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NOTES

JUDICIAL REVIEW OF DEREGULATION

by Harry T. Edwards*

During the 1980 presidential campaign, Ronald Reagan promised that, if elected, he would deregulate the country—"to make sure OSHA is no longer a four-letter word."1 In the ensuing three and one-half years, President Ronald Reagan and his aides have made every effort to carry out this campaign pledge. One day after taking office, on January 22, 1981, the President appointed a Cabinet-level Task Force on Regulatory Relief, led by Vice President Bush. One week later, President Reagan issued a memorandum, entitled "Postponement of Pending Regulations," which ordered that the effective dates of all "midnight regulations" inherited from the Carter Administration, that were then final but not yet effective, be postponed for sixty days from the date of the memorandum.2 Then, on February 17, 1981, with the issuance of Executive Order 12291,3 the new Administration formally initiated an unprecedented effort to deregulate the nation. Under the Executive Order, the Reagan Administration created, "for the first time[,] a centralized mechanism for presidential management of agency rulemaking activities with substantial authority for meaningful intervention into and direction of the process at all stages."4

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3. 3 C.F.R. 172 (1982).
4. HOUSE COMM. ON ENERGY AND COMMERCE, 97th CONG. 1ST SESS., PRESIDENTIAL CONTROL OF AGENCY RULEMAKING: AN ANALYSIS OF CONSTITUTIONAL ISSUES THAT MAY BE
For present purposes, it is not critical to understand the full details of the Executive Order. Rather, it is sufficient to note, in general terms, some of the principal facets of the President's scheme of deregulation. Most importantly, the Executive Order centralizes coordination of executive branch agencies in the Office of Management and Budget (OMB), thereby granting OMB "super-agency status" to affect proposed and existing regulations. The OMB is controlled by the President and his regulatory reform task force and given "authority to define, direct and enforce the manner in which the process is conducted." The Executive Order also requires that a Regulatory Impact Analysis, setting out potential costs and benefits, accompany all proposed "major rules," and that the OMB Director review all such RIA's. Finally, agency officials are instructed to adopt specific regulatory approaches involving the least net cost to society, and to choose objectives that maximize net benefits to society.

With the promulgation of Executive Order 12291, President Reagan accomplished several ends. He secured some real semblance of control over agencies' exercises of discretion in rulemaking. In many instances, agencies engage in rulemaking pursuant

Raised By Executive Order 12291, 6 (Comm. Print 1981) (report of Morton Rosenberg) (hereinafter cited as "ROSENBERG REPORT").

Of course, executive efforts to manage regulation did not begin with this administration. Scholars have long debated the merits of congressionally mandated executive control. See Commission on Law and the Economy, American Bar Association, Federal Regulation: Roads To Reform 68-91 (1979); (advocating increased presidential authority) (hereinafter cited as "COMMISSION REPORT"); Cutler & Johnson, Regulation and the Political Process, 84 Yale L.J. 1395 (1975); Proceedings of the National Conference on Federal Regulation: Roads To Reform, 32 Ad. L. Rev. 123, 239-84 (1980) (Panel III: Managing the Regulatory Process), and former administrations have made often valiant efforts to deregulate some sectors and manage regulation in others. See Neustadt, The Administration's Regulatory Reform Program: An Overview, 32 Ad. L. Rev. 129 (1980).


6. ROSENBERG REPORT, supra note 4, at 67. An agency dissatisfied with OMB's handling of a proposed regulation may appeal only to the President's Task Force or the President himself. Id. at 68.

7. A "major rule" is defined in § 1(b) of Executive Order 12291 as a regulation likely to affect the economy by $100 million or more a year, cause a "major increase" in costs or prices, or have a significant adverse impact on competition, employment, investment, productivity, innovation, or on the ability of United States industry to compete with foreign industry. 3 C.F.R. 127-28 (1982). Each agency may initially determine whether a rule it intends to propose is a major rule, but the Director of the OMB may designate a rule as major on his own authority. § 3(b), Exec. Order No. 12,291, 3 C.F.R. 128 (1982).
to extremely broad—sometimes, seemingly limitless—delegations of authority from Congress. In the past, presidential control over rulemaking has been questionable; the most effective controls (or limits) placed on agency rulemaking thus arguably came from the threat of congressional legislative veto or from judicial review. Under the Executive Order, President Reagan added a new means of control, in the form of a centralized executive review procedure designed to shape agency rules before they even are proposed and reach the other branches for consideration. In so doing, the President enhanced his position to affect the substance of administrative action, thereby enabling him to better press for laissez-faire policies that had helped place him in office.

One significant byproduct of the Reagan Administration efforts at deregulation has been an alteration in the process of judicial review. After years of reviewing agency actions imposing regulations, judges suddenly have had to adopt a new mindset and review decisions to move in the opposite direction. There have been a vast number of agency actions to deregulate during the past three and one-half years. However, given the relatively brief time since President Reagan’s election, it is not surprising that, to date, only a few of these actions have been subjected to any dispositive judicial review. Nevertheless, it is noteworthy that, in a number of different regulatory areas, the courts already have confronted an array of controversial agency decisions to rescind regulations. A sample of some of the more important cases to face the judiciary is as follows:

— In 1976, the FCC announced in a Policy Statement that it would no longer review changes in entertainment programming when considering applications to renew or transfer radio licenses, and that it would rely instead on the free market to achieve entertainment diversity. In *FCC v. WNCN Listeners Guild*, the Supreme Court affirmed the agency’s action.

— In 1973, the Civil Aeronautics Board first regulated smoking on airlines by requiring airlines to provide a non-smoking section for each class of service. In 1979, the agency further required that airlines accommodate all passengers desiring a no-smoking seat, that cigar and pipe smokers be specially segregated, and that smoking be prohibited altogether when ventilation systems were not functioning properly. In 1981, the Board eliminated the
protections principally related to pipe and cigar smoke and adequate ventilation. In *Action on Smoking and Health v. Civil Aeronautics Board,* the District of Columbia Circuit vacated the rescissions.

—In 1980, the Treasury Department published a rule requiring that, beginning January 1, 1983, alcoholic beverage labels contain a list of ingredients. In 1981, the Department rescinded the rule, explaining in part that increased costs to industry and consumers outweighed benefits. In *Center for Science in the Public Interest v. Department of the Treasury,* the District Court ruled that the agency had not provided an adequate explanation for its rescission and had given undue weight to “cost” concerns. It ordered the rescinded rule into effect.

—To facilitate enforcement of the Fair Labor Standards Act of 1938, the Administrator of the Wage and Hour Division prohibited employment of workers in their homes in seven industries. In 1981, the Division decided to remove restrictions on homework in one industry—knitted outerwear. In *International Ladies’ Garment Workers’ Union v. Donovan,* the Court of Appeals found the rescission to be arbitrary and capricious and vacated it.

Thus, in the past year or so, enough deregulatory actions have come up for judicial review to permit some tentative conclusions as to the nature and scope of review they receive in court. At this stage, the basic patterns of review are set, the difficult yet recurring issues are emerging, and the unanswered questions are identifiable. With the caveat that the canvas is large and the painting just begun, I shall endeavor to describe the developing landscape of judicial review of administrative deregulation.

11. Id. Pending appeal of the District Court’s decision, the Department instituted a new rulemaking proceeding and promulgated a new rescinding rule eliminating all disclosure requirements save one: it required labels to announce the use of Yellow Dye No. 5. On appeal, the Court of Appeals ruled that the second rescission required dismissal of the appeal from the first as moot. *Center for Science in the Public Interest v. Regan,* 727 F.2d 1161 (D.C. Cir. 1984).

In a very recent decision, *Farmers Union Central Exchange, Inc. v. FERC,* the court of appeals considered a FERC order specifying the generic ratemaking methodology to be applied to all oil pipelines pursuant to the Interstate Commerce Act, and remanded the case to FERC for further consideration. The court found that the Commission’s order—which articulated FERC’s belief that competitive market forces should primarily be relied on to assure proper rate levels—was “arbitrary and capricious” agency action and that it contravened the relevant statutory language.
I. INTRODUCTION: SOURCES OF CONTROL OVER ADMINISTRATIVE DISCRETION

Crucial to any comprehension of the problems that we confront is an understanding of the proper roles of Congress and the courts in shaping and reviewing the choices made by agencies in the exercises of their delegated powers. Two very recent Supreme Court decisions appear to recast these roles and lend new insight into the proper distribution of power in reviewing agency action. I turn therefore to sketch the existing interaction among the branches of Government in their control of administrative action, to put into perspective the current role of the judiciary and the limits placed upon it.

Politicians, scholars, jurists and others have for years seriously analyzed and debated the merits of various proposals for controlling agencies' exercises of the broad delegations of power bestowed upon them by Congress. Depending on the speaker, the optimal solution may be found in proposals to drastically boost the role of one or another of the three branches of Government, to slightly increase the role of all three, to require agencies to promulgate rules to confine their discretion, or to revive the non-delegation doctrine and require Congress to accompany any delegation of power with clear standards of implementation.  


An extensive study conducted by the Commission on Law and the Economy of the American Bar Association outlined in the alternative six approaches to regulatory reform:

1. Those which concentrate on the relationship of the agencies to other elements of the government (particularly the President and his staff, the cabinet departments, and the Congress), with special emphasis on the lack of responsiveness of the independent agencies to presidential policy and the lack of coordination of policy throughout the federal government.
2. Those which concentrate on the failure of the agencies to establish clearly articulated policies that give consistent guidance to their adjudications and rulemaking.
3. Those which concentrate on the internal procedural operations of the agencies, with particular emphasis on the overriding burden of delay. The lack of modern management practices is a recent concern of this school of thought. Often the other side of such considerations, of course, is the concern for fairness.
4. Those which concentrate on increasing the relative power of the general public, as
Amid these swirling debates, at least during the past two decades, Congress has sought to gain a measure of self-reliance by using the threat of legislative veto (along with the threat of appropriations cuts, oversight hearings, and the like) to rein in agencies that stray from Congress' intended, or currently favored regulatory path. Simultaneously, the courts have continued to review administrative action, in accordance with the standards established in the Administrative Procedure Act, or pursuant to agency authorizing statutes or judicially created doctrines. Until recently, however, direct presidential control of agency rulemaking has been at best inconsistent, at worst nonexistent, and mostly sparse.

With two decisions last term, the Supreme Court upset this system of checks and balances and forced a reconsideration of the issue. The first of these decisions was Immigration & Naturalization Service v. Chadha, in which the Court ruled unconstitutional the legislative veto, one of Congress' chosen means to control the exercise of its broad delegations of power, and ended a period of congressional self-reliance in limiting administrative action. In Chadha, one House of Congress exercised a legislative veto provision under section 244(c)(2) of the Immigration and Nationality Act, and, by resolution, invalidated a decision by the Attorney

compared with the power of the regulated industries, in the administrative process.

Those which concentrate on (a) reducing the importance of the regulatory mission of the agencies by increased reliance on the marketplace, and (b) relying upon alternative methods of government intervention which involve fewer elements of administrative control, such as tax incentives.

Those which concentrate on the elimination of almost all government regulation on the grounds that where it is not anticompetitive it is unnecessary, inefficient, overly coercive, and a threat to the political freedom of the American people.


See Abourezk, The Congressional Veto: A Contemporary Response to Executive Encroachment on Legislative Prerogatives, 52 IND. L.J. 323, 324 (1977). Such provisions have been included in almost 200 federal laws, id. at 324. See also Kaiser, Congressional Action to Overturn Agency Rules: Alternatives to the "Legislative Veto", 32 AD. L. REV. 667 (1980) (surveying existing mechanisms by which Congress might accomplish the same result as the legislative veto). But see INS v. Chadha, 103 S. Ct. 2764, 2795 n.10 (1983) (White, J., dissenting) (outlining flaws in alternative approaches).

Legislative veto provisions take a variety of shapes. They may be used to block proposed action if either house of Congress disapproves it, or if both houses pass resolutions disapproving it. Congressional committees also have been given power to approve or disapprove executive action. See Abourezk, supra at 324.


General of the United States to allow Chadha, a deportable alien, to remain in the United States. The Court, in turn, invalidated Congress' exercise of the one-house veto, holding that Congress' action violated the Bicameralism and Presentment Clauses of the United States Constitution; these provisions require that bills, resolutions, and other congressional actions be approved by both houses and be presented to the President for signature or veto before becoming effective. With that ruling, the Supreme Court eliminated a much debated, highly utilized (though rarely invoked) device, variously described as "the most efficient means Congress has yet devised to retain control over ... its policy as declared by statute," and as a manipulable device that enabled Congress to make overly broad delegations and avoid tough policy choices.

The result, for now, is that Congress is seriously constrained in any post hoc effort to control the vast and powerful force of federal administrative agencies that it has helped create, other than through new legislation and, perhaps, the leverage that accompanies Congress' appropriations power.

Just a few days after its Chadha decision, however, the Supreme Court reaffirmed the existence of some measure of control over administrative action pursuant to judicial review. In Motor Vehicle Manufacturers Association v. State Farm Mutual Automobile Insurance Co., a unanimous Supreme Court put to rest any belief that judicial review, under the congressionally established arbitrary and capricious standard, requires only a cursory glance; far from it, the decision resoundingly reinforced the role of courts in reviewing agency action. Read together, the decisions in Chadha and State Farm appear to place a heightened responsibility on courts to assure that agencies fulfill their statutory mandates.

The recent emergence of administrative deregulation highlights the importance of these Supreme Court decisions and the difficult

18. U.S. CONST. art. 1, § 1; id. § 7, cls. 2-3.
19. Javits & Klein, Congressional Oversight and the Legislative Veto: A Constitutional Analysis, 52 N.Y.U.L. REV. 455, 462 (1977). For other arguments in support of the legislative veto, see Chadha, 103 S. Ct. at 2795 & n.10 (White, J., dissenting) (detailing flaws in alternative control mechanisms); Abourezk, supra note 14, at 327.
task the courts face in implementing them. The current administration's sweeping efforts to control agency decisionmaking, in order to foster policies of deregulation, present the courts both with old questions in new garb and with truly novel problems. Broad and virtually standardless delegations of power to administrative agencies, limited simply by such amorphous terms as "just and reasonable," and "public interest, convenience, and necessity," are currently being utilized to justify the rescission of regulations fashioned over the years to meet those very same standards. Increasingly, therefore, courts are being asked to address the extent to which rule modifications and rescissions are consistent with the statutory intent—for example, whether market forces will suffice to supplant regulation of broadcasting or oil pipeline rates. As a policy matter, it is not at all clear that Congress' role should be diminished and the courts' role enhanced in assuring the reasonableness of administrative action. However, current circumstances have created a situation that makes this result unavoidable.

