the terms "Hurricane Katrina" or "Katrina" shall generally include Hurricane Rita and

water,[2] leading to a major legal battle over the extent of homeowners[3] insurance coverage versus flood insurance coverage.[4] The question that has emerged is, does a standard homeowners property insurance policy effectively exclude coverage for hurricane-related residential property losses be-

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Hurricane Wilma. *See also* Press Release, Office of Governor Kathleen Blanco, Governor Blanco Creates Louisiana Recovery Authority (Oct. 17, 2005), *available at* http://www.gov.state.la.us/index.cfm?md=pagebuilder&tmp=home&cpid=87 (announcing the creation of the Louisiana Recovery Authority); Press Release, Office of Mayor Ray Nagin, Mayor Calls on Citizens to Help Bring New Orleans Back (Sept. 30, 2005), *available at* http://www.cityofno.com/portal.aspx?portal=1&load=~/PortalModules/ViewPressRelease.ascx&itemid=3179 (announcing the creation of the Bring New Orleans Back Commission). *See generally Royals See Storm Hit New Orleans*, BBC NEWS, Nov. 5, 2005, http://news.bbc.co.uk/2/hi/uk_news/4409232.stm; Farah Stockman, *U.S. Accepts Nearly $1B in Foreign Aid*, BOSTON GLOBE, Sept. 8, 2005, at A12 (explaining the amount of international attention and charitable gift giving resulting from Katrina).

2 *See* Nat'l Oceanic and Atmospheric Admins. ("NOAA"), 1 National Climatic Data Center's News Highlights 4 (2005), available at http://www.ncdc.noaa.gov/oa/about/NOAANewsletter4.pdf:

> Katrina was one of the strongest storms to impact the coast of the United States during the past 100 years . . . . The loss of life and property damage was worsened by breaks in the levees that separate New Orleans from surrounding lakes. At least 80% of New Orleans was under water on August 31, 2005, largely as a result of levee failures from Lake Pontchartrain. The combination of strong winds, heavy rainfall and storm surge led to breaks in the eastern levee after the storm passed, leaving some parts of New Orleans under 20 feet of water.

Id. See also NOAA, *billion Dollar U.S. Weather Disasters*, http://www.ncdc.noaa.gov/oa/reports/billionz.html#narrative (last visited Feb. 10, 2006) (reporting that Hurricane Katrina was "the most expensive natural disaster in U.S. history" with preliminary estimates of over $100 billion in damages and high winds and some flooding in the states of Louisiana; Mississippi; Alabama; Florida; Tennessee; Kentucky; Indiana; Ohio; and Georgia); *Higher Insurance Premiums: Blame Climate Change?*, CONSUMER REP., Feb. 2006, at 6 (stating that hurricanes Dennis, Katrina, Rita, and Wilma caused an estimated $55 billion to $75 billion in insured property losses).

3 For purposes of this Article, the term "homeowners" refers to primary residential premises, not rental property. *See generally* TOM BAKER, INSURANCE LAW AND POLICY, CASES, MATERIALS, AND PROBLEMS 337, 342 (2003) (defining "residence premises" as "the one or two family dwelling, other structures, and grounds or that part of any other building where you reside and which is shown as the 'residence premises' in the Declarations").

4 *See* Leonard v. Nationwide Mutual Ins. Co., No. 2005-2021JB (Miss. Ch. Ct. filed Oct. 4, 2005) (seeking injunctive relief and a declaration that the insurer cannot rely on the policy's water exclusion to deny coverage for damages to their home caused by Katrina); Orrill v. AIG Inc., No. 2005-11720 (La. Civ. Dist. Ct. Orleans Parish filed Oct. 27, 2005) (alleging in a class action suit that an insurer failed to provide a means for its insureds to initiate a claim or to provide any temporary disaster relief); Comer v. Nationwide Mutual Ins. Co., No. 05-00436 (S.D. Miss. filed Sept. 30, 2005) (alleging in a class action complaint that homeowners insurers should not be permitted to deny coverage for damages caused to homes by Katrina's winds, naming their insurers, numerous oil companies, and mortgage lending companies as defendants). *See generally* Kathy Bushouse, *Mississippi Takes on Insurance Industry*, ORLANDO SENTINEL, Sept. 29, 2005, at C1 (noting that immediately following Katrina, Mississippi attorney general Jim Hood requested that a judge override provisions in state insurance contracts that exclude coverage of damage from storm surge, arguing that those provisions are "contrary to public policy, are unconscionable, and are ambiguous," and that insurers are "utilizing these exclusion provisions as grounds to deny and/or substantially reduce their coverage that they otherwise should pay").

cause of flooding resulting directly from levees breaking such as in New Orleans during Katrina? The resolution of this legal question will have significant national implications for the insurance industry and the availability of homeowners insurance.[5] As a result, the insurance industry faces a host of challenges in the wake of Katrina, inside and outside the courtroom.[6]

This Article focuses on finding a policy solution to the limitations of homeowners insurance coverage as applied to hurricane-related residential property losses. The outcome of this issue has tremendous implications for not only the residents of the hurricane-stricken Gulf Coast and the City of New Orleans but also for the future of insurance coverage of all homeowners. If courts or legislatures ignore contractual provisions of insurance contracts, insurance markets may require adjustments that could affect all insured homeowners nationally.[7] In addition, failure to respond

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[5] *See* EVAN MILLS, RICHARD J. ROTH, JR., & EUGENE LECOMTE, AVAILABILITY AND AFFORDABILITY OF INSURANCE UNDER CLIMATE CHANGE: A GROWING CHALLENGE FOR THE U.S. (2005), *available at* http://www.ceres.org/pub/docs/Ceres_insure_climatechange_120105.pdf (reporting that even before Hurricane Katrina, consumers and businesses in many parts of the U.S. were seeing higher premiums, lowered limits and increased restrictions in coverage due to rising weather-related losses in Florida, Texas, California and elsewhere). *But see, e.g.*, Press Release, Allstate Corporation, Allstate Reports 2005 Fourth Quarter Net Income EPS of $1.59, Fourth Quarter Operating Income EPS of $1.49, Provides Guidance on 2006 (Jan. 31, 2006), *available at* http://media.corporate-ir.net/media_files/irol/93/93125/news/all_060131er.pdf (announcing catastrophe losses totaling $657 million pre-tax in the fourth quarter of 2005, but noting "[l]iti-gation has been filed, which if ultimately decided against us, could lead to a material increase in our catastrophe claims and claims expense estimate").

[6] *See* Chehardy v. Wooley, No. 536451 (La. Dist. Ct. filed Sept. 15, 2005); *see also* Hood v. Mississippi Farm Bureau Ins., No. 05-00572 (S.D. Miss. filed Sept. 16, 2005) (asking the court in a class action suit to declare damage caused by the storm as covered); Hurricane Katrina and Hurricane Rita Flood Insurance Buy-In Act, H.R. 3922, 109th Cong. (2005) (proposing that Katrina homeowners facing a gap in their flood insurance coverage be allowed to purchase flood insurance retroactively). Katrina victims also face a host of challenges, including significant environmental threats resulting from Katrina-damaged residences. *See* U.S. Envtl. Protection Agency, News Brief: EPA Releases Longer Term Analyses of Sediment Data from Hurricane Katrina (Dec. 16, 2005), http://yosemite.epa.gov/r6/press.nsf/name/SedimentData_12-16 [hereinafter EPA News Brief] (noting that in some areas, high concentrations of various chemicals were detected to be above acceptable levels); *see also* Matthew Brown, *Groups Brand Storm Sediment Unsafe*, TIMES-PICAYUNE, Dec. 2, 2005, at 3 (stating that environmental groups found chemical contamination at thirty of thirty-one sites tested and said state and federal agencies are "grossly misleading the public" by playing down the health risks of living and working in New Orleans).

[7] Martin Grace & Robert Klein, Katrina's Liability Implications, Panel at American Enterprise Institute for Public Policy Research (Oct. 3, 2005), *available at* http://www.aei.org/events/eventID.1156,filter.all/event_detail.asp. During the program, Martin F. Grace, the James S. Kemper Professor of Risk Management and Insurance at Georgia State University, reportedly stated that if the Katrina class action litigation were successful, the insurance industry would stop in its tracks temporarily and possibly face bankruptcies and massive availability problems followed by a potential contagion into other states and a call for greater federal regulation. *Id.*; *see also Hurricanes Drive Up Insurance Costs*, BUS. ENV'T, Oct. 2005, at 14 (reporting that "[i]nsurance companies have often been caught unprepared for unforeseen combinations of events, like the 2001 attack on New York's World Trade Center, multiple hurricanes hitting Florida in 2004, or the great tsunami of 2004."); Federal Emergency Management Agency (FEMA), *New Hampshire Flooding Update: Aid Total Tops $3 Million*, Dec. 14, 2005, *available at* http://www.fema.gov/news/newsrelease.fema?id=

promptly to the economic losses that Katrina caused will result in personal bankruptcies and foreclosures; significant losses to banks, mortgage companies, and insurance companies; and losses to all levels of government.[8]

As a result of these national implications, the federal government has a duty to consider prompt preemptive action to avoid a financial disaster. This Article proposes the Katrina Homeowners Compensation Fund, which is federal bailout legislation for Katrina homeowners who suffered uninsured or underinsured property losses. The creation of the Katrina Fund[9] is modeled after the September 11th Victim Compensation Fund.[10] Its goal is to give financial relief to Katrina-affected residential homeowners, ensuring their financial integrity and that of their communities and adversely affected financial institutions and insurers. The Katrina Fund might also protect other potential Katrina-related defendants from liability, including the federal, state, and local governments; the Army Corps of Engineers and their contractors; the Orleans Levee Board; the mortgage holders; and business owners. But it should not be confused with other pending federal legislation addressing other Katrina issues, including damage to public works and other infrastructure.[11]

The Article proceeds as follows. Part II presents and analyzes the dispute between homeowners and their insurance companies over the extent of their homeowners insurance policies. Part III describes the recent class action lawsuits that have been filed and why judicial remedies are not the best solution to this current controversy. Part IV presents various legislative proposals to address homeowners' concerns and explains why these also fail to provide adequate relief to injured homeowners. Part V proposes and describes the Katrina Fund. Part VI makes the case for the Katrina Fund, explaining how it will benefit injured homeowners; financial groups; and

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21418 (noting that by December, 14, 2005, 709 victims from the nine New Hampshire counties affected by the flood had applied for FEMA assistance and more than 3 million in aid had been distributed for the rebuilding effort).

[8] *See generally Katrina's Economic Impact*, MSNBC, http://www.msnbc.msn.com/id/9241617 (last visited Apr. 17, 2006) (reporting that Congress already has allocated $10.5 billion toward recovery efforts and President Bush intends to seek an additional $40 billion). Senate Democratic leader Harry Reid said recovery and relief costs ultimately could top $150 billion. The loss of economic output from businesses shut down by Katrina and a related slowdown in consumer spending are likely to cut 0.5% from the nation's overall growth rate in the current quarter, and possibly 0.5% in the fourth quarter. According to the Congressional Budget Office, Katrina is likely to cost the economy 400,000 jobs. *See id.*

[9] *See, e.g.*, Bill Walsh, *White House Against Baker Bailout Bill*, TIMES-PICAYUNE, Jan. 25, 2006, *available at* http://www.nola.com/news/t-p/frontpage/index.ssf?/base/news-4/1138202723122050.xml (noting, however, that President Bush has disfavored a federal bailout of Katrina homeowners and Katrina survivors).

[10] Air Transportation Safety and System Stabilization Act, 49 U.S.C.A. § 40101 (West 2004).

[11] *See* Press Release, White House, Press Briefing by Scott McClellan and Senior Officials on Levee Reconstruction (Dec. 15, 2005), *available at* http://www.whitehouse.gov/news/releases/2005/12/20051215-4.html (announcing that President Bush recently asked Congress for an additional $1.5 billion to increase levee protection).

local, state, and national governments. Part VII counters the arguments against the Katrina Fund, which portray it as an unneeded, expensive, and unprecedented bailout of homeowners and the insurance industry. Finally, Part VIII concludes that Congress should promote government-sponsored relief to Katrina-related property losses through the Katrina Fund.

II. THERE IS A CURRENT, REAL CONTROVERSY OVER THE INSURANCE COVERAGE OF KATRINA-RELATED HOMEOWNERS' PROPERTY LOSSES

Overall, Katrina-related insurance losses are estimated to be around $34.4 billion, of which $22.6 billion stem from Louisiana.[12] Following Katrina, many Gulf Coast and New Orleans homeowners were shocked when their insurance companies denied their Katrina property insurance claims. One notable injured insurance claimant is U.S. Senator Trent Lott (R-Miss.) who is reportedly suing his insurance company, raising the issue of whether a wind-driven storm surge is the same as flooding.[13] Many homeowners are often unaware of what their homeowners insurance policies say, specifically regarding which events or losses are covered and which are excluded from coverage.[14] Equally frustrating is disparate treatment by different flood carriers under the same federal flood program, whereby "homeowners living in areas that were equally flooded have had drastically different experiences."[15]

The position of many insurance companies is that standard "comprehensive" homeowners property insurance policies expressly exclude floods from coverage, and hence they will not pay on claims for losses relating to many types of water-related damages or perils.[16] Unfortunately, a large percentage of Katrina homeowners had no flood insurance.[17] Many home-

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[12] *See* Press Release, I.S.O. Properties, Preliminary Estimate Puts Insured Losses from Hurricane Katrina at $34.4 Billion: ISO Property Claim Services (Oct. 4, 2005), *available at* http://www.iso.com/press_releases/2005/10_04_05.html [hereinafter I.S.O. Press Release].

[13] *See* Lott v. State Farm Fire & Casualty Co., No. 05-00671 (S.D. Miss. filed Dec. 15, 2005).

[14] *See generally Why Your Homeowners Policy Might Not Be There When You Need It Most*, CONSUMER REPORTS, Sept. 2005, *available at* http://www.consumerreports.org/cro/personal-finance/flood-insurance-905.htm (stating that when it comes to hurricane-related damages, homeowners policies are "full of holes" and typically do not cover storm drainage and sewer backups, as well as water damage from storm surges and other types of environmental flooding).

[15] Dean Starkman, *Same Insurance Claims, Different Results for Katrina Victims*, STANDARD-TIMES, Dec. 4, 2005, at B6 (stating that, "[t]here is evidence of disparate treatment of policyholders, which raises fairness questions").

[16] *See Why Your Homeowners Policy Might Not Be There When You Need It Most*, *supra* note 14 (noting that water damage from storm surge, other types of flooding, storm drainage, and sewer backup are typically not covered by homeowners policies).

[17] *See* Ins. Info. Inst., *Flood Insurance*, http://www.iii.org/media/facts/statsbyissue/ flood (last visited Mar. 17, 2006) (reporting that many homes in counties affected by Katrina lacked flood insurance).

owners who did carry flood insurance had insufficient coverage to recover from the high levels of flooding generated by Katrina.

The homeowners insurance exemption for flood damages combined with the lack of flood coverage for policyholders has created property losses over which homeowners and their attorneys are pitted against their insurance companies and the companies' attorneys.[18] Since insurance contracts, like all contracts, are subject to judicial interpretation, what insurance policies cover and do not cover is not as simple as what the policies say on their faces.[19] Ultimately, as judges determine what the policies mean and what losses they cover, it may be possible for the courts to determine that Katrina-related flood losses are covered by homeowners policies.

In the meantime, many Katrina-affected property owners are still evacuated from the devastated area and are incurring uninsured, additional living expenses, including evacuation housing expenses, while at the same time held responsible for mortgage and other loan payments secured by their hurricane-damaged residences.

A. A History of How Homeowners Insurance Policies Expressly Exclude Flood Losses

American homeowners insurance carriers have generally been unwilling to cover certain water-related losses.[20] In the early twentieth century, a homeowner needed to purchase several kinds of policies, such as fire or theft insurance, in order to receive comprehensive coverage.[21] However, by the late 1950s, a complete or "comprehensive" homeowners policy was created, which incorporated multiple types of property coverage in one policy.[22] Today, there are six standard homeowners policies, HO-1 through HO-6, which cover a variety of perils.[23]

Insurance is a form of contract between the insurer (insurance company) and the insured (the homeowner) with covered and excluded losses.[24]

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[18] *See supra* note 4 and accompanying text.

[19] ROBERT H. JERRY II, UNDERSTANDING INSURANCE LAW 16–77 (3d ed. 2002) (providing several pertinent cases in which courts have interpreted the scope of insurance policies).

[20] *See* David Herr, *Commercial and Residential Property and Liability Insurance*, 17 REAL PROP. PROB. & TR. J. 633, 633–35 (1983); Timothy Palmer & John T. Waldron III, *Insurance Coverage for Mold and Fungi Claims: The Next Battleground?*, 38 TORT TRIAL & INS. PRAC. L.J. 49, 57 (2002).

[21] *See New Orleans Residents Lament Lack of Insurance*, REUTERS, Sept. 5, 2005, *available at* http://www.msnbc.msn.com/id/9170157 (pointing out that standard homeowner insurance policies only cover damage from fire and wind).

[22] *See* JERRY, *supra* note 19, at 11–15 (providing a brief history of insurance law).

[23] *See* AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS, *Homeowners Insurance*, http://pfp.aicpa.org/Resources/Insurance+and+Risk+Management/Property+and+Casualty+and+Liability+Insurance/Homeowners+Insurance (last visited Mar. 15, 2006) (providing a description of the six standard policies).

[24] *See* Adam Scales, *How Will Homeowners Insurance Litigation After Hurricane Katrina Play Out? The Key Dynamics, the Mississippi Lawsuit, and the Courts' Likely Views*, Sept. 19,

A homeowner needs to seek additional coverage to protect against excluded losses.[25]

A number of "named" perils such as fire, windstorm, hail, and explosion are expressly protected; others, such as earthquake and war are expressly listed as policy exclusions.[26] "Water damage" is also expressly excluded.[27] "Water damage" is defined as damage resulting from:

> Flood, surface water, waves, tidal water, overflow of a body of water, or spray from any of these, whether or not driven by wind; water which backs up through sewers or drains or which overflows from a sump; or water below the surface of the ground, including water which exerts pressure on or seeps or leaks through a building, sidewalk, driveway, foundation, swimming pool or other structure.[28]

The insurance industry has generally excluded flood damage in a homeowners policy because flood insurance is not commercially viable.[29] Generally, insurers provide coverage only when risks can be calculated and rates set accordingly.[30] As flood insurance would likely be purchased only by those who live in flood hazard areas and as flood claimants are expected to make frequent claims, insurers have concluded that this type of coverage is cost prohibitive.[31]

Unfortunately, few homeowners read or understand their policies, and many are generally unaware of policy exclusions.[32] As such, when home-

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2005, http://writ.news.findlaw.com/commentary/20050919_scales.html.

[25] Rachel Emma Silverman, *Flood Coverage for Costly Homes*, WALL ST. J. GUIDE TO PROP., Sept. 2, 2005, http://www.realestatejournal.com/buysell/taxesandinsurance/20050902-silverman.html.

[26] *See* BAKER, *supra* note 3, at 337; *see also* JERRY, *supra* note 19, at 11–15, 352.

[27] BAKER, *supra* note 3, at 351–52.

[28] *Id.*; *see also* U.S. ENVIRONMENTAL PROTECTION AGENCY (EPA), TERMINOLOGY REFERENCE SYSTEM: WATER DAMAGE, http://iaspub.epa.gov/trs/trs_proc_qry.navigate_term?p_term_id=27575&p_term_cd=TERMDIS (last visited Apr. 18, 2006) (explaining that "water damage can be caused by flooding, severe storms, tidal waves, seismic sea waves, storm surges, etc.").

[29] Congress has found that:

> (1) many factors have made it uneconomic for the private insurance industry alone to make flood insurance available to those in need of such protection in reasonable terms and conditions; but (2) a program of flood insurance with large-scale participation of the Federal Government and carried out to the maximum extent practicable by the private insurance industry is feasible and can be initiated.

See 42 U.S.C. § 4001 (2000).

[30] *See id.*

[31] *See* FEDERAL EMERGENCY MANAGEMENT AGENCY (FEMA), NATIONAL FLOOD INSURANCE PROGRAM: CALL FOR ISSUES STATUS REPORT (2000), *available at* http://www.fema.gov/pdf/nfip/calliss.pdf (analyzing several cases regarding flood insurance and concluding that flood insurance is cost prohibitive).

[32] *See generally Why Your Homeowners Policy Might Not Be There When You Need It*

owners are shopping to get the most comprehensive coverage for the lowest price, they often fail to assess what they are actually getting, and, perhaps more importantly, what they are not getting, for their money.[33]

B. Many Homeowners Are Shocked by Their Insurance Companies' Denial of Hurricane-Related Property Losses: Class Action Lawsuits Ensue

As insurers have denied certain Katrina-related property insurance claims, homeowners filed lawsuits seeking payment of their insurance claims.[34] In suing their insurers, homeowners and their legal counsel are generally seeking to test the elasticity of the water-related loss exclusions.[35] Their goal is to provide greatly needed financial relief where their insurance carriers choose not to provide coverage for Katrina-damaged property losses.[36]

These lawsuits, many of them class actions, involve billions of dollars in insurance claims.[37] Their outcome will have significant consequences for Katrina victims, their communities, insurance companies, and society. If the insurers lose, they will likely decrease policy coverages and increase premiums for all insured homeowners. If, on the other hand, the Katrina homeowners lose, they will likely face foreclosure and bankruptcy, and the banks and mortgage companies that hold their loans will be adversely impacted.[38]

III. THE KATRINA-RELATED CLASS ACTION LAWSUITS WILL FAIL TO PROVIDE IMMEDIATE AND ADEQUATE RELIEF TO INJURED HOMEOWNERS

Before discussing the class action litigation that has been filed in Katrina-related property insurance claims, some review of the role courts play in insurance coverage is warranted.[39] Courts treat insurance policies as special contracts, the terms of which evolve from an interplay between

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Most, *supra* note 14.

[33] *See id.*

[34] *See supra* note 4 (describing Katrina class action lawsuits that have been filed); *see also supra* note 6 (describing other Katrina class action law suits that have been filed).

[35] *See* Leonard v. Nationwide Mutual Ins. Co., No. 2005-2021JB (Miss. Ch. Ct. filed Oct. 4, 2005); Orrill v. AIG Inc., No. 2005-11720 (La. Civ. Dist. Ct. Orleans Parish filed Oct. 27, 2005); Comer v. Nationwide Mutual Ins. Co., No. 05-00436 (S.D. Miss. filed Sept. 30, 2005); Chehardy v. Wooley, No. 536451 (La. Dist. Ct. filed Sept. 15, 2005); Hood v. Mississippi Farm Bureau Ins., No. 05-00572 (S.D. Miss. filed Sept. 16, 2005).

[36] *See Leonard*, No. 2005-2021JB; *Orrill*, No. 2005-11720; *Comer*, No. 05-00436; *Chehardy*, No. 536451; *Hood*, No. 05-00572.

[37] *See Leonard*, No. 2005-2021JB; *Orrill*, No. 2005-11720; *Comer*, No. 05-00436; *Chehardy*, No. 536451; *Hood*, No. 05-00572.

[38] *See supra* note 7 (describing effects of class action on insurance companies). *See generally* Alan O. Sykes, *Judicial Limitations on the Discretion of Liability Insurers to Settle or Litigate: An Economic Critique*, 72 TEX. L. REV. 1345 (1994).

[39] *See generally* BAKER, *supra* note 3, at 25–50.

litigation and insurance regulation.[40] The express language in homeowners insurance policies follows from decades of litigation on these issues.[41]

Usually, whenever litigation succeeds against an insurance company, policies are rewritten to remedy whatever discrepancy existed in the policy that gave rise to the litigation.[42] In some states, the rewritten language is then submitted to state insurance regulators for approval.[43] The Katrina-devastated states of Louisiana, Mississippi, and Alabama require state pre-approval of the language in property insurance contracts.[44] Once the contract terms are established, the policy is priced accordingly.[45] As judges are aware of the complexity of such contracts, they attempt to balance the insurance companies' need for the commercial viability of insurance contracts with the policyholders' usual lack of sophistication and bargaining power.[46]

Understanding the courts' role in adjudicating insurance policy cases, we now turn the discussion to two major class action insurance lawsuits filed immediately following Katrina. The first involves the Attorney General of Mississippi, who filed a class action suit seeking a court declaration that all water damage sustained due to Katrina is a covered peril.[47] The second suit, filed in New Orleans, is a class action against the Louisiana Insurance Commissioner and several insurance companies, alleging that the flood damage in the aftermath of Katrina was the result of negligent levee construction and not an excluded peril.[48]

A. Mississippi Class Action

On September 15, 2005, Mississippi Attorney General Jim Hood filed a lawsuit against several major insurers, including State Farm Fire and Casualty Co., Allstate Property and Casualty Insurance Co., and Nationwide Mutual Insurance Co., alleging violations of state law and seeking to compel them to pay for Katrina-related damages, regardless of the actual cause of damage.[49] The attorney general asserts that flood exclusions in homeowners policies are void as being against public policy and that the flood exclusions violate Mississippi's common law.[50] The suit states that Mississippi law indicates that losses should be covered if the "proximate

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[40] *See* Scales, *supra* note 24.
[41] *See* Grace & Klein, *supra* note 7.
[42] *See* Scales, *supra* note 24.
[43] *See* Grace & Klein, *supra* note 7.
[44] *See id.*
[45] *See id.*
[46] *See id.*
[47] *See* Hood v. Mississippi Farm Bureau Ins., No. 05-00572 (S.D. Miss. filed Sept. 16, 2005).
[48] *See* Chehardy v. Wooley, No. 536451 (La. Dist. Ct. filed Sept. 15, 2005).
[49] *See Hood*, No. 05-00572.
[50] *Id.*

cause" of loss is covered, even if other causes are not.[51] It also seeks a court interpretation of insurance contract language, specifically asserting that the flood exclusion language is ambiguous and violates the Mississippi Consumer Protection Act.[52] It claims that the policies are unreasonably complex and not subject to negotiation.[53]

B. Louisiana Class Action

On September 16, 2005, a class action lawsuit was filed against the Louisiana Insurance Commissioner and many insurance companies seeking a declaration that flooding in the city of New Orleans sustained during Katrina was caused by breaches in the city's flood walls and does not fall within the exclusions for "rising water" or an "act of God" contained in most standard homeowners policies.[54] The action also asserts that the waters that entered the city, thereby causing the losses, are attributable to a windstorm, which would be a covered peril.[55]

The Louisiana class action differs in scope from the Mississippi class action in that the flood damage in New Orleans was staggered and sustained as a result of levee failure, while the flood damage in Mississippi was from water directly from the Gulf of Mexico.[56] Because New Orleans' flooding resulted from breaks in its levee system, numerous investigations into the cause of the levee failures are ongoing.[57] In the meantime, the Louisiana-based plaintiffs are asking for a declaration of causation, without the rigorous investigation that such issues warrant, for the many victims who experienced water-related losses in and around New Orleans.[58]

Notwithstanding the substantive legal and factual issues involved in the two cases, there is also the procedural question of whether the class action is the appropriate legal mechanism for litigation.[59] In addition, there

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[51] *See id.*

[52] *See id.*; *see also* Mississippi Consumer Protection Act, MISS. CODE ANN. § 75-24-1 to 75-24-175 (2006).

[53] *See Hood*, No. 05-00572.

[54] *See* Chehardy v. Wooley, No. 536451 (La. Dist. Ct. filed Sept. 15, 2005); *see also* Slaton v. St. Paul Fire and Marine Ins. Co., No. 05-1138 (M.D. La. filed Sept. 30, 2005) (alleging that the defendants' actions resulted in the levee system's failure that caused the flood damage following Katrina); Barasich v. Columbia Gulf Transmission Co., No. 05-4161 (E.D. La. filed Sept. 13, 2005) (alleging in a class action that the defendants' dredging pipeline canals and other activities affected the marshes of southeast Louisiana and contributed to the loss of life and destruction of property resulting from Katrina).

[55] *See Chehardy*, No. 536451.

[56] Joe Hagan & Joseph T. Hallinan, *Why Levee Breaches in New Orleans Were Late-Breaking News*, WALL ST. J., Sept. 12, 2005, at A1 (reporting the morning after landfall that many believed that New Orleans had "dodged a bullet," but many homes flooded the following day as a result of levee breaches).

[57] *See* Gordon Russell, *Letten Probing Levee Breaches: U.S. Attorney Looks at Possible Corruption*, TIMES-PICAYUNE, Nov. 10, 2005, at 1, *available at* http://www.nola.com/news/t-p/frontpage/index.ssf?/base/news-4/1131605966166260.xml.

[58] *See Chehardy*, No. 536451.

[59] *See generally* ALBA CONTE & HERBERT B. NEWBERG, NEWBERG ON CLASS ACTIONS

are other procedural questions such as the propriety of a declaratory judgment on issues of coverage or causation.[60] From an equity perspective, the Mississippi Attorney General is asking the court to void the insurance contracts as a matter of policy, thereby forcing insurance companies to pay for damages resulting from perils excluded from their pricing models.[61] By focusing on the contract language, the Attorney General is seeking to bypass the normal rigorous judicial inspections that determine cause and allocate damage.[62] Given that the insurance companies have priced these insurance contracts according to their express written terms, judicial alterations ex post would be an unanticipated loss to the insurance industry. Also, Katrina-related property insurance litigation, especially in the class action form, is bound to be a lengthy and contentious process, making it unlikely to provide immediate relief to the injured homeowners.

Therefore, the existing battle over Katrina flood-related homeowners property losses is a "lose-lose" situation and begs for an overriding federal congressional solution.

IV. Proposed Congressional Solutions to Katrina

Recognizing that there is a current controversy over Katrina insurance coverage with billions of dollars at stake and thousands of homeowners in need, Congress has sought immediate solutions.[63] As of the close of the first session of the 109th Congress, 234 Katrina-related bills had been introduced.[64] Of these 234, only 18, most of which were appropriations and

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(Thomson West 2002).

[60] *See* Gregor J. Schwinghammer, Jr., Comment, *Insurance Litigation in Florida: Declaratory Judgments and the Duty to Defend*, 50 U. Miami L. Rev. 945, 946 (1996) (explaining that there is disagreement in Florida over whether an insurer should be able to bring a declaratory action to determine its coverage duties).

[61] *See generally Why Your Homeowners Policy Might Not Be There When You Need It Most*, *supra* note 14.

[62] This action might raise constitutional concerns over the impairment of the obligation of contract. *Cf.* U.S. Const., art. I, § 10, cl. 1.

[63] *See* Lisa Friedman, *Lawmakers, Do Something!: Rush of Legislation Echoes Frantic Days After Sept. 11*, Daily News L.A., Sept. 11, 2005, at N10 (reporting that within the two weeks following Katrina, members of Congress introduced over forty bills related to relief efforts); *see also* Keith Darcé, *Outer Ring of Flood Protection Proposed*, Times-Picayune, Nov. 15, 2005, at 1 (reporting that much discussion and planning will be undertaken in the upcoming months and years to address the prevention of future natural disasters, including numerous models of flood protection, from the systems adapted by the Dutch, to incredible sea walls being investigated by the Army).

[64] *See, e.g.*, Deficit Reduction Act, S. 1932, 109th Cong. §§ 6201–6203 (2005) (seeking to make $35 billion in spending cuts to help pay for Katrina-related expenditures); Small Business Hurricane Relief and Reconstruction Act, S. 1807, 109th Cong. (2005) (proposing a $450 million bridge loan program); Deficit Reduction Act, H.R. 4241, 109th Cong. §§ 3201–3205 (2005) (seeking to increase the federal contribution to state Medicaid and SCHIP spending to provide up to 100% of funding for individuals living in Louisiana, Mississippi, and parts of Alabama during the week prior to Katrina); Hurricane Katrina Bankruptcy Relief and Community Protection Act, S. 1647, 109th Cong. (2005); Katrina/Rita Hurricane Relief Act, H.R. 4287, 109th Cong. (2005); Small Business Gulf Coast Revitali-

changes to the Internal Revenue Code, were enacted.[65] The following discussion highlights some notable statutes and bills relating to the Katrina insurance coverage issue.[66]

A. Existing Federal Flood Insurance: The National Flood Insurance Program

Flooding is the most common and most costly natural disaster that occurs in the United States.[67] National interest in a federal flood control policy began in the late nineteenth century when extreme flooding along the Mississippi River caused catastrophic damage.[68] Congress responded by enacting the Mississippi River Commission Act of 1879.[69] The Act created the Mississippi River Commission, which was responsible for the development of a levee system.[70] For sixty years after the creation of the commission, the federal government dealt with flooding by building levees and providing disaster assistance for flood victims.

As flood insurance coverage was still sorely needed, the federal government developed the National Flood Insurance Program (NFIP) in 1968.[71] The NFIP provides coverage of up to $250,000 for property and $100,000 for contents in its residential flood insurance policy.[72] Property owners are not limited to those amounts; some private insurance companies provide excess flood coverage for those property owners who value their property in excess of the coverage provided by the NFIP.[73] A review of the

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zation Act, H.R. 4234, 109th Cong. (2005); Housing Opportunities and Mitigating Emergencies Act, H.R. 4266, 109th Cong. (2005); Hurricane Regulatory Relief Act, H.R. 3975, 109th Cong. (2005); Superfund for Hurricane Accountability and Recovery Act, H.R. 4481, 109th Cong. (2005).

[65] *See* Press Release, Bill Frist, The First Session of the 109th Congress: Securing America's Future (Dec. 23, 2005), *available at* http://frist.senate.gov/_files/122305.pdf (providing a list of bills enacted by 109th Congress).

[66] There are other related bills not discussed that deserve honorable mention, including Katrina/Rita Hurricane Relief Act of 2005, H.R. 4287, 109th Cong. (2005) (amending the Internal Revenue Code of 1986 to allow a deduction for portion of charitable contributions related to Hurricane Katrina or Hurricane Rita in computing adjusted gross income) and Housing Opportunities and Mitigation Emergencies Act of 2005, H.R. 4266, 109th Cong. (2005) (amending the Robert T. Stafford Relief and Emergency Assistance Act to provide temporary emergency assistance for primary residences damaged or destroyed by Hurricane Katrina and Rita).

[67] U.S. GOV'T ACCOUNTABILITY OFFICE, REPORT NO. GAO-03-606T, CHALLENGES FACING THE NAT'L FLOOD INSURANCE PROGRAM 1 (2003), *available at* http://www.gao.gov/new.items/d03606t.pdf.

[68] *See* RAWLE O. KING, *Federal Flood Insurance: The Repetitive Loss Problem*, CONG. RES. SERV. at 1–4 (2005), *available at* http://www.fas.org/sgp/crs/misc/RL32972.pdf.

[69] Mississippi River Commission Act of 1879, ch. 43, 21 Stat. 37 (codified as amended at 33 U.S.C. §§ 641–653a (2000)).

[70] *See id.* § 1.

[71] *See* FED. EMERGENCY MGMT. AGENCY, NATIONAL FLOOD INSURANCE PROGRAM: PROGRAM DESCRIPTION at 5–6 (2002), *available at* http://www.fema.gov/doc/library/nfipdescrip.doc.

[72] *See id.* at 22.

[73] *See, e.g.*, American International Group, http://www.aig.com (last visited Jan. 28,

history of the NFIP and of homeowners insurance reveals that the federal government has reluctantly become a provider of flood insurance.

1. The History of Federal Flood Insurance

Prior to 1968, there were several attempts to centralize flood disaster insurance under the control of the federal government.[74] In 1951, President Truman requested, but did not receive, appropriations for a federal system of flood insurance.[75] In 1956, Congress passed the Federal Flood Insurance Act, which established a five-year, $3 billion flood insurance and re-insurance program.[76] Unfortunately, the program was short-lived; no policies were written because Congress failed to appropriate funding.[77] The devastation which followed Hurricane Betsy renewed national interest in federal flood insurance and ultimately led to the creation of the National Flood Insurance Program in 1968.[78]

The Act had three goals: (1) to reduce suffering and economic losses due to floods through the purchase of flood insurance; (2) to promote state and local land-use controls to guide development away from flood prone areas; and (3) to reduce federal expenditures for disaster assistance and flood control.[79] The NFIP also sets the rates, limitations, and requirements and designates Special Flood Hazard Areas (SFHA).[80]

From the NFIP's inception until 1973, participation in the NFIP was voluntary, and only a relatively small number of communities participated.[81] This lack of participation made the program very costly because premiums were used to pay out claims. When the claims exceeded these premiums, the government would pay the difference. As a result, Congress mandated participation through the enactment of the Flood Disaster Protection Act of 1973.[82] This Act required the purchase of flood insurance by at-risk property owners who sought loans from federally insured lending institutions.[83] This requirement proved difficult to enforce and was easily

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2006) (permitting policyholders to insure their property up to its full value and providing varying premiums for excess flood coverage); Chubb Group of Insurance Companies, http://www.chubb.com (last visited Jan. 28, 2006) (offering excess flood insurance at premiums of $1,000 for $1 million in coverage).

[74] *See* King, *supra* note 68, at 1–4.

[75] *See id.* at 2.

[76] *See id.*; Federal Flood Insurance Act, Pub. L. No. 84-1016, 70 Stat. 1084 (1956).

[77] *See* King, *supra* note 68, at 2–3.

[78] *See id.* at 3–4; National Flood Insurance Act of 1968, Pub. L. No. 90-448, 82 Stat. 572 (codified as amended at 42 U.S.C. §§ 4001–4129 (2000)).

[79] *See* King, *supra* note 68, at 1.

[80] *See id.* at 6.

[81] *See id.* (noting that Congress assumed that communities with a history of flooding would take advantage of the program, yet by 1973, only 5500 communities had done so).

[82] Flood Disaster Protection Act of 1973, Pub. L. No. 93-234, 87 Stat. 975 (codified as amended at 42 U.S.C. §§ 4001–4129 (2000)).

[83] *See id.* § 102 (codified as amended at 42 U.S.C. § 4012a (2000)).

circumvented by policyholders.[84] Congress responded to this failure by making the mortgage lending institutions liable if the property owner failed to retain flood insurance.[85] Under the legislation, the lending institution was obligated to purchase the flood insurance and bill the property owner unless the owner had obtained the insurance.[86] Moreover, civil penalties could be levied against the lending institution for not enforcing the mandatory purchasing requirement.[87]

2. Unstable Management of the National Flood Insurance Program

The NFIP's management has proven to be very unstable, moving often within the federal bureaucracy over its short history. In 1968, it was initially operated by an unincorporated association of insurance companies, the National Flood Insurers Association, dealing directly with the Federal Insurance Administration (FIA).[88] Ten years later, the United States Department of Housing and Urban Development (HUD) operated the NFIP.[89] However, in 1979, the FIA and the NFIP were placed under the Federal Emergency Management Agency (FEMA).[90]

FEMA has assigned management of the NFIP to its Mitigation Division.[91] In 2003, FEMA was joined with twenty-two other agencies to form the Homeland Security Department in response to the September 11 attacks.[92] In 2004, President George Bush signed into law the Flood Insurance Reform Act, reauthorizing the NFIP through 2008.[93]

3. Coverage Issues in the Standard Flood Insurance Policy

FEMA's federal flood insurance policy (commonly referred to as the Standard Flood Insurance Policy or SFIP) defines "flood" as:

> [A] general and temporary condition of partial or complete inundation of two or more acres of normally dry land area or of two

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[84] *See* King, *supra* note 68, at 18.

[85] National Flood Insurance Reform Act of 1994, Pub. L. No. 103-325, 108 Stat. 2255 (codified as amended at 42 U.S.C. §§ 4001–4129 (2000)).

[86] *See id.*

[87] *See id.*

[88] *See* INS. INFO. INST., THE NATIONAL FLOOD INSURANCE PROGRAM 4 (2005), *available at* http://server.iii.org/yy_obj_data/binary/745030_1_0/FloodWhitePaper.pdf.

[89] *See id.* at 4–7.

[90] *See* Exec. Order No. 12127, 3 C.F.R. 376 (1979), *reprinted in* 15 U.S.C. § 2201 (2000).

[91] U.S. GOV'T ACCOUNTABILITY OFFICE, REPORT NO. GAO-06-119, IMPROVEMENTS NEEDED TO ENHANCE OVERSIGHT AND MANAGEMENT OF THE NATIONAL FLOOD INSURANCE PROGRAM 2 n.2 (2005), *available at* http://www.gao.gov/new.items/d06119.pdf.

[92] *See* FED. EMERGENCY MGMT. AGENCY, FEMA History, http://www.fema.gov/about/history.shtm (last visited Apr. 18, 2006).

[93] Bunning-Bereuter-Blumenauer Flood Insurance Reform Act of 2004, Pub. L. 108-264, 118 Stat. 712 (to be codified at 42 U.S.C. §§ 4001–4129).

> or more properties (at least one of which is your property) from: overflow of inland or tidal waters; unusual and rapid accumulation or runoff of surface waters from any source; mudflow; or collapse or subsidence of land along the shore of a lake or similar body of water as a result of erosion or undermining caused by waves or currents of water exceeding anticipated cyclical levels that result in a flood as defined above.[94]

The SFIP only covers damage caused by *direct* physical contact with flood waters.[95] For example, it only pays for the flood damaged portion of an electrical circuit.[96]

The SFIP does not cover damage caused by moisture.[97] It will not pay for cleanup of contamination of mold or sewage unless signs of contamination are open and obvious, and it does not compensate for the cleanup of mold that appears after a flood, regardless of mitigation attempts.[98] There is also a $10,000 limit for remediation of damage caused by pollutants.[99]

In applying the SFIP, the NFIP omits many items of coverage found in a standard homeowners policy. For example, the SFIP has no provisions providing for the replacement of building components that are no longer manufactured or that are hard to obtain, adjusters' pricelist or database deviations, or the reimbursement or payment of sales tax on covered items.[100]

4. Obstacles to Katrina Victims Recovering Under NFIP

Following a claims process, the National Flood Insurance Program, like other insurance programs, must make payment for losses complying with the policy coverage. Merely suffering a flood loss does not guarantee recovery or payment for that loss. As such, even under the NFIP, there are many legal issues facing a Katrina flood victim.

One issue likely to arise in most claims associated with Katrina, especially in New Orleans, will concern concurrent (or mixed) causation. Concurrent causation deals with two or more perils, with at least one falling within the coverage of a policy and at least one falling outside that coverage.[101] When addressing concurrent causation, courts often apply the "effi-cient/dominant proximate cause approach," whereby "the cause to

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[94] FED. EMERGENCY MGMT. AGENCY, NATIONAL FLOOD INSURANCE PROGRAM: GENERAL PROPERTY FORM 1 (2000), *available at* http://www.fema.gov/pdf/nfip/gpp127.pdf.

[95] *See id.* at 9.

[96] *See id.* at 4.

[97] *See id.* at 10.

[98] *See id.*

[99] *See* FED. EMERGENCY MGMT. AGENCY, NATIONAL FLOOD INSURANCE PROGRAM: GENERAL PROPERTY FORM 6 (2000), *available at* http://www.fema.gov/pdf/nfip/gpp127.pdf.

[100] *See generally id.*

[101] *See* Paulucci v. Liberty Mut. Fire Ins. Co., 190 F. Supp. 2d 1312, 1318 (M.D. Fla. 2002).

which the loss is attributed is the efficient, dominant cause, the one that sets the others in motion, although other and incidental causes may be even nearer in time and place to the result and may operate more immediately in producing the loss."[102]

For Katrina flood victims, a factor affecting the efficient/dominant cause determination is a court's decision on whether hurricane winds were the dominant cause of the flooding or whether it was the government's negligence in failing to properly maintain the levees in New Orleans. However, absent such a decision, recovery by an insured might be limited to damages attributable solely to covered causes of loss, such as wind damage or rain damage to the portions of a house located above the flood's high water mark.[103] This means that a flooded home might receive no payment from its homeowners insurance carrier except perhaps if the home also suffered wind damage to unflooded areas of the home (such as on the second floor of the home if the wind took the roof off of the home). Another problem is that while high courts in Louisiana, Alabama, and Mississippi favor the efficient proximate cause test, federal courts, which will have jurisdiction over actions brought against the federal government, do not always support the test.[104]

A new concept called an "anti-concurrent-causation clause," which appears in newer policies, is another coverage issue that Katrina victims will face. Anti-concurrent causation clauses provide that the insurer will not pay if one of the causes was an excluded loss, even if there are several enumerated causes that played a role in a loss.[105] For example, if the clause applies to damages caused by a flood, all such damages may be excluded, and it is irrelevant whether the flood was caused by any other event such as high winds, negligent levee design or global warming.[106]

Proof of loss issues may also be the source of litigation. Under the NFIP, an insured flood victim has sixty days to file a proof of loss in writing.[107] Although an insured does not have an affirmative duty to comply with claims processing, the failure to follow it will allow the insurer an excuse, and a possible defense, for not performing the duties it has agreed to undertake.[108] Under the NFIP, if a claim exceeds $7,500, only the fed-

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[102] Sidney Simon, *Proximate Cause in Insurance*, 10 AM. BUS. L.J. 33, 37 (1972).

[103] *See* Hurricane Ins. Info. Ctr., Facts & Stats, http://katrinainformation.org/disaster2/facts/katrina_faq (last visited Apr. 19, 2006).

[104] *See, e.g.*, Rhoden v. State Farm Fire & Cas. Co., 32 F. Supp. 2d 907, 912 (D. Miss. 1998); Assurance Co. of Am. v. Jay-Mar, Inc., 38 F. Supp. 2d 349, 354 (D.N.J. 1999).

[105] Preferred Mut. Ins. Co. v. Meggison, 53 F. Supp. 2d 139, 142 (D. Mass. 1999).

[106] *See* Seth A. Tucker & Ann-Kelley Kemper, *Hurricane Katrina—Insurance Coverage Issues* (Covington & Burling, Ins. Coverage Law Bull., D.C.), Oct. 4, 2005, at 3, *available at* http://www.cov.com/publications/download/oid27267/570.pdf.

[107] 44 C.F.R. pt. 61 app. at A(1) (2005).

[108] *See* JERRY, *supra* note 19, at 627.

eral insurance administrator has the authority to waive the requirement or to extend the time period for filing a proof of loss.[109]

Another proof of loss issue is whether an insured may assert estoppel against the government and its agents. An insured assumes a high burden for asserting estoppel. First, the insured must prove that the government committed an "affirmative misconduct," not just an omission or negligent failure to inform.[110] Second, after proving affirmative misconduct, he "must still prove that there was false representation by the government, the government had the intent to induce the insurer to act on the misrepresentation, the insurer lacked the knowledge or was unable to obtain the true facts, and the insured detrimentally relied on the misrepresentation."[111]

This double-layered protection of the federal government, along with the difficulty of proving intent on the government's part as the government is presumed to act in the public's interest, makes it highly unlikely that an insured would be able to successfully assert estoppel against the government.

For these reasons, the NFIP does not assure that Katrina home-owning victims will receive certain, immediate relief. Hence, some further intervention is needed to provide Katrina-affected homeowners financial relief.

B. Substantial Katrina-Related Expenditures Unrelated to Homeowners' Property Losses

Congress passed into law substantial Katrina-related expenditure bills among the many Katrina-related bills introduced in the 109th Congress. The most significant Katrina-related enactment was the $35.5 billion aid package that Senator Thad Cochran (R-Miss.) introduced as part of the Department of Defense Appropriations Bill.[112] Congress passed that bill on December 22, 2005.[113] The Act included $11.5 billion in Community Development Block Grants to assist homeowners who did not have flood insurance, including families living in subsidized hotel rooms.[114] It reportedly gave Mississippi about five times as much per household in hous-

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[109] 44 C.F.R. § 61.13 (2005).

[110] *See, e.g.*, North Dakota *ex rel.* Olson v. Ctr. for Medicare and Medicaid Serv., 403 F.3d 537, 541 (8th Cir. 2005); Pollock v. Chertoff, 361 F. Supp. 2d 126, 134 (W.D.N.Y. 2005); Tashjian v. I.R.S., 325 B.R. 56, 60 (D. Mass. 2005).

[111] Rutten v. U.S., 299 F.3d 993, 995 (8th Cir. 2002).

[112] Department of Defense Appropriations Act, 2006, H.R. 2863, 109th Cong. Div. B (2005).

[113] Department of Defense Appropriations Act of 2006, Pub. L. No. 109-148, 119 Stat. 2680.

[114] *See id.*

ing aid as Louisiana.[115] The Act made $1.6 billion available for the educational needs of the areas affected.[116]

Another recent and significant Katrina-related federal enactment increased the amount of money available to fund the NFIP, thereby giving the NFIP sufficient funds to pay Katrina-related flood property owners' claims. In September 2005, Congress increased FEMA's borrowing authority for the NFIP from $1.5 billion to $3.5 billion.[117] This was only a start in fully funding insured flood claims, as FEMA expects the total claims amount to reach $23 billion.[118]

Therefore, on November 18, 2005, Congress approved a second increase in FEMA's borrowing authority for the NFIP from $3.5 billion to $18.5 billion.[119] These budgetary allowances to the NFIP facilitated quicker payment to Katrina flood claims for those insured under the federal program.

C. Congressional Black Caucus Katrina Recovery Fund

Another significant bill relating to Katrina disaster recovery that was proposed by the Black Caucus, but not enacted, is the Hurricane Katrina Recovery, Reclamation, Restoration, Reconstruction and Reunion Act of 2005.[120] It contains several titles that address certain issues pertaining to the aftermath of Hurricane Katrina.[121] One section of particular interest is Title I, the Victim Restoration Fund, the purpose of which is to "provide compensation to an individual [or relative of a deceased individual] who sustained economic or non-economic losses as a result of Hurricane Katrina such that the individual is restored as nearly as possible to his or her condition prior to Hurricane Katrina."[122]

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[115] *See* Adam Nossiter, *A Big Government Fix-It Plan for New Orleans*, N.Y. TIMES, Jan. 5, 2006, at A1.

[116] Department of Defense Appropriations Act of 2006, Pub. L. No. 109-148, 119 Stat. 2680.

[117] National Flood Insurance Program Enhanced Borrowing Authority Act of 2005, H.R. 3669, 109th Cong. (2005).

[118] *See* U.S. GOV'T ACCOUNTABILITY OFFICE, REPORT NO. GAO-06- 335T, CHALLENGES FOR THE NATIONAL FLOOD INSURANCE PROGRAM 3 (2006), *available at* http://www.gao.gov/new.items/d06335t.pdf.

[119] *See* Bill Swindell, *Dispute Over Low-Income Energy Assistance Delays Flood Insurance Bill*, CONGRESS DAILY, Feb. 16, 2006, *available at* http://www.govexec.com/dailyfed/0206/021606cdam2.htm.

[120] Hurricane Katrina Recovery, Reclamation, Restoration, Reconstruction and Reunion Act, H.R. 4197, 109th Cong. (2005) [hereinafter H.R. 4197]; *see also* MICHAEL ERIC DYSON, COME HELL OR HIGH WATER: HURRICANE KATRINA AND THE COLOR OF DISASTER (2006) (analyzing Katrina through the lens of race and wealth).

[121] *See, e.g.*, H.R. 4197 (covering areas including environment; health; public housing; education; voting; financial services; small business opportunities; tax; and bankruptcy).

[122] H.R. 4197 § 103.

The Black Caucus's fund resembles the September 11th Victim Fund.[123] As in the September 11th Victim Fund, the Black Caucus fund proposes the use of a special master, appointed by the attorney general, who would administer the compensation program and supervise claims hearings. As in the September 11th Victim Fund, participating individuals would waive their rights to file lawsuits for damages sustained from Hurricane Katrina.[124] If an individual is a party to a pending civil action, the individual could participate in the fund provided that, within ninety days of the fund's enactment, he withdraws from the pending action.[125]

As with the September 11th Fund, the Katrina victim has to file a claim with the fund within two years from the date of enactment. To be eligible for the fund, an individual must have been present or had assets present in Louisiana, Mississippi, or Alabama at the time of or in the immediate aftermath of Hurricane Katrina and suffered physical harm, death, economic or non-economic losses, or be a personal representative of someone whose death was due to Katrina.[126] After determining eligibility, the special master would review two factors to determine how much an individual should be awarded. First, the special master would review the "extent of the harm to the claimant, including any economic and non-economic losses."[127] Second, he would look at the "amount of compensation to which the claimant is entitled based on the harm to the claimant, the facts of the claim, and the individual circumstances of the claimant."[128]

Again mirroring the September 11th Victim Fund, the special master would not consider negligence or any other theory of liability, nor would he include punitive damages.[129] Additionally, he would deduct collateral compensation from the total compensation award.[130] Hence, the amount received from collateral sources, such as payments from life insurance, would be deducted from the statutory compensation. The proposed bill is silent as to whether the statutory compensation would be increased or decreased due to the victim's receipt of charitable gifts.[131]

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[123] Air Transportation Safety and System Stabilization Act, 49 U.S.C.A. § 40101 (West 2004).

[124] H.R. 4197 § 105(c)(3)(b)(i).

[125] *Id.* § 105(c)(3)(b)(ii).

[126] *Id.* § 105(c)(2)(a)(i,ii),(b).

[127] *Id.* § 105(b)(1)(B)(i,ii).

[128] *Id.* § 105(b)(1)(B)(i,ii).

[129] *Id.* § 105(b)(2),(5).

[130] H.R. 4197 § 105(b)(6).

[131] *Id.* § 102(2).

D. Congressional Bills Specifically Targeting Katrina's Uninsured and Underinsured Homeowners

1. Congressional Buy-out of Katrina Homeowners

Representative Richard H. Baker (R-La.) has proposed the creation of a Louisiana Recovery Corporation.[132] Its main goal is for Congress to pay lenders, restore public works, buy ruined sections of New Orleans, clean them up, and then sell them to developers.[133] The plan is modeled in part on the Resolution Trust Corporation, which Congress set up in 1989 to bail out the savings and loan industry.[134] The Corporation would offer to buy out homeowners at pre-Katrina values,[135] then offer lenders on Katrina-damaged property what they are owed.[136]

In order to finance the plan, the federal government would sell bonds and pay the bonds off in part with the proceeds from the sale of the land to developers.[137] The property owners who sold their property to the government would have an option to buy the restored property back from the Corporation.[138] The federal corporation would not be directly involved with the land's redevelopment; the local authorities and the developers would draw up the redevelopment plans.[139] To date, the Bush administration has opposed the Baker Bill, stating that the block grant money already appropriated would be "sufficient" to take care of homeowners who suffered Katrina-related property losses.[140]

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[132] Louisiana Recovery Corporation Act ("Baker Bill"), H.R. 4100, 109th Cong. (2005); *see also* Louisiana Recovery Act, S. 2172, 109th Cong. (2005) (introducing a similar bill by Senator Mary Landrieu); Nossiter, *supra* note 115, at A1; Richard Wolf, *Another $120B Sought for Wars*, USA TODAY, Feb. 3–5, 2006, at 1A (noting that while the White House has requested another $120 billion for conflicts in Iraq and Afghanistan, it will only seek another $18 billion for hurricane-related expenses in the Gulf Coast).

[133] *See* Bill Walsh, *Plan Would Pay for Ruined Houses*, TIMES-PICAYUNE, Dec. 2, 2005, Nat'l at 1.

[134] *See* Nossiter, *supra* note 115; Financial Institutions Reform, Recovery, and Enforcement Act, H.R. 1278, 101st Cong. (1989).

[135] *See* Nossiter, *supra* note 115; *see also Housing Plan: Rebuild, Sell Out, or Move*, COMMERCIAL APPEAL (Memphis), Feb. 21, 2006, at A4 (describing a housing assistance plan that would provide money to repair or rebuild damaged homes, relocate people who want to rebuild elsewhere in Louisiana, or buy out people who want to leave at sixty percent of the pre-storm home value).

[136] *See* Nossiter, *supra* note 115, at A1.

[137] *See* Louisiana Recovery Corporation Act, H.R. 4100, 109th Cong. § 8(c)(3)(f)(ii) (2005) (noting six percent annual interest paid over the ten years of the Corporation's existence).

[138] *See* Louisiana Recovery Corporation Act ("Baker Bill"), H.R. 4100, 109th Cong. (2005).

[139] *See* H.R. 4100.

[140] *See* Walsh, *supra* note 9.

2. Retroactive Flood Coverage Plan

Perhaps a simpler, although equally provocative, congressional Katrina relief proposal involves retroactively applying the NFIP to uninsured homeowners. That is the concept behind Representative Gene Taylor's (D-Miss.) bill that would allow property owners affected by Katrina who did not have flood insurance to purchase retroactive coverage under the NFIP.[141] If approved, these property owners would pay the equivalent of NFIP premiums for ten years, with a five percent penalty.[142] Premiums would equal the rate of prevailing premiums in the area prior to Katrina and would permit property owners to deduct premium payments and the penalty from the claim payment.[143] This bill has yet to be seen as a viable means of dealing with flood damage to homeowners living outside areas requiring flood insurance.[144]

If passed, the Taylor bill would succeed in providing direct relief to Katrina homeowners who were not required to maintain flood insurance but still suffered flood damage. However, the Taylor bill's funding works like a retroactive tax, is cumbersome, and would be difficult to enforce after the fact. It would be better simply to pay those affected homeowners and either not expect reimbursement or deduct the reimbursement from the payout.

E. Bills Addressing Current Katrina-Related Insurance Industry Problems

1. Homeowners Insurance Protection Act of 2005[145]

This bill recognizes the strain that the 2004 and 2005 hurricane season placed on the insurance industry.[146] Its purpose is to establish a program that would provide lower cost reinsurance, the means by which insurers spread their risk to other insurers, for state natural catastrophe insurance programs and to help the federal government better prepare for natural catastrophes. The bill's other purpose is to promote stability in the homeowners insurance market.[147]

This bill seems to be more focused on bailing out the insurance industry than providing a remedy to Katrina affected homeowners. It also

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[141] Hurricane Katrina and Hurricane Rita Flood Insurance Buy-In Act, H.R. 3922, 109th Cong. (2005).

[142] *See id.*

[143] *See id.*

[144] *See* Grace & Klein, *supra* note 7 (quoting Robert W. Klein, an expert on the economics of insurance markets as opposing this plan "because it greatly undermines any incentive for people to purchase flood insurance in the first place").

[145] H.R. 4366, 109th Cong. (2005).

[146] *See id.* § 2.

[147] *See id.* § 2(14).

does nothing to preempt the various class action lawsuits against the insurance industry and the cost and delay associated with those lawsuits.

2. Natural Catastrophe Insurance Act of 2005[148]

This bill follows the same rationale as the Homeowners Insurance Protection Act of 2005 in recognizing the strain on the private insurance sector and state catastrophe funds caused by the past two hurricane seasons.[149] It seeks to create a federal program that would allow the private market to operate at full capacity and keep insurance at a reasonable price by supporting the private market through state and federal resources.[150] Similar in focus to the Homeowners Insurance Protection Act, this bill is focused on the insurance industry, does not remedy Katrina affected homeowners, and does not preempt contentious Katrina-related insurance litigation.

3. National Flood Insurance Program Commitment to Policyholders and Reform Act of 2005[151]

This bill seeks to increase the maximum coverage limits for flood insurance to reflect inflation and the increased cost of housing.[152] The purpose of this bill is "to protect the integrity of the NFIP by fully funding existing legal obligations expected by existing policyholders."[153] The bill would also increase the incentive for homeowners and communities to participate in the NFIP and further improve oversight to ensure full participation in the program for owners whose participation is mandatory.[154] It also seeks "to better mitigate future flood damage risks through a combination of enhanced protective measures, property elevation, and buyouts of flood-prone properties."[155] The major problem with this proposed legislation is that it seeks to protect homeowners who experience Katrina-like flood insurance coverage problem in the future. Unfortunately, it does little to remedy Katrina-related flood losses in the present.

Unfortunately, none of the existing congressional proposals truly address the unique insurance coverage problems facing Katrina-affected homeowners and their insurers. They either seek to make insurers more liable or fail to adequately compensate Katrina survivors' property losses. None

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[148] H.R. 4507, 109th Cong. (2005).

[149] *See id.* § 2.

[150] *See id.* § 2(6).

[151] H.R. 4320, 109th Cong. (2005).

[152] *Id.* § 6(1) (increasing maximum coverage amount for residential property from $250,000 to $335,500); *id.* § 6(2) (increasing maximum coverage amount for contents from $100,000 to $135,000).

[153] *Id.* § 2(b)(1).

[154] *See id.* § 2(b)(2).

[155] *Id.* § 2(b)(4).

address the numerous private and public mechanisms that are being investigated to determine how the insurance industry and the federal government can adequately fund future mega-catastrophes, be they man-made or not.[156] What is needed is federal legislation that will truly address and assist the needs of Katrina-affected homeowners and of their insurers, including the NFIP.

V. THE KATRINA FUND: A FEDERAL BAILOUT OF KATRINA HOMEOWNERS

A. Purpose

In response to homeowners' and insurance companies' need for federal assistance, the following proposed bill seeks to combine the best of the various congressional Katrina-related homeowners property and insurance bailout legislation. The proposed bill is entitled the "Hurricane Katrina Homeowners Compensation Fund" [hereinafter the Katrina Fund].

The Katrina Fund recognizes that the nation has experienced an unprecedented natural disaster, in which the local and state governments are unequipped to assist their citizens, and where the loss to property is so substantial as to threaten the orderly operation of capital markets, through foreclosures and bankruptcies of a major United States city and an entire region. Its overall goal is to ensure the continued national availability of reasonably priced homeowners property insurance. Its immediate mission is to fill the homeowners insurance gap in such a way to promote stable capital markets, quick and certain economic recovery, and human health and safety.

The September 11th Victim Compensation Fund is an inspirational model for the Katrina Fund. The September 11th Victim Compensation Fund is the short title for Title IV of the Air Transportation Safety and System Stabilization Act.[157] Its stated purpose is to provide full economic and non-economic compensation, without the need to prove fault, to any individual (or relative of a deceased individual or their "personal representative")[158] who was physically injured or killed as a result of the acts of terrorism committed on September 11, 2001.[159] The Fund also sheltered the airline industry and other parties from liability because eligible vic-

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[156] *See generally* U.S. GOV'T ACCOUNTABILITY OFFICE, REPORT NO. GAO-05-199, CATASTROPHE RISK: U.S. AND EUROPEAN APPROACHES TO INSURE NATURAL CATASTROPHE AND TERRORISM RISK (2005), *available at* http://www.gao.gov/new.items/d05199.pdf (analyzing different mechanisms to increase the capacity of the insurance industry to manage catastrophic events).

[157] 49 U.S.C.A. § 40101 (West 2004).

[158] *Id.; see also* 28 C.F.R. § 104.4 (2005).

[159] 28 C.F.R §§ 104.2, 104.4 (2005).

tims waived not only rights to sue the airlines but also other institutions like the World Trade Center and the City of New York.[160]

The Fund authorized Attorney General John Ashcroft to appoint a special master to develop and administer a plan.[161] The special master, Kenneth Feinberg, employed a three-step process to determine eligibility and the award amount.[162] First, he determined the extent of the harm to the claimant, including any economic and non-economic losses.[163] Second, he assessed the amount of compensation, based on the extent of the harm, the facts of the claim, and the individual circumstances of the claimant.[164] After having determined the amount of compensation to which a claimant was entitled, the Special Master reduced that amount by collateral sources received by the claimant (such as insurance awards). The Fund concluded less than three years later with a total of $8.7 billion awarded for personal losses.[165]

Those eligible for compensation were the victims from the crashes at the World Trade Center, Pentagon, or Shanksville, Pa.[166] Qualifying victims were guaranteed some form of compensation for what happened without having to prove fault.[167] When a claimant submitted a claim to the Fund, he waived the right to file or be a party of a civil action in any state or federal court for damages sustained from the terrorist attack.[168]

A claimant had to file a written claim for compensation within two years after the date on which the regulations were promulgated.[169] The minimum amount of compensation for a single individual was $300,000,[170] and the minimum for a married individual was $500,000.[171] Special Master Feinberg stated that the median payment would be $1.583 million before the deductions.[172] Feinberg set a "presumptive limit on annual earnings" at approximately $240,000 in order to "minimize award dispar-

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[160] *See* 28 C.F.R. § 104.61 (2005).

[161] 49 U.S.C.A. § 40101 (West 2004).

[162] *Id.*

[163] *Id.*

[164] Press Release, U.S. Dep't. of Justice, September 11th Victim Compensation Fund Claims' Deadline Approaches—December 22, 2003 (Nov. 25, 2003), *available at* http://usdoj.gov/opa/pr/2003/November/03_civ_648.htm.

[165] Press Release, RAND Corp., RAND Study Shows Compensation For 9/11 Terror Attacks Tops $38 billion; Business Receive Biggest Share (Nov. 8, 2004), *available at* http://www.rand.org/news/press.04/11.08b.html.

[166] *See, e.g.*, 49 U.S.C.A. § 40101 (West 2004).

[167] Anthony Sebok, *The Final Rules for the September 11 Victims Compensation Fund: Are They a Laudable Model, or a Large Mistake?*, FINDLAW.COM, Mar. 25, 2002, http://writ.corporate.findlaw.com/sebok/20020325.html.

[168] *See id.*

[169] *See* 49 U.S.C.A. § 40101 (West 2004).

[170] *See* Press Release, Dep't. of Justice, September 11th Compensation Fund Regulations Announced (Dec. 20, 2001), *available at* http://www.usdoj.gov/opa/pr/2001/December/01_ag_658.htm.

[171] *See* Stephanie Saul & Ellen Yan, *A Fund for the Families: Average Payout of $1.6M—Before Likely Deductions*, NEWSDAY, Dec. 21, 2001, at A5.

[172] *Id.*

ity."[173] Punitive damages were not considered when determining compensation.[174] The amount paid to the claimant by collateral sources[175] was deducted from the total compensation the claimant received, but charitable gifts were not deducted from the compensation.[176]

The September 11th Fund takes a broad and comprehensive approach by redressing the various types of losses. The damages that were considered were divided into two main groups: economic losses and non-economic losses. Economic losses included any "pecuniary loss resulting from harm (including the loss of earnings, or other benefits related to employment, medical expense loss, replacement services loss, loss due to death, burial costs, and loss of business or employment opportunities) to the extent recovery for such loss is allowed under applicable State law."[177] Non-economic losses included "losses for physical and emotional pain, suffering, inconvenience, physical impairment, mental anguish, disfigurement, loss of enjoyment of life, loss of society and companionship, loss of consortium (other than loss of domestic service), hedonic damages, injury to reputation, and all other non-pecuniary losses of any kind or nature."[178] While the Katrina Fund is particularly focused on the economic loss to property, there would be reason to follow the September 11th Fund approach and consider economic and non-economic losses to Katrina survivors.

B. Proposed Provisions

The Katrina Fund is a comprehensive, unencumbered, direct, immediate, and emergency approach to provide needed financial relief to the affected homeowners. In addition to correcting insurance inequities and ensuring stable insurance markets, the Katrina Fund ensures the continuing viability of a major American city, New Orleans, and the Gulf Coast region and its commerce; the United States' standing as a world leader as viewed through its ability to provide for its citizens following a natural disaster; and, relative to the war on terrorism, the United States' ability to manage a large, widespread disaster of any nature.

1. Homeowners Benefited

The Act shall apply to homeowners of any and all residential properties in Katrina's partially devastated and totally demolished communities. This applies to any and all residential properties, including those used as

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[173] *Id.*

[174] 49 U.S.C.A. § 40101 (West 2004).

[175] *See id.* (collateral sources include life insurance, pension funds, death benefit programs, payments by federal, state, or local governments related to the September 11 crashes).

[176] *See id.*

[177] *Id.*

[178] *Id.*

a primary residence, a vacation home, or a residential rental property for investment purposes. For the purpose of this Act, a "partially devastated community" is defined as any community thirty percent of whose housing stock was adversely affected by the Katrina. A "totally devastated community" is any large segment of a partially devastated community wherein fifty percent or more of the housing stock was adversely affected by the hurricane. "Adversely affected" shall mean either wind damage or water damage, including flood damage that makes the property partially or totally uninhabitable for six months or longer, due to Katrina.

2. The Payout

The Act will pay any residential homeowner whose property is located in a partially or totally devastated community 125% of the replacement cost of his or her pre-Katrina residential property values, including contents (the "payout figure"). There shall be no offset from the payout figure for any insurance monies from any sources, commercial or government, that the homeowner received. Property owners in partially devastated communities waive any rights to relocation expenses, and property owners in totally devastated communities shall receive additional relocation expenses. Furthermore, the payouts received shall be exempt from federal and state taxes.

3. Transfer of Title: Optional Versus Mandatory

In return, the Katrina-affected homeowner shall transfer title to the property to local redevelopment corporations that will be established in each devastated community for the purpose of redeveloping the properties. If the affected property is located in a partially devastated community, the homeowner shall have the option of participating in the Katrina Fund program. They shall have the right of first refusal to repurchase restored properties at the same amount as their payout figure. But if the affected property is located in a totally devastated community, the homeowner must participate in the buyout. While the Act recognizes that this raises constitutional issues of eminent domain, the Act believes that the overriding health and community development benefits outweigh any disadvantages.

4. Waiver of Right To Sue

In participating in the Fund payout, the property owners agree to waive any rights they might have to participate in any lawsuits against their homeowner and flood insurance company, as well as their insurance brokers and agents, for homeowners' residential property losses. As a part of their receipt of funds, they will be preempted from participation in any lawsuits

against any party for their residential losses, including their insurance company; the NFIP; federal, state, and local governments; and levee boards.

5. Use of Eminent Domain

Any Katrina-affected property owners, those in partially devastated communities who voluntarily participate and those in totally devastated communities whose participation is mandatory, shall have their properties taken by the federal government by condemnation through the use of eminent domain. As such, all claims to title to the affected properties shall be cleared for the redevelopment corporations.

6. Source of Funding

The federal government shall immediately provide the necessary funding to purchase all residential properties expected to participate in the program. The fund shall be known as the Hurricane Katrina Homeowners Compensation Fund. Funding will be generated from the issuance of government bonds, the Katrina Gulf Coast and City of New Orleans Restoration Bonds, which shall be offered to investors at competitive market rates and backed by the full faith and credit of the United States government. The funding for the program shall seek various means of reimbursement to repay the debt created by the operation of the fund. These shall include, but are not limited to, the following: a share in the resale profits from the redevelopment of the partially devastated and totally devastated communities; a share in the resale profits from the restored properties; a share in the property taxes from the restored communities once restored; a tax on the commercial insurance industry; and an offset from FEMA's National Flood Insurance Program.

7. Special Master To Administer Claims

The Act shall empower the President of the United States to name a special master whose task will be to arbitrate in summary manner any disputes arising out of the operation of the Fund.

8. Anti-Fraud Provisions

The Fund shall establish the creation of an office of the inspector general, whose task will be to investigate any and all fraud and corruption claims that might arise concerning the Fund.

VI. MAKING THE CASE FOR THE KATRINA FUND

A. The Katrina Fund Protects Against Katrina's Second Wave of Financial Disaster: Personal Bankruptcies and Mortgage Companies' Losses

Now and over the next several months, Katrina will produce a wave of financial disaster for Katrina victims and their communities. That disaster comes in the form of personal, business, and municipal bankruptcies, foreclosures on mortgages, and substantial financial losses by mortgage companies, insurance companies, and banks. Logically, the Katrina Fund will help protect the financial security of Katrina victims, their communities, and financial institutions throughout the country by allowing Katrina-affected homeowners to pay their mortgages, avoid foreclosure, and in some instances walk away with their equity.

1. Katrina Victims and Their Home Communities Require Immediate Financial Assistance

Katrina's first wave struck its victims on August 29, 2005.[179] It devastated three states' coastal populations.[180] Many survivors were desperate, abandoned, homeless, and hungry, most notably those at the New Orleans Superdome.[181]

Katrina's second wave will also be severe. It will cause long-term financial and health devastation and psychological distress.[182] Today, water and wind are no longer hitting Katrina's victims. Instead, Katrina is now engulfing its victims in financial ruin and environmental exposures.[183] The following are examples of the problems Katrina victims face.

First, consider the elderly who had made New Orleans and its coastal communities their homes for decades.[184] They are experiencing despair and depression, and many are removed from the comforts of familiar surroundings, church communities, family support, and medical services.[185]

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[179] *See* Charlene Porter, *Tens of Thousands of Katrina Evacuees Find Shelter Around Country*, U.S. FED. NEWS, Sept. 8, 2005.

[180] *See id.*

[181] *See id.*

[182] *See generally* KAID BENFIELD ET AL., NAT'L RES. DEF. COUNCIL, AFTER KATRINA: NEW SOLUTIONS FOR SAFE COMMUNITIES AND A SECURE ENERGY FUTURE (2005), *available at* http://www.nrdc.org/legislation/hk/hk.pdf (describing Katrina's public health effects and proposing solutions).

[183] *See* Brown, *supra* note 6, at 3; *see also* EPA News Brief, *supra* note 6.

[184] *See* Jayne Gurtler, *Katrina's Lessons: Out of the Worst Come Some of the Best*, 10 ONCOLOGIST 661–62 (2005), *available at* http://theoncologist.alphamedpress.org/cgi/reprint/10/8/661.

[185] *See id.*

Second, many tenants returning home have been evicted for not paying rent.[186] Unemployment is at a high level.[187] Many people are told that their rents have increased, and that they owe months of back rent, while landlords often are not performing needed repairs.[188] They are fearful to regain possession of Katrina-damaged properties; tenants and their attorneys are threatening to sue them for wrongful eviction.[189] These homes are also often polluted with mold.[190]

In addition to mold, Katrina unleashed an environmental plague on Gulf Coast communities and New Orleans.[191] Lower income victims are also being exposed to lead and toxins in contaminated, substandard housing.[192] Communities historically overexposed to environmental contaminants will suffer even more respiratory problems.[193]

Low income residents of public housing have been told that their homes are too damaged to be rebuilt.[194] Their families and church communities have been displaced and local schools have been destroyed.[195] Many residents were put on airplanes and flown to unfamiliar communities throughout the country and are living as "refugees," while thousands still live in shelters.[196]

In the midst of all of this, families are still separated.[197] Multigenerational families who shared one roof cannot separately receive FEMA housing assistance, so family members separated through no fault of their own are forced to fight over one housing assistance check per household.[198] They cannot seek work in different towns and face difficulties getting building permits.[199] Sadly, they are left to depend on the kindness of strangers.