Of course, judicial review of administrative action traditionally is viewed as a congressional device to help maintain agency exercises of delegations of power within acceptable bounds. As the late Judge Harold Leventhal once wrote,

In the case of legislative enactments, the sole responsibility of the courts is constitutional due process review. In the case of agency decision-making the courts have an additional responsibility set by Congress. Congress has been willing to delegate its legislative powers broadly—and courts have upheld such delegation—because there is court review to assure that the agency exercises the delegated power within statutory limits, and that it fleshes out objectives within those limits by an administration that is not irrational or discriminatory.22

The surge in congressional enactments tagged with legislative veto provisions demonstrates Congress' recognition that an additional source of control—one undeniably meant to establish administrative policy—was appropriate or necessary. Now that added layer of congressional control is gone. While State Farm makes clear that, in the short term, the courts may partially fill the void, it is not likely that judicial review will be accepted as a long-term substitute for congressional oversight of administrative

action. The situation cries out for clarification and direction from Congress, which is, after all, the legitimate creator and overseer of the regulatory schemes the agencies currently seek to dismantle.

The present situation suggests that continued congressional inaction in limiting delegations of power may result in an abdication of legislative authority to a strong executive. Even worse, congressional inaction now could lead to a wholly uncontrolled bureaucracy—to rule by nobody—if a weak President is elected, one who fails to pick up the mantle that Congress seems at times to have cast aside.

With this brief introduction as a backdrop for the ensuing discussion, I shall now aim to describe the current framework for judicial review of agency deregulatory actions, focusing on some of the open questions and the difficult issues that will face courts in the future. At the risk of oversimplification, I have structured my analysis to proceed on two fronts, and I shall discuss each in turn. The first line of cases to be considered involves judicial review of administrative action to determine whether an agency has engaged in reasoned decisionmaking. This form of review arguably was rejuvenated by the State Farm decision. The second line of cases to be discussed looks not so much at the agency's decision-making process as at the consistency of the result the agency has reached with the relevant statutory language and purpose. In this latter category, it is normally held that an agency exceeds its legally delegated authority when it issues a regulation found to be inconsistent with a statute's language or purpose. Following these analyses, I then shall discuss some peripheral issues, dealing generally with separation of powers principles, raised by the President's restructuring of the regulatory landscape.

Throughout the following sections of this article, a number of highly complex issues are either alluded to or explicitly addressed. First, of paramount concern, is a question concerning the extent to which congressional mandates, found in legislative enactments, may be affected by executive policies. A subsidiary question concerns the matter of who defines the terms of legislative enactments, in order to determine whether a congressional mandate has been overridden. Second, of equal importance, is a question concerning the extent to which either the executive or the

23. I do not include purely procedural review in this analysis because I do not believe deregulation has as yet raised unique issues in that area.
judiciary appropriately should fill the voids left by vague congressional enactments. Closely related to this question is the matter involving the extent to which "expert" administrative agencies are even subject to executive or judicial control.

Although the article will be highly inquisitorial in addressing these issues, a recurring theme will be a defense of the role of the judiciary in reviewing administrative actions. All too often, disgruntled advocates attempt to make the courts their scapegoat in controversial political struggles such as the ones that underlie current efforts at "deregulation." This article will suggest that, more often than not, the public's critique of the judiciary's role in administrative review is uninformed. It is axiomatic that judges decide cases that emanate from the political process; this does not mean, however, that judges are real parties in the political process. Indeed, what judges may decide today, in cases unaffected by constitutional law, may be undone tomorrow by congressional, or even executive or administrative, action. This reality is often sadly misunderstood, as is the fact that judges can only decide cases that are properly before them and not of their own making.

Another principal point of this article will be, in the words of an eminent administrative law scholar, that once Congress has delegated substantial power, it "accepts, runs the risk if you will, of the character of the administration." The words could hardly be more apt. The current administration already has left its imprint on agency decisionmaking. Where Congress has been specific, courts can and do insist that agencies comply with the congressional mandate. But where delegations of power are limited only by vague terminology, the task is of another kind. Courts risk the accusation that they invent legislative intent as they strive to discern the limits on delegations—limits that necessarily must be present for the delegations themselves to be constitutional.25 At

25. See Yakus v. United States, 321 U.S. 414, 426 (1944) (upholding wartime delegation of economic control to President, explaining that legislation is problematic only if so lacking in standards that it "would be impossible in a proper proceeding to ascertain whether the will of Congress has been obeyed"); Amalgamated Meat Cutters & Butcher Workmen v. Connally, 337 F. Supp. 737, 744-63 (D.D.C. 1971) (three-judge panel).

It is not entirely clear whether the non-delegation doctrine today retains much—or any—practical force. While its obituary has been written, see FPC v. New England Power Co., 415 U.S. 345, 353 (1974) (Marshall, J., concurring) (non-delegation doctrine "is surely as moribund as the substantive due process approach of the same era . . . if not more so"), recently Justice Rehnquist has twice suggested that it should be applied. See American Textile Mfrs. Inst., Inc. v. Donovan, 452 U.S. 490, 543 (1981) (Rehnquist, J., dissenting); Indust-
the same time courts often must defer to agency exercises of legislative discretion that are guided not by Congress, but by a President ready to make the hard choices that Congress has been impotent to make.

II. THE FORMS OF JUDICIAL REVIEW

A. Reasoned Decisionmaking

For years, the arbitrary and capricious standard of judicial review, set out in the Administrative Procedure Act, has served as an empty vessel into which courts have poured a veritable lexicon of meanings. The term has spawned a semantic free for all, as courts have iterated and reiterated an array of often inconsistent definitions. The confusion may be traced through courts' use of the term "rational basis" to describe the standard by which agency actions are to be tested. For example, in *Ethyl Corp. v. EPA*, the court followed Supreme Court precedent and concluded that the arbitrary and capricious test "requires affirmance if a rational basis exists for the agency's decision." The approach followed by the court in *Ethyl Corp.*, of focusing on the meaning of "rational basis" when construing "arbitrary and capricious," appeared prevalent in judicial decisions before *State Farm*. Arguably, the rational basis standard was comparable to the minimum rationality a statute must bear to withstand analysis under the Due Process Clause, which also is described as the rational basis test. The courts appeared confused as they tried to integrate the traditional deference inherent in the term rational basis with the "thorough, probing, in-depth review" mandated by the Supreme Court's 1971 decision in *Overton Park*. Judicial opinions cited to


27. In Citizens to Preserve Overton Park, Inc. v. Volpe, 401 U.S. 402, 415 (1971), the Court required that reviewing courts must assure, with a searching and careful inquiry, that the agency decision was based on a consideration of the relevant factors, and must assess...
one another and recited an incongruous blend of broad scrutiny and deference, without clearly articulating the outer limits of the arbitrary and capricious test. The results at times seemed to be jabberwock. For instance, in 1979, the Temporary Emergency Court of Appeals tried valiantly to integrate various tests and decided that arbitrary and capricious means “not simply whether there exists a rational basis for the actions,” but “whether [an agency] decision [is] based on a consideration of relevant factors, whether there has been a clear error of judgment and whether there is a rational basis for the conclusions approved by the administrative body.”

Clearly, as long as courts were to recite the deferential rational basis test without expressly severing it from its origin in Due Process review, it would never sit well beside the broader language to be found in Supreme Court decisions such as Overton Park.

Further cluttering the legal landscape are various levels of scrutiny within the maleable arbitrary and capricious standard. Under that rubric, courts have engaged in heightened scrutiny or deferential review, depending on the situation. As one court observed:

The stringency of our review, in a given case, depends upon analysis of a number of factors, including the intent of Congress, as expressed in the relevant statutes, particularly the agency’s enabling statute; the needs, expertise, and impartiality of the agency as regards the issue presented; and the ability of the court effectively to evaluate the questions posed.

In one of its more common formulations, heightened scrutiny has been deemed appropriate where agencies depart from prior policies and precedents: abrupt shifts in policy have been said to constitute “danger signals” that the agency might be acting inconsistently with the statutory mandate and to warrant a “hard look.”

whether there has been a clear error of judgment. The court in Ethyl Corp. recounted these standards as well. See Ethyl Corp., 541 F.2d at 34 & n.74.


30. See Greater Boston Television Corp. v. FCC, 444 F.2d 841, 851-52 (D.C. Cir. 1970), cert. denied, 403 U.S. 923 (1971); see also NAACP v. FCC, 682 F.2d 993 (D.C. Cir. 1982) (review intensified because agency action was reversal of prior position); Wheaton Van Lines, Inc. v. ICC, 671 F.2d 520, 527 (D.C. Cir. 1982). The term “danger signal” was first articulated in Joseph v. FCC, 404 F.2d 207, 212 (D.C. Cir. 1968).

31. For a recent example of a court’s application of such heightened scrutiny, see Office
In contrast, it also has been held that an agency’s decisions not to institute rulemaking and not to issue a new rule are subject to extremely limited and deferential review. Both the deferential and "hard look" standards fall within the arbitrary and capricious universe. Thus, in putting content into the congressionally delineated arbitrary and capricious standard, courts have not only to define the terms generally, but also to decide whether to depart from the norm and engage either in a heightened and therefore more probing review, or a lessened and therefore more deferential inquiry.

1. The State Farm Decision: Judicial Review of Deregulation

Some degree of clarification of the meaning of arbitrary and capricious came last term with the Supreme Court’s decision in the State Farm case, involving the decision whether to require airbags in newly manufactured automobiles. The decision definitively established the standard of judicial review of an agency’s decision to rescind an existing regulation and now serves as a starting point for any analysis of such action. Its impact will potentially overflow into review of agency action to promulgate new rules. At the same time, the decision raises a number of questions, hands to lower federal courts a plethora of thorny issues to resolve, and is certain to create some confusion over judicial review of deregulation.

The facts in State Farm are somewhat complicated but important to fathom in order to comprehend the full thrust of the Supreme Court’s holding. In 1967, the Department of Transportation issued Motor Vehicle Safety Standard 208, requiring the installation of seatbelts in all automobiles. In 1969, after it had be-

of Communication of United Church of Christ v. FCC, 707 F.2d 1413, 1425 (D.C. Cir. 1983). More exacting scrutiny has also been found appropriate where the agency has arrived at an identical result after remand for further explanation of reasons, see Food Mktg. Inst. v. ICC, 587 F.2d 1285, 1289-90 (D.C. Cir. 1978), or has a history of "ad hoc and inconsistent judgments" on a particular question, see Local 777, Democratic Union Org. Comm. v. NLRB, 603 F.2d 862, 869-71 (D.C. Cir. 1978), or where the health of the public is at issue, see Center for Science in the Public Interest v. Department of Treasury, 573 F. Supp. 1168, 1173 (D.D.C. 1983) (citing Wellford v. Ruckelshaus, 439 F.2d 598, 601 (D.C. Cir. 1971)).

32. WWHT, Inc. v. FCC, 656 F.2d 807 (D.C. Cir. 1981); see also Natural Resources Defense Council, Inc. v. SEC, 606 F.2d at 1049-50 (discussing variations in stringency of review under arbitrary and capricious standard).

33. 32 Fed. Reg. 2408, 2415 (1967). The National Traffic and Motor Vehicle Safety Act of 1966 directs the Secretary of Transportation to issue motor vehicle safety standards that "shall be practicable, shall meet the need for motor vehicle safety, and shall be stated in objective terms." 15 U.S.C. § 1392(a) (1982). In issuing these standards, the Secretary is to con-
come apparent that seatbelt use was too low to reduce traffic injuries to an acceptable level, the agency began a lengthy rulemaking to develop "passive restraints"—which do not depend for effectiveness on any action taken by the occupant other than that necessary to operate a vehicle. There are two types of passive restraints: automatic seatbelts and airbags. In 1972, the agency amended the standard, this time to phase in restraints in three stages, and to require full passive protection for all front seat occupants of vehicles manufactured after August 14, 1975; the effective date for mandatory passive restraint systems was later extended for a year, until August 31, 1976. Finally, after continued delays in implementation of the standard, the agency in 1977 issued Modified Standard 208, requiring that passive restraints be phased in beginning in 1982. The Modified Standard left to manufacturers the choice whether to install airbags or passive belts to satisfy its requirements.

In February 1981, with the arrival of a new administration, the Secretary of Transportation reopened the rulemaking, and in late October he rescinded the passive restraint requirement in Modified Standard 208. The proffered explanation unwound as follows: By 1981, it had become apparent to the agency that automobile manufacturers planned to install automatic seatbelts, not airbags, in virtually all cars. As a result, the acknowledged lifesaving potential of airbags would not be realized. Also, the automatic belts that manufacturers planned to install would be easily detachable; once detached, the belts would not operate

sider "relevant available motor vehicle safety data," whether the standard "is reasonable, practicable and appropriate" for the particular type of motor vehicle, and the "extent to which such standards will contribute to carrying out the purposes" of the Act. Id. § 1392(f)(1), (3), (4).

The Secretary's general authority to promulgate safety standards under the act has been delegated to the Administrator of the National Highway Traffic Safety Administration (NHTSA). 49 C.F.R. § 1.50(a) (1979).

38. In Pacific Legal Found. v. Department of Transp., 593 F.2d 1338 (D.C. Cir.), cert. denied, 444 U.S. 830 (1979), the court of appeals upheld Modified Standard 208 as a rational, nonarbitrary regulation that was consistent with the agency's mandate.
without some affirmative action by the occupant, and therefore would not necessarily lead to increased usage. Thus, the agency concluded, there was no longer a reliable basis upon which to predict that the standard would produce the hoped-for safety benefits.

State Farm Mutual Automobile Insurance Company and the National Association of Independent Insurers filed petitions for review of the rescission of the passive restraint standard. A panel of the United States Court of Appeals for the District of Columbia Circuit held that the rescission was "arbitrary and capricious." First, it found insufficient evidence in the record to support NHTSA's position that it could not reliably predict an increase in seatbelt usage under the standard. Second, a majority of the panel concluded that NHTSA had inadequately considered the possibility of amending the rule to require manufacturers either to install nondetachable, rather than detachable, belts, or simply to install airbags.

In reaching this result, the Court of Appeals was required to decide on the proper scope of review of agency rescissions of existing rules. Although the parties agreed that "arbitrary and capricious" was the appropriate standard of review, they disagreed on the proper meaning of the phrase. Indeed, the court itself noted that the standard is a multifaceted one, embracing "intensive as well as deferential judicial scrutiny, depending in part on 'the nature of the particular problem faced by the agency.'" The court rejected the argument, put forth by the Motor Vehicle Manufacturers Association, that rescission of a rule should be judged by the same highly deferential standard that a court would use to judge an agency's refusal to promulgate a rule in the first place. Instead, the court of appeals found that rescission more closely resembled agency action than inaction, and that the traditional arbitrary and capricious test applied. However, the court went on to intensify its review, explaining that "sudden and profound alterations in an agency's policy constitute 'danger signals' that the will of Congress is being ignored." The court considered the extent to which NHTSA's action might be inconsistent with

42. 680 F.2d at 219 (quoting Natural Resources Defense Council, Inc. v. SEC, 606 F.2d at 1050).
43. Id. at 221.
the congressional purpose behind the Safety Act, read legislative events to endorse Modified Standard 208, and concluded that the rescission should "be subject to 'thorough, probing, in-depth review' lest the congressional will be ignored."

The Supreme Court granted certiorari and affirmed the circuit court's ruling that the agency action was arbitrary and capricious. For the purposes of this discussion, the opinion is interesting not so much for the outcome as for the methodology by which the Court reviewed the rescission. At the outset, the Court held that rescission or modification of the existing standard is subject to the same test as the agency's action in promulgating a standard—i.e., arbitrary and capricious. It unanimously rejected the suggestion that rescission is analogous to agency inaction, indicating that "re-vocation of an extant regulation is substantially different than a failure to act." It reasoned that,

[revocation constitutes a reversal of the agency's former views as to the proper course. A "settled course of behavior embodies the agency's informed judgment that, by pursuing that course, it will carry out the policies committed to it by Congress. There is, then, at least a presumption that those policies will be carried out best if the settled rule is adhered to." Atchison, T. & S.F.R. Co. v. Wichita Bd. of Trade, 412 U.S. 800, 807-08, 93 S. Ct. 2367, 2374-2375, 37 L.Ed.2d 350 (1973).]

Justice White, writing for the Court, recognized that an agency must have latitude to adapt rules and policies to changing circumstances, but resolved that these changes "do not always or necessarily point in the direction of deregulation." In a ringing rejection of any notion that a less intrusive standard of review might apply, the Court instructed that,

[in the abstract, there is no more reason to presume that changing circumstances require the rescission of prior action, instead of a revision in or even the extension of current regulation. If Congress established a presumption from which judicial review should start, that presumption—contrary to petitioners' views—is not against

44. Id. at 228.
45. In fact, the Court had applied this standard earlier, in reviewing an agency's rescission of a rule. See FCC v. WNCN Listeners Guild, 450 U.S. 582, 594 n.30 (1981).
46. 103 S. Ct. at 2866.
47. Id.
48. Id.
safety regulation, but against changes in current policy that are not justified by the rulemaking record.49

In other words, the Court made clear, "the standard of judicial review is not altered by the fact that the agency has rescinded a regulation, rather than moved in some other direction."50

Having determined that the arbitrary and capricious standard applies, the Court took its turn at pouring meaning into that phrase. It recited the necessary caveat—that review is narrow and a court is not to substitute its judgment for that of the agency—and then continued:

Normally, an agency rule would be arbitrary and capricious if the agency has relied on factors which Congress has not intended it to consider, entirely failed to consider an important aspect of the problem, offered an explanation for its decision that runs counter to the evidence before the agency, or is so implausible that it could not be ascribed to a difference in view or the product of agency expertise. The reviewing court should not attempt itself to make up for such deficiencies: "We may not supply a reasoned basis for the agency's action that the agency itself has not given."51

In addition to explicating this searching inquiry into the evidence before the agency and the appropriate factors of decision, the Court took yet another decisive step. In a footnote, the full Court categorically rejected any suggestion "that the arbitrary and capricious standard requires no more than the minimum rationality a statute must bear in order to withstand analysis under the Due Process Clause."52 On this point, the Court made clear that the "presumption of regularity afforded an agency in fulfilling its statutory mandate" does not reach the "presumption of constitutionality afforded legislation drafted by Congress."53

State Farm clearly establishes several important propositions governing judicial review of administrative agency action, and leaves others to be formulated in future cases. I turn now to discuss several of the propositions particularly pertinent to judicial review of deregulation, to highlight gray areas in which courts necessarily will be active in the coming months.

49. Id.
51. 103 S. Ct. at 2867 (quoting SEC v. Chenery Corp., 332 U.S. 194, 196 (1947)).
52. 103 S. Ct. at 2866 n.9.
53. Id.
2. "Arbitrary and Capricious": How Many Standards?

The most straightforward holding of State Farm is that repeal or rescission of an agency rule is subject to review as "arbitrary and capricious," precisely as is a new rule. The question arises, however, whether the test articulated in State Farm constitutes "heightened scrutiny" or simply the level of scrutiny required by the arbitrary and capricious test in the more usual agency review case. The question is an important and difficult one; either the Court implicitly affirmed the court of appeals' argument that heightened scrutiny is proper when an agency reverses course, or it rejected any notion of variable content in the arbitrary and capricious standard and proffered a test to be applied in all circumstances, or it rejected heightened scrutiny in this case but left open its possible application in other situations.

The opinion itself is not entirely clear on this issue. The appeals court had remarked that the test took not one but several forms, depending on the context, and had intensified the scope of review "[b]ased on the legislative reaction to the passive restraint standard." The Supreme Court rejected the appeals court's rationale for applying heightened scrutiny, stating that it "erred in intensifying the scope of its review based upon its reading of legislative events." Whether it also rejected the appeals court's result, or the concept of heightened scrutiny in proper circumstances, is not so apparent. In other words, one might ask whether the Supreme Court in State Farm applied heightened scrutiny, as had many lower federal courts, because the rescission represented a significant change in the course of regulation and therefore a danger signal. Alternatively, one might as easily conclude that the Court spurned the concept of a variable content and defined an all-purpose arbitrary and capricious test.

Shortly after the Supreme Court's decision in State Farm the District of Columbia Circuit again was confronted with an agency's rescission of a rule, this time one of considerable long-

55. 680 F.2d at 228.
56. 103 S. Ct. at 2867.
standing. The case, *International Ladies’ Garment Workers’ Union v. Donovan,*⁷¹ arose out of the decision of the Secretary of Labor to rescind restrictions on the employment of workers in their homes—known as “homeworkers”—in the knitted outerwear industry. A group made up of knitted outerwear manufacturers and manufacturers’ associations, labor organizations representing factory workers in the industry and state labor law enforcement officials brought suit arguing principally that the rescission was arbitrary and capricious. Their concern was that when homeworkers are employed, effective enforcement of the minimum wage, overtime compensation and child labor provisions of the Fair Labor Standards Act⁵⁸ is not possible. They also claimed that payment of subminimum wages to homeworkers in the industry would cause competitive injury to employers complying with the Fair Labor Standards Act and would drive down wages of all industry employees.

The Court of Appeals found that the Secretary’s rescission was arbitrary and capricious and vacated it. In reaching this result, the court plainly was guided by the *State Farm* decision. The court did not, however, distinguish the facts of the homeworkers case and the airbags case to intensify the level of judicial scrutiny. The argument in favor of heightened review would have noted that the homeworker rule had been in effect for almost forty years,⁵⁹ whereas the airbags rule had been promulgated only four years earlier and had not yet taken effect when rescinded.⁶⁰ The court arguably might have followed the lead of numerous cases that had held an agency’s shift from a settled course of regulation to be a “danger signal” warranting a more probing judicial inquiry. Instead, the court in *Donovan* used the fact of the agency’s settled course of behavior to justify adherence to the *State Farm* standard. As a result, at least in the D.C. Circuit, the same level of scrutiny applies to a court’s review of all agency rescissions of rules, no matter how longstanding.⁶¹

⁵⁹. 722 F.2d at 813 n.30.
⁶⁰. *Id.* The airbags rule had been promulgated but applied only to future car models and therefore had not yet been fully implemented.

⁶¹. This conclusion assumes, of course, that no other factors affect the level of scrutiny, such as a distinction drawn in the statute. *See also* Building & Constr. Trades’ Dep’t v. Donovan, 712 F.2d 611 (D.C. Cir. 1983) (agency’s longstanding choice of means to exercise discretion held not irrevocably binding on agency); *cert. denied,* 104 S. Ct. 975 (1984).
Whether "heightened scrutiny"—or, indeed, the very concept of a sliding scale of meanings for the phrase "arbitrary and capricious"—survives State Farm is therefore an open question. For example, with what stringency should the arbitrary and capricious test be applied to agency actions that in the past have triggered heightened scrutiny, other than abrupt changes in course? An indication that the concept of variable scrutiny has not been totally rejected may be found in State Farm, which acknowledged the view that agency decisions not to institute rulemakings are subject to deferential review. However, the Court rejected the analogy between decisions not to promulgate rules and rescissions and, therefore, did not really reach the propriety of lower courts' rulings that particularly deferential review applies to the former.

Another related and unanswered question is whether the level of scrutiny set out in State Farm applies only to rescissions—and

62. Cases decided since State Farm suggest that courts will recite the test set out in that case whenever reviewing agency action under the arbitrary and capricious standard, regardless whether they confront a "deregulation" case. See, e.g., Farmers Union Central Exchange, Inc. v. FERC, ___ F.2d ___ (D.C. Cir. 1984) (following State Farm’s analysis in a deregulation case); National Ass’n of Metal Finishers v. EPA, 719 F.2d 624, 637 (3d Cir. 1983) (quoting State Farm’s explication of arbitrary and capricious review); Steger v. Defense Investigative Serv. Dep’t of Defense, 717 F.2d 1402, 1404 (D.C. Cir. 1983) (citing State Farm for proposition that agency must consider relevant factors).

Whether courts will continue to vary the level of stringency of that review is less certain. In one case, American Friends Serv. Comm. v. Webster, 720 F.2d 29, 60 (D.C. Cir. 1983), the District of Columbia Circuit cited State Farm as providing the basic arbitrary and capricious test, then proceeded to quote from Natural Resources Defense Council, Inc. v. SEC, 606 F.2d 1031, 1050 (D.C. Cir. 1979), a pre-State Farm case, in particular from a passage that described the varying stringency of the arbitrary and capricious test.

Another recent case offered an interesting twist on the concept of heightened scrutiny. In Black Citizens for a Fair Media v. FCC, 719 F.2d 407 (D.C. Cir. 1983), the court reviewed a decision of the FCC to adopt simplified renewal applications for radio and television broadcast licensees. Although a deregulation case, the court did not cite State Farm. However, because adoption of the new procedure represented a significant change in policy, the court reviewed to assure that "the agency was aware that it was changing its views and has articulated permissible reasons for change." Id. at 417. Most interestingly, the court acknowledged that this review is known as "heightened scrutiny," but then explained, "[t]he nature of our scrutiny is the same whether the action is wholly new or a revision of an older rule; a change is another factor to scrutinize, not a warrant for employing a different standard of review. Our scrutiny is heightened in that it includes this additional factor." Id. at 417 n.25.

63. For example, courts will have to decide whether the level of scrutiny should be heightened above that applied in State Farm to cases that historically have evoked heightened scrutiny when "danger signals" other than an abrupt change in course were implicated. See, e.g., Food Mktg. Inst. v. ICC, 587 F.2d 1285, 1289-90 (D.C. Cir. 1978) (greater scrutiny required where agency arrives at precisely the same result following a further elaboration).
is, in essence, heightened scrutiny—or whether it now applies to all agency rulemakings. *State Farm* made clear that the same standard of judicial review attends all rulemaking activities, regardless whether the agency moves to more or less regulation.\(^6^4\) The level of scrutiny was not mentioned. It is therefore conceivable that all activity, whether promulgation, modification or rescission, is susceptible to the test set out in *State Farm*. Or, perhaps, though less likely, *State Farm* implicitly heightened scrutiny, because the agency had abruptly changed course, and applied a more rigorous review than the norm.\(^6^5\) It similarly remains open whether the same scrutiny should apply to modifications of rules, as opposed to rescissions. Does an agency have more discretion to change a rule within the existing regulatory framework than to rescind one altogether? If so, difficult issues of line-drawing to distinguish a modification from a rescission no doubt will arise. For example, in the homeworkers case the Labor Department modified the general regulation and rescinded a specific component. How should the change be classified?

In coming months courts will have to decide such issues as what level of scrutiny *State Farm* defined, and how many other levels of scrutiny exist. The questions defy easy answers, at least on the basis of *State Farm*’s analysis, in part because the Court has neither expressly endorsed nor rejected the idea that the one congressionally delineated standard in fact may take numerous forms.

3. Presumptions and the Burden of Proof

Even if it is assumed that deregulation is a viable economic concept, politically salable and otherwise lawful, questions remain as to whether rescissions of existing regulations should be viewed more as eliminations of unwarranted burdens on private parties or reductions of important rights given to the beneficiaries of regulatory policies.\(^6^6\) Pragmatically, these questions are important be-

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\(^6^4\) 103 St. Ct. at 2866.
\(^6^5\) The Court made clear that rescission should not be treated by the highly deferential standard a court would use to judge an agency’s refusal to promulgate a rule in the first place. 103 S. Ct. at 2866; see *WWHT, Inc. v. FCC*, 656 F.2d 807 (D.C. Cir. 1981). The more deferential standard conceivably might be seen either as a wholly different standard from the arbitrary and capricious test or as an example of less probing review within that standard.
\(^6^6\) *See Commission Report*, supra note 4, at 105 (noting that beneficiaries of regulatory policies may find it in their interest to oppose changes in regulatory programs); Stewart,
cause they raise the issue whether a regulation has an on-going burden of justification, or whether, because a regulation represents the status quo, any change therefrom must be justified. In other words, do the beneficiaries of a regulation develop a vested right to those benefits? Or should agencies work from a presumption against regulation, and in favor of reliance on market forces?

Prior to 1983, the Supreme Court never had addressed this issue in any concrete form. In State Farm, however, the Court gave at least a partial answer to the questions posed. In a passage particularly understandable against the background of the ideological debate described above, the Court made absolutely clear that no presumption exists against regulation. Justice White wrote,

the forces of change do not always or necessarily point in the direction of deregulation. In the abstract, there is no more reason to presume that changing circumstances require the rescission of prior action, instead of a revision in or even the extension of current regulation. If Congress established a presumption from which judicial review should start, that presumption—contrary to petitioners' views—is not against safety regulation, but against changes in current policy that are not justified by the rulemaking record.68

The Court also made clear that the burden of justifying a shift away from the status quo is on the agency, no matter what direction the agency has chosen to take.

What is far less certain, and less surely established by State Farm, is whether any presumption exists in favor of regulation in a rescission case and, if so, what form it might take. A related question is the extent to which a presumption exists that the

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The Reformation of American Administrative Law, 88 Harv. L. Rev. 1669, 1723-47 (1975) (tracing development of concept of statutory beneficiaries and resulting changes in law of standing); Active Judges and Passive Restraints, Regulation, July-Aug. 1982, at 10, 11 ("surely an agency's elimination of burdens upon private parties—like an agency's failure to impose burdens in the first place—must fall within that portion of the scale giving the administrator broadest leeway, and the courts the narrowest scope of review") [hereinafter cited as "Active Judges"].