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[186] *See* Interview by Amy Goodman with Ishmael Muhammad, Attorney at Advancement Project, and Sonia Kahn, New Orleans resident, in Atlanta, Ga. (Dec. 16, 2005), *available at* http://www.democracynow.org/article.pl?sid=05/12/16/1457242.

[187] *See id.*

[188] *See id.*

[189] *See id.*

[190] *See id.*

[191] *See* Brown, *supra* note 6, at 3; EPA News Brief, *supra* note 6.

[192] *See* Brown, *supra* note 6, at 3. .

[193] *Id.*

[194] *See American Morning: Thousands of Katrina Evacuees Still Living in Shelters* (CNN broadcast Oct. 14, 2005), *available at* http://transcripts.cnn.com/TRANSCRIPTS/0510/14/ltm.03.html.

[195] *See id.*

[196] *See id.*

[197] *See* Larry Magid, *Reuniting Families After Katrina*, CBS NEWS, Sept. 15, 2005, http://www.cbsnews.com/stories/2005/09/15/scitech/pcanswer/main850384.shtml.

[198] *See id.*

[199] *See* JASON WALSH & ANDY VAN KLEUNEN, WORKFORCE ALLIANCE, WORKFORCE (RE)DEVELOPMENT IN THE GULF COAST REGION: A THREE-PART AGENDA FOR ACTION 1 (2005), *available at* http://workforcealliance.org/policy/WorkforceReDevelopmentintheGulfCoastFINAL.pdf (outlining the Workforce Alliance's agenda to address this problem); *see also* Adam Nossiter, *Sparing Houses in New Orleans Spoils Planning*, N.Y. TIMES (Late Edition), Feb. 5, 2006, § 1, at 22 (noting the frustration that Katrina survivors face in getting building permits to rebuild in light of FEMA's pending flood insurance guidelines).

2. *Katrina Homeowners and Mortgage Companies Are Especially Affected*

Katrina's second wave also impacts middle and upper class homeowners.[200] They have new refugee living expenses, and they often lack savings or insurance proceeds to pay their bills.[201] Their mortgage companies are demanding overdue payments and threatening foreclosure, following a 90-day moratorium.[202] While they face almost certain bankruptcy, the banks and mortgage companies are losing substantial revenue, facing bad loan write-offs, foreclosing on damaged collateral, and downsizing.[203]

Insurance companies are facing huge claims and litigation from many seeking compensation for wind and water damages.[204] Many insurance checks are often mailed to the damaged property address, not the refuge address, adding further delays.[205] Once the checks are received, banks and mortgage companies are slow to process them and often hold insurance funds in escrow.[206]

These are the faces of Katrina's financial fury: "refugee Americans" on the verge of having their homes foreclosed and having to consider filing for bankruptcy.

B. The Katrina Fund Protects the Smooth Operation of Residential Property Insurance Markets

Congress has a responsibility to ensure the smooth operation of the nation's capital markets, including the insurance markets.[207] Under normal circumstances, insurance companies anticipate losses through actuarial analysis, taking into account risk and contract coverage.[208] They price their policies accordingly and establish financial reserves to handle anticipated

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[200] *See* Jessica Robertson, *Hurricane Katrina Victims May Feel Financial Effects for Years to Come*, WORLD INTERNET NEWS, Dec. 5, 2005, http://soc.hfac.uh.edu/artman/publish/article_315.shtml; Carol Rust, Staci Semrad & Dirk Johnson, Katrina's Refugees, NEWSWEEK, Sept. 2, 2005, at 42, *available at* http://www.msnbc.msn.com/id/9149624/site/newsweek.

[201] *See id.*

[202] *See id.*

[203] *See id.*

[204] *See supra* text accompanying note 4 (describing Katrina class action lawsuits that have been filed); *see also supra* text accompanying note 6 (describing other Katrina class action lawsuits that have been filed).

[205] *See* Food Research and Action Center (FRAC), Special: Hurricane Katrina Center, *available at* http://www.frac.org/html/disaster/disaster_media.html (last visited Mar. 14, 2006) (pointing out that Katrina evacuees are dispersed across the country from Arkansas to New Mexico and are having trouble accessing their bank accounts and receiving mail); *see also* PATRICK BUCKLEY ET AL., AMS. FOR INS. REFORM, THE INSURANCE INDUSTRY'S TROUBLING RESPONSE TO HURRICANE KATRINA 12 (2006), *available at* http://www.centerjd.org/air/pr/KATRINAREPORT.pdf. (noting that a Katrina victim had to press her insurance company for over two months in order to receive her insurance check).

[206] *See id.*

[207] *See generally* BUCKLEY, *supra* note 205.

[208] *See* JERRY, *supra* note 19, at 13–24.

losses.[209] Post-Katrina litigation threatens to add unanticipated losses to the insurance industry.[210] If the class action litigation against the insurance industry is successful, it could have substantial effects on the insurance industry that could raise prices for all residential property owners.

Assuming such litigation is unsuccessful, the insurance industry can reportedly handle the amount of insured losses following Katrina.[211] Still, five of the ten costliest hurricanes have occurred in the last thirteen months; six of the ten costliest disasters have occurred in the last four years.[212] Katrina-related insured losses are estimated to be around $34.4 billion, $22.6 billion of which is in Louisiana.[213]

Natural disasters pose challenges for insurers because they involve potentially high losses and large degrees of uncertainty.[214] They also involve geographically concentrated losses and often the simultaneous occurrence of many losses from a single event.[215] As a result, insurance companies have generally found that providing insurance coverage for natural disasters is commercially not viable.[216] Therefore, losses from natural disasters are expressly exempted from most residential homeowners insurance policies.[217] If judges force private insurance companies to pay for Katrina flood damages, there could be negative effects on the insurance industry, existing policyholders, and future policyholders, as well as society as a whole.[218]

One insurance industry legal commentator has painted a dire picture for the insurance industry if the Katrina litigation succeeds.[219] According to his analysis, consequences may include an exacerbation of already heavy underwriting losses by private and public insurers; impairment of insurance industry capital available for coverage during recovery; possible destruction of the marketability of federal flood insurance; cash flow or solvency crises in the affected states' Insurance Guaranty Associations; declination by primary and reinsurance companies to write coverage in the affected states on reconstruction; "lock-in" legislation attempting to mandate availability and forbid withdrawal; creation of new state-run insurance availability plans operated by political appointees without insurance experience; expensive antitrust actions to discourage insurers from withdrawing; and federal mandates to purchase flood insurance.[220] A number of

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[209] *See id.*

[210] *See id.*

[211] *See Regulators Say Industry Prepared for Katrina Costs*, INSURANCE J., Sept. 2, 2005, *available at* http://www.insurancejournal.com/news/national/2005/09/02/59132.htm.

[212] *See* NOAA's Report, *supra* note 2; CONSUMER REPORTS, *supra* note 2.

[213] *See id.*

[214] *See* MILLS, *supra* note 5, at 7.

[215] *See id.*

[216] *See id.*

[217] *See id.*

[218] *See id.*

[219] *See* Doug Simpson, *Unintended Consequences of Flood Avoidance Suits*, Sept. 17, 2005, http://www.dougsimpson.com/blog/archives/000478.html.

[220] *See id.*

these potentialities are extremely likely, given the instances of the failure and withdrawal of insurance companies in Florida following Hurricane Andrew.[221]

By circumventing costly and potentially far-reaching litigation, the Katrina Fund is an appealing solution that would protect against these severe and numerous consequences that are likely to further devastate the nation's insurance markets.

C. The Katrina Fund Protects the Integrity of the National Flood Insurance Program, Without Which It Would Fail

The federal government established the NFIP because flood-related loss is generally excluded in homeowners property insurance coverage.[222] One important hallmark of the NFIP is the floodplain, the federal government's maps that guide homeowners and insurers in their flood insurance decisions. The NFIP uses a 100-year floodplain to determine who should and who should not purchase flood insurance.[223] Katrina's losses, as interpreted by commercial insurance companies, went beyond the 100-year floodplain.[224] Unfortunately, the federal government, in planning the budget for NFIP, did not account for the unprecedented level of hurricane activities the nation has experienced over the last two hurricane seasons.[225]

As a result, the NFIP simply lacks the capital reserves to handle Katrina's financial burden. A report by the Government Accountability Office (GAO) notes that the NFIP has not collected sufficient premium-based income to build the reserves necessary to meet the long-term, anticipated flood losses.[226] That is, in part, because Congress authorized subsidized insurance rates for some properties.[227] Despite the increased borrowing capacity of the NFIP since Katrina,[228] future premiums would probably be insufficient to support the cost of Katrina flood-related losses.[229]

If the Katrina Fund is not passed, Congress will need to require more homeowners to carry federal flood insurance or increase flood insurance

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[221] *See* Adrian Sainz, *Ten Years After Hurricane Andrew, Effects Are Still Felt*, SUN-SENTINEL, Aug. 18, 2002, at 2, *available at* http://www.sun-sentinel.com/news/weather/hurricane/sfl-1992-ap-mainstory,0,913282.story (noting that eleven insurers became insolvent at least partly because of Andrew, and surviving insurers were reluctant to stay in Florida).

[222] *See* FED. EMERGENCY MGMT. AGENCY, *supra* note 71, at 1.

[223] *See id.* at 5.

[224] *See id.* at 15.

[225] *See id.*

[226] *See* GOV'T ACCOUNTABILITY OFFICE, REPORT NO. GAO-06-174T , CHALLENGES FACING THE NATIONAL FLOOD INSURANCE PROGRAM 7 (2005), *available at* http://www.gao.gov/new.items/d06174t.pdf.

[227] *See id.* at 2.

[228] *See id.* Congress increased the borrowing capacity of the NFIP by $2 billion, bringing the total to $3.5 billion. *See id.*

[229] *See id.*

premiums for other program participants.[230] In written testimony delivered to the Senate Committee on Banking, Housing, and Urban Affairs on the future of the NFIP, Robert Hartwig, an insurance economist, stated that if the NFIP were a private insurer, it would be bankrupt.[231] And relative to homeowners' attempts to judicially expand homeowners insurance to cover flood losses, Hartwig opined:

> In the remote likelihood that such suits were to be successful, an immediate national crisis in the availability and affordability of homeowners insurance would ensue and the NFIP's very reason for existence would be threatened. Why buy flood coverage from the NFIP when you can just sue your homeowner's insurer and get it for free?[232]

Indeed, the Katrina Fund will counter the federal government's mis-assessment and miscalculation of the NFIP's budget that will otherwise produce harsh results. While the floodplain used in the NFIP is based on many factors, the federal government was likely aware of the erosion of the flood protective barriers along the Gulf Coast and in levee-guarded New Orleans. As people who lived outside the floodplain but who experienced flooding will argue, the federal government should assist them in covering their flood loss. Had the federal government done a better job predicting flood occurrences, those outside the floodplain would likely have purchased flood insurance through the NFIP.

In response to this negligence on the federal government's part, the Katrina Fund would provide an immediate, equitable solution to provide federal relief to innocent homeowners who might have otherwise purchased flood insurance or greater flood insurance. In addition, the federal government is scheduled to redefine, post-Katrina, the 100-year floodplain in the Gulf Coast region. As a result, it is expected that the "totally-devastated" communities, as defined by the Katrina Fund statute, will be below the arguably new 100-year floodplain and will likely not be eligible for federal flood insurance under the NFIP. Without the Katrina Fund, these hardest hit communities will be lost to their homeowners. In addition, it is likely that, without the Katrina Fund, the NFIP will become bankrupt and therefore will be unavailable to assist other American communities in the future.[233]

For Congress to rely solely on the NFIP to provide relief for Katrina homeowners would be cumbersome and would ignore the dire nature of

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[230] *See id.*

[231] *The Future of the National Flood Insurance Program: Hearing Before the S. Comm. on Banking, Housing and Urban Affairs*, 109th Cong. 3 (2005) (written statement of Robert Hartwig, Vice President and Chief Economist for the Insurance Information Institute).

[232] *See id.* at 6.

[233] *See supra* note 226 and accompanying text.

the post-Katrina disaster. It would require Congress to radically amend the NFIP, provide retroactive coverage, and pour billions of dollars into it.

D. The Katrina Fund Equitably Treats Natural Disaster Victims on Par with Victims of Terrorism

Following the precedent set by provisions for victims of the September 11 attacks, the Katrina Fund is an equitable approach to assisting innocent victims of national disasters. The same issues that the September 11th Victim Compensation Fund strove to address are similarly pertinent in the aftermath of Katrina: both the survivors (victims) of a major disaster and industries are threatened by crippling litigation, massive suffering, and need.[234] It would be unconscionable and plainly inequitable to treat Katrina victims with less sympathy and financial support than the September 11 victims.

Some civic leaders have called for the establishment of a Katrina victims' fund similar to the September 11th fund.[235] Creating a fund for the Katrina victims, modeled after the September 11th Victim Compensation Fund, would avoid costly litigation while protecting the insurance and mortgage industries. The Katrina Fund is also needed because Katrina victims, like the injured families following September 11, are not in a financial position to wait for possible assistance following protracted litigation.

There are several reasons why the Katrina Fund would address the needs of the Katrina victims better than costly class action litigation. In noting how the September 11th Fund provided a means of preempting costly and time-consuming litigation, its special master, Kenneth Feinberg, stated that the point of a government compensation scheme is to reduce transaction costs, reduce uncertainty, and direct money to those in need.[236] In a similar manner, the Katrina Fund would both address the needs of Katrina-affected homeowners as well as provide a preemptive remedy for costly litigation against the insurance industry, the NFIP, and other defendants.

Any and all litigation, regardless of how "good" the case is, is subject to an uncertain and delayed outcome. In contrast, the Katrina Fund, managed by a single special master, would distribute funds directly and quickly. Second, while transaction costs (i.e., attorney fees) take money away from victims, the Katrina Fund would eliminate attorney fees, dis-

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[234] *See* Scales, *supra* note 24.

[235] *See* Press Release, Nat'l Urban League (Sept. 8, 2005), *available at* http://www.nul.org/PressReleases/2005/2005PR222.html (stating that Marc Morial, President and CEO of the National Urban League, as well as former mayor of New Orleans, is calling for the creation of such a fund); NAACP, *Congress Urged to Establish a Hurricane Victims Compensation Fund*, Sept. 9, 2005, http://www.naacp.org/news/2005/2005-09-06.html (declaring the NAACP's support for such a fund).

[236] *See* Anthony J. Sebok, *Ken Feinberg's 9/11 Victims' Fund Rules Versus Cantor Fitzgerald's Critique of the Rules: What Did Congress Intend to Be "Full Compensation"?*, FINDLAW, Sept. 23, 2002, *available at* http://writ.news.findlaw.com/sebok/20020923.html.

tributing money only to victims. Third, victims eligible for the Katrina Fund, like those eligible for the September 11th Fund, would waive their rights against the insurance industry but retain their rights against others. For example, those participating in the Katrina Fund would retain the right to sue those whose negligence caused the flooding, while admitting it was indeed "flooding" as defined in their homeowners insurance policy exclusions.[237]

Arguably, such a fund may be more appropriate for Katrina victims than it was for September 11 victims. Although the September 11 tragedy was devastating, it consisted of three geographically isolated events, and affected property owners were not scattered throughout every other state in the nation.[238] There was no debate about rebuilding New York City or the Pentagon.[239] New Yorkers and Pentagon staff did not deliberate about whether to return.[240] New Orleans and Gulf Coast property owners are facing such issues, which the Katrina Fund would alleviate. Currently, property owners in New Orleans are debating whether they should return and rebuild.[241] The President has committed the resources of the nation to rebuilding New Orleans and the surrounding region.[242] While participation in the Katrina Fund would not force someone to rebuild in New Orleans or on the Gulf Coast, it would facilitate the process for those who want to rebuild. The longer business and personal property owners must go without compensation for their loss, the easier the decision will be for them to relocate permanently.

Hence, the Katrina Fund would help Gulf Coast residents return to their communities, to their loved ones, and to their pre-Katrina lives. Without it, they will remain displaced and a likely burden on supporting communities that are temporarily assisting them.

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[237] *See* Russell, *supra* note 57. Several investigations into the design and construction of the levee system in New Orleans are ongoing. *See id.*

[238] *See Evacuees Fan out Through 50 States*, ASSOC. PRESS, Sept. 5, 2005, *available at* http://www.cbsnews.com/stories/2005/09/05/katrina/main815262.shtml.

[239] *See Hastert Questions Rebuilding New Orleans*, ASSOC. PRESS, Sept. 1, 2005, *available at* http://abcnews.go.com/Politics/wireStory?id=1089373 (last visited Mar. 17, 2006) (quoting House Speaker Dennis Hastert as having said, "[i]t makes no sense to spend billions of dollars to rebuild a city that's 7 feet under sea level" and that "[i]t looks like a lot of that place could be bulldozed."); Charles Babington, *Hastert Tries Damage Control After Remarks Hit a Nerve*, WASH. POST, Sept. 3, 2005, at A17.

[240] *See, e.g.*, John Pomfret, *Evacuees Begin to Put Down Roots*, WASH. POST, Oct 22, 2005, at A8.

[241] *See* Kate Moran, *Shrinking City*, TIMES-PICAYUNE, Oct. 23, 2005, at 1, *available at* http://www.nola.com/news/t-p/frontpage/index.ssf?/base/news-4/113005104877980.xml. New Orleans Mayor Ray Nagin estimates that half of the 500,000 people who lived in New Orleans will return. *See id.*

[242] *See* Press Release, President George W. Bush, President Discusses Hurricane Relief in Address to the Nation (Sept. 15, 2005), *available at* http://www.whitehouse.gov/news/releases/2005/09/20050915-8.html. On September 15, 2005, President Bush addressed the nation in front of Jackson Square in New Orleans and promised that "[t]hroughout the area hit by the hurricane, we will do what it takes, we will stay as long as it takes, to help citizens rebuild their communities and their lives." *Id.*

VII. PRESENTING THE ARGUMENTS AGAINST THE KATRINA FUND[243]

A. The Katrina Fund Is a Shameful Insurance Industry Bailout Program That Unnecessarily Preempts the Equitable Workings of Existing Homeowners Insurance Contracts and NFIP

1. Another Needless Government Bailout

While proponents of the Katrina Fund describe their proposal through the needs of Katrina victims, critics argue that the Fund's true disposition is as a widespread, costly federal government bailout of the insurance industry. Its mere suggestion validates recent criticism of the federal government for its continuing policies and programs of corporate welfare.[244] If the Katrina Fund is adopted, American businesses will continue to use the federal budget as their guarantor against losses. It will follow the expensive bailout examples of the savings and loan industry through the Resolution Trust Corporation and the airline industry through the September 11th Victim Fund.[245]

Also, critics argue that American courts are well equipped to adjudicate Katrina homeowners property insurance claims. Both Louisiana and Mississippi, like Florida, have a valued policy provision in their state law.[246] This area of law was a major source of litigation in Florida following its devastating hurricanes prior to Katrina. For example, in a 2004 Florida Court of Appeal ruling, the court held that the state's value policy law allowed a homeowner to recover policy limits under wind coverage, even though he received a substantial payment for flood damage under the federal flood insurance program.[247] The courts are, therefore, adequate to handle the insurance-related issues that Katrina raises. The matters generally involve direct issues of insurance contract law and the assessment of physical losses to real property and contents therein.

Even in cases of damage from uncovered peril, courts have shown competence in protecting homeowners. As interpreted by insurers, the value

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[243] Other arguments against the Katrina Fund include the Fund's use of eminent domain; potential cuts to other social services; and the opportunity for corruption in the operation and implementation of the Fund. *See generally* SUSAN F. FRENCH ET AL., CASES AND TEXT ON PROPERTY 1065–1222 (5th ed. 2004) (discussing case law involving eminent domain, condemnation, and taking).

[244] *See* Lee Davison, *Politics and Policy: The Creation of the Resolution Trust Corporation*, 17 FDIC BANKING REV. 2 (2005); Gillian Hadfield, *The September 11th Victim Compensation Fund: "An Unprecedented Experiment in American Democracy,"* 7 (Univ. of S. Cal. Legal Working Paper Series, Univ. of S. Cal. Law and Econ. Working Paper Series, Working Paper No. 29, 2005), *available at* http://ssrn.com/abstract=690401.

[245] *See* Davison, *supra* note 244 at 2; Hadfield, *supra* note 244, at 11.

[246] FLA. STAT. ANN. § 627.702(1)(a) (West 2003).

[247] *See* Mierzwa v. Fla. Windstorm Underwriting Ass'n, 877 So. 2d 774, 775 (Fla. Dist. Ct. App. 2004).

policy of Florida law,[248] means that in the event of a total loss, the amounts of property damage in a mixed causation scenario are determined and paid proportionally to the covered versus uncovered amounts.[249] In a concurring opinion, the Florida appellate court in *Mierzwa* stated that in the event of a total loss, "if the insurance carrier has *any* liability at all to the insured for a building damaged by a covered peril and deemed a total loss, that liability is for the face amount of the policy."[250] As a consequence, if the premiums are based on the value of the property, and there is a total loss resulting from an uncovered peril and a covered peril, the insurer must pay the full policy amount. Due to this unintended outcome, Florida legislators rewrote the law to void the ambiguous language that gave rise to the appellate court's interpretation.[251] Louisiana[252] and Mississippi[253] have similar statutes, but their provisions apply to fire only. Given the political environment in the aftermath of Katrina, it is probable that the *Mierzwa* outcome will be argued by plaintiffs.[254] In either case, as shown in Florida, courts are adequately equipped and capable to adjudicate Katrina-related homeowners claims without congressional interference.

2. The Katrina Fund Does Not Avoid the NFIP's Bankruptcy.

Essentially, critics believe the flaws of the Katrina Fund outweigh its benefits. They argue that one of the Fund's crucial flaws is that it changes the NFIP's role from a program financed by policy premiums to a pipeline for federal grants. This argument equates the Katrina Fund with a huge government grant, a bailout first of citizens who should have purchased flood insurance and secondly of mortgage lenders who should have acquired

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[248] *See* FLA. STAT. ANN. § 627.702(1)(a) (West 2003).

[249] *See id.*

[250] *Mierzwa*, 877 So. 2d at 781–82 (Gross, J. concurring).

[251] The statute provides:

> The intent of this subsection is not to deprive an insurer of any proper defense under the policy, to create new or additional coverage under the policy, or to require an insurer to pay for a loss caused by a peril other than the covered peril. In furtherance of such legislative intent, when a loss was caused in part by a covered peril and in part by an uncovered peril, paragraph (a) does not apply. In such circumstances, the insurer's liability under this section shall be limited to the amount of the loss caused by the covered peril. However, if the covered perils alone would have caused the total loss, paragraph (a) shall apply. The insurer is never liable for more than the amount necessary to repair, rebuild, or replace the structure following the total loss, after considering all other benefits actually paid for the total loss.

FLA. STAT. ANN. § 627.702(1)(b) (West 2005).

[252] *See* LA. REV. STAT. ANN. § 22:695 (2004).

[253] *See* MISS. CODE ANN. § 83–13-5 (1999).

[254] Mississippi Attorney General Jim Hood has filed a class action suit and may be using this rationale. *See* Hood v. Mississippi Farm Bureau Ins., No. G2005-1642 (Miss. Ch. filed Sept. 15, 2005).

adequate flood insurance.[255] Arguably, it is unfair to taxpayers and to homeowners who did in fact pay premiums for flood insurance.[256]

Second, they argue that the Katrina Fund appears to protect current NFIP policyholders by specifying that payments must come from a separate appropriation. The semantic arguments being posited in the contractual litigation require that this giveaway not be labeled "insurance." Drafters of the policy included language prohibiting the NFIP from considering buy-in claims when setting future premiums. This is not how the business of insurance works. Hence, this underscores that the Katrina Fund is not insurance but grants of public money.

Therefore, critics argue, the Katrina Fund is nothing more than a federal bailout of the insurance industry and a political guarantee for risk-takers, including mortgage companies, that establishes the federal government as the guarantor against all business risks. Where would we draw the line if the Congress insured against all business losses?

Third, critics predict that the Katrina Fund would likely overtax and virtually bankrupt the NFIP.[257] While not denying the massive assistance needed by Katrina victims, they argue that alternative avenues of financial aid and assistance should be used, rather than the "deep pockets" of the insurance industry or the NFIP.[258] Allowing insurance to be purchased, or the terms therein to be negotiated after disaster strikes, sets a bad precedent. Why buy insurance if, when you don't, the federal government pays for your losses anyway? The Katrina Fund thus undermines the NFIP as well as commercial insurers.

3. Response to Those Who See the Katrina Fund as an Insurance Industry Bailout

Proponents of the Katrina Fund acknowledge that it financially assists the insurance industry and preempts Katrina-related litigation against the industry, but that is one of its intended, stated benefits.[259] They suggest that opponents are overlooking an important provision of the Katrina Fund: as one of several means to pay off the Katrina Fund Bonds, the Fund taxes the insurance industry.[260] The opponents are furthermore ignor-

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[255] *See* Memorandum from David C. John, Heritage Found., Providing Flood Insurance Coverage After the Disaster Is a Mistake (Oct. 19, 2005), *available at* http://www.heritage.org/Research/Regulation/wm888.cfm.

[256] *See id.*

[257] *See* H. Sterling Burnett, *Bush Should Apply the Ownership Society to Environmental Issues*, Department B, Feb. 13, 2006, http://www.pmandr.com/physiatry/index.php?option=comnewsfeeds&task=view&feedid=218&Itemid=60 (noting that bringing people back to New Orleans all at the government's expense is a huge mistake).

[258] *See* U.S. CONGRESSIONAL BUDGET OFFICE, THE MACROECONOMIC AND BUDGETARY EFFECTS OF HURRICANES KATRINA AND RITA 21 (2005), *available at* http://www.cbo.gov/ftpdoc.cfm?index=6669&type=1.

[259] *See id.* at 2.

[260] *See id.* at 2.

ing the potentially negative impact on the national market for homeowners and flood insurance if the Katrina Fund is not enacted. Those who criticize the Katrina Fund as an inequitable insurance industry bailout are also ignoring the immediate financial needs of the Katrina victims.

B. The Katrina Fund Preempts Judicial Jurisdiction and Undermines the Integrity of Contract Law

1. Courts Are Competent To Handle Katrina-Related Litigation

Critics further argue that the Katrina Fund is not only a costly effort to alleviate financial fallout that amounts to an after-the-fact contractual negotiation, but that it also contradicts the principles of contract law in general and those of insurance law in particular. If implemented, they argue, it would wreak far greater damage on society and even upon those whom the Fund is trying to serve.[261] Furthermore, in addition to undermining the integrity of contract law, critics believe the Katrina Fund wrongly preempts judicial jurisdiction on insurance contract matters.

As argued earlier, courts have both the jurisdiction and sophistication to adjudicate the Katrina-related property insurance claims of homeowners. Due to the large number of hurricanes inflicting damage, for example, Louisiana courts have already had ample opportunity to address the issues that arise after hurricanes.[262]

Certain rules of law have been established regarding insurance contract interpretation. Insurance policies are treated as special contracts by the courts due to the complexity of the contracts and the lack of bargaining power held by the policyholder.[263] Should the courts feel sympathetic to the Katrina survivors, there are rules of law that favor plaintiffs in insurance claim litigation. On the one hand, the courts can find that there is ambiguous language in the policy.[264] They could also look to the reasonable expectations of the policyholder.[265]

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[261] Peter Flaherty, president of the National Legal and Policy Center (NLPC), has questioned whether the Katrina Fund will help those affected by Katrina, particularly African Americans, or merely be a financial "bonanza" for civil rights groups such as the Southern Christian Leadership Council (SCLC), the National Urban League, and the Rainbow/PUSH Coalition. *See* Marc Morano, *Katrina Cash Could Create "Slush Fund" for Left*, CNSNEWS.COM, Oct. 03, 2005, http://www.cnsnews.com/ViewSpecialReports.asp?Page=%5C%5Cspecial Reports%5C%5Carchive%5C%5C200510%5C%5CSPE20051003a.html.

[262] *See* DAVID ROTH, NAT'L WEATHER SERV., LOUISIANA HURRICANES 1 (1998), http://www.srh.noaa.gov/lch/research/lahur.php. The first well-documented hurricane hit September 22–24, 1722. *See id.*

[263] *See* Scales, *supra* note 24.

[264] *See id.*

[265] *Cf.* Loyola Univ. v. Sun Underwriters Ins. Co., 93 F. Supp. 186, 189 (E.D. La. 1950), *aff'd*, 196 F.2d 169 (5th Cir. 1952) (holding that when no ambiguity exists, insurance contracts are enforced as written).

A primary issue in disputes over coverage is that of causation. Since hurricanes bring destruction via wind and water, the process of litigating a causation dispute is extremely fact-intensive, often taking years to adjudicate, with the plaintiff bearing the burden of establishing causation by a preponderance of the evidence.[266] *Lorio v. Aetna Insurance Co.*[267] was one of a few cases in which Louisiana courts have ruled on causation issues in the aftermath of hurricanes. In this case, which arose after Hurricane Betsy (1965) and did not involve flood damage, the Louisiana Supreme Court discussed the concept of proximate cause.[268] The plaintiff argued that the death of a horse was covered under his windstorm policy. The Court interpreted the words "direct loss" as written in a windstorm insurance policy to be "a loss proximately caused by the peril insured against, the term having essentially the same meaning as 'proximate cause' applied in negligence cases."[269]

In a later case, *Urrate v. Argonaut Great Cent. Insurance Co.*,[270] the court went to great lengths to allocate damages among the causes in a mixed causation case. Plaintiff Brunings Seafood Restaurant was operating in a wood frame building built on pilings over Lake Pontchartrain.[271] Hurricane Georges severely damaged the restaurant, sweeping away part of the building.[272] The owners of the restaurant had flood insurance and wind insurance through private insurers; the policies were complementary in that one covered what the other did not.[273] In the original trial, experts testified on both sides regarding the amount and cause of the damages.[274] The appellate court affirmed the lower court and stated:

> It was the consensus of the adjusters that the restaurant suffered both wind and water damages. The trial court found that the business loss attributable to wind damage in 1998 and 1999 was 25% and 15%, respectively. A large part of the back of the building was gone, including the window wall across the back. Other windows in the restaurant were also broken. The roof was damaged and part of it was blown back over itself by wind force. The winds reached the 50-mile per hour range during the storm.[275]

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[266] *See id.* at 190.
[267] 232 So. 2d 490 (La. 1970).
[268] *Id.* at 493.
[269] *Id.*
[270] 881 So. 2d 787 (La. Ct. App. 2004).
[271] *See id.* at 788.
[272] *See id.*
[273] *See id.*
[274] *See id.* at 788–89.
[275] *Urrate*, 881 So. 2d at 790.

Eventually, the case concluded after writs to the Louisiana Supreme Court were denied,[276] almost eight years after the hurricane.

In an earlier case, *Loyola Univ. v. Sun Underwriters Ins. Co. of New York*,[277] a Louisiana federal court examined coverage for several structures damaged by a hurricane that struck the St. Bernard Parish in September 1947.[278] The court held that the insured was entitled to recover for all direct loss or damage caused by the hurricane winds, as well as for all loss or damage to the interior of the property and the contents thereof caused by water or rain, where such water or rain entered the property through openings in the roof or walls made by the direct action of the wind.[279] The court reached this conclusion by determining that, at the time of the structures' destruction, the water in the area was still below the elevation of the structures.[280] The court stated:

> If the cause of the damage or destruction be not the direct result of the wind alone, but the damage or destruction be caused by a combination of wind and water, and the damage by either cannot be separated, then, there can be no recovery under the policy, because the insured bears the burden of proving the cause of the damage, and if it fails to make that proof, it cannot recover.[281]

This dicta shows that there is a delicate interplay between facts in evaluating insurance coverage, one that courts are better able to weigh.

2. Response to Those Who Advocate Reliance on Judicial Remedies

Certainly, the courts are competent to handle Katrina-related homeowners property insurance litigation. Unfortunately, the traditional judicial process takes too long to effectively address the immediate financial and housing needs of Katrina victims. One thing is clear from the past cases addressing coverage for hurricane-related damage: when required to allocate damages between those caused by flood and those caused by wind, the litigation is very fact intensive and time consuming; it sometimes takes several years from the time the hurricane hit to conclude a claim.

For example, in *Boudreaux v. Louisiana Department of Transportation*,[282] claims for damages were brought against the State of Louisiana by a

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[276] *See* Urrate v. Argonaut Great Cent. Ins. Co., 891 So. 2d 690 (La. 2005); Urrate v. Argonaut Great Cent. Ins. Co., 891 So. 2d 686 (La. 2005).

[277] 93 F. Supp. 186 (E.D. La. 1950).

[278] *See id.* at 187.

[279] *See id.* at 190.

[280] *See id.* at 187.

[281] *Id.* at 190; *see also* Constitution State Insurance Company v. Werner Enterprises, Inc., No. 86-1624, 1987 U.S. Dist. LEXIS 6023, *1–2 (E.D. La. June 26, 1987).

[282] So. 2d 695 (La. Ct. App. 2005), *reh'g denied*, 2005 La. App. LEXIS 1922 (La. App. Aug. 2, 2005).

class of individuals whose homes and businesses were flooded in 1983.[283] Plaintiffs alleged that the State negligently designed and built the Interstate 12 bridge over the Tangipahoa River, thereby disrupting the natural floodplain and causing the river's rising waters to flood the plaintiffs' properties.[284] Less than one month before Katrina hit, the Louisiana Court of Appeals issued a decision addressing and upholding various damage determinations made by the trial court,[285] providing a judicial resolution twenty-two years after the flood.

There seems to be a long road ahead in civil action suits, and not only for actions against homeowners' property insurance companies. Several roadblocks exist for individuals wishing to sue other entities. For example, the Army Corps of Engineers has immunity from suits arising from levee failures under the legislation that "put the corps in the levee building business, a year after the severe Mississippi River floods of 1927."[286] Attorneys are currently trying to circumvent that immunity by arguing that the Corps was negligent in failing to "tell the public that a contractor hired to build the flood wall above the 17th Street Canal levee in 1993 reported soil stability problems."[287]

Another possible litigation roadblock to be overcome is the Federal Tort Claims Act (FTCA).[288] The FTCA limits federal sovereign immunity, allowing recovery in federal court for tort damages caused by federal employees, but only if the state law where the injury occurred would hold a private person liable.[289] In the class action against the Corps, the plaintiffs' attorneys are arguing that the Corps breached its fiduciary duty to the contractor and to the citizens.[290]

It is unclear whether the victims will succeed in such lawsuits. Even if they do, their actual cash settlement may be far less than what they might receive from the Katrina Fund. More importantly, it may be years before any Katrina survivor who sues these entities sees any form of monetary award.

C. The Katrina Fund Will Fail as Did Its Model, the September 11th Victim Compensation Fund

Critics of the Katrina Fund believe that the Fund will be a disaster and fraught with corruption. They characterize the September 11th Victim Compensation Fund as a failure and oppose modeling the Katrina Fund after it.

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[283] *See id.* at 698–99.

[284] *See id.* at 699.

[285] *See id.* at 695.

[286] Susan Finch, *Rocky Course Awaits Flooding Lawsuits; Insurers, Army Corps of Engineers, Levee Board Sued*, TIMES-PICAYUNE, Dec. 25, 2005, at B1.

[287] *Id.*

[288] 28 U.S.C.A. § 1346 (b) (West 2005).

[289] *See id.*

[290] *See* Finch, *supra* note 286.

1. Criticism of the September 11th Fund

New York Attorney General Eliot Spitzer and a group of victims have criticized the September 11th Fund. One critique is that the Fund did not follow Congress's intent to fully compensate victims.[291] The limitation on civil actions in the Fund was perceived as forcing or binding the victims to seek compensation from the Fund instead of bringing a separate civil action suit.[292] If a victim were to bring an action against an airline, security service company, or another liable party, the victim ran the risk of getting nothing because the victim's commencement of a civil action waived his right to receive Fund compensation.[293]

Also, the "Families of September 11" group criticized the low amount of compensation for pain and suffering and the cap on economic damages.[294] The group noted that if a family waived the opportunity to receive Fund compensation and instead sued an airline, the airline's liability was limited to its insurance coverage.[295] Another such criticism has been that considering life insurance proceeds a "collateral source" and deducting it from the Fund compensation is improper because no state deducts life insurance proceeds from damage awards.[296] The Fund also has been criticized for not protecting unmarried partners and undocumented workers.[297]

Hence, while the Katrina Fund might on its face appear to expedite recovery for Katrina survivors, critics contend that, based on experience with the September 11th Fund, it will create more obstacles to speedy recovery.

2. Response to the Criticism That the Katrina Fund Will Fail, as Did Its Model, the September 11th Fund

Despite some early criticism of the September 11th Fund, it has been a huge success. It has provided quick, certain compensation of September 11 victims without costly and lengthy litigation.[298] It also has relieved litigation pressure on the beleaguered airline industry.[299]

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[291] Lee S. Kreindler, *Pros and Cons of Victims' Fund*, N.Y. L.J., Nov. 27, 2001, at 5; *see also* Bob Van Voris, *Fund Boss Spurns Huge Payout Gaps*, NAT'L L.J., Dec. 10, 2001, at A1.

[292] *See* Kreindler, *supra* note 291, at 5.

[293] *See id.*

[294] *See* Saul & Yan, *supra* note 171, at A5.

[295] *See* Kreindler, *supra* note 291 at 5 (noting that liability insurance maintained by American and United Airlines is on the basis of per-aircraft, per-occurrence, and each plane is insured for $1.5 billion). *See generally* BAKER, *supra* note 3, at 401–02 (discussing insurance issues involving the September 11th Fund).

[296] *See* Kreindler, *supra* note 291, at 5.

[297] *See id.*

[298] *See Benefits for U.S. Victims of International Terrorism: Hearing Before the S. Comm. on Foreign Relations*, 108th Cong. 5 (2003), *available at* http://www.mipt.org/GetDoc.asp?id=1993&type=d (examining the issue of providing terrorism compensation in a deliberative, timely, and detailed fashion).

[299] This issue was already being discussed ten days after the September 11 attacks. *See* Julie Hirschfeld Davis, *The Economic Initiative: A Cautious Start for Stimulus*, CONG. Q.

Similarly, a Katrina relief fund, modeled after the September 11th Fund, would immediately benefit victims of Katrina. In all likelihood, the Katrina Fund would be a much quicker and beneficial way for victims to receive compensation for damages occurring from this catastrophic event than lengthy class action litigation.[300] It would relieve insurance providers and the NFIP, as well as protect nationwide insurance customers from increased rates or reduced coverage.[301]

In addition to speeding recovery to the Katrina-battered homeowners, the Katrina Fund would preempt runaway litigation seeking to expand commercially provided homeowners insurance contracts so as to include flood-related losses. The number of class actions in Louisiana and Mississippi is sure to grow; the named defendants have already reached beyond insurance companies into other industries.[302] In addition, they will result in risky markets, thereby hampering recovery efforts.[303] The federal government is the only entity financially capable of the immediate, large scale action needed to provide emergency relief.

VIII. CONCLUSION

The Katrina Fund is an appropriate, timely, and essential response to the Katrina homeowners property insurance dilemma. It is needed to provide displaced Katrina survivors with immediate and sufficient financial support to emerge with dignity from both waves of Katrina's destruction. Specifically, it provides homeowners cash payments for the pre-Katrina value of their homes and contents, plus relocation expenses. It uses eminent domain to condemn the damaged communities and allows for local development teams to rebuild communities. It provides that when new communities are built, the former residents will be given the right of first refusal to buy into those communities.

While effective, prompt action by the government at all levels was absent in the opening rounds of Katrina,[304] the federal and state governments have a chance to redeem themselves. Congress should use the Sep-

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WKLY., Sept. 22, 2001, *available at* http://www.financialpolicy.org/dscquotes2001.htm.

[300] *See* BAKER, *supra* note 3, at 435–36 (noting the longevity of asbestos litigation, over thirty years, and opining that "[w]hat makes [the asbestos cases] significant to insurance law is their status as the first mass tort cases that really pushed the boundaries of liability insurance coverage").

[301] *See generally* MILLS, ROTH & LECOMTE, *supra* note 5 and accompanying text.

[302] In addition to the insurers named as defendants, Ned Comer named numerous oil companies and mortgage lending companies claiming, among other things, that the oil companies caused the global warming that caused Katrina. *See* Comer v. Nationwide Mutual Ins. Co., No. 05-00436 (S.D. Miss. filed Sept. 30, 2005).

[303] *See id.*

[304] *See, e.g.*, Scott Shane, *After Failures, Government Officials Play Blame Game*, N.Y. TIMES, Sept. 5, 2005, at A2, *available at* http://www.nytimes.com/2005/09/05/national/nationalspecial/05blame.html?ex=1283572800&en=5d14ec03d94387d0&ei=5088&partner=rssnyt&emc=rss.

tember 11th Victim Compensation Fund as a model to create the Hurricane Katrina Homeowners Compensation Fund. To do so would protect Katrina-injured homeowners, the insurance industry and its customers, and the banks and mortgage companies that have loaned money on Katrina-damaged property. They would be protected against Katrina's second coming: namely, a wave of bankruptcies, foreclosures, and homelessness.

ARTICLE

THE TAX CODE AS NATIONALITY LAW

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This Article questions the frequently asserted axiom that Congress's taxing power knows no bounds. It does so in the context of recently enacted legislation that creates a special definition of citizenship that applies only for tax purposes. Historically, a person was treated as a citizen for tax purposes (and therefore taxed on her worldwide income and estate) if, and only if, she was a citizen under the nationality law. As a result of the new statute, in certain circumstances a person might be treated as a citizen for tax purposes (and therefore taxed on her worldwide income and estate) for years or even decades after she is no longer a "real" citizen under the nationality law. The analysis first looks at international law principles, concluding that in certain circumstances the new statute exceeds the prescriptive jurisdictional limits of customary international law. It then examines the constitutional implications, arguing that the statute, at least in certain circumstances, reflects a rare occasion where Congress might have exceeded its Article I taxing powers. Moreover, even to the extent the statute is within Congress's powers, certain aspects of it violate the due process limitations of the Fifth Amendment. These conclusions highlight the importance of Congress taking constitutional and international law considerations more seriously with respect to future legislation in the increasingly important area of international taxation.

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> To boost the [national] economy I'd tax all foreigners living abroad.
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> —Monty Python's Flying Circus[1]

This Article explores the outer limits of Congress's power to tax individuals in an international context. Traditionally, the United States has been among the most aggressive countries in exercising taxing jurisdiction abroad. The United States is the only major country that taxes the worldwide income of its citizens even if they live outside the country.[2]

Notwithstanding its existing position at the outer edges of taxing jurisdiction, the United States recently stretched these limits even further. As part of the American Jobs Creation Act ("AJCA") of 2004,[3] Congress adopted special provisions for determining whether an individual is considered a "citizen" for federal tax purposes and is thereby subject to taxation on her worldwide income. Prior to the enactment of the AJCA, the tax code definition of citizenship relied on the nationality law definition of citizenship: a person was treated as a citizen for tax purposes if, and only if, she was a citizen under the nationality law.[4] The enactment of the AJCA broke this direct link between the tax code and nationality law, at least in certain circumstances, and it is now possible for an individual to be treated as a citizen for tax purposes during a period when she is not a U.S. citizen under nationality law.[5]

The ACJA provisions that added sections 877(g) and 7701(n) to the Internal Revenue Code focus on a particular group of individuals: those who had been U.S. citizens but who renounced or otherwise lost their citizenship under the nationality law.[6] The new Code sections were intended to prevent perceived abuses of the tax law by these expatriates.[7] However, in enacting these anti-abuse provisions, Congress gave little attention to the broader consequences of unmooring the tax code definition of citizenship from the nationality law.

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[1] GRAHAM CHAPMAN ET AL., THE COMPLETE MONTY PYTHON'S FLYING CIRCUS: ALL THE WORDS 196 (1989).

[2] *See* FEDERAL INCOME TAX PROJECT, AMERICAN LAW INSTITUTE, INTERNATIONAL ASPECTS OF UNITED STATES INCOME TAXATION: PROPOSALS ON UNITED STATES TAXATION OF FOREIGN PERSONS AND OF THE FOREIGN INCOME OF UNITED STATES PERSONS 6 (1987).

[3] Pub. L. No. 108-357, § 804, 118 Stat. 1418, 1569 (2004).

[4] *But see infra* note 114 (discussing very limited circumstances when the IRS by administrative ruling provided tax relief for certain periods when an individual was a citizen under the nationality law).

[5] The new AJCA provisions do not enable the opposite result—the treatment of an individual as a noncitizen for tax purposes when she is a citizen under the nationality law.

[6] The provisions also address persons who had been long-term residents (i.e., green card holders in at least eight of the preceding fifteen years) and who surrendered or otherwise lost that status.

[7] The term "expatriate" in this Article refers to an individual who has lost U.S. citizenship, not to a person who resides abroad but retains her U.S. citizenship.

This Article addresses the extent to which the special definitions of citizenship for federal tax purposes violate customary international law and constitutional limitations. In so doing, it considers what, if any, limits constrain Congress from moving toward the absurdist position of the introductory epigraph, which contemplates a country attempting to tax aliens who have absolutely no connection to that country.

Part I discusses the tax code's traditional reliance on the nationality law definition of citizenship and examines the concerns that led Congress to enact the new special definitions of citizenship for tax purposes. Part II then examines the relevant jurisdictional contours of international law, with a particular focus on prescriptive limitations under customary international law. It concludes that, at least in some circumstances, the new tax definitions of citizenship violate customary international law jurisdictional principles.

Part III examines the constitutional implications of the new tax definitions of citizenship. In particular, it considers the limits, if any, of Congress's taxing power under Article I as well as the constraints imposed by due process and equal protection principles. While acknowledging that Congress's taxing powers are almost unlimited, it argues that this is a rare circumstance in which Congress might have exceeded its sovereign taxing powers. Moreover, even if the provisions are within Congress's Article I taxing powers, certain aspects of the new provisions violate the due process limitations of the Fifth Amendment. Part IV addresses additional concerns raised by the new provisions, particularly with respect to the United States tax treaty network, relations with other countries, and practical enforcement difficulties.

The Article concludes that the significant constitutional, international law, and other problems raised by the new provisions greatly outweigh any purported benefits and that Congress should return to a uniform definition of citizenship for both tax and nationality law purposes. More generally, the Article demonstrates that there are constitutional and international law limits on Congress's ability to tax individuals in the international context and that these limitations deserve increased attention when Congress enacts future legislation.

I. THE NEW DEFINITION OF TAX CITIZENSHIP

A. *Why Citizenship Matters for Tax Purposes*

In general, the United States taxes the worldwide income of its citizens and resident aliens regardless of where the individual lives or where the income arises.[8] In contrast, the United States taxes a nonresident alien—

[8] I.R.C. § 1 (2000); Treas. Reg. § 1.1-1(b) (as amended in 1974). This worldwide taxation of citizens and resident aliens is subject to several significant exceptions. For example,

a person who is neither a citizen nor a resident alien[9]—only on income connected with U.S. business activities[10] and certain investment-type income from United States sources.[11] A nonresident alien generally is not subject to U.S. income tax on income from sources outside the United States or on capital gains from the sale of property, regardless of where the property is located.

Because of this disparity between the income taxation of citizens and nonresident aliens, as well as similar distinctions in the context of the estate and gift tax regime,[12] incentives exist for a U.S. citizen to move outside the United States and surrender her citizenship status, thereby becoming a nonresident alien for tax purposes.[13] In response to concerns about tax-motivated expatriation, Congress in 1966 enacted a special alternative tax regime under Internal Revenue Code section 877 applicable to tax-motivated expatriates.[14] This regime did not purport to tax the former citizen on her worldwide income. Rather, it expanded the definition of U.S. source income upon which the former citizen could be taxed for a ten-year period[15] following the loss of citizenship.[16] During the past decade, Congress

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a qualified individual may exclude up to $80,000 of foreign earned income, as well as certain foreign housing costs, from her gross income. *See* I.R.C. § 911. In addition, the United States generally allows a tax credit to the extent of foreign income taxes imposed on the individual's foreign-source income. *See* I.R.C. §§ 901, 903–905 (2000).

[9] In general, a noncitizen is treated as a resident alien for income tax purposes during the year if she meets at least one of three tests: (1) the lawful permanent resident test; (2) the substantial presence test; or (3) the first-year election test. *See* I.R.C. § 7701(b)(1)(A). Only the first two tests are relevant to this Article. The lawful permanent residence test applies if the individual is a "lawful permanent resident" (i.e., green card holder) under the immigration laws at any time during the calendar year. I.R.C. § 7701(b)(1)(A)(i) (2000). The substantial presence test generally applies if the individual is physically present in the United States for at least 31 days during the calendar year and for at least 183 days under a three-year weighted formula (calculated by adding the days of physical presence in the current year, plus 1/3 of such days in the immediately preceding year, plus 1/6 of such days in the second preceding year). *See* I.R.C. § 7701(b)(3) (2000).

[10] *See* I.R.C. § 871(b) (2000).

[11] *See* I.R.C. § 871(a) (2000).

[12] For a discussion of the disparate estate and gift tax treatment of citizens and nonresident aliens, see Michael S. Kirsch, *Alternative Sanctions and the Federal Tax Law: Symbols, Shaming, and Social Norm Management as a Substitute for Effective Tax Policy*, 89 IOWA L. REV. 863, 871–73 (2004).

[13] Of course, significant non-tax considerations weigh heavily against surrendering U.S. citizenship. In particular, a former citizen would no longer enjoy the rights and privileges associated with U.S. citizenship. *See id.* at 875. Moreover, feelings of patriotism and loyalty might preclude many citizens from expatriating regardless of the potential tax benefits that might be derived from the surrender of citizenship. *Id.* at 894.

[14] For a summary of the 1966 law and its 1996 amendments, see *id.* at 877–86.

[15] The so-called "ten-year period" could, as a practical matter, apply for slightly less than ten full years. *See id.* at 879 n.63.

[16] In particular, the section 877 alternative tax regime expands the definition of U.S.-source income so that the individual will be taxable on capital gains from the sale of stock in a U.S. corporation during the ten-year period. However, the individual, as a nonresident alien, will not be subject to tax on her foreign-source investment income and her foreign business income. The alternative tax regime also expanded the definition of U.S. situs property that could be subjected to the gift and estate tax for ten years following expatriation. *See*

has expended significant effort addressing perceived shortcomings in this regime, enacting legislation in this area in 1996[17] and again in 2004.[18]

B. Historic Reliance on Nationality Act Definition of Citizenship

Given the significant U.S. tax consequences that turn on citizenship, an important threshold question is whether or not an individual is a citizen for tax purposes. Prior to the enactment of the AJCA, the Internal Revenue Code did not define citizenship.[19] Instead, the tax law traditionally relied on the definition of citizenship under the Immigration and Nationality Act (INA).[20] Thus, if an individual was considered a citizen under the nationality laws, she was treated as a citizen for tax purposes.[21] If an indi-

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I.R.C. §§ 2107, 2501(a)(3) (LexisNexis 2006).

[17] *See* Health Insurance Portability and Accountability Act of 1996, Pub. L. No. 104-191, § 511, 110 Stat. 1936, 2093 (1996) (modifying sections 877, 2107, and 2501(a)(3) of the Internal Revenue Code).

[18] *See* American Jobs Creation Act of 2004, Pub. L. No. 108-357, § 804, 118 Stat. 1418, 1569. In addition to adding the new tax-focused definitions of citizenship described at length in this Article, AJCA eliminated the tax-motivation test for determining whether the alternative tax regime applies, replacing it with objective tests based on average income tax liability and net worth. With certain exceptions, a person who loses citizenship is subject to the alternative regime of section 877 if her average income tax liability for the five pre-expatriation years exceeds $124,000 (as modified annually for cost-of-living adjustments), her net worth on the date of expatriation is at least $2 million, or she fails to comply with certain documentation requirements. *See* I.R.C. § 877(a)(2) (LexisNexis 2006).

[19] As discussed *infra* notes 41–44 and accompanying text, the staff of the Joint Committee of Taxation prepared a report in 2003 analyzing the effectiveness of the 1996 legislation and containing proposals that were subsequently enacted by the AJCA. *See* STAFF OF JOINT COMM. ON TAXATION, 108TH CONG., REVIEW OF THE PRESENT-LAW TAX AND IMMIGRATION TREATMENT OF RELINQUISHMENT OF CITIZENSHIP AND TERMINATION OF LONG-TERM RESIDENCY (Comm. Print JCS-2-03, 2003), *available at* http://www.house.gov/jct/s-2-03.pdf [hereinafter 2003 JCT REPORT]. The 2003 JCT Report, referring to a transition rule in the 1996 legislation, stated that "there is some precedent for the divergence of the tax and nationality definitions of citizenship." *Id.* at 124. The transition rule cited, however, only involved an extension of the ten-year period under section 877 for certain pre-effective date expatriations if the individual delayed giving notice of citizenship loss to the Department of State. *Id.* at 80–81. The transition rule did not purport to continue taxing the individual on her worldwide income for periods after citizenship was lost under the nationality law.

[20] 8 U.S.C. §§ 1101–1537 (2000). This cross-reference to the nationality law appears in the Treasury Regulations rather than the Internal Revenue Code. *See* Treas. Reg. § 1.1-1(c) (as amended in 1974) (paraphrasing the citizenship clause of the Fourteenth Amendment and citing Immigration and Nationality Act provisions and Supreme Court decisions regarding citizenship).

This historical reliance on the nationality law's definition of citizenship dates back to the earliest days of the modern income tax. Although the early statutes did not explicitly state that the term "citizen" as used in the tax acts had the same meaning as under nationality law, such a connection was evident in early administrative guidance. *See* T.D. 3406, I-2 C.B. 42 (1922) (quoting the Commissioner of Internal Revenue's statement that a newly enacted nationality law, "while not an internal-revenue measure, is published for the information and guidance of revenue officers and others concerned in determining the citizenship" of relevant taxpayers); *see also* T.D. 861, 4 C.B. 59–60 (1921); T.D. 695, 3 C.B. 74 (1920); T.D. 533, 2 C.B. 59 (1920).

[21] In isolated circumstances involving individuals whose citizenship has been restored

vidual was not considered a citizen under the nationality law, she was treated as an alien for tax purposes.

In effect, this reliance on the nationality law kept the Internal Revenue Service out of the business of determining a taxpayer's citizenship status. Instead, such determinations were left to those federal departments with principal administrative responsibility over the immigration and nationality laws—most recently, the Department of State[22] and the Department of Homeland Security.[23]

Of particular relevance, for tax purposes the timing of citizenship loss was tied directly to the Department of State's administrative procedures for determining citizenship loss under the INA. The INA provides that an individual can lose citizenship by voluntarily performing one of several enumerated acts, provided the act was performed with the intent to relinquish citizenship.[24] These acts fall into two categories. First, an individual can make a formal renunciation of citizenship by executing an oath of renunciation before a U.S. diplomatic or consular officer outside the United States.[25] Second, rather than making a formal renunciation, an individual can commit one of several potentially expatriating acts enumerated in the statute, such as obtaining nationality in another country after reaching age eighteen or taking an oath of allegiance to another country after reaching age eighteen.[26]

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retroactively due to changes in nationality law interpretation, the IRS has issued administrative rulings treating those individuals as noncitizens for portions of the retroactivity period. *See infra* note 114.

[22] The Department of State is responsible for determining the citizenship status of a person located outside the United States, or in connection with the application for a U.S. passport while in the United States. *See* 22 C.F.R. §§ 50.1, 51.20, 51.40–43, 51.54, 51.80(a)(1) (2005); *see also* Department of State, Possible Loss of U.S. Citizenship and Dual Nationality, http://travel.state.gov/law/citizenship/citizenship_778.html (last visited Mar. 12, 2006). This authority includes determinations of loss of citizenship status. *See* 22 C.F.R. §§ 50.40–51 (2005) (discussed *infra* notes 29–35 and accompanying text).

[23] Pursuant to the Homeland Security Act of 2002, as of March 1, 2003, the Department of Homeland Security—in particular, its Bureau of U.S. Citizenship and Immigration Services—took over the immigration and naturalization functions previously handled by the Department of Justice's Immigration and Naturalization Service. *See* The Homeland Security Act, Pub. L. No. 107-296, § 451, 116 Stat. 2135 (2002); *see also* 8 C.F.R. § 1.1 (2005).

[24] 8 U.S.C. § 1481 (2000). Originally, the performance of an enumerated act caused an individual to lose citizenship regardless of whether the individual intended to lose citizenship thereby. *See* INA § 349, Pub. L. No. 82-414, 66 Stat. 163, 267–68 (1952); *see also* Perez v. Brownell, 356 U.S. 44, 61 (1958), *overruled by* Afroyim v. Rusk, 387 U.S. 253, 268 (1967). However, the Supreme Court subsequently determined that the Fourteenth Amendment prevents Congress from stripping an individual of citizenship based solely on a particular act unaccompanied by an intent of the individual to lose citizenship. *Afroyim*, 387 U.S. at 257. Congress subsequently amended the INA to make this intent requirement explicit. *See* Immigration and Nationality Act Amendments of 1986, Pub. L. No. 99-653 § 18(a), 100 Stat. 3658.

[25] 8 U.S.C. § 1481(a)(5) (2000).

[26] *Id.* §§ 1481(a)(1)–(2). Other potentially expatriating acts in this second category include serving as an officer in the armed forces of another country, serving at any rank in the armed forces of a country engaged in hostilities against the United States, serving as an

Whereas an individual's intent to relinquish citizenship is clear in the case of a formal renunciation before a consular officer, an individual's intent often is not clear when she performs one of the other potentially expatriating acts. For example, a U.S. citizen who becomes a naturalized citizen of another country may or may not intend thereby to surrender her U.S. citizenship.[27] The INA requires that the party asserting that citizenship has been lost must establish the existence of requisite intent by a preponderance of the evidence.[28]

The Department of State has established administrative presumptions to determine whether an individual who performs a potentially expatriating act had the intent to relinquish citizenship.[29] In the case of three potentially expatriating acts—naturalization in a foreign country, taking a routine oath of allegiance to a foreign country, or accepting non-policy level employment with a foreign government—the Department of State presumes that the individual intended to retain her U.S. citizenship unless the individual affirmatively asserts to a consular officer that the act was performed with the intent to relinquish U.S. citizenship.[30] In the case of any other potentially expatriating act,[31] a U.S. consular officer attempts to ascertain whether there is evidence of intent to relinquish U.S. nationality.[32] If the consular official believes that an individual has lost citizenship under these standards, the official prepares a certificate of loss of nationality, which is then forwarded to the Department of State for approval.[33]

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officer or employee of a foreign government under certain circumstances, making a formal written renunciation of U.S. citizenship while in the United States during a time of war, or committing treason or attempting to overthrow the government of the United States. §§ 1481(a)(3)–(4), (6)–(7); *see also* Kirsch, *supra* note 12, at 873 n.40.

[27] In the *Afroyim* case, where the Supreme Court set out the intent requirement, Mr. Afroyim, a naturalized U.S. citizen, had voted in an election in Israel. 387 U.S. at 254–55. At the time, the INA provided that voting in a foreign election caused a U.S. citizen to lose his citizenship. *Id.* The *Afroyim* Court held that Mr. Afroyim could not be stripped of his U.S. citizenship in the absence of evidence that he intended to relinquish his citizenship by voting in the foreign election. *Id.* at 268.

[28] 8 U.S.C. § 1481(b); *see also* Vance v. Terrazas, 444 U.S. 252, 267 (1980) (upholding Congress's constitutional authority to legislate this "preponderance of evidence" standard for determining intent). While the Department of State is usually the party asserting that the individual intended to lose citizenship, in the case of an individual seeking to invoke citizenship loss to avoid taxes, the citizen assumes this role. *See* U.S. v. Matheson, 532 F.2d 809, 811 (2d Cir. 1976); *see also* U.S. v. Lucienne D'Hotelle de Benitez Rexach, 558 F.2d 37, 40 (1st Cir. 1977).

[29] 22 C.F.R. § 50.40(a) (2005). These presumptions were in effect even before their adoption as federal regulations in 1996. *See* Letter from Wendy R. Sherman, Assistant Sec'y for Legislative Affairs, Dep't of State, to Sen. Robert Packwood, Tab 2 (May 9, 1995), *reprinted in* STAFF OF THE JOINT COMM. ON TAXATION, 104TH CONG., ISSUES PRESENTED BY PROPOSALS TO MODIFY THE TAX TREATMENT OF EXPATRIATION G-59 (Comm. Print JCS-17-95 1995), *available at* http://www.house.gov/jct/s-17-95.pdf, at 249 [hereinafter 1995 JCT REPORT].

[30] 22 C.F.R. § 50.40(a).

[31] *See supra* note 26.

[32] Letter from Wendy R. Sherman, *reprinted in* 1995 JCT REPORT, *supra* note 29, at G-59.

[33] *See* 8 U.S.C. § 1501 (2000); 22 C.F.R. § 50.40(c) (2000). The Department of State

Of particular relevance, the actual date of citizenship loss is not governed by either the date the certificate of loss of nationality is prepared by a consular official or the date on which it ultimately is approved by the Department of State.[34] Rather, an individual's loss of citizenship is effective under the nationality law as of the date the expatriating act occurs (provided it was done with the requisite intent).[35] Thus, in the case of an expatriating act other than a formal renunciation, there could be a significant gap between the date citizenship is lost and the time when a consular official is notified of the loss and the Department of State documents the loss.

C. New Tax-Specific Definitions of Citizenship

In 2004, Congress enacted the AJCA, which unmoored the tax definition of citizenship from the INA nationality law definition.[36] In two particular circumstances the AJCA treats an individual as a U.S. citizen for tax purposes with respect to a period when the individual is not a citizen under the nationality laws.[37] The following Sections briefly describe the two circumstances where the AJCA creates a special definition of citizenship for tax purposes and provide a brief summary of the congressional rationale for the provisions.

1. Delayed Loss of Citizenship—Section 7701(n)

New Internal Revenue Code section 7701(n), as enacted by the AJCA,[38] provides that an individual who relinquishes citizenship under the nationality laws nonetheless continues to be treated as a citizen for tax purposes until the individual both notifies the Secretary of State that she has committed an expatriating act with the requisite intent and provides a statement to the IRS in accordance with Internal Revenue Code section 6039G.[39] Whereas the loss of citizenship is effective for nationality law pur-

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typically takes between two weeks and six months to approve a certificate of loss of nationality submitted by a consular official. *See* Letter from Wendy R. Sherman, *reprinted at* 1995 JCT REPORT, *supra* note 29, at G-55.

[34] *See* Letter from Wendy R. Sherman, *reprinted at* 1995 JCT REPORT, *supra* note 29, at G-55.

[35] *Id.*

[36] The AJCA also modified certain aspects of the substantive tax rules that apply to individuals who relinquish citizenship or long-term resident status. *See* AJCA, Pub. L. 108-357, § 804(a), 118 Stat. 1418, 1659 (2004).

[37] The nationality law's definition of citizenship continues to govern for tax purposes in other contexts.

[38] § 804(b), 118 Stat. at 1570; *see also* § 804(f), 118 Stat. at 1573 (applying the provision to individuals who expatriate after June 3, 2004); Gulf Opportunity Zone Act of 2005, Pub. L No. 109-135, § 403(v), 119 Stat. 2577, 2628 (making technical amendments to Internal Revenue Code section 7701(n)).

[39] I.R.C. § 7701(n) (LexisNexis 2006). The cross-reference to the information reporting requirement of I.R.C. § 6039G is somewhat vague. Section 6039G requires reporting by "any individual to whom section 877(b) applies for any taxable year." I.R.C. § 6039G(a)

poses as of the date of the expatriating act, it is not effective for tax purposes until both of these notification requirements are satisfied. Thus, under the new provision, it is possible for an expatriate to remain a citizen for tax purposes, taxable on her worldwide income, for many years after citizenship has been lost for nationality law purposes, even for the remainder of the individual's life.[40] Moreover, at her death her worldwide assets could be subject to U.S. estate tax.

This provision was based on a recommendation made by the staff of the Joint Committee on Taxation in a 2003 report on the taxation of expatriates.[41] In that report, the committee staff noted the pre-AJCA tax enforcement difficulties raised by the "lag time between citizenship relinquishment, which occurs upon the individual's completion of an expatriating act with the requisite intent to relinquish citizenship, and the date upon which the Department of State receives notice of the citizenship relinquishment."[42] In particular, the special income tax provisions pertaining to individuals who renounce citizenship with a principal purpose of tax avoidance apply for the ten-year period following the citizenship loss.[43] The committee staff noted that under pre-AJCA law, a significant portion of this time period might elapse before the IRS learns of the expatriation, thereby creating a significant enforcement hardship for the IRS.[44]

An additional potential concern, not directly addressed by the joint committee report or other legislative reports, might also have influenced the enactment of the new provision. As discussed above, the State Department utilizes administrative presumptions in determining whether a citizen who performs a potentially expatriating act had the requisite intent to relinquish citizenship.[45] In a 1998 report, the Treasury Department expressed concern that these presumptions could "provide[ ] a potential expa-

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(LexisNexis 2006). Thus, it focuses on ongoing annual reporting during the ten years that an expatriate is subject to the special income tax regime of I.R.C. § 877. Section 6039G, as amended by AJCA, does not expressly require the filing of an information statement at the time citizenship is purportedly lost. Nonetheless, in the context of I.R.C. § 7701(n)(2), the I.R.S. has interpreted "a statement in accordance with section 6039G" to refer to the initial information reporting that the expatriate makes on IRS Form 8854, *Initial and Annual Expatriation Information Statement*. *See* Notice 2005-36, 2005-19 I.R.B. 1007; *see also* I.R.S., Instructions for Form 8854, at 2.

[40] Similarly, a former long-term resident who fails to notify the IRS of the loss of such status can continue to be taxed as a resident in perpetuity, even after she surrenders her green card to the Department of Homeland Security. *See* I.R.C. § 7701(n)(2). Although many of the arguments set forth in this Article also apply to former long-term residents who continue to be taxed as residents pursuant to the AJCA provisions, this Article focuses primarily on former citizens.

[41] *See* 2003 JCT REPORT, *supra* note 19, at 208–10; *see also* H.R. REP. NO. 108-548, pt. 1, at 253 (2004) (citing similar enforcement concerns as those raised by the Joint Committee staff).

[42] 2003 JCT REPORT, *supra* note 19, at 124.

[43] *See* I.R.C. § 877(a)(1) (LexisNexis 2006).

[44] *See* 2003 JCT REPORT, *supra* note 19, at 124, 209.

[45] *See supra* notes 29–35 and accompanying text.

triate with the ability to engage in significant tax planning"[46] and "allow certain expatriating citizens to avoid U.S. worldwide taxing jurisdiction for periods when they might have been entitled to receive the benefits of U.S. citizenship."[47]

In particular, a U.S. citizen willing to surrender citizenship to avoid taxes might commit a potentially expatriating act, such as obtaining nationality in another country, yet refrain from notifying a consular official as to any expatriating intent. Thus, the individual could retain her "ability to invoke [her] U.S. citizenship if, for example, an emergency arose and [she] needed the assistance of a U.S. embassy or consulate."[48] Yet, if at some future date the individual determines that losing citizenship at the earlier date would have been tax advantageous (e.g., if the IRS audits the individual and asserts worldwide taxation over the individual based on her citizenship), the individual could inform a consular official that the earlier expatriating act had been performed with an intent to lose citizenship. In the absence of contrary evidence,[49] the Department of State presumably would accept the individual's statement of intent and would document the individual's loss of citizenship under the nationality law retroactive to the date of the expatriating act. Because the tax law definition of citizenship refers to the nationality law, the loss would also be retroactive for tax purposes. In effect, the subjective intent criteria and the retroactive nature of the citizenship loss under the nationality law allow the individual "to determine after the fact whether an expatriation effective from the earlier date would be tax advantageous now."[50] During the period between the acquisition of the foreign nationality and the date, if any, that the IRS audits the individual, she would retain the ability to claim that she remained a U.S. citizen. If, for example, she faced an emergency that required assistance of a U.S. consulate or embassy or she decided to return to the United States to live, the State Department, under its administrative presumptions, would accept that assertion.

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[46] OFFICE OF TAX POL'Y, DEP'T OF TREASURY, INCOME TAX COMPLIANCE BY U.S. CITIZENS AND U.S. LAWFUL PERMANENT RESIDENTS RESIDING OUTSIDE THE UNITED STATES AND RELATED ISSUES 33 (1998), *reprinted in* 98 LEXIS TNT 87-16 [hereinafter TREASURY REPORT]. In the interest of disclosure, it should be noted that the author, while working at the Internal Revenue Service and subsequently at the Treasury Department, participated in the drafting of the Treasury Report.

[47] *Id.* at 28.

[48] *Id.* at 33.

[49] Contrary evidence could include "evidence of travel on a U.S. passport or of any other acts unequivocally indicating that the person had held himself out as a U.S. citizen" during the period following the potentially expatriating act. *Id.*

[50] *Id.* at 34. A similar result would apply for gift and estate tax purposes. For example, if the individual died before notifying a consular official about a potentially expatriating act, her executor might attempt to argue that the individual intended to lose citizenship pursuant to the act, and therefore the estate should not be subject to U.S. estate tax on its worldwide assets.

The 1998 Treasury Report, in highlighting this potential abuse, did not assert that a significant number of citizens were engaging in this abuse of the State Department administrative presumptions for tax avoidance purposes. Rather, the report described the scheme in hypothetical terms.[51]

The two-pronged test of citizenship loss under new Internal Revenue Code section 7701(n) would prevent this abuse by ignoring, for tax purposes, the retroactive effect of citizenship loss under the nationality law. An individual would remain a citizen for tax purposes until she notified the U.S. consular official of an expatriating act and intent (assuming that she also complied with the IRS notification requirement). Thus, under the new law, an individual could no longer gain the tax advantages of retroactively revoking citizenship. The new tax provision does not alter the nationality law rules, so the loss would still be retroactive for nationality law purposes.

The new law goes much further than merely shutting down this potential abuse of the nationality law. It also creates the possibility of continued worldwide taxation even for periods after the State Department has issued the certificate of loss of nationality, when the possibility no longer exists that the individual could try to invoke the benefits of citizenship. Because new section 7701(n) delays the loss of citizenship for tax purposes until *both* the notification of a consular official and the filing under I.R.C. section 6039G,[52] an individual who fails to file IRS Form 8854 as required by section 6039G would remain a U.S. citizen for tax purposes even after notifying the Department of State, subjecting her to continued worldwide U.S. tax liability for the remainder of her lifetime,[53] as well as worldwide U.S. estate taxation upon her death.[54]

2. *Reacquisition of Renounced Citizenship—Section 877(g)*

New Internal Revenue Code section 877(g), also enacted by the AJCA, creates a second tax code departure from the nationality law definition of citizenship. Whereas section 7701(n) focuses on the timing of citizenship loss, section 877(g) addresses the period following citizenship loss. Pursuant to section 877(g), certain individuals who lose citizenship under the nationality law and have that loss recognized for tax purposes under section 7701(n) may, nonetheless, be treated as citizens for tax purposes in future years. In particular, if an expatriate who is subject to the alternative tax regime of section 877[55] is physically present in the United States

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[51] *Id.* at 28.

[52] I.R.C. § 6039G (LexisNexis 2006).

[53] If the individual fails to file income tax returns voluntarily, the period of limitations for assessing tax will remain open indefinitely. *See* I.R.C. § 6501(c)(3) (2000).

[54] *See* Notice 2005-36, *supra* note 39.

[55] *See supra* notes 14–18 and accompanying text.

for more than thirty days in any of the ten years following expatriation,[56] she will be treated as a citizen for tax purposes during that year.[57] Accordingly, during that year she will be subject to U.S. income taxation on her worldwide income and, if she makes any gifts or dies during that year, she will be subject to U.S. gift or estate taxation on her worldwide gifts or estate.[58]

Consider the example of an individual who committed a potentially expatriating act in 2006 but did not notify the State Department of her expatriating intent and file IRS Form 8854 until 2010. Under section 7701(n), she will be treated as losing citizenship for tax purposes in 2010, although her citizenship loss for nationality law purposes will be retroactive to 2006. If her net worth or average pre-expatriation income tax liability exceeds the thresholds of section 877(a), she will be subject to the alternative tax regime of section 877(b) for ten years, beginning in 2010. As discussed previously,[59] that alternative regime imposes tax on a broader range of income from U.S. sources than would ordinarily apply to a nonresident alien, but it falls far short of imposing worldwide taxation on the individual.

Assume that the individual visits the United States in 2014 and is physically present in the country for 31 days during that year. Pursuant to new section 877(g), the individual will be treated as a citizen for U.S. tax purposes in 2014, even though she previously was treated as having lost citizenship for tax purposes in 2010 (and for nationality law purposes in 2006). As a result, in 2014 she will be subject to U.S. taxation on her worldwide income. Of course, the individual will not be treated as a citi-

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[56] This ten-year period in section 877(g) begins only when the individual is treated as having lost citizenship for tax purposes. *See* I.R.C. § 7701(n) (LexisNexis 2006).

[57] Section 877(g) provides that the special income tax regime of section 877:

> [S]hall not apply to any individual to whom this section [877] would otherwise apply for any taxable year during the 10-year period referred to in subsection (a) in which such individual is physically present in the United States at any time on more than 30 days in the calendar year ending in such taxable year, and such individual shall be treated for purposes of this title as a citizen or resident of the United States, as the case may be, for such taxable year.

I.R.C. § 877(g)(1) (2000). The "as the case may be" language treats a former citizen who runs afoul of the 30-day test as a citizen, and treats a former long-term resident who runs afoul of the test as a resident. *See* H.R. REP. No. 108-548, pt. 1, at 255 (2004).

The statute provides certain exceptions. In particular, in counting the number of days of physical presence during the year, the former citizen may disregard up to thirty days in which she is performing services in the United States for an employer, provided that the individual is not related to the employer and the employer meets reporting requirements that may be specified by the IRS. *See* I.R.C. § 877(g)(2)(A) (2000).