67. See DeLong, Repealing Rules, 8 Ad. L. News, Winter 1983, at 1, 8; Active Judges, supra note 66, at 13 ("private freedom can neither be constrained nor continue to be constrained without good reason"); see also NAACP v. FCC, 682 F.2d 993, 1000-01 (D.C. Cir. 1982) ("agency should not continue to regulate unless it can clearly identify the harm it seeks to remedy"). This view was also apparent in petitioners' argument in State Farm, to the effect that rescission should be treated in the same manner as an agency decision to do nothing. In each case, the result is an absence of regulatory burdens on private parties.

68. 103 S. Ct. at 2866.
agency's chosen means to achieve the objectives set out by its enabling statute—its past implementation policy, in essence—is the correct one.

Again, the facts of the airbags case in *State Farm* are illustrative. Both the D.C. Circuit and the Supreme Court required the agency to consider alternatives to wholesale rescission of passive restraints that would effectuate the agency's past means of achieving its goals. By statute, the agency must issue motor vehicle standards that are practicable and meet the need for highway safety. The statute does not require that the agency use passive restraints to meet this goal. Prior to rescission, however, the agency had decided as a policy matter that passive restraints constituted the best means to implement the statute. Modified Standard 208 (including automatic seat belts and airbags) was the tool chosen to carry out that policy choice. When the agency rescinded the Standard because it doubted the efficacy of automatic seat belts, the Supreme Court observed that "[t]he first and most obvious reason for finding the rescission arbitrary and capricious is that [the agency] apparently gave no consideration whatever to modifying the standard to require that airbag technology be utilized." A natural inference to be drawn is that the reviewing court will presume the legitimacy of an agency's existing implementation policy unless the agency expressly and cogently explains otherwise. Thus, in *State Farm*, even if flaws had been identified in Modified Standard 208, the agency still was required to investigate other means to gain the benefits of passive restraints. Merely finding fault in Modified Standard 208 does not justify departure from the implementation policy the agency has selected. As the Court said: "Given the judgment made in 1977 that airbags are an effective and cost-beneficial life-saving technology, the mandatory passive-restraint rule may not be abandoned without any consideration whatsoever of an airbags-only requirement."

Thus, the opinion in *State Farm* appears to compel an agency to justify a change in implementation policy—i.e., how best to effectuate statutory goals—as well as shifts in the tools its uses to effectuate the policy. Faulty tools do not warrant eradication of the

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70. *Id.* § 1392(a).
71. 103 S. Ct. at 2868.
72. *Id.* at 2871 (emphasis added).
underlying policy. The unanswered question is how strong a presumption exists in favor of the traditional policy; or, put another way, how can an agency justify changes in policy based on political judgment?

The question is neatly posed by the homeworkers case recently decided by the District of Columbia Circuit. The restriction on homework was adopted forty years ago to help implement the Fair Labor Standards Act, on the ground that the wage and hour laws could not feasibly be enforced when people work at home. The restriction against homework was an outgrowth of many years of unsuccessful attempts by state and Federal officials to regulate homework, and numerous Secretaries of Labor had determined that the regulatory ban was essential to enforce the statutory goal. On this record, the Court of Appeals in Donovan found the reasoning of State Farm to be particularly compelling because the Secretary of Labor failed to consider alternatives to elimination of restrictions on homework, and failed to explain why such alternatives were not chosen. As in State Farm, the court in Donovan obviously presumed the regularity of the existing regulation.

What is particularly interesting about both State Farm and Donovan is that, in finding that the agencies failed to consider viable alternatives to rescission, there was no need for the courts to consider whether rescission was tantamount to an abandonment of the underlying statutory goal. In other words, in State Farm, automobile safety was the statutory goal and the agency promulgated a requirement of passive restraints as an implementation policy found to be essential to achieve Congress' purpose. Since the agency failed to show that the passive restraint requirement was no longer justified as a policy to implement the statutory goal, and since airbags remained a legitimate option within the realm of passive restraints, the act of rescission was declared to be arbitrary and capricious. The Court, therefore, did not have to consider whether rescission also resulted in an unlawful abandonment or alteration of the underlying statutory goal.

To be sure, the line between an agency policy and the particular tools an agency chooses to implement the policy will not always be clear. In some instances an agency might articulate a general policy to give meaning to a broad statutory delegation, such as the development and use of passive restraints. In other instances the policy might be narrow, such as the use of nonpassive seatbelts to
further the "safety" goal set out in the language of the broad delegation. In the latter instance, tools and policy merge, and the analysis blurs; in such a case a court might find the designation of specific alternatives for consideration a more difficult task. However, to the extent that they are separable, an agency must be cautious about attempting to justify an about-face in policy solely with a critique of certain of the tools.

Courts in the future will have to work out the intricacies of such analysis. They will have to consider whether an equivalent presumption exists in favor of an existing tool selected to implement the agency's chosen enforcement policy, and in favor of the enforcement policy itself. They must decide how strong the presumptions may be, and what an agency may do to justify a shift in course as to either. The analysis in State Farm surely makes clear what questions must be asked, and assures that courts in coming months will grapple with the answers.

4. Vermont Yankee in Light of State Farm.

State Farm made explicit that a court may require an agency to consider substantive alternatives to a rule rescission. In so doing, it pointedly rejected petitioner's argument that the Court's 1978 Vermont Yankee decision73 precluded such court action. It explained that Vermont Yankee held only that a court may not impose additional procedural requirements on an agency and could not be invoked "as though it were a talisman under which any agency decision is by definition unimpeachable."74 This ringing rejection raises the possibility that the decision in State Farm was designed in part to temper the expansive and deferential gloss that commentators and lower courts occasionally have added to the holding of Vermont Yankee.

After Vermont Yankee, the question remained open whether the Court would accompany its harnessing of courts' imposition of additional procedures with a similar restriction on substantive judicial review.75 As one commentator posed the problem, "[n]ow

74. 103 S. Ct. at 2870.
that the technique of controlling discretion through additional procedures has been rejected, the Supreme Court must either accede to intrusive substantive review under the Overton Park approach or it must insist upon the more deferential standard suggested by Camp [v. Pitts]." Further confusion followed with the Court's 1980 decision in Strycker's Bay Neighborhood Council, Inc. v. Karlen, in which the Court stated that "once an agency has made a decision subject to NEPA's procedural requirements, the only role for a court is to insure that the agency has considered the environmental consequences." Justice Marshall argued in dissent that the Court's formulation improperly failed to apply the substantive arbitrary and capricious test after assuring merely that the agency had met the procedural requirements of the statute. In other words, Strycker's Bay suggested to some, including Justice Marshall, that Overton Park's mandated "thorough, probing, in-depth review" of an agency's decision to proceed along a particular regulatory course had yielded to a more superficial and deferential review of an agency's minimal compliance with a statute's procedural requirements.

State Farm may signal a renewed endorsement of Overton Park's probing review, and a rejection of the expansive reading of Vermont Yankee's bar to judicially imposed procedural requirements. State Farm required that the agency consider a set of alternatives—any "technological alternative within the ambit of the existing standard"—even though the statute did not so require. To be sure, the Court's cautious delineation of the alternatives to be considered was more restrained than that of lower courts, which have called for agency consideration of all relevant or serious alternatives. Nevertheless, the Court's express denial of

78. Id. at 228-29 (Marshall, J., dissenting).
79. 401 U.S. at 415.
80. 103 S. Ct. at 2871.
81. Compare Overton Park, where the applicable statute required that the agency consider "feasible and prudent" alternatives. 401 U.S. at 411.
82. Justice White made clear that the court did not "broadly require an agency to consider all policy alternatives in reaching decision." 103 S. Ct. at 2871.
the fact that the requirement conflicts with *Vermont Yankee*, and its explanation that it was not in fact imposing specific procedures that NHTSA had to follow, suggests a retreat. *State Farm* might bring to an end litigants “talismanic reliance” on *Vermont Yankee* to preclude courts from requiring agencies to defend their decisionmaking process through presentation of evidence and consideration of relevant factors and proper alternatives.\(^8^4\)

**B. Statutory Language and Purpose**

A second potent source of judicial control of agency decisionmaking, and particularly of rescissions of rules and regulations, derives from the APA’s admonition to set aside agency action “in excess of statutory . . . authority.”\(^8^5\) The standard principally requires that an agency act in accordance with the language and purpose of its enabling statute. Where Congress has delineated careful and precise limits on agency discretion, this inquiry may be relatively straightforward. Where Congress has used language that the agency traditionally has interpreted in one way and then reinterprets differently, the reviewing court’s task is more difficult. Most troublesome of all—and the scenario most likely to recur as administrative self-deregulation continues—is where Congress has limited its delegation simply with a recitation of platitudes—such as “just and reasonable,” or “public interest, convenience and necessity.” In those cases, courts confronted with agencies choosing to exercise their discretion through reliance on the market forces must determine whether these broad terms that traditionally have connoted regulation of one kind or another can consistently with their own language and purpose be read to

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\(^8^4\) I note also, in passing, that the requirement that an informal rule be supported by a statement of basis and purpose provides an alternative, related means to challenge a rescissory rule. See 5 U.S.C. § 553(c) (1982). In *Action on Smoking and Health v. CAB*, 699 F.2d 1209, 1216 (D.C. Cir. 1983), the court construed the requirement in § 553(c) to mean that an agency must “respond in a reasoned manner to the comments received, to explain how the agency resolved any significant problems raised by the comments, and to show how that resolution led the agency to the ultimate rule.” *Id.* (quoting *Rodway v. Department of Agriculture*, 514 F.2d 809, 817 (D.C. Cir. 1975)). The court—reviewing CAB rescissions of certain rules against smoking on aircraft—made clear that an agency’s obligation to explain, pursuant to § 553(c), is not reduced when it rescinds rather than promulgates. Then, after noting the “stark absence of explanation,” 699 F.2d at 1217, particularly as to why matters covered by the rescinded regulations would be better left to carrier discretion, the court vacated the recission. *See also New England Coalition on Nuclear Pollution v. NRC*, 727 F.2d 1127 (D.C. Cir. 1984) (new rule modifying existing rules of practice is not supported by its accompanying statement of basis and purpose; remanded for further proceedings).

authorize complete or partial deference to the market. This last inquiry operates amid the obvious tension between the historical fact of decades of regulation to implement the standard and the deference that courts must show to agencies' policy choices. In the long run, it is in these cases that Congress' expansive delegations might take their toll, as courts are asked to supply the meaning Congress failed to offer or defer to agencies' own policy decisions.

1. The Mechanics of Review Under This Standard

Judicial review based on statutory language and purpose is, in some critical respects, vastly different from and sometimes much more significant than review based on the arbitrary and capricious standard. For one thing, and most importantly, no agency has the authority to ignore or change a specific statutory mandate. In other words, if a statutory purpose may be determined, an agency is without discretion to alter it. For another thing, review based on statutory language and purpose typically involves purely legal issues, focused on congressional intent. Although courts may defer to agency judgments on the meaning of a statute, deference is not mandatory. Because legal issues are for the courts to decide, the final word on the construction of disputed statutory provisions always comes from the judiciary. Finally, it is worth noting that judges invariably are more comfortable with review in connection with challenges based on statutory language and purpose than those brought under the arbitrary and capricious standard. The latter category often will involve cases in which the agency is acting in its "expert" capacity to regulate, pursuant to broad delegations of discretion, in highly complex technical areas. Judges are thus loathe to second-guess agency experts on the details of regulation. In statutory language and purpose review, however, legal construction, not technical implementation, is the focal point of any litigation, and judges are totally at ease with this, their traditional, function.

To highlight some of these points, it is useful to consider a recent case that illustrates a court's inquiry into a rule's accordance with statutory authority. Building & Construction Trades' Department v. Donovan" considered the scope of review of agency modifications of longstanding exercises of discretion in implementing a statute. A group of unions challenged new, effectively deregulatory, rules issued by the Secretary of Labor under the Davis-

Bacon Act\textsuperscript{87} and the Copeland Anti-Kickback Act.\textsuperscript{88} These two statutes guarantee to workers on federal construction projects a minimum wage based on locally prevailing wage rates. Three of the regulations altered the method for finding the prevailing wage. Another set allowed federal contractors greater freedom to use semiskilled helpers. The last provision was intended to reduce the regulatory burden on federal contractors by reducing the detail required in their weekly submissions to the Government regarding wages. The Court of Appeals upheld all these regulations except, first, the provision simplifying submissions of wage data, which it found to be inconsistent with the language and purpose of the statutory command that the submissions contain such data as to "each employee," and second, part of the expanded permission to use helpers, as similarly inconsistent with statutory language and purpose.

The \textit{Building Trades} case confronted the extent to which an agency's longstanding regulations promulgated pursuant to certain statutory language constitute a statutory construction binding on the agency. The court held that although a longstanding definition may be persuasive evidence of the single "proper" interpretation of statutory language, it carries less weight when the statute affords an agency discretion to reach a number of different results and the agency is merely choosing one reasonable and effective way to exercise its discretion. For example, where the enabling statute delegates to the Secretary, "in the broadest terms imaginable, the authority to determine which wages are prevailing,"\textsuperscript{89} and the legislative history makes clear that the Secretary was to establish the method to be used, the court will not infer any intent that a prior method—no matter how longstanding—denies validity to all possible alternative approaches. As the court explained addressing yet another new rule reversing longstanding practice,

\textit{More fundamentally, our disagreement with the District Court's heavy reliance on administrative practice stems from our view that in promulgating these two rules... the Secretary was acting in an area as to which he had some discretion to reach a number of different results rather than an area of pure statutory interpretation as to which there is in theory only a single answer.}\textsuperscript{90}

\begin{itemize}
\item \textsuperscript{87} 40 U.S.C. § 276a-276a-5 (1976).
\item \textsuperscript{88} 40 U.S.C. § 276c (1976).
\item \textsuperscript{89} 712 F.2d at 616.
\item \textsuperscript{90} \textit{Id.} at 619.
\end{itemize}
The court further distinguished between actions in the area of discretion and in the area of interpretation and explained that prior administration practice carries much less weight when reviewing the former, discretionary, acts than the latter interpretative ones. Thus, in light of *Building Trades*, a federal court reviewing rescissory agency action for consistency with statutory language will not give precedential authority to past agency decisions on how best to make the choices that Congress delegated to it. Instead, the court will review to assure the new interpretation is "sufficiently reasonable" and does not defeat the essential purpose of the statute. In conducting such review, the court must evaluate the statute and its legislative history to determine whether the agency action comports with Congress' intent. If the court finds the agency's elaboration of the statute to be "sufficiently reasonable" and consistent with congressional intent, the inquiry ceases.