[58] Because section 877(g), if applicable, treats the individual as a citizen for purposes of the entire Internal Revenue Code, the citizenship definition applies not only to the income tax regime but also to the estate and gift tax regimes. *See* H.R. REP. No. 108-548, pt. 1, at 255–56.

[59] *See supra* note 16.

zen for nationality law purposes in 2014 and therefore will not be eligible for any of the benefits of citizenship during that year.

According to the House Ways and Means Committee report, section 877(g) was enacted due to concern that "[i]ndividuals who relinquish citizenship . . . for tax reasons often do not want to fully sever their ties with the United States; they hope to retain some of the benefits of citizenship . . . without being subject to the U.S. tax system as a U.S. citizen."[60] In particular, Congress was concerned that an individual, following citizenship loss, could spend an average of four months per year[61] in the United States without being treated as a resident alien taxable on worldwide income.[62] By treating a former citizen who spends more than thirty days in the United States in a single calendar year as a citizen for tax purposes, the new

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[60] H.R. REP. No. 108-548, pt. 1, at 253. The Committee report's assertion that a former citizen might be able to retain some of the benefits of citizenship is somewhat misleading. As discussed *infra* note 61 and accompanying text, the Committee's main concern focused on individuals who spend significant time in the United States following their citizenship loss. However, a former citizen who enters and spends time in the United States after relinquishing citizenship is subject to significant visa and other requirements generally applicable to aliens. This stands in stark contrast to a citizen, who can enter the United States at will. Thus, while an expatriate might desire to retain various ties to the United States, including the ability to make future visits, it is misleading to characterize those ties as a continuation of citizenship benefits.

Like the new citizenship loss provision of section 7701(n), the new section 877(g) citizenship reacquisition provision was based on a recommendation by the staff of the Joint Committee on Taxation. *See* 2003 JCT REPORT, *supra* note 19, at 210–11.

[61] 2003 JCT REPORT, *supra* note 19, at 210–11. As discussed *supra* note 9, a non-citizen can be treated as a resident alien, taxable on worldwide income, if she is physically present in the United States for at least 31 days during the calendar year and for at least 183 days under a three-year weighted formula. *See* I.R.C. § 7701(b)(3) (2000). The committee report's reference to four months per year contemplates a non-citizen who spends 120 days in the United States in three successive years, yielding a total of 180 days under the weighted formula, just under the 183-day threshold that would trigger resident status. Even if the 183-day threshold is triggered, under certain circumstances the individual might be able to avoid tax resident status, provided she is present in the United States for fewer than 183 days during the *current* year and has a closer connection to a foreign country in which she has her tax home. I.R.C. § 7701(b)(3)(B).

[62] Congress previously addressed this purported abuse by former citizens attempting to spend significant time in the United States. In 1996, it enacted legislation intended to permanently ban former citizens who had relinquished citizenship for tax-avoidance purposes from reentering the United States. *See* Illegal Immigration Reform and Immigrant Responsibility Act of 1996, Pub. L. No. 104-208, § 352, 110 Stat. 3009-546, 3009-641. This provision, known as the "Reed Amendment," placed tax-motivated expatriates on the same immigration law inadmissibility list that includes "terrorists, World War II–era Nazis, practicing polygamists, persons with communicable diseases, and persons convicted of certain crimes." Kirsch, *supra* note 12, at 892 (citing INA § 212, *codified at* 8 U.S.C. § 1182). Due to substantive and technical problems with the statute, the Department of Homeland Security has not yet implemented the provision, and in practice it has had only limited in terrorem effects. *See id.* at 900. By enacting new I.R.C. section 877(g), which contemplates the possibility of a former citizen spending significant amounts of time in the United States after relinquishing citizenship, Congress has implicitly recognized the many shortcomings of the Reed Amendment. *See generally* Kirsch, *supra* note 12 (critiquing the Reed Amendment on instrumental, expressive, and symbolic grounds).

provision eliminates any tax benefits the individual otherwise would have enjoyed for that year by having previously renounced her citizenship.

II. CUSTOMARY INTERNATIONAL LAW VIOLATIONS

The two recently enacted tax code definitions of citizenship raise significant jurisdictional issues under international law. The relevant jurisdictional principles of international law arise from two main sources: specific agreements, in the form of treaties or conventions, which may be either bilateral between two states or multilateral among several states; and international custom of nations that evidences a general practice accepted as law (known as "customary international law").[63]

As a practical matter, most individuals who are subject to the AJCA tax citizenship provisions would not be expected to establish residence in a country with which the U.S. has a tax treaty.[64] Accordingly, the jurisdictional limitations imposed on the United States by tax treaties would not be of assistance to these individuals.[65] Instead, these individuals would have to rely on customary international law[66] to find potential jurisdictional restrictions on the ability of the United States to enact the AJCA definitions of tax citizenship.[67]

Customary international law addresses several jurisdictional categories.[68] Of particular relevance to the present inquiry is the United States' jurisdiction to prescribe[69]—i.e., the extent of its authority "to make its sub-

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[63] *See* RESTATEMENT (THIRD) OF THE FOREIGN RELATIONS LAW OF THE UNITED STATES § 102 (1987). The Restatement cites a third source of international law, "derivation from the general principles common to major legal systems of the world," *see id.* § 102(1)(c), although it acknowledges that treaties and customary international law represent the principal sources. *See id.* at pt. 1, ch. 1, introductory note.

[64] The majority of the United States' tax treaties are with countries that are members of the Organization for Economic Cooperation and Development (OECD). To the extent that taxes influence an individual's decision to surrender U.S. citizenship, that individual is more likely to move to a non-OECD country with relatively low taxes and more limited exchange of tax information with the United States.

[65] The jurisdictional limitations of tax treaties as applicable to the AJCA provisions is discussed *infra* Part IV.A.

[66] Customary international law reflects those practices that countries follow because they feel legally obligated to behave in that way. *See* RESTATEMENT (THIRD) OF THE FOREIGN RELATIONS LAW OF THE UNITED STATES § 102(2) (1987).

[67] An individual who is a resident of a treaty country could rely on these customary international law arguments in addition to any jurisdictional restrictions set forth in the treaty.

[68] The Restatement recognizes three types of jurisdiction: prescriptive (defined in the text), enforcement (the ability of a country "to induce or compel compliance or to punish noncompliance with its laws or regulations"), and adjudicative (the ability of a country "to subject persons or things to the process of its courts or administrative tribunals"). RESTATEMENT (THIRD) OF THE FOREIGN RELATIONS LAW OF THE UNITED STATES § 401 (1987). *But see* Cecil J. Olmstead, *Jurisdiction*, 14 YALE J. INT'L L. 468 (1989) (criticizing the Restatement's addition of the adjudicative category of jurisdiction).

[69] In the tax context, jurisdiction to enforce also plays a significant role. The enforcement difficulties associated with the AJCA provisions are discussed *infra* notes 291–300 and accompanying text. Jurisdiction to adjudicate might also play a significant role with

stantive laws applicable to particular persons and circumstances."[70] In contrast to adjudicative jurisdiction, which focuses on the ability of a court to adjudicate a particular dispute, prescriptive jurisdiction focuses on the power of the legislature to make a law apply in certain international contexts.

This Part analyzes the extent to which the AJCA citizenship definitions violate the prescriptive jurisdictional principles of customary international law. The analysis concludes that in certain contexts the tax citizenship definitions violate these jurisdictional limits. Part III then addresses the relevance, if any, of these customary international law violations under the U.S. Constitution.

A. Prescriptive Jurisdictional Principles

1. Bases for Prescriptive Jurisdiction

Customary international law recognizes several bases that permit a country to exercise prescriptive jurisdiction. The three most widely recognized bases are territoriality, nationality, and the protective principle.[71] The following analysis briefly summarizes each of these principles then considers the extent, if any, to which these principles permit the worldwide taxation of a former citizen (in the nationality law sense) who is treated as a citizen for tax purposes under the AJCA provisions.

a. Territoriality and Effects

Customary international law recognizes a country's jurisdiction to prescribe law with respect to "conduct that, wholly or in substantial part, takes place within its territory" and with respect to persons or things present within its territory.[72] In the context of taxation, this territorial-based principle generally is referred to as source-based taxation.[73] Source-based taxa-

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respect to a former citizen living abroad who purportedly is subject to the AJCA provisions. However, even if the United States is able to exercise personal jurisdiction over the individual because, for example, she visits the United States, the issue regarding prescriptive jurisdiction will remain significant.

[70] RESTATEMENT (THIRD) OF THE FOREIGN RELATIONS LAW OF THE UNITED STATES pt. IV, introductory note (1987).

[71] *See id.* § 402(1)–(3). Other jurisdictional bases, which are less widely applied, include the passive personality principle (involving an act committed outside the country's territory if the victim is a national of that country) and universality (allowing prosecution of certain offenses, such as genocide and war crimes, that are universally condemned, even though there is no link to the country's territory). *See id.* §§ 402 cmt. g, 404. These jurisdictional bases are not relevant to the analysis of the AJCA tax provisions.

[72] *Id.* § 402(1).

[73] *See* AMERICAN LAW INSTITUTE, *supra* note 2, at 6; Reuven S. Avi-Yonah, *International Tax as International Law*, 57 TAX L. REV. 483, 490 (2004); Walter Hellerstein, *Jurisdiction to Tax Income and Consumption in the New Economy: A Theoretical and Comparative Perspective*, 38 GA. L. REV. 1, 6–8 (2003). So-called residence-based taxation,

tion refers to a country imposing tax based on some connection between the nation's geographic territory and the location of the business activity or property that gives rise to the income.[74] For example, the United States exercises source-based taxation when it taxes a nonresident alien on income connected to a U.S. business operation or arising from certain U.S.-source passive investments.[75]

Effects-based jurisdiction is closely related to territorial jurisdiction.[76] The effects principle permits a country to prescribe laws covering conduct that takes place outside its territory but that has, or is intended to have, substantial effect within its territory.[77] While the effects doctrine has been recognized for much of the last century in the criminal law area,[78] some questions still remain regarding the outer boundaries of this principle, particularly with respect to economic regulation.[79] Nonetheless, the United States has relied extensively on the effects doctrine in applying U.S. antitrust laws to conduct outside the United States when that conduct was intended to produce, and actually did produce, a substantial effect in the United States.[80]

b. Nationality

Customary international law also allows a country to prescribe law with respect to the "activities, interests, status, or relations of its nationals outside as well as within its territory."[81] This principle, which allows ex-

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discussed *infra*, particularly as applied to non-citizens residing in the United States, has elements of territoriality, given its focus on the taxpayer's physical presence within the country's territory. *See* RAMON J. JEFFERY, THE IMPACT OF STATE SOVEREIGNTY ON GLOBAL TRADE AND INTERNATIONAL TAXATION 45 (1999). However, because residence-based taxation often involves taxation of extraterritorial income by reason of the personal status of the taxpayer in relation to the country, it is more generally associated with nationality-based jurisdiction. *See infra* notes 82–85 and accompanying text.

[74] *See* AMERICAN LAW INSTITUTE, *supra* note 2, at 7; *see also* RESTATEMENT (THIRD) OF THE FOREIGN RELATIONS LAW OF THE UNITED STATES § 411 (1987).

[75] *See supra* notes 9–11 and accompanying text.

[76] *See* RESTATEMENT (THIRD) OF THE FOREIGN RELATIONS LAW OF THE UNITED STATES § 402(1)(c) & cmt. (d) (1987) (categorizing effects-based jurisdiction as a type of territorial jurisdiction). Indeed, effects-based jurisdiction is often referred to as "objective territoriality." *See* DAVID J. BEDERMAN, INTERNATIONAL LAW FRAMEWORKS 176 (2001).

[77] RESTATEMENT (THIRD) OF THE FOREIGN RELATIONS LAW OF THE UNITED STATES § 402(1) (1987).

[78] *See* S.S. Lotus (Fr. v. Turk.), 1927 P.C.I.J. (ser. A) No. 9 (Sept. 7, 1927).

[79] *See* BEDERMAN, *supra* note 76, at 177; *see also* H. Lowell Brown, *The Extraterritorial Reach of the U.S. Government's Campaign Against International Bribery*, 22 HASTINGS INT'L & COMP. L. REV. 407, 446–47 n.154 (1999) (citing circumstances where "the doctrine's applicability to instances of solely economic effect within U.S. territory has been questioned").

[80] *See* Hartford Fire Ins. Co. v. California, 509 U.S. 764, 795–96 (1993).

[81] RESTATEMENT (THIRD) OF THE FOREIGN RELATIONS LAW OF THE UNITED STATES § 402(2) (1987). As a technical matter, the terms "national" and "citizen" are not necessarily synonymous. Nationality is a concept of international law, and has international consequences, such as diplomatic protection and jurisdiction. *Id.* § 211 cmt. (h) rept. note 6. Citizen-

traterritorial application of law based on the person's status, has expanded so that in certain circumstances "[i]nternational law has increasingly recognized the right of a state to exercise jurisdiction on the basis of domicile or residence,"[82] rather than just nationality. Indeed, in the field of taxation, it is very common for countries to tax income arising outside of the country's geographical boundaries if it is earned by a resident of the country (whether or not the resident is a citizen of the country). While the United States embraces this broad taxation of its residents,[83] it is one of the few countries in the world that takes full advantage of nationality-based jurisdiction to tax the foreign income of its citizens who reside outside the country.[84] Taxation of income based on the individual's status in relation to the country, rather than the location of the activities or property giving rise to the income, is often referred to as residence-based taxation, even when the taxpayer is a citizen residing abroad.[85]

c. Protective Principle

Customary international law also recognizes that a country can prescribe laws regarding "certain conduct outside its territory by persons not its nationals that is directed against the security of the state or against a limited class of other state interests."[86] This principle generally does not apply in the taxation area. However, it is relevant to the extent the AJCA provisions are viewed as protecting the United States against one of the "limited class of other state interests" as contemplated by the principle.

2. Reasonableness Limitation

Even if one of the three above-mentioned bases of jurisdiction exists, under customary international law a country "may not exercise jurisdiction to prescribe law with respect to a person or activity having connections with another state when the exercise of such jurisdiction is unrea-

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ship is a concept in the nationality law of many countries and generally reflects that subset of nationals who are entitled to full political rights in the country, such as the right to vote and hold office. *Id.* Because the relevant tax provisions focus on citizenship (which implies nationality), this Article treats the two terms interchangeably.

[82] *Id.* § 402 cmt. (e). The comments in the Restatement explicitly list taxation as an area where extraterritorial prescriptive jurisdiction has been expanded to include not only nationals, but also domiciliaries and residents. *Id.*; *see also* Avi-Yonah, *supra* note 73, at 484–86 (discussing the expansion of nationality-based taxing jurisdiction to include residence and domicile); Hellerstein, *supra* note 73, at 5–6.

[83] *See supra* note 8.

[84] *See supra* note 2 and accompanying text.

[85] *Cf.* AMERICAN LAW INSTITUTE, *supra* note 2, at 6 (referring to it as "domiciliary jurisdiction").

[86] RESTATEMENT (THIRD) OF THE FOREIGN RELATIONS LAW OF THE UNITED STATES § 402(3) (1987).

sonable."[87] The determination of whether an exercise of prescriptive jurisdiction is reasonable depends on "all relevant factors,"[88] including the extent to which there is a link between the activity and the country; the connections, such as nationality or residence, between the country and the person; and the character of the activity to be regulated, its importance to the country, and the degree to which it is regularly accepted.[89]

In the tax context, it is not necessarily unreasonable for a country to exercise taxing jurisdiction over a person's income merely because another country exercises jurisdiction over the same income. Indeed, this potential for double-taxation is a common phenomenon in international taxation, particularly when one country exercises jurisdiction based on a territorial-based source principle and another country exercises nationality or residence-based jurisdiction over the taxpayer.[90] Under such circumstances, source-based jurisdiction generally is treated as having a superior claim, and the country exercising nationality or residence-based taxation is expected to provide relief from double-taxation.[91]

B. Shifting Jurisdictional Basis of Section 877

Before analyzing the extent to which the new AJCA tax definitions of citizenship violate these jurisdictional principles, it is interesting to note the extent to which these new definitions reflect a shift in jurisdictional exercise over individuals who lose citizenship (in a nationality law sense). Prior to the AJCA, an individual who lost citizenship (under the nationality laws) with a principal purpose of tax avoidance became subject to the alternative tax regime of Internal Revenue Code section 877 for a ten-year period.[92] Even after the enactment of the AJCA, this alternative tax regime applies to individuals who lose citizenship under the new definition and whose average income tax liability or net worth exceeds statutory thresholds.[93]

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[87] *Id.* § 403(1); *see also* Stephen E. Shay et al., *What's Source Got To Do with It? Source Rules and U.S. International Taxation*, 56 TAX L. REV. 81, 116 n.112 (2002). The Restatement lists relevant factors for determining whether the exercise of jurisdiction is unreasonable. *See* RESTATEMENT (THIRD) OF THE FOREIGN RELATIONS LAW OF THE UNITED STATES § 403(2) (1987); *cf.* Hartford Fire Ins. Co. v. California, 509 U.S. 764, 818–19 (Scalia, J., dissenting) (relying on the Restatement's reasonableness standards on the grounds that they "appear fairly supported in the decisions of this Court construing international choice-of-law principles").

[88] RESTATEMENT (THIRD) OF THE FOREIGN RELATIONS LAW OF THE UNITED STATES § 403(2) (1987).

[89] *Id.*

[90] AMERICAN LAW INSTITUTE, *supra* note 2, at 7.

[91] *See id.* § 413, rept. notes 1, 2. The United States, when exercising nationality or residence-based taxation, generally provides a tax credit to the extent a foreign country imposes tax on foreign-source income. *See* I.R.C. § 901 (2000).

[92] *See* I.R.C. § 877(a) (LexisNexis 2006).

[93] *See supra* note 18.

The section 877 alternative tax regime, if applicable, does not provide that the former citizen is taxable on her worldwide income (as she would have been had she remained a citizen). Rather, it generally applies the same source-based taxation that normally applies to nonresident aliens (i.e., imposing tax only on income connected to a U.S. business or arising from certain U.S.-source passive investments).[94] In exercising this source-based taxation, however, it creates a broader definition of U.S. source income (e.g., capital gain from the sale of stock in a U.S. domestic corporation) than would ordinarily apply to a nonresident alien.[95]

Thus, prior to the AJCA, Congress exercised restraint in taxing individuals who surrendered citizenship, implicitly avoiding taxation based on nationality or residence. By enacting a source-based regime, it relied on broadly accepted territorial principles, merely expanding the types of income connected to its territory that would be subject to tax in the hands of certain former citizens.[96] While Congress has continued this exercise of expanded source-based jurisdiction in some circumstances following the enactment of the AJCA,[97] the new definitions of citizenship for tax purposes reflect a shift in jurisdictional focus in those circumstances when they apply. In particular, by classifying certain former citizens (in the nationality law sense) as citizens for tax purposes, and thereby purporting to tax their worldwide income, Congress apparently is trying to invoke nationality-based jurisdiction over these individuals. The following Section examines the extent to which such an expansion of jurisdiction is justifiable under customary international law.

C. AJCA Jurisdictional Violations

In analyzing whether the AJCA's special definitions of citizenship for tax purposes satisfy the above-mentioned prescriptive jurisdictional limits under customary international law, it is important to consider each of the AJCA provisions separately. Under the AJCA provisions, a person who loses citizenship under the nationality law might be treated as a citizen for tax purposes following the date on which her loss occurs for nationality law purposes under three main circumstances. The first two circumstances contemplate a delayed loss of citizenship for tax purposes, while the third circumstance causes a reacquisition of citizenship for tax purposes.

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[94] *See* I.R.C. § 877(b)(1) (cross-referencing the provisions of I.R.C. § 872, which generally apply to nonresident aliens).

[95] *See* I.R.C. § 877(d)(1)(B).

[96] For another example of Congress's recognition that it lacked jurisdiction under customary international law to tax a nonresident directly on foreign source income, see Avi-Yonah, *supra* note 73, at 498 (discussing Congress's structuring of the Foreign Personal Holding Company and Controlled Foreign Corporation rules in order to comply with its understanding of the jurisdictional limitations of then-existing customary international law).

[97] *See supra* notes 16–18 and accompanying text.

First, the person might commit a potentially expatriating act (e.g., obtaining nationality in another country) with an intent to lose citizenship but might refrain from notifying either the Department of State or the IRS of that action. Under such circumstances, the loss of citizenship for nationality law purposes technically occurs on the date the act is committed with requisite intent, even though the Department of State will not be aware of the loss and will not be in a position to document that loss. Under new Internal Revenue Code section 7701(n), the individual remains a citizen for tax purposes under these circumstances.[98]

Second, the person might commit a potentially expatriating act with an intent to lose citizenship and might notify the Department of State of the act but fail to notify the IRS as required by section 6039G. Under such circumstances, the Department of State will document the loss of citizenship retroactively to the date the act was committed.[99] However, under new Internal Revenue Code section 7701(n), the individual will remain a citizen for tax purposes because that statute requires notification of both the Department of State[100] and the IRS in order to lose citizenship status for tax purposes.[101]

Third, the person might commit a potentially expatriating act with an intent to lose citizenship and might notify both the Department of State and the IRS of the loss of citizenship. Under such circumstances, the individual will have complied with section 7701(n), and the loss of citizenship will be recognized for tax purposes. If, however, the individual's average income tax liability or net worth exceeds the section 877(a) statutory thresholds and the individual is physically present in the United States for more than thirty days in any of the ten calendar years following citizenship loss, the individual will again be treated as a citizen for tax purposes during that year pursuant to Internal Revenue Code section 877(g).[102]

The relevant question is whether the treatment of the individual as a citizen for tax purposes in each of these circumstances is within the permissible jurisdictional principles of customary international law.[103] For

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[98] *See supra* notes 38–39 and accompanying text.

[99] *See supra* notes 34–35 and accompanying text.

[100] Although the statute refers to notification of the "Secretary of State or the Secretary of Homeland Security," the reference to the Secretary of Homeland Security is directed principally at long-term residents who are terminating their residency status. *See supra* note 40.

[101] *See* I.R.C. § 7701(n) (LexisNexis 2006).

[102] *Id.* § 877(g); *see supra* notes 55–59 and accompanying text.

[103] The 2003 JCT Report acknowledges as a general matter that "[i]ndefinitely taxing a nonresident noncitizen on his or her worldwide income . . . would seem to exceed U.S. taxing jurisdiction and could be viewed as inconsistent with principles of international taxation." 2003 JCT REPORT, *supra* note 19, at 109; *see also* Avi-Yonah, *supra* note 73, at 498 ("Can a country simply decide to tax nonresidents that have no connection to it on foreign source income? The answer is clearly no, both from a practical perspective and, I would argue, from a customary international law perspective."). The 2003 JCT Report, upon which the AJCA provisions are based, contains a cursory analysis of whether the tax citizenship provisions violate international law, concluding that they do not interfere with the right to surrender citizenship but failing to address potential violations of prescriptive

each potential application of the AJCA provisions, it is sufficient if there is at least one applicable jurisdictional basis. An application of the AJCA provisions will exceed permissible jurisdictional limits only if none of the prescriptive jurisdictional bases justifies the application under the circumstances.[104]

1. Territoriality and Effects

a. Section 7701(n)—Failure To Notify

Section 7701(n), which delays the loss of citizenship for tax purposes until the individual has notified both the Department of State and the IRS, cannot be justified under territorial jurisdiction principles, regardless of whether it is applied because of failure to notify the Department of State, the IRS, or both. Classifying the individual as a citizen for tax purposes results in taxation not only of income connected to a U.S. business or U.S.-source passive investments—both of which are legitimate targets of taxation under territorial principles[105]—but also of foreign-source income that has no connection to a U.S. business or U.S. investments.[106] Moreover, the individual, particularly if she has notified the Department of State of her citizenship loss but has not yet notified the IRS, is unlikely to have any significant connection with U.S. territory.[107] Because section 7701(n) imposes tax on persons that are not within U.S. territory with respect to their business or investment activities that are not connected to U.S. territory, it is difficult to see any territorial-based justification for taxing the worldwide income of the individual.

Similarly, the effects-based aspect of territoriality does not justify the application of worldwide taxation under section 7701(n). As a threshold matter, it is doubtful that a former citizen residing outside the United States who fails to file an information statement could be viewed as having a "substantial" effect on United States territory in years following her expatriation.[108] At most, the failure to file an information statement with the Internal Revenue Service could be viewed as an attempt to avoid or evade the extended source-based tax regime of section 877. Even in the unlikely

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jurisdiction. *See* 2003 JCT REPORT, *supra* note 19 at 123–25.

[104] In general, a country is presumed to have a valid jurisdictional basis for its legislation, and the burden of proof is on the party asserting that no valid jurisdictional basis exists. *See supra* note 76; *see also* GARY B. BORN, INTERNATIONAL CIVIL LITIGATION IN UNITED STATES COURTS 499 (1996).

[105] Indeed, the United States generally taxes nonresident aliens on these types of income. *See supra* notes 72–75 and accompanying text.

[106] *See supra* note 8 and accompanying text.

[107] Once the Department of State has documented the loss of citizenship, the individual will be an alien who is subject to the same restrictions on entering the United States as are other aliens.

[108] *See supra* notes 77–80 and accompanying text.

event that this could be viewed as having a substantial effect on the United States,[109] the United States response—imposition of worldwide tax pursuant to the "citizen" label of section 7701(n)—goes well beyond any territorial connection to the United States.

b. Section 877(g)—More than Thirty Days of Physical Presence

In contrast to section 7701(n), which generally involves individuals who remain outside the United States, section 877(g) applies to individuals who have at least some physical connection with U.S. geographic territory—i.e., more than 30 days of physical presence in any of the ten post-expatriation years. Nonetheless, territorial jurisdictional principles do not support taxation of the worldwide income of such an individual under section 877(g). Unlike nationality-based jurisdiction, which supports the taxation of income arising outside a country's territory, territorial-based principles only permit taxation of income derived from or associated with the individual's presence or business activities in the country, or derived from property located in the territory of the country.[110] Because section 877(g) purports to tax the individual on her worldwide income (by reason of its "citizen" characterization), its broad reach cannot be justified by customary international law's territoriality principle of prescriptive jurisdiction.

2. Nationality

a. Section 7701(n)—Failure To Notify Department of State

Nationality-based jurisdictional principles support the application of section 7701(n) when it is applied due to the individual's failure to notify the Department of State of the potentially expatriating act. Consider the example in which an individual commits a potentially expatriating act, such as obtaining nationality in another country in 2006, and fails to inform a Department of State consular official of the act and requisite intent until 2010. The Department of State will then, in 2010, document the loss of citizenship retroactive to 2006.[111]

The relevant question is whether, with respect to that interim period from 2006 through 2010, the nationality principle provides a jurisdictional basis for the United States to tax the individual's worldwide income.

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[109] *See supra* note 79 and accompanying text (discussing potential limitations on customary international law effects-based jurisdiction in the economic sphere).

[110] *See* RESTATEMENT (THIRD) OF THE FOREIGN RELATIONS LAW OF THE UNITED STATES § 412(1)(b) & (c) cmt. a (1987); *see also supra* notes 72–75 and accompanying text.

[111] This assumes that the individual has not, as a factual matter, traveled on a U.S. passport or otherwise acted as a U.S. citizen during the intervening period. *See supra* notes 29–33, 49 and accompanying text.

Nationality-based taxing jurisdiction is based not only on the inherent relationship between the country and the individual but also on the benefits that citizenship provides.[112] For example, in *Cook v. Tait*,[113] the Supreme Court rejected a taxpayer's assertion that international law prohibits the taxation of a nondomiciliary citizen's income arising outside the United States and observed that "the government, by its very nature, benefits the citizen and his property wherever found, and therefore, has the power to make the benefit complete [by having authority to collect tax.]"[114]

The benefits rationale underlying nationality-based jurisdiction provides strong support for allowing application of section 7701(n) to the individual who delays notifying the Department of State of the expatriat-

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[112] *See* Hellerstein, *supra* note 73, at 6.

[113] 265 U.S. 47 (1924).

[114] *Id.* at 56. Edwin R.A. Seligman, a Columbia University economist who played a leading role in the development of modern international income taxation, observed that nationality-based taxing jurisdiction developed because "political rights involve political duties. Among them is certainly the duty to pay taxes." EDWIN R. A. SELIGMAN, ESSAYS IN TAXATION 111 (10th ed. 1931).

The Court of Appeals for the First Circuit, in *United States v. D'Hotelle de Benitez Rexach*, 558 F.2d 37 (1st Cir. 1977), also recognized the importance of the benefits rationale in determining whether the United States could impose tax for periods when an individual's citizenship status was in doubt. That case considered whether the taxpayer was subject to tax as a citizen for the period between 1949 and her death in 1973. Although her residence abroad purportedly caused her to lose citizenship in 1949 under the then-existing nationality law, the Supreme Court's decision in *Afroyim v. Rusk*, 387 U.S. 253, 268 (1967), declared that intent to relinquish citizenship is a necessary prerequisite to citizenship loss, thereby casting doubt on the taxpayer's earlier loss. The First Circuit (ruling in the tax case after the taxpayer's death) held that the taxpayer had not lost citizenship by reason of her 1949 actions because she did not have an intent to lose citizenship in 1949. Nonetheless, the court declared that the taxpayer "cannot be dunned for taxes to support the United States government during the years in which she was denied its protection." *D'Hotelle*, 558 F.2d at 43. As a factual matter, the court found that the taxpayer had utilized the benefits of citizenship from 1949 through 1952 (because her passport had been renewed during that period), but that as of 1952 both the taxpayer and the Department of State had ceased to consider her a citizen, and she no longer utilized any benefits of citizenship. Accordingly, the court held that the taxpayer was subject to tax from 1949 through 1952 but not thereafter. *Id.* Although the court's reasoning focused on equity principles, the benefits rationale reflected therein closely parallels the benefits rationale that arises under customary international law's nationality jurisdiction. *See* U.S. v. Matheson, 532 F.2d 809, 819 (2d Cir. 1976) ("[O]ne gaining governmental benefits on the basis of a representation or asserted position is thereafter estopped from taking a contrary position in an effort to escape taxes.").

The IRS has applied a benefits analysis to provide administrative relief to certain taxpayers whose citizenship was restored retroactively under changes to the immigration laws after the Department of State had treated them as losing citizenship in the absence of intent to do so. *See* Rev. Rul. 92-109, 1992-2 C.B. 3; Rev. Rul. 75-357, 1975-2 C.B. 5 (noting that tax relief would not be available if the taxpayer had "affirmatively exercised a specific right of citizenship" during the interim period when citizenship purportedly had been lost); Rev. Rul. 70-506, 1970-2 C.B. 1. The IRS purported to base these rulings on its discretionary authority regarding the retroactivity of regulations under I.R.C. § 7805(b) (2000), instead of on international law grounds. *See* R. RHOADES & M. LANGER, U.S. INTERNATIONAL TAXATION AND TAX TREATIES § 24.02[1] (2001) (discussing an IRS policy statement allowing discretionary relief for certain individuals who mistakenly thought they had lost citizenship, provided, inter alia, that the individual had not affirmatively exercised any citizenship rights during the relevant period).

ing act. Despite the Department of State's eventual determination that the individual's loss of citizenship occurred as of the expatriating act, during the actual years of that period before the determination the Department of State would not have contemporaneous knowledge that the individual had committed the act with the requisite intent. The Department of State would therefore not be in a position to deny the individual the benefits of citizenship.[115] Because the individual would retain the de facto ability to obtain the benefits of citizenship prior to the time she notified the Department of State, the benefits rationale underlying nationality-based taxing jurisdiction justifies the imposition of tax under section 7701(n) for that period based on the contemporaneous understanding.

b. Section 7701(n)—Failure To Notify IRS

Assume that the individual commits the potentially expatriating act in 2006 and notifies the Department of State of the act and expatriating intent in 2010 but fails to notify the IRS of the citizenship loss as required by section 6039G. Section 7701(n) would continue to treat the individual as a U.S. citizen for tax purposes, even though the Department of State has become aware of the citizenship loss and issues a certificate of loss of nationality.[116] For example, decades later, the United States could attempt to subject the individual to income tax or, perhaps more importantly, to estate taxes based on worldwide assets upon her death.[117] Nationality-based jurisdiction is much more difficult to justify under these circumstances.

The benefits rationale discussed above does not apply in this situation. Once the Department of State determines that citizenship was lost pursuant to a previously committed act, it will no longer permit the individual to invoke any benefits of U.S. citizenship. Accordingly, any effort to tax the individual for periods after 2010 would reflect an attempt to impose a duty associated with citizenship without any of the corresponding benefits of citizenship.

More fundamentally, once the Department of State has been notified of the expatriating act and makes a determination of loss of citizenship, the individual can no longer be considered a national as that term is used in customary international law, and nationality-based jurisdiction is inapplicable for subsequent periods.[118] Although customary international law

[115] If questioned about the prior potentially expatriating act, the individual presumably could claim that the act was performed without intent to lose citizenship. As long as the consular official was not aware of any evidence to the contrary, the official would accept the individual's assertion. *See supra* text accompanying note 30. Of course, if the individual actually exercised these rights during the interim period, it would undercut a subsequent claim that the potentially expatriating act had been performed with an intent to lose citizenship. *See supra* note 49 and accompanying text.

[116] *See supra* notes 38–39 and accompanying text.

[117] *See supra* note 12.

[118] Although customary international law extends nationality-based taxing jurisdiction

does not define who is a "national" and generally leaves that determination to the internal law of each country,[119] a country cannot merely label a person as a national (or citizen) for purposes of a narrow context, such as taxation, and thereby subject her to the duties that arise.[120] International law contemplates some basic parameters of the nationality definition. In particular:

> [N]ationality is a continuing legal relationship between the sovereign State on the one hand and the citizen on the other. The fundamental basis of a man's nationality is his membership in an independent political community. This legal relationship involves rights and corresponding duties upon both—on the part of the citizen no less than on the part of the State.[121]

By classifying the person as a "citizen" for tax purposes, section 7701(n) does not purport to establish nationality in this international law sense. It creates no rights typically associated with nationality. It merely purports to impose one particular obligation often associated with nationality—the burden of worldwide taxation—on a person who no longer has nationality (or the benefits thereof) either under U.S. nationality law or in

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to include the taxation of residents, *see supra* notes 81–85 and accompanying text, this aspect of nationality-based jurisdiction does not apply in the current circumstances. Section 7701(n) can apply even if the individual never returns to the United States and therefore could not be considered a U.S. resident. *See* I.R.C. § 7701(n) (LexisNexis 2006).

[119] *See* RESTATEMENT (THIRD) OF THE FOREIGN RELATIONS LAW OF THE UNITED STATES § 211 cmt. c (1987). Although countries are given wide latitude in defining who is a national, under international law "other states need not recognize a nationality that is not based on an accepted 'genuine link.'" *Id.* § 211 (internal citation omitted). Universally accepted "genuine links" for establishing nationality include nationality conferred by reason of birth in a state's territory (*jus soli*) or of birth to parents who are nationals (*jus sanguinis*). *Id.* § 211 cmt. c. In addition, voluntary naturalization generally is recognized as long as the individual has at least some ties to the state before naturalization, such as a period of residence. *Id.* The application of section 7701(n) in the present context does not establish or recognize "nationality" in the international law sense, so the question of whether there is a genuine link is not reached.

[120] The 2003 JCT Report, upon which the AJCA provisions are based, attempts to justify section 7701(n) based on a country's ability to create evidentiary standards for determining when citizenship is lost. *See* 2003 JCT REPORT, *supra* note 19, at 124. The Report cites Congress's ability to "require reasonable evidentiary standards, such as the filing of an IRS form, as a requirement for loss of citizenship." *Id.* The Report, however, takes the concept of evidentiary standards out of context. While Congress does indeed have the ability to adopt evidentiary standards for determining when a person loses citizenship under the nationality laws, under section 7701(n) a failure to file the requisite tax form does not affect the individual's citizenship status under the nationality laws. *See supra* notes 29–35 and accompanying text. At most, the JCT Report's focus on evidentiary standards would justify Congress in changing the nationality law itself to deny loss of citizenship for nationality law purposes until the proper tax form is completed.

[121] Re Lynch, *Ann. Dig. Of Pub. Int'l Law Cases, 1929–30* 221, 223, *quoted in* I.A. SHEARER, STARKE'S INTERNATIONAL LAW 307 (11th ed. 1994); *see also* Nottebohm Case (Liech. v. Guat.) (second phase), 1955 I.C.J. 4 (Apr. 5) (noting reciprocal rights and obligations of nationality).

the international law sense. Unlike the situation discussed in the prior Section, where section 7701(n) imposes the tax burden of citizenship for a period when the benefits of citizenship are de facto available contemporaneously to the individual, section 7701(n) continues a significant obligation associated with nationality for periods when the corresponding rights and benefits of citizenship have already been extinguished under U.S. nationality laws. Because section 7701(n) in this context purports to impose citizenship-based taxation for periods when there is no nationality in the customary international law sense, it cannot be justified under nationality-based jurisdictional principles.[122] This conclusion is made even stronger by the fact that the United States' practice of imposing worldwide taxation based on citizenship is viewed as pushing the limits of acceptable state practice even when the taxpayer is a national in the customary international law sense.[123]

c. Section 877(g)—More than Thirty Days of Physical Presence

For the same reasons, section 877(g) cannot be justified on pure nationality-based jurisdictional grounds. Although section 877(g) classifies certain individuals[124] as "citizens" for tax purposes if they spend more than thirty days in the United States during one of the ten calendar years immediately following citizenship loss, that status does not constitute nationality as that term is used under customary international law.

Nonetheless, another interpretation of the provision might justify the use of nationality-based taxing jurisdiction. In the context of taxation, customary international law has expanded the idea of nationality-based jurisdiction to include jurisdiction based on an individual's residence or domicile.[125] Although section 877(g) classifies an individual to whom it applies as a "citizen" for tax purposes,[126] in order to provide the most deferential analysis of the statute's validity under customary international law

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[122] *See* RESTATEMENT (THIRD) OF THE FOREIGN RELATIONS LAW OF THE UNITED STATES § 211 cmt. a (1987) (noting the link between nationality, as the term is used in customary international law, and nationality-based prescriptive jurisdiction). Moreover, because the individual is not physically in the United States, it cannot be justified under the residence-based extension of nationality jurisdiction. *See supra* notes 81–85 and accompanying text.

[123] *See supra* notes 82–83.

[124] As discussed *supra* notes 55–58 and accompanying text, section 877(g) generally applies to an individual whose citizenship loss has been recognized for both nationality law and tax purposes, whose average income tax liability or net worth on the date of citizenship loss exceeded statutory thresholds, and who is physically present in the United States for more than thirty days during any of the ten post-expatriation years.

[125] *See supra* notes 81–85 and accompanying text.

[126] Section 877(g) provides that an individual to whom it applies "shall be treated . . . as a citizen or resident of the United States, as the case may be," for the relevant year. I.R.C. § 877(g)(1) (LexisNexis 2006). In context, this language indicates that a person who previously lost citizenship is treated as a "citizen" under this provision, and a person who previously lost long-term residency status (i.e., having held a green card for at least eight of the prior fifteen years) is treated as a "resident" under this provision. *Id.*

the following analysis assumes that the statute is treating the individual as a resident. This assumption is justified by the fact that the statute's application depends on the number of days of physical presence (a concept often associated with residence), and worldwide taxation generally would result from the application of the statute regardless of whether the individual is labeled a "citizen" or a "resident."[127]

No uniform definition of residence exists. Instead, "[t]he concept of residence as applied for tax purposes varies considerably among states. It usually refers, however, to the personal connection an individual has with a particular territory."[128] One commentator summarized the acceptable range of definitions as follows:

> An important element in most definitions of residence is presence in the jurisdiction for a specified length of time: often 183 days or more in the taxable year . . . . Sometimes presence in prior years is also taken into account. Although some countries rely on the physical presence test exclusively . . . , many—particularly OECD countries—have additional reasons for which someone can be considered a resident, including status as a permanent resident for immigration purposes, domicile, having an habitual place of abode, and so forth.[129]

The United States has adopted several of these elements.[130] The United States' "substantial presence" test sets a lower threshold for residence than do most countries that use a physical presence test (typically 183 days in the current year).[131] The United States also treats a person as a resident for income tax purposes if she holds a green card.[132] For estate and gift tax purposes, the United States generally uses the subjective common law

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[127] Although citizens and resident aliens generally are subject to the same tax rules under the Internal Revenue Code, *see* Treas. Reg. § 1.1-1(a)(1) (as amended in 1974), there are some isolated circumstances where their treatment differs, *see, e.g.*, I.R.C. § 911(d)(1) (2000) (providing the definition of a "qualified individual" who is eligible for the foreign earned income exclusion). Even if section 877(g) cannot be read as a matter of statutory interpretation to impose residence-based taxation on the former citizen, the analysis in the text is important. If customary international law would permit residence-based taxation under the circumstances, while not allowing nationality-based jurisdiction, Congress presumably could change the statute so that a former citizen to whom section 877(g) applies is treated as a "resident" for tax purposes.

[128] RICHARD L. DOERNBERG ET AL., ELECTRONIC COMMERCE AND MULTIJURISDICTIONAL TAXATION 74 (2001).

[129] VICTOR THURONYI, COMPARATIVE TAX LAW 289 (2003); *see also* DOERNBERG, *supra* note 128, at 74.

[130] *See generally supra* note 9 (discussing U.S. rules for determining tax residency).

[131] *See* RHOADES & LANGER, *supra* note 114, ¶ 6.8 n.29 ("[A] typical definition of residence is physical presence in the state for seven months or more during the taxable year.").

[132] *See* I.R.C. § 7701(b)(1)(A)(i) (2000).

domicile test, rather than a physical presence test, for determining residence.[133]

In the present section 877(g) context, the relevant question is whether a former citizen's physical presence in the United States for only 31 days during a calendar year is sufficient to justify worldwide taxation under residency jurisdiction principles. While customary international law does not specify a bright-line 183-days-per-year rule for countries that rely on a physical presence test—indeed, the United States' weighted substantial presence formula sets a slightly lower standard by including a portion of the days in the two preceding years—customary international law does seem to establish a threshold in that general range.[134] A test triggered by only 31 days of physical presence in a single year is substantially below the typical 183-day test used by most countries that rely on a physical presence test.[135]

In short, none of the commonly accepted physical presence-based tests of residence support a hairtrigger 31-day standard for making a person a tax resident who is thereby subject to worldwide taxation. Indeed, the section 877 standard is well below any commonly accepted standard. Moreover, the more subjective common law domicile standard often used as a residence test, which involves a subjective intent to remain indefinitely,[136] provides even less support for allowing 31 days of physical presence to constitute residence.

The "reasonableness" requirement of customary international law jurisdiction provides another impediment to justifying section 877(g) on residence grounds. As noted above, even if a country has jurisdiction to prescribe under one of the customary bases, that jurisdiction may not be exercised in an unreasonable way.[137] The Restatement commentary specifically addresses this limitation in the residence-based taxation context. The commentary observes that "a tax on a nonresident alien temporarily present within a state, measured by his worldwide income, could be challenged as a violation of international law."[138] A similar concern was raised by one of the leading figures in the development of the modern U.S. income tax, who observed that "[t]emporary residence is plainly inadmissible as a test" for residence-based taxing jurisdiction.[139] Given the gross disparity be-

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[133] *See* Treas. Reg. § 20.0-1(b) (as amended in 1994).

[134] *See supra* note 131 and accompanying text.

[135] *See supra* notes 129 & 131 and accompanying text.

[136] *See* Treas. Reg. § 20.01-(b)(1) (as amended in 1994).

[137] *See* RESTATEMENT (THIRD) OF THE FOREIGN RELATIONS LAW OF THE UNITED STATES § 403(1) (1987); *see also supra* notes 87–91 and accompanying text (discussing reasonableness limitation).

[138] *See* RESTATEMENT (THIRD) OF THE FOREIGN RELATIONS LAW OF THE UNITED STATES § 411 cmt. d (1987).

[139] SELIGMAN, *supra* note 114, at 112. Professor Seligman observed that "[i]f a traveler chances to spend a week in a town just when the tax collector comes around, there is no good reason why he should be assessed on his whole property by this particular town; the relations between him and the government are too slight." *Id.*

tween a 31-day threshold and the thresholds generally used by countries to define residence, the 31-day standard of section 877(g) appears to be much closer to the "temporarily present" concept referred to in the Restatement commentary, for which worldwide taxation is not permitted.

The reasonableness limitation is particularly relevant given the underlying purposes of allowing residence-based taxing jurisdiction. The U.S. Supreme Court has noted that the "universally recognized" principle allowing residence-based taxation of extraterritorial income is based on the individual's "[e]njoyment of the privileges of residence in the State and the attendant right to invoke the protection of its laws," noting that these are "inseparable from responsibility for sharing the costs of government."[140] An individual who spends close to half the year or more in a state—as the tests based on 183 days of physical presence contemplate—indeed has enjoyed significant privileges in that state. In contrast, an individual who has spent only 31 days in a country has enjoyed significantly fewer privileges and protections in that country, particularly when those limited privileges and protections are used as a justification to tax the individual's worldwide income for the entire year, as is the case under section 877(g).

Thus, in the case of a person who is subjected to worldwide taxation under section 877(g) by reason of spending only 31 days in the United States during one of the ten post-expatriation years, the imposition of tax most likely would violate customary international law. If, in contrast, the person triggers section 877(g) by reason of spending significantly more time in the United States—for example, 160 days in a single year during the post-expatriation period—the case against taxing jurisdiction is much weaker. Whereas the large gulf between 31 days and 183 days makes a conclusion of unreasonableness somewhat easier, the difference between 160 days and the commonly accepted 183-day period is much less.[141] Accordingly, the question of whether the application of section 877(g) violates customary international law might depend on the specific facts of the case—in particular, how many days of physical presence the individual actually had in the United States. The strongest case for finding a violation of customary law exists for an individual who is physically present in only a single year during the ten-year period and barely exceeds the 31-day threshold in that year. Under such circumstances, worldwide taxation based on residence would be extremely difficult to justify under customary

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[140] New York *ex rel.* Cohn v. Graves, 300 U.S. 308, 313 (1937); *see also* Hellerstein, *supra* note 73, at 5–6. In this regard, the rationale is similar to the benefits rationale underlying citizenship-based jurisdiction. *See id.* at 6.

[141] At the extreme, consider an individual who had 120 days of physical presence in each of three consecutive years within the ten-year period after citizenship loss. Such an individual would just fail to be treated as a resident under the weighted average substantial presence test. *See supra* note 9. Given how close the individual was to meeting the accepted U.S. residency standard, it would be very difficult to argue that the imposition of section 877(g) would violate customary international law's residence-based standards.

international law jurisdictional principles and the reasonableness limitations.

3. Protective Principle

The final potential jurisdictional basis considered—the protective principle—does not justify taxation under either section 7701(n) or section 877(g). Customary international law recognizes that a country can prescribe laws regarding "certain conduct outside its territory by persons not its nationals that is directed against the security of the state or against a limited class of other state interests."[142] The principle generally permits a state to punish offenses, such as:

> offenses directed against the security of the state or other offenses threatening the integrity of governmental functions that are generally recognized as crimes by developed legal systems, e.g., espionage, counterfeiting of the state's seal or currency, falsification of official documents, as well as perjury before consular officials, and conspiracy to violate the immigration or customs laws.[143]

The interests implicated by sections 7701(n) and 877(g) fall far short of this "limited class" of offenses against state interests for which the protective principle can be invoked. The principal interests that sections 7701(n) and 877(g) protect against are perceived abuses of citizenship renunciation to achieve tax savings.[144] In particular, the sections are directed at people who either fail to notify the Department of State of the expatriating act immediately, or subsequently re-enter the United States, presumably on a legal basis,[145] in future years. However, none of these concerns rises to the level of an offense "generally recognized as crimes by developed legal systems."[146] Indeed, none of them is even a crime under U.S. law.[147] Moreover, the act underlying the purported abuse—i.e., the re-

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[142] RESTATEMENT (THIRD) OF THE FOREIGN RELATIONS LAW OF THE UNITED STATES § 402(3) (1987).

[143] *Id.* § 402 cmt. f.

[144] *See supra* notes 41–50, 60–62 and accompanying text.

[145] Although the Reed Amendment, enacted in 1996, purports to deny future admittance to a former citizen who lost citizenship for tax purposes, that provision has never been enforced, and the enactment of section 877(g) appears to be an acknowledgment by Congress that it will not be enforced in any meaningful way. *See supra* note 62; *cf.* Kirsch, *supra* note 12, at 881–83.

[146] RESTATEMENT (THIRD) OF THE FOREIGN RELATIONS LAW OF THE UNITED STATES § 402 cmt. f (1987).

[147] The nationality laws continue to treat an individual as losing citizenship at the time she voluntarily commits a potentially expatriating act with an intent to lose citizenship. *See* 8 U.S.C. § 1481; *see also supra* note 24 and accompanying text. Moreover, the Reed Amendment, restricting the admissibility of former citizens whose loss of citizenship was tax-motivated, has never been enforced. *See supra* note 145.

nunciation of citizenship—is generally considered to be a protected right under customary international law.[148] Finally, while worldwide taxation based on citizenship is recognized as legitimate under international law, it is generally viewed with disfavor by many countries.[149] For these reasons, an argument that sections 877(g) and 7701(n) are justified by the protective principle of taxing jurisdiction is not persuasive.

4. Consequences

Based on the foregoing analysis, the strongest case for the existence of valid taxing jurisdiction under customary international law applies when a person commits a potentially expatriating act (e.g., obtaining nationality in another country) with an intent to lose citizenship but refrains from notifying the Department of State. Under such circumstances, section 7701(n) can be justified under nationality-based principles, particularly given the contemporaneous potential availability of citizenship benefits prior to notifying the Department of State.

In contrast, section 7701(n) is not justifiable under nationality-based principles when applied to periods after the individual has informed the Department of State of the citizenship loss but before she has complied with the IRS reporting requirements of section 6039G. Moreover, territorial principles and the protection principles do not justify worldwide taxation under these circumstances.

The validity of section 877(g) depends on the particular circumstances in which it is applied. To the extent that it is applied to a person who is physically present in the United States for a significant number of days during a relevant year—e.g., a number that narrowly fails to trigger the substantial presence test—the application of the statute most likely is a valid exercise of residence-based jurisdiction. However, at the other extreme, if an individual's physical presence barely trips the section 877(g) threshold—e.g., a number close to the 31-day minimum in only a single year of the ten-year post-expatriation period—the application of the statute to impose worldwide taxation might not be justified under residence-based jurisdictional principles, particularly given the reasonableness limitation thereon. Moreover, territorial principles and the protection principles would not justify worldwide taxation under such circumstances.

It is important to note that a taxpayer may not have any effective remedy with respect to these potential international law violations. If the United States seeks to apply section 877(g) or 7701(n) against an individual in

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[148] *See* RESTATEMENT (THIRD) OF THE FOREIGN RELATIONS LAW OF THE UNITED STATES § 211 cmt. d. Indeed, the United States has a long history, dating back to the War of 1812, of supporting a person's right under international law to renounce citizenship. *See generally* Kirsch, *supra* note 12, at 903 n.183 (discussing historical basis of right to renounce citizenship).

[149] *See supra* note 2 and accompanying text.

violation of the prescriptive jurisdictional limits of customary international law, no international judicial forum is available in which the individual (or the individual's new country of nationality[150]) can seek relief. Although the International Court of Justice generally hears disputes involving violations of customary international law, the United States withdrew its consent to compulsory jurisdiction to that court in 1986.[151] Accordingly, in the event the United States seeks to assert tax liability against the individual, her only direct legal recourse would be a constitutional challenge in U.S. courts.[152]

Various indirect responses may be available for violations of customary international law.[153] For example, the individual's new state of nationality might make a formal diplomatic protest against the United States if the United States seeks to tax the individual in violation of customary international law.[154] Moreover, the new state of nationality could pursue unilateral countermeasures against the United States for the jurisdictional violation, provided that such actions are in proportion to the United States' violation.[155] However, none of these responses is likely to provide any practical benefit to the taxpayer.

III. CONSTITUTIONAL VIOLATIONS

While the international law violations discussed in the preceding Part may create problems for the United States in its international relations,[156] they do not provide the taxpayer with any direct legal remedy.

This Part considers the extent to which an individual might be able to challenge the new provisions under the U.S. Constitution. In so doing, it focuses on the circumstance that most clearly violates customary interna-

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[150] In general, obligations of customary international law run between states, and it is the responsibility of each state to seek redress on behalf of its nationals. *See* RESTATEMENT (THIRD) OF THE FOREIGN RELATIONS LAW OF THE UNITED STATES § 902(2), cmt. i. *But see id.* § 906 cmt. a ("[F]ew international agreements have given private persons access to an international forum where the agreement establishing the forum allows such extension of its jurisdiction.").

[151] *See* 85 DEPT. OF STATE BULL. 82 (1985).

[152] The constitutional issues raised by the AJCA provisions are discussed in the next Part. There are other significant practical considerations of relevance to the taxpayer, particularly with respect to potential difficulties the United States might face in enforcing collection of taxes in the international context. *See infra* notes 291–300 and accompanying text.

[153] Any such claims generally may be made only if the individual's attempt for relief through U.S. courts is unsuccessful. *See* RESTATEMENT (THIRD) OF THE FOREIGN RELATIONS LAW OF THE UNITED STATES § 902 cmt. k.

[154] *See* RESTATEMENT (THIRD) OF THE FOREIGN RELATIONS LAW OF THE UNITED STATES § 902.

[155] *See id.* § 902 cmt. d. The countermeasures could only be directed against the United States itself, not against U.S. nationals. *Id.* § 905 cmt. b. Thus, the other country could not retaliate by attempting to impose taxes against U.S. nationals in a manner that violated jurisdictional principles.

[156] *See infra* Part IV.

tional law jurisdictional principles; the continued treatment of a person as a tax citizen under section 7701(n) for periods after the individual has informed the Department of State of her citizenship loss but before she has complied with the IRS reporting requirements of section 6039G. In this circumstance, the Department of State has already documented that the individual is no longer a citizen under the nationality law and is no longer entitled to the benefits of citizenship. Yet, as a "tax citizen," her worldwide income continues to be taxable for decades and, upon her death, she could be subject to U.S. estate tax on her worldwide assets.

A. General Principles

The interplay of customary international law and the U.S. Constitution raises many noteworthy issues. For example, significant academic debate has addressed the extent, if any, to which the substantive rules of customary international law constitute federal common law, thereby creating subject matter jurisdiction for federal courts and potentially preempting inconsistent state laws.[157] In addition, recent Supreme Court opinions have raised issues regarding the extent to which international norms are relevant in interpreting constitutional standards, such as the term "cruel and unusual punishments" under the Eighth Amendment as applied to state death penalty provisions.[158]

This Article does not address these general debates. Rather, it focuses on potential constitutional limits under the Constitution on Congress's ability to impose worldwide taxation on former citizens pursuant to the new tax-specific definitions of citizenship. In particular, it considers whether the new provisions exceed Congress's taxing power under Article I of the

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[157] In particular, these debates focus on the modern validity, if any, of the Supreme Court's famous observation that "[i]nternational law is part of our law," The Paquete Habana, 175 U.S. 677, 700 (1900), and the extent to which customary international law constitutes federal common law after the Court's decision in Erie Railroad Co. v. Tomkins, 304 U.S. 64 (1938). *Compare, e.g.*, Curtis A. Bradley & Jack L. Goldsmith, *Customary International Law as Federal Common Law: A Critique of the Modern Position*, 110 HARV. L. REV. 815 (1997) (arguing that customary international law is general common law that was abrogated by *Erie* and does not have the status of post-*Erie* federal common law), *with* Gerald L. Neuman, *Sense and Nonsense About Customary International Law: A Response to Professors Bradley and Goldsmith*, 66 FORDHAM L. REV. 371 (1997), *and* Beth Stephens, *The Law of Our Land: Customary International Law as Federal Law After* Erie, 66 FORDHAM L. REV. 393 (1997) (defending the "modern" position that customary international law can constitute federal common law). *See generally* Ernest A. Young, *Sorting Out the Debate over Customary International Law*, 42 VA. J. INT'L L. 365 (2002).

[158] *See* Roper v. Simmons, 543 U.S. 551, 575 (2005) (considering international norms in holding that the Eighth Amendment prohibits execution of juveniles under age eighteen); Atkins v. Virginia, 536 U.S. 304, 316 n.21 (2002) (considering the view of the "world community" in holding that the Eighth Amendment prohibits execution of mentally retarded individuals). *But see Roper*, 543 U.S. at 622–28 (Scalia, J., dissenting) (arguing that the practices of other countries are irrelevant in interpreting the Eighth Amendment).

Constitution or violate other constitutional limitations, such as the due process and equal protection principles under the Fifth Amendment.[159]

Constitutional challenges to federal tax statutes face difficult hurdles. As many commentators have observed,[160] since the enactment of the Sixteenth Amendment in 1913, federal tax statutes repeatedly have withstood challenges brought on constitutional grounds. Nonetheless, as the following analysis demonstrates, the AJCA definitions of tax citizenship, at least as applicable in certain circumstances, may cross the boundaries of constitutional permissibility.

As a threshold matter, it should be noted that a federal statute that violates customary international law is not necessarily unconstitutional.[161] The United States generally has a dualist system in which national law and international law are considered separate and distinct legal systems, with international law having applicability only to the extent it is incorporated or transformed into national law.[162] Even those scholars who claim that customary international law rises to the status of federal common law generally recognize that Congress has the ability to alter that law by statute. Accordingly, the violation of prescriptive jurisdiction under customary international law discussed in the prior Part is relevant to this Part's constitutional analysis only indirectly. In particular, the violation is relevant to the analysis of Congress's taxing powers only to the extent that Article I incorporates prescriptive jurisdictional limitations of customary international law. The violation is even less relevant to the potential due process and equal protection limitations, except to the extent that the same concerns underlying the customary international law prescriptive jurisdictional limitations might have relevance to the constitutional limitations.

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[159] *Cf.* A. Mark Weisburd, *Due Process Limits on Federal Extraterritorial Legislation?*, 35 COLUM. J. TRANSNAT'L L. 379 (1997) (distinguishing between Congress's power to legislate extraterritorially and an individual's Fifth Amendment rights that might preclude application of that legislation).

[160] *See, e.g.*, JOSEPH ISENBERGH, INTERNATIONAL TAXATION, U.S. TAXATION OF FOREIGN PERSONS AND FOREIGN INCOME ¶ 1.5.1; AMERICAN LAW INSTITUTE, *supra* note 2, at 1; Boris I. Bittker, *Constitutional Limits on the Taxing Power of the Federal Government*, 41 TAX LAW 3, 4 (1987). *But see* Nichols v. Coolidge, 274 U.S. 531 (1927) (including transfer in gross estate for estate tax purposes violated Due Process when transfer had been completed prior to 1916 enactment of the estate tax).

[161] Indeed, Congress may constitutionally override a treaty obligation of the United States, even though the Supremacy Clause, U.S. CONST. art. VI, cl. 2, explicitly refers to treaties (along with federal statutes) as the supreme law of the land. *See infra* notes 279–284 and accompanying text. In contrast to its explicit reference to treaties, the Supremacy Clause does not explicitly mention customary international law.

[162] *See* BEDERMAN, *supra* note 76, at 151–53. In contrast, a monist system treats international law and national law as parts of the same legal system, with international law having a higher prescriptive value than national law. *Id.* at 151.

B. Congressional Authority

The Constitution grants Congress broad taxing powers. Article I provides that "[t]he Congress shall have Power To lay and collect Taxes, Duties, Imposts and Excises."[163] Although the text of the Constitution provides one express exception[164] and two express limitations[165] to this taxing authority, none of those restrictions applies in the current context. Accordingly, the threshold inquiry is whether the general grant of taxing authority in Article I permits Congress to tax the worldwide income (or worldwide estate) of individuals treated as tax citizens under section 7701(n) many years after having lost citizenship under the nationality laws.

Courts generally have interpreted the Constitution's taxing power very broadly. The Supreme Court has on numerous occasions rejected arguments that Congress lacked the constitutional authority under Article I to enact a particular tax.[166] Indeed, some Supreme Court dicta implies that the authority knows no limits.[167]

However, these broad statements regarding taxing authority generally arise in domestic situations where the focus is on the particular type of tax involved instead of in an international setting where there are questions of jurisdiction to tax a particular individual. In those cases involving Congress's authority to impose taxes in an international setting, the Supreme Court has been less inclined to rely on flat assertions of unlimited authority under the Article I taxing power clause. Instead, the Supreme Court, while upholding all constitutional challenges to Congress's taxing

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[163] U.S. CONST. art. I, § 8, cl. 1.

[164] Congress may not impose any tax or duty on an export from a state. *Id.* art. I, § 9, cl. 5.

[165] All duties, impost, and excise taxes must be uniform throughout the United States, *id.* art. I, § 8, cl. 1, and any capitation or other "direct" tax must be apportioned among the states in proportion to their population. *Id.* art. I, § 9, cl. 4. The former restriction is not relevant in the present circumstances. With respect to the latter restriction, the Sixteenth Amendment makes clear that an income tax is not a direct tax within the meaning of the apportionment clause. *See id.* amend. XVI. The Supreme Court has observed that the Sixteenth Amendment did not augment Congress's power to tax, but merely eliminated the apportionment requirement. *See* Brushaber v. Union Pac. R.R. Co., 240 U.S. 1, 17–18 (1916); *see also* South Carolina v. Baker, 485 U.S. 505, 523 n.13 (1988); William E. Peck & Co. v. Lowe, 247 U.S. 165, 172–73 (1918).

[166] *See, e.g.*, Stanton v. Baltic Mining Co., 240 U.S. 103 (1916) (upholding tax on income of a mining company); *Brushaber*, 240 U.S. at 12–26 (upholding tax on corporate income); *see also infra* notes 168–184 and accompanying text (citing cases upholding taxes imposed in international context).

[167] For example, in upholding a nineteenth-century federal license tax on selling alcohol and lottery tickets, the Court stated that, apart from the export exception and the apportionment and uniformity limitations, the federal taxing power "reaches every subject, and may be exercised at discretion." License Tax Cases, 72 U.S. (5 Wall.) 462, 471 (1867). Similarly, in upholding various challenges to an income tax enacted shortly after the ratification of the Sixteenth Amendment, the Court declared that congressional taxing power "is exhaustive and embraces every conceivable power of taxation," and that this proposition "has been so often authoritatively declared as to render it necessary only to state the doctrine." *Brushaber*, 240 U.S. at 12.

authority in the international sphere, has analyzed Congress's authority in a broader context. As discussed below, the Court repeatedly has justified Congressional authority to tax in the international context by reference to international prescriptive jurisdictional standards, implying that the Article I taxing authority granted to Congress, while encompassing the full power granted to a sovereign country, is nonetheless limited to the taxing power that sovereign countries enjoy under international law.

In *United States v. Bennett*,[168] the Supreme Court upheld Congress's authority to impose an excise tax with respect to a U.S. citizen's ownership and use of a yacht outside of U.S. territorial waters.[169] The Court first distinguished the taxing power of Congress from the more limited taxing power of the states, stating that congressional power "is coextensive with the limits of the United States; it knows no restriction except where one is expressed in or arises from the Constitution and therefore embraces all the attributes which appertain to sovereignty in the fullest sense."[170] Although this language might imply almost unlimited congressional power, the Court then elaborated on the taxing "attributes which appertain to sovereignty." The Court did not reject outright the limitation on taxing sovereignty proposed by the taxpayer—"that the power to tax [is] limited by the capacity of the taxing government to afford that benefit and protection which is the true basis of the right to tax . . . ."[171] Rather, the Court implicitly acknowledged this limitation on the inherent taxing authority of sovereign nations but noted that the taxpayer's "confusion of thought consists in mistaking the scope and extent of the sovereign power of the United States as a nation and its relation to its citizens and their relations to it."[172] In particular, the Court concluded that the standard was satisfied because the federal government "by its very nature benefit[s] the citizen and his property wherever found."[173]

In the landmark *Cook v. Tait* decision,[174] the Court addressed the scope of Congress's taxing power under the income tax, holding that Congress has authority to tax a U.S. citizen residing abroad on income arising from foreign sources.[175] The Court noted the need to "make further exposition of the national power as the case depends upon it."[176] The Court then quoted extensively from *Bennett*, particularly with reference to the link between the power to tax and the benefits of citizenship, concluding that the "power in its scope and extent . . . is based on the presumption that government by its very nature benefits the citizen and his property wherever

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[168] 232 U.S. 299 (1914).
[169] *Id.* at 307.
[170] *Id.* at 306.
[171] *Id.* at 307.
[172] *Id.*
[173] *Id.*
[174] 265 U.S. 47 (1924).
[175] *Id.* at 56.
[176] *Id.* at 55.

found."[177] The *Cook* Court then summarized the *Bennett* principle, observing:

> In other words, the principle was declared that the government, by its very nature, benefits the citizen and his property wherever found and, therefore, has the power to make the benefit complete. Or to express it another way, the basis of the power to tax was not and cannot be made dependent upon the situs of the property in all cases, it being in or out of the United States, and was not and cannot be made dependent upon the domicile of the citizen, that being in or out of the United States, but upon his relation as citizen to the United States and the relation of the latter to him as citizen.[178]

In *Burnet v. Brooks*,[179] the most recent of the relevant Supreme Court cases addressing congressional taxing authority in an international context, the Court focused on Congress's taxing power with respect to noncitizens who reside outside the United States. In *Brooks*, the decedent was an alien residing abroad who, at the time of his death, owned bonds and stock certificates that were physically located in the United States. The Court concluded that Congress had the power to impose the estate tax with respect to these securities.[180] In addressing the power to impose the tax, the Court explicitly concluded that "[w]e determine national power [to tax] in relation to other countries and their subjects *by applying the principles of jurisdiction recognized in international relations*."[181] The Court engaged in a lengthy analysis of the nation's inherent sovereign taxing powers,[182] stating that:

> So far as our relation to other nations is concerned, and apart from any self-imposed constitutional restriction, we cannot fail to regard the property in question as being within the jurisdiction of the United States,—that is, it was property *within the reach of the power which the United States by virtue of its sovereignty could exercise as against other nations and their subjects without violating any established principle of international law*.[183]

After mentioning the traditional jurisdictions to tax recognized by international law, such as citizenship, domicile, source of income, or situs of

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[177] *Id.* at 56.
[178] *Id.*
[179] 288 U.S. 378 (1933).
[180] *Id.* at 396.
[181] *Id.* at 405–06 (emphasis added).
[182] *See id.* at 396–400.
[183] *Id.* at 396 (emphasis added).

property, the Court stated that "the sovereign taxing power as exerted by governments in the exercise of jurisdiction [can be based] upon any one of these grounds."[184]

None of these three cases addressing the reach of Congress's taxing powers relied on the apparently broad language in Article I, section 8 of the Constitution, although the government's counsel in *Cook* explicitly invited the Court to do so.[185] The Court instead positioned the federal taxing power within the broader context of the United States' rights as a sovereign nation.[186] The analysis in the three cases implies that Congress's Article I taxing power, although it encompasses the full measure of a sovereign's taxing power, cannot exceed the power that a sovereign enjoys under international law.[187] While the particular exercises of taxing power in those three cases fell within accepted taxing jurisdictional bases and thus were held valid,[188] the Court's rationale implies that a tax statute with no jurisdictional basis would be invalid.

As discussed in Part II.C, the application of Internal Revenue Code section 7701(n) to impose worldwide income (or worldwide estate) taxation on a former citizen who had notified the Department of State of her citizenship loss decades earlier but had failed to notify the IRS cannot be supported under customary international law jurisdictional principles.[189] Ac-

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[184] *Id.* at 399; *see also* Comm'r v. Nevious, 76 F.2d 109, 110 (2d Cir. 1935) (citing *Brooks* to conclude that "[t]he United States has jurisdiction to tax when it can lay hold of either the obligor or the obligee of a chose in action"); McDougall v. Comm'r, 45 B.T.A. 803, 809–10 (1941) (citing *Brooks*'s reliance on "the principles of jurisdiction recognized in international relations" to hold that Congress can impose worldwide estate tax based on the decedent's U.S. domicile).

[185] Brief for Defendant in Error at 3, Cook v. Tait, 265 U.S. 47 (1924) (No. 220). Indeed, the government counsel's principal argument was based on the assertion in the *License Tax Cases* that the taxing power under Article I "reaches every subject, and may be exercised at discretion." License Tax Cases, 72 U.S. (5 Wall.) 462, 471 (1867).

[186] *Cook*, 265 U.S. at 56.

[187] One additional Supreme Court case supports the foregoing analysis. In *United States v. Rice*, 17 U.S. (4 Wheat.) 246 (1819), the Court held that no federal customs duties were owed with respect to a period when a U.S. port was under British occupation during the War of 1812. The Court stated that the British had "acquired that firm possession which enabled [them] to exercise the fullest rights of sovereignty over that place [and the] sovereignty of the United States over the territory was, of course, suspended." *Id.* at 254. The Court then observed that the port "was, therefore, during this period, so far as respected our revenue laws, to be deemed a foreign port; and goods imported into it by the inhabitants were subject to such duties only as the British government chose to require." *Id.* While the *Rice* case admittedly involved unusual facts, the Court's reasoning implies that Congress's seemingly broad powers to impose duties under Article I, section 8 are subject to the jurisdictional restraints generally applicable to a sovereign under international law.

[188] The taxes in *Bennett* and *Cook* were upheld on nationality-based principles, while the tax in *Brooks* was upheld based on the property's situs in U.S. territory. United States v. Bennett, 232 U.S. 299, 307 (1914); *Cook*, 265 U.S. at 56; *Brooks*, 288 U.S. at 405.

[189] Even to the extent the provision is viewed as a method for preventing tax avoidance or evasion, such a rationale would only justify taxing jurisdiction tailored to the extended source-based taxation of the section 877 alternative tax regime, not ongoing worldwide taxation. *See supra* notes 108–109 and accompanying text.

cordingly, such an application would present the strongest case for constitutional challenge under the foregoing analysis.[190]

It is important to acknowledge that these cases addressing Congress's jurisdictional powers to impose tax were decided more than seventy years ago during the pre-*Erie* and *Lochner* eras and prior to the Court's explicit acknowledgment of broad legislative jurisdiction in certain non-tax areas.[191] Nonetheless, by the time these tax cases were decided, the Court's views regarding Congress's prescriptive jurisdiction in an international context had already undergone significant evolution and expansion. Whereas early nineteenth-century Supreme Court cases reflected a natural law-based focus on territorial jurisdictional limitations,[192] by the time of the *Cook v. Tait* decision in 1924 and *Brooks* in 1933, the Court had shown a significant willingness to expand the limits of Congress's international prescriptive jurisdiction beyond the constraints of nineteenth-century jurisprudence.[193] Accordingly, the Court's tax decisions quoted above, with their limiting language regarding Congress's legislative jurisdiction, cannot be wholly dismissed as merely reflecting the views of a bygone era.

While some non-tax lines of cases might provide support for a broad interpretation of Congress's powers in an international context, these cases are distinguishable from the present circumstances. For example, the Supreme Court has often upheld the extraterritorial application of federal statutes in non-tax areas. While the Court applies a presumption that Congress does not intend for statutes to apply extraterritorially,[194] the Court permits extraterritorial application of federal law when congressional intent to do so is sufficiently clear.[195] By focusing on Congress's intent, the

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[190] In contrast, the application of section 7701(n) in the case of an individual who has notified neither the Department of State nor the IRS of the expatriating act does not violate the prescriptive jurisdictional principles of customary international law, *see supra* notes 111–115 and accompanying text, and therefore would not be subject to constitutional challenge under the foregoing rationale. While the application of section 877(g) might raise prescriptive jurisdiction questions under customary international law in the case of an individual who spends only thirty-one days in the United States eight or nine years after losing citizenship, *see supra* notes 134–141 and accompanying text, such circumstances involve at least some territorial connection to the United States and would be more difficult to challenge on constitutional grounds than would the application of section 7701(n). For example, the Court found in *Brooks* that the mere physical location of stock certificates and bonds in the United States was sufficient to bring those assets within the constitutional taxing power of the United States. 288 U.S. at 405.

[191] *See* Erie R.R. v. Tomkins, 304 U.S. 64; Lochner v. New York, 198 U.S. 45 (1905). This broad extraterritorial jurisdiction perhaps is most notable in the context of effects-based jurisdiction as applied to U.S. antitrust laws. *See supra* note 80 and accompanying text; *see also infra* notes 194–199 and accompanying text.

[192] *See* BORN, *supra* note 104, at 496–98.

[193] *See id.* at 497–500 (citing *Cook v. Tait* and other early twentieth-century Supreme Court cases as evidence of the development of "contemporary" limits on legislative jurisdiction).

[194] *See* EEOC v. Arabian American Oil Co. ("Aramco"), 499 U.S. 244, 248 (1991).

[195] The Supreme Court recently found that Congress intended to apply Title III of the Americans with Disabilities Act to foreign-flag cruise ships that dock in United States ports. *See* Spector v. Norwegian Cruise Line Ltd., 125 S. Ct. 2169, 2178 (2005). For ex-

cases assume, either explicitly or implicitly, that Congress has the power to legislate extraterritorially if it chooses to do so.[196]

These cases, however, differ from the present circumstances in a significant way. The parties in these cases generally have some connection to the United States sufficient to establish a basis for prescriptive jurisdiction. For example, in cases regarding the potential extraterritorial application of labor laws, the cases typically involve a U.S. citizen employee and a U.S.-incorporated employer.[197] Similarly, in cases involving ships, the ships typically dock in U.S. ports, carry U.S. passengers, or have some other connection to the United States.[198] Accordingly, the outer limits of congressional power are not seriously at issue in those cases. Thus, dicta in those cases stating that Congress has the power to legislate extraterritorially might merely be an acknowledgement that a sufficient jurisdictional connection exists in those particular cases,[199] rather than a statement that Congress has unlimited authority in all situations. Accordingly, that dicta would not be dispositive in the case of an application of section 7701(n) to tax the worldwide income of a person decades after she notified the Department of State of her citizenship loss, because no recognized prescriptive jurisdictional basis exists.