*Building Trades* arguably removes a source of interpretation of broadly worded statutes. It established that courts may not give binding authority to an agency's elaboration of a statutory command merely because the agency has long chosen to give a certain meaning to an ambiguous phrase. The result may be to make even more difficult courts' tasks of determining congressional intent in order to assure consistency with it.

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91. Similarly, in Columbia Broadcasting System v. FCC, 454 F.2d 1018, 1026 (D.C. Cir. 1971), the court deferentially reviewed a decision under the discretionary 'public interest' standard.


92. FEC v. Democratic Senatorial Campaign Comm., 454 U.S. 27, 39 (1981) ("in determining whether the Commission's action was 'contrary to law,' the task for the Court of Appeals was not to interpret the statute as it thought best but rather the narrower inquiry into whether the Commission's construction was 'sufficiently reasonable' to be accepted by a reviewing court") (quoting Train v. Natural Resources Defense Council, Inc., 421 U.S. 60, 75 (1975)).


94. See also Black Citizens for a Fair Media v. FCC, 719 F.2d 407, 411 (D.C. Cir. 1983) (reliance on past FCC statements of its mandate is misplaced in challenge to current FCC interpretation of its mandate); National Tour Brokers Ass'n v. ICC, 671 F.2d 528, 531-32 (D.C. Cir. 1982) (prior ICC interpretation of statute's "public interest" standard does not forever bind agency).
2. The Next Step: Defining the Undefined

Cases reviewing agency action for consistency with statutory language and purpose are theoretically significant not so much for the analytical framework they establish—which as a daily judicial matter is also of utmost importance—as for the questions they place before the courts. In essence, agencies engaged in deregulation will quickly learn the kinds of demands courts will place on them to justify the decisionmaking process, and withstand arbitrary and capricious review. They will learn what reasons must be given, what alternatives considered, and what evidence presented. As that process occurs, judicial review will likely focus increasingly on the result of this decisionmaking process. Courts will pore through legislative histories and dissect statutory language to formulate a concept of a statute's mandate, against which they will assess actions.

In the context of “deregulation,” the ultimate inquiry will be whether no regulation at all—that is, mere reliance on the free market—can be consistent with the mandate of a statute establishing a regulatory agency. Consider, for example, the words of Professor Jaffe, who once wrote:

The occasions for delegating power to administrative officers have been variously enumerated. They can be compassed by a single generalization. Power should be delegated where there is agreement that a task must be performed and it cannot be effectively performed by the legislature without the assistance of a delegate or without an expenditure of time so great as to lead to the neglect of equally important business.95

If Professor Jaffe is correct that delegations of authority indeed presume there is a task to be performed, how can an agency conclude otherwise? Or is Professor Jaffe's statement better read to say the legislature delegates to the agency the decision on how best to perform a task, including possible reliance on the market's own regulatory system? If that is the case, is the task to determine whether market forces will produce the statutorily mandated result and subsequently to monitor the results of reliance on the market, to assure the initial determination was, and remains, correct?96

96. See discussion, infra, regarding agencies' duty to monitor the effects of reliance on market forces.
Looking ahead, one can readily discern at least several oft-used, amorphous standards whose meaning will be tested in this way. One such phrase already the subject of considerable litigation, and on which I shall focus, is the "public interest, convenience and necessity" standard by which the Federal Communications Commission operates. The Communications Act is peppered with the requirement that the Commission act in accordance with that standard. Thus, for example, the Communications Act requires that the FCC make an affirmative finding that granting or renewing a radio license to operate a broadcast station would be in the public interest.

The FCC, although an independent agency, appears to be in the forefront of administrative deregulation. Its current Chairman, Mark S. Fowler, has openly espoused a deregulated market approach to both radio and television broadcasting whereby the Commission relies on broadcasters' ability to determine the wants of their audiences through normal marketplace mechanisms. In some areas, such as entertainment programming, the Commission has adopted a policy wholly consistent with this faith in the efficacy of marketplace forces. In other areas, such as nonentertain-


Another phrase whose outer limit has already been considered, at least in one statutory context, is "just and reasonable." In Federal Power Commission v. Texaco Inc., 417 U.S. 380 (1974), the Supreme Court held that the FPC lacks authority to rely exclusively on market forces in setting natural gas rates, largely because Congress had subjected producers to regulation in the first place because of anti-competitive conditions in the industry. Apparently aware of the argument that such conditions no longer exist, Justice White replied,

In concluding that the Commission lacks the authority to place exclusive reliance on market prices, we bow to our perception of legislative intent. It may be, as some economists have persuasively argued, that the assumptions of the 1930's about the competitive structure of the natural gas industry, if true then, are no longer true today. It may also be that control of prices in this industry, in a time of shortage, if such there be, is counterproductive to the interests of the consumer in increasing the production of natural gas. It is not the Court's role, however, to overturn congressional assumptions embedded into the framework of regulation established by the Act. This is a proper task for the Legislature where the public interest may be considered from the multifaceted points of view of the representational process.

ment programming, the Commission has concluded that complete deregulation would be inappropriate because "each licensee has a bedrock obligation, historically rooted, to cover public issues," and instead has redefined, and lightened, licensees' nonentertainment programming obligations. These and other FCC deregulatory decisions of the past decade have forced courts to consider the proper limits on FCC deference to market forces in interpreting such amorphous standards as the "public interest." They provide a preview of the kinds of questions courts will ask, the degree of deference they will display, and the outcome of judicial inquiries into other deregulatory activities.

Of primary importance is the Supreme Court's 1981 decision in FCC v. WNCN Listeners Guild, in which the Court affirmed the decision of the FCC to rely on market forces, not evidentiary hearings, to determine whether a planned change in a radio station's entertainment format would be in the public interest. The issue arose when the FCC issued a Policy Statement announcing that the public interest would best be served "by promoting diversity in entertainment formats through market forces and competition among broadcasters," and that changes in entertainment formats therefore are not material factors that need be considered by the FCC in ruling on an application for a license or a transfer. The Court of Appeals for the District of Columbia held that the Policy Statement violated the Communications Act. The court relied on a line of D.C. Circuit cases that had established the so-called "format doctrine" to control FCC implementation of the public interest standard. The format doctrine rested on the thesis that "preservation of a format [that] would otherwise disappear, although economically and technologically viable and preferred by a significant number of listeners, is generally in the public interest." When these factors were present, the doctrine required an evidentiary hearing prior to licensing, to consider the change in format.

In an opinion that is extremely deferential to the FCC's exercise of the discretion accorded it by the Communications Act, the Supreme Court rejected the format doctrine and affirmed the Policy Statement. It concluded that the format doctrine is not

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102. Id. at 585.
compelled by the Act and that the Act's public interest standard gives to the Commission considerable leeway to determine how to achieve the Act's goal of securing "the maximum benefits of radio to all the people of the United States." \(^{104}\) The case established that an agency providing a rational explanation for its action may opt to rely on market forces as the best guarantor of the goals it must seek, so long as such reliance is not precluded by the statutory language or mandate. Assessing the outer limits of the statutory mandate is, of course, the crux of the matter. Whether the proposition will be applied as smoothly to other agencies than the FCC, or to other decisions by the FCC, and how much evidentiary support is necessary to justify reliance on the market, are open issues in light of this decision.

Several different aspects of the opinion illustrate the Court's considerably deferential approach. For example, the opinion for the majority in \textit{WNCN Listeners Guild} took as a given that to promote diversity is to promote the public interest—a proposition with which neither the dissent nor the court of appeals had any quarrel. Accordingly, it reviewed the Policy Statement and concluded that the Commission had provided a rational explanation for its conclusion that reliance on the market would best promote diversity in entertainment formats. However, it continued, diversity is not the sole goal of the Act; the Court observed that the FCC's market reliance "reflects a reasonable accommodation of the policy of promoting diversity in programming and the policy of avoiding unnecessary restrictions on licensee discretion."\(^{105}\) The Court therefore accepted the Commission's choice of policies that constitute the public interest and accorded considerable deference to its choice of how best to achieve those policies.

Also, the Court deferred to the agency's interpretation of the statute for evidence of plausible, albeit not binding, variations. Thus, after deciding that a rational reason was given for the choice among alternative paths, the Court considered whether the path elected by the Commission was consistent with the language of the Act and with its legislative history and statutory purpose. The statutory language certainly did not \textit{preclude} the Commission's new construction, even if it did not authorize it expressly, and therefore offered little guidance. To understand the statutory purpose, the Court sought guidance from the construction given

\(^{104}\) National Broadcasting Co. v. United States, 319 U.S. 190, 217 (1943).
\(^{105}\) 450 U.S. at 596.
the statute by the Commission in the days prior to the D.C. Circuit's imposition of its format doctrine. During that earlier stage, the Commission had left the choice of programming formats to the licensee. Without suggesting that the prior construction was in any respect binding, the Court accorded the agency's interpretation deference in setting the limits on viable meanings to the statute's broad delegation. Accordingly, it concluded that such deference to licensees was within the realm of acceptable constructions of the statute.

Perhaps the most controversial aspect of the decision revolved around the issue of deference to agencies' predictive judgments. The question arose in the context of whether the FCC has a duty to make a particularized public interest determination on every application that comes before it and whether the Commission, by invariably relying on market forces, merely assumes that the public interest will be served in all cases because it will in many or most cases. Without denying that the Act requires that each license application be found to be in the public interest, the Court acquiesced in the Commission's prediction that the market, "although imperfect, would serve the public interest as well or better by responding quickly to changing preferences and by inviting experimentation with new types of programming," particularly because the assessments made by the Commission in the past were necessarily subjective and "would only approximately serve the public interest." Thus, the Court deferred to the agency's predictive judgment as to how effectively the market would assure diversity. As the Court explained, "the Commission's decisions must sometimes rest on judgment and prediction rather than pure factual determinations. In such cases complete factual support for the Commission's ultimate conclusions is not required since 'a forecast of the direction in which future public interest lies necessarily involves deductions based on the expert knowledge of the agency.'"

106. In contrast to Building Trades, where the appeals court held that an agency's past interpretation of the statute is not binding on the agency, the Court simply established that an agency's past interpretation is evidence of the permissible range of interpretations.

107. WNCN Listeners Guild, 450 U.S. at 601.

108. Id. The dissent focused on cases in which the market fails to act in the public interest and questioned whether the FCC's reliance on the market may be applied "indiscriminately and without regard to the effect in particular cases." Id. at 607 (Marshall, J., dissenting).

Such deference to a prediction, of course, raises numerous questions—about the degree to which agencies must produce factual support for their predictions of market reliability, and the contexts that warrant such deference. As to the first, can an agency make conclusory assertions as to the effectiveness of market forces and coast on that argument alone? In *WNCN* that apparently was not the case: the Court found that the FCC had provided a rational explanation for its conclusion that reliance on the market was the optimal solution. It therefore is clear only that complete factual support is not required and that a rational explanation might be a prerequisite to acceptance of predictive judgments. Surely the space between these two end points leaves considerable room to play.

The second question, i.e., the context in which courts can or must defer to agencies' prognostications of how currently regulated entities will act, and in particular how they will respond to market forces, is in the long run perhaps the crucial issue. It is conceivable that the deference shown to the FCC's predictive judgment will not prove to be a phenomenon across the board. That agency traditionally has been accorded significant discretion because of the rapid expansion and development of broadcasting and its complex technology. Its enabling statute accords almost complete deference to the agency to determine how regulated entities should and will behave. In areas where the pace of change is slower, the statute less sweepingly deferential, or the technology less complex, courts may chose to defer less and require greater support for predictive judgments.

If *WNCN* sets the tenor for all review, then agencies might be able to proclaim reliance on the market, and faith in the good intentions of the entities it regulates, and do no more. However, such a reading of *WNCN* overlooks numerous distinguishing features of that decision and the agency whose action it reviewed. I turn, then, to consider those characteristics of *WNCN* that are unique to it and might counsel against broad-based reliance on it in future deregulatory cases.

As a general matter, the language and history of statutes provide a natural limit to the areas in which agencies may try to rely

solely on the market. The deference accorded in WNCN applies only when the agency operates in an arena that the statute has expressly left to the agency to elaborate. Where a statute specifically accords an agency discretion to give meaning to a statutory term—as it did regarding the "prevailing wage rate" in Building Trades, or to define the "public interest" in WNCN—courts ultimately must defer to rational agency choices of meaning. However, not all statutes by their terms, their history, or their judicial interpretation, accord any such leeway, either completely or even as to particular agency acts. Some statutes by their nature assume that specific enforcement is necessary and that agencies will operate in a regulated sphere. Within that largely regulated sphere, some choices might be left to the agency, as in Building Trades, whereas others, such as whether actively to enforce the statute, simply are not for the agency to make. WNCN itself supports this view. The Court made clear that nonentertainment programming on public issues—which, under accepted interpretations of the Communications Act, each licensee must provide—raised distinguishable issues, perhaps because the requirement that licensees provide public interest programming constricts the agency's usually unfettered discretion.

The facts of the homeworker case in Donovan provide another example. Assume that the agency had predicted that active enforcement was no longer required to implement the Fair Labor Standards Act, and had provided at least a rational reason for that belief. The question would arise whether Congress had implicitly made findings to the contrary in establishing a statutory scheme that entailed specific enforcement provisions. If it in fact had, could the agency rebut those findings with its own? Do enforcement provisions implicitly constitute a requirement to regulate, until Congress revokes its findings? Clearly, to determine whether an agency remains free not to regulate on any given issue entails inquiry beyond the explicit language of the statute. Future cases will have to flesh out the sources to which courts may look, such as enforcement provisions, to determine whether

111. See Fair Labor Standards Amendments of 1949, Pub. L. No. 81-393, § 9, 63 Stat. 910, 916-17 (codified at 29 U.S.C. § 211(d) (1976); see also supra note 97 (quoting Justice White's refusal, in FPC v. Texaco Inc., 417 U.S. at 400, to "overturn congressional assumptions embedded into the framework of regulation established by the Act.").
the statutory scheme, in part or as a whole, precludes deference to market forces.

The degree of deference to an agency prediction might also depend on whether the prediction is based, on the one hand, on intuition, or, on the other, on objective or empirical data. If it is in fact based on intuition, the next question is whether the requisite intuition is that of a lay person or an agency expert. Several cases already discussed illustrate the variety of court responses that different scenarios will engender. In *State Farm*, the Court reviewed the agency’s determination that it could not “reliably predict” that automatic seatbelts would increase belt usage by five percent,\(^{112}\) to find support in the record and a rational explanation. It concluded that the agency had failed to take account of the critical difference between detachable automatic belts and current manual belts—*inertia*. Unlike a manual seat belt, a detachable passive belt functions automatically unless disconnected. Thus, the Court recognized that the agency’s prediction had neglected certain relevant factors readily apparent to a lay person and required that it include consideration of those factors in making predictions.

Similarly, in the homeworkers case, the court first noted that it must give deference to predictive judgments within an agency’s area of expertise. It then identified several factors it believed were relevant to the prediction whether the Fair Labor Standards Act was susceptible to adequate enforcement absent homework restrictions—factors that the agency had failed to consider, and that the court believed might be relevant and were therefore worthy of consideration. For example, the court noted that the agency had not considered whether rescission of restrictions on homework might increase the number of homeworkers and make enforcement more difficult. As in the airbags case, the factor was one that a lay person could identify—a logical flaw in a predictive judgment that was readily apparent regardless of expertise. In addition, the court considered past agency findings as to the specific impediments to enforcement of the Act that homework presents and noted that the agency had not addressed those concerns, and therefore had not rebutted past intuitive judgments and empirical data. In contrast, in the *WNCN* context it apparently was clear that the FCC had believed all along that the market

\(^{112}\) 103 S. Ct. at 2871.
would adequately control entertainment program, and no past agency findings contradicted the current agency stance. Thus deference might have been appropriate where no factors even arguably contradicted the agency's judgment.

In sum, the Court's deference to the agency in WNCN followed from a recognition that the parties before it had presented "two arguably rational, workable and constitutional regulatory schemes": the FCC believed any intervention "would do more harm than good," while its opponents "advocated government intervention to save unique formats from disappearing due to the pursuit by licensees of an audience with the largest possible discretionary income." Moreover, nothing in the enabling statute denied the agency's authority to act as it had chosen. The case suggests at a minimum that an agency able to make an adequate showing, however that may be defined, that the market is as reliable as existing regulatory techniques, and that reliance on market forces does not conflict with the statutory scheme, may be able to choose that path. Whether the courts will ultimately require equivalent deference in other contexts remains to be seen.

An interesting caveat appeared in the WNCN Court's opinion, however. The Court made clear that its approval of reliance on the market did not similarly constitute approval of any FCC decision to close up shop and abdicate all responsibility. To the contrary, the Court imposed on the agency an obligation to be "alert to the consequences of its policies" and to "stand ready to alter its rule if necessary to serve the public interest more fully." Similarly, in an early deregulation case in which the Supreme Court upheld the Federal Power Commission's decision to exempt small producers from certain regulations, the Court noted the Commission's "intention to keep the experiment under close review." Perhaps this ongoing burden to monitor leaves the agency open to challenges that its policy in fact is not assuring that particular licensees act in the public interest. Or, perhaps, it simply requires the FCC to assure as a general proposition that

114. Id.
115. Id.
116. 450 U.S. at 603.
117. Id.
the market truly requires that most radio broadcasters act in the public interest.

At the very least, the monitoring requirement assures that the agency always will be able to test the accuracy of its predictions which, virtually by definition, means that agencies must continue to gather data. Thus, in a lengthy decision upholding much of the FCC's partial deregulation of nonentertainment programming, the court of appeals considered whether the FCC's decision to eliminate the requirement that licensees retain programming logs, and make those logs publically available, was arbitrary and capricious. In vacating that portion of the FCC's action, the court was not persuaded by what it called the unsupported assertion that the Commission would be capable of monitoring its deregulation without the logs. As the court explained,

Despite the Commission's conclusory assurances, this court does not understand, for example, where the Commission will obtain information to confirm its prediction that adequate amounts of non-entertainment programming will continue on radio. The Commission may not rely today on predictive judgments, while simultaneously foreclosing its, and the public's, ability tomorrow to assess the accuracy of those predictions.  

III. LEGALITY OF EXECUTIVE ORDER 12291

Apart from the legal issues surrounding judicial review of agency decisionmaking, pre-clearance participation by OMB in the agency rulemaking process—a direct result of President Reagan's Executive Order 12291—creates an array of legal problems and questions of its own. Broadly stated, it raises questions about secrecy, about the sanctity of the rulemaking process, and about the proper degree of isolation, if any, from other agencies and the President that courts should impose on that process. More specifically, it presents issues dealing with *ex parte* contacts in in-

120. Id. at 1442.


122. An *ex parte* communication is an "oral or written communication not on the public record with respect to which reasonable public notice is not given." 5 U.S.C. § 551(14) (1982).
formal rulemaking, and with policing interagency contacts to limit outside private influence. Although peripheral to the primary theme of review of deregulatory decisions, these issues highlight some key areas of administrative law that are especially affected by the current deregulatory process.

On February 17, 1981, when President Reagan issued Executive Order 12291, he stated a goal to

reduce the burdens of existing and future regulations, increase agency accountability for regulatory actions, provide for presidential oversight of the regulatory process, minimize duplication and conflict of regulations, and insure well-reasoned regulations. 123

To this end, the Executive Order established both procedural and substantive requirements to be followed by executive branch agencies. Briefly, agencies must adhere to the following substantive provisions in promulgating new regulations, reviewing existing ones, and developing legislative proposals concerning regulation:

— a regulation’s potential benefit to society must outweigh its potential cost
— an agency must choose the least costly approach to any given regulatory objective
— in setting priorities, an agency must take into account the condition of particular industries affected by regulations, the condition of the national economy, and other regulatory actions contemplated for the future. 124

What is most striking about these procedures, which were designed to enable OMB to exercise its appointed role, is the considerable amount of activity that occurs outside the agency itself before the agency promulgates its rule. 125 Thus, each agency must

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123. 3 C.F.R. 127 (1982).
124. Id. § 2, at 128.
125. See id. § 3, at 128-30.
forward to OMB for review all proposed and final rules, as well as regulatory impact analyses, before they are published. The Order grants OMB varying lengths of time to review documents, depending on their nature. The OMB Director may order an agency not to publish a notice of proposed rulemaking or preliminary regulatory analysis until its review is complete. Similarly, the OMB may order the agency not to publish a final rule or regulatory impact analysis until the agency has responded to the Director’s views and incorporated those views and the agency response in the rulemaking file.

When the Executive Order was issued the Administration also released a Department of Justice Memorandum discussing the legal justification for the Executive Order.126 Thereafter, Congressman John Dingell, as chairman of the Subcommittee on Oversight and Investigations of the Committee on Energy and Commerce, requested that the American Law Division of the Library of Congress prepare a study of the constitutional issues raised by the Executive Order.127 The resulting report looked askance at the new centralized framework. It concluded first, that the Order “appears to conflict with the intent of Congress” in enacting the Administrative Procedure Act and its informal rulemaking scheme, principally by displacing the Act’s independent in-house agency rule development prior to public notification, and second, that the Order might displace the discretionary authority of agency decisionmakers in violation of congressional delegations of rulemaking authority. Third, it concluded that the Order’s centralization of rulemaking authority in the OMB had “created a critical access point to the agency decision-making process without providing safeguards against secret, undisclosed, and unreviewable contacts by governmental and non-governmental interests seeking to influence the substance of agency action.”128 Accordingly, it noted that a court might rule that the failure to protect the integrity of the policymaking process deprived persons of their due process rights to meaningful participation in the decisionmaking process, to a reasoned decision based on a record, and to the possibility of effective judicial review.129

Whatever the merits of the report’s analysis, no court has re-

126. The memorandum is reprinted as Appendix B to the ROSENBERG REPORT, supra note 4.
127. See Letter of Transmittal to the ROSENBERG REPORT, supra note 4.
128. ROSENBERG REPORT, supra note 4, at 5.
129. Id.
jected the Order as unconstitutional. The Executive Order has, however, spawned some litigation resulting in reinstatement of the effective date of at least one rule that had been suspended indefinitely. One source of trouble was a provision of the Order dealing with regulations published in final form but not yet effective on the date of the Order. With some exceptions, the Order required that agencies suspend these rules, if "major," pending reconsideration of the rule in accordance with the substantive provisions of the Order. In *Natural Resources Defense Council, Inc. v. United States Environmental Protection Agency*, the Third Circuit held that EPA's indefinite postponement of the effective date of amendments to certain Clean Water Act regulations—after those amendments had undergone notice and comment procedures, had been published in final form and had become final for judicial review purposes—constituted rulemaking under the APA and that the agency had failed to adhere to the APA's rulemaking requirements. As the court explained, unless a rule's effective date were part of the "agency statement" that is an essential part of any rule, an agency might guide a future rule through the rulemaking process, promulgate a final rule, and then effectively repeal it by indefinitely postponing its operative date, thereby skirting the APA's mandated procedures for repealing a rule.

Having decided that the indefinite postponement constituted a repeal, the court declined to fit the repeal within the APA's narrow exception for good cause non-compliance with its strictures. Importantly, the court observed that the Executive Order stated that action taken in compliance with it must accord with law and ruled that the agency could have complied both with the Order and the APA. Therefore the agency had no good cause not to comply, because compliance with both was not impossible. The court left unanswered how it would rule had compliance with both the Order and the APA not been possible. Thus, at a minimum the court made clear that the Order does not enable agencies to fore-

130. See *supra* note 7.
131. 683 F.2d 752 (3d Cir. 1982).
132. See 5 U.S.C. § 551(4) (1982) ("rule" means the whole or part of an "agency statement").
133. NRDC v. EPA, 683 F.2d at 762.
135. NRDC v. EPA, 683 F.2d at 765 n.26. See also Environmental Defense Fund, Inc. v. Gorsuch, 713 F.2d 802 (D.C. Cir. 1983) (agency decision effectively suspending implementation of duly promulgated standards for hazardous waste management facilities constitutes rulemaking subject to notice and comment requirements of the APA).
swear procedures established by the APA—at least where compliance with the APA is not impossible. Whether the fact that agencies act under congressionally delegated authority would ultimately be dispositive, and tip the balance in favor of compliance with the APA, remains to be seen should a true conflict arise.

While the Order’s procedural framework has not sparked much other litigation, the congressional report does raise at least one issue worth highlighting, particularly if future administrations rely on the same structure to implement their regulatory goals; that issue is *ex parte* contacts in informal rulemaking. At one level, involving intraexecutive branch contacts, the law is quite well settled and the issue is noteworthy more for what it says about the nature of decisionmaking than for unanswered legal questions. At another level, involving outsider contacts with the agency, transmitted through the executive, the Order raises potentially difficult questions about necessary limits on unrecorded, unrebutted conversations and comments that might influence decisionmakers.

In *Sierra Club v. Costle,* the District of Columbia Circuit endorsed the notion of executive involvement in the rulemaking process; the court ruled that absent congressional direction to the contrary, courts should not interpose barriers to communication among executive branch members and should not overlay the isolation of judicial decisionmaking on an essentially legislative procedure. As it explained,

The authority of the President to control and supervise executive policymaking is derived from the Constitution; the desirability of such control is demonstrable from the practical realities of administrative rulemaking. Regulations such as those involved here demand a careful weighing of cost, environmental, and energy considerations. They also have broad implications for national economic policy. Our form of government simply could not function effectively or rationally if key executive policymakers were

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136. In *Sierra Club v. Costle,* 657 F.2d 298 (D.C. Cir. 1981), the court considered the legality of intra-executive meetings between the President, his advisers, and agency decisionmakers during the post-comment period of a rule’s promulgation. The meeting was not reported in the rulemaking docket, and the agency made no claim that additional facts had not come to its attention at the conference. Nonetheless, the court found the conference had violated neither due process nor the relevant statutory provision, which required that of documents becoming available after a proposed rule has been published, only those that the Administrator determines to be of central relevance to the rulemaking shall be placed in the docket. See 657 F.2d at 402. 42 U.S.C. § 7607(d)(4)(B) (Supp. V 1981).

isolated from each other and from the Chief Executive. Single mission agencies do not always have the answers to complex regulatory problems. An overworked administrator exposed on a 24-hour basis to a dedicated but zealous staff needs to know the arguments and ideas of policymakers in other agencies as well as in the White House.\footnote{138}

The contacts at issue in \textit{Sierra Club} involved the President, his advisers, and agency decisionmakers. The court's concern was not so much whether such contacts are permissible (absent congressional prohibition, they generally are) as whether they somehow must be logged or docketed in the rulemaking record. Under the circumstances of the case,\footnote{139} the court found they did not. While the opinion focused narrowly on presidential intervention, its language broadly suggests similar contacts with other White House officials, as well as with other agencies (such as OMB), might be received with similar deference; in practical terms, that means the meeting might not require docketing in the rulemaking record. Whether the opinion imposes a blanket rule against a judicially imposed requirement that the substance of these interagency contacts be revealed is less certain. Despite some hedging language in the relevant portion of the opinion, its overall tone suggests that an agency able to justify its decision on the existing record might not be required to docket even facts learned \textit{ex parte} that are centrally important to its case. However, the prospect of judicial review on a record different from that actually before the agency—a scenario clearly not before the \textit{Sierra Club} panel\footnote{140}—might counsel against such a sweeping explication of that decision.

What, then, of Executive Order 12291? On the basis of \textit{Sierra Club}, the argument might well be made that the Executive Order's requirement of interagency contacts is little different from the contact perhaps initiated by the agency in \textit{Sierra Club}, and that neither procedure is constitutionally or statutorily infirm.\footnote{141} At the same time, some commentators have drawn lines between direct White House-agency contacts and presidential communications funneled through OMB, as under the Executive

\begin{footnotes}
\item[138] Id. at 406 (footnotes omitted).
\item[139] Id. at 402. See supra note 136.
\item[140] EPA made no effort to base the rule on any information or data arising from the meeting, \textit{id.} at 407, and more importantly, claimed its decision was not based on any information not in the docket. \textit{Id.} at 407 n. 529.
\end{footnotes}
Order; between contacts at the rule formation and post-comment stages; and between contacts that do and do not provide the agency with undocketed facts and ideas of central relevance. The outcome of cases falling on the more troublesome side of each line is of course uncertain, in large part because of the law of ex parte contacts generally is in flux. Sierra Club gives important guidance, but its particular facts leave questions unanswered. It makes clear that courts simply ought not even try to police at least presidential contacts with executive agencies, even if they might dispositively affect an outcome. Less certain is whether information from—or the mere fact of—such contacts must be included in the record. Sierra Club’s statute required that information of central relevance be included in the record: it explicitly required that such documents be included, and the court recognized that the same rule might apply to face-to-face contacts. Whether a statute carrying no requirement as to centrally relevant contacts or documents would be more troublesome is not yet decided; to contest such contacts one presumably would argue no legitimate review on the agency record was possible, without knowing what the complete record contained. For now, however, absent a congressional requirement that information from contacts be placed in the record, so long as the existing record supports the outcome, contacts with the White House, its officials, and perhaps with other agency personnel, may well be a legitimate part of the informal rulemaking process.