A complementary line of Supreme Court cases explicitly states that Congress has the power to enact legislation that contravenes customary international law.[200] These cases can arise either outside U.S. territory or

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amples of cases holding that there was not sufficient evidence of congressional intent to override the presumption against extraterritoriality, see *Aramco*, 499 U.S. 244 (1991) (then-existing version of Title VII of the Civil Rights Act of 1964); McCulloch v. Sociedad Nacional de Marineros de Honduras, 372 U.S. 10 (1963) (National Labor Relations Act); Benz v. Compania Naviera Hidalgo, S.A., 353 U.S. 138 (1957) (Labor Management Relations Act of 1947); Foley Bros., Inc. v. Filardo, 336 U.S. 281 (1949) (Eight Hour Law).

In the present circumstances, sections 877(g) and 7701(n) focus on the worldwide income of former citizens who spend all or a significant portion of their time outside the United States. Accordingly, by their very nature these provisions evince a congressional intent to tax persons and income outside the United States, and the presumption against territoriality would be overridden.

[196] For example, the opinion in *Foley Bros.* states that "[t]he question before us is not the power of Congress to extend the Eight Hour Law to work performed in foreign countries. Petitioner concedes that such power exists." 336 U.S. at 284.

[197] *See, e.g.*, *Aramco.*, 499 U.S. at 246; *Foley Bros.*, 336 U.S. at 283.

[198] *See, e.g.*, *Norwegian Cruise Line*, 125 S. Ct. at 2175; *McCulloch*, 372 U.S. at 12; *Benz*, 353 U.S. at 139.

[199] For example, in support of its brief statement in dicta that Congress has the power "to extend the Eight Hour Law to work performed in foreign countries," the *Foley Bros.* opinion cites *Blackmer v. United States*, 284 U.S. 421 (1932), and *United States v. Bowman*, 260 U.S. 94 (1922). Those cases do not purport to grant Congress unlimited prescriptive power worldwide. Rather, both of those cases involved Congress's power to subject U.S. citizens outside the United States to certain criminal proceedings. Indeed, those cases referred to the United States's right as a sovereign to assert authority over its citizens. Thus, the statement in *Foley Bros.* regarding Congress's extraterritorial powers is best interpreted as referring to Congress's authority over U.S. citizens (the factual situation in *Foley Bros.* itself).

[200] *Cf. Authority of the Federal Bureau of Investigation to Override Customary or Other International Law in the Course of Extraterritorial Law Enforcement Activities*, 13 U.S.

within U.S. territory.[201] Because of the desire to avoid conflicts with customary international law, these cases provide that "[a]n act of Congress ought never to be construed to violate the law of nations if any other possible construction remains."[202] This presumption against violations of customary international law implies that, if it so intends, Congress has the power to enact legislation violating customary international law. Indeed, in a dissenting opinion in a non-tax case, Justice Scalia stated "[t]hough it clearly has constitutional authority to do so, Congress is generally presumed not to have exceeded those customary international-law limits on jurisdiction to prescribe."[203] Justice Scalia provides no direct citation for this pronouncement regarding Congress's prescriptive authority, relying instead on the implication arising from the judicial presumption.[204]

As with the cases addressing the presumption against extraterritoriality, these cases involving the presumption against violating customary international law differ from the section 7701(n) circumstances in a significant way. As discussed previously, section 7701(n), at least when applied

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Op. Off. Legal Counsel 163, 183 (1989) (arguing that "[t]he President, acting through the Attorney General, has the inherent constitutional authority to deploy the FBI to investigate and arrest individuals for violations of United States law, even if those actions contravene international law").

[201] *See* Romero v. Int'l Terminal Operating Co., 358 U.S. 354 (1959) (holding that as a matter of statutory interpretation, Congress did not intend to violate customary international law by applying Jones Act to a foreign-flagged, foreign-owned ship manned by foreign seamen, while in U.S. territorial waters); *see also* Lauritzen v. Larsen, 345 U.S. 571 (1953) (similarly holding that Congress would not intend to violate customary international law by applying the Jones Act to a foreign-flagged, foreign owned ship in Cuban waters). Accordingly, this line of cases is separate from the previously discussed line of cases dealing with the presumption against extraterritoriality. *See* Hartford Fire Ins. Co. v. California, 509 U.S. 764, 815 (1993) (Scalia, J., dissenting) (citing EEOC v. Arabian American Oil Co., 499 U.S. 244, 264 (Marshall, J., dissenting)).

[202] Murray v. Schooner Charming Betsy, 6 U.S. (2 Cranch) 64, 118 (1804) (Marshall, C.J.).

[203] *Hartford Fire Ins.*, 509 U.S. at 815 (Scalia, J., dissenting). Justice Scalia's dissent argued that, as a matter of statutory interpretation, in the absence of evidence to the contrary Congress should not be considered to have intended an unreasonable application of the Sherman Act to foreign corporations. *Id.* at 819.

[204] The only relevant citation in the paragraph containing Justice Scalia's statement is to the *Schooner Charming Betsy* presumption against interpreting a statute to violate customary international law if any other interpretation is possible. *Id.* at 814–15; *see also supra* note 202 and accompanying text (quoting *Schooner Charming Betsy* presumption). One D.C. Circuit case, in dicta, makes an assertion similar to that of Justice Scalia, stating that the "reverse side of this general [*Schooner Charming Betsy*] canon of statutory construction, of course, is that courts of the United States are nevertheless obligated to give effect to an unambiguous exercise by Congress of its jurisdiction to prescribe even if such an exercise would exceed the limitations imposed by international law." FTC v. Compagnie de Saint-Gobain-Pont-A-Mousson, 636 F.2d 1300, 1323 (D.C. Cir. 1980). The D.C. Circuit, however, made this assertion in a context where the United States clearly had jurisdiction to prescribe under international law (based on the effects of the foreign company's sales on the U.S. market). *Id.* at 1316. Moreover, as the court recognized, the issue in the case involved jurisdiction to enforce rather than jurisdiction to prescribe. The court applied the *Schooner Charming Betsy* presumption to find that Congress had not intended for the statute to permit service of subpoenas abroad in a manner that would violate enforcement jurisdiction under customary international law. *Id.* at 1323.

to a person who many years earlier notified the Department of State of her loss of citizenship but failed to notify the IRS, lacks any recognized prescriptive jurisdiction under customary international law. In contrast, the relevant Supreme Court cases involve situations where the United States has some valid jurisdictional claim over the matter, but customary international law provides that the United States' jurisdiction must yield to that of another sovereign.

For example, in *Lauritzen v. Larsen*,[205] the Court observed that customary international maritime law provided that Danish law, rather than the Jones Act, should apply to an injury suffered by a Danish seaman on a Danish-owned and flagged ship in Cuban waters. The Court, applying the presumption against violating customary international law, held that, as a matter of statutory interpretation, Congress did not intend for the Jones Act to apply and override customary international law. Of particular relevance to the present inquiry, the Court acknowledged that the United States had a jurisdictional claim over the case, because the seaman had been hired in the United States while the ship was in the New York port and he was later returned to the United States after the voyage.[206] Thus, the Court's implication that Congress had power to override customary international law if it so desired might have been based on the inherent understanding that the United States itself had a valid jurisdictional basis for prescribing law, even though that basis was inferior to another country's claim under international law. If so, the case might merely support Congress's ability to override international choice of law principles when multiple countries (including the United States) have jurisdiction, rather than a broader ability to assert prescriptive jurisdiction even when the United States has no jurisdictional basis whatsoever under international law.[207] Un-

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[205] 345 U.S. 571 (1953).

[206] *Id.* at 582–83.

[207] Other cases recognizing Congress's power to override customary international law also involve facts where the United States has some type of prescriptive jurisdictional basis but where customary international law would require the United States to defer to a greater claim of another sovereign. *See, e.g.*, The Schooner Exchange v. M'Faddon, 11 U.S. (7 Cranch) 116, 145–46 (1812) (holding that although international law provides that ships of war entering the port of a friendly power are exempt from that host country's jurisdiction, "[w]ithout doubt, the sovereign of the place is capable of destroying this implication"). In *The Paquete Habana*, 175 U.S. 677 (1900), the Court implied that Congress, if it had enacted a specific statute, could have permitted the seizure of foreign ships that were violating a U.S. wartime blockade of Cuba. Such a statute would not have fit squarely into the traditional prescriptive jurisdictional bases, but the wartime situation might have given rise to protective principles. Moreover, the case does not fit squarely within the current analysis because any such statute might have been justified by Congress's explicit constitutional authority to "make Rules concerning Captures on Land and Water." U.S. CONST. art. I, § 8, cl. 11.

A legal memorandum prepared by the Department of Justice's Office of Legal Counsel relies on the *Schooner Exchange* and other cases to conclude that "[b]oth Congress and the President, acting within their respective spheres, retain the authority to override" any customary international law limits on U.S. law enforcement in foreign countries. *See Authority of the Federal Bureau Of Investigations*, *supra* note 200, at 171. That legal memoran-

der this interpretation, this line of cases would not necessarily support Congress's power to exercise taxing jurisdiction in circumstances, such as the potential application of section 7701(n) discussed above, where the United States has no claim for prescriptive jurisdiction.

At least one federal district court has adopted similar reasoning in a foreign Commerce Clause setting. In *United States v. Yunis*, the alien defendant was charged with various federal crimes relating to the hijacking of a foreign aircraft in a foreign country.[208] The court denied defendant's motion to dismiss with respect to most charges but the court granted the motion to dismiss with respect to certain charges under a federal statute that purported to regulate foreign air commerce. The court reasoned:

> [T]he government contends that Congress has authority to regulate global air commerce under the commerce clause. U.S. Const. art. I, § 8, c.3. The government's arguments based on the commerce clause are unpersuasive. Certainly Congress has plenary power to regulate the flow of commerce within the boundaries of United States territory. But it is *not empowered to regulate foreign commerce which has no connection to the United States.* Unlike the states, foreign nations have never submitted to the sovereignty of the United States government nor ceded their regulatory powers to the United States.[209]

A commentator subsequently cited this rationale for the proposition that Congress does not have the power to make "outrageous assertions" of U.S. jurisdiction, such as an attempt to "to criminalize a high stakes poker game between two Australians sailing an Australian sailboat from Australia to Fiji."[210]

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dum, however, implicitly assumes that the United States has some underlying jurisdictional connection to the overseas activity. In particular, the memo implicitly invokes "protective principle" jurisdiction, focusing on the ability of the United States to "protect its own vital national interests" with respect to terrorist groups and drug traffickers that target the United States in circumstances where the foreign government fails to take steps to protect the United States. *Id.* at 166. Under this interpretation, the memorandum does not necessarily support an unlimited exercise of congressional power when the United States has no underlying jurisdictional connection to the person or activity (as is the case with an extreme application of section 7701(n)).

[208] 681 F. Supp. 896, 898 (1988), *conviction aff'd*, 924 F.2d 1086 (D.C. Cir. 1991).

[209] *Id.* at 907 n.24 (emphasis added).

[210] *See* Weisburd, *supra* note 159, at 418–20. Professor Weisburd also relies on the Supreme Court decision in *United States v. Furlong*, 18 U.S. (5 Wheat.) 184 (1820). In that case, the Court "addressed in dictum the question whether a statute criminalizing piracies and felonies at sea should be read as applying to murders committed by aliens against alien victims upon non-American ships." Weisburd, *supra* at 419. The Court concluded that Congress lacked the power to punish murder on the high seas (as opposed to piracy, which is explicitly covered by Article I, § 8, cl. 9). *Furlong*, 18 U.S. at 198. Despite Professor Weisburd's broad reading of the *Furlong* decision to support a restricted view of enumerated Article I powers, such as the commerce clause, when they purport to reach events with no U.S. connection, the case might instead stand for the narrower proposition that murder,

In summary, while a constitutional challenge to Congress's power to enact section 7701(n) may face significant hurdles, such a challenge finds significant support in the reasoning of those Supreme Court cases that have addressed the extent of Congress's sovereign powers to tax in an international context. The Supreme Court cases applying interpretive presumptions against Congress legislating extraterritorially or in violation of customary international law do not necessarily imply that Congress has unlimited jurisdiction to tax in situations when there is no valid prescriptive jurisdiction claim under customary international law. Although claims challenging Congress's power to tax historically have received a chilly response from the Court and the principal cases discussed above are at least seventy years old, the rationale of those opinions warrants a serious consideration of the outer boundaries of Congress's power to tax in an international setting, particularly given the Court's recent willingness to find limitations on Congress's powers under the Commerce Clause of Article I.[211]

Despite the potential merits of this argument regarding limitations on Congress's taxing power, the political question doctrine might preclude the Supreme Court from addressing it. As the Supreme Court noted in *Baker v. Carr*,[212] the political question doctrine "is primarily a function of the separation of powers,"[213] and the dominant considerations for determining its applicability turn on "the appropriateness under our system of government of attributing finality to the action of the political departments and also the lack of satisfactory criteria for a judicial determination."[214] While *Baker v. Carr* left this determination to case-specific inquiry, it did note several relevant factors, including the extent to which the issue touches on foreign relations.[215] To the extent that the Court were to regard the present issue as a political question,[216] it would decline to rule on the issue and would not invalidate section 7701(n) as exceeding Congress's powers.

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unlike piracy, is not an enumerated power under Article I, section 8, and therefore is beyond Congress's legislative authority.

[211] *See* United States v. Morrison, 529 U.S. 598 (2000) (holding that Congress lacked commerce clause authority to provide a civil remedy for gender-motivated violence); United States v. Lopez, 514 U.S. 549 (1995) (holding that Congress lacked commerce clause authority to regulate handguns in school zones). Unlike the international concerns at issue in the present context, the *Morrison* and *Lopez* cases involved federalism concerns.

[212] 369 U.S. 186 (1962).

[213] *Id.* at 210.

[214] *Id.* (citing Coleman v. Miller, 307 U.S. 433, 454–55 (1939)).

[215] 369 U.S. at 211.

[216] *See generally* Rachel E. Barkow, *More Supreme Than Court? The Fall of the Political Question Doctrine and the Rise of Judicial Supremacy*, 102 COLUM. L. REV. 237 (2002) (arguing that recent Supreme Court decisions, demonstrate a decreasing reliance on the political question doctrine and an increasing willingness to decide a broader range of constitutional questions).

C. Due Process and Equal Protection Limitations

If, notwithstanding the foregoing arguments, Congress is found to have the power under Article I to enact the AJCA special definitions of tax citizenship, the statute might still be challenged as violating other constitutional limitations.[217] This Section considers two potential limitations under the Fifth Amendment: due process and equal protection. It concludes that a strong argument exists for invalidating section 7701(n) on due process grounds for periods after an individual has notified the Department of State of her citizenship loss but has not yet notified the IRS.

As a threshold matter, it is important to note that an individual subject to section 7701(n) is an alien for nationality law purposes, and the Supreme Court has found that aliens with insufficient connections to the United States are not entitled to the full protections of the Fifth Amendment.[218] However, the application of section 7701(n) is itself based on the fiction that the individual is in some sense a "citizen" who has sufficient connection to the United States to warrant the imposition of worldwide taxation. Moreover, any attempt to adjudicate section 7701(n) would occur in a federal court, where the Supreme Court has shown a stronger willingness to accord aliens Fifth Amendment protections.[219]

1. Due Process

The Due Process Clause of the Fifth Amendment provides that "[n]o person shall . . . be deprived of life, liberty, or property, without due process of law."[220] The Supreme Court has interpreted this clause as requiring not only adequate procedures, such as notice and hearing, but also justification for the government's action.[221] The Court has given wide latitude to the government in applying due process standards, with no economic legislation having been found to violate the Due Process Clause since 1937.[222]

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[217] *See* BORIS I. BITTKER & LAWRENCE LOKKEN, FEDERAL TAXATION OF INCOME, ESTATES AND GIFTS ¶ 1.2.1 (3d ed. 1999) ("Like all other federal powers, the right of Congress to levy and collect taxes is subject to a wide range of constitutional limits, including the due process clause . . . ."); RONALD D. ROTUNDA & JOHN E. NOWAK, TREATISE ON CONSTITUTIONAL LAW, SUBSTANCE AND PROCEDURE § 5.2 (3d ed. 1999).

[218] *See, e.g.*, United States v. Verdugo-Urquidez, 494 U.S. 259, 269 (1990) (analogizing the lack of Fifth Amendment protections for aliens to the refusal to extend Fourth Amendment protections to the Mexico home of a Mexican citizen).

[219] *See* Weisburd, *supra* note 159, at 399–403.

[220] U.S. CONST. amend. V.

[221] *See* ERWIN CHEMERINSKY, CONSTITUTIONAL LAW: PRINCIPLES AND POLICIES 523–24 (2d ed. 2002).

[222] *See id.* at 601; *see also* United States v. Carlton, 512 U.S. 26, 34 (1994) (noting that these pre-1937 cases were decided during an era characterized by exacting review of economic legislation under an approach that 'has long since been discarded'" (quoting Ferguson v. Skrupa, 372 U.S. 726, 730 (1963))).

However, several federal appeals courts[223] and numerous commentators[224] have observed that in an international setting, an overly broad assertion of federal prescriptive jurisdiction might violate due process constraints on federal lawmaking. Section 7701(n), particularly as applied to individuals after they have notified the Department of State of their citizenship loss but before they have notified the IRS, appears to present such a situation.

Perhaps the most relevant Supreme Court case is *Helvering v. City Bank Farmers Trust Co.*,[225] which involved a due process challenge in a domestic setting[226] to a federal estate tax anti-avoidance provision. In determining whether the tax statute violated due process, the Court focused on whether the anti-abuse provision was "unreasonably harsh or oppressive" or was "arbitrary."[227] While subsequent Supreme Court cases addressing economic legislation have formulated the standard somewhat differently, focusing on whether the legislation has a "legitimate legislative purpose furthered by rational means,"[228] a more recent opinion noted that the "harsh and oppressive" standard "does not differ from the prohibition against arbitrary and irrational legislation that applies generally to enactments in the sphere of economic policy."[229]

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[223] *See* Tamari v. Bache & Co., 730 F.2d 1103, 1107 n.11 (7th Cir. 1984) ("Were Congress to enact a rule beyond the scope of these [customary international law prescriptive] principles, the statute could be challenged as violating the due process clause on the ground that Congress lacked the power to prescribe the rule."); Leasco Data Processing Equip. Corp. v. Maxwell, 468 F.2d 1326, 1334 (2d Cir. 1972).

[224] *See* Lea Brilmayer & Charles Norchi, *Federal Extraterritoriality and Fifth Amendment Due Process*, 105 HARV. L. REV. 1217 (1992); Kenneth W. Dam, *Extraterritoriality in an Age of Globalization: The Hartford Fire Case*, 1993 SUP. CT. REV. 289, 313; Larry Kramer, *Vestiges of Beale: Extraterritorial Application of American Law*, 1991 SUP. CT. REV. 179, 206 (1991). *But see* Weisburd, *supra* note 159, at 408–17.

[225] 296 U.S. 85 (1935). Several more recent circuit court cases have relied on *City Bank* in analyzing due process challenges to federal tax statutes. *See, e.g.*, Di Portanova v. United States, 690 F.2d 169, 180 (Ct. Cl. 1982) (upholding constitutionality of earlier version of I.R.C. § 877); Schuster v. Commissioner, 312 F.2d 311, 318 (9th Cir. 1962).

[226] Although the decedent was a non-resident citizen, this fact was not relevant to the decision.

[227] *City Bank Farmer's Trust*, 296 U.S. at 89–90.

[228] General Motors Corp. v. Romein, 503 U.S. 181, 191 (1992); *see also* CHEMERINSKY, *supra* note 221, at 600–01.

[229] United States v. Carlton, 512 U.S. 26, 30 (1994) (holding that retroactive estate tax legislation did not violate due process).

The Supreme Court has established a higher standard for reviewing due process challenges if a fundamental right is infringed. *See* United States v. Carolene Products Co., 304 U.S. 144, 152 n.4 (1938); *see generally* CHEMERINSKY, *supra* note 221, at 764. In determining whether something is a fundamental right, the Supreme Court has included liberties that are "deeply rooted in this Nation's history and tradition." Moore v. City of East Cleveland, 431 U.S. 494, 503 (1977). The Supreme Court has recognized the importance in our nation's history of the right to renounce citizenship. *See* Afroyim v. Rusk, 387 U.S. 253 (1967); *see also* Kirsch, *supra* note 12. Even if the right to renounce citizenship rises to the level of a fundamental right, the higher standard of review would not apply. Although sections 877(g) and 7701(n) apply to individuals who purport to lose citizenship, these tax provisions do not "infringe" a person's ability to renounce citizenship. In particular, they do not interfere with a person's ability to commit a potentially expatriating act with the requisite intent and have the resulting citizenship loss recognized by the Department of State.

The Court in *City Bank Farmer's Trust* concluded that the estate tax provision at issue did not violate due process because Congress had a legitimate purpose to prevent tax avoidance.[230] It was uncontested that trust property was includible in a decedent's gross estate if the decedent had previously transferred property to the trust and, at the time of death, had held a right to revoke the trust.[231] Congress was concerned that the decedent might try to plan around this result by conditioning the revocation power on the consent of a (potentially pliant) trust beneficiary.[232] Accordingly, the statute provided that the need for the beneficiary's consent was to be ignored in determining whether the decedent held a revocation power.[233] The Court concluded that the statute, by ignoring the beneficiary's consent power and requiring the property to be included in the decedent's gross estate, was sufficiently related to Congress's tax avoidance purpose.[234] In effect, the statute ensured that the underlying estate tax provision (the inclusion of trust property over which the original donor holds a revocation power) would be enforceable despite attempts by taxpayers to circumvent it with potentially meaningless joint consent powers.

As was the estate tax provision in *City Bank Farmer's Trust*, section 7701(n) was enacted to address tax avoidance concerns. However, section 7701(n) is not rationally related to this purpose when it is used to tax an individual years after she has notified the Department of State of her expatriating act but before she has complied with the IRS reporting requirements.[235] For time periods after which the individual has notified the Department of State of her citizenship loss, the only purpose of section 7701(n) is to ensure that the IRS obtains sufficient information from the individual to enable enforcement of the alternative tax regime of section 877 (and related estate and gift tax provisions).[236] Section 877's alternative tax regime does not impose perpetual worldwide taxation on former citi-

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Even though a potential tax taint might remain, for nationality law purposes the loss would be recognized and other burdens associated with citizenship, such as potential obligations of military service, would no longer apply.

[230] *City Bank Farmer's Trust*, 296 U.S. at 92. The challenged tax provision was the predecessor to current I.R.C. section 2038 (governing revocable transfers).

[231] *Id.* at 88.

[232] *Id.* at 90.

[233] *Id.* at 88–89.

[234] *Id.* at 91.

[235] A stronger relationship exists in the case of an individual who has failed to notify either the Department of State or the IRS of the expatriation. *See supra* notes 45–51 and accompanying text. To the extent an anti-avoidance provision, such as section 7701(n), imposes the same type of tax (i.e., worldwide taxation) as the underlying provisions that it is backstopping, there appears to be a rational relationship.

[236] *See supra* notes 41–44 and accompanying text. For periods prior to the notification of the Department of State, Congress also might have been concerned with an individual's obtaining the benefits of citizenship while avoiding the burdens of worldwide taxation. *See supra* notes 46–52 and accompanying text. However, such concerns no longer apply once the individual has notified the Department of State and thereby had the citizenship loss documented for nationality law purposes.

zens; rather, it merely expands the types of U.S. source income upon which a former citizen will be taxed for a ten-year period.[237] In contrast, section 7701(n), which purports to backstop the enforcement of section 877, imposes worldwide taxation on the individual (by treating her as a citizen for tax purposes), potentially in perpetuity.

The enactment of an anti-abuse provision that imposes taxation much more broadly than the tax provision it is intended to backstop seems difficult to justify even under the admittedly lenient rational basis test. The provision's constitutional infirmity is not based on the mere assertion that Congress could have crafted a better-tailored statute[238] (although Congress did, in fact, create a more narrowly tailored anti-abuse provision in the context of the 1996 amendments to section 877).[239] Rather, it is based on the lack of any rational connection between the perceived abuse and the legislative response. Unlike the anti-abuse estate tax provision in *City Bank Farmer's Trust*, which ensured that the underlying estate tax provision would apply notwithstanding taxpayer's efforts to circumvent it, section 7701(n) bears no relationship, and is grossly disproportionate to, the U.S. source-focused alternative tax regime of section 877 that it purports to backstop.[240]

If section 7701(n), in this context, were viewed as satisfying the due process rational basis test, it is difficult to envision any due process limitation on the taxation of individuals in an international context. Taken to an extreme, a lack of due process violation in the present context might justify Congress imposing a worldwide taxation regime on almost any nonresident alien in the guise of an anti-avoidance provision. For example, if a nonresident alien (who had never been a citizen) failed to report or pay tax on income connected with a U.S. business or U.S. investment property,[241] Congress might enact an "anti-abuse" provision that treats the individual as a citizen for tax purposes, taxable on worldwide income. To the extent such a response is viewed as having no rational relation to the prevention of tax avoidance by nonresident aliens, section 7701(n) also should be viewed as having no rational connection to the prevention of tax avoidance under section 877. After all, both situations involve an overly broad application of worldwide taxation to protect the enforceability of a narrow U.S. source-focused tax regime.

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[237] *See supra* notes 14–18 and accompanying text.

[238] Di Portanova v. United States, 690 F.2d 169, 180 (Ct. Cl. 1982) (upholding a prior version of I.R.C. § 877 against due process and equal protection challenges, stating that "the possibility that Congress might draft a better or a more comprehensive statute is not a reason for invalidating" a statute as long as it meets a minimum rationality test).

[239] *See* 2003 JCT REPORT, *supra* note 19.

[240] *See* Helvering v. City Bank Farmers Trust Co., 296 U.S. 85, 92 (1935). In this context, the special definition of citizenship provided in section 7701(n) for tax purposes could be an example of the *City Bank Farmer's Trust* court's observation that there are due process limitations on Congress's ability "to create a fictitious status under the guise of supposed necessity." *Id.*

[241] As discussed *supra* notes 9–11 and accompanying text, nonresident aliens generally are taxable on these types of income under the Internal Revenue Code.

2. Equal Protection

An equal protection claim in the present context would compare the treatment of expatriates who run afoul of section 877(g) or 7701(n) against the treatment of expatriates who do not trigger those provisions.[242] In the most extreme case, involving the application of section 7701(n) to a person who informed the Department of State of the citizenship loss but failed to notify the IRS under section 6039G, the relevant inquiry would be whether the adverse treatment of this person, in contrast to a person who notified both the Department of State and the IRS, is justified.

Although a "strict scrutiny" standard sometimes applies to classifications that discriminate against aliens,[243] it is doubtful that such a standard would apply in the present circumstance, even though the individual would be a noncitizen (under nationality laws) at the time the IRS attempts to assert tax under section 7701(n). First, the Supreme Court has recognized that Congress has significantly more power than states to establish distinctions based on alienage.[244] That power includes the right to make distinctions not only between aliens and citizens but also among different classes of citizens.[245] Moreover, the Court's rationale for providing heightened scrutiny for state alienage classifications is largely inapplicable in the present context. Whereas heightened scrutiny generally is grounded in the inability of aliens to vote and thereby protect themselves in the political process,[246] former citizens subject to section 7701(n) previously were enfranchised and voluntarily surrendered that right pursuant to their expatriation. The case for strict scrutiny is undercut further by the fact that the present circumstances involve tax legislation. The Supreme Court has been particularly reluctant to subject tax statutes to heightened scrutiny, noting that "legislatures have especially broad latitude in creating classifications and distinctions in the tax statutes."[247]

For the foregoing reasons, it is likely that a court would apply a rational basis, rather than strict scrutiny, test to sections 877(g) and 7701(n). Unlike the due process analysis, which focuses on the substantive aspects

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[242] Unlike the Fourteenth Amendment that applies to the states, the Fifth Amendment does not explicitly refer to equal protection rights. However, the Supreme Court has held that equal protection principles apply to the federal government through the Fifth Amendment. *See* Bolling v. Sharpe, 347 U.S. 497, 499 (1954); *see also* CHEMERINSKY, *supra* note 221, at 642–43.

[243] *See* CHEMERINSKY, *supra* note 221, at 739–43.

[244] *See id.* at 745 (citing Mathews v. Diaz, 426 U.S. 67 (1976)).

[245] *Diaz*, 426 U.S. at 80.

[246] *See* CHEMERINSKY, *supra* note 221, at 742.

[247] Regan v. Taxation with Representation, 461 U.S. 540, 547 (1983); *see also* Barclay & Co. v. Edwards, 267 U.S. 442, 449–50 (1924) (permitting Congress to treat foreign corporations as a separate class for tax purposes); BITTKER & LOKKEN, *supra* note 217, ¶ 1.2.5 ("[T]he tax laws have drawn so many distinctions that even a Supreme Court confident of its power to distinguish between reasonable and arbitrary behavior in other statutory areas has hesitated to act as a referee of tax legislation.").

of the provisions, the equal protection analysis merely focuses on whether there is a rational basis for creating some kind of distinction between the classes of persons.[248] In this narrow context, it appears that there is a rationale for distinguishing between former citizens who give up citizenship and run afoul of section 877(g) or 7701(n), and those who give up citizenship and do not trigger those provisions. In particular, with respect to section 877(g), the classes spend different amounts of time in the United States during the ten-year post-expatriation period. With respect to section 7701(n), the classes create different levels of enforcement difficulty for the IRS. Accordingly, a challenge based solely on equal protection concerns would most likely fail.

IV. Additional Considerations

As discussed in Part II, certain aspects of the AJCA definitions of tax citizenship violate the prescriptive jurisdictional bases of customary international law. As argued in Part III, certain applications of section 7701(n) raise significant constitutional concerns, particularly with respect to due process. Even to the extent the AJCA provisions are consistent with the Constitution, additional considerations demonstrate the need for Congress to reconsider its use of special tax-based definitions of citizenship in this context. This Part briefly summarizes these considerations.

A. Effect on Treaty Network

1. Inapplicability of Treaty Saving Clause

The United States is a party to bilateral income tax treaties with more than sixty countries.[249] While the specific terms of each treaty differ,[250] tax treaties generally are structured so that the United States provides certain relief from U.S. taxation to residents of the treaty partner, while the

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[248] *See* CHEMERINSKY, *supra* note 221, at 643.

[249] *See* John Venuti et al., *Current Status of U.S. Tax Treaties and International Tax Agreements*, 34 TAX MGM'T. INT'L J. 707, 711 (2005) (listing countries). The United States also has a network of bilateral estate and/or gift tax treaties with sixteen countries. *Id.*

[250] Discrepancies are due to differences in the tax systems of each treaty partner and the results of bilateral treaty negotiations. However, the treaties share a common structure and common provisions and are based on similar model treaties. *See* ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT, COMMITTEE ON FISCAL AFFAIRS, MODEL TAX CONVENTION ON INCOME AND CAPITAL (2000), *reprinted in* MODEL TAX CONVENTION ON INCOME AND ON CAPITAL (Organisation for Economic Co-Operation and Development, 2000) [hereinafter OECD Model Treaty]; Dep't of Treasury, United States Model Income Tax Convention of Sept. 20, 1996, http://www.treas.gov/offices/tax-policy/library/model996.pdf [hereinafter U.S. Model Treaty] (based largely on the OECD Model Treaty); Dep't of Treasury, Technical Explanation of the United States Model Income Tax Convention of Sept. 20, 1996, http://www.irs.gov/pub/irs-trty/usmtech.pdf [hereinafter U.S. Model Technical Explanation].

treaty partner reciprocally provides relief from its tax to residents of the United States.[251] For example, the Internal Revenue Code generally imposes a thirty percent tax on certain U.S. source investment income earned by a nonresident alien and imposes a graduated tax on income connected to a nonresident alien's conduct of a U.S. trade or business. However, if the taxpayer is a resident of a country with which the United States has an income tax treaty, the treaty either eliminates or reduces the U.S. tax on the individual's U.S. investment income[252] and prevents the United States from taxing the individual's U.S. business income unless the individual conducts the business through a "permanent establishment" in the United States.[253]

Under a treaty's definition of "resident," it is possible that a U.S. citizen living abroad could be treated as a resident of the other country for treaty purposes.[254] Nonetheless, U.S. tax treaties contain a "saving clause" that prevents such a U.S. citizen from invoking the treaty against the United States to reduce her U.S. tax liability.[255] For example, a U.S. citizen who resides in the United Kingdom might be treated as a resident of the United Kingdom under the U.S.-U.K. treaty's tie-breaker rule. Nevertheless, the United States, pursuant to the treaty's saving clause, reserves the right to exercise its full taxing jurisdiction over the U.S. citizen.

The U.S. Model Treaty contains a special definition of "citizen" for purposes of applying the saving clause:

> [f]or this purpose [i.e., the saving clause], the term "citizen" shall include a former citizen . . . whose loss of such status had as one of its principal purposes the avoidance of tax (as defined under the laws of the Contracting State of which the person was a citizen or long-term resident), but only for a period of 10 years following such loss.[256]

This aspect of the saving clause is intended to ensure that the United States can impose tax under Internal Revenue Code section 877 on a person who has surrendered U.S. citizenship, even if the individual subsequently

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[251] In addition to providing benefits to certain taxpayers, income tax treaties often contain provisions that benefit the respective governments' abilities to enforce their tax laws. For example, income tax treaties generally provide for information exchange and limited collection assistance between the respective tax administrators. *See, e.g.*, U.S. Model Treaty, *supra* note 250, art. 26; 2003 JCT REPORT, *supra* note 19, at 98–99 n.377 (citing five income tax treaties that contain broad collection assistance provisions).

[252] *See, e.g.*, U.S. Model Treaty, *supra* note 250, arts. 10 (dividends), 11 (interest), and 12 (royalties).

[253] *See, e.g.*, *id.* art. 7.

[254] *See id.* art. 4. If the individual meets the general definition of "resident" with respect to both countries, the definition's tie-breaker rules might treat her as a resident of the other country. *See id.*

[255] *See id.* art. 1, para. 4. The treaty contains limited exceptions to the saving clause, which allow a U.S. citizen who is resident in the other treaty country to claim certain benefits of the treaty. *See id.* art. 1, para. 5(a).

[256] *See* U.S. Model Treaty, *supra* note 250, art. 1, para. 4.

acquires residence in a country with which the United States has a tax treaty.[257] The treaty provision's focus on former citizens "whose loss of such status had as one of its principal purposes the avoidance of tax" tracks the threshold requirement of section 877 in effect prior to the enactment of the AJCA. Following the enactment of the AJCA, tax liability under section 877 no longer depends on whether the former citizen had a principal purpose of tax avoidance.[258]

The enactment of the AJCA raises significant issues regarding the applicability of the treaty saving clause to individuals who lose citizenship under the nationality laws.[259] Of particular relevance, it raises the question of whether the saving clause applies to an individual who has lost citizenship under the nationality laws but who continues to be treated as a citizen for tax purposes under section 877(g) or 7701(n).[260]

The general language of the saving clause provides that the United States "by reason of citizenship may tax its citizens, as if the Convention had not come into effect."[261] The principal issue, then, is whether the treaty's reference to a "citizen" encompasses only those individuals who are citizens in a nationality law sense or whether it is broad enough to cover an

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[257] *See* U.S. Model Technical Explanation, *supra* note 250, at 6.

[258] *See supra* note 18.

[259] As a practical matter, a former citizen who is subject to the ACJA provisions might be unlikely to move to a country with which the United States has a tax treaty. *See supra* note 64.

[260] The AJCA modifications to section 877 also raise the question of whether the saving clause applies to a person whose nationality loss is respected for tax purposes and who is subject to the alternative tax regime of section 877. Although this Article focuses on expatriates whose expatriation is not respected for tax purposes, this question is worth brief consideration. The principal issue is whether the model treaty's special saving clause definition regarding former citizens, which tracks the tax-motivation language of pre-AJCA section 877, continues to apply now that section 877 no longer depends on a principal purpose of tax avoidance. *See supra* note 18. A strong argument can be made that the saving clause does not apply, and the United States therefore cannot apply the section 877 alternative tax regime to a former citizen who is a resident of a treaty country. Although the treaty saving clause states that the existence of tax avoidance motive is determined "under the laws of the Contracting State of which the person was a citizen," that language has no direct relevance under the post-AJCA version of section 877, because the new statute does not purport to look at tax motivation. *See* 2003 JCT REPORT, *supra* note 19, at 206 (observing that "no subsequent inquiry into the taxpayer's intent would be required or permitted"); IRS, Notice 2005-36, *supra* note 39, at 1007 (observing that new section 877 applies "without regard to tax motivation"). *But see* 2003 JCT REPORT, *supra* note 19, at 206 (noting that the objective monetary thresholds of new section 877 are intended to "serve as a proxy for tax motivation"). To the extent the other treaty country may have been willing to accept the saving clause's applicability to pre-AJCA section 877 because that statute looked to actual tax motivation, the treaty country might view the new section 877, with its purely objective inquiry and lack of any reference to tax motivation, as beyond the scope of the saving clause. The IRS might be able to address this problem by making a factual determination of tax avoidance purpose with respect to a former citizen who establishes residence in a treaty partner and is otherwise subject to new section 877, although such a factual inquiry would raise the many administrative difficulties that led Congress to discard motivation in the statute. *See also infra* note 286 (noting that the legislation probably will not be treated as overriding the treaty in this context).

[261] U.S. Model Treaty, *supra* note 250, art. 1, para. 4.

individual who, despite having lost citizenship under the nationality laws, is labeled as a "citizen" for tax purposes under the Internal Revenue Code.

Both the language of the treaty and the general circumstances surrounding treaty negotiations suggest that the treaty reflects the former interpretation and that the general saving clause therefore cannot be invoked to tax the worldwide income of the individual. The U.S. Model Treaty does not provide a specific definition of the term "citizen."[262] However, it does refer to citizenship in the context of defining the term "national."[263] The term "national" of a Contracting State is defined, with respect to an individual, as "any individual possessing the nationality or citizenship of that State."[264] This "possessing" citizenship language, as commonly used, refers to a person who holds citizenship in the nationality law sense and is thereby entitled to the benefits of citizenship.[265] Moreover, the official commentary to the OECD Model Treaty, upon which this provision of the U.S. Model is based,[266] makes clear that the definition of the term "national" is governed by the nationality laws of each state.[267]

This connection between the treaty's use of the term citizenship and a country's nationality laws is furthered by the special reference to former citizens in the saving clause. The saving clause specifies that "citizens" shall include those who relinquished their citizenship within the prior ten years with "one of [their] principle purposes the avoidance of tax."[268] The inclusion of this special definition strongly implies that, in its absence, the saving clause's general preservation of taxing jurisdiction over "citizens" applies only to individuals who currently are citizens in the nationality law sense. Moreover, the special definition's use of the term "former citizen"

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[262] *See* U.S. Model Treaty, *supra* note 250, art. 3 (no definition of citizenship in the "General Definitions" article).

[263] *See id.* art. 3, para. 1(h). The definition of "national" is relevant for purposes of the residence tie-breaker provision, the taxation of income from government services, and the application of non-discrimination provisions. *See id.* art. 4, para. 2; art. 19; art. 24, para. 1.

[264] *Id.* art. 3, para. 1(h).

[265] *See also* U.S. Model Technical Explanation, *supra* note 250, at 82 (using the terms "citizenship" and "nationality" interchangeably in explaining that, in the event of certain disputes arising under a tax treaty, taxpayers can present their case "only to the competent authority of their country of residence, or citizenship/nationality").

[266] *See id.* at 11 ("This definition [of national] is closely analogous to that found in the OECD Model.").

[267] ORGANISATION FOR ECONOMIC COOPERATION AND DEVELOPMENT, COMMITTEE ON FISCAL AFFAIRS, COMMENTARY ON MODEL TAX CONVENTION ON INCOME AND CAPITAL art. 3, ¶ 8 (2000), *reprinted in* MODEL TAX CONVENTION ON INCOME AND ON CAPITAL (Organisation for Economic Co-Operation and Development, 2000) [hereinafter OECD Model Commentary] ("Obviously, in determining what is meant by 'the nationals of a Contracting State' in relation to individuals, reference must be made to the sense in which the term is usually employed and each State's particular *rules on the acquiring or loss of nationality*." (emphasis added)). Indeed, the drafters of the commentary apparently viewed this relationship between the term "national" and the countries' nationality laws as self-evident, stating that "[i]t was not judged necessary to include in the text of the Convention any more precise definition of nationality, nor did it seem indispensable to make any special comment on the meaning and application of the word." *Id.*

[268] *See supra* text accompanying note 256.

and reference to the ten-year period following the loss of citizenship makes clear that the term "citizen" is used in its nationality law sense.[269]

One definitional provision of the U.S. Model Treaty potentially supports an interpretation of the term "citizen" in the saving clause to include a person who has lost citizenship under the nationality law but is treated as a tax citizen under the AJCA provisions. The catch-all provision of the general definitions article provides that "unless the context otherwise requires," a term not otherwise defined in the treaty should "have the meaning which it has at that time under the law of that State for the purposes of the taxes to which the Convention applies, any meaning under the applicable tax laws of that State prevailing over a meaning given to the term under other laws of that State."[270]

This provision implies that the term "citizen" in the saving clause, because it is not otherwise explicitly defined in the treaty, should have the same meaning it has under the laws of the United States, with the U.S. tax law's definition taking precedence. Under such a reading, an individual who is treated as a citizen for tax purposes under the new AJCA provision would be a citizen within the meaning of the saving clause, and the United States would retain unlimited taxing jurisdiction over the individual.

The principal shortcoming of this argument is that the treaty looks to the domestic law definition only if the context does not otherwise require.[271] In the case of the citizenship definition, the context does otherwise require. As discussed above, both the treaty and the technical explanation repeatedly use the terms "citizen" and "citizenship" by reference to the nationality law. Moreover, the special "former citizen" definition in the saving clause is understandable only if citizenship is understood in the nationality law sense.

In addition, the Treasury Department's technical explanation to this catch-all provision states that the domestic law's definition of an otherwise undefined term is not applicable if it "lead[s] to results that are at variance with the intentions of the negotiators and of the Contracting States when the treaty was negotiated and ratified."[272] Given the reluctance of most countries to recognize United States taxing jurisdiction over actual citizens residing outside the United States, it is extremely unlikely that a treaty partner's negotiators would have intended that the U.S. could stretch its taxing jurisdiction under the treaty to cover the worldwide income of individuals who are no longer U.S. citizens under the nationality law. Indeed,

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[269] Indeed, at the time the U.S. Model Treaty was developed and the actual treaties based on it were negotiated, there was no special tax definition of citizenship under the Internal Revenue Code. The treaty negotiators most likely did not contemplate the possibility that "citizen" could refer to anything other than its commonly understood nationality law status.

[270] U.S. Model Treaty, *supra* note 250, art. 3, para. 2.

[271] *See id.*

[272] U.S. Model Technical Explanation, *supra* note 250, at 12.

by including a narrow expansion of the saving clause to permit taxation of tax-motivated "former citizens" for ten years under the pre-AJCA version of section 877,[273] negotiators implicitly agreed that the United States could not unilaterally effect a significant jurisdictional expansion over the worldwide income of a broader class of former citizens in perpetuity.

A final consideration involves the potential use of the special "former citizen" language of the saving clause as a basis itself for taxing a former citizen (in the nationality law sense) who is a resident of the other country. The AJCA provisions, by treating the person as a citizen, cause the individual to be taxable on worldwide income. This goes far beyond the limited jurisdiction contemplated by the special "former citizen" treaty language. That special provision, drafted in the context of pre-AJCA section 877, was intended merely to allow the United States to impose a slightly expanded version of source taxation to the tax-motivated former citizen than would otherwise apply to a nonresident alien.[274] This narrow purpose of section 877 is made clear in the Treasury Department's Technical Explanation to the U.S. Model Treaty,[275] as well as the technical explanations to actual tax treaties that contain the provision.[276] Accordingly, if the United States were to attempt to bootstrap worldwide taxation using this narrow "former citizen" provision of the saving clause, the other treaty country could be expected to object.

2. *Potential Treaty Override*

Before concluding that this analysis would permit a former citizen (in a nationality law sense) who resides in a treaty country to invoke the benefits of the treaty to prevent the United States from applying the new AJCA provisions, it is important to consider the relationship between tax treaties and statutes. Once a tax treaty enters into force, it constitutes the "supreme Law of the Land"[277] under the Constitution, along with the Internal Revenue Code and other federal statutes.[278]

Given the equal constitutional weight of treaties and statutes,[279] courts have adopted several principles to determine whether a taxpayer is subject to tax when a tax code provision imposes tax but a treaty purports to call

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[273] *See supra* notes 256–258 and accompanying text.

[274] Most notably, under the alternative regime of section 877, the former citizen is taxable on gain from the sale of stock in a U.S. domestic corporation, which ordinarily is not taxable when derived from a nonresident alien. *See* I.R.C. § 877(b). *See generally supra* notes 14–18 and accompanying text.

[275] *See* U.S. Model Technical Explanation, *supra* note 250, at 6.

[276] *See, e.g.*, Dep't of Treasury, Technical Explanation to the U.S.-U.K. Income Tax Treaty 6 (Mar. 5, 2003), http://www.ustreas.gov/offices/tax-policy/library/teus-uk.pdf.

[277] U.S. CONST. art. VI.

[278] *Id.*

[279] *See* I.R.C. §§ 894(a), 7852(d)(1) (2005).

off taxation.[280] As a threshold matter, courts will attempt to interpret the treaty and the statute in a way that avoids a conflict between the two.[281] If a nonconflicting interpretation is not possible, courts generally give precedence to the provision that was adopted later in time.[282] Thus, it is possible that Congress can enact a statutory provision that overrides a provision of a preexisting bilateral tax treaty. However, given the significance of the United States unilaterally overriding its international treaty obligations,[283] courts adopt such an interpretation only if Congress expresses a clear intent that the statute override a preexisting treaty provision.[284]

In the present context, if the treaty saving clause does not apply, then the statute cannot be read consistently with the treaty—the treaty would prevent the United States from taxing the individual, whereas the ACJA provisions would purport to impose tax. Accordingly, the relevant question is whether Congress, in enacting AJCA, expressed a clear intention that the statute override preexisting treaties, such as those based on the U.S. Model Treaty. In contrast to the 1996 amendments to section 877, wherein the committee reports explicitly discussed the extent to which a treaty override was intended,[285] neither the statutory language of section 877 nor the relevant committee reports discuss this issue. Indeed, there is no indication that Congress considered whether the new statutory provisions might lead to a treaty conflict. Moreover, the JCT Report, upon which the legislation was based, did not address the potential treaty conflict that could result, nor did it indicate that the JCT recommendation was intended to override any treaty obligations. Given this lack of congressional intent to override a treaty, it is likely that a court would follow the jurisdictional limitations

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[280] *See* FEDERAL INCOME TAX PROJECT, AMERICAN LAW INSTITUTE, INTERNATIONAL ASPECTS OF UNITED STATES INCOME TAXATION II: PROPOSALS ON UNITED STATES INCOME TAX TREATIES 64 (1992). For a more detailed explanation of these principles, including illustrations of their application to specific treaty provisions, see JOEL D. KUNTZ & ROBERT J. PERONI, U.S. INTERNATIONAL TAXATION ¶ 4.03 (Warren, Gorham & Lamont 1992).

[281] *See* AMERICAN LAW INSTITUTE, *supra* note 280, at 64.

[282] *Id.*

[283] Because a treaty override may be considered a breach of the tax treaty, the treaty partner may have remedies available to it under international law, including the possibility of terminating or suspending the treaty in the case of a material breach. *See generally* ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT, COMMITTEE ON FISCAL AFFAIRS, TAX TREATY OVERRIDE, R(8)-10 (2000), *reprinted in* MODEL TAX CONVENTION ON INCOME AND ON CAPITAL (Organisation for Economic Co-Operation and Development, 2000); *see also* AMERICAN LAW INSTITUTE, *supra* note 280, at 73–77 (recommending that "the United States should not adopt a policy of implementing legislation in a manner that would constitute a breach of its obligations under income tax treaties").

[284] *See* KUNTZ & PERONI, *supra* note 280, ¶ 4.03. For a list of several occasions in the past thirty years in which Congress has overridden tax treaty provisions, see Infanti, *supra* note 279, at 682–83; *cf.* Avi-Yonah, *supra* note 73, at 493–96 (arguing that several recent congressional treaty overrides were justified due to the excessively slow pace of treaty negotiations).

[285] The 1996 conference report contained an unusual directive that 1996 legislative changes would override then-existing treaties for only ten years, at which time any then-existing treaties that had not yet been renegotiated would no longer be overridden. *See* H.R. REP. NO. 104-738, at 329 (1996) (Conf. Rep.).

imposed by the treaty, thereby precluding the application of the AJCA special tax citizenship definitions in the context discussed above.[286]

B. Undermining Respect for International Law

By violating customary international law jurisdictional principles, the AJCA tax citizenship definitions might undermine respect among other countries for international law, particularly in the tax context. The United States depends on other countries' general adherence to the principles of international law. To the extent that other countries no longer feel compelled to comply with these standards, or seek to retaliate against United States companies or individuals in response to the United States' perceived overreaching,[287] U.S. interests might suffer.

Justice Scalia has noted the importance of prescriptive comity, whereby sovereign nations afford each other respect by limiting the reach of their laws.[288] Under this principle, U.S. interests might be better served if Congress refrained from prescribing laws that could be perceived as unreasonable, even if jurisdiction technically exists under customary international law.[289] Obviously, this argument regarding the potential adverse impact of overbroad legislation is even stronger when international law jurisdiction is lacking, as in the present case.

C. Enforcement Difficulties

A final concern is extremely important from a practical perspective. Even if the AJCA provisions are upheld as constitutional, they will probably yield little revenue and be extremely difficult to enforce. Congress has imposed various versions of section 877 (and the related estate and gift tax provisions) for almost forty years, and the IRS has had significant enforcement problems since the outset.[290] Although the issue occupied significant congressional time in the mid-1990s, the resulting modifications in

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[286] A similar rationale would preclude the IRS from applying post-AJCA section 877 to a person whose loss of citizenship is respected for tax purposes. *See supra* note 260.

[287] *Cf.* Christopher J. Lord, Note, *Stapled Stock and I.R.S. Sec. 269B: Ill-Conceived Change in the Rules of International Tax Jurisdiction*, 71 CORNELL L. REV. 1066, 1089–90 (1986) (observing that other countries might perceive the U.S. staple stock regime to be an overbroad taxation of foreign corporations and might therefore retaliate against U.S. corporations). It is possible that such retaliation might itself violate customary international law. *See supra* note 155.

[288] *See* Hartford Fire Ins. Co. v. California, 509 U.S. 764, 817 (1993) (Scalia, J., dissenting).

[289] *See id.* at 818 (citing RESTATEMENT (THIRD) OF THE FOREIGN RELATIONS LAW OF THE UNITED STATES § 403(1) (1987)).

[290] *See* 2003 JCT REPORT, *supra* note 19, at 83–102 (summarizing enforcement problems with 1996 legislation); Kirsch, *supra* note 12, at 881–83 (summarizing enforcement problems with original 1966 legislation).

1996 had only limited effect and created additional administrative problems of their own.[291]

While some aspects of the AJCA—particularly the elimination of the previously existing ruling process and its subjective inquiry into motivation—may alleviate administrative difficulties, the AJCA provisions creating special definitions of citizenship for tax purposes will create additional enforcement difficulties. Prior to the enactment of the AJCA, section 877 focused on expanding the definition of U.S. source income—in particular, focusing on gains from the sale of domestic U.S. corporations. While that expansion of the tax base might have created some enforcement problems, at least it focused on property with a U.S. connection, thereby creating a possibility that the IRS could enforce the provision. In contrast, the new provisions, by treating the individual as a citizen taxable on her worldwide income, put the IRS in an almost impossible enforcement position.[292] Problems could arise both with respect to the IRS receiving information regarding the individual and her potential tax liability, and with respect to enforcing the law if the individual is determined to have tax liability.[293]

Regarding the information collection problem, the individuals to whom the AJCA tax citizenship definitions apply might have little future contact with the United States. Whereas a person subject to section 877(g) will at least have thirty-one days of contact, a person subject to section 7701(n) might have none, particularly if that person has already notified the Department of State of her citizenship loss but has failed to notify the IRS. Given the admitted difficulties the IRS has had in enforcing worldwide taxation against continuing U.S. citizens who happened to live abroad,[294] the chance of collecting useful information with respect to the new class of tax citizens is slim. The United States does not have unilateral authority to conduct tax investigations overseas.[295] Even if the individual resides in a country with which the United States has a tax treaty that gener-

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[291] *See* 2003 JCT REPORT, *supra* note 19, at 83–137 (discussing administrative and enforcement problems of 1996 legislation).

[292] Even the 2003 JCT Report, upon which the AJCA provisions were based, acknowledged that "with the person, property, and income outside of the United States, effective administration of" a rule that indefinitely taxes a nonresident noncitizen on worldwide income "may be impossible." 2003 JCT REPORT, *supra* note 19, at 109.

[293] As prominent commentators have noted, an analysis of jurisdiction to prescribe "is incomplete without also taking into account the limits on jurisdiction to adjudicate and enforce. A country cannot enforce an income tax in the absence of information and the ability to compel compliance." Shay et al., *supra* note 87, at 116; *see also* ISENBERGH, *supra* note 160, ¶ 1.5.2; Hellerstein, *supra* note 73, at 13 (discussing theoretical and practical limitations on jurisdiction to enforce tax collection); Martin Norr, *Jurisdiction to Tax and International Income*, 17 TAX L. REV. 431, 432 (1962) ("Tax jurisdiction in practice is a different matter from tax jurisdiction in theory. However lawful an assertion of tax jurisdiction may be, power to make the assertion effective is nevertheless required.").

[294] *See* TREASURY REPORT, *supra* note 46, para. 27.

[295] *See Authority of the Federal Bureau Of Investigations*, *supra* note 200, at 165 (observing that the United States cannot mount tax investigations in another state's territory except under the terms of a treaty or with the consent of the other country).

ally provides for information sharing, the other country is unlikely to provide the IRS with information under the treaty regarding the individual.[296]

Even if the IRS becomes aware of a taxable event regarding a tax citizen—for example, if a well-known person who has surrendered citizenship (in the nationality law sense) subsequently dies, the death might be reported in the press—the IRS will have little ability to collect any taxes. In particular, if the individual has no ongoing connection to the United States, the United States might have neither *in personam* nor *in rem* jurisdiction with respect to collection attempts.[297] Moreover, under longstanding principles of international law, the country in which the individual resides generally is not required to recognize or enforce judgments for the collection of taxes rendered by a U.S. court.[298]

Thus, to the extent that Congress was attempting to improve compliance with respect to citizens and long-term residents who lose their status, these AJCA provisions will prove disappointing. Of course, it is possible that revenue collection was not Congress's only concern. After all, relatively few individuals expatriate each year, and Congress's prior sojourns in this area have been fraught with symbolic political concerns.[299] However, to the extent that Congress sought to make a symbolic statement in the AJCA by purporting to heighten the tax consequences of renouncing citizenship, its approach might have backfired. In particular, to the extent potential expatriates perceive that the new provisions are unenforceable, they might be encouraged to expatriate. Moreover, to the extent the general public perceives that Congress has enacted unenforceable legislation, the public's respect for the tax system, and desire to comply, might be undermined.[300]

V. CONCLUSION

Under U.S. tax law, significant tax burdens are imposed on U.S. citizens. The worldwide taxation of U.S. citizens traditionally has been justified

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[296] *See supra* notes 249–276 and accompanying text.

[297] This potential lack of court jurisdiction to adjudicate should be distinguished from the lack of legislative jurisdiction to prescribe, which is the focus of this Article. *See* RESTATEMENT (THIRD) OF THE FOREIGN RELATIONS LAW OF THE UNITED STATES pt. IV, intro. note; *see also* Hartford Fire Ins. Co. v. California, 509 U.S. 764, 813–14 (1993) (Scalia, J., dissenting).

[298] *See* RESTATEMENT (THIRD) OF THE FOREIGN RELATIONS LAW OF THE UNITED STATES § 483 (1987). Although the foreign country might have discretion to enforce a U.S. court judgment regarding collection, *see id.* cmt. a, given the AJCA provisions' jurisdictional overreach, it is highly doubtful that a foreign country would exercise such discretion.

[299] *See generally* Kirsch, *supra* note 12 (discussing symbolic aspects of 1996 legislation).

[300] *Id.* at 917 (citing studies regarding social norms and tax compliance). These potential problems illustrate the observation by a commentator in another context that a "nation has little to gain from attempting to levy on property, taxpayers, or activities that are beyond the limits of the nation's enforcement power." Robert L. Palmer, *Toward Unilateral Coherence in Determining Jurisdiction to Tax Income*, 30 HARV. INT'L L.J. 1, 4 (1989).

based on the important link between the rights and obligations of citizenship. Merely calling a person a citizen for tax purposes does not necessarily justify imposing the same significant tax consequences that attach to "real" citizens.

This Article demonstrates the significant problems that arise under customary international law and the U.S. Constitution when the term "citizen" is separated from its conceptual underpinnings. In particular, in certain situations the treatment of an individual as a citizen for tax purposes after she has lost citizenship for nationality law purposes violates the prescriptive jurisdictional limitations of customary international law and raises significant questions regarding the statute's constitutionality, both with respect to Congress's Article I power to enact the tax and with respect to Fifth Amendment due process. Even to the extent the provisions are constitutional, they might create conflicts with U.S. tax treaty partners and undermine respect for international law in the tax field. Moreover, they ultimately may be of little practical benefit to the United States, given the significant enforcement difficulties they create.

Assuming that Congress continues to believe that renunciation of citizenship necessitates a targeted response,[301] Congress should reconsider the special tax definitions of citizenship enacted by AJCA. To the extent Congress is concerned with the Department of State's administrative procedures and evidentiary standards for determining when citizenship is lost, it should consider the possibility of revising relevant aspects of the Immigration and Nationality Act.[302] To the extent it is concerned with tax-motivated former citizens re-entering the United States for significant periods, it should consider amending relevant 1996 immigration law provisions to make them properly targeted and enforceable.[303] Regardless of which, if any, alternative approaches are enacted to address tax-motivated expatriation,[304] the definition of citizenship in regards to tax should be returned to its historic roots in the nationality law.

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[301] While it is unlikely that any significant number of elected officials would take the position that the tax code should not contain special rules targeting tax-motivated expatriates, well-reasoned arguments for that position have been advocated by Professor Alice Abreu. *See* Alice G. Abreu, *Taxing Exits*, 29 U.C. DAVIS L. REV. 1087, 1158 (1996) (arguing that individuals should be able to weigh the value of U.S. citizenship against the tax benefits of expatriation and act accordingly).

[302] For example, in 1995 the Clinton administration proposed a Department of State-initiated Consular Efficiency Act, which would have provided that an individual could lose citizenship under the nationality laws only by taking an oath of renunciation before a U.S. consular official, with loss of citizenship effective as of the date of the oath. *See* TREASURY REPORT, *supra* note 46, at 35.

[303] The 1996 immigration provisions (the Reed Amendment) are summarized *supra* note 62; *see also* Kirsch, *supra* note 12, at 935–36 (outlining a proposal for narrowly targeting the Reed Amendment in an enforceable way).

[304] The other significant proposal frequently considered in this area involves a mark-to-market approach, where an expatriate is treated for tax purposes as having sold all her assets on the date of her citizenship loss and, thereafter, she is treated as any other nonresident alien. *See also* Andrew Walker, *The Tax Regime for Individual Expatriates: Whom to Im-*

The analysis set forth in this Article also has broader implication beyond its application to the new AJCA provisions. In a world of increased individual mobility, Congress may have future occasion to consider the extent to which it will assert taxing jurisdiction over individuals with only limited connections to the United States. The constitutional and international law limitations addressed herein deserve attention in any such legislative action.

press?, 58 TAX LAW. 555, 562 (2005) (proposing a departure wealth tax based on the estate tax). *See generally* Kirsch, *supra* note 12, at 883–86 (describing mark-to-market proposals).

ARTICLE

THE CHALLENGE OF COMPANY STOCK TRANSACTIONS FOR DIRECTORS' DUTIES OF LOYALTY

DANA M. MUIR*
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This Article explores the intersection of state and federal law in defining corporate directors' duties of loyalty to shareholders and obligations to 401(k) plan beneficiaries. Part I describes the duty of loyalty in trust law, upon which loyalty obligations in state corporate law and federal ERISA law are based. Part II explores the evolving role of the duty of loyalty in Delaware corporate law. Part III analyzes the loyalty obligations that the ERISA law imposes and examines the application of loyalty principles in 401(k) employer stock litigation. Part IV scrutinizes how Delaware jurisprudence and ERISA law diverge and argues that enhanced scrutiny should apply to transactions in which fiduciaries suffer from a "substantial lack of independence." The authors argue that limiting enhanced scrutiny to situations of self-dealing in the transaction itself fails to properly protect shareholders and conclude that their proposal offers increased flexibility and effectiveness in protecting beneficiaries and shareholders from self-interested fiduciaries.

Seventy-seven years have passed since Justice Cardozo, while serving as Chief Judge of the New York Court of Appeals, opined that joint adventurers owe one another "the duty of the finest loyalty."[1] He described this standard with the famous phrase: "A trustee is held to something stricter than the morals of the market place. Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior."[2]

One might logically expect the elapsed years and the wealth of state corporate law litigation to have defined any remaining contours in corporate directors' duties of loyalty. Such logic, however, is not justified in this instance. In a recent opinion, which has become well known for other reasons,[3] the Delaware Chancery Court recognized that "the Delaware Supreme

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[1] Meinhard v. Salmon, 164 N.E. 545, 546 (N.Y. 1928).

[2] *Id.*

[3] *In re* Emerging Commc'ns, Inc. S'holders Litig., No. 16415, 2004 Del. Ch. LEXIS 70 (Del. Ch. June 4, 2004). The case is best known because one director with substantial expertise in finance and the telecommunications sector was held, at least in part because of that expertise, to have violated his duty to shareholders. *See* Harvey L. Pitt, *The Changing Standards by Which Directors Will Be Judged*, 79 ST. JOHN'S L. REV. 1, 3–5 (2005); E. Norman Veasey, *Musings from the Center of the Corporate Universe*, 7 DEL. L. REV. 163, 172 (2004).

Court has yet to articulate the precise differentiation between the duties of loyalty and of good faith."[4] This contributed to a debate about the role of good faith in Delaware corporate law. In *In re Walt Disney Company Derivative Litigation* (*Disney II*), however, the chancery court stated that "[i]t does no service to our law's clarity to continue to separate the duty of loyalty from its essence; nor does the recognition that good faith is essential to loyalty demean or subordinate that essential requirement."[5]

One of the areas where corporate directors' duties of loyalty are most important, as well as most complex, is in the context of transactions in company stock. Those transactions might involve a going private transaction,[6] which have become more frequent in the more intense regulatory environment of the post-Sarbanes-Oxley Act[7] period; a freeze-out merger;[8] or use of employer stock in 401(k) plans.

At the same time that Delaware law on directors' fiduciary duty of loyalty has come under scrutiny, directors increasingly face fiduciary litigation under the Employee Retirement Income Security Act of 1974 (ERISA).[9] In one category of such cases, the "ERISA employer stock" cases, the plaintiffs typically allege that directors breached their fiduciary duty of loyalty vis-à-vis the employees' investment in company stock where the investment was made through employer-sponsored benefit plans.[10] The scope of directors' fiduciary obligations in those cases has become the subject of considerable litigation.[11]

In this Article we consider the developing standards of loyalty governing director conduct and the tension between state and federal laws. Part I describes the fiduciary duty of loyalty in trust law, upon which loyalty obligations in state corporate law and fiduciary standards in 401(k) regulations are based. Part II explains how the business judgment rule and exculpatory provisions often protect corporate directors from liability, thereby establishing the duty of loyalty as a critical principle in protecting the capital structure of corporations. The Part then evaluates the duty of loyalty imposed on directors by Delaware corporate law with special emphasis on the chancery court's opinions in *Disney II* and *In re Emerging Communications, Inc. Shareholders Litigation* (*ECM*).[12] It concludes that the *Disney II* court appropriately utilized a rigorous loyalty analysis. In com-

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[4] *Emerging Commc'ns*, 2004 Del. Ch. LEXIS 70, at *142 n.184.

[5] *In re* Walt Disney Co. Derivative Litig. (*Disney II*), No. 15452, 2005 Del. Ch. LEXIS 113, at *169 n.447 (Del. Ch. Aug. 9, 2005).

[6] *See Emerging Commc'ns*, 2004 Del. Ch. LEXIS 70.

[7] Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (codified as amended in scattered sections of 11 U.S.C., 15 U.S.C., 18 U.S.C., and other titles (2000)).

[8] *See* Cinerama, Inc. v. Technicolor, Inc., 663 A.2d 1156 (Del. 1995).

[9] Employee Retirement Income Security Act (ERISA) of 1974 §§ 1–4402, 29 U.S.C. §§ 1001–1461 (2000).

[10] *See infra* notes 175–187 and accompanying text.

[11] *See infra* notes 175–187 and accompanying text.

[12] *Disney II*, 2005 Del. Ch. LEXIS 113; *Emerging Commc'ns*, 2004 Del. Ch. LEXIS 70.

parison, the *ECM* court signaled an analysis that may set an inappropriately arbitrary standard.

Part III analyzes the fiduciary loyalty obligations imposed by ERISA. Although ERISA's fiduciary scheme draws upon trust law, it is complicated by provisions permitting conflicted fiduciaries and limiting fiduciary obligations to decisions made as a fiduciary as opposed to decisions made in a nonfiduciary role. Part III then examines the application of loyalty principles in the specific context of the 401(k) employer stock litigation. Breach of loyalty allegations surface in the context of claims that plan fiduciaries failed to terminate the use of company stock in the plan or permit the plan participants to diversify their investments, failed to properly appoint or monitor other plan fiduciaries, or failed to fully and honestly disclose important facts.[13]

Part IV scrutinizes the significant ways in which the duty of loyalty jurisprudence in Delaware corporate law diverges from the federal law of ERISA. Part IV argues that corporate law transactions should receive enhanced scrutiny when the relevant fiduciaries operate under a substantial lack of independence. Additional limitations on fiduciary review, such as the *ECM* court's indication that only self-dealing in the transaction itself can give rise to a breach of loyalty, would fail to protect shareholders from self-interested fiduciaries. The ERISA fiduciary standards are less well-developed than the corporate law standards and must accommodate some level of self-interest because of the statutory provision for conflicted fiduciaries. However, permitting corporate officers and other individuals with ties to the plan sponsor to serve as fiduciaries should not nullify ERISA's imposition of the duty of loyalty. As is true in corporate law settings, a substantial lack of independence by plan fiduciaries poses a serious risk of self-interested decisionmaking. We conclude that both Delaware corporate law and federal law, under ERISA,[14] must continue to give serious and flexible content to the fiduciary duty of loyalty.

I. TRUST LAW AS THE SOURCE OF THE FIDUCIARY DUTY OF LOYALTY

Both state corporate law and federal employee benefit plan law have relied on trust law in shaping their development of fiduciary obligations. Trust law provides that a trustee must act "solely in the interest of the [trust]."[15] In situations where there are multiple current beneficiaries, the

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[13] *See infra* notes 175–187 and accompanying text.

[14] 29 U.S.C. §§ 1001–1461.

[15] RESTATEMENT (SECOND) OF TRUSTS § 170(1) (1959). Trust law imposes an array of other obligations on trustees in addition to loyalty. *See* Dana M. Muir, *Fiduciary Status As an Employer's Shield: The Perversity of ERISA Fiduciary Law*, 2 U. PA. J. LAB. & EMP. L. 391, 396 (2000).

trustee must be impartial among those beneficiaries.[16] Similar obligations arise when the trust provides for successive beneficiaries.[17]

Historically, trustees have been subject to harsh conflict of interest standards. When a fiduciary acts in a transaction in which her personal interest conflicts with the beneficiary's interest, the basic rule is to conclusively presume the transaction to be invalid.[18] This presumption is intended to reflect the assumption that a trustee acting under the temptations inherent in a conflict of interest will all too often neglect the best interests of the beneficiary.[19]

Given both the draconian nature of trust law's conclusive presumption and the changing nature of trusts and trustees, it is not surprising that exceptions permit specific categories of interested transactions.[20] Professor John Langbein recently questioned this approach, suggesting instead that the presumption of invalidity should remain but that it should be rebuttable.[21] He would permit a trustee to defend a breach of loyalty allegation by proving that the transaction was in the beneficiary's best interest.[22]

II. CORPORATE LAW FIDUCIARY STANDARDS

The concept of fiduciary duty, as applied to corporate officers and directors, is a significant part of corporate law jurisprudence.[23] The most salient duties are the duties of care and loyalty,[24] which are sometimes dis-

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[16] RESTATEMENT (SECOND) OF TRUSTS, *supra* note 15, § 183 ("When there are two or more beneficiaries of a trust, the trustee is under a duty to deal impartially with them.").

[17] John H. Langbein, *Questioning the Trust Law Duty of Loyalty: Sole Interest or Best Interest?*, 114 YALE L.J. 929, 938–39 (2005).

[18] *Id.* at 931.

[19] *Id.* at 934.

[20] *Id.* at 963–79 (describing the three exclusions to the sole interest rule: settlor authorization, beneficiary consent, and advance judicial approval).

[21] *Id.* at 933–34.

[22] Langbein, *supra* note 17, at 933–34.

[23] *See, e.g.*, Omnicare, Inc. v. NCS Healthcare, Inc., 818 A.2d 914, 931 (Del. 2003); Paramount Commc'ns Inc. v. QVC Network, Inc., 637 A.2d 34, 43 (Del. 1994); Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173 (Del. 1986); Smith v. Van Gorkom, 488 A.2d 858, 872 (Del. 1985); Alessi v. Beracha, 849 A.2d 939, 950 (Del. Ch. 2004) ("[F]iduciary duties are owed by the directors and officers to the corporation and its stockholders." (quoting Arnold v. Soc'y for Sav. Bancorp, 678 A.2d 533, 539 (Del. 1996)); Dennis v. Copelin, 669 So. 2d 556, 560 (La. App. 4 Cir. 1996); Chambers v. Beaver-Advance Corp., 392 Pa. 481, 486 (1958); Victor Brudney, *Contract and Fiduciary Duty in Corporate Law*, 38 B.C. L. REV. 595, 595 (1997); *see also* WILLIAM E. KNEPPER ET AL., LIABILITY OF CORPORATE OFFICERS AND DIRECTORS § 1.07 (7th ed. 2003); J. C. SHEPHERD, THE LAW OF FIDUCIARIES (1981); Michael Bradley & Cindy A. Schipani, *The Relevance of the Duty of Care Standard in Corporate Governance*, 75 IOWA L. REV. 1 (1989); D. Kyle Sampson, *The Fiduciary Duties of Corporate Directors to "Phantom" Stockholders*, 62 U. CHI. L. REV. 1275, 1276 (1995). *But see* John C. Carter, *The Fiduciary Rights of Shareholders*, 29 WM. & MARY L. REV. 823, 824 (1988) ("Although courts commonly speak of a fiduciary duty of directors to the corporation and its shareholders, one is hard pressed to find a case in which directors are held directly liable to shareholders, absent circumstances that create a special relationship.").

[24] One of the earliest cases discussing the duty of care in the United States is Percy v.

tinguished from the obligation to act in good faith.[25] This Part examines these duties in light of the decisions in *ECM* and *Disney II*.

A. The Duty of Care

Although the duty of care imposes upon directors an affirmative duty to use reasonable care under the circumstances in making corporate decisions, historically, relatively few cases have held directors personally liable for breach of due care.[26] Prior to 1987, the most likely reason for the paucity of cases was the courts' regular application of the business judgment rule. Under the business judgment rule, courts will presume that "in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company."[27] Where the presumptions of the business judgment rule apply, courts have been loath to second guess business decisions. In order to qualify for business judgment rule protections, the directors must have acted in good faith and in the best interest of the corporation without breaching the duty of loyalty.[28]

In 1986, Delaware adopted Section 102(b)(7) of the Delaware Code to provide that corporations may limit or eliminate the potential liability of corporate directors for breach of the duty of care by including an exculpatory provision in the company's articles of incorporation.[29] Nearly

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Millaudon, 8 Mart. (n.s.) 68, 74–75 (La. 1829).

[25] *See infra* notes 171–174 and accompanying text for a discussion of the obligation of good faith.

[26] *See, e.g.*, Joseph W. Bishop, Jr., *Sitting Ducks and Decoy Ducks: New Trends in the Indemnification of Corporate Directors and Officers*, 77 YALE L.J. 1078, 1099–1100 (1968) (finding only four such cases); Stuart R. Cohn, *Demise of the Director's Duty of Care: Judicial Avoidance of Standards and Sanctions Through the Business Judgment Rule*, 62 TEX. L. REV. 591, 592 n.2 (1983) (finding only six cases in which directors of industrial corporations had been held liable to a standard of negligence); *see also* Henry Ridgely Horsey, *The Duty of Care Component of the Delaware Business Judgment Rule*, 19 DEL. J. CORP. L. 971 (1994) (tracing the development of the duty of care in Delaware).

[27] Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984).

[28] *See* Joseph Hinsey IV, *Business Judgment and The American Law Institute's Corporate Governance Project: The Rule, the Doctrine, and the Reality*, 52 GEO. WASH. L. REV. 609, 610 (1984).

[29] Section 102(b)(7) of the Delaware Code provides that the articles of incorporation may include:

> A provision eliminating or limiting the personal liability of a director to the corporation or its stockholders for monetary damages for breach of fiduciary duty as a director, provided that such provision shall not eliminate or limit the liability of a director: (i) for any breach of the director's duty of loyalty to the corporation or its stockholders; (ii) for acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law; (iii) under § 174 of this title; or (iv) for any transaction from which the director derived an improper personal benefit.

DEL. CODE ANN. tit. 8, § 102(b)(7) (2001).

all states have followed suit and have adopted similar legislation.[30] Thus, post-1986, not only are directors protected from liability through the business judgment rule jurisprudence, but they are also protected by the 102(b)(7)-type exculpation provided in the articles of incorporation of the firms they serve.

The Delaware Chancery Court discussed the duty of care in its recent decisions regarding the activities of the board of directors of The Walt Disney Company. In May 2003, the Delaware Chancery Court, *In re Walt Disney Co.*, denied a motion to dismiss the claims against the directors of The Walt Disney Company alleging lack of good faith and breach of due care regarding the board's approval of an employment agreement.[31] An earlier complaint was dismissed in *Brehm v. Eisner*,[32] because the complaint did not allege sufficient facts to overcome the presumption of the business judgment rule. The later complaint alleged that the "defendant directors consciously and intentionally disregarded their responsibilities."[33] The court let the claim stand for a determination whether the board "exercised any business judgment or made any good faith attempt to fulfill the fiduciary duties they owed to Disney and its shareholders."[34]

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[30] The following statutes are similar to Section 102(b)(7) in Delaware: ALA. CODE. § 10-2B-2.02(3) (1999); ALASKA STAT. § 10.06.210(1)(N) (2004); ARIZ. REV. STAT. ANN. § 10-202(B) (2004); ARK. CODE ANN. § 4-27-202(b)(3) (2001); CAL. CORP. CODE § 204(a)(10) (Deering 2003); GA. CODE ANN. § 14-2-202(b)(4) (2003); IDAHO CODE § 30-1-202(2)(d) (2005); 805 ILL. COMP. STAT. 5/2.10(b)(3) (2004); IOWA CODE ANN. § 490.202(d) (West Supp. 2005); KAN. CORP. CODE ANN. § 17-6002(b)(8) (West Supp. 2005); KY. REV. STAT. ANN. § 271B.2-020(2)(d) (West 2003); LA. REV. STAT. ANN. § 12:24(c)(4) (1994 & Supp. 2006); MASS. GEN. LAWS ch. 156B, § 13(b)(1 ½) (2005); MICH. COMP. LAWS § 450.1209(c) (2002); MINN. STAT. § 302A.251(4) (2004); MISS. CODE ANN. § 79-4-2.02(b)(4) (West 1999); MO. REV. STAT. § 351.055(2)(3) (Supp. 2004); MONT. CODE ANN. § 35-1-216(2)(d) (2005); NEB. REV. STAT. § 21-2018(2)(d) (1997); N.M. STAT. § 53-12-2(E) (Supp. 2003); N.Y. BUS. CORP. LAW § 402(b) (McKinney 2003); N.C. GEN. STAT. § 55-2-02(b)(3) (2005); N.D. CENT. CODE § 10-19.1-50(5) (2001); OKLA. STAT. ANN. tit. 18, § 1006(B)(7) (West 1999 and Supp. 2006); OR. REV. STAT. § 60.047(2)(d) (2003); R.I. GEN LAWS § 7-1.2-202(b)(3) (Supp. 2005); S.C. CODE ANN. § 33-2-102(e) (1990); S.D. CODIFIED LAWS § 47-2-58.8 (2000); TENN. CODE. ANN. § 48-12-102(b)(3) (2002); TEX. REV. CIV. STAT. ANN. art. 1302-7.06, § B (Vernon 2003); VT. STAT. ANN. tit. 11A, § 2.02(b)(4) (1997); W. VA. CODE ANN. § 31D-2-202(4) (LexisNexis 2003); WYO. STAT. ANN. § 17-16-202(b)(iv) (2005). The following statutes also provide liability protection for officers: LA. REV. STAT. ANN. § 12:24(C)(4) (1994 & Supp. 2006); ME. REV. STAT. ANN. tit. 13-C, § 202(2)(D) (2005); MD. CODE ANN., CORPS. & ASS'NS § 2-405.2 (LexisNexis 1999); NEV. REV. STAT. § 78.138(7) (2003); N.H. REV. STAT. ANN. § 292:2(V-a) (1999); N.J. STAT. ANN. § 14A:2-7(3) (West 2003); VA. CODE ANN. § 13.1-692.1 (1999). Exculpation is provided automatically by FLA. STAT. § 607.0831 (2005); IND. CODE § 23-1-35-1(e) (1998); OHIO REV. CODE ANN. § 1701.59(c) (West 1994 & Supp. 2004). Wisconsin automatically provides for exculpation, unless the corporation provides otherwise. WIS. STAT. § 180.0828 (2003-04). The following statutes permit exculpatory language in the corporate bylaws. HAW. REV. STAT. ANN § 414-32(5) (LexisNexis 2004); UTAH CODE ANN. § 16-10a-841(1) (2005); VA. CODE ANN. § 13.1-692.1 (1999).

[31] *In re* Walt Disney Co. Derivative Litig. (*Disney I*), 825 A.2d 275, 291 (Del. Ch. 2003).

[32] 746 A.2d 244, 248 (Del. 2000).

[33] *Disney I*, 825 A.2d. at 289 (emphasis omitted).

[34] *Id.* at 287.

After a trial on the merits, the Delaware Chancery Court in *Disney II*[35] found that the directors were not liable for breach of any fiduciary duty. The court stated that duty of care requires the directors to "use the amount of care which ordinarily careful and prudent men would use in similar circumstances"[36] and to "consider all material information reasonably available."[37] The court noted that liability may arise either from a negligent board decision or failure to pay due attention.[38] Despite that seemingly broad base for liability, *Disney II* emphasized that the threshold to prove a breach of care is very high due to the business judgment rule.[39] According to the court, as long as a director has acted in good faith, the director "should be deemed to satisfy fully the duty of attention."[40] In order to recover for a violation of this duty, a plaintiff must show a lack of good faith as evidenced by systematic failure to exercise reasonable oversight.[41] Although the court recognized that the actions of the director defendants "fell significantly short of the best practices of ideal corporate governance,"[42] the court concluded that Delaware law does not hold them liable for failure to comply with the "aspirational ideal of best practices."[43]

Thus, between the protections afforded by the business judgment rule and the exculpatory legislation adopted by most states, the duty of care analysis appears to turn on the exceptions to the business judgment rule, violations of loyalty or good faith. Neither business judgment rule protection nor exculpation is available for acts in violation of the duty of loyalty or lacking in good faith. Because liability does not attach for negligent or grossly negligent violations of due care, claims regarding breach of loyalty or lack of good faith take on added significance. These issues were at the forefront of the plaintiffs' claims in *Disney II*[44] and *In re Emerging Communications, Inc. Shareholders Litigation.*[45]

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[35] *In re* Walt Disney Co. Derivative Litig. (*Disney II*), No. 15452, 2005 Del. Ch. LEXIS 113, at *245 (Del. Ch. Aug. 9, 2005).

[36] *Id.* at *158 (quoting Graham v. Allis-Chalmers Mfg. Co., 188 A.2d 125, 130 (Del. 1963)).

[37] *Id.* (quoting Brehm v. Eisner, 746 A.2d 244, 259 (Del. 2000)).

[38] *Id.* at *159.

[39] *Id.* at *176.

[40] *Disney II*, 2005 Del. Ch. LEXIS 113, at *160 (quoting *In re* Caremark Int'l Inc. Derivative Litig., 698 A.2d 959, 967–68 (Del. Ch. 1996) (citations, emphasis and footnotes omitted)).

[41] *Id.* at *161.

[42] *Id.* at *3.

[43] *Id.* at *4.

[44] *Id.*

[45] No. 16415, 2004 Del. Ch. LEXIS 70 (Del. Ch. June 4, 2004).

B. The Duty of Loyalty

As discussed above, the fiduciary duties in corporate law, including the duty of loyalty, have their genesis in the law of trusts.[46] This relationship exists between trustees and their beneficiaries and between agents and their principals.[47] A fiduciary relationship exists "when one is given power that carries a duty to use that power to benefit another."[48] Although corporate officers and directors as fiduciaries are not formally considered trustees of the organizations they serve,[49] corporate law analogizes to the fiduciary obligations of trustees when determining the scope of corporate fiduciary duties.[50]

The duty of loyalty requires corporate officers and directors to refrain from using their corporate position of trust and confidence for their own benefit.[51] It has thus become well-established in corporate law that a conflict of interest will trigger a duty of loyalty analysis.[52] Loyalty "re-

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[46] *See, e.g.*, Horsey, *supra* note 26, at 973; Edward Rock & Michael Wachter, *Dangerous Liaisons: Corporate Law, Trust Law, and Interdoctrinal Legal Transplants*, 96 NW. U. L. REV. 651, 651 (2002); L. S. Sealy, *Fiduciary Relationships*, 1962 CAMBRIDGE L.J. 69, 70 (1962); Joseph T. Walsh, *The Fiduciary Foundation of Corporate Law*, 27 J. CORP. L. 333 (2002).

[47] *See* SHEPHERD, *supra* note 23, at 98.

[48] RESTATEMENT (SECOND) OF TRUSTS, *supra* note 15, § 2 cmt. b.

[49] *See* Sealy, *supra* note 46, at 71–72 ("The word fiduciary (which earlier had received very little judicial support) was adopted to describe these situations which fell short of the now strictly-defined trust." (footnote omitted)); *see also* Walsh, *supra* note 46, at 334.

[50] *See* Horsey, *supra* note 26, at 974; Walsh, *supra* note 46, at 334.

[51] *See* Cede & Co. v. Technicolor, Inc., 634 A.2d 345, 361 (Del. 1993) ("Corporate officers and directors are not permitted to use their position of trust and confidence to further their private interests." (quoting Guth v. Loft, Inc., 5 A.2d 503, 510 (Del. 1939))); *see also* Ivanhoe Partners v. Newmont Mining Corp., 535 A.2d 1334, 1345 (Del. 1987) ("[D]irectors must eschew any conflict between duty and self-interest."); Walsh, *supra* note 46, at 334. Most states have codified the duty of loyalty. *See* ALA. CODE § 10-2B-8.30 (2004); ALASKA STAT. § 10.06.450 (2004); ARIZ. REV. STAT. ANN. § 10-830 (2004); CAL. CORP. CODE § 309 (Deering 2004); CONN. GEN. STAT. § 33-756 (2003); FLA. STAT. ANN. § 607.0830 (West 2003); GA. CODE ANN. § 14-2-830 (2004); HAW. REV. STAT. ANN. § 414-221 (LexisNexis 2003); IOWA CODE § 490.830 (2003); KY. REV. STAT. ANN. § 271B.8-300 (LexisNexis 2004); ME. REV. STAT. ANN. tit. 13-C, § 831 (2003); MD. CODE ANN., CORPS. & ASS'NS § 2-405.1 (LexisNexis 2003); MASS. GEN. LAWS ANN. ch. 156B, § 65 (West 2004); MICH. COMP. LAWS § 450.1541a (2004); MINN. STAT. ANN. § 302A.251 (West 2003); MISS. CODE ANN. § 79-4-8.42 (2004); MONT. CODE ANN. § 35-2-441 (2004); N.H. REV. STAT. ANN. § 293-A:8.30 (2004); N.M. STAT. ANN. § 53-4-18.1 (LexisNexis 2004); N.C. GEN. STAT. § 55-8-30 (2004); N.D. CENT. CODE § 10-19.1-50 (2003); OHIO REV. CODE ANN. § 1701.59 (LexisNexis 2004); OR. REV. STAT. § 60.357 (2003); 15 PA. CONS. STAT. § 1712 (2004); R.I. GEN. LAWS § 7-1.1-33 (2004); S.C. CODE ANN. § 33-8-300 (2003); TENN. CODE ANN. § 48-18-301 (2003); VA. CODE ANN. § 13.1-690 (2004); WASH. REV. CODE ANN. § 23B.08.300 (West 2004); W. VA. CODE ANN. § 31D-8-830 (LexisNexis 2003); WYO. STAT. ANN. § 17-16-830 (2003).

[52] *See, e.g.*, Continuing Creditors' Comm. of Star Telecommc'ns Inc. v. Edgecomb, 385 F. Supp. 2d 449, 460 (D. Del. 2004) (Plaintiff must "plead facts demonstrating that a majority of a board that approved the transaction in dispute was interested and/or lacked independence" (quoting Orman v. Cullman, 794 A.2d 5, 23 (Del. Ch. 2002))); McMillan v. Intercargo Corp., 768 A.2d 492 (Del. Ch. 2000) (granting defendant's motion for judgment on the pleadings because plaintiffs failed to meet burden showing bad faith or self-dealing); *In*

quires [that] officers and directors not profit at the expense of their corporation . . . ."[53] In *Guth v. Loft, Inc.*,[54] the Delaware Supreme Court analogized to the law of trusts in finding the president and director liable for breach of the duty of loyalty for taking personal advantage of an opportunity that came to him because of his position in the corporation.[55] The court said that a director is obligated to "affirmatively . . . protect the interests of the corporation committed to his charge."[56] More recently, the Delaware Chancery Court in *Disney II*[57] reaffirmed this obligation. Quoting *Guth*, *Disney II* stated that "[c]orporate officers and directors are not permitted to use their position of trust and confidence to further their private interests . . . . The rule that requires an undivided and unselfish loyalty to the corporation demands that there be no conflict between duty and self-interest."[58] *Disney II* then found that there is no safe harbor for divided loyalties, citing the classic example of a transaction where a fiduciary appears on both sides and derives a benefit not shared by other shareholders.[59]

Yet, although the duty of loyalty requires the "punctilio of an honor the most sensitive,"[60] conflicts of interest do not automatically give rise to breach. However, when a transaction gives rise to a conflict of interest between members of the board and the corporation, the presumptions of the business judgment rule or of § 102(b)(7)-type exculpatory provisions no longer apply to protect the business decisions of the board members.[61] If the conflict in a transaction is disclosed and disinterested members of the board approve the transaction, there will generally be no cause for liability.[62] If a transaction is contested because the decision was not made by a disinterested board, a court will likely evaluate the transaction substantively for fairness.[63]

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re Gaylord Container Corp. S'holders Litig., 753 A.2d 462, 476 (Del. Ch. 2000) (finding that a breach of loyalty may be committed either by self-interested actions or actions of bad faith).

[53] JOEL SELIGMAN, CORPORATIONS: CASES AND MATERIALS 415 (1995).

[54] 5 A.2d 503.

[55] *Id.* at 510.

[56] *Id.*

[57] *Disney II*, No. 15452, 2005 Del. Ch. LEXIS 113 (Del. Ch. Aug. 9, 2005).

[58] *Id.* at *163–64 (quoting *Guth*, 5 A.2d at 510).

[59] *Id.* at *164. (citing Weinberger v. UOP, Inc., 457 A.2d 701 (Del. 1983)).

[60] Meinhard v. Salmon, 164 N.E. 545, 546 (N.Y. 1928).

[61] *See, e.g.*, Cinerama, Inc. v. Technicolor, Inc., 663 A.2d 1134 (Del. Ch. 1994).

[62] Stegemeier v. Magness, 728 A.2d 557, 562 (Del. 1999) ("The absolute prohibition under common law against self-dealing by a trustee has been modified in the corporate setting to offer a safe harbor for the directors of a corporation if the transaction is approved by a majority of disinterested directors."); Schock v. Nash, 732 A.2d 217, 225 n.21 (Del. 1999) ("The statute . . . provide[s] corporate directors with a safe harbor from allegations of self-dealing if the transaction is approved by a majority of the informed and disinterested directors . . . ."); *see also* Oberly v. Kirby, 592 A.2d 445, 466 (Del. 1991) ("[S]ection 144 [of the Delaware Code] allows a committee of disinterested directors to approve a transaction and bring it within the scope of the business judgment rule.").

[63] *Stegemeier*, 728 A.2d at 562 ("If . . . the transaction is not approved by the requisite

Fairness issues come to the fore in the context of claims made by minority shareholders regarding the unfairness of a freeze-out merger. In these cases, the courts shift the burden of proof of fairness to the defendants who approved the transaction. For example, the fairness standard was applied by the court in *Cinerama, Inc. v. Technicolor, Inc.*,[64] where the plaintiff alleged that the defendant directors violated their duty of loyalty in approving a merger. The court held that the burden of proof shifted to the directors to prove the entire fairness of the transaction because the business judgment rule had been rebutted. The court stated that in assessing the entire fairness of a transaction, "the court must consider the process itself that the board followed, the quality of the result it achieved and the quality of the disclosures made to the shareholders to allow them to exercise such choice as the circumstances could provide."[65] The court affirmed the decision of the lower court, holding that its use of a disciplined balancing test in determining fairness and credibility would not be disturbed.[66]

Similarly, in *Roland International Corp. v. Najjar*,[67] the court held that "even when a parent corporation has a *bona fide* purpose for merging with its subsidiary, the minority shareholders of the subsidiary are entitled to judicial review for 'entire fairness' as to all aspects of the transaction." The Delaware courts thus recognize the special conflicts that may arise in transactions between majority and minority shareholders.[68]

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number of disinterested directors, the directors must prove that the transaction was entirely fair."); *see also Oberly*, 592 A.2d at 466–67 ("[W]here an independent committee is not available, the stockholders may either ratify the transaction or challenge its fairness in a judicial forum . . . . When a challenge to fairness is raised, the directors carry the burden of 'establishing . . . entire fairness.'" (citations omitted) (quoting *Weinberger*, 457 A.2d at 710)); President & Fellows of Harvard Coll. v. Glancy, No. 18790, 2003 Del. Ch. LEXIS 25, at *69 (2003) (Del. Ch. Mar. 21, 2003) ("To invoke the entire fairness standard of review, a complaint must 'allege facts as to the interest and lack of independence of the *individual members* of [the] board.'" (quoting Orman v. Cullman, 794 A.2d 5, 22 (Del. Ch. 2002))).

[64] 663 A.2d 1134 (Del. Ch. 1994).

[65] *Id.* at 1140.

[66] *Id.*; *see also* Mills Acquisition Co. v. Macmillan, Inc., 559 A.2d 1261, 1279 (Del. 1989) ("[B]ecause the effect of the proper invocation of the business judgment rule is so powerful and the standard of entire fairness so exacting, the determination of the appropriate standard of judicial review frequently is determinative of the outcome of derivative litigation." (quoting AC Acquisitions v. Anderson, Clayton & Co., 519 A.2d 103, 111 (Del. Ch. 1986))).

[67] 407 A.2d 1032, 1034 (Del. 1979).

[68] *Id.* at 1035 ("In other words, the fiduciary duty exists even if the majority has a bona fide purpose for eliminating the minority; in that case, the duty of the majority is to treat the minority fairly.").

1. Duty of Loyalty and/or Good Faith: In re Emerging Communications, Inc. Shareholders Litigation

In *In re Emerging Communications, Inc. Shareholders Litigation ("ECM")*,[69] the Delaware Chancery Court recently considered allegations of breach of the duties of care, loyalty, and good faith in connection with a board's decision to sell a company in a going-private transaction. The *ECM* plaintiffs were former minority shareholders of Emerging Communications, Inc. (ECM) who sold their stock to Innovative Communications Corporation (Innovative) in a two-step transaction designed to take ECM private.[70] Innovative was owned by Innovative Communication Company (ICC), which was also a majority shareholder of ECM. ICC in turn was owned by ECM's Chairman and Chief Executive Officer, Jeffrey Prosser, who thus had voting control over both ECM and Innovative. The plaintiffs filed actions requesting a statutory appraisal of the value of the shares sold and claiming in a class action that the transaction was not entirely fair to the ECM minority shareholders and thus was in breach of the directors' fiduciary duties.[71] The court consolidated the claims.[72]

In considering the claim of breach of fiduciary duty, the court cited the Delaware Supreme Court decision in *Emerald Partners v. Berlin*[73] and determined that analysis of a "going private" transaction and the liability of the fiduciaries requires application of the entire fairness standard.[74] This standard considers both fair dealing and fair price.[75]

The court first made a determination of the fairness of the price paid for the shares.[76] After a lengthy financial analysis, the court rejected the defendants' claim that the price was fair, holding that the $10.25 price paid to the minority shareholders represented neither the fair value nor the intrinsic value at the time of the merger.[77] Instead, the court determined that the fair value at the time of the transaction was $38.05 per share.[78]

Once the court determined that the price was unfair, the question became whether a fair dealing analysis was necessary.[79] The chancery court noted that Delaware law had not yet determined whether an unfair price establishes "*ipso facto*, the unfairness of the merger, thereby obviating the need for any analysis of the process oriented issues."[80] The court found,

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[69] No. 16415, 2004 Del Ch. LEXIS 70, at *2 (Del. Ch. June 4, 2004).
[70] *Id.*
[71] *Id.* at *35.
[72] *Id.* at *4.
[73] 787 A.2d 85 (Del. 2001).
[74] *Emerging Commc'ns*, 2004 Del. Ch. LEXIS 70, at *35–36.
[75] *Id.* at *36.
[76] *Id.* at *43–101.
[77] *Id.* at *85.
[78] *Id.* at *81.
[79] *Emerging Commc'ns*, 2004 Del. Ch. LEXIS 70, at *101.
[80] *Id.* at *102.

however, that a fair dealing analysis was required because a Section 102(b)(7) exculpatory defense had been raised by defendants,[81] "if only to enable the Court to determine the 'basis for the [defendants'] liability' for § 102(b)(7) exculpation purposes."[82] The determination of an unfair price did not "address whether the unfairness was the product of a breach of fiduciary duty or if so, the nature or character of that duty."[83]

The court then proceeded with a fair dealing analysis. The court reviewed "when the transaction was timed, how it was initiated, structured, negotiated, and disclosed to the board, and how director and shareholder approval was obtained."[84] An analysis of these factors led the court to conclude that the privatization transaction failed the entire fairness standard.[85] The court found that Prosser's original intent, in about January 1998, was not to privatize the company but instead to merge Innovative into a subsidiary of ECM.[86] But by May 1998, in light of the low market interest in ECM's common stock, Prosser decided to "flip the transaction,"[87] and become a buyer instead of a seller. Based on these facts the court found that this transaction, which was initiated by a majority stockholder to freeze out the minority shareholders at a time when the stock price was artificially low, was unfair in both its initiation and timing.[88]

When Prosser was contemplating the original merger transaction, he engaged the Prudential firm to evaluate the fairness of the merger for ECM and the Cahill, Gordon and Reindel (Cahill) law firm to assist ECM with drafting the terms of the merger.[89] When Prosser later decided to privatize, he hired both Prudential and Cahill to advise him personally with regard to the privatization transaction.[90] By co-opting Prudential and Cahill, Prosser thus deprived ECM's board of valuable advisors.[91] The court found these facts indicative of unfairness in the structure of the transaction.[92]

The court next addressed the question of whether a transaction adjudicated to be not entirely fair violates the duty of care, the duty of loyalty, or the duty of good faith. If the violation were solely one of due care, ECM's 102(b)(7)-type provision would exonerate the directors from money damages. But this exoneration would not be applicable "(i) for any breach of the director's duty of loyalty, (ii) for acts or omissions not in good faith or

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[81] *Id.* at *103 (citing Emerald Partners v. Berlin, 787 A.2d 85, 94 (Del. 2001) (quoting Cinerama v. Technicolor, 663 A.2d 1156, 1165 & n.16 (1995))).

[82] *Id.* at *104.

[83] *Id.*

[84] *Id.* at *116 (quoting Rosenblatt v. Getty Oil Co., 493 A.2d 929, 937 (Del. 1985)).

[85] *Emerging Commc'ns*, 2004 Del. Ch. LEXIS 70, at *137.

[86] *Id.* at *14.

[87] *Id.* at *18.

[88] *Id.* at *116–18.

[89] *Id.* at *14.

[90] *Id.* at *20.

[91] *Emerging Commc'ns*, 2004 Del. Ch. LEXIS 70, at *118–19.

[92] *Id.*

which involve intentional misconduct or a knowing violation of the law . . . ."[93]

The *ECM* court went on to determine the nature of the fiduciary duties for each director individually. Prosser, the chairman, CEO and controlling stockholder, was found to have breached his duty of loyalty "by eliminating ECM's minority stockholders for an unfair price in an unfair transaction."[94] His receipt of an improper personal benefit from the transaction also nullified the exculpation provision.[95]

Director Raynor was also found to have breached his duty. Although Raynor did not personally profit from the transaction as Prosser did, he furthered Prosser's interests as opposed to the interests of the minority shareholders. Raynor served both as Prosser's personal attorney and ECM's counsel,[96] and he acted as Prosser's advisor in connection with the transaction.[97] The court stated that although Raynor did not directly benefit, his loyalties were solely to Prosser because his economic interests were tied solely to Prosser.[98]

Interestingly, although the court at one point stated that "Raynor . . . is liable for breaching his fiduciary duty of loyalty,"[99] it later found that Raynor breached "his fiduciary duty of loyalty and/or good faith."[100] According to the court:

> Raynor did not personally and directly benefit from the unfair transaction (as did Prosser), but Raynor actively assisted Prosser in carrying out the Privatization, and he acted to further Prosser's interests in that transaction, which were antithetical to the interests of ECM's minority stockholders . . . .
>
> Accordingly, Raynor is liable to [plaintiffs] for breaching his fiduciary duty of loyalty and/or good faith.[101]

The court explained this unusual finding by noting that the Delaware Supreme Court "has yet to articulate the precise differentiation between the duties of loyalty and good faith."[102] It further stated that:

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[93] *Id.* at *138 (citation omitted).
[94] *Id.* at *139.
[95] *Id.* at *140.
[96] *Emerging Commc'ns*, 2004 Del. Ch. 70, at *140.
[97] *Id.* at *140–41.
[98] *Id.* at *141.
[99] *Id.* at *140.
[100] *Id.* at *142. In its introductory sentence on Raynor's liability the court stated that "Raynor also is liable for breaching his fiduciary duty of loyalty . . . ." *Id.* at *140. That statement is inconsistent with the later statement that Raynor breached his "fiduciary duty of loyalty and/or good faith" and does not appear to reflect the court's analysis. *Id.* at *142.
[101] *Emerging Commc'ns*, 2004 Del. Ch. 70, at *140–42 (footnotes omitted).
[102] *Id.* at *142 n.184.

> If a loyalty breach requires that the fiduciary have a self-dealing conflict of interest in the transaction itself . . . Raynor would be liable [only] for violating his duty of good faith for consciously disregarding his duty to the minority stockholders . . . . On the other hand, if a loyalty breach does not require a self-dealing conflict of interest or receipt of an improper benefit, then Raynor would be liable for breaching his duties of loyalty and good faith.[103]

The court did not decide the issue, because either way, Raynor's conduct would violate the duty of good faith and would not be exculpated.[104]

From this finding, it would be logical to infer that good faith is a fiduciary duty separate from the duties of loyalty and care and that conscious disregard for these latter duties violates the duty of good faith. However, this issue is apparently not settled in Delaware. As discussed in Part II.C below, the *Disney II* court stated "there is no case in which a director can act in subjective bad faith towards the corporation and act loyally."[105] Thus, once a determination was made that Raynor did not act in good faith, application of the analysis of *Disney II* would seemingly require a finding that he had also violated his duty of loyalty. Even so, neither *ECM* nor *Disney II* answers the question regarding whether, absent evidence of bad faith, a finding of self-dealing in the transaction itself is required to establish a loyalty breach.

Having addressed Raynor's liability, the court turned to the liability of director Muoio. Muoio was also held liable for breach of the duty of loyalty and/or good faith,[106] although the court found his conduct less egregious than that of Prosser and Raynor.[107] Muoio was held liable "because he voted to approve the transaction even though he knew, or at the very least had strong reasons to believe, that the $10.25 per share merger price was unfair."[108] Muoio had significant experience in finance and telecommunications in light of his position with an investment advising firm.[109] The court held that Muoio should have advised the board to reject the $10.25 price.[110] Rather than delineate between the duties of loyalty and good faith, the court held that Muoio's conduct violated the duty of "loyalty and/or good faith."[111] It thus appears that the "conscious disregard" standard that

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[103] *Id.* (citing Hillary A. Sale, *Delaware's Good Faith*, 89 CORNELL L. REV. 456 (2004); Strassburger v. Early, 752 A.2d 557 (Del. Ch. 2000)) (emphasis omitted).

[104] *Id.*

[105] *In re* Walt Disney Co. Derivative Litig. *(Disney II)*, No. 15452, 2005 Del. Ch. LEXIS 113, at *170 n.447 (Del. Ch. Aug. 9, 2005).

[106] *Emerging Commc'ns*, 2004 Del. Ch. LEXIS 70, at *146–47.

[107] *Id.* at *143.

[108] *Id.*

[109] *Id.*

[110] *Id.* at *144.

[111] *Emerging Commc'ns*, 2004 Del. Ch. LEXIS 70, at *147.

the court is applying in the context of good faith is breached if the director "knew or had strong reasons to believe" that a transaction was unfair.

It is also noteworthy that Muoio was found not to be independent of Prosser when the court undertook the fair dealing analysis.[112] Although the court noted that Muoio's independence was in question because he would likely wish to seek future business opportunities from Prosser, it appears that the court was uncertain whether this lack of independence was enough of a conflict of interest to raise concerns about the duty of loyalty. Instead of making the determination regarding whether a conflict in the transaction is a necessary finding in a loyalty case, the court sidestepped the issue and found Muoio in violation of loyalty and/or good faith, due to his lack of independence from Prosser.[113]

The four remaining directors, Goodwin, Ramphal, Todman, and Vondras, were not found liable for breaching either the duty of loyalty or good faith. With respect to these four, the court found that the evidence did not implicate more than breach of the duty of care.[114] None of these directors had received an improper personal benefit, nor did any of them have a personal conflicting financial interest in the transaction.[115] Of these four directors, only Goodwin was found to be possibly independent of Prosser.[116] Yet, it seems that lack of independence could not sustain liability for Ramphal, Todman, and Vondras because their votes were not found to have been motivated by lack of independence. The court stated:

> [T]here is no evidence that they actually engaged in such improperly motivated conduct, or otherwise acted with disloyal intent .... But negligent or even gross negligent conduct, however misguided, does not automatically equate to disloyalty or bad faith. There is no evidence that Goodwin, Ramphal and Vondras intentionally conspired with Prosser to engage in ... benefiting Prosser at the expense of the minority stockholders.[117]

The *ECM* court did not decide whether the duty of loyalty or the obligation of good faith was breached in the cases of Muoio and Raynor. Rather, the court in effect stated that good faith was breached and loyalty may have been. *Disney II* seems to provide an answer to this aspect of the loyalty question because, according to *Disney II,* lack of good faith is tantamount to breach of the duty of loyalty.[118] The next sections revisit the

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[112] *Id.* at *125 (footnotes omitted).
[113] *Id.*
[114] *Id.* at *147–54.
[115] *Id.*
[116] *Emerging Commc'ns*, 2004 Del. Ch. LEXIS 70, at *152.
[117] *Id.* (footnote omitted).
[118] *See Disney II*, No. 15452, 2005 Del. Ch. LEXIS 113, at *169, n.447 (Del. Ch. Aug. 9, 2005).

duty of loyalty and the obligation of good faith, with an objective of picking up the analysis from where *ECM* left off.

2. *Conflict of Interest in the Transaction*

The case law is relatively clear that a director's conflict of interest in a corporate transaction will trigger an analysis of whether there is a breach of the duty of loyalty.[119] What is murky, in light of the decision in *ECM*, is whether lack of independence is enough of a conflict of interest to implicate the duty of loyalty, or whether a more direct conflict of interest in the transaction itself is required. This Section returns to the origins of the duty of loyalty to analyze whether evidence of a conflict of interest in the transaction is necessary to establish breach.

As discussed above, corporate law fiduciary duties have their genesis in the law of trusts.[120] According to the Restatement (Second) of Trusts, the trustee's duty of loyalty is a "duty to the beneficiary to administer the trust solely in the interest of the beneficiaries."[121] This definition does not seem to require self-dealing before finding a violation. However, if the transaction presents conflicts of interest, the trustee is "under a duty to deal fairly and to communicate to the beneficiary all material facts the trustee knows or should know in connection with the transaction."[122]

As mentioned above, one of the more famous cases discussing the contours of the duty of loyalty in the context of a business relationship is *Meinhard v. Salmon*.[123] The *Meinhard* case involved application of the duty to a joint venture relationship. Chief Justice Cardozo, addressing the duty of joint adventurers to each other, said that they owe one another "the duty of the finest loyalty . . . the punctilio of an honor the most sensitive."[124] Although evidence of conflict of interest in the transaction could lead to a finding of breach of the duty of loyalty, it did not seem to be a requirement of breach. That is, a conflict of interest could evidence a breach of loyalty, as could any other behavior indicating that the director did not communicate all material facts or did not otherwise act with "an honor the most sensitive."

3. *Lack of Independence*

Another question left unanswered by the *ECM* court is whether lack of independence by itself is enough of a conflict of interest to implicate the duty of loyalty. In finding Raynor and Muoio liable for breach of loy-

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[119] *See supra* notes 52–63 and accompanying text.
[120] *See supra* notes 15–22 and accompanying text.
[121] RESTATEMENT (SECOND) OF TRUSTS, *supra* note 15, § 170(1).
[122] *Id.* § 170(2).
[123] 164 N.E. 545 (1928).
[124] *Id.* at 546.

alty and/or care, the court stated that loyalty was only implicated if a conflict of interest in the transaction itself was not required.[125] Raynor and Muoio were not found to be interested in the transaction. They were, however, beholden to Prosser and not independent advisors to the company.

Although lack of independence is not an issue that has been decided by the Delaware Supreme Court in the context of breach of loyalty claim, it is an issue that has been addressed recently by the Chancery Court. In *Orman v. Cullman*,[126] the Delaware Chancery Court stated that to establish a breach of the directors' duty of loyalty and to overcome the presumption of the business judgment rule, the plaintiff can "establish that the *board* was either interested in the outcome of the transaction or lacked the independence to consider objectively whether the transaction was in the best interest of its company and all of its shareholders."[127] The court further delineated the distinction between interest in the transaction and lack of independence. According to *Orman*, directors are interested in the transaction when they appear on both sides of a transaction or expect to derive a personal financial benefit from it in the sense of self-dealing.[128] This is in contrast to "a benefit which devolves upon the corporation or all stockholders generally."[129] On the other hand, "lack of independence can be shown when a plaintiff pleads facts that establish 'that the directors are 'beholden' to [the controlling person] or so under their influence that their discretion would be sterilized.'"[130]

The *Orman* court then discussed whether the plaintiffs' allegations of breach of fiduciary duty were sufficient to survive the motion to dismiss. Four defendant directors were alleged to be interested in the transaction "because they received benefits from the transaction that were not shared with the rest of the shareholders."[131] The court found the allegations insufficient with respect to three of the directors: Israel, Vincent and Lufkin.[132] The only allegation against Israel and Vincent was that they were self-interested because they had served on the board since 1989 and 1992, respectively.[133] With respect to Lufkin, the court found that his board membership since 1976 was insufficient to show lack of independence and his role as founder of one of the two leading underwriters of the company's IPO did not establish that he received a personal benefit from the transaction not shared by other shareholders.[134] Similarly, director Barnet was

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[125] *See supra* notes 102–112 and accompanying text.

[126] 794 A.2d 5 (Del. Ch. 2002).

[127] *Id.* at 22 (footnotes omitted).

[128] *Id.* at 23.

[129] *Id.*(quoting Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984)).

[130] *Id.* at 24 (citing Rales v. Blasband, 634 A.2d 927, 936 (Del. 1993)); see also *id.* at 25 for the distinctions between "interested" and "lack of independence."

[131] *Id.* at 25.

[132] *Id.* at 26–28.

[133] *Orman*, 794 A.2d at 26.

[134] *Id.* at 28.

not interested in the transaction solely because he was to be a director in the surviving corporation.[135]

On the other hand, the court found that director Bernbach may have lacked independence because he was beholden to the Cullman Group—the group that negotiated the transaction—due to his consulting contract with that company and was beholden to the controlling shareholders for a continuation of the contract.[136] Interestingly, the court stated that the consulting contract was not enough to establish that Bernbach was interested or that he would have profited from the transaction.[137] Bernbach's potential liability was based solely on his alleged lack of independence.[138]

A fifth director, Solomon, was possibly interested in the transaction because his company, PJSC, was to receive a $3.3 million fee if the merger were approved.[139] Finally, the court found it unnecessary to rule upon the interest or lack of independence of director Sherren because a majority of the board being interested or lacking independence was sufficient to rebut defendants' claim that the decision was protected by the business judgment rule.[140]

Similarly, a U.S. district court, applying Delaware law in *Hollinger International, Inc. v. Hollinger Inc.*,[141] utilized a two-prong test in its discussion of the duty of loyalty. According to the *Hollinger* court, a breach of loyalty claim requires the plaintiff to allege that: "(1) the director was 'interested in the outcome' of the alleged self dealing transaction; or (2) 'lacked independence to consider objectively whether the transaction was in the best interest of the company and all its shareholders.'"[142] In *Hollinger*, the plaintiff alleged that defendants Black and Radler engaged in various self-dealing transactions, including receiving non-competition payments from Hollinger International, Inc. (International), selling International's assets at below-market prices to a corporation they controlled, loaning International's funds at below-market interest rates to a corporation they controlled, and receiving "'unwarranted, excessive, and unauthorized' 'management fees,' 'incentive payments,' and other compensation."[143] Defendant Perle was a director of International and sat on its audit, compensation, and executive committees.[144] At the same time, Perle was an officer of Digital Management, a company that plaintiffs alleged had received excessive fees for managing International's investments.[145]

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[135] *Id.* at 28–29.
[136] *Id.* at 30.
[137] *Id.* at 29–30.
[138] *Orman*, 794 A.2d at 29–30.
[139] *Id.* at 31.
[140] *Id.* at 31 n.70.
[141] No. 04 C 0698, 2005 WL 589000 (N.D. Ill. Mar. 11, 2005).
[142] *Id.* at *27 (citing *Orman*, 794 A.2d at 22).
[143] *Id.* at *2.
[144] *Id.* at *1.
[145] *Id.*

The district court found that the plaintiff had not alleged that defendant Perle had a direct financial interest in the transactions at issue, but had sufficiently pleaded lack of independence.

> To sufficiently plead "lack of independence," the plaintiff must allege "particularized facts" supporting "a reasonable inference" that the director was "beholden" to the controlling shareholder through a close personal, family, or business relationship. A director is "considered beholden to (and thus controlled by) another when the allegedly controlling entity has the unilateral power . . . to decide whether the director continues to receive a benefit, financial or otherwise," which is of material importance to the director.[146]

According to the court, because Black had appointed Perle CEO of Digital Management, a subsidiary of International, where Perle received over $3.1 million in incentive payments, the plaintiff sufficiently alleged that Perle lacked independence from Black.[147]

The logical import from this reasoning is that a conflict of interest in the transaction, although a sufficient condition, is not a necessary condition to trigger a loyalty analysis. It would seem that other conflicts of interest, such as the lack of independence, would also violate the obligation to act with "an honor the most sensitive." This notion is consistent with *Disney II*'s discussion of the "strict and unyielding"[148] terms of the duty of loyalty. *Disney II*, quoting *Guth v. Loft, Inc.*,[149] stated that "public policy, existing through the years, and derived from a profound knowledge of human characteristics and motives, has established a rule that demands of a corporate officer or director, peremptorily and inexorably, the most scrupulous observance of his duty . . . ."[150] The court further stated that there must be "no conflict between duty and self-interest."[151] It would thus seem inconsistent with the reasoning of both *Disney II* and *Guth* to allow conflicts of interest, such as a lack of independence, to avoid judicial scrutiny when considering claims alleging breach of the duty of loyalty.

4. Independence in Shareholder Derivative Litigation

Given the significance of director independence in considerations of loyalty claims, it is instructive to consider the developing case law on inde-

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[146] Hollinger Int'l, Inc. v. Hollinger, Inc., No. 04 C 0698, 2005 WL 589000, at *28 (N.D. Ill. Mar. 11, 2005) (citing *Orman*, 794 A.2d at 30) (citations omitted).

[147] *Id.* at *28.

[148] *Disney II*, No. 15452, 2005 Del. Ch. LEXIS 113, at *163 (Del. Ch. Aug. 9, 2005).

[149] 5 A.2d 503 (Del. 1939).

[150] *Disney II*, 2005 Del. Ch. LEXIS 113, at *163.

[151] *Id.*

pendence in other areas of corporate law. For example, independence has become a significant concern in shareholder derivative litigation.[152]

Boards may appoint special litigation committees ("SLCs") to make decisions regarding whether derivative litigation should be pursued or terminated. In *Zapata Corp. v. Maldonado*,[153] the Delaware Supreme Court articulated a two-step analysis for evaluating the decision of a special litigation committee. This analysis requires the court to evaluate the independence and good faith of the members of the special litigation committee and permits the court to use its own business judgment to determine whether it is in the best interest of the corporation for the suit to be either continued or terminated.[154]

The lynchpin of the willingness of courts to defer to the special litigation committee is the independence of that committee. Recently, in *In re Oracle Corp. Derivative Litigation*,[155] the Delaware Chancery Court considered whether two special litigation committee members, both of whom were Stanford University faculty members and Oracle Corp. (Oracle) directors, were independent from the director defendants, who also bore significant ties to Stanford. The court noted that independence "'turns on whether a director is, *for any substantial reason*, incapable of making a decision with only the best interests of the corporation in mind.'"[156] In *Oracle*, the court noted the various ties defendant directors had with Stanford.[157] One defendant was a Stanford professor, had served with an SLC member at the Stanford Institute for Economic Policy Research (SIEPR), and had also taught one of the SLC members when the SLC member was a Ph.D. student at Stanford.[158] Another defendant was a Stanford alumnus who served as chair of the SIEPR board and who had directed millions of dollars in contributions to Stanford recently.[159] A third defendant donated mil-

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[152] Before bringing a derivative claim, the shareholder must first make a demand on the board of directors, unless a demand would be futile. *See, e.g.*, Lewis v. Curtis, 671 F.2d 779, 787 (3d Cir. 1982). A refusal of the board to pursue the claim demanded by shareholders is a decision of the board that will generally be afforded the usual protections of the business judgment rule provided it is made by disinterested directors in good faith. *See, e.g.*, Atkins v. Hibernia Corp., 182 F.3d 320, 324 (5th Cir. 1999); Cramer v. Gen. Tel. & Elec. Corp., 582 F.2d 259, 274–76 (3d Cir. 1978); Aronson v. Lewis, 473 A.2d 805, 813–17 (Del. 1984).

Shareholders are not required to make a demand on the board when that demand would be futile. These are often cases in which the action of the board of directors gave rise to the shareholder's claim. In cases where demand is excused, it is still possible for the board to terminate the litigation provided that the decision to terminate is made in good faith by disinterested directors, who apply their own business judgment. *See, e.g.*, Zapata Corp. v. Maldonado, 430 A.2d 779, 788–89 (Del. 1981).

[153] 430 A.2d at 779.

[154] *Id.* at 788–89.

[155] 824 A.2d 917 (Del. Ch. 2003).

[156] *Id.* at 920 (quoting Parfi Holding AB v. Mirror Image Internet, Inc., 794 A.2d 1211, 1232 (Del. Ch. 2001), *rev'd in part on other grounds*, 817 A.2d 149 (Del. 2002)).

[157] *Oracle*, 824 A.2d at 920–21.

[158] *Id.* at 920.

[159] *Id.*

lions of dollars to Stanford both directly through personal donations and indirectly through a foundation. He was also considering further donations of hundreds of millions of dollars around the time that the SLC members had been appointed to the corporate board.[160] These facts gave the court reasonable doubt concerning the independence of the SLC members.[161] The court further noted that the burden of proof rests with the SLC to establish its independence[162] and denied the SLC's motion to terminate the derivative litigation.[163] The ties among the SLC members and the defendants were, according to the court, so substantial that that they cast doubt about the impartiality of the SLC.[164]

Independence was also at issue recently in *In re eBay, Inc. Shareholders Litigation*.[165] The court determined that demand was futile and permitted the litigation to proceed over the objection of the non-defendant directors who comprised the SLC.[166] The court was not convinced that the non-defendant directors on the SLC could "objectively and impartially consider a demand to bring litigation against those to whom [they are] beholden for [their] current and future position on eBay's board."[167] The court reached this conclusion after noting that the defendant directors owned enough stock to control the corporation and the election of directors, including the non-defendant directors on the SLC.[168] An additional concern was that the non-defendant directors owned options worth millions that had not vested and would not vest unless they continued to serve as directors of eBay.[169]

These cases illustrate that various interests in the outcome or relationships with the parties involved may show the lack of independence of special litigation committees. These guideposts seem to have been reaffirmed in the *Disney II* court's discussion of the duty of loyalty. Citing precedent going back to 1939, *Disney II* emphasized that "[t]he rule that requires an undivided and unselfish loyalty to the corporation demands that there be no conflict between duty and self-interest."[170]

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[160] *Id.* at 920–21.
[161] *Id.* at 921.
[162] *Oracle*, 824 A.2d at 928.
[163] *Id.* at 948.
[164] *Id.* at 942.
[165] No. 19988-NC, 2004 Del. Ch. LEXIS 4 (Del. Ch. Feb. 11, 2004).
[166] *Id.* at *11.
[167] *Id.*
[168] *Id.* at *10.
[169] *Id.* at *8–9.
[170] *Disney II*, No. 15452, 2005 Del. Ch. LEXIS 113, at *163–64 (Del. Ch. Aug. 9, 2005) (quoting Guth v. Loft, Inc., 5 A.2d 503, 510 (Del. 1939)).

C. Where Does Good Faith Fit In?: Disney II

The Delaware Chancery Court recently opined on the relationship among the duties of care, loyalty, and good faith in *Disney II*.[171] According to *Disney II*, the duty of good faith is intertwined with the duties of care and loyalty:

> It does no service to our law's clarity to continue to separate the duty of loyalty from its essence; nor does the recognition that good faith is essential to loyalty demean or subordinate that essential requirement. There might be situations when a director acts in subjective good faith and is yet not loyal (e.g., if the director is interested in a transaction subject to the entire fairness standard and cannot prove financial fairness), but there is no case in which a director can act in subjective bad faith towards the corporation and act loyally . . . .[172]

The court outlined the three most salient violations of good faith. These include situations where (1) the fiduciary intentionally acts with a purpose other than advancing the best interests of the corporation; (2) the fiduciary acts with intent to violate positive law; or (3) the fiduciary intentionally fails to act in the face of a known duty to act.[173] The court noted that it is unclear whether a motive is required to successfully claim bad faith.[174]

III. ERISA'S FIDUCIARY STANDARDS

This Part begins by discussing the paradigmatic ERISA employer stock cases and their relationship to widely used employee benefit plans. It then turns to a brief discussion of the ERISA imposed fiduciary duty of loyalty. Finally, the Part engages in a detailed evaluation of the application of the duty of loyalty in the ERISA employer stock cases.

A. 401(k) Plans and the ERISA Employer Stock Cases

Most employees who have a pension plan through their employer are participants in a defined contribution plan.[175] Each employee has an indi-

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[171] *Id.* at *169.
[172] *Id.* at *169 n.447.
[173] *Id.* at *177.
[174] *Id.* at *173.
[175] *See New EBRI Research: Defined Contribution Worker Coverage Grows; Retirement Savers Continue Reliance on Stocks*, U.S. NEWSWIRE, Jan. 21, 2004 ("The segment relying solely on defined contribution retirement plans, such as 401(k)s, rose from 40.8% to 61.5% in the 1992–2001 period . . . ."). Defined contribution plans held more than $3.9 trillion in 2003. *Total Assets Increase in Retirement Plans*, WALL ST. J., Apr. 26, 2004, at

vidual account in the plan that enjoys favorable tax treatment, and the assets in the account belong to the employee.[176] Typically these plans are 401(k) or KSOP[177] accounts in which each employee makes an individualized decision on whether to make elective contributions to the plan, the employer may match some portion of the employee contributions, and each employee makes some or all of the decisions on how to invest the assets in the individual account.[178]

During the past few years, these types of plans, which we refer to as company-sponsored employee investment plans,[179] have been subject to considerable litigation because of their use of employer stock as a required or optional investment vehicle. The majority of 401(k) plans sponsored by publicly held companies offer company stock as an investment option.[180] Employees are likely to hold assets, sometimes a substantial portion of their assets, in company stock in those plans.[181]

The consistent fact pattern in the employer stock cases begins with a situation where some employees hold at least a portion of their plan account assets in employer stock.[182] The employer stock drops in value.[183] The employees who had invested in employer stock bring a class action suit alleging: (1) directors and others continued to offer company stock as a plan investment option, continued to make matching contributions in company stock, or continued to enforce plan rules prohibiting diversification out of employer stock at a time when the directors knew or should have known that the stock was not a prudent investment option;[184] (2) directors and others made materially inaccurate or incomplete disclosures regard-

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[176] Muir, *supra* note 15, at 393 n.19. Depending upon the plan's vesting provisions, some of the assets may be forfeitable for some period of time.

[177] A KSOP is a hybrid plan with both ESOP and 401(k) components. *See* Janice Kay Lawrence, *Pension Reform in the Aftermath of Enron: Congress' Failure to Deliver the Promise of Secure Retirement to 401(k) Plan Participants*, 92 KY. L.J. 1, 25 (2003–2004). This hybrid structure translates into millions of dollars in tax savings for large publicly traded companies and serves as a strong incentive for 401(k) conversion into KSOPs. *See id.* (citing Ellen E. Schultz & Theo Francis, *Companies' Hot Tax Break: 401(k)s*, WALL ST. J., Jan 31, 2002, at C1).

[178] Dana M. Muir, *The Dichotomy Between Investment Advice and Investment Education: Is No Advice Really the Best Advice?*, 23 BERKELEY J. EMP. & LAB. L. 1, 8–9 (2002).

[179] *See* Dana M. Muir & Cindy A. Schipani, *New Standards of Director Loyalty and Care in the Post-Enron Era: Are Some Shareholders More Equal Than Others?*, 8 N.Y.U. J. LEGIS. & PUB. POL'Y 279, 282 (2004–2005) (discussing the authors' reasons for adopting this terminology).

[180] Lawrence, *supra* note 177, at 4 n.8. Employers have begun to reevaluate the use of company stock in these plans. *See, e.g.*, Suzanne Cosgrove, *An Unhealthy Slice of Company Stock*, CHI. TRIB., Mar. 26, 2006, at C5.

[181] Maureen B. Cavanaugh, *Tax as Gatekeeper: Why Company Stock is Not Worth the Money*, 23 VA. TAX. REV. 365, 378–79 (2003).

[182] *See, e.g.*, *In re* Worldcom, Inc. ERISA Litig., 263 F. Supp. 2d 745, 751–54 (S.D.N.Y. 2003).

[183] *Id.*

[184] *See, e.g.*, DiFelice v. US Airways, Inc., 397 F. Supp. 2d 758 (E.D. Va. 2005); *Worldcom*, 263 F. Supp. 2d 745.

ing company stock;[185] or (3) directors and others failed to meet their obligations in appointing and monitoring other plan fiduciaries.[186] All three allegations raise issues involving the directors' fiduciary duty of loyalty.[187]

B. ERISA's Fiduciary Duty of Loyalty

Pension funds give rise to agency problems that mirror the agency issues in corporate law. Regardless of the type of pension plan,[188] company officials, typically including members of the company's board of directors, oversee the plan and make critical decisions affecting the investment of assets or the available investment vehicles. Prior to the enactment of ERISA's extensive regulatory framework, fraud or underfunding of plans resulted in numerous situations where employees never received the benefits they expected.[189]

In reaction to these and other concerns about agency issues affecting pension plan governance and investments, the drafters of ERISA explicitly adopted trust law standards in establishing a complex set of provisions governing the behavior of anyone who has discretion in administering or dealing with the assets of an employee benefit plan. First, all pension plan assets must be held in trust.[190] Second, the statute establishes a counterpart to the trust law duty of loyalty, requiring fiduciaries to act "solely in the interest of the participants and beneficiaries and . . . for the exclusive purpose of . . . providing benefits to participants and their beneficiaries."[191]

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[185] *See, e.g.*, Pa. Fed'n v. Norfolk S. Corp., No. 02-9049, 2004 U.S. Dist. LEXIS 20654 (E.D. Pa. Oct. 12, 2004); Enron Corp. Sec., Derivative, & "ERISA" Litig., 284 F. Supp. 2d 511 (S.D. Tex. 2003).

[186] *See, e.g.*, Howell v. Motorola, 337 F. Supp. 2d 1079 (N.D. Ill. 2004); Rankin v. Rots, 278 F. Supp. 2d 853 (E.D. Mich. 2003).

[187] Muir & Schipani, *supra* note 179, at 331–40.

[188] The two primary categorizations of pension plans are as defined benefit or defined contribution plans. *See* Muir, *supra* note 178, at 5.

[189] *See generally* JAMES A. WOOTEN, THE EMPLOYEE RETIREMENT INCOME SECURITY ACT OF 1974: A POLITICAL HISTORY 118 (2004). During the 1960s, the Senate Permanent Subcommittee on Investigations discovered the trustee of two union pension and welfare funds had arranged for several million dollars in plan funds to be moved to companies in Puerto Rico and Liberia. According to federal officials, no federal laws precluded the trustee's actions. Similarly, Jimmy Hoffa, former head of the Teamsters Union, was prosecuted for conspiracy and mail and wire fraud for the self-interested loans he received from a union pension fund. There was no pension-specific federal law that governed Hoffa's behavior. *Id.*

[190] ERISA § 403, 29 U.S.C. § 1103 (2000).

[191] *Id.* § 404(a)(1)(A)(i); *see also* EMPLOYEE BENEFITS LAW 662 (Steven J. Sacher et al. eds., 2d ed. 2000); Daniel Fischel & John H. Langbein, *ERISA's Fundamental Contradiction: The Exclusive Benefit Rule*, 55 U. CHI. L. REV. 1105, 1108 (1988) ("ERISA's exclusive benefit rule . . . imports into pension fiduciary law one of the most fundamental and distinctive principles of trust law, the duty of loyalty."). In addition to the fiduciary obligation of loyalty, ERISA requires fiduciaries to act prudently; to diversify investments; and to act in accordance with the benefit plan's terms to the extent those terms do not conflict with ERISA. ERISA § 404(a)(1)(B)–(D).

After establishing a duty of loyalty, however, ERISA's drafters backtracked and explicitly permitted fiduciaries to be conflicted by stating that the statute shall not be construed to "prohibit any fiduciary from serving as a fiduciary in addition to being an officer, employee, agent, or other representative of a party in interest."[192] Arguably this departure from traditional trust law recognizes that employers have a special interest in the benefit plans they establish and may be reluctant to sponsor such plans if they are not permitted to retain a degree of control over the administration and investment of the plans.[193] Regardless of the reason for the provision permitting conflicted fiduciaries, the drafters of ERISA seemed to recognize the agency tensions inherent in the regime they were creating because they barred a wide variety of "prohibited transactions."[194]

Harmonizing the realities of conflicted fiduciaries with the obligation of loyalty has not been simple, particularly given the variety of benefit plans governed by ERISA. A challenge for directors and other ERISA fiduciaries is to reconcile two lines of cases that flow from the conflicts of interest that ERISA allows. One strand of law imposes absolute loyalty on fiduciaries, setting a standard of an "eye single" to the interests of plan participants and beneficiaries.[195] This strand is consistent with traditional trust law and Justice Cardozo's famous language.[196] The other strand recognizes that employers may receive "'incidental' and thus legitimate benefits . . . from the operation of a pension plan."[197] This strand of the law is unique to ERISA and is compelled in part by the statute's approval of conflicted fiduciaries. It also recognizes that employers sponsor benefit plans, including company-sponsored employee investment plans, for a variety of

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[192] ERISA § 408(c)(3). ERISA defines a party in interest to include plan service providers, an employer with employees who are plan participants, certain individuals and entities with an ownership interest in a plan sponsor, and plan fiduciaries. *Id.* § 3(14).

[193] Fischel & Langbein, *supra* note 191, at 1126–28.

[194] These provisions are broadly drawn to proscribe any transactions between a party in interest, including a fiduciary, and the plan. § 406. The Department of Labor has issued numerous class and individual exemptions to the prohibited transactions provisions. For a detailed discussion of those exemptions, see Donald J. Myers & Michael B. Richman, *Class Exemptions from Prohibited Transactions*, *in* ERISA FIDUCIARY LAW 267 (Susan P. Serota ed., 1995); William P. Wade & Richard I. Loebl, *Individual Prohibited Transaction Exemptions*, *in* ERISA FIDUCIARY LAW 315 (Susan P. Serota ed., 1995); EMPLOYEE BENEFITS LAW, *supra* note 191, at 744–63. One specific exception permits benefit plans to acquire employer securities for adequate consideration. § 408(e). Plaintiffs in company stock cases have unsuccessfully alleged that the use of company stock in the plan when the stock is an imprudent investment constitutes a breach of the prohibited transaction requirements because the stock is purchased for more than adequate consideration. *See, e.g.*, *In re* Honeywell Int'l ERISA Litig., No. 03-1214, 2004 U.S. Dist. LEXIS 21585, at *46–49 (D.N.J. Sept. 14, 2004).

[195] *See, e.g.*, Donovan v. Bierwirth, 680 F.2d 263, 271 (2d Cir. 1982).

[196] Meinhard v. Salmon, 164 N.E. 545, 546 (N.Y. 1928); *see supra* text accompanying notes 1–2.

[197] Hughes Aircraft Co. v. Jacobson, 525 U.S. 432, 445 (1999) (quoting Lockheed Corp. v. Spink, 517 U.S. 882, 893 (1996)).

self-interested reasons including decreasing employee turnover, competitive issues, and tax incentives.[198]

Not only does ERISA depart from traditional trust law in its provisions for conflicted fiduciaries and specified prohibited transactions, but it also defines who is a fiduciary in terms more sweeping than trust law. Trust law contemplates that the typical trust will be managed by a single or small number of trustees.[199] In contrast, ERISA contemplates numerous fiduciaries for each benefit plan. An individual may become an ERISA fiduciary by being named as a "named fiduciary"[200] or by having the functional responsibility that brings with it fiduciary status.[201] Fiduciary status based on this functional definition, however, is limited "to the extent" the individual exercises or has discretionary authority over the functions that gave rise to the fiduciary status.[202] Plaintiffs in some employer stock cases have successfully alleged that company directors are functional fiduciaries because they have a measure of control over plan assets or because they appoint and monitor the actions of other plan fiduciaries.[203]

C. Specific Application of Duty of Loyalty in the ERISA Employer Stock Cases

The ERISA employer stock cases occupy a particularly important place in the development of the fiduciary obligation of loyalty. Few of the cases have progressed past the summary judgment phase, though most have permitted the plaintiffs to go forward on some claims.[204] At the same time, because of the litigation and potential liability involved with the use of employer stock in company-sponsored employee benefit plans, companies have begun to reconsider the use of employer stock in the plans.[205] This Section considers the fiduciary obligation of loyalty that inheres in such

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[198] *See, e.g.*, Daniel Halperin, *Employer-Based Retirement Income—The Ideal, the Possible, and the Reality*, 11 ELDER L.J. 37, 56 ("Moreover, one of the motivations for establishing pension plans is to reduce turnover and retain skilled workers.").

[199] Dana M. Muir, *ERISA Remedies: Chimera or Congressional Compromise?*, 81 IOWA L. REV. 1, 15 (1995).

[200] ERISA § 402(a), 18 U.S.C. § 1102(a) (2000).

[201] ERISA § 3(21)(A). Typically, individuals become functional fiduciaries by having discretion over the assets, administration, or management of a benefit plan or by providing investment advice for a fee to a plan. *Id.*

[202] *Id.*

[203] *In re Elec. Data Sys. Corp. "ERISA" Litig.*, 305 F. Supp. 2d 658, 666–67 (E.D. Tex. 2004); *see also In re* Tyco Int'l, No. 02-1335-PB, 2004 U.S. Dist. LEXIS 24272, at *16 (D.N.H. Dec. 2, 2004) (categorizing board members as fiduciaries due to power to appoint fiduciaries).

[204] *See, e.g.*, LaLonde v. Textron, Inc., 369 F.3d 1 (1st Cir. 2004) (reversing dismissal); *In re* Xcel Energy, Inc., 364 F. Supp. 2d 980 (D. Minn. 2005) (awarding attorneys fees); *In re* Xcel Energy, Inc., 364 F. Supp. 2d 1005 (D. Minn. 2005) (approving settlement); *In re* Polaroid ERISA Litig., 362 F. Supp. 2d 461 (S.D.N.Y. 2005) (denying motion to dismiss).

[205] Jessica Marquez, *Taking Stock*, WORKFORCE MGMT., May 2005, at 79, *available at* http://www.workforce.com/ section/02/feature/24/03/71/index.html.

use of company stock in order to later contrast those obligations with directors' loyalty obligations to shareholders generally under corporate law.

1. Imprudence of Employer Stock as an Investment

Some typical claims made in the ERISA employer stock cases are that fiduciaries did not amend the plan (1) to eliminate company stock as an investment option; (2) to halt the employer matches in company stock; or (3) to permit employees to diversify their plan accounts out of employer stock even though the stock had become an imprudent investment. The most obvious statutory claim in these instances may be that the fiduciaries violated their fiduciary obligations of prudence and due care by failing to reconsider the use of company stock in company-sponsored employee investment plans once that stock became a problematic investment choice. In one such case, *In re WorldCom, Inc. ERISA Litigation*, the court denied the defendants summary judgment where the plaintiffs alleged that the fiduciary defendants failed to fulfill their responsibilities to evaluate the continued availability of WorldCom stock as an investment alternative under the plan.[206] More recently, the court in *DiFelice v. US Airways, Inc.* denied summary judgment to the company, which was the named trustee of the plan, in the face of the plaintiff's allegations that, given the obviousness of the company's financial distress, the company had an obligation to close the company stock fund in the plan and to end employees' ability to contribute to that fund on a certain date.[207] Even recognizing the latitude fiduciaries have in exercising their judgment on appropriate plan investments,[208] the court found that the numerous facts indicating the precarious nature of US Airways' financial situation could be sufficient to question whether the company had met its obligation of prudence.[209]

The continued use of company stock also may breach the fiduciaries' duty of loyalty. One claim often raised by plaintiffs in the ERISA employer stock cases is a variant of the allegation that fiduciaries had conflicting interests in using company stock in the plan because either their compensation was stock-based or they owned substantial amounts of company stock.[210] In three cases in the Southern District of New York, plaintiffs' claims of this type failed to survive motions to dismiss.[211] In cases with similar facts, however, courts in the District of New Jersey and the Northern

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[206] 263 F. Supp. 2d 745, 763 (S.D.N.Y. 2003); *see also* 59 Fed. R. Serv. 3d 1170 (S.D.N.Y. 2004) (approving partial settlement).

[207] 397 F. Supp. 2d 758, 771–72 (E.D. Va. 2005).

[208] *Id.* at 773.

[209] *Id.* at 773–74.

[210] *See infra* notes 213–230 and accompanying text.

[211] *See infra* notes 213–220 and accompanying text.

District of Georgia held that the plaintiffs had stated a claim for breach of loyalty.[212]

In *In re Polaroid ERISA Litigation*, the court appeared to dismiss the conflict of interest claim because the existence of a compensation-based conflict was insufficient to establish a breach of loyalty.[213] The court in *In re WorldCom, Inc. ERISA Litigation* was more explicit.[214] The plaintiffs alleged that Bernard Ebbers, a WorldCom director as well as its President and CEO, breached his duty of loyalty by receiving stock-based compensation that created an incentive for him to keep the stock price high and ignore the best interests of plan participants and beneficiaries.[215] The court rejected the claim, relying on both ERISA's explicit provision for conflicted fiduciaries and its limitation of liability to only those acts taken while in the role of an ERISA fiduciary.[216] The plaintiffs had not shown that the conflict of interest caused Ebbers to act other than in the best interests of plan participants and beneficiaries when making decisions as a plan fiduciary.[217] In *In re AOL Time Warner, Inc. Securities and "ERISA" Litigation*, the court took a slightly different approach to a similar claim that directors had sold their company stock while continuing to offer the stock as a plan investment.[218] The court ruled that the directors' personal sales of nonplan stock could not be considered a fiduciary act under ERISA because the sales were not undertaken as part of their administration or as investment of the plan assets.[219] As only functional fiduciaries, the directors could not be held liable under ERISA for acts taken outside their functional fiduciary roles.[220]

In contrast, the district court in *In re Honeywell International ERISA Litigation* permitted the plaintiffs' breach of loyalty claim premised on a compensation-based conflict of interest to go forward.[221] The defendants had argued that ERISA's provisions for conflicted fiduciaries protected them and that fiduciaries' participation in stock-based compensation programs was not sufficient to state a breach of loyalty claim against them.[222] The court agreed with both arguments but declared that the defendants could "still be held liable for disloyalty if they acted in their own interests or the Company's, and against the interests of the Plan, while per-

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[212] *See infra* notes 221–230 and accompanying text.

[213] 362 F. Supp. 2d 461, 479 (S.D.N.Y. 2005).

[214] 263 F. Supp. 2d 745, 768 (S.D.N.Y. 2003).

[215] *Id.* at 767.

[216] *Id.* at 768.

[217] *Id.*

[218] No. 02 Civ. 8853, 2005 U.S. Dist. LEXIS 3715, at *9 (S.D.N.Y. Mar. 10, 2005).

[219] *Id.* at *25.

[220] *Id.*

[221] No. 03-1214, 2004 U.S. Dist. LEXIS 21585, at *44–45 (D.N.J. Sept. 14, 2004). It does not appear that these particular claims were alleged against company directors, but the plaintiffs' theory would seem to apply to directors who receive stock-based compensation.

[222] *Id.* at *45.

forming fiduciary duties."[223] The court had already decided that the plaintiffs had adequately alleged both misrepresentation of the company's financial position[224] and failure to change the availability of company stock in the plan after the stock became an imprudent investment.[225] These alleged actions were sufficient to support an inference that the fiduciaries had acted in their own or Honeywell's best interest while performing their fiduciary obligations.[226]

Similarly, the plaintiffs' claim of conflict of interest survived a motion to dismiss in *Hill v. BellSouth Corp.*[227] The court found sufficient the plaintiffs' allegations that the defendants' participation in a stock-based compensation plan gave them an incentive to maintain the price of company securities and that two defendants, including the chairman of the Board of Directors, had personally sold company stock during the class period.[228] The *BellSouth* court did not articulate the standard it ultimately would use to determine whether the defendants breached their duty of loyalty, nor did it explicitly recognize ERISA's provision for conflicted fiduciaries.[229] But the court's statement that the plaintiffs had alleged that defendants "acted in a way that benefited them personally, yet did not protect the trust" may indicate that the fiduciaries' personal benefit will be important in the final determination.[230]

In another variant, plaintiffs have argued that fiduciaries have breached their duty to avoid conflicts of interest, but the plaintiffs have declined to specify any particularized conflicts. The tension in these claims lies in determining the boundary between the statutory provision permitting conflicted fiduciaries[231] and a Supreme Court opinion that listed the "avoidance of conflicts of interest"[232] as being among the duties of an ERISA fiduciary. To date, courts have not articulated the extent to which fiduciaries must act affirmatively to avoid conflicts of interest tied to the use of employer stock. In *In re Dynegy, Inc. ERISA Litigation*, the plaintiffs argued that the fiduciaries should have hired an independent fiduciary to determine the prudence of company stock as an investment or notified the Department of Labor (DOL) of the circumstances that made investment in company stock imprudent.[233] The plaintiffs relied on Fifth Circuit precedent that:

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[223] *Id.*
[224] *Id.* at *27–34.
[225] *Id.* at *35–40.
[226] *In re* Honeywell Int'l ERISA Litig., 2004 U.S. Dist. LEXIS 21585, at *44–45.
[227] 313 F. Supp. 2d 1361, 1370 (N.D. Ga. 2004).
[228] *Id.*
[229] *Id.* at 1369–70.
[230] *Id.* at 1370.
[231] *See supra* text accompanying note 192.
[232] Mertens v. Hewitt Assocs., 508 U.S. 248, 251–52 (1993).
[233] 309 F. Supp. 2d 861, 896 (S.D. Tex. 2004).

> [t]he presence of conflicting interests imposes on fiduciaries the obligation to take precautions to ensure that their duty of loyalty is not compromised . . . "The level of precaution necessary to relieve a fiduciary of the taint of a potential conflict should depend on the circumstances of the case and the magnitude of the potential conflict." . . . In some instances, the only open course of action may be to appoint an independent fiduciary.[234]

The *Dynegy* court dismissed the plaintiffs' claim for failing to identify specific conflicts of interest and the harm those conflicts caused.[235] In *Pennsylvania Federation v. Norfolk Southern Corp.*, the plaintiffs alleged that the defendants violated their duty of loyalty by continuing to make matching contributions in plan stock and by precluding diversification in order to inflate the price of the stock while the company's financial performance was poor.[236] The court held that the defendants could not have violated their obligation of loyalty because they had followed the plan's terms regarding the investment of matching contributions.[237]

In a decision contrasting with those of *Dynegy* and *Norfolk Southern*, the court in *In re Electronic Data Systems Corp. "ERISA" Litigation (EDS)* denied a motion to dismiss a nearly identical claim—because the fiduciaries operated under a conflict of interest they should have engaged an independent fiduciary or otherwise eliminated the conflict.[238] Although the plaintiffs had not argued that the fiduciaries' conflict resulted from stock-based compensation, the defendants contended that ERISA permits fiduciar-ies to take part in such compensation programs.[239] The court rejected this defense as an "attempt to place un-pled factual restrictions" on the plaintiffs' claim.[240] The court gave no hint as to whether the plaintiffs must ultimately prove direct benefit to the defendants at the plan's expense and did not otherwise discuss the standard for evaluating the plaintiffs' claim.[241]

Finally, a quite different breach of loyalty claim may be predicated on the argument that a conflicted fiduciary must reconsider the use of company stock in a plan even though the plan terms require the use of such stock. In what is known as the settlor doctrine, the Supreme Court has determined that ERISA actors do not act in an ERISA fiduciary role when establishing, amending, or terminating a benefit plan.[242] Defendants have argued that, where the terms of the company-sponsored employee investment plan require the use of employer stock, the settlor doctrine protects

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[234] *Id.* at 897 (quoting Bussian v. RJR Nabisco, Inc., 223 F.3d 286, 299 (5th Cir. 2000)).
[235] 309 F. Supp. 2d at 897–98.
[236] No. 02-9049, 2004 U.S. Dist. LEXIS 20654, at *6 (E.D. Pa. Oct. 12, 2004).
[237] *Id.*
[238] 305 F. Supp. 2d 658, 673 (E.D. Tex. 2004).
[239] *Id.*
[240] *Id.*
[241] *Id.*
[242] *See, e.g.*, Hughes Aircraft Co. v. Jacobson, 525 U.S. 432, 444 (1999).

them from having to reconsider the use of such stock and from any liability in failing to evaluate the stock's appropriateness as an investment alternative.[243] Courts have split over the extent to which the doctrine actually protects ERISA fiduciaries in such situations, but even where the fiduciaries have been held to an obligation to reconsider the use of company stock, the courts typically accord them a presumption of prudence.[244] The presumption in favor of the fiduciaries recognizes the policy considerations favoring the use of company stock and the liability a fiduciary might face by being overly cautious in revoking the use of company stock.[245]

In *In re Honeywell International ERISA Litigation*, however, the court noted that the combination of a fiduciary's "conflicted status," knowledge of the impending collapse of the company, and a "precipitous decline in the price of employer stock" could be sufficient to overcome the fiduciary's presumption of prudence.[246] The courts have not clarified the weight to be accorded an opinion from an independent fiduciary that supports the defendants' actions nor have they announced a standard for evaluating the use of company stock when an independent fiduciary has made the usage determination. Elsewhere we have suggested that stricter scrutiny is appropriate in situations—such as the use of company stock—that present inherent conflicts of interest, and that one way to minimize those conflicts would be through the use of independent fiduciaries.[247]

2. *Failing To Properly Appoint or Monitor Plan Fiduciaries*

Courts generally agree with the DOL's view that appointing plan fiduciaries is itself a fiduciary function and that it includes an obligation to monitor the appointed fiduciaries.[248] Plaintiffs who allege wrongdoing associated with investments in company stock frequently allege that corporate directors and others who have appointment authority over plan administrators, or plan investment committee members, failed in their obligation to properly appoint or monitor those lower level plan fiduciaries.[249] The

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[243] *Id.* at 146–47.

[244] *See infra* notes 298–304 and accompanying text.

[245] *Id.*

[246] No. 03-1214, 2004 U.S. Dist. LEXIS 21585, at *39 (D.N.J. Sept. 14, 2004).

[247] *See* Muir & Schipani, *supra* note 179, at 356–57.

[248] *In re* Enron Corp. Sec., Derivative & "ERISA" Litig., 284 F. Supp. 2d 511, 552 (S.D. Tex. 2003) ("A person or entity that has the power to appoint, retain and/or remove a plan fiduciary from his position has discretionary authority or control over the management or administration of a plan and is a fiduciary to the extent that he or it exercises that power."); *see also* Questions and Answers Relating to Fiduciary Responsibility Under the Employee Retirement Income Security Act of 1974, 29 C.F.R. § 2509.75-8, FR-17 (2006) ("At reasonable intervals the performance of trustees and other fiduciaries should be reviewed by the appointing fiduciary . . . to ensure that their performance has been in compliance with the terms of the plan and statutory standards, and satisfies the needs of the plan.").

[249] *See, e.g.*, *In re* Sprint Corp. ERISA Litig., No. 03-2202-JWL, 2004 WL 2182186, at *2 (D. Kan. Sept. 24, 2004).

claims can implicate the duties of prudence and care, but some are filed as claims for breach of duty of loyalty.[250]

The plaintiff's contentions in *Howell v. Motorola, Inc.*[251] illustrate the complexities in these claims. The plaintiff alleged that defendants, who were directors of Motorola, breached their fiduciary duty, presumably the duty of loyalty, by failing to appoint plan fiduciaries who were independent and thus who were "influenced or controlled by the tacit or explicit direction of Motorola and/or the Director Defendants with respect to the management, investment and/or proposed or actual disposition of Plan assets."[252] The perceived lack of independence appeared to be grounded entirely in the fact that the appointed fiduciaries were Motorola employees.[253] The court was troubled because the claim appeared inconsistent with ERISA's provision permitting employees to act as fiduciaries; however, it decided that it did not yet need to reach the issue since the court found the plaintiff's failure to monitor claim sufficient to survive the motion to dismiss.[254]

The director defendants in *Motorola* argued that they had no obligation to monitor those fiduciaries directly responsible for selecting plan investment vehicles and participant communications.[255] They contended that the duty of monitoring only arises where fiduciaries appoint "close business associates" such that the lower level fiduciaries have "clear conflicts of interest beyond their assumed loyalty to their employer."[256] Although it acknowledged some limited contrary authority,[257] the court found

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[250] *See, e.g.*, *In re* Cardinal Health, Inc. Erisa Litig., No. C2-04-643, 2006 WL 833129, at *31–32 (S.D. Ohio Mar. 31, 2006).