142. See Verkuil, supra note 121, at 978-82; Rosenberg Report, supra note 4, at 72.
144. 657 F.2d at 408. Another issue entirely is presidential, or executive branch contacts with independent agencies.
145. Support for the idea that a line may properly be drawn between contacts with intra-executive agency staff, on the one hand, and outside persons with financial or similar interest, on the other hand, may be found in D.C. Circuit precedent. See United Steelworkers v. Marshall, 647 F.2d 1189, 1210-16 (D.C. Cir. 1980) (approving ex parte contacts with agency staff, limiting rule against ex parte contacts in informal rulemaking to communications with private persons with financial or related interest in outcome), cert. denied, 453 U.S. 913 (1981); Home Box Office, Inc. v. FCC, 567 F.2d 9 (D.C. Cir.) (per curiam) (agency’s undocketed contacts with interested parties created separate record for insiders and public generally, thereby undermining fairness and judicial review), cert. denied, 453 U.S. 913 (1981). However, not all observers agree that even intra-agency, or intra-executive ex parte contacts are always proper.

Professor Davis, for example, focuses on the inevitable creation of two records, one before the appropriate agency decisionmakers and the public, the other before the other executive branch participants, and the problems that situation poses for rebuttal and review. His critique of such intra-executive communications is most pointed in the context of Executive Order 12291, and the difficulties it presents.

Professor Davis describes the mechanics of the Executive Order as follows:
The *Sierra Club* panel expressly declined to consider the effect on rulemaking proceedings of a failure to disclose "conduit" contacts, in which White House or interagency communications serve as conduits for private parties to make known the latter's off-the-record views. The situation of course differs from that actually presented in *Sierra Club*, in that the rationales proffered in that case for approval of undocketed executive contacts do not extend to secret communications with interested outside parties. The problem is exacerbated by the fact that Executive Order 12291 seemingly contains no safeguards against any kind of non-governmental attempts to influence the decisionmaking process. The Order does not require that written or oral contacts with OMB or the Task Force by outsiders either be logged or disclosed. Thus, beyond direct White House intervention, concern arises that White House actions might reflect the interests of powerful private lobbies. "The expressed fear is that government regulation will be co-opted by private groups through the intercession of the White House." The contact might flow from the private party through OMB to the agency, or from the private party to the White House.

Affected persons do still have a chance to present facts and ideas to the rulemaking agency, and the agency does take them into account in preparing its final rule. But the agency's final rule then goes over to OMB, where it can be altered by someone who (a) is not required to consider the written comments, (b) does not in fact ordinarily consider them, (c) considers other facts and influences that may be kept secret, and (d) does in fact keep secret the new facts and influences.

When a good lawyer loses in the agency, should he do what he can to win in OMB? Should he then collaborate with his client's lobbyists? If he is afraid his opponents may effectively answer his best arguments, should he withhold them from the agency and present them for the first time to OMB, where they can be kept secret?

At its worst, the system under the Executive Order can become one in which the presentation of written comments to the rulemaking agency is totally nullified and decisions are made totally on the basis of secret presentations to people in the Executive Office.


In this regard, note also the recommendation of the ABA Commission on Law and the Economy, that

memoranda exchanged between the agency and the President or his staff or other agencies be made part of the public record and that the occurrence of any meeting or discussion between them be placed in the record, but that the substance of the discussion remain private for the same reason that intra-agency discussions remain private—in order to encourage a full and frank exchange of opinions and advice.

Commission Report, supra note 4, at 81.

146. 657 F.2d at 405 n.520.

147. See Rosenberg Report, supra note 4, at 59.

148. Verkuil, supra note 121, at 950-51.
to OMB;\textsuperscript{149} either way, at least to the extent that direct outsider \textit{ex parte} contacts in informal rulemaking characteristically require justification, such indirect contacts are troublesome. So, too, is the mechanism that permits them to occur.

While I offer no view on the merits of contentions that such contacts violate due process or the APA, I do note that both this and the prior Administration have understood the possible implications of such contacts for the fairness of the process. Thus, during the Carter Administration, prior to Executive Order 12291, the Department of Justice Office of Legal Counsel took the position that it might be improper for White House advisers to act as conduits for outsiders' views on an informal rulemaking. It recommended that officials of the Council of Economic Advisers, who were working with agency decisionmakers, summarize and place in the rulemaking record \textit{all} written or oral communications they had with interested private persons.\textsuperscript{150} A related responsive policy emerged from the current Administration. On June 13, 1981, OMB Director David Stockman sent to executive branch heads a memo stating that OMB's procedures would be "consistent with the holding and policies discussed in \textit{Sierra Club},"\textsuperscript{151} and that when OMB "receives" or "develops" factual [as opposed to policy] material it believes should be considered by an agency, it will identify the material as appropriate for inclusion in the rulemaking record.\textsuperscript{152} The Stockman memo leaves uncertain the fate of oral communications, as well as that of material having to do with policy, not facts. Even if in place, it perforce creates at least a possibility that OMB could serve as a conduit for oral communications from private interest groups. It has been noted that a policy requiring that all written materials received be passed on to the agency, and that all outsider oral communications be docketed,\textsuperscript{153} would alleviate that possibility; however, the Administration thus far has not opted for

\textsuperscript{149} \textit{Rosenberg Report}, \textit{supra} note 4, at 60.
\textsuperscript{150} See Office of Legal Counsel, Department of Justice, Memorandum for Hon. Cecil D. Andrus, Secretary of Interior, Re: Consultation with Council of Economic Advisers Concerning Rulemaking under Surface Mining Control and Reclamation Act, reprinted in Legal Times of Washington, Jan. 29, 1979, at 32-33; \textit{see also Commission Report}, \textit{supra} note 4, at 81 (President and his staff should "be free to receive oral presentations from interested private persons (except where the affected agency would be prohibited from doing so), but a public record of those making such presentations and a summary of the proceedings would have to be kept and filed in the agency's rulemaking docket.").
\textsuperscript{151} Sohn \& Litan, \textit{supra} note 141, at 23.
\textsuperscript{152} \textit{Id.}
\textsuperscript{153} \textit{Id.} at 24.
such an approach and the Congress has not chosen to require it as an aspect of the APA's informal rulemaking. Whether courts, if and when confronted with the issue, will follow existing D.C. Circuit precedent on contacts with interested outsiders remains to be seen.

IV. THE POLITICS OF Deregulation AND SOME MISPERCEPTIONS ABOUT THE ROLE OF THE JUDICIARY

At least since President Reagan took office, determined to fulfill campaign promises to deregulate American industry, "deregulation" has been a major political issue. Indeed, the current Administration has turned it into a matter of political ideology: the general view appears to be that the President and his supporters are for it, whereas many liberals are against it. A few commentators have been so carried away by the politics of deregulation that they have gone so far as to suggest that the courts are opponents of deregulation when they strike down certain agency actions as arbitrary and capricious.154

Neat as this bipartite formulation may be, reality belies its accuracy. As an ideological matter, it is clear that neither the liberal opponents, nor the conservative proponents of deregulation always live up to the labels currently attached to them. Some of the so-called liberals who are presumed to oppose deregulation in fact have led congressional fights to reduce economic regulation in a number of industries. The so-called conservatives in charge at the FCC have been accused of engaging more in talk than action;155 and even President Reagan has been accused of going too easy on deregulation in industries where it might adversely affect certain special interest groups.156 Certain portions of the political picture are thus blurred.

Nonetheless, it is difficult to deny that political lines have formed as the Administration has moved to rescind social regulations, such as those that seek to affect occupational health and safety, wage and hour restrictions, environmental policy and equal employment. In these areas the Reagan Administration has sought to free industry from the economic burdens of such regula-

tions, and it has done so more through the agencies charged generally with promoting the designated social policies than through Congress. In the view of Ralph Nader, a strong opponent of this Administration, rescinding rules guaranteeing a minimal level of health and safety "is not deregulation. What they're doing is not enforcing the law."157 Or, as Mark Green has rhetorically noted, "The child labor laws or the abolition of slavery would never have passed a cost-benefit test,"158 referring to the cost-benefit analysis that now permeates all regulatory decision-making. At the same time, business representatives have expressed both approval of the President's efforts to ease the burden on industry and disappointment that the Administration has not brought about more changes in the system. In the words of one, responding to the disbanding last year of the Vice President's Task Force on Regulatory Relief, "It's just like when the country got out of the Vietnam war. The Administration has simply declared, 'We won,' and is pulling out."159 Another praised the Administration's efforts, saying, "The Administration gets good marks for installing deregulation-minded people in charge of the agencies and for using President Reagan's executive order to reexamine existing regulations and to review proposed regulations."160

In short, there is no doubt whatsoever that deregulation is a divisive issue, particularly when it means revocation of social regulations. It evokes strong, visceral reactions that reflect the public's views on the most basic questions about modern society, having to do with the respective roles of the public and private sectors, government-granted entitlements, and government-imposed

158. S. TOLCHIN & M. TOLCHIN, supra note 1, at 22 (quoting Mark Green).

In fact, the review framework set up by President Reagan has been said to bear more directly on social than economic regulation, "in part because the logic of weighing benefits and costs is more closely applicable to the decisions of the social regulatory agencies and in part because more of these agencies are within the executive branch [and subject to executive control]. The change in policy direction has been most pronounced at these agencies." Kosters & Eisenach, Is Regulatory Relief Enough?, REGULATION, March-April 1982, at 25. In other areas, such as agriculture, finance, and international trade, reform efforts were less evident than in the social regulatory areas. Id.

Of course, the underlying notion that all regulatory costs and benefits are quantifiable is a highly debatable one.
160. Id. at 56-57 (quoting James Carty, National Association of Manufacturers).
burdens. Perhaps because the questions presented so pointedly challenge some of our most deeply felt perceptions about the nature of government and man, answers to those questions from all sides often are harsh, critical, overtly ideological and, as a consequence, at times misguided or flatly wrong.

One manifestation of this attitude may be found in remarks by some political writers about decisions of the courts in this area. Simply because the issue is at heart a political one, some columnists and editors seem to assume that judges are acting as politicians when they decide cases relevant to deregulation. I do not mean simply that they utter the age-old charge that judges' politics affect their decisions. The charge is a new one and potentially more destructive, i.e., that merely by acting—by applying the standards established by Congress and defined by the Supreme Court—lower federal courts are entering the fray, taking sides, making law, and upsetting the balance of power. Judges traditionally are not expected to comment publicly either on politics or on the public response to court decisions, and particularly those that bear the Judge's name. Nor do I wish to do that here. Yet, when prominently published criticisms fundamentally confuse the role of courts with the merits of judicial decisions, and lambast courts not for their analysis but for the mere act of reviewing decisions—for carrying out their appointed role—then the criticisms merit response.

For example, a long editorial in the Wall Street Journal tagged the arbitrary and capricious review performed in the homeworkers case in Donovan as "procedural," and then ridiculed the court for emphasizing procedural requirements. At best, the editorial is somewhat amusing for its lack of understanding of the statutory mandate contained in the Administrative Procedure Act; at worst, it is a distressing distortion of the judicial function which, if taken seriously, badly misleads the public about the role of judges and the courts. Only a direct quotation adequately conveys the Journal's apparent view that courts simply should not interfere with actions taken by administrative agencies. The editorial stated:

We don't know what the appeals court judges think because they cast their votes only on "procedural" grounds. But the procedural grounds also are highly suspect. The homework restrictions are not congressionally approved statutes, but merely department regulations. The court is suggesting, following the
strange precedent set recently by Judge Abner Mikva in his attempts to legislate auto air bags, that one administration can't reverse some wrongheaded policy of a past administration without getting the permission of Congress. Where does the Constitution say that? And if that's to be the law of the land, what's the point of presidential elections?^161

Initially it is worth noting that the "strange precedent" to which the editorial refers was set not by Judge Mikva of the District of Columbia Circuit, but by the unanimous Supreme Court in its State Farm decision last summer. It is also worth noting that the Supreme Court's auto airbags decision construed the arbitrary and capricious standard of judicial review established by Congress, not some concoction of its own design.

More importantly, the editorial criticizes the courts for having the audacity to perform the kind of judicial review that Congress has ordered it to perform—to assure that agencies give reasons for their decisions. The essential purpose of that review—which the editorial ignores—is to assure that neither new administrations (of any political persuasion) nor overly zealous agency heads overstep the bounds of their delegated authority or exercise their discretion irrationally or discriminatorily. Review is calculated to assure compliance with long-term congressional mandates by participants in the process who might have contrary short-term goals. It is a profoundly important adjunct to the often vague delegations of power that Congress has written into the statute books. The point of judicial review is to assure compliance with, not flouting of, Congress' will. Few propositions about the balance of power in our nation are so well established. The Journal asks what, then, is the point of presidential elections. The answer surely is not to sidestep Congress and ignore, or rewrite, the law instead of executing it. As Justice Rehnquist noted in his separate opinion in State Farm, "[o]f course, a new administration may not choose not to enforce laws of which it does not approve."^162

Indeed, another editorial column, apparently better attuned to basic separation of powers principles, understood this proposition. While agreeing with the Labor Department that restrictions on homework might not serve the necessary purpose any longer, the Chicago Tribune wrote,

The appeals court probably was right in insisting that the admin-

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162. 103 S. Ct. at 2875 n. (Rehnquist, J., concurring and dissenting).
JUDICIAL REVIEW OF DEREGULATION

istration's proper quarrel is not with the Labor Department regulations but with the law that spawned them. In this case, the law is starkly at odds with the interests of a class of workers. The administration should get on with the business of amending it, an effort that deserves the support of Congress. 163

I certainly do not in any respect mean to criticize or deny anyone's right to take issue with the analysis of a decision, or indeed with the role that Congress has chosen to fashion for courts. My concern is strictly focused at those who automatically assume that courts are substituting their own judgment for the agency's when they review and reverse, or, alternatively, that every decision to uphold an agency means the court agrees with the agency. Such narrow-minded thinking leads commentators inaccurately to accuse the courts of intentionally substituting "their own arbitrary and capricious judgment for what they condemned as the arbitrary and capricious action" 164 of an agency. Lawyers involved in administrative practice recognize that arbitrary and capricious review has to do with explanations and justifications. Unfortunately, some commentators fail to comprehend the proper role of the courts and, as a consequence, perpetuate the myth that judges are real participants in the political process. This is distressing principally because it inaccurately taints the appearance and fact of the propriety of the judicial process, and it misleads the public into believing that purely political struggles may be waged pursuant to litigation in the courts. There is no doubt that the results of some litigation may produce political advantage; however, it is quite another thing—and false—to suggest that judges are power brokers in the political process.

The foregoing points recently were amplified in an extremely insightful article written by Professor Sallyanne Payton. The article, which deals with the intricacies of Administrative Law, makes the following observations about the role of the courts in review of administrative agency action:

Even the continuing controversies respecting the institutional role of the courts in overseeing the work of the agencies tend to focus on the agencies themselves, since it is their peculiar role in making law that gives rise to judicial deference or disquiet. Administrative law is mainly about agencies, not mainly about courts.