[251] 337 F. Supp. 2d 1079 (N.D. Ill. 2004).

[252] *Id.* at 1096 (citation of record omitted). In *In re AOL Time Warner, Inc. Securities and "ERISA" Litigation*, a similar claim, alleging that defendant board members breached their fiduciary duties by appointing company employees who lacked independence as fiduciaries, survived a motion to dismiss. No. 02 Civ. 8853, 2005 U.S. Dist LEXIS 3715, at *24 (S.D.N.Y. Mar. 10, 2005).

[253] *Howell*, 337 F. Supp. 2d at 1097.

[254] *Id.*

[255] *Id.*

[256] *Id.* (citation to record omitted).

[257] *Id.* The plaintiffs in *In re WorldCom, Inc. ERISA Litigation* argued that the company directors were fiduciaries because they acted on behalf of WorldCom, which had been named by the plan as its Plan Administrator and Investment Fiduciary, and thus they had fiduciary obligation to appoint and monitor plan fiduciaries. *See In re* Worldcom, 263 F. Supp. 2d 745, 760 (S.D.N.Y. 2003), *aff'd*, No. 02 Civ.4816(DLC), 2004 LEXIS 20, 671 (S.D.N.Y. Oct. 18, 2004) (approving partial settlement). The plaintiffs attempted to reinforce their argument by relying on the law of Georgia, where WorldCom was incorporated, which provides, as do most state corporation statutes, that boards of directors have the responsibility to oversee the corporation's business and management. *See WorldCom*, 263 F. Supp. 2d at 760. The court concluded that the plaintiffs' argument proved too much because its logical result would be that every person who supervised an ERISA fiduciary automatically would become an ERISA fiduciary. *See id.* Nor, according to the court, did the argument appropriately recognize the difference between board members' obligations as plan settlors, which do not result in any fiduciary duty, and their obligations as plan fiduciaries. *Id.* at 761.

persuasive the DOL position and the clear weight of decisional authority that fiduciaries have an obligation to monitor all fiduciaries they appoint.[258]

3. Material Misstatements and Omissions

Among its many provisions in addition to fiduciary regulation, ERISA sets forth specific disclosure obligations requiring plans to provide information to plan participants and beneficiaries, as well as to the DOL.[259] The Supreme Court has held that misrepresentations made in the course of plan administration violate ERISA's fiduciary duty of loyalty.[260] There is some trend in the ERISA case law to find that benefit plan fiduciaries have affirmative disclosure obligations even beyond those explicitly established in the statute and regulation.[261] Courts have developed this theory of expanded disclosure by looking to traditional trust law, which requires a fiduciary who knows that particular information would be of interest and value to a beneficiary to communicate that information.[262] According to those courts, failing to communicate material information that could "adversely affect a plan member's interests" violates an ERISA fiduciary's duty of loyalty.[263]

Plaintiffs in the ERISA employer stock cases frequently allege that plan fiduciaries made, or permitted to be made, misstatements or omissions about the company's financial status and prospects and that those misstatements or omissions affected the plaintiffs' purchase or sale decisions.[264]

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[258] *See* Howell v. Motorola, 337 F. Supp. 2d 1079, 1097–99 (N.D. Ill. 2004).

[259] Edward E. Bintz, *Fiduciary Responsibility Under ERISA: Is There Ever a Fiduciary Duty to Disclose?*, 54 U. PITT. L. REV. 979, 980 (1993).

[260] Varity Corp. v. Howe, 516 U.S. 489, 506 (1996).

[261] *See generally* Bryan L. Clobes, *In the Wake of* Varity Corp. v. Howe*: An Affirmative Fiduciary Duty to Disclose Under ERISA*, 9 DEPAUL BUS. L.J. 221, 226–27 (1997) ("The recent trend favors imposing upon fiduciaries the common law rule requiring them to disclose material information concerning existing plans and benefits when they know that silence might be harmful."); Joseph E. Czerniawski, Comment, Bins v. Exxon*: Affirmative Duties to Disclose Proposed Benefit Changes in the Absence of Employee Inquiry*, 76 NOTRE DAME L. REV. 783, 808 (2001) ("There has been considerable disagreement among the lower courts dealing with disclosure of proposed benefit changes, but there has been a trend towards a 'serious consideration' test as triggering fiduciary disclosure duties in these cases."); Melissa Elaine Stover, Note, *Maintaining ERISA's Balance: The Fundamental Business Decision v. The Affirmative Fiduciary Duty to Disclose Proposed Changes*, 58 WASH. & LEE L. REV. 689, 691 (2001) ("The current trend in the federal courts [is] to expand a plan administrator's disclosure duties by emphasizing her fiduciary obligation to provide material information to plan participants."). The Supreme Court, however, has left open the question of whether fiduciaries must make disclosures in the absence of a specific statutory or regulatory obligation and a direct question from a participant. In the context of potential transactions in plan stock, disclosure also raises securities law issues including insider trading. *See* Muir & Schipani, *supra* note 179, at 287–89.

[262] Clobes, *supra* note 261, at 227.

[263] *See, e.g.*, Shea v. Esensten, 107 F.3d 625, 628 (8th Cir. 1996); *see also* Bins v. Exxon Co. U.S.A., 220 F.3d 1042, 1049 (9th Cir. 2000) (requiring accurate responses to questions when plan amendments are under serious consideration).

[264] *See* DiFelice v. US Airways, Inc., 397 F. Supp. 2d 758, 769–72 (E.D. Va. 2005)

Intentional misrepresentations made by ERISA fiduciaries would violate the standard that the Supreme Court established. To the extent case law supports an affirmative dissemination requirement, fiduciaries would also need to make appropriate disclosures related to company stock. Finally, as the plaintiffs in the *EDS* case argued, the duty to avoid conflicts of interest imposes on fiduciaries the obligation to make appropriate disclosures to plan participants and beneficiaries.[265] The *EDS* plaintiffs tied together an affirmative disclosure obligation, the duty of loyalty, and its alleged breach by arguing that as fiduciaries and "corporate officers they had both an incentive to conceal unknown information about EDS' stock value and a duty to reveal that information to Plan beneficiaries."[266] The allegation survived defendant directors' motion to dismiss.[267]

IV. THE DEVELOPING DUTY OF LOYALTY

The corporate scandals of the late 1990s, the resulting public attention to corporate wrongdoing, the financial losses workers experienced in their 401(k) accounts, and the enactment of the Sarbanes-Oxley Act[268] have increased the public scrutiny of corporate directors.[269] Commentators have observed the resulting pressure brought to bear on Delaware corporate law to retain its position as the primary regulator of director responsibility to shareholders.[270] The numerous cases challenging fiduciary decisions regarding the use of employer stock in company-sponsored employee investment plans are forcing the federal courts to address directors' obligations in the ERISA context.[271]

As a result of these pressures, jurisprudence on directors' duty of loyalty is developing along parallel tracks as Delaware courts interpret traditional state corporate law principles and federal courts interpret the statutory obligations imposed by ERISA. The concepts underlying the development of the duty of loyalty in these two fields are strikingly similar. Both fields trace their imposition of a loyalty obligation to the duty of loyalty

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(dismissing claims of failure to disclose because plan had met all specific ERISA requirements); Pa. Fed'n v. Norfolk S. Corp., No. 02-9049, 2004 U.S. Dist. LEXIS 20654, at *8 (E.D. Pa. Oct. 12, 2004) (arguing the duty to disclose derives from the duty of prudence).

[265] *See In re* Elec. Data Sys. Corp. "ERISA" Litig., 305 F. Supp 2d 658, 673 (E.D. Tex. 2004).

[266] *Id.*

[267] *Id.*

[268] Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (codified as amended in scattered sections of 11 U.S.C.A., 15 U.S.C.A., 18 U.S.C.A., and 28 U.S.C.A. (2002)).

[269] *See, e.g.*, David A. Katz & Laura A. McIntosh, *Director Compensation Moves Up Board Agendas*, 235 N.Y. L.J. 5 (2006) ("It is undeniable that more is being expected of directors today in terms of . . . exposure to public scrutiny and potential liability.").

[270] *See, e.g.*, Sean J. Griffith, *Good Faith Business Judgment: A Theory of Rhetoric in Corporate Law Jurisprudence*, 55 DUKE L.J. 1, 53–68 (2005); Sale, *supra* note 103, at 456–62.

[271] *See supra* Part III.C.

established under trust law.[272] Although the duty of loyalty is applied in many contexts in both fields, state corporate law and the federal law of ERISA share the need to apply the duty of loyalty when fiduciaries make decisions regarding company stock.[273] In corporate law, for example, that obligation becomes important when a corporation is buying out minority shareholders or making decisions on merger and acquisition transactions.[274] In ERISA, the use of employer stock as an investment vehicle and a source of matching contributions for company-sponsored employee investment plans poses numerous loyalty considerations.

This Part analyzes and compares recent developments in the fiduciary duty of loyalty in Delaware corporate law and in federal law under ERISA. The continued shaping of the loyalty doctrine raises critical questions, particularly for corporate directors, who may be fiduciaries under both Delaware corporate law and ERISA. In what situations are directors considered to have a conflict of interest that matters for purposes of the duty of loyalty? What standards should be used to evaluate whether directors have violated the obligation of loyalty? What distinctions are developing between Delaware state law and federal law under ERISA? Are any diverging approaches, overlaps, or tensions firmly grounded in principle and not such that they impose inconsistent obligations on directors? This Part begins by considering the values to be served by a loyalty analysis. It then considers the categories of factual situations most likely to result in duty of loyalty violations. It next discusses the standards used to determine whether a loyalty violation has in fact occurred. It concludes by examining the determinants of liability for individual directors.

A. The Threshold Loyalty Analysis

A properly balanced duty of loyalty analysis performs three functions. First, it identifies those specific factual situations that create a serious threat of fiduciary wrongdoing and harm to those whose interests the fiduciaries are obligated to put first. Second, once such a factual situation has been identified, the analysis provides the legal standards to determine whether the fiduciary obligation of loyalty has been breached. Third, once a breach has been found the final step is to determine which individual fiduciaries are liable for that breach. Proper identification of those factual situations in which fiduciary violations are likely to occur ensures scrutiny of those transactions. At the same time it ensures that the vast majority of transactions that do not incorporate a high threat of fiduciary violation can proceed without the litigation and other costs that heightened scrutiny imposes.

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[272] *See supra* Parts I & III.B.

[273] *See supra* Parts II.B.2 & III.B.

[274] *See supra* notes 64–68 and accompanying text.

The proper analysis must respond to the underlying dynamics of both corporate and ERISA law. If the threshold for when the presumption of the business judgment rule is set aside and the plaintiffs' claims survive a motion to dismiss is set too low, then the fears that that the *Smith v. Van Gorkom*[275] decision precipitated regarding the duty of care may come to pass: encouraging directors to be overly risk averse, discouraging qualified people from serving as directors, increasing the cost of insurance, and promoting excessive litigation.[276] The threshold must respect corporate law's traditional deference to the business judgment of directors. At the same time, it must consistently identify the factual situations where directors will be most tempted to put their personal interests ahead of the interests of the shareholders. Once shareholders have adequately alleged the necessary facts, then scrutiny of the transaction in question must be serious enough to address the specific situation and to protect the integrity of corporate governance generally by discouraging other directors from profiting at the expense of shareholders.

In company-sponsored employee investment plans that utilize employer stock, the need to develop a properly sensitive standard for when to use enhanced scrutiny is equally complex. ERISA permits both interested fiduciaries and the use of employer stock.[277] Imposing too low a standard for when scrutiny will be applied could doom the use of employer stock in these plans. Conversely, imposing too high a standard could leave plan participants unprotected in the face of fiduciaries who profit directly or indirectly at their expense. Thus, proper identification of those factual situations that deserve enhanced scrutiny and the extent of that scrutiny are both outcome determinative and critical for the sponsorship of the company-sponsored employee investment plans.

B. Identifying Potential Violations of the Duty of Loyalty

The initial consideration in analyzing duty of loyalty claims should be determining whether it is likely, given the facts, that a violation has occurred. By engaging in scrutiny when, and only when, the factual situation is one that is likely to have given rise to a duty of loyalty violation, the analysis protects the majority of transactions from the costs of scrutiny while ensuring that the transactions that carry with them a high risk of violations are properly reviewed. One category of transactions long understood to

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[275] 488 A.2d 858 (Del. 1985); *see also, e.g.*, R. Franklin Balotti & Mark J. Gentile, *Commentary from the Bar, Elimination or Limitation of Director Liability for Delaware Corporations*, 12 DEL. J. CORP. L. 5, 9 (1997); Dennis J. Block et al., *Advising Directors on the D&O Insurance Crisis*, 14 SEC. REG. L.J. 130, 131–32 (1986); Karen L. Chapman, *Statutory Responses to Boardroom Fears*, 3 COLUM. BUS. L. REV. 749, 749–50 (1987).

[276] *See* DENNIS J. BLOCK ET AL., THE BUSINESS JUDGMENT RULE: FIDUCIARY DUTIES OF CORPORATE DIRECTORS 12–18 (5th ed. 1998).

[277] *See supra* Parts III.B & III.C.

threaten the integrity of traditional trusts occurs when trustees operate under a conflict of interest.[278]

Theoretically, an individual's mere status as a corporate director creates a conflict of interest because directors receive fees from the company for their service and the prestige associated with such a position may be generally career enhancing. However, treating every director as conflicted in every corporate transaction would effectively nullify the business judgment rule, decrease directors' risk tolerance for transactions, burden the court system, and discourage individuals from accepting directorships.[279] One ERISA provision acknowledges that imposing an extensive loyalty analysis on each plan-related decision made by officers, employees, and agents would burden their ability to serve as fiduciaries.[280] Clearly, for both Delaware corporate law purposes and federal ERISA purposes, the bar for a conflict of interest that gives rise to fiduciary scrutiny must be set higher than mere status as a corporate director.

1. Requirement of Finding a Self-dealing Conflict of Interest in the Transaction Itself

The chancery court in *ECM* speculated that a loyalty breach may require the director to have "a self-dealing conflict of interest in the transaction itself."[281] This standard, if Delaware were to adopt it, would establish too high a threshold for when conflicts rise to the level that triggers scrutiny for loyalty violations. For example, *ECM* was unusual in that it was presented as both an appraisal case and a case of generalized fiduciary breach claims. The chancery court easily determined that the fiduciary claims met the threshold for review under the entire fairness standard because the privatization was without question a self-dealing transaction.[282] The court's concern that "a self-dealing conflict of interest in the transaction itself" is required for a breach of loyalty arose only in the final step of analysis—the determination of individual liability.[283] The implication, however, is that

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[278] *See supra* Part II.B.

[279] *See, e.g.*, Growbow v. Perot, 539 A.2d 180, 188 (Del. 1988) (finding allegation that directors received payment for their services insufficient to establish financial interest); Orman v. Cullman, 794 A.2d 5, 28–29 (Del. Ch. 2002) (finding board service insufficient to cause directors to be interested, at least as long as director received only normal fees); Moran v. Household Int'l, Inc., 490 A.2d 1059, 1075 (Del. Ch. 1985) ("[I]t is . . . obvious that if directors were held to the same standard as ordinary fiduciaries the corporation could not conduct business." (quoting Johnson v. Trueblood, 629 F.2d 287, 292 (3d Cir. 1980))); *see also In re* eBay S'holders Litig., No. 19988-N.C., 2004 Del. Ch. LEXIS 4, at *10–11 (Del. Ch. Feb. 11, 2004) (indicating concern that directors were beholden to other directors for the board positions but also finding that millions of dollars of unvested options affected their lack of independence).

[280] *See supra* notes 192–193 and accompanying text.

[281] *In re* Emerging Commc'ns, Inc. S'holders Litig., No. 16415, 2004 Del. Ch. LEXIS 70, at *142 n.184 (Del. Ch. June 4, 2004).

[282] *Id.* at *111.

[283] *Id.* at *142 n.184.

if such a conflict is necessary for individual liability under the duty of loyalty, then it also would be necessary as a threshold matter for the plaintiffs seeking scrutiny beyond the business judgment rule. The potential precedent from this latter approach based upon *ECM*, even in light of the seemingly inconsistent language in *Disney II*, concerns us here.

The chancery court's language on the potential need for "a self-dealing conflict of interest in the transaction itself"[284] appears to require a two-part inquiry. The plaintiffs presumably would need to establish both that the conflict resulted in self-dealing and that the self-dealing was part of the transaction in question. Self-dealing would include any benefit the directors would ultimately receive other than retention of directorships. If directors derived the benefit as a result of a vote on or other involvement with a transaction, then the benefit could give rise to a conflict that would fit within the court's language.

A careful examination of the *ECM* court's application of its articulated standard implies, however, that it contemplates a higher bar for conflicts. When it got to the stage of determining individual liability, the court found that Raynor voted to approve the price of $10.25 per share to avoid opposing Prosser because "Raynor's economic interests were tied solely to Prosser and he acted to further those economic interests."[285] In the very next sentence, the court held that Raynor had violated his duty of "loyalty and/or good faith,"[286] and attributed its inconclusiveness to its concern that Delaware law might require "a self-dealing conflict of interest in the interest in the transaction."[287] If that were the standard for a loyalty violation, the court believed that Raynor would not have violated his duty of loyalty.

The only way to understand the *ECM* court's analysis is that either the personal "economic interests" Raynor had pursued via his vote did not constitute "self-dealing" or the self-dealing was not sufficiently connected to the transaction to meet the articulated standard. It appears that the court's concern was the latter. By its statement that "Raynor did not benefit directly from the transactions,"[288] the court implied that, in the absence of the direct gain to Prosser, a potential financial quid pro quo to Raynor in return for his vote in favor of the $10.25 share price transaction would not sufficiently become part of the transaction to avoid the business judgment rule and give rise to scrutiny of the transaction for a loyalty violation.

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[284] *Id.*

[285] *Id.* at *142. The court is not clear in this portion of the opinion about the extent of Raynor's economic interests and dependence on Prosser. Earlier, though, it had discussed those interests in detail. *See supra* text accompanying notes 96–105.

[286] *Emerging Commc'ns*, 2004 Del. Ch. LEXIS 70, at *142.

[287] *Id.* at *142 n.184.

[288] *Id.* at *142.

Understood in this way, the court's analysis is troubling. If Raynor had owned ECM stock and benefited financially from the unfairly low purchase price imposed on the minority shareholders, then Raynor's benefit would meet both the self-dealing requirement and the need for the self-dealing to be "in the transaction itself."[289] It is appropriate that minority shareholders receive the protection of scrutiny for compliance with a director's duty of loyalty when the director financially benefits in such a direct way. But, the actual facts also could cause significant loyalty concerns for ECM's minority shareholders. If Raynor in fact derived significant economic gain, or avoided a significant economic harm, as a quid pro quo for his vote in favor of the $10.25 share price transaction, then it does not seem as though the minority shareholders would care that the financial benefit, or avoidance of loss, came from a source other than Raynor's stock ownership in ECM. Either way, his personal financial interests caused Raynor to vote for a transaction that the court eventually found was not fair to the minority shareholders.[290] The source of the funds giving rise to the conflict of interest does not reduce the risk to the minority shareholders; nor does it alter the underlying agency concern. Trustees with conflicts of interest will all too often neglect the best interests of the beneficiary in favor of their own interests.[291]

The implications of the *ECM* analysis for ERISA employer stock cases further reveal the defects in the court's analysis. One typical allegation is that directors and other fiduciaries violate their duties by permitting the continued use of company stock as a voluntary or mandated investment vehicle or the use of company stock as the employer's matching contribution.[292] The approach courts currently use to evaluate what factual allegations are sufficient to survive a motion to dismiss and give rise to scrutiny of the directors' decisions depends in part on whether the plan terms require the use of employer stock.[293]

The notion that, in order to survive a motion to dismiss, plaintiffs in ERISA employer stock cases must allege a "self-dealing conflict of interest in the transaction itself" arguably draws some support from the case law indicating that fiduciaries only have fiduciary obligations to the extent they act as fiduciaries.[294] The traditional import of this well-developed doctrine is to protect fiduciaries from liability when they make business decisions that may cause harm to the interests of benefit plan participants or beneficiaries.[295] The doctrine also protects fiduciaries in circumstances

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[289] *Id.* at *142 n.184.
[290] *Id.* at *137.
[291] *See supra* text accompanying notes 18–19.
[292] *See supra* Part III.C.1.
[293] *See supra* notes 242–245 and accompanying text.
[294] *Id.*
[295] *See* Muir & Schipani, *supra* note 179, at 321–24.

where the fiduciaries make settlor decisions about the plan.[296] In the former situation, the fiduciaries might make a poor business decision that causes the company's profits to drop and thereby reduces the company's contribution to an ERISA profit sharing plan. The poor business decision would harm the ERISA plan participants and beneficiaries but would not give rise to any kind of ERISA fiduciary violation because the directors did not make the business decision in their capacity as ERISA fiduciaries. Or, the fiduciaries might modify prospectively the terms of a plan to decrease participant benefits and make the firm more competitive. That decision would harm participants but would be protected by the settlor doctrine.[297]

It might seem that a director's decision to use company stock in a benefit plan would easily constitute a potential conflict in the transaction itself. However, an established presumption in Employee Stock Ownership Plan (ESOP) law complicates this analysis. *Moench v. Robertson*, an ESOP case from the Third Circuit, established that when the benefit plan's terms require the use of employer stock, the plan's fiduciaries enjoy a presumption of prudence in favor of their decision to use and continue the use of employer stock in the plan.[298] According to *Moench*, fiduciaries enjoy a presumption of prudence for investments in employer stock, but the plaintiffs may rebut the presumption by showing that "circumstances not known to the settlor and not anticipated by him [in the making of such investment] would defeat or substantially impair the accomplishment of the purposes of the trust."[299] In a further refinement, it appears that, at least in some jurisdictions, plaintiffs must prove that "the company is on the brink of collapse or undergoing serious mismanagement" in order to rebut the *Moench* presumption.[300] ESOPs differ from the 401(k) plans that typify the ERISA employer stock cases because ESOPs are statutorily required to invest primarily in employer stock whereas no such provision exists for standard 401(k) plans.[301] Courts deciding ERISA employer stock cases could have distinguished *Moench* on this basis, but multiple courts have applied the *Moench* presumption when analyzing a 401(k) plan fiduciary's prudence.[302] While the *Moench* presumption only explicitly governs the duty of care,[303] not loyalty, the use of the presumption could help explain the

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[296] *Id.*

[297] *Id.* at 321 (describing settlor doctrine as meaning that actions taken to establish, amend, or terminate an employee benefit plan are not fiduciary actions and do no not create fiduciary duties).

[298] 62 F.3d 553 (3d Cir. 1995).

[299] *Id.* at 571 (quoting RESTATEMENT (SECOND) OF TRUSTS § 227 cmt. g (1959)).

[300] *See, e.g.*, Wright v. Oregon Metallurgical Corp., 360 F.3d 1090, 1098 (9th Cir. 2004); *In re* SYNCOR ERISA Litig., 351 F. Supp. 2d 970 (C.D. Cal. 2004).

[301] ERISA § 407(d)(6)(A), 29 U.S.C. § 1107(d)(6) (2000).

[302] *See, e.g.*, Crowley v. Corning, Inc., No. 02-CV-6172 CJS, 2004 U.S. Dist. LEXIS 758, at *20–23 (W.D.N.Y. Jan. 14, 2004); *In re* WorldCom, Inc. ERISA Litig., 263 F. Supp. 2d 745, 764–65 (S.D.N.Y. 2003).

[303] *See* Moench v. Robertson, 62 F.3d 553, 560–61 (3d Cir. 1995). In the ESOP con-

skepticism with which some courts have approached the plaintiffs' loyalty claims. Interestingly, courts are split on whether the presumption should be applied at the motion to dismiss stage.[304]

Even when plan terms do not require the use of company stock, a rote application of the *ECM* court's "transaction itself" standard could lead to the sort of nonsensical analysis performed by the district court in *In re AOL Time Warner, Inc., Securities and "ERISA" Litigation.*[305] Assume directors of Company *A* sell their personal Company *A* stock and, at the same time, continue unchanged the use of Company *A* stock in the company-sponsored employee investment plan as an optional investment vehicle and as the form of the company's matching contributions. Assume also that the directors do not participate, as outside directors typically would not, in the plan. Instead, the directors' Company *A* stock holdings are held in personal accounts unaffiliated with any company-sponsored plan. Assume, finally, that the directors decided not to make any change to the plan's use of Company *A* stock and not to communicate business concerns with participants or beneficiaries solely because the directors wanted to support the price of Company *A* stock while they sold their own holdings. Such a scenario raises egregious duty of loyalty concerns.

Whether application of the *ECM* court's logic and the "self-dealing conflict in the transaction itself" standard to the foregoing situation would permit the plaintiffs to get beyond the motion to dismiss stage, however, depends on how the "transaction itself" requirement is interpreted. Like Raynor, the directors enjoyed a personal benefit—the sale of their own Company *A* stock. There are two transactions that one might look at for the "transaction itself": the personal sale of the Company *A* stock or the plan-related decision. The *AOL Time Warner* court focused on the directors' sales of their personal securities as the transaction in question and dismissed the plaintiffs' loyalty claims because directors do not act as plan fiduciaries when they sell their own non-plan stock.[306]

The claims of the *AOL Time Warner* plaintiffs, however, should not have been evaluated as alleging an ERISA violation and loss based upon the directors' sale of their own securities. Instead, the alleged violation and loss resulted from the directors' decision to continue using company stock in

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text, this duty is often referred to as the "duty of prudence." The statute requires fiduciaries to act "with the care, skill, prudence, and diligence under the circumstances . . . ." ERISA § 404(a)(1)(B).

[304] *Compare In re* Reliant Energy ERISA Litig., 366 F. Supp. 2d 646, 668–69 (S.D. Tex. 2004) (holding the presumption should not be applied at motion to dismiss), *In re* Xcel Energy, Inc. Sec., Derivative & "ERISA" Litig., 312 F. Supp. 2d 1165, 1180 (D. Minn. 2004) (same), *In re* CMS Energy ERISA Litig., 312 F. Supp. 2d 898, 914 (E.D. Mich. 2004) (same), *and In re* EDS Corp. "ERISA" Litig., and 305 F. Supp. 2d 658, 668–70 (E.D. Tex. 2004) (same), *with In re* Sprint Corp. ERISA Litig., 388 F. Supp. 2d 1207 (D. Kan. 2004) (holding allegations were insufficient to rebut the presumption).

[305] No. 02 Civ. 8853, 2005 U.S. Dist. LEXIS 3715 (S.D.N.Y. Mar. 10, 2005).

[306] *Id.* at *25.

the plan.[307] Similarly, in the hypothetical Company *A* situation, the "transaction itself" that matters would be the directors' decision not to change the plan's use of Company *A* stock and not to communicate concerns regarding the stock to the plan participants and beneficiaries. Assuming the directors did not own any stock held by the plan, one analysis would conclude that the directors' personal financial interests were not derived from the "transaction itself," if "transaction" is defined as the plan's continued use of company stock. Instead, the directors' gain came from the unrelated transactions of their personal stock sales. That would logically lead to dismissal of the plaintiffs' case.

An alternative approach that would distinguish the *ECM* situation and find a sufficient conflict in the Company *A* situation would be to focus on the directors' ownership of Company *A* securities, their self-dealing gains derived from Company *A* securities, and the transaction—the decision regarding plan use of Company *A* securities and communication—related directly to the price of Company *A* securities. Therefore, the relationship between the gain and the transaction could be direct enough to support a finding of a conflict of interest and a need for scrutiny. In such a situation, as has occurred in a number of the actual ERISA employer stock cases discussed above, where the directors' gains were derived from stock-based compensation,[308] a finding of a conflict of interest in the Company *A* hypothetical would depend on the application of the *ECM* court's analysis.[309]

2. *An Alternative: A Substantial Lack of Independence*

As an alternative to requiring a self-dealing conflict in the transaction at issue, the courts should recognize that a sufficient lack of independence should trigger scrutiny to ensure a fiduciary has complied with the duty of loyalty. This alternative would appropriately expand beyond the cramped *ECM* approach the types of factual allegations that give rise to scrutiny in line with the approach used in most Delaware cases.[310] For example, the lack of independence would have been sufficient, under the reasoning of the courts in *Orman* and *Hollinger*,[311] to give rise to a potential violation of the duty of loyalty and typically would shift the burden of proof to defendants to prove the entire fairness of the transaction. The *Oracle* court articulated the substantial lack of independence as follows: "The question of independence 'turns on whether a director is, for any sub-

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[307] *Id.*

[308] *See supra* text accompanying notes 210–247.

[309] *See supra* text accompanying notes 96–105.

[310] *See* Sale, *supra* note 103, at 483.

[311] *See* Orman v. Cullman, 794 A.2d 5, 22 (Del. Ch. 2002); Hollinger Int'l, Inc. v. Hollinger Inc., No. 04 C 0698, 2005 WL 589000, at *28 (N.D. Ill. Mar. 11, 2005); see also *supra* text accompanying notes 126–147 for a detailed discussion of these cases.

stantial reason, incapable of making a decision with only the best interests of the corporation in mind.' That is, the independence test ultimately 'focus[es] on impartiality and objectivity.'"[312]

Application of a lack of independence standard would be more complicated in ERISA cases because the statute authorizes conflicted fiduciaries.[313] That authorization, however, is not without boundaries. In addition to the existence of the statutory loyalty provision, the prohibited transactions requirements and the Supreme Court's statement that a basic duty of ERISA fiduciaries is to avoid conflicts of interest serve to limit the acceptance of actions by conflicted fiduciaries.[314] The Supreme Court has also written that conflicts of interest, presumably including a lack of fiduciary independence, should increase the scrutiny given to fiduciaries' interpretation of plan terms.[315] The same logic should require scrutiny for compliance with loyalty when fiduciaries make decisions about the use of employer stock while operating under a substantial lack of independence.

In sum, both Delaware corporate law and the federal law of ERISA rely on the fiduciary obligation of loyalty to prevent self-interested fiduciaries from acting to their own advantage and to the detriment of the shareholders or plan members. It is critical that each legal regime establish a threshold for factual allegations that will give rise to scrutiny of transactions perceived as potential loyalty violations. The Delaware Chancery Court has appropriately recognized that either self-dealing in the transaction or a substantial lack of independence could result in scrutiny.[316] The *ECM* courts' analysis potentially, and unwisely, puts that jurisprudence in question.

Beyond the *Moench* presumption of prudence,[317] which is troubling in itself, the ERISA employer stock cases have not established any clear guidance as to what factual allegations present a threat of fiduciary breach of loyalty. Development of a standard would give guidance to fiduciaries. It would also increase the predictability and efficiency of litigation. The corporate law standards of permitting review where the plaintiffs sufficiently allege self-dealing in the transaction or a substantial lack of independence provide a reasonable starting point for the development of an ERISA standard. Finally, the independence standard respects principles of trust law while giving meaningful deference to fiduciaries.

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[312] *In re* Oracle Corp. Derivative Litig., 824 A.2d 917, 920 (Del. Ch. 2003) (emphasis omitted) (citations omitted).

[313] *See* ERISA § 408(c)(3), 29 U.S.C. § 1108(c)(3) (2000); *see also supra* notes 192–194 and accompanying text.

[314] *See* Mertens v. Hewitt Assocs., 508 U.S. 248, 251–52 (1993).

[315] *See* Firestone Tire & Rubber Co. v. Bruch, 489 U.S. 101, 115 (1989); *see also supra* notes 232–247 and accompanying text.

[316] *See, e.g.*, Orman v. Cullman, 794 A.2d 5, 22 (Del. Ch. 2002); *see also* Official Comm. of Unsecured Creditors of Integrated Health Servs., Inc. v. Elkins, No. Civ.A. 20228-NC, WL 1949290, at *10–11 (Del. Ch. Aug. 24, 2004) (applying *Orman* standards).

[317] *See* Moench v. Robertson, 62 F.3d 553 (3d Cir. 1995).

C. The Duty of Loyalty Analysis

Where plaintiffs sufficiently allege either self-dealing in the transaction or a substantial lack of independence, the next step is to determine the standard to be applied to analyze whether breach of loyalty has occurred. This Section compares Delaware corporate law's entire fairness standard to the approach in the ERISA employer stock cases.

Case law has long held that a corporate action in a company stock transaction would be evaluated using the entire fairness standard.[318] The burden of proof would shift to the conflicted directors to convince the reviewing court that the transaction met both fair price and fair dealing requirements. If the directors did not meet their burden of proof in either prong of the analysis, the court would find a breach of the directors' duty of loyalty.[319] The directors may shift the burden of proof back to the plaintiffs by showing the transaction was approved by a fully informed independent committee of disinterested directors or an informed vote of a majority of the minority shareholders.[320]

As noted above, in *ECM*, the court held that the burden of proof remained with the defendants.[321] Although the directors' independence was in question, the court held that the problem with the special committee's approval of the transaction was that the committee had not received the company's most recent financial projections and was therefore insufficiently informed.[322] Similarly, the vote of the minority shareholders was considered uninformed because they had not received those projections.[323]

In its fair dealing analysis, the court considered factors such as how shareholder approval was obtained, and how the transaction was timed, initiated, structured, negotiated, and disclosed to the board.[324] The court found that the *ECM* transaction was unfair in all these aspects.[325] Moreover, the court noted that a critical aspect of the fair dealing analysis is the adequacy of the representation of the minority shareholders.[326] The court found that neither the majority of the ECM board, nor the special committee it appointed to negotiate for the minority shareholders, was independent, and thus, the interests of the minority shareholders were not adequately represented.[327]

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[318] *See* Weinberger v. UOP, Inc., 457 A.2d 701 (Del. 1983); *In re* Emerging Commc'ns, Inc. S'holders Litig., No. 16415, 2004 Del. Ch. LEXIS 70, at *35–36 (Del. Ch. June 4, 2004); Cinerama, Inc. v. Technicolor, Inc., 663 A.2d 1134, 1140 (Del. Ch. 1994); *see also supra* notes 63–68 and accompanying text.

[319] *See* Cede & Co. v. Technicolor, Inc., 634 A.2d 345 (Del. 1993).

[320] *See Emerging Commc'ns,* 2004 Del. Ch. LEXIS 70, at *38.

[321] *Id.* at *101.

[322] *Id.* at *112–13.

[323] *Id.* at *112–13.

[324] *Emerging Commc'ns*, 2004 Del. Ch. LEXIS 70, at *116–37.

[325] *Id.* at *116–38.

[326] *Id.* at *119–20.

[327] *Id.*

No standard equivalent to the entire fairness standard has emerged in the ERISA employer stock cases. As a general rule, however, the *Employee Benefits Law* treatise states: "Dealing with plan assets in order to further one's own interests rather than those of the plan clearly violates the exclusive benefit rule."[328] Case law outside the ERISA employer stock context adds texture to this principle.

In one case, officers of a company defending against a hostile takeover were also retirement plan fiduciaries.[329] The fiduciaries caused the plan to purchase additional company stock and not to tender any of the stock in the plan.[330] Their actions violated their duty of loyalty to the plan and its participants.[331] The court recognized that some defendants had no assurances of employment after the acquisition or would have diminished roles in the merged entity.[332] The court found that the officers had treated their plan obligations "quite casually"[333] and suggested that the fiduciaries should have obtained independent advice.[334] The court also criticized the fiduciaries for not fully informing themselves about the circumstances of the pension plan and the effect of the company stock investments on the plan.[335] Absent these actions, the court concluded that the fiduciaries had not done enough to ensure the security of the employee benefit plans.[336]

Similarly, in cases not involving company stock, courts have found ERISA loyalty violations where fiduciaries used plan assets to benefit their individual interests. In *Marshall v. Carroll*, the Secretary of Labor alleged that the defendant fiduciaries, an individual and companies he had financial interests in, had breached a variety of fiduciary duties and violated ERISA's prohibited transactions requirements.[337] The defendants had caused plan assets to be invested in a deposit administration group annuity contract, which had terms less favorable to the plans than alternative investments but provided excessive commissions to the defendant fiduciaries.[338] In addition, the defendant fiduciaries had deposited significant sums of plan assets in banks, which in return provided loans to the fiduciaries.[339] The court held that both sets of transactions violated the fiduciaries' duty of loyalty.[340]

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[328] EMPLOYEE BENEFITS LAW, *supra* note 191, at 662.
[329] *See* Donovan v. Bierwirth, 680 F.2d 263, 264–68 (2d Cir. 1982).
[330] *Id.* at 268–69.
[331] *Id.* at 271.
[332] *Id.* at 272 n.9.
[333] *Id.* at 271–72.
[334] *Donovan*, 680 F.2d 263 at 272–73.
[335] *Id.* at 273.
[336] *Id.* at 274.
[337] No. C-79-495-WHO, 1980 U.S. Dist. LEXIS 17767 (N.D. Cal. Apr. 18, 1980).
[338] *Id.* at *15–16.
[339] *Id.* at *18.
[340] *Id.* at *21–22; *see also* Reich v. Lancaster, 55 F.3d 1034, 1058 (5th Cir. 1995) (finding fiduciary breached duty of loyalty by causing health and welfare fund to purchase coverage at unreasonable costs with result that fiduciaries received excessive commis-

The ERISA jurisprudence appears to concentrate its loyalty inquiry on an analysis similar to the fair dealing prong of Delaware's entire fairness standard. In the context of ERISA company stock cases, this would require review of a number of relevant factors in the same way the fair dealing analysis looks at a variety of factors.[341] To fulfill their loyalty obligations, fiduciaries must at relevant times: consider the plan's use of company stock; act appropriately to minimize their conflicts of interest, for example, by obtaining independent advice on the use of company stock; and ensure that the fiduciaries responsible for deciding on the use of company stock receive all reasonably available information relevant to the decision.[342] If plan participants have options involving investment in company stock, they also must receive all reasonably available information relevant to their decision.[343]

The foregoing comparison of the standards used in Delaware corporate law and in the ERISA employer stock cases reveals that Delaware law is more developed and nuanced in this area. Federal district courts are only beginning to evaluate fiduciary actions for duty of loyalty violations in the ERISA employer stock cases, whereas Delaware courts have long subjected corporate fiduciaries to scrutiny for lapses of loyalty in company stock transactions in the general corporate context. Given the equivalent theoretical underpinnings of the two doctrinal areas—both trace their development and application of the duty of loyalty to traditional trust law—Delaware corporate law logically serves as a model for federal courts' ERISA analysis.

One important difference between the two regimes, though, lies in ERISA's explicit provision for conflicted fiduciaries.[344] In contrast, Delaware corporate law encourages decisions by disinterested directors by providing those directors with the benefit of the business judgment rule and, in turn, subjecting interested directors to the enhanced scrutiny of the entire fairness rule.[345] Another distinction militating in favor of some flexibi-

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sions).

[341] *See, e.g.*, *In re* Winstar Energy, Inc., No. 03-4031, 2005 U.S. Dist. LEXIS 28585, at *81–82 (D. Kan. Sept. 29, 2005) (evaluating compensation-based conflicts of interest); *In re* Honeywell Int'l ERISA Litig., No. 03-1214, 2004 U.S. Dist. LEXIS 21585, at *44–45 (D.N.J. Sept. 14, 2004) (allowing loyalty claim based on alleged compensation confcts); Hill v. Bellsouth Corp., 313 F. Supp. 2d 1361, 1370 (N.D. Ga. 2004) (allowing loyalty claim based on fiduciaries' alleged inside information and selling of own securities); *see also* Whitman v. IKON, No. 1318, 2002 U.S. Dist. LEXIS 14683, at *12–13 (E.D. Pa. Aug. 9, 2002) (approving settlement of loyalty claims based on fiduciaries' insider status and appointing independent advisors to serve on plan committee).

[342] We realize this factor implicates insider trading issues under the federal securities laws and, thus, might require broader dissemination of the relevant information. *See* Muir & Schipani, *supra* note 179, at 283–90.

[343] *See supra* Part III.C.3.

[344] *See supra* notes 192–193 and accompanying text.

[345] *See* Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984) (defining business judgment rule); Cinerama, Inc. v. Technicolor, Inc., 663 A.2d 1134 (Del. Ch. 1994) (describing entire fairness review).

lity in the standard applied to ERISA fiduciaries is the provision in ERISA and the Internal Revenue Code that favors the use of company stock in benefit plans.[346] It would be troubling for federal law to encourage the use of company stock in benefit plans and then to always subject plan fiduciaries to enhanced scrutiny in determining whether they met their fiduciary duty of loyalty when making company stock-related plan decisions.

Legitimate reasons exist for utilizing different standards to evaluate whether directors have met their fiduciary obligation of loyalty in the Delaware state corporate law context and in the federal law under ERISA. However, neither area should lose track of the concerns that gave rise to the use of a duty of loyalty in these contexts. Fiduciary directors who enjoy the power to act in transactions where their personal interests conflict with the interests of shareholders or plan participants can be expected to be sorely tempted to act in their own best interests at the expense of the shareholders and the plan participants.

D. The Individual Liability Analysis

The third analytical step taken by the *ECM* court was to determine the liability of individual directors: "The liability of the directors must be determined on an individual basis because the nature of their breach of duty (if any), and whether they are exculpated from liability for that breach, can vary for each director."[347] This is the point at which the court made alternative findings that directors Raynor and Muoio were liable for breaching the "fiduciary duty of loyalty and/or good faith."[348] The existence of a loyalty violation, according to the court, depended on whether a breach of loyalty requires "a self–dealing conflict of interest in the transaction itself."[349]

Such a cramped view of the loyalty analysis has no grounding in prior Delaware law, nor is it consistent with the principles underlying the duty of loyalty. Most of Delaware's loyalty jurisprudence has been developed in the context of the threshold analysis discussed above.[350] It appropriately recognizes that either self-dealing in the transaction or a substantial lack of independence can give rise to scrutiny of the directors' decision.[351]

A more limited standard for the determination of individual liability would be irrational. Assume, for example, that a court finds it appropriate to scrutinize a transaction for loyalty because the directors responsible for

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[346] *See, e.g.*, I.R.C. § 402, 404(a) (2000) (providing immediate deduction for employers' contribution); *see also* Muir & Schipani, *supra* note 179, at 353–54.

[347] *In re* Emerging Commc'ns, Inc. S'holder Litig., No. 16415, 2004 Del. Ch. LEXIS 70, at *140 (Del. Ch. May 3, 2004).

[348] *Id.* at *142 n.184, *146–47.

[349] *Id.* at *142 n.184.

[350] *See supra* Part II.B.

[351] *See, e.g.*, Orman v. Cullman, 794 A.2d 5, 23 (Del. Ch. 2002).

the decision were not sufficiently independent. Suppose too that the court finds the transaction itself does not withstand the entire fairness inquiry. If the cramped *ECM* standard is used and no directors have a self-dealing conflict of interest in the transaction then no director would be individually liable. This result would hold true even if the directors clearly were not independent and personally benefited in indirect ways from their approval of the transaction. Surely, such a result is inconsistent with the principles undergirding the duty of loyalty.

In the ERISA context, separately evaluating the individual liability of fiduciaries is consistent with the understanding that an ERISA fiduciary's liability is limited to acts undertaken as a fiduciary. The individualized inquiries in the ERISA employer stock cases, though, are likely to require evaluation of the actions of a large number of fiduciaries, from the board of directors down to the committee members responsible for plan investments. Regardless of the number of relevant fiduciaries, it is as important in this context as in the general corporate arena that the situations that give rise to a breach of loyalty not be artificially constrained. Here too the possibility for self-interested decision making arises from a substantial lack of independence as well as from a self-dealing conflict in the decision regarding the use of company stock.

V. CONCLUSION

Cases like *Disney II*,[352] *ECM*,[353] *Enron*,[354] *and US Airways*[355] show that the fiduciary duty of loyalty has developed far beyond its historical role as a mechanism governing testamentary trusts. Loyalty now plays a critical role in protecting the capital structure of corporations and the involvement of employers in the benefit plans they sponsor by ensuring that those with power over corporate funds and benefit plan decision-making are not tempted to profit at the expense of those they serve.

As duty of loyalty jurisprudence continues to develop during the current era of recovery from corporate scandal and of sensitivity to employees who have seen their retirement dreams fade along with their 401(k) account balances, the doctrine must strike a balance. The doctrine cannot hold fiduciaries liable for merely being fiduciaries. In the corporate context, the *Disney II* court articulated a strong standard of loyalty.[356] The court reiterated that "there is no safe-harbor for divided loyalties in Delaware"[357] and applied the loyalty standard in a way that recognized the realistic limits on corporate decision-making and the danger of arguments based

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[352] No. 15452, 2005 Del. Ch. LEXIS 113 (Del. Ch. Aug. 9, 2005).
[353] No. 16415, 2004 Del. Ch. LEXIS 70 (Del. Ch. June 4, 2004).
[354] 284 F. Supp. 2d 511 (S.D. Tex. 2003).
[355] 397 F. Supp. 2d 758 (E.D. Va. 2005).
[356] *See Disney II*, 2005 Del. Ch. LEXIS 113, at *164.
[357] *Id.* (citing Weinberger v. UOP, Inc., 457 A.2d 701, 710 (Del. 1983)).

on hindsight. In contrast, corporate cases like *ECM* have appeared to set arbitrary standards for fiduciary analysis.[358] The doctrine cannot be so cramped as to ignore fact patterns that raise valid loyalty concerns. Similarly, in the context of whether fiduciary compensation can affect breach of loyalty analysis, the courts in *In re Polaroid ERISA Litigation*,[359] *In re WorldCom, Inc. ERISA Litigation*,[360] and in *In re AOL Time Warner, Inc. Securities and "ERISA" Litigation*,[361] have taken a very narrow view. While predictability of outcome is valuable, fiduciary analysis has always been flexible in an effort to protect the relatively powerless from the self-dealing of those they have trusted to act on their behalf. The goal should not be to develop an arbitrary, bright-line approach that relies on a particularized type of conflict of interest. Instead, *Disney II* correctly required that corporate directors take seriously the duty of loyalty they owe to corporate shareholders. The standard for the duty of loyalty can be both strong and flexible, scrutinizing both self-dealing and a lack of independence.

[358] *See Emerging Commc'ns*, 2004 Del. Ch. LEXIS 70, at *140–42.
[359] 362 F. Supp. 2d 461 (S.D.N.Y. 2005).
[360] 263 F. Supp. 2d 745 (S.D.N.Y. 2003).
[361] No. 02 Civ 8853, 2005 U.S. Dist. LEXIS 3715 (S.D.N.Y. Mar. 10, 2005).

ARTICLE

UNITED STATES MILITARY AND CENTRAL INTELLIGENCE AGENCY PERSONNEL ABROAD: PLUGGING THE PROSECUTORIAL GAPS

JOHN SIFTON*

The U.S. government has not held its personnel accountable for detainee abuse committed overseas. This lack of accountability is at least partly attributable to inherent flaws in military and federal criminal law. This Article introduces the detainee abuse problem and outlines systemic prosecutorial hurdles and criminal defenses that complicate accountability efforts. The Article concludes with recommendations that could help enable real accountability for detainee abuse cases.

The U.S. government has not held its personnel accountable for detainee abuse committed overseas. Hundreds of cases of detainee abuse and killings have occurred in Afghanistan and Iraq since late 2001, but only a handful of people—mostly enlisted soldiers—have been sentenced to significant prison time.[1] This lack of accountability is at least partly attributable to inherent flaws in military and federal criminal law that make prosecution of detainee abuse difficult.

Part I of the Article provides an introduction to the problem of detainee abuse. Part II outlines the systemic hurdles in military and federal law that make prosecutions difficult. Part III discusses the legal defenses to prosecution that further complicate accountability efforts. Part IV offers recommendations for Congress and the Executive Branch that could help remove the systemic hurdles to abuse prosecution, thereby enabling real accountability for detainee abuse.

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[1] *See infra* Parts I.A–B.

I. THE PROBLEM OF DETAINEE ABUSE

A. Mistreatment and Torture of Detainees Is Widespread

Since late 2001, the U.S. military and the Central Intelligence Agency ("CIA") have detained and interrogated tens of thousands of battlefield combatants and terrorist suspects worldwide.[2] The arrests have taken place in a broad spectrum of contexts: in battlefield operations in Afghanistan and Iraq,[3] in counter-terrorism raids in locales such as Rawalpindi and Bangkok,[4] and in roundups conducted by cooperating foreign authorities that transfer prisoners to U.S. custody.[5] In Afghanistan, those arrested over the years have included Taliban troops, civilians, and foreign combatants from various countries who fought with the Taliban.[6] In Iraq, detainees include Iraqi military troops and insurgent combatants, Iraqi civilians, and a few foreign insurgents.[7] Some of the detainees arrested since 2001 have been held for a short term and released, while others (such as suspected terrorist planners) have been kept for years.[8] Many of those detained by the

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[2] The U.S. Department of Defense ("DOD") claimed to have detained a total of approximately 83,000 detainees since late 2001, of which about 3800 have been held for more than one year. *See* Katherine Shrader, *U.S. Has Detained 83,000 in War on Terror*, ASSOCIATED PRESS, Nov. 16, 2005. As of November 2005, around 14,500 detainees were still in U.S. custody, mostly in Iraq, although over 500 were being held at the Guantanamo Bay detention facility. *Id.* In addition, a number of unregistered "ghost detainees" have been held by the CIA without being processed in official channels. *See* Josh White, *Army Documents Shed Light on CIA "Ghosting,"* WASH. POST, Mar. 24, 2005, at A15; Josh White, *Army, CIA Agreed on "Ghost" Prisoners*, WASH. POST, Mar. 11, 2005, at A16. The list of possible "ghost detainees" includes persons suspected of high-level involvement in the 9/11 attacks, the 2002 Bali bombings, and the 1998 embassy bombings in Tanzania and Kenya. *See* Human Rights Watch, *List of Ghost Prisoners Possibly in CIA Custody*, Nov. 30, 2005, http://hrw.org/english/docs/2005/11/30/usdom12109.htm.

[3] *See, e.g.*, Dana Priest & Joe Stephens, *Secret World of U.S. Interrogation*, WASH. POST, May 11, 2004, at A1; Edward Wong, *American Jails in Iraq Bursting with Detainees*, N.Y. TIMES, Mar. 4, 2005, at A1.

[4] *See, e.g.*, Erik Eckholm & David Johnston, *Qaeda Suspect Sound Asleep at Trail's End*, N.Y. TIMES, Mar. 3, 2003, at A1 (describing arrest of terrorist suspect Khalid Sheikh Mohammad in Rawalpindi, Pakistan); Ellen Nakashima & Alan Sipress, *Tips, Traced Calls Led to Fugitive; Al Qaeda Suspect Was Tracked Through Four Countries*, WASH. POST, Aug. 17, 2003, at A16 (detailing arrests by U.S. and Thai authorities in Bangkok).

[5] *See, e.g.*, David S. Cloud, *Long in U.S. Sights, A Young Terrorist Builds Grim Resume*, WALL ST. J., Feb. 10, 2004, at A1 (detailing arrest of terrorist suspect in Azerbaijan and transfer to U.S. authorities); Nick Paton Walsh, *Al-Qaida Men Handed to US, Says Georgia*, GUARDIAN, Oct. 23, 2002, at 14 (detailing transfer of terrorist suspects by Georgian authorities to U.S. custody).

[6] *See, e.g.*, Eric Schmitt & Tim Golden, *A Growing Afghan Prison Rivals Bleak Guantanamo*, N.Y. TIMES, Feb. 26, 2006, § 1, at 1 (outlining detention record at Bagram Air Base, the main U.S. detention facility in Afghanistan).

[7] *See, e.g.*, Peter Eisler & Tom Squitieri, *Foreign Detainees Are Few in Iraq*, USA TODAY, July 6, 2004, at A1 (describing detainees as mainly insurgents).

[8] *See, e.g.*, Schmitt & Golden, *supra* note 6 (detailing detentions at Bagram Air Base in Afghanistan ranging from months to sometimes years, with an average detention time of fourteen and a half months); Priest & Stephens, *supra* note 3 (detailing detentions of various lengths in Afghanistan, Iraq, Guantanamo Bay, and secret CIA prisons).

United States since 2001 have been civilians, unconnected to military, insurgency, or terrorist- related activities.[9]

Abuse of detainees has been a chronic problem, though by no means universal. However, because of security limitations and military obstructionism, gauging the full scope of abuse is difficult, if not impossible. The Detainee Abuse and Accountability Project ("DAA Project") conducted by Human Rights Watch, Human Rights First, and the Center for Human Rights and Global Justice at New York University School of Law has recorded 330 separate incidents in which U.S. personnel are alleged to have committed abuses of detainees, ranging from simple assaults to murders, encompassing over a thousand individual criminal acts (incidents in some cases involved more than one type of abuse).[10] An estimated 600 personnel are implicated in the alleged abuses, which involve roughly 460 detainees (some incidents involve multiple detainees or multiple accused personnel).[11]

B. Few Abuse Prosecutions Have Been Pursued

Since the Abu Ghraib scandal broke in May 2004, the Bush Administration and the Department of Defense ("DOD") have repeatedly claimed that abuse allegations are robustly investigated and prosecuted.[12] Available data and information, however, do not support that assertion. The Pentagon and Army have each claimed that military investigators have looked into more than 600 allegations of abuse since October 2001,[13] but the DAA Project has found evidence of only approximately 210 incidents in which investigations have been announced.[14]

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[9] *See, e.g.*, Greg Miller, *Many Held at Guantanamo Not Likely Terrorists*, L.A. TIMES, Dec. 22, 2002, at 1 (reviewing record of U.S. detentions of Afghan farmers and taxi drivers, among others, at Guantanamo Bay).

[10] *See* HUMAN RIGHTS WATCH, HUMAN RIGHTS FIRST, AND THE CENTER FOR HUMAN RIGHTS AND GLOBAL JUSTICE AT NYU SCHOOL OF LAW, DETAINEE ABUSE AND ACCOUNTABILITY PROJECT 5 (forthcoming Spring 2006) [hereinafter DAA PROJECT].

[11] *Id.*

[12] *See, e.g.*, Richard A. Oppel, Jr., & Ariel Hart, *Contractor Indicted in Afghan Detainee's Beating*, N.Y. TIMES, June 18, 2004, at A1 (quoting Attorney General John Ashcroft's statement that "[t]he United States will not tolerate criminal acts of brutality and violence against detainees . . . ."); *The Ongoing Investigation into the Abuse of Prisoners Within the Central Command Area of Responsibility: Before the H. Armed Serv. Comm.*, 108th Cong. 13 (2005) (statement of Secretary of Defense Donald Rumsfeld) ("It is my obligation to evaluate what happened, to make sure those who have committed wrongdoing are brought to justice, and to make changes as needed to see that it doesn't happen again."); Interview by Al-Arabiya Television with President George W. Bush (May 5, 2004) ("[W]e will find the truth, we will fully investigate. The world will see the investigation and justice will be served.").

[13] Donna Miles, *Rumsfeld: Military Always Has Banned Detainee Abuse*, AMERICAN FORCES PRESS SERVICE, Dec. 16, 2005, http://www.defenselink.mil/news/Dec2005/20051216_3679.html (last visited Apr. 15, 2006); Eric Schmitt, *Iraq Abuse Trial Is Again Limited to Lower Ranks*, N.Y. TIMES, Mar. 23, 2006, at A1.

[14] DAA PROJECT, *supra* note 10, at 5.

The military has also failed to prosecute substantiated abuse. The DAA Project found only sixty-three cases that have proceeded to courts-martial—most other cases of substantiated abuse were either dismissed or brought before non-judicial administrative hearings.[15] Of the thirty-nine defendants sentenced to prison time,[16] only ten have been sentenced to prison time longer than a year.[17] In at least fifty-seven cases, personnel have been sent into non-judicial hearings, which cannot order sentences of confinement.[18]

Very few officers have been punished for abuse overseas, and the few cases in which officers have been court-martialed or disciplined have involved officers' direct participation in crimes. Not one officer has been convicted as a principal under the doctrine of command responsibility or for dereliction of duty in failing to stop abuses.[19]

The record with civilians is even worse. The DOD reportedly referred eleven cases of detainee abuse by civilian contractors to the Department of Justice ("DOJ") for investigation. Yet, as of early 2006, the DOJ has not begun prosecution of any cases involving those contractors.[20]

The CIA does not release information concerning its internal investigations, but the CIA Inspector General's Office opened as many as five investigations into criminal abuses, including four cases of homicides.[21] Yet, federal prosecutors have filed only a single indictment, in the case of a CIA contractor, David Passaro, who allegedly beat to death an Afghan detainee in eastern Afghanistan in June 2003 and was indicted in 2004 for assault.[22] At the time of this writing, no other CIA personnel have been prosecuted.[23]

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[15] *Id.* at 6.

[16] *Id.* at 7.

[17] *Id.*

[18] *Id.* at 6. The military contends that 234 abuse cases were resolved as of April 2006, in the following manner: "there have been 85 Courts-Martial (CM), 93 Non-Judicial Punishments (NJP) and 81 admin[istrative] actions." The military refused to provide details on the 178 cases dealt with non-judicially or administratively. E-mail from Maj. Wayne Marotto, Public Affairs Staff Officer, Department of the Army, to DAA PROJECT Researchers (Apr. 7, 2006, 10:50 EST) (on file with author).

[19] DAA PROJECT, *supra* note 10, at 8; *see infra* Part II.A.2.

[20] *See* Letter from William E. Moschella, Assistant Attorney General, to Senator Richard Durbin (Jan. 17, 2006), *available at* http://www.aclu.org/images/asset_upload_file606_23910.pdf (noting cases that have been referred to Department of Justice ("DOJ") and stating that the DOJ has not begun prosecutions in any of them).

[21] *See* Douglas Jehl & Tim Golden, *C.I.A. Is Likely to Avoid Charges in Most Prisoner Deaths*, N.Y. TIMES, Oct. 23, 2005, at A6 (detailing four homicide cases).

[22] United States v. Passaro, No. 5:04-CR-211-1 (E.D.N.C. filed June 17, 2004), *available at* http://www.cdi.org/news/law/cia-contractor-indictment-passaro.pdf.

[23] *See* Letter from William E. Moschella to Senator Richard Durbin, *supra* note 20. According to the Moschella letter, of the twenty total recorded allegations, investigations in two cases "have been completed and the Department has determined in each of them that there was insufficient evidence to support a prosecution. The remaining allegations remain under investigation." *Id.*

II. THE HURDLES TO PROSECUTING U.S. PERSONNEL

Prosecutors face many hurdles in seeking and obtaining convictions for crimes involving abuse of detainees overseas. Broadly speaking, two types of problems exist under the current legal framework that impede prosecutions: those arising from *substantive issues* and those arising from *jurisdictional issues*.

On a purely substantive basis, abusive acts have not been clearly or adequately criminalized in military and federal law. Definitional ambiguities exist in some criminal statutes, and many types of abuses are not covered at all. Under military law, there are no statutes criminalizing war crimes, torture, or cruel, inhuman, or degrading treatment, and it is difficult to hold officers accountable for the abuses of their subordinates.[24] Under federal law, torture is defined narrowly,[25] and the federal criminal statute on war crimes does not sufficiently define its elements.[26] At the same time, acts of torture and other cruel, inhuman or degrading treatment are difficult to prosecute under assault laws or other federal statutes.[27] Moreover, even when convictions can be attained, maximum punishments for many abuse crimes are surprisingly low.[28]

Even if substantive provisions were thorough and clear, abuse prosecutions would remain difficult because extraterritorial jurisdiction over non-military personnel and veterans is riddled with gaps and is overly complex. The Torture Statute, until recently, contained a major gap in its territorial application,[29] and the War Crimes Statute arguably does not apply in non-conflict contexts.[30] Federal assault and homicide statutes, in most cases, do not apply to non-military personnel overseas.[31]

A. Prosecuting Abuses Under Military Law

Members of the military are subject to state and federal laws, but in practice the primary vehicle for enforcing criminal law in the military is the Uniform Code of Military Justice (UCMJ).[32] The UCMJ criminalizes

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[24] *See infra* Part II.A.
[25] *See infra* Part II.B.1.
[26] *See infra* Part II.B.2.
[27] *See infra* Part II.B.3.
[28] *See infra* notes 41–48 and accompanying text.
[29] *See infra* Part II.B.1.c.
[30] *See infra* Part II.B.2.
[31] *See infra* Part II.B.3.c.
[32] *See* UNIF. CODE OF MIL. JUST. (codified at 10 U.S.C. §§ 801–950 (2000)). The military can transfer certain cases to the DOJ for prosecution—for instance, cases of fraud and embezzlement—but under a memorandum of understanding between the Departments of Justice and Defense, most offenses committed by military personnel are disposed of under the UCMJ. *See* Memorandum of Understanding Between the Dept's of Justice and Defense Relating to the Investigation and Prosecution of Certain Crimes, part C, Investigative and Prosecutive Jurisdiction (August 1984), *in* MANUAL FOR COURTS-MARTIAL, UNITED

certain acts committed by military personnel at home and overseas, from simple assault to homicide.[33] There are no territorial jurisdictional limits on the UCMJ: soldiers are criminally liable for conduct they commit anywhere in the world.[34]

1. General Provisions

Though the UCMJ provides for punishments by courts-martial for violations of the laws of war,[35] it contains no provisions directly prohibiting torture or war crimes as such, and fails even to define the elements and punishments for such crimes. Accordingly, there are no heightened criminal sanctions under military law for torture or violations of the Geneva Conventions. If a member of the military tortures a detainee, he or she can only be prosecuted by court-martial for assault,[36] cruelty and maltreatment,[37] and possibly "maiming,"[38] as well as under the UCMJ's catch-all article 134, which allows prosecutions in general for acts that harm the "good order and discipline in the armed forces."[39]

However, the maximum sentences under the UCMJ for abuse-related crimes can be quite low. Simple assault is capped at six months of confinement, while the maximum punishment for aggravated assault is only three to five years, depending on the circumstances.[40] The maximum punishment for a charge of "cruelty and maltreatment" is only one year.[41] "Maiming" carries a maximum punishment of seven years but requires an intent to injure and heightened proof of physical disfigurement or the destruction of a bodily part, which would not apply in a variety of torture

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STATES A3–4 (2002 ed.) [hereinafter MCM].

[33] *See* 10 U.S.C. §§ 928 (assault), 893 (cruelty and maltreatment), 924 (maiming), 918 (murder), & 919 (manslaughter); *see also infra* note 39 on UNIF. CODE OF MIL. JUST., art. 134.

[34] 10 U.S.C. § 805; *see also* RULES FOR COURTS-MARTIAL, 201(a)(2), *in* MANUAL FOR COURTS-MARTIAL, UNITED STATES (2002 ed.) [hereinafter RCM] ("The Code applies in all places.").

[35] *See* 10 U.S.C. § 818 ("General courts-martial also have jurisdiction to try any person who by the law of war is subject to trial by a military tribunal and may adjudge any punishment permitted by the law of war."); *see also* RCM 201(f)(1)(B).

[36] 10 U.S.C. § 928.

[37] *Id.* § 893.

[38] *Id.* § 924.

[39] *Id.* § 934. In general, article 134 prohibits "disorders and neglects to the prejudice of good order and discipline in the armed forces, [and] all conduct of a nature to bring discredit upon the armed forces." Specific article 134 "crimes" are defined in the MCM. Those applicable to detainee abuse cases include "communicating a threat" and "negligent homicide." MCM, *supra* note 32, pt. IV, ¶¶ 85, 110.

[40] MCM pt. IV, ¶ 54(e)(2), (8)–(9). The maximum punishment for "assault with a dangerous weapon or other means of force likely to produce death or grievous bodily harm" is three years. *Id.* ¶ 54(e)(8)(b). The maximum punishment for "assault in which grievous bodily harm is intentionally inflicted" is five years. *Id.* ¶ 54(e)(9)(b). Prosecution for assault with intent to commit murder provides for a more robust maximum punishment of twenty years. *Id.* ¶ 64(e).

[41] *See id.* ¶ 17(e).

cases that do not involve such injuries.[42] If military commanders opt to use a special or summary court-martial, maximum sentences are even lower.[43] The maximum punishment for soldiers prosecuted by Special Court-Martial is one year of confinement,[44] while Summary Courts-Martial can only order thirty days confinement.[45]

Prosecutors can obtain additional sentences under other criminal provisions, such as failure to obey orders or regulations (dereliction of duty), with punishments ranging from six months to two years,[46] or "false official statements," with a maximum punishment of five years.[47] While prosecutors can of course seek consecutive sentences, the fact remains that the available sentences for substantive abuses are quite low. Thus, it is possible that even soldiers who have severely tortured detainees can receive minor punishments of mere months of confinement. Such outcomes have, in fact, occurred in Iraq.[48]

To make matters worse, prosecutorial independence in the military is severely limited. Any individual prosecution can be vetoed by the accused personnel's commanding officer,[49] creating a conflict of interest in any case in which a commander's own conduct might be called into question. A commander can simply punish enlisted personnel or subordinate officers using "administrative action"[50] or even decide that an alleged offense will not be prosecuted at all.[51]

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[42] *See id.* ¶ 50(f). The defendant must be shown to have intentionally inflicted an injury that "seriously disfigured the person's body, destroyed or disabled an organ or member, or seriously diminished the person's physical vigor by the injury to an organ or member." *Id.* ¶ 50(b)(2).

[43] Special courts-martial can be convened by lower rank officers than general courts-martial. They have similar jurisdiction to general courts-martial, but cannot try capital cases. *See* 10 U.S.C. § 823(a) (2000). Summary courts-martial are specifically meant for minor offenses. RCM, *supra* note 34, 1301(b) ("The function of the summary court-martial is to promptly adjudicate minor offenses under a simple procedure.").

[44] 10 U.S.C. § 819.

[45] 10 U.S.C. § 820.

[46] MCM, *supra* note 32, pt. IV, ¶ 16(e); *see also* 10 U.S.C. § 892.

[47] MCM pt. IV, ¶ 31(e); *see also* 10 U.S.C. § 907.

[48] In a case from April 2003, a Marine shown to have mock-executed four Iraqi juveniles (by making them kneel next to a ditch and firing his weapon to simulate an execution) was found guilty of cruelty and maltreatment and sentenced to thirty days hard labor without confinement and a fine of $6336. *See* United States Marine Corps, *USMC Alleged Detainee Abuse Cases Since 11 Sep 01*, at 2 (2004), *available at* http://www.aclu.org/torturefoia/released/navy3740.3749.pdf (last visited Apr. 15, 2006). Two other marines who used an electrical transformer to shock a detainee were found guilty of assault, cruelty and maltreatment, dereliction of duty, and conspiracy, but were sentenced to only eight months and one year respectively. *See id.* at 3.

[49] RCM, *supra* note 34, 306(a) ("Each commander has discretion to dispose of offenses by members of that command.").

[50] *Id.* 306(c)(2) ("A commander may take or initiate administrative action, in addition to or instead of other action taken under this rule, subject to regulations of the Secretary concerned. Administrative actions include corrective measures such as counseling, admonition, [and] reprimand.").

[51] *Id.* 306(c)(1) ("A commander may decide to take no action on an offense. If charges have been preferred, they may be dismissed.").

Commanding officers can also push criminal cases into non-judicial administrative proceedings, called Article 15 hearings.[52] Article 15 hearings are meant for "minor offenses,"[53] with available penalties including reprimands, admonishments, pay and rank reductions, or imposition of extra duties.[54] In some cases, Article 15 hearings can result in confinement to quarters or correctional custody, but only for short durations, usually no more than one week.[55] Troublingly, Article 15 hearings have been used in Iraq and Afghanistan to prosecute even serious offenses, thus allowing personnel accused of detainee abuse to escape with a punishment that, when compared to the criminal liability at stake in a court-martial, amounts to a slap on the wrist.[56]

Lastly, officers and enlisted personnel can also be discharged from the military in lieu of prosecution.[57] Discharge is hardly a punishment for some, and is notably deficient as a punishment for another reason: the military cannot prosecute most veterans. Retired regular officers can be court-martialed, but once non-officer soldiers are fully detached from service, they are not subject to courts-martial jurisdiction.[58] However, like all members of the military, discharged personnel can be prosecuted under ordinary federal criminal law.

2. *Command Responsibility*

Under military law, there are serious hurdles to punishing commanders for abuses committed by their subordinates, even under the doctrine of command responsibility. The command responsibility doctrine, which specifies that commanding officers are ultimately responsibility for the

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[52] *See* RCM 306(c)(3); *see generally* MCM, *supra* note 32, pt. V.

[53] 10 U.S.C. § 815(b) (Supp. II 2003).

[54] *See id.*

[55] *See id.*; *see also* MCM pt. V, ¶ 5(b).

[56] *See* DAA PROJECT, *supra* note 10, at 9. In one case from Iraq in 2003, three soliders in the Army's 519th Military Intelligence Battalion sexually assaulted a female detainee. Commanders chose to punish the soliders non-judicially rather than convene courts-martial. The three soliders each received one month of confinement; one of the soliders was fined $500 while the other two were fined $750. *See* COMMANDER'S REPORT OF DISCIPLINARY OR ADMINISTRATIVE ACTION (2004), *available at* http://www.aclu.org/torturefoia/released/22TFa.pdf; AGENT NOTES AND SUPPLEMENTARY DOCUMENTS FROM THE FIELD FILE (2003), http://www.aclu.org/torturefoia/released/22TFb.pdf; *see also* Elise Ackerman, *Prisoner Abuse in Afghanistan May Have Foreshadowed Iraq Scandal*, MILWAUKEE J. SENTINEL, Aug. 23, 2004, at A6 (describing seemingly overly lenient non-judicial punishments in Afghanistan and Iraq).

[57] *See* RCM, *supra* note 34, 306(c)(1). Commanders can choose to take no action on recommended criminal charges and subsequently recommend that a soldier be discharged. If the solider does not contest the discharge, the matter can be closed without a judicial or administrative hearing. Alternately, a soldier who is facing prosecution can request discharge in lieu of prosecution. *See id.*

[58] *See* 10 U.S.C. § 802 (2000) (defining persons subject to the UCMJ). Some persons, such as civilians who are in inactive reserve components of the armed forces, remain subject to the UCMJ in certain circumstances. *See generally* RCM 202.

successes, failures, and criminal acts of forces under their command, serves as a cornerstone to military command structure and has a long tradition in military culture.[59] Except for one instance arising during the Vietnam War, *United States v. Medina*,[60] the doctrine remains largely untested under U.S. military law, and open questions remain about its actual effectiveness in future prosecutions.

Any prosecution of officers under a command responsibility theory would occur through court-martial, where the officer would be charged as a principal for crimes committed by subordinates.[61] To prove that an officer is a principal to a crime, a prosecutor must show that the commander aided, abetted, counseled, commanded, procured, or caused the commission of the offense in question.[62] Non-perpetrators can be found guilty of an offense if they "assist, encourage, advise, counsel, or command another in the commission of the offense, and share in the criminal purpose or design."[63]

Also, the Manual for Courts-Martial ("MCM") further suggests that an affirmative act may not be necessary: "In some circumstances, inaction may make one liable as a party, where there is a duty to act."[64] However, inaction can suffice as a basis for prosecution only if "such a noninterference is intended to and does operate as an aid or encouragement to the actual perpetrator."[65] In *Medina*, the judge interpreted Article 77 to require actual knowledge of criminal abuses occuring and failure to stop them.[66]

The Article 77 explanation in the MCM and the *Medina* interpretation appear to create a more stringent standard for prosecutors to surmount than that supplied by the traditional command responsibility standard of international humanitarian law, under which commanders may be held liable when they fail to act and "knew or should have known" illegal abuses were occurring.[67] Under the Article 77 and *Medina* standards, prosecutors could face problems proving commanders' criminal liability in cases in which "actual knowledge" cannot be shown, there is no "duty" to act, or when a commander cannot be shown to have intended to aid or encourage the commission of the offense.

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[59] *See generally* Michael L. Smidt, *Yamashita, Medina, and Beyond: Command Responsibility in Contemporary Military Operations*, 164 MIL. L. REV. 155 (2000).

[60] 43 C.M.R. 243 (1971); *see also* C.M. 427162 (1971), *reprinted in* Kenneth A. Howard, *Command Responsibility for War Crimes*, 21 J. PUB. L. 7, 8–12 (1972).

[61] 10 U.S.C. § 877 (defining "principal").

[62] *See id.*

[63] *See* MCM, *supra* note 32, pt. IV, ¶ 1(b)(2)(b).

[64] *Id.*

[65] *Id.*

[66] *See* 43 C.M.R. 243; *see also* Smidt, *supra* note 59, at 193–98 (comparing the *Medina* standard with that found in the MCM).

[67] *See* Mark J. Osiel, *Obeying Orders: Atrocity, Military Discipline, and the Law of War*, 86 CAL. L. REV. 939, 971–72 (1998); Timothy Wu & Yong-Sung (Jonathan) Kang, *Criminal Liability for the Actions of Subordinates—The Doctrine of Command Responsibility and Its Analogues in United States Law*, 38 HARV. INT'L L.J. 272, 276–78 (1997).

3. Failure To Obey and Dereliction of Duty

Notwithstanding the problems surrounding command responsibility, prosecutors may be able to charge commanders in abuse cases under UCMJ Article 92, which allows the prosecution of officers (as well as enlisted personnel) for "violation of or failure to obey a lawful general order or regulation,"[68] and for "dereliction in the performance of duties."[69] Each of these would presumably include officers' failures to perform their duties under international humanitarian law to stop abuses by subordinates.[70] Unfortunately, maximum punishments under Article 92 are quite low: only three to six months for "dereliction in the performance of duties" and two years for "violation of or failure to obey regulations."[71]

Moreover, such prosecutions could be complicated where officers can show that they were authorized to commit certain activities, for instance, where interrogation rules of engagement were promulgated authorizing commanders to use interrogation techniques that were, in fact, unlawful. The resulting clash of regulations and duties could make it extremely difficult to prosecute a dereliction of duty case.[72]

B. Prosecuting Abuses Under Federal Criminal Law

The task of prosecuting CIA personnel, civilian contractors, and veterans detached from service is even more problematic than prosecuting active military personnel. While federal law contains provisions allowing the prosecution of civilians for crimes overseas, most of the laws contain definitional ambiguities and jurisdictional loopholes that make prosecution difficult.

1. The Torture Statute

The federal Torture Statute[73] allows the government to prosecute torture committed outside the United States. The statute defines "torture" as conduct "specifically intended" to cause "severe physical or mental pain or suffering."[74] The defined punishments are robust, allowing for imprison-

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[68] 10 U.S.C. § 892(1) (2000).

[69] *Id.* § 892(3).

[70] The "duties" noted in Article 92 can be imposed by "treaty, statute, regulation, lawful order, standard operating procedure, or custom of the service." MCM, *supra* note 32, pt. IV, ¶ 16(b)(3)(a).

[71] *Id.* ¶ 16(e).

[72] *See infra* Part III.

[73] 18 U.S.C.A. § 2340A (West 2004).

[74] *Id.* § 2340(1).

ment of up to twenty years.[75] If a torture victim is killed, prosecutors can seek the death penalty or life imprisonment.[76]

The Torture Statute has been in existence for only ten years, and no charges have yet been brought under it.[77] When the Senate debated, affirmed and consented to the U.N. Convention Against Torture in 1990,[78] implemented via the Torture Statute in 1994, the prevailing notion was that it would benefit potential torture victims in other countries by strengthening prohibitions against torture internationally.[79] There was little debate about dealing with torture as an American phenomenon.

"We do not have a torture problem within the United States," said Abraham Sofaer, testifying as the legal advisor to the Department of State before the Senate Committee on Foreign Relations in 1990.[80] Janet Mullins, President George H. Bush's assistant secretary of state for legislative affairs, wrote to Senator Pressler in 1990, "[T]here is no possibility of a well-founded indication of systematic torture in the United States . . . . To our knowledge, no human rights group has ever accused the United States of systematic torture."[81]

a. Specific Intent

Serious definitional issues surround the Tortute Statute as it stands today. Defense attorneys could raise the legal argument that a torture conviction requires evidence of "specific intent" to cause *severe* pain or suffering.[82] If that argument were to succeed, defendants in cases involving interrogation techniques such as prolonged sleep deprivation, constant shackling, and forced standing could claim that they did not intend to cause the *severe* pain or suffering that did in fact occur. Though in many or most cases specific intent could be inferred from the circumstances surrounding such acts alone, the clause could still present a hurdle for prosecutors in obtaining convictions for seemingly outrageous mistreatment of detainees.

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[75] *Id.* § 2340A(a).

[76] *Id.*

[77] *See* Matthew McAllester, *War Criminals in the U.S.: 1994 Anti-Torture Statute Still Sits Unused*, NEWSDAY (New York), Mar. 14, 2006, at A20.

[78] The United Nations Convention Against Torture and Other Forms of Cruel, Inhuman or Degrading Treatment or Punishment, G.A. Res. 39/46, U.N. Doc. A/39/51 (Dec. 10, 1984); U.S. Senate Advice and Consent to the Ratification of the Convention Against Torture, 136 CONG. REC. S17,486 (1990).

[79] *See, e.g.*, S. EXEC. REP. NO. 101-30, at 4 (daily ed. Oct. 2, 1990) (stating that "the United States will be in a stronger position to prosecute alleged torturers and to bring to task those countries in the international arena that continue to engage in this heinous and inhumane practice.").

[80] *Convention Against Torture: Hearing on Advice and Consent to Treaty 100-20 Before the S. Comm. on Foreign Relations*, 101st Cong. 718 (1990) (statement of Abraham Sofaer, Legal Advisor, Department of State).

[81] Letter from Janet Mullins, Assistant Secretary of State for Legislative Affairs, to Senator Larry Pressler (Apr. 4, 1990) (reprinted in S. EXEC. REP. NO. 101-30, at 40 (1990)).

[82] 18 U.S.C.A. § 2340(1) (West 2004).

Indeed, the DOJ's Office of Legal Counsel (OLC) produced a memorandum for the Bush administration in 2002 arguing for exploitation of this very loophole.[83] The memorandum outlined the distinction between general and specific intent requirements in the Torture Statute and argued that the higher bar is applicable in torture prosecutions.[84] The memorandum claimed that in the context of prosecuting torture, "knowledge alone that a particular result is certain to occur [i.e., severe pain or suffering] does not constitute specific intent."[85] However, the memorandum finally notes that the distinction is primarily "theoretical" and that as a practical matter juries could generally infer "intent" from factual circumstances.[86]

The 2002 memorandum was later repudiated by a December 2004 memorandum from the OLC's Daniel Levin, which stated that "it would not be appropriate" for the government to exploit the theoretical distinction in the specific intent requirement "to approve as lawful conduct that might otherwise amount to torture."[87] Even if the repudiated 2002 memorandum's interpretations are wrong, it might still be possible for defendant in cases of alleged offenses that took place in most of 2002 and 2003 to introduce the memorandum as part of a "mistake of law" defense, suggesting that the defendants relied on the OLC's legal interpretations.[88]

b. Prolonged Mental Harm

Another definitional issue could arise in cases in which the alleged torture involves only severe *mental* pain or suffering. The numerous methods of torture involving mental but not physical pain include death threats, mock executions, severe sleep and food deprivation, and manipulation of sensory environment, such as subjecting detainees to no light and extremely loud music for weeks.[89] In such cases, defense attorneys could argue that the prosecution must prove that alleged torture resulted in "prolonged mental

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[83] *See* Memorandum from Jay S. Bybee, the Dep't of Justice Office of Legal Counsel, to Alberto R. Gonzales, Counsel to the President, Standards of Conduct for Interrogation under 18 U.S.C. §§ 2340–2340A 4 (Aug. 1, 2002), *available at* http://www.washingtonpost.com/wp-srv/nation/documents/dojinterrogationmemo20020801.pdf; *see also* DEPARTMENT OF DEFENSE, WORKING GROUP REPORT ON DETAINEE INTERROGATIONS IN THE GLOBAL WAR ON TERRORISM: ASSESSMENT OF LEGAL, HISTORICAL, POLICY, AND OPERATIONAL CONSIDERATIONS 9 (2003), *available at* http://www.defenselink.mil/news/Jun2004/d20040622doc8.pdf.

[84] Memorandum from Jay S. Bybee, *supra* note 83, at 3.

[85] *Id.* at 4.

[86] *Id.*

[87] Memorandum from Daniel Levin, Dep't of Justice Office of Legal Counsel, to James B. Comey, Deputy Attorney General, Legal Standards Applicable Under 18 U.S.C. §§ 2340–2340A, 16–17 (Dec. 30, 2004), *available at* http://www.usdoj.gov/olc/dagmemo.pdf.

[88] *See infra* Part III.

[89] *See, e.g.*, Carlotta Gall, *The Reach of War: Detainees*, N.Y. TIMES, Dec. 19, 2005, at A14; Associated Press, *2 Officers Punished in 2003 For Mistreatment of Detainees*, N.Y. TIMES, May 18, 2005, at A10.

harm," a term that appears in the definition of "severe mental pain or suffering."[90] Under this argument, a prosecutor alleging mental torture who cannot show that the mental harm was "prolonged" would fail.

It is unclear whether such a showing is necessary. In the 2002 memorandum, the OLC took the position that "mental pain or suffering" required a specific showing of "prolonged mental harm" as well as a showing that the defendant specifically intended the prolonged mental harm, rehashing the specific intent issues already discussed.[91] The December 2004 memorandum also argued that a showing of "prolonged" mental harm is required to prosecute a case of non-physical torture,[92] though it shied away from the 2002 memorandum's determination that "prolonged" mental harm would have to last for "months or even years."[93]

Numerous human rights advocates and other observers have suggested that this requirement does not exist and that the "prolonged mental harm" mentioned in the statute is the harm assumed by congressional drafters to result from the enumerated acts listed in § 2340(2).[94] There are several good arguments supporting this view.[95] Regardless of the correct statutory interpretation, the key issue is whether defense attorneys could take advantage of these distinctions. If a showing of intentional prolonged mental harm is required, it could make future torture prosecutions very difficult in cases of mental torture.

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[90] 18 U.S.C.A. § 2340(2) (West 2004) (defining torture as "the prolonged mental harm caused by . . . (A) the intentional infliction or threatened infliction of severe physical pain or suffering; (B) the administration or application, or threatened administration or application, of mind-altering substances or other procedures calculated to disrupt profoundly the senses or the personality; (C) the threat of imminent death . . .").

[91] Memorandum from Jay S. Bybee, *supra* note 83, at 8.

[92] *See* Memorandum from Daniel Levin, *supra* note 87, at 14–15 (discussing cases brought under the Torture Victims Protection Act, such as Sackie v. Ashcroft, 270 F. Supp. 2d 596 (E.D. Pa. 2003); Villeda Aldana v. Fresh Del Monte Produce, Inc., 305 F. Supp. 2d 1285 (S.D. Fla. 2003); and Mehinovic v. Vuckovic, 198 F. Supp. 2d 1322 (N.D. Ga. 2002)).

[93] *Id.* at 14 n.24.

[94] *See, e.g.*, Physicians for Human Rights, *New Opinion Will Not Prevent Torture or Cruel, Inhuman or Degrading Treatment, Particularly Severe Mental Pain and Suffering: An Analysis of the Office of Legal Counsel Opinion of December 30, 2004* (Jan. 4, 2005), http://www.phrusa.org/research/torture/tortureopinion.html (last visited Apr. 15, 2006).

[95] The inclusion in 18 U.S.C.A. § 2340(2) of the word "the" before "prolonged mental harm" (not present in the Torture Victims Protection Act ("TVPA"), from which Congress took the definitional language) suggests that Congress assumed that "the prolonged mental harm" noted in the statute was the harm that naturally or inevitably results from the four enumerated acts listed in § 2340(2). *Compare* 18 U.S.C.A. § 2340(2), *with* Torture Victims Protection Act of 1991, Pub. L. No. 102-256, 106 Stat. 73, 74 (codified at 28 U.S.C. § 1350 (2000)). In addition, the cases cited in the OLC memorandum do not support the argument presented very strongly. *Mehinovic* does not specifically outline prolonged mental harm as a separate element, but merely mentions the phrase in passing. *See* 198 F. Supp. 2d at 1346. The Eleventh Circuit vacated the *Villeda* court's dismissal of TVPA mental torture claims without overtly discussing prolonged mental harm as a necessary element, after the 2004 OLC memorandum was published. *See* Aldana v. Del Monte Fresh Produce, N.Am., Inc., 416 F.3d 1242, 1253 (11th Cir. 2005).

c. Jurisdiction

The Torture Statute also contains a jurisdictional problem: it prohibits only acts occurring "outside the United States."[96] The statute currently defines "outside the United States" as outside the regular territorial United States, including territories and possessions.[97] In other words, CIA agents or civilian contractors who engage in torture *within* the United States (say, at an airbase in Maine or in the Northern Mariana Islands) cannot be prosecuted under the Torture Statute.

This issue is not entirely academic—at least one case of alleged torture has already been raised within the United States. Ali Saleh Kahlah al-Marri, a citizen of Qatar held as an enemy combatant in a Navy brig in South Carolina, has alleged that during his interrogations in South Carolina in 2002 and 2003, interrogators told him he would be sent to Egypt or Saudi Arabia, tortured, and sodomized, and that his wife would be raped in front of him.[98] He also alleges he was held in twenty-four-hour isolation for several lengthy durations in conditions that caused severe suffering.[99] Al-Marri claims that his treatment amounts to torture or cruel, inhuman, or degrading treatment.[100] Even if the allegations in his complaint are true and al-Marri can show that he suffered severe mental pain or suffering, a torture prosecution is impossible because the conduct occurred *inside the United States*. Thus, while other state and federal law, including assault provisions, might still apply, prosecutors would be unable to utilize the only statute prohibiting torture as such.

Another serious loophole exists in the jurisdictional framework. Until it was changed to its current form in late 2004, the Torture Statute defined "outside the United States" as outside the territorial United States *and* outside the "special maritime and territorial jurisdiction" ("SMTJ") of the United States.[101] The resulting problem occurred because the SMTJ includes places that lie outside the regular territorial United States, including the Guantanamo Bay detention facility, Abu Ghraib prison, forward operating bases in Iraq and Afghanistan, and secret CIA detention facilities.[102] Therefore, all of these places were arguably "inside the United States"

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[96] 18 U.S.C.A. § 2340A (Supp. 2002).

[97] *Id.* 18 U.S.C.A. § 2340(3) (West 2004).

[98] *See* Complaint at 11, Al-Marri v. Rumsfeld (D.S.C. 2005), *available at* http://hrw.org/us/us080905.pdf (unpublished plaintiff's complaint).

[99] *See id.* at 7.

[100] *See id.* at 24.

[101] 18 U.S.C.A. § 2340(3) (West 2005) ("'United States' includes all areas under the jurisdiction of the United States including any of the places described in sections 5 and 7 of this title . . . .") (amended by Pub. L. No. 108-375, § 1089, 118 Stat. 1811, 2067 (2004)). Section 7 defines all the areas in the special maritime and territorial jurisdiction of the United States. 18 U.S.C.A. § 7 (West 2005) (amended by Pub. L. No. 107-56, § 804, 115 Stat. 377 (2001)).

[102] *See infra* text accompanying notes 141–143 (discussing changes in the SMTJ).

from 2002 until late 2004, so civilian personnel likely could not be prosecuted under the Torture Statute for torture committed in these places.

2. *The War Crimes Statute*

There is another way to prosecute torture: the federal War Crimes Statute.[103] The War Crimes Statute criminalizes any "grave breach" of the Geneva Conventions,[104] which includes, in the context of international armed conflicts only, "wilful[l] killing, torture or inhuman treatment" of persons protected by the Conventions.[105] The War Crimes Statute also criminalizes violations of common Article 3 of the Geneva Conventions, which, in the context of non-international armed conflict only, prohibits "violence to life and person, in particular murder of all kinds, mutilation, cruel treatment and torture; . . . outrages upon personal dignity, in particular humiliating and degrading treatment."[106]

The War Crimes Statute also allows for notably severe punishments, stating that violators "shall be fined . . . or imprisoned for life or any term of years, or both."[107] If the victim dies, the offender can receive the death penalty.[108]

However, as with the Torture Statute, no one has ever been charged under the War Crimes Statute, and thus questions remain about how it might work in a real prosecution. The statute's language is broader than that of the Torture Statute, as the defined crimes include "cruel," "humiliating," and "degrading" treatment as well as torture.[109] Yet, as with the Torture Statute, there are definitional complexities. Some of the underlying language referred to in the statute has been adjudicated in international tribunals,[110]

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[103] 18 U.S.C. § 2441 (2000).

[104] *Id.* § 2441(c)(1), (3).

[105] *See* Geneva Convention (First) for the Amelioration of the Condition of the Wounded and Sick in the Armed Forces in the Field, Aug. 12, 1949, 6 U.S.T. 3314, 75 U.N.T.S. 31, art. 50 [hereinafter First Geneva Convention]; Geneva Convention (Second) for the Amelioration of the Condition of Wounded, Sick and Shipwrecked Members of Armed Forces at Sea, Aug. 12, 1949, 6 U.S.T. 3217, 75 U.N.T.S. 85, art. 51 [hereinafter Second Geneva Convention]; Geneva Convention (Third) Relative to the Treatment of Prisoners of War, Aug. 12, 1949, 6 U.S.T. 3316, 75 U.N.T.S. 135, art. 130 [herinafter Third Geneva Convention]; Geneva Convention (Fourth) Relative to the Protection of Civilian Persons in Time of War, Aug. 12, 1949, 6 U.S.T. 3516, 75 U.N.T.S. 287, art. 147 [hereinafter Fourth Geneva Convention].

[106] First Geneva Convention, art. 3; Second Geneva Convention, art. 3; Third Geneva Convention, art. 3; Fourth Geneva Convention, art. 4.

[107] 18 U.S.C. § 2441(a).

[108] *Id.*

[109] *Compare* 18 U.S.C.A. § 2340(1)–(2) (West 2004) (defining torture without including "cruel," "humiliating," and "degrading" treatment), *with* notes 103–106 and accompanying text (including those terms as criminalized behavior under the War Crimes Statute).

[110] For a detailed outline and discussion of cases defining violations of the Geneva Conventions, especially "common article three" violations, see generally HUMAN RIGHTS WATCH, GENOCIDE, WAR CRIMES, AND CRIMES AGAINST HUMANITY: TOPICAL DIGESTS OF THE CASE LAW OF THE INTERNATIONAL CRIMINAL TRIBUNAL FOR RWANDA AND THE INTERNATIONAL

but most of the prohibited actions remain undefined under U.S. law. In the absence of authoritative case law, it is possible that an interpreting court would fall back on the definition of torture provided in the Torture Statute, which would raise the same definitional issues already discussed.[111]

To complicate matters, it is unclear whether abuse-prone interrogations fall within the category of armed conflict as required by the statute, and if so, whether that conflict is international or non-international. Defining conflicts is particularly difficult given the context of the Bush administration's "global war on terrorism," since the objective classification of a specific conflict (for instance, the ongoing insurgency in Afghanistan) might differ from the administration's claims of a global international counterterrorism "conflict" in which terrorist combatants are not protected by the Geneva Conventions.[112] These definitional ambiguities, combined with the lack of authoritative precedent, serve as major impediments to effective use of the War Crimes Statute in abuse prosecutions.

For instance, when a defendant is charged with a "grave breach" (which, by the terms of the Geneva Conventions, only occurs within international armed conflict), a prosecutor needs to prove that the victim was a "protected person" under the Conventions (i.e., a prisoner of war protected under the Third Convention or a civilian protected under the Fourth Convention).[113] Proving that a victim is "protected" might be easy in some clear cases (where the victim is a mistakenly arrested civilian, for instance). Yet, it could prove very difficult in cases where the victim is a detainee whom the U.S. government has labeled an "unlawful combatant." Under the Bush administration's legal theory, such detainees (particularly, members of al Qaeda and Afghan Taliban combatants) are not entitled to the protections of the Geneva Conventions.[114] Thus, it is uncertain whether the War Crimes Statute can adequately punish and deter torture and abuse in detention locales where the legal status of detainees is unclear—namely, Afghanistan and Iraq.

CRIMINAL TRIBUNAL FOR THE FORMER YUGOSLAVIA (2004), *available at* http://www.hrw.org/reports/2004/ij (citing tribunal cases including Prosecutor v. Tadic, Case No. IT-94-1, Decision on the Defence Motion for Interlocutory Appeal on Jurisdiction (Oct. 2, 1995); Prosecutor v. Kordic and Cerkez, Case No. IT-95-14/2 (Feb. 26, 2001); Prosecutor v. Naletilic and Martinovic, Case No. IT-98-34 (Mar. 31, 2003)).

[111] *See supra* Part II.B.

[112] Courts have wrestled with some of these issues, for example, in the habeas corpus case of Guantanamo Bay detainee Salim Hamdan. *See* Hamdan v. Rumsfeld, 415 F.3d 33 (D.C. Cir. 2005) (holding that common article 3 of the Geneva Convetion does not apply to the United States' conduct toward al Qaeda personnel captured in the conflict in Afghanistan), *cert. granted*, 74 U.S.L.W. 3287 (U.S. Nov. 7, 2005) (No. 05-184).

[113] Third Geneva Convention, *supra* note 105, art. 130; Fourth Geneva Convention, *supra* note 105, art. 147.

[114] *See* Memorandum from President George W. Bush to National Security Advisors, *Humane Treatment of al Qaeda and Taliban Detainees* (Feb. 7, 2002), *available at* http://www.gwu.edu/~nsarchiv/NSAEBB/NSAEBB127/02.02.07.pdf.

3. Other Title 18 Crimes

If prosecutions cannot be mounted via the torture or War Crimes Statutes, prosecutors are left with less powerful ammunition. No federal criminal statute specifically prohibits acts of "cruel, inhuman or degrading treatment" ("CID").[115] Accordingly, what remains in the prosecutorial arsenal are prohibitions of basic violent crimes: assault,[116] sexual abuse,[117] kidnapping,[118] conspiracy crimes,[119] and offenses relating to violations of detainees' constitutional rights.[120] The problems with these standard felony crimes are that they may not be applicable in many abuse cases and often carry lower sentences than the Torture and War Crimes Statutes.

a. Simple Assault

Simple assault, the most obvious baseline crime that could be used to punish abuse perpetrators, has several shortcomings. First, the punishment allows for imprisonment of only up to six months.[121] This scarcely provides the deterrent or retributive function administered by the high penalties available under the Torture and War Crimes Statutes.[122]

Second, the definition of assault is surprisingly unclear under federal law. Because the federal statute does not actually define "assault,"[123] federal courts have consulted common law.[124] But in doing so, courts have provided differing definitions, especially when distinguishing between cases where contact does or does not occur as well as when dealing with cases where there is "non-injurious" contact.[125] The myriad formulations of assault under federal law could thus cause serious problems for prosecutors.

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[115] 42 U.S.C.A. § 2000dd (West 2006) contains a statutory prohibition of CID but does not create a criminal offense. *Id.*

[116] 18 U.S.C. § 113 (2000).

[117] *Id.* § 109A.

[118] 18 U.S.C.A. § 1201 (West 2003).

[119] 18 U.S.C. § 373 (2000) (prohibiting "[s]olicitation to commit a crime of violence").

[120] *Id.* §§ 241–242 (prohibiting "[c]onspiracy against rights" and "[d]eprivation of rights under color of law").

[121] *Id.* § 113(a)(5).

[122] *See supra* notes 75–76, 107–108 and accompanying text.

[123] 18 U.S.C. § 113.

[124] *See, e.g.*, United States v. Turley, 352 U.S. 407, 411 (1957) ("[W]here a federal criminal statute uses a common-law term of established meaning without otherwise defining it, the general practice is to give that term its common-law meaning.").

[125] For example, some courts interpreting the common law have folded assault and battery together, holding that "[s]imple assault" under 18 U.S.C. § 113 is an "assault committed by way of a battery," defined as an intentionally harmful or offensive "touching." United States v. Bayes, 210 F.3d 64, 68–69 (1st Cir. 2000) (affirming conviction under § 113(a)(5) for simple assault in a case of nonviolent but sexually offensive groping and discussing other cases where non-injurious contact resulted in convictions for assault); *see also* United States v. Whitefeather, 275 F.3d 741, 742 (8th Cir. 2002) (affirming conviction where jury instruction defined simple assault as "any intentional or knowing harmful or offensive bodily touching or contact, however slight, without justification or excuse, with

For example, consider the so-called "stress" and psychological torture techniques allegedly used by the military and CIA in Afghanistan and Iraq, which included subjecting detainees to weeks or months of sleep deprivation using noise or light, exposing detainees to extreme cold, and ordering detainees to stand for days at a time.[126] As a baseline, assault convictions require a threatened or actual physical touching of some sort.[127] Yet many stress techniques do not involve threats or physical touching, making an assault conviction difficult if not impossible. Similarly, the federal assault statute may not apply to some cases of humiliation or threats, such as when personnel strip detainees naked and sexually humiliate them,[128] or when interrogators threaten detainees with death or torture without creating a threat of imminent harm.[129]

b. Aggravated Assault

Prosecutors could also face difficulties obtaining convictions for aggravated assault, which requires the use of a weapon or the imposition of a serious form of bodily injury.[130] The situations noted above, in which acts of torture (such as prolonged sleep deprivation or mock execution) inflict primarily *mental* pain and suffering, are potentially problematic because the statute requires proof of extreme *physical* pain or harm, such as the impairment of organ function.[131] Instances of torture where the interrogator causes severe mental suffering do not clearly qualify, and it is therefore possible that a severe incident of mental torture would not even be prosecuted under this statute.

Moreover, it is unclear whether the "extreme physical pain" required by 18 U.S.C. § 1365(h)(3) for aggravated assault is distinct from the "severe physical pain or suffering" required by the Torture Statute.[132] It is also unclear whether "waterboarding," an approved CIA technique in which interrogators either dunk detainees' heads underwater or tape their mouths

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another's person, regardless of whether physical harm is intended or inflicted").

Other courts, however, have held that simple assault is a threatened or attempted battery. *See, e.g.*, United States v. Yates, 304 F.3d 818, 821–22 (8th Cir. 2002) (holding that "simple assault" is distinct from other forms of federal assault that involve physical touching akin to common law battery); United States v. McCulligan, 256 F.3d 97, 104 (3d Cir. 2001) (defining simple assault under § 113 as either an "attempted battery or the placing of one in apprehension of immediate harm—actions that do not involve contact").

[126] *See, e.g.*, Don Van Natta, Jr., *Threats and Responses: Interrogations*, N.Y. TIMES, Mar. 9, 2003, at 11.

[127] *See supra* note 125 and accompanying text.

[128] *See, e.g.*, Ian Fisher, *The Struggle for Iraq: Inmate*, N.Y. TIMES, May 5, 2004, at A1.

[129] *See supra* note 89 and accompanying text.

[130] 18 U.S.C. § 113(a)(3) (2000) (allowing imprisonment of up to ten years for "[a]ssault with a dangerous weapon, with intent to do bodily harm, and without just cause or excuse"); *id.* § 113(a)(6) (allowing imprisonment of up to ten years for "[a]ssault resulting in serious bodily injury").

[131] *Id.* § 113(b)(2) (referring to 18 U.S.C. § 1365(h)(3) (Supp. 2003)).

[132] 18 U.S.C.A. § 2340A (West 2004).

shut and pour water over their faces to induce fear of drowning,[133] qualifies as "assault resulting in serious bodily injury," "assault with a dangerous weapon," "assault with intent to do bodily harm," or just simple assault.

Even aggravated assault, when shown, does not carry a particularly long sentence. Under the Federal Sentencing Guidelines,[134] an aggravated assault only correlates to a Base Offense Level of fourteen,[135] which corresponds to a sentence of fifteen to twenty-one months.[136] A prosecutor might be able to add four or five levels under various provisions,[137] but even at a Base Offense Level of nineteen, the suggested sentence is only thirty to thirty-seven months for a defendant without a prior criminal history.[138] Of course, as suggested above, it might be possible in some cases to bring additional charges, such as conspiracy,[139] but such charges are seldom appropriate and often unavailable.

c. Special Maritime and Territorial Jurisdiction

Jurisdictional issues are also problematic for prosecution of detainee abusers under Title 18. As discussed in Part II.B.2, most basic Title 18 crimes, including assault, kidnapping, and homicide, apply only in the special maritime and territorial jurisdiction.[140] But case law and academic interpretations suggest that the scope of the SMTJ is anything but clearly defined; defense attorneys could question the SMTJ's applicability, and even its constitutionality, in complex cases involving acts committed overseas.

The SMTJ had its origins in efforts to prosecute crimes committed by U.S. nationals in the admiralty and maritime jurisdiction of the United States.[141] Over the years, the SMTJ has expanded to include other places,[142] but was most notably amended by the USA PATRIOT Act of 2001 to include "the premises of United States diplomatic, consular, military or other United States Government missions or entities in foreign States" as

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[133] *See* Richard W. Stevenson & Joel Brinkley, *More Questions As Rice Asserts Detainee Policy*, N.Y. TIMES, Dec. 8, 2005, at A1; Douglas Jehl, *Report Warned C.I.A. on Tactics In Interrogation*, N.Y. TIMES, Nov. 9, 2005, at A1.

[134] It should be noted that the Federal Sentencing Guidelines are now advisory rather than binding. *See* United States v. Booker, 543 U.S. 220, 245–46 (2005).

[135] U.S. SENTENCING GUIDELINES MANUAL § 2A2.2(a) (2005).

[136] *Id.* ch. 5, pt. A.

[137] *Id.* § 2A2.2(b).

[138] *Id.* ch. 5, pt. A.

[139] *See* 18 U.S.C. § 956 (2000) (prohibiting "[c]onspiracy to kill, kidnap, maim, or injure persons or damage property in a foreign country").

[140] *See, e.g., id.* § 113 (criminalizing assault within the "special maritime and territorial jurisdiction of the United States").

[141] *See* historical and revision notes to 18 U.S.C. § 7 (Supp. 2003) ("This section first appeared in the 1909 Criminal Code. It made it possible to combine in one chapter all the penal provisions covering acts within the admiralty and maritime jurisdiction . . . .").

[142] *See, e.g.*, Pub. L. No. 98-473, § 1210, 98 Stat. 1837, 2164 (1984) (expanding the SMTJ to include any area "outside the jurisdiction of any nation" when the offense is committed by or against a U.S. national).

well as "residences in foreign States . . . used for purposes of those missions or entities or used by United States personnel assigned to those missions or entities."[143] Little legislative history is available on the inclusion of this provision in the Patriot Act, but one possibilty is that it was added to allow for simpler prosecutions of terrorist suspects accused of attacking U.S. installations overseas.[144]

When the alleged offense is committed by or against a U.S. national, the SMTJ includes "buildings, parts of buildings, and land appurtenant or ancillary thereto or used for purposes of [U.S. government] missions or entities, irrespective of ownership . . . ."[145] Thus, CIA agents and civilian contractors could potentially be indicted if they assault detainees in temporary facilities (such as a house) "used" by the CIA. While a narrow interpretation of the "use" element in 18 U.S.C. § 7(9) might permit indictments only when facilities are used regularly or for an extended period, a broader interpretation could allow prosecutions for actions in any place that the CIA agent or contractor in question had simply stood and "used" in some context. Such an interpretation would greatly enhance the opportunity for criminal punishment under Title 18 to serve as an appropriate and effective detainee abuse remedy.

The new, expanded SMTJ is notably being tested in the case of *United States v. Passaro*, in which CIA contractor David Passaro was indicted for assaulting Afghan detainee Abdul Wali in June 2003 on a U.S. Army forward operating base near Asadabad, Afghanistan.[146] The Passaro indictment asserted that the Asadabad base is "a place" within the SMTJ, "as provided by . . . Section 7(9)(A)."[147] Therefore, because the ambiguous "use" provisions discussed earlier are not implicated, establishment of jurisdiction should be relatively straightforward.

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[143] *See* United and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001, Pub. L. No. 107-56, § 804, 115 Stat. 377 (2001) (amending 18 U.S.C. § 7(9) (2000)).

[144] Of course, it was possible in 2001 to prosecute defendants for terrorist attacks occurring overseas. In the case of the 1998 terrorist attacks against U.S. embassies in Tanzania and Kenya, prosecutors charged four defendants with numerous counts under 18 U.S.C. § 844(h) (use of explosives during a felony) and 18 U.S.C. § 2332(murder during commission of an international terrorist act). *See* United States v. Bin Laden, 91 F. Supp. 2d 600, 616–17 (S.D.N.Y. 2000). Attacks on foreign soil could also be prosecuted under 18 U.S.C. § 956 (punishing "[c]onspiracy to kill, kidnap, maim, or injure persons or damage property in a foreign country"). However, the expansion of the SMTJ and accompanying liability under Title 18 clearly allowed for easier and more straightforward prosecutions at U.S. embassies, military bases, and government offices and residences overseas.

[145] 18 U.S.C. § 7(9)(a).

[146] United States v. Passaro, No. 5:04-CR-211-1 (E.D.N.C. filed June 17, 2004). The detainee was actually killed while in custody, but for unknown reasons prosecutors did not pursue homicide charges. Passaro, the first non-military person charged with abuse in Afghanistan and Iraq, could not be court-martialed because he was not a member of the military. *See* Oppel & Hart, *supra* note 12.

[147] United States v. Passaro, No. 5:04-CR-211-1, at 2.

4. The Military Extraterritorial Jurisdiction Act

The Military Extraterritorial Jurisdiction Act of 2000 ("MEJA") allows civilians in certain cases to be prosecuted for their conduct overseas as if it had occurred in the United States.[148] MEJA permits the prosecution in federal court of U.S. civilians who, while employed by, assisting, or accompanying U.S. forces abroad,[149] commit acts that, had they been committed in the SMTJ, would be criminal offenses punishable by imprisonment for more than one year.[150] Qualifying crimes would thus include torture,[151] war crimes,[152] and aggravated assault,[153] but not simple assault.[154]

Unfortunately, MEJA remains untested in complex cases, in part because the DOD has yet to issue final implementing regulations. The statute also might not be applicable to CIA agents or CIA contractors who can claim that they were not directly "assisting" or "accompanying" overseas military missions. However, even if the statute covers CIA operatives, MEJA will not solve the multitude of definitional problems plaguing application of traditional Title 18 prosecutions.[155]

III. Defenses to Abuse Prosecution

More potential pitfalls for prosecutors arise from mistake of law and "obedience to orders" defenses available under military and federal law. In military trials, defendants can introduce an "obedience to orders" defense to excuse criminal conduct ordered by a superior.[156] Defendants in federal detainee-abuse cases can also raise a defense available under the "McCain Amendment,"[157] which added a provision permitting military and nonmilitary personnel engaged in counter-terrorism operations to use (in certain cases) what amounts to a mistake of law defense.[158] Such defendants

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[148] Pub. L. No. 106-523, 114 Stat. 2488 (2000) (codified as amended at 18 U.S.C. §§ 3261–3267 (2000)).

[149] 18 U.S.C. § 3267(1)(A) (2000), *amended by* Ronald W. Reagan National Defense Authorization Act for Fiscal Year 2005, Pub. L. No. 108-375, § 1088, 118 Stat. 1811, 2066–67 (2004) (covering contractors and employees of not only the DOD but also "any other Federal agency, or any provisional authority, to the extent such employment relates to supporting the mission of the Department of Defense overseas").

[150] 18 U.S.C. § 3261 (2000).

[151] *See supra* note 75 and accompanying text.

[152] *See supra* note 107 and accompanying text.

[153] *See supra* note 135 and accompanying text.

[154] *See supra* note 121 and accompanying text.

[155] *See supra* Part II.B.3.

[156] RCM, *supra* note 34, 916(d).

[157] Detainee Treatment Act of 2005, Pub. L. No. 109-163, Div. A, §§ 1401–1404, 119 Stat. 3136, 3475 (codified at 42 U.S.C.A. § 2000dd-1 (West 2006)).

[158] 42 U.S.C.A. § 2000dd-1(a).

can also make "innocent intent,"[159] "public authority,"[160] and "entrapment by estoppel"[161] defenses.

These defenses are not in themselves necessarily objectionable. Legal and moral accountability for abuses that have been authorized or ordered should lie at least partly with the officials who authorized or ordered them. Lower-ranking perpetrators, at least in some cases, should be able to mitigate their punishments by demonstrating that they were either ordered or authorized to commit crimes. Allowing such defenses might also have the positive effect of disclosing to the public (and to prosecutors) evidence of criminal orders and authorizations issued by high-ranking officials. However, the combination of the existing defenses with the general failure to hold ranking officers accountable[162] actually allows both low-level personnel *and* higher-level officials to escape prosecution.

A. Military Law

The MCM allows defendants in the military to make an "obedience to orders" defense when they show they were acting pursuant to an order.[163] However, a prosecutor can defeat such a defense by proving that "the accused knew the orders to be unlawful or a person of ordinary sense and understanding would have known the orders to be unlawful."[164]

The defense of "obedience to orders" exists in military law primarily because military personnel are strictly obligated to follow orders; in the military, disobeying an order is a crime,[165] and choosing to disobey means exposing oneself to criminal prosecution. It is therefore sensible to allow a defense in cases where a reasonable person acts pursuant to an apparently legal order.

Admittedly, there is little to suggest that the rule might be abused in future cases involving "ordered" or "authorized" abuse. On the contrary, in most of the prosecutions arising out of the Abu Ghraib abuses of 2003, judges refused to allow defense teams to call relevant officers as witnesses to testify that abuses had been ordered, and so the defenses were defeated.[166] Still, the defense could prove more successful in future cases where evidence of orders is better established. Higher-level military officials may also choose to use the defense more aggressively if they are ever charged for abuses committed overseas.

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[159] *See infra* Part III.C.

[160] *See infra* Part III.C.2.

[161] *See infra* Part III.C.3.

[162] *See* DAA PROJECT, *supra* note 10, at 8; *see also supra* Part II.A.2.

[163] RCM, *supra* note 34, 916(d).

[164] *Id.*

[165] 10 U.S.C. § 892(1) (2000); *see also supra* Part II.A.3.

[166] *See* Schmitt, *supra* note 6 (detailing several detainee abuse cases where military judges refused defense attorneys' requests to call superiors to testify).

B. Federal Law: The McCain Amendment Defense

The McCain Amendment extended a legal defense to U.S. personnel, both military and non-military, involved in interrogations of terrorism suspects overseas.[167] The Amendment defined the defense by borrowing language from the same rule in military law, despite the notable fact that the military's strict obligation to follow orders generally is not found in non-military contexts. The McCain Amendment, providing for "protection of United States Government Personnel," states that in any criminal prosecution arising out of the detention or interrogation of non-citizen terrorist suspects, defendants can escape conviction if they show that first, the practices for which they are being prosecuted were "*authorized* and *determined to be lawful* at the time that they were conducted"; second, they did not know the practices were unlawful; and third, a "person of ordinary sense and understanding would not know the practices were unlawful."[168]

The Act adds that "[g]ood faith reliance on advice of counsel should be an important factor, among others, to consider in assessing whether a person of ordinary sense and understanding would have known the practices to be unlawful."[169] Presumably, this means that when defendants can show that they relied on legal advice (perhaps from CIA or OLC attorneys), the likelihood increases that a jury will find that a reasonable person would not have deemed the conduct to be unlawful. Moreover, while juries can acquit if they find evidence that the allegedly employed techniques were "officially authorized and determined to be lawful at the time they were conducted," it is unknown whether a court can even compel the White House or the CIA, under classified evidence rules, to produce such an authorization if it exists.[170]

In cases where such an authorization is shown, juries can still convict if they find either that an official knew the techniques were illegal or that a "person of ordinary sense and understanding" would have known the practices to be unlawful. The defense may therefore be viewed skeptically in cases of outright torture, since it is less likely that official authorization was actually given and more likely that a "person of ordinary sense and understanding" would have known that such techniques were illegal.

The defense could meet greater success in cases where the applicable law is unclear. For example, a McCain Amendment defense could be highly plausible in cases where the alleged acts are arguably outside the

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[167] Detainee Treatment Act of 2005, Pub. L. No. 109-163, Div. A, § 1404, 119 Stat. 3136, 3475 (codified at 42 U.S.C.A. § 2000dd-1 (West 2006)).

[168] *Id.* § 2000dd-1(a).

[169] *Id.*

[170] *See* The Classified Information Procedures Act, Pub. L. No. 96-456, 94 Stat. 2025 (1980) (codified as amended at 18 U.S.C. app. § 1–16 (2000)) (defining the circumstances under which classified evidence can be obtained by defendants).

scope of the SMTJ statutory provisions;[171] where detainees are arguably not protected by the Geneva Conventions and thus not protected by the War Crimes Statute;[172] or where the pain and suffering caused arguably do not constitute torture under the federal Torture Statute.[173] In addition, where CIA lawyers have told CIA officials that certain techniques were legal because of jurisdictional or definitional issues,[174] both agents and officials may have a viable defense even if the attorneys' interpretation of the law is ultimately shown to be incorrect.[175]

C. Previously Available Defenses Under Federal Law

The defenses of "innocent intent," "public authority," and "entrapment by estoppel" typically are raised by federal defendants in cases where they claim to have been misled to believe that their actions were part of government-sanctioned operations.[176] The defenses are also frequently raised when the defendants claim to have been told by government officials that their conduct was lawful, when in fact it was not.[177] Those accused of detainee abuse may use one or more of these defenses either alone or to supplement the McCain Amendment defense.

First, a defendant may invoke an "innocent intent" defense by claiming to have acted in cooperation with the government under the sincere belief that the conduct in question was legal.[178] Second, a defendant may invoke a "public authority" defense by admitting to having knowingly committed a criminal act but claiming that the act was done in reasonable reliance upon a grant of authority from a government official.[179] Third, a defendant may invoke a defense of "entrapment by estoppel" by claiming that a government official with legal authority in a certain area told him

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[171] *See supra* Part II.B.3.c.

[172] *See supra* Part II.B.2.

[173] *See supra* Part II.B.1.

[174] *See supra* Part II.

[175] The defense applies where "good faith reliance" on legal counsel has been shown, seemingly regardless of that counsel's ultimate accuracy. *See supra* note 169 and accompanying text.

[176] *See, e.g.*, United States v. Clegg, 846 F.2d 1221, 1222–24 (9th Cir. 1988) (stating that defendant claimed his gun-smuggling activities in Afghanistan were part of an operation conducted with the aid of high-ranking U.S. officials).

[177] *See, e.g.*, Cox v. Louisiana, 379 U.S. 559, 570–71 (1965) (stating that protestors claimed that they were told by a local police chief that they could lawfully protest across the street from the courthouse).

[178] *See, e.g.*, United States v. Baptista-Rodriguez, 17 F.3d 1354, 1368 n.18 (11th Cir. 1994); United States v. Anderson, 872 F.2d 1508, 1517–18 (11th Cir. 1989); United States v. Juan, 776 F.2d 256, 258 (11th Cir. 1985).

[179] *See, e.g.*, United States v. Fulcher, 250 F.3d 244, 252 (4th Cir. 2001); United States v. Pitt, 193 F.3d 751, 756 (3d Cir. 1999); *see also* United States v. Smith, 780 F.2d 1102 (4th Cir. 1985). Such a defense is sometimes referred to as a "CIA Defense." *See Pitt*, 193 F.3d at 756.

that the proscribed conduct was permissible and that he reasonably relied on that official statement.[180]

1. The "Innocent Intent" Defense

The "innocent intent" defense requires that "(1) the defendant honestly believed that he was acting in cooperation with the government, and [that] (2) the government official or officials upon whose authority the defendant relied possessed actual authority to authorize his otherwise criminal acts."[181] The strategy has typically been invoked only in cases where the defendant has been charged with a crime that a law enforcement agency might actually authorize as part of its operations. Thus, its application is rare: when authorities use an FBI informant to make an initial drug buy from a suspected drug dealer (in order to gain the dealer's trust), the involved U.S. attorney typically will grant immunity in return for the informant's testimony regarding his role in the operation.[182]

The innocent intent defense is probably not directly applicable to most cases of detainee abuse, since the government, as a general matter, has agreed to forgo authorization of torture.[183] However, in cases involving conduct that takes advantage of the definitional ambiguities currently surrounding "torture" under U.S. law, one can imagine the defense at least being raised, if not successful. For example, in cases where the authorized acts toe the line between a violation of the Torture Statute and a simple assault under Title 18, the likelihood of the defense's success is uncertain.

2. The "Public Authority" Defense

The "public authority" defense, also known as the "CIA defense," can be invoked only when a government official authorized the criminal conduct in question, and, in fact, possessed *actual* and not merely *appar-*

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[180] *See, e.g.*, Cox, 379 U.S. at 570–71 (reversing conviction for violating a statute prohibiting demonstrations near a courthouse because protestors were told by a local police chief that they could lawfully protest across the street from the courthouse); United States v. Tallmadge, 829 F.2d 767, 773–75 (9th Cir. 1987) (holding that defendant, a felon, reasonably relied on legal representation by federally licensed gun dealer that his purchase of a firearm was legal).

[181] United States v. Fulcher, 250 F.3d 244, 253 (4th Cir. 2001).

[182] *See* 18 U.S.C. § 6003(b)(1) (2000).

[183] *See* Convention Against Torture and Other Cruel, Inhuman or Degrading Treatment or Punishment, *Consideration of Reports Submitted by States Parties Under Article 19 of the Convention, United States of America*, ¶ 6, U.N. Doc. CAT/C/28/Add.5 (Feb. 9, 2000), *available at* http://documents-dds-ny.un.org/doc/ UNDOC/GEN/G00/406/56/pdf/G0040656.pdf ("No official of the Government, federal, state or local, civilian or military, is authorized to commit or to instruct anyone else to commit torture. Nor may any official condone or tolerate torture in any form.").

ent authority to sanction such illegal activity.[184] Thus, the defense cannot be raised in most cases involving CIA personnel because, as a baseline rule, CIA officials do not have *actual* authority to allow lower-level personnel or contractors to engage in illegal activities.[185] Accordingly, a defendant's mistaken assumption that CIA officials or agents can authorize commission of illegal acts does not constitute a valid defense.[186]

Notably, an apparent public authority defense was allowed in one of the Watergate break-in cases in the 1970s, where the defendants mistakenly believed they had been recruited for a CIA operation.[187] However, the clear weight of subsequent case law has disfavored such a defense when based on mistake of law.[188] As such, an "apparent public authority" defense is likely applicable only where the mistake was actually one of fact, for example, where a defendant mistakenly believed that the person who authorized his criminal conduct was a public official.

The public authority defense will be raised in at least one pending case. David Passaro, the CIA contractor charged with assault,[189] plans to raise the defense at trial by arguing that he committed assault in reliance on a grant of authority from CIA and DOJ officials.[190] The defense seems likely to fail because it requires that Passaro prove that CIA or DOJ officials, as a matter of law, have the legal authority to authorize criminal activities. Government lawyers have already responded to Passaro's anticipated defense

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[184] *See, e.g.*, United States v. Pitt, 193 F.3d 751, 758 (3d Cir. 1999) (limiting the public authority defense "to those situations where the government agent in fact had the authority to empower the defendant to perform the acts in question"); United States v. Baptista-Rodriguez, 17 F.3d 1354, 1368 n.18 (11th Cir. 1994) ("If the agent had no such power, then the defendant may not rest on the 'public authority'; reliance on the *apparent* authority of a government official is not a defense in this circuit, because it is deemed a mistake of law, which generally does not excuse criminal conduct.").

[185] *See* United States v. Rosenthal, 793 F.2d 1214, 1236 (11th Cir. 1986) ("Officials of the C.I.A . . . do not have the authority to authorize conduct which would 'violate the constitution or statutes of the United States,' . . . . [Defendants'] theory that they were acting on apparent authority of a C.I.A. agent is not a viable defense.") (quoting Exec. Order No. 12,333, 3 C.F.R. 200 (1982)).

[186] *See, e.g.*, *Rosenthal*, 793 F.2d at 1236; United States v. Duggan, 743 F.2d 59, 84 (2d Cir. 1984) (rejecting the defense because defendants' mistaken reliance on an informant's purported authority as a CIA agent amounted to an "error based upon a mistaken view of legal requirements and therefore constitute[d] a mistake of law").

[187] United States v. Barker, 546 F.2d 940, 948 n.24 (D.C. Cir. 1976) (reversing defendants' convictions after they successfully raised an "apparent authority" defense by claiming that they had been recruited by Watergate co-conspirator Howard Hunt, who they mistakenly believed was a CIA agent (though even a CIA agent could not have authorized their acts, thus making their mistake one of law)).

[188] *See supra* notes 184–186 and accompanying text.

[189] *See supra* note 146 and accompanying text.

[190] Andrea Weigl, *Passaro Can Claim He Was Doing His Job: Judge To Let Jury Hear His Evidence*, NEWS & OBSERVER (Raleigh), Feb. 3, 2006, at B5. The trial judge said that he will decide whether to allow Passaro's public authority defense after hearing evidence at trial. *Id.*

by arguing that it cannot succeed because CIA officials never have the power to authorize the criminal acts for which Passaro is charged.[191]

3. The "Entrapment by Estoppel" Defense

The third defense, "entrapment by estoppel," may be useful to CIA agents or officials and civilian contractors charged with detainee abuse. Similar to the McCain Amendment defense, entrapment by estoppel applies in cases where the defendant reasonably relied on a government official's statement that proscribed conduct is permissible, if the government official actually had legal authority in that area.[192] A defendant's reliance on the government official is "reasonable" if "a person sincerely desirous of obeying the law would have accepted the information as true, and would not have been put on notice to make further inquiries."[193]

This defense is most plausible in the context of reliance by agents, officials, or civilian contractors on legal opinions issued by the OLC or DOJ. For instance, if the OLC were to issue an opinion stating that waterboarding[194] does not constitute torture, it might prompt U.S. personnel to utilize the technique during interrogations. Depending on the circumstances, reliance on that opinion might be considered reasonable and thus grounds for an entrapment by estoppel defense. While the waterboarding opinion is almost certainly legally incorrect,[195] that alone would not prevent the use of the opinion as the source of a potentially successful entrapment by estoppel defense.

The likelihood of success of these defenses in future detainee abuse cases is difficult to predict. The defenses have caused some confusion in the courts, fueled at least in part by the difficulty in distinguishing between defenses based on mistake of fact and defenses based on mistake of law.[196] The overlap between some of these defenses and the McCain Amendment defense will likely only exacerbate the confusion over the correct applicable standards and elements.

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[191] *See* Andrea Weigl, *Trial's Weight Hinges on Ruling*, NEWS & OBSERVER, Dec. 16, 2005, at B1; *see also* United States v. Rosenthal, 793 F.2d 1214, 1236 (11th Cir. 1986).

[192] *See supra* note 180 and accompanying text.

[193] United States v. Lansing, 424 F.2d 225, 227 (9th Cir. 1970); *see also* United States v. Abcasis, 45 F.3d 39, 43 (2d Cir. 1995); United States v. Nichols, 21 F.3d 1016, 1018 (10th Cir. 1994) (stating that belief must be reasonable "in light of the identity of the agent, the point of law misrepresented, and the substance of the misrepresentation").

[194] *See supra* note 133 and accompanying text.

[195] Over 100 legal scholars recently signed a document asserting that waterboarding is torture and constitutes assault under federal criminal law and asking Attorney General Gonzales to clarify that publicly. *See* Letter from Law Professors to Attorney General Alberto Gonzales (Apr. 5, 2006), *available at* http://hrw.org/english/docs/2006/04/06/usdom13130.htm.

[196] *See, e.g.*, United States v. Baptista-Rodriguez, 17 F.3d 1354, 1368 n.18 (11th Cir. 1994) (commenting on the "tangled web" of defenses based on defendants' reliance on acts or statements by government officials that has resulted in a "muddled state of the law").

Thus, federal defenses create yet another potential loophole in the already complex legal framework surrounding prosecution of detainee abuse. If use of these defenses succeeds in releasing information necessary for the prosecution of culpable higher-ranking officials, the prospect of establishing accountability for detainee abuse will be substantially increased. On the other hand, if authorizations are uncovered but no higher-ranking officials are subsequently prosecuted, these defenses could have the unfortunate effect of allowing all involved perpetrators to go free.

IV. RECOMMENDATIONS

Legislative additions over the years, from the War Crimes Statute to efforts to close gaps in extraterritorial jurisdiction, have not solved the systemic weaknesses that make abuse prosecutions difficult. To establish the framework for an appropriate and complete remedy for detainee abuse, Congress, with the administration's support, should undertake several major legislative fixes. Changes in extraterritorial military and federal criminal law are complex, entailing issues of constitutional authority and the limits of extraterritorial jurisdiction under international law. However, a short list of possible changes can be given here.

First, Congress should amend the Torture Statute to clarify the mens rea requirement and other definitions. Such action would remove ambiguities about whether acts of torture must be "specifically intended" to cause severe pain or suffering. Suggested language might read: "'torture' is an intentional or reckless act that inflicts severe physical or mental pain or suffering."

Second, Congress should amend the Torture Statute to clarify the definition of "mental pain or suffering," by removing the word "prolonged" before "*prolonged* mental harm" on the grounds that it is unnecessary and confuses the definition. Suggested language might read: "'Severe mental pain or suffering' means mental harm caused by or resulting from "the types of acts of physical torture, threats of death or torture, or forced administration of drugs."

Third, Congress should remove the jurisdictional clause from the Torture Statute that limits its application to conduct "outside the United States." The War Crimes Statute has no similar geographic limitation, and there is no reason why federal criminal law, which already has broad extraterritorial jurisdiction, should not reach military and civilian employees of the federal government—or anyone acting under color of law—both at home and abroad.

Fourth, Congress should amend MEJA to elimimate its military ties, enabling much broader application to personnel working overseas. This expansion should cover not just official U.S. personnel, but also any civilian contractors assisting military, intelligence, or law enforcement opera-

tions. Congress should also ensure that implementing regulations are speedily promulgated.

Fifth, Congress should amend the War Crimes Statute to specify prohibited acts and outline the specific elements of crimes, especially those related to detainee operations. Clear definitions are needed for the grave breaches criminalized under section 2441(c)(1), including "torture and inhuman treatment," and "willfully causing great suffering or serious injury to body or health." Similarly, although violations of the Geneva Conventions' common article three are already criminalized under section 2441(c)(3),[197] the definitions of "cruel treatment and torture," and "outrages upon personal dignity, in particular humiliating and degrading treatment" should be clarified. A provision should also be added defining "international" versus "non-international" armed conflict so that the "global war on terror" falls under one provision or the other.

Sixth, Congress should create a new federal crime amended to the Torture Statute, called "cruelty and mistreatment," applicable to the same detainees or prisoners covered under the Torture Statute. The specific elements of the crime could be debated, but they should at least match international human rights standards for prisoner treatment and not merely follow U.S. definitions of "cruel, inhuman, or degrading treatment," which, as currently defined, are less protective than international standards.[198]

Seventh, Congress should amend the UCMJ to create specific war crimes and torture provisions that match those under federal criminal law. This would allow for broader jurisdictional coverage and stricter punishments in courts-martial. Similarly, the UCMJ should be regularly updated with provisions matching any federal criminal laws concerning detainees passed in the future, to ensure that military justice does not lag behind that administered in Article III courts.

Eighth, Congress should pass legislation clarifying that the underlying purpose of "entrapment by estopppel" and other defenses is simply to lessen punishment of lower-level good faith actors when others may share responsibility for their actions. This will ensure that defenses remain available for lower-ranking personnel while preventing the exoneration of all perpetrators at every level of command.

Given the continuing controversies surrounding overseas detainees and the immense damage that has been done to the image of the United States internationally,[199] it would behoove all parts of the U.S. government to take a hard look at the effectiveness of current torture and abuse

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[197] *See supra* note 104 and accompanying text.

[198] 136 CONG. REC. S17,486 (1990) (announcing the reservation that the Convention Against Torture bound the U.S. to prevent CID only insofar as it is already prohibited by the Fifth, Eighth, and Fourteenth Amendments to the U.S. Constitution).

[199] *See, e.g.*, Foster Klug, *McCain Says Torture Ban Vital to U.S. Image*, SEATTLE TIMES, Nov. 14, 2005, at A5; Mark Brzezinski, Op-Ed, *Torture Reports Tarnish U.S. Image*, BOSTON GLOBE, Nov. 22, 2005, at A11.

provisions. If the President, the military, the CIA, and Congress are serious about addressing detainee abuse, they must show their commitment by engaging in debate as to the merits of potential changes. The measures suggested above should provide a foundation for that debate. If implemented, they will help repair some of the problems in federal law outlined in this Article, with the ultimate goal, of course, being consistent and appropriate accountability for detainee abuse.

RECENT DEVELOPMENTS

THE NSA TERRORIST SURVEILLANCE PROGRAM

Since the attacks of September 11, 2001, the War on Terror has been the impetus and justification for asserting expansive presidential powers.[1] Under the auspices of the Authorization for Use of Military Force (AUMF)[2] and Article II of the U.S. Constitution, the Bush administration has detained American citizens as enemy combatants at Guantanamo Bay,[3] instituted military tribunals, and used extraordinary rendition to transfer detainees to countries that employ harsher interrogation techniques than the United States.[4] In addition to those new programs, the administration also instituted a widespread, secret eavesdropping program (which the administration calls the "terrorist surveillance program"),[5] under which the National Security Agency (NSA) intercepts communications between individuals on American soil and individuals abroad, without judicial approval.[6] This recent revelation poses important questions about the desirability and legality of a perhaps unprecedented expansion in presidential power.

This Recent Development critically examines the NSA surveillance program. Part I discusses the Foreign Intelligence Surveillance Act (FISA) of 1978,[7] which sets forth the legal framework for electronic surveillance in the United States pertaining to foreign intelligence. Part II presents the publicly known aspects of the terrorist surveillance program and the administration's arguments for the program's legality. Part III presents arguments from academics and government officials that the administration's program violates FISA and the U.S. Constitution. Finally, Part IV makes

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[1] Tactics in the War on Terror, including the authorization of domestic wiretapping, appear to be part of a concerted, organized effort to rebuild presidential powers. *See* Maura Reynolds, *Cheney Defends Domestic Spying*, L.A. TIMES, Dec. 21, 2005, at A20.

[2] Pub. L. No. 107-40, 115 Stat. 224 (2001).

[3] *See* Memorandum from Jay S. Bybee, Assistant Attorney Gen., Dep't of Justice Office of Legal Counsel, to Alberto R. Gonzales, Counsel to the President, Re: Standards of Conduct for Interrogation under 18 U.S.C. §§ 2340–2340A (Aug. 1, 2002), *available at* http://news.findlaw.com/nytimes/docs/doj/bybee80102mem.pdf; Memorandum from John C. Yoo, Deputy Assistant Attorney Gen., Office of Legal Counsel to Alberto R. Gonzales, Counsel to the President (Aug. 1, 2002), http://news.findlaw.com/ wp/docs/doj/bybee80102 ltr.html.

[4] *See* Jane Mayer, *Outsourcing Torture*, NEW YORKER, Feb. 14, 2005, at 106, *available at* http://www.newyorker.com/printables/fact/050214fa_fact6; Scott Shane, *Behind Power, One Principle*, N.Y. TIMES, Dec. 17, 2005, at A1; George W. Bush, President of the U.S., President's Radio Address (Dec. 17, 2005), *available at* http://www.whitehouse.gov/news/releases/2005/12/20051217.html [hereinafter President's Radio Address].

[5] Letter from Alberto R. Gonzales, Attorney Gen., to Arlen Specter, Senate Judiciary Chairman (Feb. 28, 2006), http://www.washingtonpost.com/wp-srv/nation/nationalsecurity/gonzales.letter.pdf.

[6] *See* James Risen & Eric Lichtblau, *Bush Lets U.S. Spy on Callers Without Courts*, N.Y. TIMES, Dec. 16, 2005, at A1.

[7] Pub. L. No. 95-511, 92 Stat. 1783 (codified as amended at 50 U.S.C. §§ 1801–1811 (2000 & Supp. II 2003) and in scattered sections of 18 U.S.C. (2000 & Supp. III 2003)).

suggestions for reform and concludes that any changes should be made by Congress, not by presidential directive.

I. FISA BACKGROUND

Prior to the terrorist surveillance program, the Foreign Intelligence Surveillance Act (FISA) of 1978 governed all domestic electronic gathering of foreign intelligence.[8] FISA created the Foreign Intelligence Surveillance Court (FISC), which secretly reviews requests for domestic surveillance.[9] These requests must be approved by the Attorney General and certified by the Assistant to the President for National Security Affairs or an officer in the area of national security or defense,[10] as well as show probable cause that the target is a foreign power or an agent of a foreign power.[11] Since its inception, FISC has granted nearly 19,000 warrants, rejecting only five.[12]

II. BACKGROUND AND BUSH ADMINISTRATION JUSTIFICATION OF THE TERRORIST SURVEILLANCE PROGRAM

A. Background of the Terrorist Surveillance Program

In 2002, the President signed an order secretly authorizing the NSA to eavesdrop on individuals within the United States without FISC approval.[13] Surveillance activity under the order has encompassed the communications of potentially thousands of Americans,[14] signaling a shift from intense, long-term monitoring of a few individuals to data mining (whereby the NSA searches for threatening patterns in the communications of hundreds of individuals for short time periods).[15] To date, the terrorist surveillance program is credited with helping to uncover a plot by Iyman Faris,

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[8] *See id.*

[9] *See* 50 U.S.C. § 1803. The NSA may conduct domestic surveillance for up to seventy-two hours without a court order if the Attorney General determines there is an emergency and informs a FISC judge. *Id.* § 1805(f). An application must still be made within seventy-two hours of this authorization. *Id.*

[10] This officer must occupy a position subject to Senate confirmation. He must certify that the information cannot be obtained by normal means and state the proposed acquisition method. *See id.* §§ 1803–1804.

[11] *Id.* § 1805(a)(3)(A).

[12] *See* James Bamford, *The Agency That Could Be Big Brother*, N.Y. TIMES, Dec. 25, 2005, § 4, at 1.

[13] Risen & Lichtblau, *supra* note 6, at A1. Even before the presidential directive, the NSA began to expand its domestic surveillance operations. *See* Eric Lichtblau & Scott Shane, *Files Say Agency Initiated Growth of Spying Effort*, N.Y. TIMES, Jan. 4, 2006, at A1.

[14] *See* Bamford, *supra* note 12, at 1.

[15] Government officials claim this shift responds to the different challenges posed by a highly delocalized, mobile adversary. *See* Risen & Lichtblau, *supra* note 6, at A1. Analysis emphasizes "meta-data," the tags that identify the date, time, destination, and origin of a message, in a search for patterns from which to identify those linked to al Qaeda. *See* David Ignatius, Op-Ed., *Spying Within the Law*, WASH. POST, Jan. 13, 2006, at A21.

a naturalized American citizen, to bring down the Brooklyn Bridge with blowtorches and another plot to attack British pubs and train stations with fertilizer bombs.[16]

Notwithstanding such examples, the success of the terrorist surveillance program remains debatable. Most people targeted by the program have not been charged with a crime.[17] Yet despite the dearth of tangible results, the program appears to be expansive in scope. Despite attempts to portray the terrorist surveillance program as limited, the NSA harvested and analyzed large volumes of phone and Internet traffic in a search for patterns leading to terrorist suspects.[18]

Even prior to its exposure by the *New York Times*, the terrorist surveillance program had generated substantial concern about oversight, including from U.S. District Judge Colleen Kollar-Kotelly (who oversees the FISC), and as a result of such concerns, the program was suspended in 2004.[19] Unlike targets of surveillance conducted under FISA, the targets of the terrorist surveillance program may be chosen by the "operational work force" at the NSA and approved by a shift supervisor.[20] Neither government assurances nor a requirement that the calls be international in nature has prevented the terrorist surveillance program from capturing purely domestic conversations.[21] Judge Kollar-Kotelly expressed particular concern that the Justice Department had improperly used information obtained under the terrorist surveillance program to obtain FISA warrants.[22]

High-level, interagency oversight of the terrorist surveillance program has been minimal. The program entails no case-by-case input from the administration or Justice Department.[23] Instead, its activities are reviewed cumulatively prior to presidential reauthorization every forty-five days.[24]

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[16] *See* Risen & Lichtblau, *supra* note 6; *see also* Attorney Gen. Alberto R. Gonzales and Gen. Michael Hayden, Principal Deputy Dir. for Nat'l Intelligence, Press Briefing (Dec. 19, 2005), *available at* http://www.whitehouse.gov/news/releases/2005/12/print/20051219-1.html [hereinafter Press Briefing] (statement of Gen. Michael Hayden) ("I can say unequivocally, all right, that we have got information through this program that would not otherwise have been available [under the old regulatory framework].").

[17] *See* Risen & Lichtblau, *supra* note 6, at A1.

[18] The NSA negotiated access to switches, many of which are on American soil, which act as gateways for voice and Internet traffic into and out of the United States. Telecommunications companies have cooperated by storing information on calling patterns, which is then turned over to the NSA. *See* Eric Lichtblau & James Risen, *Spy Agency Mined Vast Data Trove, Officials Report*, N.Y. TIMES, Dec. 24, 2005, at A1.

[19] Risen & Lichtblau, *supra* note 6, A1.

[20] *See* Press Briefing, *supra* note 16.

[21] Press Briefing, *supra* note 16 (statement of Gen. Michael Hayden) ("I can assure you, by the physics of intercept, by how we actually conduct our activities, that one end of these communications are [sic] always outside the United States of America."); *see also* James Risen & Eric Lichtblau, *Spying Program Snared U.S. Calls*, N.Y. TIMES, Dec. 21, 2005, at A1.

[22] *See* Risen & Lichtblau, *supra* note 6, at A1.

[23] The first audit in over two years since its inception resulted in new guidelines for assessing targets. *See id.*

[24] *See* President's Radio Address, *supra* note 4. President Bush has reauthorized the

Rather than seek amendments to FISA or specific congressional authorization of the terrorist surveillance program, the administration chose to limit input to occasional informative briefings of congressional leaders, who were then sworn to secrecy.[25] With public opinion split over the revelations, the Senate Judiciary Committee began hearings on the terrorist surveillance program on February 6, 2006.[26]

B. The Bush Administration's Defense of the Terrorist Surveillance Program

The Bush administration defends the NSA program as a necessary early warning system for preventing future attacks, justified by both statute and the Constitution.[27] First the administration claims that by passing the AUMF, Congress authorized a broad range of presidential actions relating to the deterrence and prevention of terrorist acts, of which the terrorist surveillance program is an "indispensable aspect."[28] Second, it claims that even in the absence of congressional authorization, the Commander-in-Chief Clause in Article II of the Constitution confers the power to approve the type of warrantless surveillance conducted under the terrorist surveillance program.[29]

The administration employs a broad reading of the AUMF to justify the terrorist surveillance program. Passed shortly after the September 11 attacks, the AUMF authorized the President "to use all necessary and appropriate force" against "persons he determines planned, authorized, committed, or aided the terrorist attacks that occurred on September 11, 2001, or harbored such organizations or persons" to protect the United States.[30]

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terrorist surveillance program more than thirty times. *Supra* note 4.

[25] *See* Risen & Lichtblau, *supra* note 6, at A1. Several cabinet members, as well as officials at the NSA, CIA, and Justice Department, were also aware of the program. *See id.*; President's Radio Address, *supra* note 4; Press Release, White House, Setting the Record Straight: Democrats Continue to Attack Terrorist Surveillance Program (Jan. 22, 2006), *available at* http://www.whitehouse.gov/news/releases/2006/01/print/20060122.html.

[26] *See Wartime Executive Power and the National Security Agency's Surveillance Authority: Hearing Before the S. Comm. on the Judiciary*, 109th Cong. (2006), *available at* http://judiciary.senate.gov/hearing.cfm?id=1727 [hereinafter *Hearings*]; Douglas Jehl, *Specter Vows a Close Look at Spy Program*, N.Y. TIMES, Jan. 16, 2006, at A11; Letter from Arlen Specter, Senate Judiciary Chairman, to Alberto R. Gonzales, Attorney Gen. (Jan. 24, 2006), *available at* http://news.findlaw.com/hdocs/docs/nsa/specgonz12406ltr.html. A survey by the New York Times/CBS News found that fifty-one percent of respondents thought that the President was right to order wiretaps without warrants to reduce the threat of terrorism, while forty-six percent said he was wrong. Adam Nagourney & Janet Elder, *New Poll Finds Mixed Support for Wiretaps*, N.Y. TIMES, Jan. 27, 2006, at A1.

[27] This defense focuses on the method of authorizing the terrorist surveillance program. *See* DEP'T OF JUSTICE, LEGAL AUTHORITIES SUPPORTING THE ACTIVITIES OF THE NATIONAL SECURITY AGENCY DESCRIBED BY THE PRESIDENT (2006), *available at* http://news.findlaw.com/hdocs/docs/nsa/dojnsa11906wp.pdf [hereinafter DOJ WHITE PAPER].

[28] *See id.* at 1–2.

[29] *See id.*; President's Radio Address, *supra* note 4.

[30] Authorization for Use of Military Force, Pub. L. No. 107-40, 115 Stat. 224 (2001).

Supporters of the terrorist surveillance program emphasize that this general language implies presidential discretion.[31] Furthermore, the administration argues that recent Supreme Court decisions justify such a broad construction.[32] The *Hamdi* plurality found implicit authority to detain military combatants in the "necessary and appropriate force" language of the AUMF.[33] The administration likens electronic surveillance to the detention of military combatants in *Hamdi*, asserting that both activities play essential roles in the War on Terror, and argues that the AUMF similarly authorizes domestic surveillance.[34]

While admitting that the terrorist surveillance program does not follow FISA procedures, the administration argues it still complies with FISA because FISA allows exceptions to its procedures when authorized by a statute, such as the AUMF.[35] Supporters of the program point to the general nature of the FISA exemption as evidence that Congress wanted to leave room for later statutes to authorize surveillance outside of FISA.[36] Thus, supporters argue that the terrorist surveillance program fits within FISA's exception to criminal liability and does not violate another federal law—Title III of the Omnibus Crime Control and Safe Streets Act—that makes FISA the "exclusive means" by which the government may conduct electronic surveillance.[37] To further support the argument for a broad reading of the FISA exemption, the administration cites *Hamdi*, in which the Court fit the AUMF into a similar statutory exception and avoided a general prohibition on detention of U.S. citizens.[38]

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[31] *See* DOJ WHITE PAPER, *supra* note 27, at 10–12. They also note that Congress could have limited authorization in the AUMF to specific actions. *See id.*; *see also* Hamdi v. Rumsfeld, 542 U.S. 507, 519 (2004) (finding authorization for the detention of enemy combatants in the broad language of the AUMF); Padilla v. Hanft, 423 F.3d 386, 396 (4th Cir. 2005) (citing *id.*).

[32] DOJ WHITE PAPER, *supra* note 27, at 11; *see Hamdi*, 542 U.S. at 518–19; *Padilla*, 423 F.3d at 396.

[33] Authorization for Use of Military Force; *see Hamdi*, 542 U.S. at 518; DOJ WHITE PAPER, *supra* note 27, at 14–17.

[34] DOJ WHITE PAPER, *supra* note 27, at 27.

[35] *Id.* at 20–21; *see also* 50 U.S.C. § 1809(a) (2000) (providing criminal sanctions for electronic surveillance under color of law unless authorized by statute).

[36] DOJ WHITE PAPER, *supra* note 27, at 20–21. When Congress intends for more specific exceptions, it typically provides for them. *Cf.* 18 U.S.C. § 2511(1) (2000) (limiting exceptions to those enumerated in that chapter).

[37] DOJ WHITE PAPER, *supra* note 27, at 21. Title III of the Omnibus Crime Control and Safe Streets Act enumerates the specific means for intercepting domestic wire, oral, and electronic communications and includes FISA in these means. Omnibus Crime Control and Safe Streets Act of 1968, 18 U.S.C. §§ 2510–2520 (2000) (governing general use of wiretapping and electronic surveillance). The AUMF, as a claimed exception to FISA, thus also falls within the Title III exception for FISA.

[38] DOJ WHITE PAPER, *supra* note 27, at 24; *see Hamdi*, 542 U.S. at 517 (holding that the AUMF permits detention of U.S. citizens deemed to be enemy combatants, since it fits within an exception for acts of Congress to a general prohibition on detention, as provided by 18 U.S.C. § 4001(a)).

Although FISA expressly limits warrantless electronic surveillance after a declaration of war by Congress,[39] supporters argue this does not diminish presidential authority to authorize warrantless electronic surveillance. Rather, supporters claim that Congress was undecided on whether FISA would continue to apply in wartime.[40] Under this interpretation, FISA allows for authorization of wartime activities, such as electronic surveillance, through a conflict-specific resolution, like the AUMF.[41] The administration characterizes post-AUMF amendments to FISA (through the USA PATRIOT Act) as mere general revisions, not wartime indications that Congress viewed FISA as the sole method for electronic surveillance.[42]

The administration then maintains that any ambiguity regarding whether FISA forbids the terrorist surveillance program should be resolved in favor of the President's authority. Reading FISA to prohibit the terrorist surveillance program would raise serious constitutional questions: first, whether such intelligence gathering is sufficiently central to the President's role as Commander-in-Chief to preclude congressional interference, and, if so, second, whether FISA in particular impermissibly impedes the President's role as Commander-in-Chief.[43] The canon of constitutional avoidance mandates a reading of FISA and the AUMF that avoids these constitutional questions—one that does not prohibit the terrorist surveillance program.[44]

Aside from the AUMF, the President claims that inherent constitutional authority, arising under the Commander-in-Chief Clause of Article II,[45] allows him to authorize the terrorist surveillance program.[46] This power derives from a perceived historical responsibility for overseeing collection of foreign intelligence in times of conflict and peace.[47] Under this analysis, the terrorist surveillance program simply continues a longstanding practice of secretive intelligence collection methods for foreign and military affairs.[48]

The administration argues that after September 11, the President's constitutional powers authorized him to use force "without waiting for any

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[39] 50 U.S.C. § 1811.

[40] *See* H.R. REP. No. 95-1720, at 34 (1978), *as reprinted in* 1978 U.S.C.C.A.N. 4048, 4063 (acknowledging possible need for wartime amendments to FISA).

[41] *See* 50 U.S.C. § 1811; DOJ WHITE PAPER, *supra* note 27, at 25–28.

[42] *See* DOJ WHITE PAPER, *supra* note 27, at 27 n.13; *see also, e.g.*, Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism (USA PATRIOT) Act of 2001, Pub. L. No. 107-56, § 204, 115 Stat. 272, 281 (amending 18 U.S.C. § 2511(2)(f) (2000 & Supp. III 2003)).

[43] *See* DOJ WHITE PAPER, *supra* note 27, at 29.

[44] The continuation of the armed conflict favors avoiding the resulting ambiguity. *See* DOJ WHITE PAPER, *supra* note 27, at 34–36.

[45] *See* U.S. CONST. art. II, § 2.

[46] *In re:* Sealed Case No. 02-001, 310 F.3d 717, 742 (Foreign Int. Surv. Ct. Rev. 2002).

[47] *See* DOJ WHITE PAPER, *supra* note 27, at 7.

[48] *See id.* Presidential discretion has invoked use of similar methods since the Revolutionary War. *Id.* at 15–17.

special legislative authority."[49] At least one court, the FISA Court of Review, has assumed the President has inherent authority to conduct warrantless searches to obtain foreign intelligence.[50] Also, the Supreme Court, in *United States v. United States District Court (Keith)*,[51] recognized such presidential power over intelligence gathering without delineating the scope of that power.[52] Furthermore, limiting intelligence collection would contravene policies underlying Article II by impairing the executive branch's ability to protect the nation[53] and undermining the President's unitary command of the military.[54]

Supporters suggest this constitutional authority casts doubt on Congress's ability to regulate executive action.[55] The administration contends that past congressional statutes limiting presidential power upheld by the Supreme Court, such as those in *Youngstown Sheet & Tube Co. v. Sawyer*,[56] derived from congressional power to regulate commerce under Article I.[57] The terrorist surveillance program, however, has no direct implications for commerce[58] but rather has an exclusively military role[59] central to the "day-to-day fighting in a theater of war."[60]

The administration argues that this constitutional power to conduct warrantless surveillance is consistent with the Fourth Amendment, noting the Supreme Court has reserved judgment on the propriety of warrantless searches in foreign intelligence surveillance.[61] Warrantless searches in this context are reasonable under the Fourth Amendment, balancing admittedly important privacy rights against the government's compelling need for foreign intelligence.[62] Supporters also contend that the terrorist surveillance program fits within a "special needs" exception to the Fourth Amendment's warrant requirement, because the surveillance targets a specific threat rather than general crime prevention.[63] Noting that the Fourth Amendment does not require the least intrusive methods, supporters ar-

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[49] The Prize Cases, 67 U.S. (2 Black) 635, 668–69 (1863); DOJ WHITE PAPER, *supra* note 27, at 6–7, 10.

[50] *In re: Sealed Case No. 02-001*, 310 F.3d at 742.

[51] 407 U.S. 297 (1972).

[52] *Id.* at 308–11.

[53] *See* DOJ WHITE PAPER, *supra* note 27, at 7.

[54] *See id.* at 10.

[55] *See id.*

[56] 343 U.S. 579 (1952).

[57] DOJ WHITE PAPER, *supra* note 27, at 33–34. *See generally* U.S. CONST. art. I, § 8, cl. 3.

[58] *See* DOJ WHITE PAPER, *supra* note 27, at 32–33.

[59] *Id.* at 1.

[60] *Youngstown*, 343 U.S. at 587.

[61] United States v. United States District Court (Keith), 407 U.S. 297, 308, 321–22 (1972); DOJ WHITE PAPER, *supra* note 27, at 8.

[62] DOJ WHITE PAPER, *supra* note 27, at 39–41.

[63] The nature and magnitude of the threat are crucial considerations. *In re:* Sealed Case No. 02-001, 310 F.3d 717, 744 (Foreign Int. Surv. Ct. Rev. 2002).

gue that the program's selection criteria[64] and frequent reauthorization requirements adequately protect civil liberties.[65]

Under the administration's analysis, the President has broad power to conduct warrantless surveillance. Because FISA and the AUMF authorize his actions, the President is at the pinnacle of his executive powers, according to the Supreme Court's framework set forth in *Youngstown*.[66] Accordingly, opponents of the terrorist surveillance program will confront a high bar for holding the terrorist surveillance program unconstitutional; such a finding would mean that the entire federal government lacks such power to acquire foreign intelligence for national security purposes—a proposition never suggested, let alone upheld.

III. CRITICS' ASSESSMENT OF THE TERRORIST SURVEILLANCE PROGRAM

Many have criticized the terrorist surveillance program, though criticism can be based only on the limited information available. After examining the relevant statutes and administration's position, the Congressional Research Service (CRS) described the administration's legal arguments as hardly foolproof.[67] Legal scholars and government officials (both current and former) have gone further, even concluding that the program is illegal.[68]

Some critics contend that Congress has not made as broad a grant of power as the administration claims. FISA provides the President with a fifteen-day grace period after a formal declaration of war, during which he may conduct electronic surveillance without a warrant.[69] Given Congress's decision to amend FISA after September 11, through the PATRIOT Act,

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[64] There must be "a reasonable basis to conclude that one party to the communication is a member of al Qaeda, affiliated with al Qaeda, or a member of an organization affiliated with al Qaeda." Press Briefing, *supra* note 16 (statement of Gen. Michael Hayden).

[65] This allows adjustments between government and individual interests. *See* DOJ WHITE PAPER, *supra* note 27, at 41.

[66] Dames & Moore v. Regan, 453 U.S. 654, 669 (1981) (citing Youngstown Sheet & Tube Co. v. Sawyer, 343 U.S. 579, 635 (1952) (Jackson, J., concurring)).

[67] Memorandum from Elizabeth B. Bazan & Jennifer K. Elsea, Legislative Attorneys, Am. Law Div., Cong. Research Serv., Presidential Authority to Conduct Warrantless Electronic Surveillance to Gather Foreign Intelligence Information, at 44 (Jan. 5, 2006), *available at* http://www.fas.org/sgp/crs/intel/m010506.pdf [hereinafter CRS Memo].

[68] Beth Nolan et al., *On NSA Spying: A Letter to Congress*, N.Y. REV. BOOKS, Feb. 9, 2006, *available at* http://www.nybooks.com/articles/18650; Letter from Laurence H. Tribe, Carl M. Loeb Univ. Professor, Harvard Univ., to Senator Joseph R. Biden, Jr. (Jan. 6, 2006) (on file with author).

[69] This window exists to give Congress an opportunity to pass any necessary amendments, a posture consistent with FISA's providing the exclusive means for electronic surveillance. *See* 50 U.S.C. § 1811 (2000); Nolan et al., *supra* note 68. The explicit rejection of a one-year window by the House of Representatives as too long suggests they would not look favorably on the terrorist surveillance program's four-year window. Letter from Laurence H. Tribe to Senator Joseph R. Biden, Jr., *supra* note 68, at 3.

Congress seemingly still wanted FISA to govern electronic surveillance during the War on Terror.[70]

Moreover, CRS concludes from congressional records that Congress probably intended FISA and Title III of the Omnibus Crime Control and Safe Streets Act of 1968[71] to govern exclusively all electronic surveillance, contrary to the administration's claims that this is an area in which Congress left room for other, later statutes.[72] To support this argument, CRS cites 18 U.S.C. § 2511(2)(f), which states that FISA shall provide the "exclusive means" through which the federal government may conduct electronic surveillance.[73] CRS also notes that FISA repealed 18 U.S.C. § 2511 (3) (1976),[74] which had stated that nothing in Title 18, Chapter 119 of the U.S. Code limited the President's power to obtain foreign intelligence.[75] Together, these actions suggest Congress intended for FISA alone to govern the use of electronic surveillance for foreign intelligence.

To reconcile any conflict between AUMF and FISA, critics advocate a slightly narrower interpretation of AUMF that would not authorize electronic surveillance outside FISA. They cite the analysis in *Youngstown* in which general statutory language (such as the AUMF) authorizes nothing when Congress has already spoken on the issue,[76] especially when it has done so through a carefully drawn statute such as FISA.[77] To augment this point, critics argue that nothing suggests that Congress intended the AUMF to repeal FISA's "exclusive means" provision by implication.[78] They claim that AUMF and FISA can easily be read to limit electronic surveillance to FISA procedures.

The CRS also contends that the administration generally misinterprets FISA as it relates to Title III of the Omnibus Crime Control and Safe

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[70] CRS Memo, *supra* note 67, at 43. The President does not have a monopoly on "war powers"; congressional power over armed forces may impinge upon the Commander-in-Chief role. *See Dames & Moore*, 453 U.S. at 669 (citing *Youngstown*, 343 U.S. at 635 (Jackson, J., concurring)).

[71] 18 U.S.C. §§ 2510–2520 (2000) (governing general use of wiretapping and electronic surveillance).

[72] CRS Memo, *supra* note 67, at 44.

[73] 18 U.S.C. § 2511(2)(f).

[74] Foreign Intelligence Surveillance Act (FISA) of 1978, Pub. L. No. 95-511, § 201(c), 92 Stat. 1783, 1797 (codified as amended in 50 U.S.C. §§ 1801–1811 (2000 & Supp. II 2002) and in scattered sections of 18 U.S.C. (2000 & Supp. III 2003)).

[75] Omnibus Crime Control and Safe Streets Act of 1968, Pub. L. No. 90-351, § 802, 82 Stat. 197, 212–23 (codified as 18 U.S.C. § 2511(3)). "The exclusivity clause makes it impossible for the President to 'opt-out' of the legislative scheme by retreating to his 'inherent' Executive sovereignty over foreign affairs." United States v. Andonian, 735 F. Supp. 1469, 1474 (C.D. Cal. 1990); *see also* CRS Memo, *supra* note 67, at 29.

[76] Youngstown Sheet & Tube Co. v. Sawyer, 343 U.S. 579, 609 (1952) (Frankfurter, J., concurring) ("To find authority so explicitly withheld is . . . to disrespect the whole legislative process and the constitutional division of authority between President and Congress.").

[77] The legislative history and context of FISA's enactment suggest FISA was carefully constructed. *See* Nolan et al., *supra* note 68.

[78] Repeal by implication is strongly disfavored unless the statutes are (1) irreconcilable; and (2) supported by overwhelming evidence. *See id.*; 18 U.S.C. § 2511(2)(f).

Streets Act of 1968.[79] As codified by Title III, 18 U.S.C. § 2511(2)(e) (2000) allows the federal government to conduct electronic surveillance in accordance with FISA. FISA criminalized the use of electronic surveillance "except as authorized by statute."[80] The administration has argued that if 18 U.S.C. § 2511(2)(e) allows electronic surveillance under FISA and FISA allows surveillance as authorized by statute, then § 2511(2)(e) allows surveillance as authorized by statute (such as the AUMF).[81] Critics emphasize how the administration's interpretation would nullify the provision in Title III that limits electronic surveillance to FISA procedures, instead reading it to allow electronic surveillance as provided by any statute.[82] Thus, even if the administration's interpretation of the AUMF does not violate FISA, it may still violate the more-specific Title III.[83]

CRS also maintains that *Hamdi* actually undercuts the administration's terrorist surveillance program. In *Hamdi*, the Court reasoned that the permissibility of killing someone in battle authorized the less extreme step of detaining him for the battle's duration to avert a continued threat.[84] However, CRS distinguishes electronic surveillance of suspected potential terrorists from restraining an enemy combatant from rejoining the battlefield, specifically because the latter case implicates the laws of war while the former does not.[85] Also, CRS suggests that the reasoning and narrow holding in *Hamdi*[86] disfavor a broad interpretation of the AUMF.[87]

Even if statutorily authorized and permissible under the laws of war, critics suggest that the terrorist surveillance program still poses serious

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[79] CRS Memo, *supra* note 67, at 40; *see supra* notes 35–38 and accompanying text.

[80] Foreign Intelligence Surveillance Act of 1978, Pub. L. 95-511, § 109, 92 Stat. 1783, 1796 (codified as amended in 18 U.S.C. § 1809).

[81] *See supra* notes 35–38 and accompanying text.

[82] It seems unlikely that Congress would provide such a large "backdoor" for invalidating Title III. *See* CRS Memo, *supra* note 67, at 40–41.

[83] Such a broad construction of the AUMF would allow the Executive Branch to override any statutory prohibition associated with national security with an "except as authorized by statute" provision. CRS Memo, *supra* note 67, at 36. Furthermore, separation-of-powers concerns are heightened because this construction may apply Commander in Chief powers to the domestic sphere. Youngstown Sheet & Tube Co. v. Sawyer, 343 U.S. 579, 645 (1952) (Jackson, J., concurring). Notably, FISA's subchapter on physical searches also contains a provision that bars physical searches by persons acting under color of law "except as authorized by statute." 50 U.S.C. § 1827 (2000).

[84] The Court relied heavily on international law to reach its conclusion. Hamdi v. Rumsfeld, 542 U.S. 507, 518 (2004); *see also* CRS Memo, *supra* note 67, at 34–36; Letter from Laurence H. Tribe to Senator Joseph R. Biden, Jr., *supra* note 68, at 4.

[85] The CRS disputes whether signals intelligence is as fundamental to combat as restraining the enemy. CRS Memo, *supra* note 67, at 34–35.

[86] *Hamdi*, 542 U.S. at 516.

[87] The "state of war is not a blank check for the President when it comes to the rights of the Nation's citizens." CRS Memo, *supra* note 67, at 33–34 (quoting *Hamdi*, 542 U.S. at 536). In *Padilla*, the Fourth Circuit expanded this detention authority to U.S. soil, finding that the detainee's express intention to fight against America justified military detention. Padilla v. Hanft, 423 F.3d 386, 392–94 (4th Cir. 2005), *cert. denied*, No. 05-533, 2006 WL 845383 (Apr. 3, 2006).

constitutional questions.[88] Critics contend that the terrorist surveillance program has exceeded any constitutional power of the President to conduct warrantless surveillance. The vague criteria used to select targets[89] make anyone fair game for surveillance.[90] Also, the terrorist surveillance program was secret for some time, subject only to minimal, internal review.[91] Critics note that the Supreme Court has never upheld sweeping surveillance power lacking both of the Fourth Amendment safeguards: individualized suspicion and judicial oversight.[92]

In disputing the inherent constitutional authority to authorize the terrorist surveillance program, critics place the terrorist surveillance program even farther outside Article II powers than President Truman's actions in *Youngstown*. In *Youngstown*, the Court held that the President lacked constitutional authority to seize and operate privately owned steel mills without congressional authorization, even though labor problems might otherwise have jeopardized the nation's ability to produce weapons for national defense.[93] A fortiori, monitoring personal conversations with only some probability of acquiring potentially useful intelligence would appear to fall even further outside the scope of Article II, implicating not only individual liberty but also personal privacy.[94]

Using a *Youngstown* analysis,[95] CRS classifies the President's power to conduct warrantless surveillance in the third category delineated in Justice Jackson's concurrence, where presidential power is weakest.[96] It claims that rulings upholding FISA's constitutionality endorse congressional power to regulate domestic surveillance and, perhaps by extension, electronic foreign surveillance.[97] If Congress has the power to regulate electronic surveillance and has accordingly limited the President's power to conduct elec-

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[88] Nolan et al., *supra* note 68.

[89] The administration described targets with terms like "working in support" and "affiliated." *See* Press Briefing, *supra* note 16.

[90] Letter from Laurence H. Tribe to Senator Joseph R. Biden, Jr., *supra* note 68; CRS Memo, *supra* note 67, at 37; Press Briefing, *supra* note 16.

[91] *See supra* notes 23–26 and accompanying text.

[92] Nolan et al., *supra* note 68. The Court worried that Fourth Amendment rights would be endangered if domestic surveillance were left to the discretion of the Executive Branch. *See* Katz v. United States, 389 U.S. 347, 356–57 (1967) (stating that the Constitution requires the interposition of a judicial officer between the citizen and the police).

[93] Youngstown Sheet & Tube Co. v. Sawyer, 343 U.S. 579, 582–83, 587 (1952).

[94] Letter from Laurence H. Tribe to Senator Joseph R. Biden, Jr., *supra* note 68, at 3.

[95] Justice Jackson's concurrence in *Youngstown* classifies presidential power into three categories. *Youngstown*, 343 U.S. at 635 (Jackson, J., concurring). In the first category, the President's power is at a maximum when he acts pursuant to an expressed or implied congressional authorization. *Id.* If Congress has not addressed the subject matter of a particular presidential action, that action may fall within "twilight," the second category, in which the President and Congress may have concurrent authority. *Id.* at 637. In the third category, the President's power is weakest when he takes actions incompatible with expressed or implied congressional will. *Id.*

[96] CRS Memo, *supra* note 67, at 44.

[97] *See* United States v. United States District Court (Keith), 407 U.S. 297, 321–22 (1972); CRS Memo, *supra* note 67, at 30–31, 44.

tronic surveillance to FISA procedures and Title III,[98] then the President's actions fall in the third category of *Youngstown*, where presidential power is weakest and sustainable only if Congress's restrictions are unconstitutional.[99]

Critics observe that some of the administration's recent actions are inconsistent with its broad interpretation of the AUMF. The strong lobbying for renewal of the PATRIOT Act seems superfluous if the AUMF justifies actions such as the terrorist surveillance program.[100] Additionally, the Attorney General admitted the decision to keep the program secret stemmed from suggestions by legislators that amendments to FISA authorizing the terrorist surveillance program would be "difficult, if not impossible" to obtain.[101] The administration's lobbying for FISA amendments seems to belie claims that the President thought he had sufficient power under the AUMF or the Constitution to conduct electronic surveillance.

IV. Conclusions and Suggestions for Reform

Admittedly, the War on Terror presents unique dangers. Preventing terrorist acts requires finding the proverbial needle in the haystack, an endeavor requiring timely acquisition and analysis of intelligence. Considering only the national security threat without accounting for the new threat would be myopic and would fail to address reality.

However, the War on Terror also presents unique challenges to our constitutional rights. The terrorist surveillance program implicates many of the same interests the Court has considered in the context of purely domestic surveillance, particularly since one target in each communication is in a domestic location. Although the set of possible targets of the terrorist surveillance program is limited to those individuals with some connection to a foreign party, globalization assures this proportion of the population will grow to include many with no connection to terrorist activities. We must find a balance between the new dangers the War on Terror poses and protection of constitutional rights.

By undertaking electronic surveillance outside the bounds of FISA,[102] the terrorist surveillance program directly conflicts with the judicially sanctioned procedure[103] for conducting warrantless electronic surveillance.[104]

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[98] *See supra* notes 71–75 and accompanying text.

[99] CRS Memo, *supra* note 67, at 44.

[100] Letter from Laurence H. Tribe to Senator Joseph R. Biden, Jr., *supra* note 68, at 5–6 (claiming that the PATRIOT Act authorized actions that the President already could have taken under the administration's broad reading of the AUMF).

[101] Press Briefing, *supra* note 16.

[102] Press Briefing, *supra* note 16 (noting that electronic surveillance would normally require a warrant).

[103] *In re:* Sealed Case No. 02-001, 310 F.3d 717, 742 (Foreign Int. Surv. Ct. Rev. 2002). At the time of this case, the United States was involved in the War on Terror, making difficult any argument that its interests have changed. If the FISA Court of Review be-

The largely technical amendments to FISA through the USA PATRIOT Act[105] display no congressional desire for national security to trump civil liberties.[106] It seems unlikely that Congress would have enacted the USA PATRIOT Act if it believed the AUMF authorized initiatives like the terrorist surveillance program.[107]

Even ignoring any conflict between the terrorist surveillance program and federal law, the terrorist surveillance program still may violate the Fourth Amendment. One federal appellate court stated that "the procedures and government showings required under FISA, if they do not meet the minimum Fourth Amendment warrant standards, certainly come close."[108] If FISA, with all its safeguards, might not meet this standard, the terrorist surveillance program certainly falls short. Even a strong government interest such as national security should not validate electronic surveillance without a warrant and probable cause.[109]

The terrorist surveillance program may present an even greater threat to the Fourth Amendment than other warrantless searches. Continued electronic surveillance is potentially far more intrusive than warrantless searches of physical property, which courts sometimes permit upon a finding of "special needs."[110] Unlike physical searches, which alert the suspect to law enforcement's presence, the terrorist surveillance program purposely avoids such disclosure. Yet despite this particularly egregious intrusion, the terrorist surveillance program proceeds without judicial supervision, even though FISA's history demonstrates that investigators easily obtain FISC warrants for such surveillance.[111]

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lieved the War on Terror made FISA unconstitutional, it would have said so.

[104] Thus, the NSA program falls into the third category of the *Youngstown* analysis. *See supra* note 95.

[105] *See, e.g.*, Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism (USA PATRIOT) Act of 2001, Pub. L. No. 107-56, § 206, 115 Stat. 272 (amending 50 U.S.C. § 1805(c)(2)(B) (2000 & Supp. II 2002)).

[106] "[T]he FISA court will still need to be careful to enter FISA orders only when the requirements of the Constitution as well as the statute are satisfied." 147 CONG. REC. S10589 (daily ed. Oct. 11, 2001) (statement of Sen. Edwards). The unwillingness to consider an exemption for one year after a declaration of war strongly suggests that in a less formal confrontation, there would be even less willingness to grant the four-year grace period so far enjoyed by the terrorist surveillance program. *See* H.R. REP. NO. 95-1720, at 34 (1978), *as reprinted in* 1978 U.S.C.C.A.N. 4063.

[107] *See supra* note 100 and accompanying text.

[108] *See In re: Sealed Case No. 02-001*, 310 F.3d at 746.

[109] Nolan et al., *supra* note 68.

[110] *In re: Sealed Case No. 02-001*, 310 F.3d at 746; *see also* Nolan et al., *supra* note 68 (noting that the existence of such special needs has never been held to permit warrantless wiretapping). Special needs arise when a warrant and individualized suspicion are impracticable and the privacy intrusion is minimal. *In re: Sealed Case No. 02-001*, 310 F.3d at 744–46.

[111] The FISA procedure is not only established, but the record of the FISC court suggests obtaining one is not difficult. *See In re: Sealed Case No. 02-001*, 310 F.3d at 744–46; *see also* Risen & Lichtblau, *supra* note 6, at A1.

More generally, the terrorist surveillance program poses great dangers to civil liberties. It potentially targets a large segment of the population with little factual basis.[112] In both *Padilla* and *Hamdi*, the plaintiffs had planned or engaged in acts of violence against the United States, and their detainment prevented them from returning to combat.[113] In contrast, several degrees separate NSA targets from the original suspect.[114] Suspicions founded on indirect association with alleged terrorists seem a comparatively poor justification for impinging upon civil liberties.

The terrorist surveillance program also may have a "chilling effect" on communication, whereby fear of surveillance compels individuals to self-censor their communications.[115] This problem deserves substantial scrutiny, as the Senate Judiciary Committee recently suggested:

> Our Bill of Rights is concerned not only with *direct* infringements on constitutional rights, but also with government activities which *effectively inhibit the exercise of these rights* . . . . Arbitrary or uncontrolled use of warrantless electronic surveillance can violate that understanding and impair that public confidence so necessary to an uninhibited political life.[116]

The solution should come from legislation.[117] Necessary amendments to FISA should not be conceptually difficult; the law already accommodates the need for immediate surveillance in light of the ephemeral and sporadic nature of terrorist communications.[118] Even if FISA has antiquated procedures,[119] by ignoring its guidelines the administration only disrupts the separation of powers in the federal government with what is, at best, a makeshift solution. The potentially indefinite nature of the War on Terror requires long-term FISA amendments to ensure oversight over the terrorist surveillance program without fundamentally impairing its capacity to process vast amounts of data.

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[112] *See supra* notes 89–90 and accompanying text.

[113] *See* Hamdi v. Rumsfeld, 542 U.S. 507, 592 (2004); Padilla v. Hanft, 423 F.3d 386, 392–94 (4th Cir. 2005).

[114] Lichtblau & Shane, *supra* note 13.

[115] *See* S. REP. NO. 95-604 (I), at 8 (1978), *as reprinted in* 1978 U.S.C.C.A.N. 3904, 3909–10.

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

[117] Several bills amending FISA are already in circulation, including one sponsored by Senator Arlen Specter that would clearly bring the terrorist surveillance program within FISA's control. *See* National Security Surveillance Act of 2006, S. 2453, 109th Cong. (2006); *see also* NSA Surveillance Act, H.R. 4976, 109th Cong. (2006); Terrorist Surveillance Act of 2006, S. 2455, 109th Cong. (2006).

[118] FISA provides for retroactive application for a warrant as well as certification by the Attorney General in lieu of particular elements of proof, allowing for immediate surveillance of fleeting terrorist communications. *See* 50 U.S.C. §§ 1802, 1804 (2000).

[119] *See* President's Radio Address, *supra* note 4; Press Briefing, *supra* note 16 (discussing outdated nature of FISA).

The President should not have unilateral authority over electronic surveillance programs because his role as Commander in Chief naturally tends to take precedence over his other duties. Specifically, the administration's emphasis on the President's Commander in Chief power[120] suggests a particular concern for national security and deemphasis on speech and privacy rights. Indeed, the President's balance between security and civil liberties seems out of step with popular opinion.[121] Including congressional input better protects those constitutional interests, because Congress has a less central role than the President does in commanding the military.

Neither the Constitution nor the courts have barred Congress from enacting laws regarding national security. The Constitution places the President in command of the military, but it authorizes Congress to raise, support, and make laws applying to the armed forces.[122] Supreme Court jurisprudence indicates that this congressional power includes regulation of at least some forms of surveillance; in *Keith*, the Court specifically invited Congress to establish statutory guidelines for domestic surveillance.[123] Other cases suggest that Congress should also have authority to regulate electronic foreign surveillance.[124] If it does have this authority, Congress has many options regarding how to regulate electronic surveillance while accounting for both the new security risk and civil liberties.

For example, Congress should streamline the process for obtaining an electronic surveillance warrant. Miring the NSA in paperwork impedes its surveillance by lowering its capacity to process data.[125] Rather than "reinvent the wheel" with every warrant application, Congress could streamline the process by using standardized warrant applications that require minimal alterations.[126] FISC could even pre-approve common form requests, clarifying judicial standards and providing a template for construct-

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[120] *See* DOJ WHITE PAPER, *supra* note 27, at 30–36; President's Radio Address, *supra* note 4; Press Release, Dick Cheney, Vice President's Remarks on Iraq and the War on Terror (Jan. 4, 2006), *available at* http://www.whitehouse.gov/news/releases/2006/01/print/200060104-2.html.

[121] Sixty-four percent of those polled were somewhat to very concerned about losing civil liberties as a result of antiterrorism measures. *See* Nagourney & Elder, *supra* note 26.

[122] U.S. CONST. art. I, § 8, cl. 12–14; *id.* art. II, § 2.

[123] *See* United States v. United States District Court (Keith), 407 U.S. 297, 321–22 (1972). Simply because Congress requires a more restrictive framework than unfettered executive discretion does not necessarily mean the President's military role has been impermissibly impaired. *See* Press Briefing, *supra* note 16.

[124] *See supra* notes 95–99 and accompanying text.

[125] *Hearings*, *supra* note 26 (statement of Alberto Gonzales, Att'y Gen.), *available at* http://judiciary.senate.gov/hearing.cfm?id=1727.

[126] At present, the administration identifies the chain of approval required even for emergency warrants as too cumbersome, especially since it requires input from the Attorney General. Alberto R. Gonzales, Attorney Gen., Responses to Questions from Chairman Specter 4 (Feb. 3, 2006), *available at* http://www.cdt.org/security/nsa/20060203gonzalez.pdf.

ing applications.[127] If the NSA wished to monitor multiple individuals for the same reason,[128] it could combine the requests in one application. Congress could then couple this change with FISC line-item vetoes for individuals who fail to meet the required showing of probable cause. Congress might also allow FISC to request more evidence for vetoed requests, deliverable within a reasonable time, thereby expediting approval while still assuring individualized scrutiny of cases.

Congress could also create a more flexible probable-cause requirement to reflect different types of electronic surveillance, being mindful to ensure that these new standards still provide meaningful FISC review.[129] Since the urgency and type of information required varies with the anticipated danger, Congress might accordingly create different probable-cause standards.[130] A flexible probable-cause requirement reflecting the intrusiveness of the search[131] would reinstate judicial oversight while allowing necessary surveillance that the traditional probable-cause standard might prohibit.

A more flexible probable-cause requirement is a necessary update that recognizes the latitude in surveillance that new technologies provide.[132] These new technologies have the power to maximize the information obtained while minimizing the intrusion on personal privacy.[133] For example, Congress might allow the President to collect encrypted data without a warrant[134] but require a warrant before permitting decryption.[135] The NSA

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[127] Situation-specific procedures should not be overlooked. However, in the event they are omitted in the original application, FISC could still conditionally grant the warrant, subject to submission of appropriate adjustments within a reasonable time.

[128] For example, the NSA may want to tap a set of phone numbers in a cell phone address book obtained from an al Qaeda operative.

[129] Distinguishing between criminal and domestic security purposes, the Court has stated:

> Different standards may be compatible with the Fourth Amendment if they are reasonable both in relation to the legitimate need of Government for intelligence information and the protected rights of our citizens. For the warrant application may vary according to the governmental interest to be enforced and the nature of citizen rights deserving protection.

See United States v. United States District Court (Keith), 407 U.S. 297, 323–24 (1972).

[130] *See* PHILIP B. HEYMANN & JULIETTE N. KAYYEM, PRESERVING SECURITY AND DEMOCRATIC FREEDOMS IN THE WAR ON TERRORISM 78 n.3 (2004), *available at* http://bcsia.ksg.harvard.edu/BCSIA_content/documents/LTLS_final_5_3_05.pdf (positing that a higher threat level may warrant faster access to data).

[131] For example, determining the location of parties to a phone call is hardly as invasive as monitoring the content of all phone and e-mail communications.

[132] While only limited options were available in the past, today not only are a range of surveillance options available, but also they yield vastly different types of data. Now, it is easier than ever to manage the degree of intrusiveness. *See* HEYMANN & KAYYEM, *supra* note 130, at 79–80.

[133] *See id.*

[134] TECH. AND PRIVACY ADVISORY COMM., SAFEGUARDING PRIVACY IN THE FIGHT AGAINST TERRORISM 50 (2004), *available at* http://www.defenselink.mil/news/Jan2006/d20060208tapac.pdf.

[135] This would maintain the individual's anonymity prior to a finding of probable ter-

could continue to look for patterns but could not unilaterally impinge further upon privacy. In cases where patterns suggest terrorist activity, the NSA could apply through FISC for access to more data.[136] Access to the data should expire after a reasonable period of time.

Even with a more streamlined process, Congress must still accommodate the most pressing surveillance needs. A larger window in which to apply for retroactive warrants would help accommodate emergency situations. However, this would lengthen the time during which the government encroaches on the rights of potentially innocent individuals. Thus, too large a grace period may defeat oversight goals. Furthermore, a larger delay may increase the chance that applications will be lost and never filed. To further accommodate emergency situations, Congress could place FISC judges "on call." Bolstering FISC's ability to handle the most pressing surveillance cases should obviate the need to conduct electronic surveillance outside statutory boundaries.

Congress should also ensure any surveillance is subject to thorough review and oversight. It might consider creating an interagency advisory commission to review and update guidelines for the NSA operational workforce and develop general data-mining protocols.[137] Such a commission could also conduct its own separate reviews of the terrorist surveillance program to determine its efficacy and the need for any improvements.[138]

In 1963, the Supreme Court remarked that "[i]t would indeed be ironic if, in the name of national defense, we would sanction the subversion of . . . those liberties . . . which make[ ] the defense of the Nation worthwhile."[139] This remains true today; the freedoms the government seeks to protect through the War on Terror are those most threatened by its prosecution.[140] This Recent Development readily acknowledges that America faces a novel enemy; however, it questions the process chosen to secure ourselves from that enemy. While perhaps less horrifying than other tactics in the War on Terror, the terrorist surveillance program represents a more insidious attack on the basic governmental framework. The harshest critics claim that the administration kept the terrorist surveil-

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rorist activity. *See* HEYMANN & KAYYEM, *supra* note 130, at 79–80.

[136] Ideally, such applications would be for incrementally more information. For example, the first application could seek meta-data (including a communication's origin, destination, and the identity of the individuals), while subsequent applications would be required to delve into the content of the communications. *See id.*

[137] *Cf.* TECH. AND PRIVACY ADVISORY COMM., *supra* note 134, at 52–55.

[138] *Cf. id.*

[139] United States v. Robel, 389 U.S. 258, 264 (1967).

[140] "America will always stand firm for the non-negotiable demands of human dignity: the rule of law; limits on the power of the state; . . . free speech; equal justice; and religious tolerance." President George W. Bush, State of the Union Address (Jan. 29, 2002), *available at* http://www.whitehouse.gov/news/releases/2002/01/20020129-11.html#.

lance program clandestine for political ends.[141] Others assert that the terrorist surveillance program is simply unconstitutional.[142]

Protecting the United States from future terrorist attacks poses unique challenges to constitutional rights. While a perfect balance between national security and constitutional rights may remain elusive, Congress can reconcile these two interests more objectively and democratically with amendments to FISA than can the enforcement-oriented Executive Branch acting unilaterally. Congress should modernize the safeguards for warrantless electronic surveillance, and the administration should comply with and respect Congress's judgment.

—*Katherine Wong**

[141] S. REP. No. 95-604 (I), at 7–8 (1978), *as reprinted in* 1978 U.S.C.C.A.N. 3904, 3908.

[142] *See* Letter from Laurence H. Tribe to Senator Joseph R. Biden, Jr., *supra* note 68; CRS Memo, *supra* note 67; Nolan et al., *supra* note 68.

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INDEPENDENT REDISTRICTING COMMISSIONS

In 2001, a divided Texas legislature deadlocked over the drawing of congressional districts.[1] In response, a panel of federal judges instituted a compromise redistricting plan.[2] In the following election, using the congressional districts drawn by these judges, Texas voters elected seventeen Democrats and fifteen Republicans to the United States House of Representatives.[3] At the state level, Republicans fared better, winning control of both houses of the Texas legislature. Then, in 2003, those Texas legislature Republicans broke with tradition and began a campaign to perform a second round of redistricting based on the 2000 census data.[4]

A struggle ensued between Texas Democrats and Republicans,[5] but the new redistricting plan eventually passed.[6] The results of the 2004 election using the new redistricting plan were drastically different from the results of the 2002 election: whereas Texans elected seventeen Democrats and fifteen Republicans in 2002 to the U.S. House of Representatives, in 2004 they elected eleven Democrats and twenty-one Republicans.[7] While it is debatable just how egregious the Republican-led redistricting plan was,[8] this election does demonstrate the potential power of a legislature to adjust political outcomes through the redistricting process—a practice that has been employed by Democrats and Republicans alike.[9]

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[1] Jeffrey Toobin, *The Great Election Grab*, NEW YORKER, Dec. 8, 2003, at 63. The Republicans controlled the Texas State Senate and the Democrats controlled the State House of Representatives.

[2] *Id.*

[3] Office of the Secretary of State, 1992–2006 Election History, http://elections.sos.state.tx.us/elchist.exe (last visited Feb. 21, 2006) [hereinafter Election History].

[4] *See* Justin Driver, *Rules, the New Standards: Partisan Gerrymandering and Judicial Manageability After* Vieth v. Jubelirer, 73 GEO. WASH. L. REV. 1166, 1187 (2005). States usually redistrict just once a decade, immediately following the release of new census data. *See id.* However, while this once-per-decade rate is traditional, there are no federal statutory or constitutional prohibitions to redistricting multiple times in a single decade. *See id.*

[5] JoAnn D. Kamuf, Note, *"Should I Stay or Should I Go?": The Current State of Partisan Gerrymandering Adjudication and a Proposal for the Future*, 74 FORDHAM L. REV. 163, 163–64 (2005).

[6] *Id.* at 164.

[7] Election History, *supra* note 3.

[8] The Republicans won every statewide election held in Texas in both 2002 and 2004. Election History, *supra* note 3. This makes the large Republican victory in the congressional elections seem less unfair and less startling, especially since it is not unusual for the party receiving a majority of the votes statewide to win a disproportionate number of seats. *See* Sam Hirsch, *The United States House of Unrepresentatives: What Went Wrong in the Latest Round of Congressional Redistricting*, 2 ELECTION L.J. 179, 198 (2003) ("Under a single-member districting plan with two major parties and winner-take-all elections, there is typically a healthy 'winner's bonus' that rewards the stronger party with a disproportionate share of the seats.").

[9] *See* Editorial, *The Gerrymander Moment*, WALL ST. J., Dec. 5, 2003, at A12 (discussing Democratic gerrymandering following the 1980 census in California and the 1990 census in Texas).

Shortly after these events in Texas, on June 13, 2005, California Governor Arnold Schwarzenegger called a special election[10] in which Californians would vote on four propositions designed to address California's budgetary woes and reform the political process in the state.[11] One of the four measures, Proposition 77, called for the creation of an independent commission, composed of three retired judges, to replace the state legislature as the chief body in charge of performing redistricting in California.[12] Californians rejected Proposition 77 by a fairly sizeable margin.[13] On the same day, Ohio voters also decisively defeated State Issue 4, a ballot measure that would have created an independent redistricting commission there.[14]

However, the defeat of Proposition 77 and State Issue 4 does not necessarily mean that the public does not support redistricting reform. For instance, Arizona voters passed an initiative creating an independent redistricting commission in 2000.[15] Also, there were numerous factors weighing against the two doomed ballot propositions. For instance, Proposition 77's fate was likely tied to the unpopularity of its chief supporter, Governor Schwarzenegger; public disapproval of the special election and its expense in general; efforts by both major political parties against the measure; and historic skepticism toward redistricting commissions in California.[16] State Issue 4 was likely harmed by perceptions that it was a ploy by Democrats to increase their political power and that it used a confusing formula to perform redistricting, producing sample redistricting plans that "looked like strands of spaghetti thrown against a wall."[17] Further, while California voters rejected Proposition 77, polls indicated that a majority

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[10] Gary Delsohn, *Special Election Set for Nov. 8*, SACRAMENTO BEE, June 14, 2005, at A1.

[11] *Id.*; *see also* Kate Folmar, *Governor Calls for Special Election Nov. 8*, SAN JOSE MERCURY NEWS, June 14, 2005, at 1A; John Mercurio, *Schwarzenegger Calls for Special Election*, CNN.com, June 14, 2005, http://www.cnn.com/2005/POLITICS/06/13/schwarzenegger/index.html.

[12] *See* Cal. Proposition 77 (2005), *available at* http://www.ss.ca.gov/elections/bp_nov05/voter_info_pdf/text77.pdf.

[13] BRUCE MCPHERSON, OFFICE OF THE SECRETARY OF STATE, CALIFORNIA, SPECIAL STATEWIDE ELECTION STATEMENT OF VOTE xiii (2005), *available at* http://www.ss.ca.gov/elections/sov/2005_special/sov_entire.pdf. Proposition 77 lost with 40.2% of voters voting in favor of the measure and 59.8% against. *Id.*

[14] SECRETARY OF STATE OF OHIO, 2005 OFFICIAL RESULTS (2005), *available at* http://www.sos.state.oh.us/sos/electionsvoter/results 2005.aspx?Section=1168. State Issue 4 lost with 69.7% of voters voting no and 30.3% voting yes. *Id.* For the full text of the amendment proposed under State Issue 4, see REFORM OHIO NOW, AMENDMENTS TO THE CONSTITUTION PROPOSED BY INITIATIVE PETITIONS TO BE SUBMITTED DIRECTLY TO THE ELECTORS: AMENDMENT FOR AN INDEPENDENT REDISTRICTING PROCESS (2005), *available at* http://www.reformohionow.org/downloads/ron_amendments.pdf.

[15] *See* David K. Pauole, Comment, *Race, Politics & (In)Equality: Proposition 106 Alters the Face and Rules of Redistricting in Arizona*, 33 ARIZ. ST. L.J. 1219, 1220–21 (2001).

[16] *See* Nicholas D. Mosich, Note, *Judging the Three-Judge Panel: An Evaluation of California's Proposed Redistricting Commission*, 79 S. CAL. L. REV. 165, 198 (2005).

[17] Opinion, *State Issues 2, 3, 4, 5 Are Bogus Election Reforms, In a Word, Vote No, No, No, No*, MORNING J., Oct. 25, 2005.

of likely California voters supported making some sort of change in the redistricting process.[18] In addition, numerous other states are considering adopting independent commissions to perform redistricting in the future.[19] The lessons that the stories of Proposition 77 and State Issue 4 provide are pertinent to future redistricting reform efforts.

Part I of this Article provides an overview of Proposition 77 and State Issue 4. Part II discusses the challenge of creating appropriate levels of competition and constructing districts that are not biased in favor of one political party. Part III critiques the processes used to select commission members that are intended to lessen the chance of bias. Part IV looks at the democratic accountability of the failed ballot measures, and Part V addresses the fairness of one-time mid-decade redistricting that occurs shortly after the passage of redistricting reform.

I. OVERVIEW OF PROPOSITION 77 AND STATE ISSUE 4

Proposition 77 called for the creation of a commission composed of three retired judges to perform redistricting.[20] While redistricting under the plan would normally have occurred once per decade, a special one-time redistricting would have followed passage of the proposition.[21]

According to the measure, the process for selection of the three retired judges would have begun with the Judicial Council's nominating twenty-four retired judges willing to serve as special masters to perform redistricting.[22] No more than twelve of the retired judges could have been from a single political party.[23] From the pool of twenty-four nominated judges, the speaker and the minority leader of the State Assembly and the president pro tempore and the minority leader of the State Senate each would have nominated three retired judges to serve as special masters, for a total of twelve.[24] The proposed statute would have forbidden nominators from selecting judges who share his or her party affiliation.[25] Each politician then would have had the opportunity to peremptorily strike one remaining retired judge from consideration.[26] The chief clerk of the State As-

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[18] Mosich, *supra* note 16, at 204.

[19] Nancy Vogel, *Several States May Revisit Redistricting*, L.A. TIMES, Sept. 26, 2005, at B1.

[20] The commission would oversee the redistricting of California State Senate, State Assembly, United States House of Representatives, and State Board of Equalization districts. Cal. Proposition 77, sec. 2, § 1(a) (2005), *available at* http://www.ss.ca.gov/elections/bp_nov05/voter_info_pdf/text77.pdf.

[21] *Id.* § 1(b). These new districts would have been used until new redistricting could occur after the 2010 census. *Id.* § 1(a).

[22] *Id.* § 1(c)(2)(A).

[23] *Id.* Both California state and federal judges could have served as special masters. *Id.*

[24] *Id.* § (1)(c)(2)(C).

[25] *Id.* § (1)(c)(2)(c). For instance, if the Speaker of the State Assembly were to have been a Democrat, he or she could not have nominated a judge who is also a Democrat. *Id.*

[26] Proposition 77, sec. 2, § 1(c)(2)(E).

sembly would have drawn the special masters from the remaining pool of candidates by lot, continuing to draw until pulling a special master from each of the two largest political parties.[27] A retired judge would not have been permitted to serve as a special master if he or she had ever held elected partisan public office or a political party office, changed political party affiliation since becoming a judge, or received income in the past year from certain political entities.[28]

Districts drawn by the commission would have had to conform to the geographic boundaries of counties and cities to the "greatest extent practicable"[29] and to have been as compact as possible while respecting those boundaries.[30] The special masters would have been forbidden from considering the potential effects that a redistricting plan would have on incumbents or political parties.[31] Additionally, they could not have considered the residence of any candidate, or the party affiliation and voting history of the electorate, except as required by federal law.[32]

Meetings of the commission would have been subject to a number of provisions,[33] and the special masters would have had to approve the final redistricting plan by a unanimous vote.[34] The plan would have gone into effect for the next primary and general election,[35] when voters would have had the opportunity to either accept or reject by majority vote the continued use of the redistricting plan adopted by the special masters.[36]

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[27] *Id.* § 1(c)(2)(F).

[28] *Id.* § 1(c)(2)(A). These entities are: the state legislature; Congress; a political party; or a partisan candidate or a committee controlled by the candidate. *Id.*

[29] *Id.* § 2(f).

[30] *Id.* § 2(g). Proposition 77 would have required that all districts of a particular type be as nearly equal in population as possible. A further requirements would have been that the population differences between congressional districts conform to federal constitutional standards. *Id.* § 2(b).

[31] Proposition 77, sec. 2, § 2(i).

[32] *Id.* For a newspaper article about why the authors of Proposition 77 designed the redistricting commission as they did, and about some of the perceived benefits and disadvantages of this design, see John Wildermuth, *Redistricting Initiative Would Set State Apart*, S.F. CHRON., Oct. 7, 2005, at B3.

[33] Public notice would have been required for all meetings of the special masters. The rules governing meetings of other state bodies would have applied to the commission. Proposition 77, sec. 2, § 1(f)(1). The special masters would have been required to establish procedures restricting certain ex parte communications. *Id.* At least three public meetings would have been required for the special masters to consider comments and proposed redistricting plans from any member of the public or Legislature. *Id.* § 1(f)(2). After devising a preliminary redistricting plan, the Legislature would have been afforded an opportunity to comment on the plan, and any legislator recommendation that is adopted would have had to have been addressed in writing. *Id.* § 1(f)(3).

[34] *Id.* § 1(g).

[35] *Id.*

[36] *Id.* §§ 1(g), 1(h). If the redistricting plan were approved, it would have been adopted until the new federal census took place in the following decade. *Id.* § 1(g). If the redistricting plan were rejected, a new panel of special masters would have been appointed to create a new redistricting plan for the next general and primary elections. *Id.* § (1)(i). It is unclear whether voter approval would have been required for this second redistricting plan to be used for the rest of the decade until the next federal census.

Ohio's State Issue 4 would have created an independent redistricting commission consisting of five members.[37] A special redistricting would have followed the passage of the proposition, with subsequent redistricting occurring only in the year following a national census.[38] The two longest continually serving judges on the state district court of appeals who had been nominated by members of different political parties each would have appointed to the redistricting commission one person who shares his or her political affiliation.[39] These two appointees then would have selected the three other members of the commission.[40] One of these three subsequent appointees would have to have been an independent, while the other two would have been forbidden from belonging to the same political party.[41] Regional, gender, and racial diversity would have been requisite considerations in the appointment process.[42]

The measure would have spelled out a long list of requirements to bar candidates with close partisan connections.[43] There also would have been strict prohibitions on future possible conflicts of interest, including restrictions on future political activity and dealings with government.[44]

State Issue 4 also would have provided a complicated array of procedures and formulas in an attempt to ensure a maximum number of competitive races. The measure also would have encouraged parity in the number of both competitive and uncompetitive districts that support each political party.[45] The commission would have been allowed to adjust a prevailing plan to preserve "communities of interest based on geography, economics or race," as long as there would be little change in competitiveness.[46] Four out of five votes would have been required for a plan to be approved, with commission meetings subject to several openness requirements.[47]

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[37] REFORM OHIO NOW, AMENDMENTS TO THE CONSTITUTION PROPOSED BY INITIATIVE PETITIONS TO BE SUBMITTED DIRECTLY TO THE ELECTORS: AMENDMENT FOR AN INDEPENDENT REDISTRICTING PROCESS § 2(B) (2005), *available at* http://www.reformohionow.org/downloads/ron_amendments.pdf.

[38] *Id.* §§ 2(A), 6.

[39] *Id.* § 2(B)(1)(a).

[40] *Id.*

[41] *Id.*

[42] *Id.*

[43] AMENDMENT FOR AN INDEPENDENT REDISTRICTING PROCESS § 2(B)(3).

[44] *Id.* § 2(B)(4). Each member of the commission also would have been required to file a financial disclosure and an ethics report before entering into performance of his or her duties. *Id.* § (2)(B)(5).

[45] *See id.* § (5)(E)–(F).

[46] *Id.* § (5)(F)(2).

[47] Id. § 2(B)(7). Other than legal consultations, all business of the commission would have to have been conducted at open meetings. *Id.* All redistricting plans would have been made available for public scrutiny. *Id.* § (5)(C)(1). Five public hearings would have to have been held throughout the state to solicit public comments before a redistricting plan could have been adopted. *Id.*

II. THE PANDORA'S BOX OF COMPETITION AND PARTISAN REPRESENTATION

One of the frequent arguments for independent redistricting commissions is that they are needed to ensure competitive races. In 2002, less than ten percent of congressional elections were decided by fewer than ten percentage points, and only four congressional incumbents lost general election races for re-election.[48] The concern is that if redistricting is left to the state legislature and the governor, aided by advanced modern technology,[49] they will draw districts in a way to ensure easy re-election for incumbents or to further partisan advantage. The lack of competition may lead to unaccountable legislators who have little to fear from the electoral process.[50] Similarly, shifts in voter alignment may not be reflected adequately in electoral outcomes.[51] Furthermore, the creation of districts heavily favoring one political persuasion may lead to the victory of ideologically extreme candidates, who do not feel compelled to appeal to the politically moderate.[52] The evidence suggests that gerrymandering is one cause of lack of competition,[53] though the causal relationship can be exaggerated.[54]

However, a serious problem for creators of independent redistricting commissions aimed at preventing gerrymandering is that there is no such thing as purely neutral redistricting criteria.[55] Even seemingly apolitical

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[48] Richard H. Pildes, *The Constitutionalization of Democratic Politics*, 118 HARV. L. REV. 28, 62–63 (2004).

[49] *See* Samuel Issacharoff, *Supreme Court Destabilization of Single-Member Districts*, 1995 U. CHI. LEGAL F. 205, 232–33 (1995).

[50] Pildes, *supra* note 48, at 43–44.

[51] *See* Samuel Issacharoff, *Collateral Damage: The Endangered Center in American Politics*, 46 WM. & MARY. L. REV. 415, 430–31 (2004) ("A national swing of five percent in voter opinion . . . will change very few seats in the current House of Representatives.").

[52] *Id.* at 427–28.

[53] *See, e.g.*, Hirsch, *supra* note 8, at 186–88 (presenting evidence that redistricting has been used to strengthen the electoral prospects of incumbents facing shaky re-election prospects).

[54] Other factors that may contribute to a lack of competition in voting districts include incumbency; campaign expenditures; the media; geographic concentration of likeminded voters; and the Voting Rights Act. There are strong incumbency advantages in non-district-based elections. Nathaniel Persily, Reply, *In Defense of Foxes Guarding Henhouses: The Case for Judicial Acquiescence to Incumbent-Protecting Gerrymanders*, 116 HARV. L. REV. 649, 665 (2002). Also, the presidential election results from 1992 to 2000 suggest that congressional districts were more competitive in presidential elections than congressional races. *Id.* at 663–64. Evidence indicates that the 2002 congressional races, the first races since the redistricting following the 2000 census, were the least competitive in history. *See* Pildes, *supra* note 48, at 61–64. At least one study has found that independent redistricting commissions lead to higher levels of competitiveness. *See* Jamie L. Carson & Michael H. Crespin, *The Effect of State Redistricting Methods on Electoral Competition in the United States House of Representative Races*, 4 ST. POL. & POL'Y Q. 455, 455–69 (2004).

[55] Mitch Altman, *The Computational Complexity of Automated Redistricting: Is Automation the Answer?*, 23 RUTGERS COMPUTER & TECH. L.J. 81, 86 (1997).

criteria may lead to low levels of competitiveness and may also systematically hinder the political fortunes of one of the major political parties.[56] Redistricting commissions should utilize election and partisan data to adjust redistricting plans so that they are not unduly biased against one of the major political parties and to ensure adequate levels of competition.

A redistricting system like Proposition 77, which ignores partisan voting data and focuses on political boundaries, may increase competition less than some supporters of redistricting commissions would like.[57] For example, in 2000 Arizona created an independent commission to perform redistricting using criteria similar to those employed by Proposition 77.[58] Yet in 2004, no congressional election in Arizona was decided by fewer than twenty percentage points.[59] In fact, fewer than twenty percentage points decided only six of the thirty State Senate seats, and over half of the State Senate seats were not contested by one of the major political parties.[60]

This lack of competition can partially be explained by the reality that often voters with similar partisan preferences tend to be concentrated in large geographical areas of the state.[61] Large continuous areas consisting of multiple counties may be populated with majorities of citizens who lean the same way politically. Drawing a district entirely within one of these homogenous areas will likely produce an uncompetitive district.

This problem is illustrated vividly in California. California, with fifty-eight counties,[62] is the largest state in the country in terms of population[63] and the third largest in terms of land area.[64] In the 2004 presidential election, there was one continuous block of counties that supported Democrat

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[56] *See* Daniel H. Lowenstein & Jonathan Steinberg, *The Quest for Legislative Districting in the Public Interest: Elusive or Illusory?*, 33 UCLA L. REV. 1, 26–27 (1985); *see also* Steven Hill, *Schwarzenegger vs. Gerrymander*, 7 J.L. & SOC. CHALLENGES 179 (2005).

[57] *See* Hill, *supra* note 56. *But see* DOUGLAS JOHNSON ET AL., THE ROSE INST. OF STATE & LOCAL GOV'T, RESTORING THE COMPETITIVE EDGE: CALIFORNIA'S NEED FOR REDISTRICTING REFORM AND THE LIKELY IMPACT OF PROPOSITION 77 (2005), *available at* http://rose.research.claremontmckenna.edu/redistricting/redistricting.asp (follow "Full Report" hyperlink) (concluding that Proposition 77 would have resulted in more competition). For an article that discusses the Claremont McKenna College study and tempers expectations about possible increases in competition in California from Proposition 77, see *Modest Change Seen Under Prop. 77*, Nancy Vogel, L.A. TIMES, Sept. 27, 2005, at B1.

[58] Arizona does take competition into consideration, but it is the least important factor considered. *See* Pauole, *supra* note 15, at 1225.

[59] All Arizona general election results for 2004 are available from the Arizona Secretary of State's website. ARIZ. SEC'Y OF STATE, 2004 GENERAL ELECTION RESULTS (2004), *available at* http://www.azsos.gov/election/2004/General/2004_General_results_query.htm.

[60] *Id.* The six districts decided by less than twenty points were Senate Districts 1, 5, 9, 10, 12, and 25. *Id.*

[61] *See* Hill, *supra* note 56, at 179–80.

[62] *California*, in INFOPLEASE, http://www.infoplease.com/ipa/A0108187.html (Pearson Education) (last visited Apr. 10, 2006).

[63] *Population by State*, in INFOPLEASE, http://www.infoplease.com/ipa/A0004986.html (Pearson Education) (last visited Apr. 10, 2006).

[64] *Land and Water of States, 2000*, in INFOPLEASE, http://www.infoplease.com/ipa/A0108355.html (Pearson Education) (last visited Apr. 10, 2006).

John Kerry and one continuous block that supported Republican George W. Bush.[65] Only five counties are not part of one of these continuous political blocks.[66] Within the Republican and Democratic counties, the level of partisan competition is quite low on average. In the thirty-six California counties where President Bush received more votes than John Kerry, President Bush won an average vote share of 64.28%.[67] In the twenty-two counties where John Kerry was the top vote getter, Senator Kerry received an average vote share of 61.55%.[68] This means that districts drawn completely within one of California's two partisan blocks will likely be quite uncompetitive.

Consequently, to achieve higher levels of competition in California, districts must be created that include territory from both Republican and Democratic areas. A system that emphasizes geographic compactness, fragments counties and cities as little as possible, and ignores partisan voting preferences may produce little of the commingling needed for higher levels of competition.

Further, because the majorities enjoyed by each political party in the areas where it has the advantage may be of different sizes, the party whose voters are more heavily concentrated geographically will likely see more of its votes "wasted." A party will win elections easily in districts where its voters are concentrated, while being drained of electoral strength in the rest of the districts. This phenomenon is more likely to harm the Democratic Party because the concentration of Democratic voters in urban areas tends to be higher than the concentration of Republican voters in Republican areas.[69] As discussed further below, redistricting commissions should be empowered to adjust a redistricting plan to prevent bias.

Another factor is that the federal Voting Rights Act requires that minorities have an equal opportunity to "elect representatives of their choice."[70] To comply with the Voting Rights Act, districts must be created with populations designed to allow minority voters, often Democrats, the opportunity to elect minority candidates.[71] While this requirement may be important to

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[65] California voter data from the 2004 presidential election is available on the California Secretary of State's website. CAL. SEC'Y OF STATE, VOTE 2004 (2004), *available at* http://vote2004.ss.ca.gov/Returns/pres/mapAN.htm. In addition, as demonstrated by the results of the 1996 and 2000 presidential races, there has been remarkably little change in Republican and Democratic alignment in California since 1996. For voting data by county for the 1996 and 2000 presidential elections, see CAL. SEC'Y OF STATE, U.S. PRESIDENT 1996–2000 COMPARISON, http://vote2000.ss.ca.gov/Returns/pres/mapComp.htm (last visited Feb. 21, 2006).

[66] These five counties are Imperial County, Mono County, Santa Barbara County, Alpine County, and Los Angeles County. CAL. SEC'Y OF STATE, VOTE 2004, *supra* note 65.

[67] *Id.*

[68] *Id.*

[69] *See* Lowenstein & Steinberg, *supra* note 56, at 21–27 ("[T]he adoption of compactness as a criterion for drafting or evaluating districting plans will systematically advance the interests of the Republican Party.").

[70] 42 U.S.C. § 1973(b) (2000).

[71] For a discussion on the judicial requirements of the Voting Rights Act, the problems

ensure proper minority representation, it also makes it more challenging for any redistricting system to be created that is not biased against one of the political parties.

The drafters of State Issue 4 clearly saw the maximization of competition as a paramount goal. As outlined above, State Issue 4 would have created a complex set of mechanisms designed to achieve high levels of competition.[72]

Under a regime like the one State Issue 4 would have created, in states where the number of Republican and Democratic voters is relatively equal, nearly all districts would have an electorate that tends to support Republican and Democratic candidates fairly evenly. The result would be that candidates would have to appeal to the political center in order to command a broad base of constituents.[73] However, while this means that there might be less ideological division in the legislature, certain segments of the population, such as farmers, inner city dwellers, or those to the far left or right, might feel inadequately represented.

Finally, it must be noted that while there is concern in the academic literature over lack of competition in voting districts, this does not mean that uncompetitive districts are without merit. Higher rates of re-election produced by a lack of competition might lead to incumbents who know their constituents better, are more likely to acquire positions of power in the legislature based on seniority, and could improve their job performance with years of experience. Furthermore, if there are at least enough competitive districts so that the majority party faces a real possibility of losing its majority, this may create an incentive for all members of the majority party to appease median voters to ensure that the party maintains control. It is possible that even legislators who have safe seats would want to assure that the party as a whole does not alienate voters in competitive districts. Lastly, it should be noted that a high level of competition comes with problems of its own. For example, higher levels of competition might lead to increased levels of pork barrel spending, with insecure politicians feeling a need to "buy off" their electorates by bringing new projects and funds to their home districts.[74]

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they have created for Democrats, and how Democrats have tried to respond, see Michael A. Carvin & Louis K. Fisher, *"A Legislative Task": Why Four Types of Redistricting Challenges Are Not, or Should Not Be, Recognized by Courts*, 4 ELECTION L.J. 2, 12–28 (2005). For a discussion of recent judicial developments on the Voting Rights Act and redistricting that looks at how the issues affect minorities, see generally Note, *The Implications of Coalitional and Influence Districts for Vote Dilution Litigation*, 117 HARV. L. REV. 2598 (2004) [hereinafter *Vote Dilution Litigation*].

[72] *See supra* text accompanying notes 45–47.

[73] There is evidence that politicians are responsive to the ideological preferences of their district, though Democrats are more responsive to liberal changes and Republicans to conservative changes. *See* Amihai Glazer & Marc Robbins, *Congressional Responsiveness to Constituency Change*, 24 J. POL. SCI. 259 (1985).

[74] *See* Robert M. Stein & Kenneth M. Bickers, *Congressional Elections and the Pork Barrel*, 56 J. POL. 377, 389 (1994).

Achieving optimum levels of competition and results that are not systematically biased against one political party is a difficult problem for redistricting reformers. As we have seen, seemingly fair criteria may inadvertently lead to sub-optimal results. Redistricting commissions should be allowed to use electoral and partisan data to adjust district boundaries to ensure that there are not too many districts that are politically skewed toward one party and that the redistricting plan is not biased against either major political party. Statistical models and software have been developed to aid in these tasks, and various actors performing redistricting have extensively used these models and software.[75] In addition, policy choices must be made about how much bias is acceptable and what levels of competition are optimal. A redistricting plan should be drawn that best conforms to criteria that the public supports, such as compact districts drawn with respect for city and county boundaries, and then readjusted until the plan contains an acceptable expected level of bias and competitiveness.

III. Rating the Anti-Bias Mechanisms

One of the primary reasons to employ an independent commission to perform redistricting is to prevent officials from drawing district lines in a manner designed to achieve political gain. When creating a redistricting system, it is important that the system ensure the highest level of impartiality.[76]

The regimes envisioned by Proposition 77 and State Issue 4 would have gone to great lengths to ensure that redistricting commission members would not have had conflicts of interests with either the government or a political party. State Issue 4 would have placed restrictions on political activity and business with political actors after service on the commission.[77] Such restrictive policies seem crucial to ensuring that members of redistricting commissions will be as nonpartisan as possible and not tempted by the possibility of future political or financial gain. Even if a commission is balanced in partisanship, if the commission members are too politically connected, they may sponsor a plan that helps to ensure elec-

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[75] *See* Brief for Professor Gary King et al. as Amici Curiae in Support of Neither Party at 4–9, Jackson v. Perry, Nos. 05-204, 05-254, 05-276, 05-429 (U.S. Jan. 10, 2006); *see also* Andrew Gelman & Gary King, *A Unified Method of Evaluating Electoral Systems and Redistricting Plans*, 38 Am J. Pol. Sci. 514 (1994).

[76] For an article that evaluates the level of neutrality likely to result from the redistricting commissions of other states, see Jeffrey C. Kubin, Note, *The Case for Redistricting Commissions*, 75 Tex. L. Rev. 837 (1997).

[77] Reform Ohio Now, Amendments to the Constitution Proposed by Initiative Petitions To Be Submitted Directly to the Electors: Amendment for an Independent Redistricting Process §§ 2(B)(3)–(4) (2005), *available at* http://www.reformohionow.org/downloads/ron_amendments.pdf.

toral victory for incumbents from both parties; both parties would be interested in ensuring easy re-election for their incumbents.[78]

State Issue 4 also would have attempted to limit bias by giving the members of the redistricting commission very little personal leeway in the redistricting process. The measure enumerated very specific criteria to be followed. In fact, most of the process could have been performed by a computer.[79] However, while such a system can help to prevent abuses, it also creates inflexibility and inhibits honest commissioners from better implementing comments from the public and from avoiding previously unanticipated problems.

Proposition 77 also would have employed commission member selection mechanisms that might have lessened the chance of bias and partisanship. One mechanism employed by Proposition 77 was that the four state legislators involved in the selection process would have evenly represented the minority and majority parties.[80] Also, each partisan politician could only have nominated candidates for the commission who did not belong to the same political party as he did.[81] Presumably, a politician would not pick someone from the other party who is known as a partisan ideologue or who is likely to be unfair. A commission of neutral members is less likely to be biased and more likely to compromise than an evenly divided commission of partisans.

Another safeguard was that each major political party would have to have been represented on the commission and a unanimous vote would have been required for ratification of a redistricting plan. Thus, a member of each major party would have to have supported the plan, preventing supporters of one political party from taking over the process, though this also could have led to deadlocks. Additionally, the Judicial Council would have picked the twenty-four people from which the four legislators would have chosen. While judges are not always apolitical, presumably a judicial body would be less political in its selections than a legislative body. Also, allowing each of the four legislators involved in the selection process to strike a nominee from consideration would have helped to ferret out problematic candidates.

One peculiar provision of Proposition 77's selection process was that the three members of the redistricting commission would have been chosen at random from the remaining pool of nominees after each legislator

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[78] For a recent example from California of a "bipartisan gerrymander" where both parties successfully colluded in achieving zero competitive congressional races in California, see Mosich, *supra* note 16, at 172.

[79] For an article discussing the inherent problems of determining redistricting criteria, as well as the possible benefits of using computers to perform redistricting, see Michelle H. Browdy, Note, *Computer Models and Post-Bandemer Redistricting*, 99 YALE L. J. 1379 (1990).

[80] Cal. Proposition 77, sec. 2, § 1(c)(2)(C) (2005), *available at* http://www.ss.ca.gov/elections/bp_nov05/voter_info_pdf/text77.pdf.

[81] *Id.*

was afforded an opportunity to strike a nominee. Problematic candidates could have survived the lottery. Also, immensely qualified and fair candidates, who would enjoy universal approval, could have been removed by the lottery. A better mechanism to achieve neutrality would have been to have the legislators initially nominate eleven candidates and then require each legislator to strike two candidates.

IV. DEMOCRATIC ACCOUNTABILITY

Drawing legislative districts carries significant political ramifications that affect the average citizen. One common critique of creating independent redistricting commissions is that it puts redistricting in the hands of unelected officials who have little or no accountability to the voters.[82] A related argument is that the independent redistricting commissions will be unrepresentative of the diverse population of a state.[83]

One problem with the arguments that independent redistricting commissions are too unaccountable is that they assume elected politicians are more accountable. In fact, elected politicians may calculate that the political gains from gerrymandering are potentially so great that they outweigh any potential backlash from voters.[84]

Also, even if the redistricting commissions are less responsive to some of the concerns of voters, the political system overall may become more accountable. If an independent redistricting commission is well-designed, the plan it produces should make elections more competitive.[85] Since more competitive elections should make politicians more accountable generally, this increased responsiveness may outweigh any loss of accountability in the redistricting process.[86]

Both Proposition 77 and State Issue 4 would have required the commissions to have public meetings where citizens could have an opportunity to voice their ideas and concerns. Redistricting business must also be conducted in public, helping to keep the process transparent and facilitating public discourse with the commission. In turn, it is important that a redistricting commission have enough flexibility that it can incorporate public opinion.

One challenge is determining the way in which a redistricting commission will be implemented. In the case of implementation through a ballot

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[82] *See, e.g.*, Opinion, MORNING J., *supra* note 17.

[83] *See* LEAGUE OF WOMEN VOTERS ET AL., POSITION PAPER ON PROPOSITION 77, at 1 (2005), *available at* http://ca.lwv.org/lwvc/action/redistrict/prop77_positionpaper.pdf ("Proposition 77 places redistricting in the hands of three individuals who do not reflect California's diversity.").

[84] Presumably, rational political actors would not choose to gerrymander if they thought the political cost of gerrymandering would be greater than the political gain.

[85] A 2004 study found this to be the case. *See* Carson & Crespin, *supra* note 54, at 461.

[86] *See* Samuel Issacharoff, *Gerrymandering and Political Cartels*, 116 HARV. L. REV. 593, 615–16 (2002).

referendum that alters the state constitution, the actions of the commission could not be controlled without additional constitutional change.[87] In contrast, many key actions made by administrative agencies can be overturned by the legislature. On the other hand, the problem with a redistricting commission created through a legislative action and not a state constitutional amendment is that one political party may take control of the legislature and the governorship and then dissolve the redistricting commission or otherwise disregard its work.

The problem of democratic accountability may seem especially pertinent to women and minorities, who might be inadequately represented on the redistricting commission. This concern was especially pertinent with respect to Proposition 77 for two reasons. First, the commission would have had only three members.[88] Those three members could not have represented every ethnic group in an incredibly diverse state like California. Second, retired judges are likely to be white males. State Issue 4 addressed this concern over the lack of minority and female representation by stating that regional, gender, and racial diversity should be considered in the appointment process.[89] However, it is equally doubtful, with only five members on the Ohio commission, that all pertinent racial, ethnic, and regional groups would have been represented, even if the selectors had made a good faith effort to include women and minorities.

However, while a redistricting commission may inevitably not reflect the diversity of the population as well as the state legislature can, it is debatable how big of a problem this is. First, individual politicians may care more about making their districts as easy to win as possible and protecting their political party's fortunes than about the interests of various groups. Second, the Voting Rights Act ensures that minority groups will have districts where they are able to pick representatives of their own choice.[90] Third, the criteria directing the redistricting commission's work can be drafted in a manner to protect the interests of minorities or other groups. Provisions can be included to allow (or in some cases require) the preservation of communities of interest, but too many of such districts may lead to heavy bias for one party. Fourth, many administrative agencies do not adequately reflect the ethnic, gender, and regional differences of the

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[87] Since legislatures are likely to be reluctant to give up their redistricting power, the ballot referendum is likely to be a source of pressure for future redistricting reform. Initiative states have been found to be more likely to implement redistricting commissions. Nathaniel Persily & Melissa Cully Anderson, *Regulating Democracy Through Democracy: The Use of Direct Legislation in Election Law Reform*, 78 S. CAL. L. REV. 997, 998 (2005). Both Proposition 77 and State Issue 4 would have altered the state constitutions had they passed. Proposition 77 (introductory text); REFORM OHIO NOW, AMENDMENTS TO THE CONSTITUTION PROPOSED BY INITIATIVE PETITIONS TO BE SUBMITTED DIRECTLY TO THE ELECTORS: AMENDMENT FOR AN INDEPENDENT REDISTRICTING PROCESS (introductory text) (2005), *available at* http://www.reformohionow.org/downloads/ron_amendments.pdf.

[88] Proposition 77, sec. 2, § 1(a).

[89] AMENDMENT FOR AN INDEPENDENT REDISTRICTING PROCESS, § 2(B)(1)(a).

[90] *See Vote Dilution Litigation*, *supra* note 71, at 2599.

citizens they govern, and yet administrative agencies are allowed to make many vital decisions.[91] Fifth, state legislatures often do not adequately reflect the diversity of the state, either.[92]

Proposition 77 did attempt an additional safeguard; while any newly created redistricting plan would have been used in the next scheduled election, voter approval of the plan at that election would have been required for the plan to continue to be utilized in subsequent elections.[93] This measure seemingly would have ameliorated the problem of democratic accountability in measures like Proposition 77. If a plan did not reflect the wishes of the voters, it would be rejected. However, it must be acknowledged that redistricting is a technical and seemingly mundane issue. It might be difficult and costly to educate voters about the ramifications of a redistricting plan.[94] Voters may be more concerned about issues that seem more pertinent to them, such as healthcare, the economy, and national security. Unless there were large and obvious problems with a plan, such as adverse impacts on large portions of the state or on a major political party, it could be difficult to defeat a plan.

V. Special One-time Redistricting

One common criticism of both Proposition 77 and State Issue 4 is that the measures called for a special, one-time redistricting to occur after passage by the voters.[95] Some contend that a special mid-decade redistricting is unfair because such a redistricting uses old data from the last census.[96] For instance, if a special redistricting were to occur in 2006, as was called for by Proposition 77, the data used would be from the 2000 census.[97] This means that population changes that had occurred since 2000 would not be taken into account, which might especially hurt the representation of minorities when their populations grow more quickly than the rest of the population.[98]

This critique has one major flaw: regardless of whether a special redistricting occurs, data from the last census will still govern the election. For example, if no special redistricting occurs, the previously drawn dis-

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[91] For instance, seventeen of the twenty-one cabinet-level members of the Bush Administration are men. *See* White House, President Bush's Cabinet, http://www.whitehouse.gov/government/cabinet.html (last visited Feb. 13, 2006).

[92] Patricia Thompson, *The Equal Rights Amendment: The Merging of Jurisprudence and Social Acceptance*, 30 W. St. U. L. Rev. 205, 220 n.59 (2003) (citing Institute For Women's Policy Research Report, The Status of Women in the States (3d ed. 2000)). A 2000 report showed that the proportion of state legislators who were women ranged from 7.9% in Alabama to 40.8% in Washington. *Id.*

[93] Proposition 77, sec. 2, § 1(g)–(h).

[94] *See* League of Women Voters, *supra* note 83.

[95] *See id.*

[96] *Id.*

[97] *See* Kubin, *supra* note 76, at 849.

[98] *Id.*

tricts will be used, which were based on data from the last census. Therefore, mid-decade population shifts would not be reflected anyway.

Another criticism of a special redistricting for the next election is that it would be very difficult logistically to perform redistricting that quickly.[99] This concern seems especially warranted considering that it would be the first redistricting performed under the new plan. Presumably, the first time employing any plan will take longer than later uses, as there would be no previous experience using the plan. Calling for redistricting to occur in an election two or more years away would likely provide more time.

If the negative effects of political gerrymandering still exist when redistricting reform occurs, it would be desirable to perform a special one-time redistricting. However, unless the current maps are particularly unfair, no special redistricting should be proposed in a redistricting reform measure. The inclusion of the special redistricting reform in the measures was one possible reason for the lack of support for both Proposition 77 and State Issue 4. In both cases, there was a sense that the redistricting reform measures were motivated by the out-of-power party's desire to change its political fortunes.[100] Calling for immediate redistricting is likely to increase the perception that the party proposing the reform simply wants a quick change to help it in the next election.

CONCLUSION

There has long been concern about allowing legislators to draw the districts in which they face reelection.[101] There is potential for legislators to collude to draw safe districts that incumbents can win easily.[102] Also, there is the possibility that one political party will control the state legislature and the governorship and will use their power to gerrymander the state's districts to enhance their future electoral prospects at the expense of their opponents and the democratic process.[103]

Designers of redistricting commissions need to be aware of the potential ramifications of their system and of its possible flaws. Even if the only goal of a commission system is to remove the possibility of the worst

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[99] *See* Nancy Vogel, *Drawing New Maps a Daunting Possibility*, L.A. TIMES, Oct. 24, 2005, at B1 ("[T]he California Association of Clerks and Election Officials said in a report that the deadline set by Proposition 77 'poses serious risks to the accuracy and viability of the administration' of the June 2006 election.").

[100] *See* Michael Finnegan, *Voters Dislike 3 of Governor's Ballot Measures*, L.A. TIMES, Nov. 2, 2005, at A1 ("[A] plurality [in a poll regarding the Nov. 2005 California special election] also say . . . that the election is more of a ploy by Schwarzenegger to undermine Democratic lawmakers than an effort to enact needed reforms."); *see also* Vogel, *supra* note 19 ("Mid-decade redistricting raises questions about the rush to draw new lines.").

[101] Paul V. Niemeyer, *The Gerrymander: A Journalistic Catch-word or Constitutional Principle? The Case in Maryland*, 54 MD. L. REV. 242, 243 (1995).

[102] *See supra* note 78 and accompanying text.

[103] *See* Hirsch, *supra* note 8, at 199–203.

abuses of gerrymandering, designers must be careful not to introduce unintended consequences. Using seemingly apolitical redistricting criteria may unfairly harm the political prospects of one political party and result in low levels of competition.[104] Partisan voting data and preferences would have to be utilized to adjust district lines to achieve minimum levels of competition and results that are not unduly biased against one political party.

This Article posits that redistricting commissions can be created without significant problems with political bias. An ideal system should not just rely on bipartisanship to achieve neutrality. A collection of neutral people should be better at both working together and achieving fairness than a politically balanced group of ideologues. Efforts to keep politically connected people off of the commission, to curtail potential abuse of discretion, and to limit dealings with political figures after service on the panel will minimize the costs of entrusting commissions with political data.

While there are legitimate concerns about the democratic accountability of independent redistricting commissions, on balance a well-designed redistricting commission should better represent the interests of the public than legislators, who may allow potential political gain to dictate their actions. Also, federal law protects minorities in the redistricting process, and the new statute or amendment creating the redistricting commission can provide extra guarantees to minorities if federal law is deemed inadequate. The redistricting commission should be required to take public input, as was the case in both Proposition 77 and State Issue 4, and the redistricting commission should be given enough flexibility to take this input into account.

On the whole, the complex issues that are raised by creating a redistricting commission may make the endeavor impracticable, especially since the negative effects of political gerrymandering can be exaggerated. However, if a commission is crafted with enough thought, care, help from statisticians, and input from the public about its views on what a fair redistricting system would achieve, a fairer redistricting commission system should result.

—*Scott M. Lesowitz*[*]

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[104] *See* Lowenstein & Steinberg, *supra* note 56, at 26–27; *see also* Hill, *supra* note 56.

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