There is a good practical reason for centering the discipline on

the work of the agencies. Ever since the flowering of government regulation during the New Deal, it has been apparent that judicial review alone, or even in combination with legislative oversight, is inadequate to discipline administrative discretion. These oversight mechanisms operate episodically and largely consist of review or criticism after the fact. If the agencies are to be influenced decisively, they must be affected directly and prospectively—that is, through statute and regulation.

Administrative law attempts to reconcile the practical realities of the administrative state with two central propositions on which the government itself is founded: first, that the laws of a free people are anchored in the consent of the governed as expressed by its elected representatives; and second, that no matter how legitimate its short-term political authority the government must act in accordance with the higher and more enduring requirements of the rule of law, which preserves the individual liberty that makes democratic self-governance conceivable.

Thus, administrative law concentrates on ensuring that government officials act only within the scope of their lawful authority and adhere to minimum standards of fairness and rationality in dealing with those subject to their power. Since the government is an active force, administrative law tends to reflect current political controversies. The development of administrative law can fairly be characterized as a collective scramble by the judiciary to keep up with what the government is doing and to civilize executive branch officials who are inclined to tear the fabric of fundamental law in their pursuit of immediate programmatic or political gains.165

Courts cannot, and certainly should not, abdicate the reviewing role Congress has given them merely because the issues they review are political and controversial. Indeed, in such a climate courts fill perhaps their most important function in our system of popular government. The view that courts should remain inert when confronted with politically sensitive issues, and instead allow the majority of a given election year to exercise its authority unchecked even by Congress' will, represents a disturbing vision of our political system. The executive function is to see that congressional policies are faithfully carried out, and judicial review of executive agency action oversees this function, largely at Congress' behest. Courts have a role and judges have a role. Merely to act, to inquire, and at times to question, is not to be im-

properly political or activist, particularly when the acts are taken at the direction of our most representative body, Congress.

V. CONCLUSION

As the title of this paper is “Judicial Review of Deregulation,” my closing remarks no doubt should focus on that topic. The curious truth is that in the short term, and as a first step, judicial review of administrative deregulation can and should continue to be a meaningful restraint on agencies' exercise of their considerable discretion—an on-going assurance that they engage in reasoned decision-making and do not act in an arbitrary or capricious manner. In the long run, however, the ultimate source of control of the substance of agency action will be either the Executive or Congress. Congress' broad, virtually standard-free delegations of power, both to executive and independent agencies, open the way for a strong executive to recast policy in a wholly new direction, and to do so with the knowledge that courts may well defer to the agencies' policy selections. Broad delegations also open the way for agencies to make those choices themselves, in the event of a weak administration—and to do so with no coherent methodology. In its own way, each of these prospects is troublesome.

It has often been said that Congress should, or must, revisit and reassess its past delegations of power, to add structure and standards based on years of regulatory experience. There is some wisdom to this view. Absent such a review, one scenario emerges in which short-term political objectives prevail over long-term congressional ones, thereby standing our system of Government on its head. In the worst-case scenario, involving broad delegations to administrative agencies, no meaningful congressional oversight, and a weak executive, we approach "Rule by Nobody."¹⁶⁶

What all this has to do with judicial review is that there are limits to what courts may substantively do. It is time for Congress to take notice of the situation, and to shape at least the broadest outlines of policy in the many substantive areas that have been made the subject of legislative enactment. This at least will ensure that all three branches of government are functioning in some legitimate and meaningful fashion.

¹⁶⁶. The concept of "Rule by Nobody" comes from the profound works of Hannah Arendt. See H. ARENDT, CRISES OF THE REPUBLIC (1972) and H. ARENDT, EICHMANN IN JERUSALEM (1963).
KENTUCKY BANK DIRECTORS' LIABILITY

by

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and

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INTRODUCTION

Difficulty in identifying the Kentucky bank director's liability arises because a Kentucky bank director may be a director of a national bank, a state member bank or a nonmember insured bank. Generally, and from a regulatory standpoint, these categories may be described as follows:

National banks are under the control of the Comptroller of the Currency, which is a part of the Treasury Department, and are subject to all federal banking laws and regulations, which include those imposed by the Federal Reserve System and the FDIC. State member banks are subject to the laws and regulations of the state in which they are chartered and to applicable federal laws since they are members of the Federal Reserve System and the FDIC. Nonmember insured banks are subject to state regulation plus, the rules and regulations of the FDIC, . . . .

Accordingly, the director's liability is dependent on the bank's affiliation category.

Although the director's liability may be dependent on the banking affiliation, a body of law exists that generally applies to all Kentucky bank directors. This body of law is a synthesis of the relevant concepts applicable to each category of director and may be described as the general theory of the Kentucky bank director's liability. The theory states that upon acceptance of the position, the director is obligated to:

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1. comply with the law;
2. manage the bank's affairs; and
3. exercise loyalty to the position.

A failure on the part of the director in fulfilling any of these obligations can result in the director being liable, either civilly or criminally.

I. COMPLIANCE WITH THE LAW

Initially the director is confronted with the responsibility of complying with the law when the oath of office is administered. Directors of state chartered banks are required to take an oath stating that the director "will uphold the laws of the state, and particularly the banking laws." The statute requiring the national bank directors' oath establishes that:

Each director, when appointed or elected, shall take an oath that he will, so far as the duty devolves on him, diligently and honestly administer the affairs of such association, and will not knowingly violate or willingly permit to be violated any of the provisions of this title, . . . .

Directors should be concerned with more than their own compliance, however, because statutes establishing penalties for non-compliance expand the director's responsibility. The state bank director's responsibility is expanded as follows:

Any directors of a bank who knowingly violate, or knowingly permit any officer or employee of the bank to violate, any of the laws relating to banks, shall be jointly and severally liable to the creditors and stockholders for any loss or damage resulting from such violation. If the loss or damage is not made good within a reasonable time, the commissioner, with the consent of the attorney general, shall institute proceedings to revoke the corporate powers of the bank.

Similarly for national bank directors:

If the directors of any national banking association shall knowingly violate, or knowingly permit any of the officers, agents, or servants of the association to violate any of the provisions of this Title, all the rights, privileges, and franchises of the association shall

3. 12 U.S.C. § 73 (1978) ("This title," as used in this section, means Title LXII of the Revised Statutes relating to "National Banks.").
be thereby forfeited. Such violation shall, however, be determined and adjudged by a proper district or territorial court of the United States in a suit brought for that purpose by the Comptroller of the Currency, in his own name, before the association shall be declared dissolved. And in cases of such violation, every director who participated in or assented to the same shall be held liable in his personal and individual capacity for all damages which the association, its shareholders, or any other person, shall have sustained in consequence of such violation.

Any national banking association which violates, or any officer, director, employee, agent, or other person participating in the conduct of the affairs of such association who violates any of the provisions of this chapter [12 USCS §§ 21 et seq.], or any regulation issued pursuant thereto, shall forfeit and pay a civil money penalty of not more than $1,000 per day for each day during which such violation continues. 5

Likewise, similar statutes exist covering violations of sections of the Federal Reserve Act. 6 These enactments not only hold the dir-

5. 12 U.S.C. § 93 (1982) ("This title," as used in this section, means Title LXII of the Revised Statutes relating to "National Banks.").

§ 503. Liability of directors and officers of member banks

If the directors or officers of any member bank shall knowingly violate or permit any of the agents, officers, or directors or any member bank to violate any of the provisions of sections 375, 375a, and 376 of this title or regulations of the board made under authority thereof, or any of the provisions of sections 217, 218, 219, 220, 655, 1005, 1014, 1906, or 1909 of Title 18, every director and officer participating in or assenting to such violation shall be held liable in his personal and individual capacity for all damages which the member bank, its shareholders, or any other persons shall have sustained in consequence of such violation.

§ 504. Civil penalty—Making loans, extensions of credit, purchases of securities, etc., respecting affiliates, executive officers, etc.

(a) Any member bank which violates or any officer, director, employee, agent, or other person participating in the conduct of the affairs of such member bank who violates any provision of section 371c, 375, 375a, 375b, 376 or 503 of this title, or any regulation issued pursuant thereto, shall forfeit and pay a civil penalty of not more than $1,000 per day for each day during which such violation continues: Provided, that the agency having authority to impose a civil money penalty may, in its discretion, compromise, modify, or remit any civil money penalty which is subject to imposition or has been imposed under such authority. The penalty may be assessed and collected by the Comptroller of the Currency in the case of a national bank, or the Federal Reserve Board in the case of a State member bank, by written notice. As used in this section, the term "violates" includes without any limitation any action (alone or with another or others) for or toward causing, bringing about, participating in, counseling, or aiding or abetting a violation.

Amount of penalty

(b) In determining the amount of the penalty the Comptroller of the Currency or
ector responsible for his own actions, but also those known actions of others affiliated with the bank. Thus the director can be held

the Board, as the case may be, shall take into account the appropriateness of the penalty with respect to the size of the financial resources and good faith of the member bank or person charged, the gravity of the violation, the history of previous violations, and such other matters as justice may require.

Opportunity for hearing

(c) The member bank or person assessed shall be afforded an opportunity for agency hearing, upon request made within ten days after issuance of the notice of assessment. In such hearing, all issues shall be determined on the record pursuant to section 554 of Title 5. The agency determination shall be made by final order which may be reviewed only as provided in subsection (d) of this section. If no hearing is requested as herein provided, the assessment shall constitute a final and unappealable order.

Review by United States court of appeals

(d) Any member bank or person against whom an order imposing a civil money penalty has been entered after agency hearing under this section may obtain review by the United States court of appeals for the circuit in which the home office of the member bank is located, or the United States Court of Appeals for the District of Columbia Circuit, by filing a notice of appeal in such court within twenty days from the service of such order, and simultaneously sending a copy of such notice by registered or certified mail to the Comptroller of the Currency or the Board, as the case may be. The Comptroller of the Currency or the Board, as the case may be, shall promptly certify and file in such court the record upon which the penalty was imposed, as provided in section 2112 of Title 28. The findings of the Comptroller of the Currency or the Board, as the case may be, shall be set aside if found to be unsupported by substantial evidence as provided by section 706(2)(E) of Title 5.

Action by Attorney General for failure to pay assessment

(e) If any member bank or person fails to pay an assessment after it has become a final and unappealable order, or after the court of appeals has entered final judgment in favor of the agency, the Comptroller of the Currency or the Board, as the case may be, shall refer the matter to the Attorney General, who shall recover the amount assessed by action in the appropriate United States district court. In such action the validity and appropriateness of the final order imposing the penalty shall not be subject to review.

§ 505. Civil penalty respecting depository, reserve, etc., requirements; amount; hearing; review; action by Attorney General; regulations

(1) Any member bank which violates or any officer, director, employee, agent, or other person participating in the conduct of the affairs of such member bank who violates any provision of this section, or any regulation or order issued by the Board pursuant thereto, shall forfeit and pay a civil money penalty of not more than $100 per day for each day during which such violation continues: Provided, that the Board may, in its discretion, compromise, modify, or remit any civil money penalty which is subject to imposition or has been imposed under authority of this subsection. The penalty may be assessed and collected by the Board by written notice. As used in this section, the term "violates" includes without any limitation any action (alone or with another or others) for or toward causing, bringing about, participating in, counseling, or aiding, or abetting a violation.

(2) In determining the amount of the penalty the Board shall take into account the appropriateness of the penalty with respect to the size of financial resources and good faith of the member bank or person charged, the gravity of the violation, the history of previous violations, and such other matters as justice may require.
responsible even though he did not actually participate directly in the violation.

**A. Standard For Measuring Statutory Compliance**

A statutory violation is determined by applying a standard developed by the Supreme Court of the United States in *Yates v. Jones Nat'l Bank*. The standard states that:

[I]t is self-evident that the rule expressed by the statute is exclusive, because of the elementary principle that where a statute creates a duty and prescribes a penalty for non-performance the rule prescribed in the statute is the exclusive test of liability. *Farmers' & M. Nat. Bank v. Dearing*, 91 U.S. 29, 35 [1875], and cases cited. . . . also established by previous decisions of this court, pointing out that where by law a responsibility is made to arise from the violation of a statute knowingly, proof of something more than negligence is required, that is, that the violation must in effect be intentional. *McDonald v. Williams*, 174 U.S. 397 [1899]; *Potter v. United States*, 155 U.S. 438, 446 [1894] and cases cited. See, also, *Utley v. Hill*, 155 Missouri 232, 264, [1899] and cases cited.7

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7. 206 U.S. 158, 179 (1906). See also Corsicana v. Johnson, 251 U.S. 68, 71 (1919); Thomas v. Taylor, 224 U.S. 73, 81 (1912); Hoehn v. Crews, 144 F.2d 665, 672 (10th Cir. 1944), cert.
It is apparent from this decision that the director's responsibilities have been redefined from those imposed by the statutes. In effect, a boundary is established for interpreting the statutes. The director is only responsible for those violations that are intentional thus relieving him of the responsibility for unintentional violations of the law. Furthermore, the restriction may be applied to the responsibility established for the actions of others affiliated with the bank.

However, further refinement of the standard was necessary because the rule, as established, would allow the director a means of avoiding liability simply by proving lack of knowledge in the area of concern. This door was soon closed.

The language there [Yates v. Jones National Bank] is "that where by law a responsibility is made to arise from the violation of a statute knowingly, proof of something more than negligence is required—that is, that the violation must in effect be intentional." Not, therefore, that as a condition of liability there should be proof of something more than recklessness; not that there should be an intentional violation, but a violation "in effect" intentional. There is "in effect" an intentional violation of a statute when one deliberately refuses to examine that which it is his duty to examine. Merely failing "to examine that which it is a duty to examine" does not constitute the violation. The unfulfilled examination must be related to the violation in such a manner that the requisite knowledge would be present had the examination been made.

B. Statutes Are No Substitute For Common Law

The director should not be deluded into thinking that statutory violations are the only violations of concern. A legislative enactment or regulation does not relieve the director of common law

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denied, 323 U.S. 773 (1944); Michelsen v. Penny, 135 F.2d 409, 417 (2d Cir. 1943); Atherton v. Anderson, 99 F.2d 883, 896 (6th Cir. 1938); Atherton v. Anderson, 86 F.2d 518, 521 (6th Cir. 1936), cert. granted, 300 U.S. 652 (1936), rev'd per curiam on other grounds and remanded for reheg, 302 U.S. 643 (1937); Holman v. Cross, 75 F.2d 909, 910 (6th Cir. 1935); Payne v. Ostrus, 50 F.2d 1039, 1041 (8th Cir. 1931); Hughes v. Reed, 46 F.2d 435, 437 (10th Cir. 1931); Gamble v. Brown, 29 F.2d 366, 370 (4th Cir. 1928), cert. denied, 279 U.S. 839 (1928); Anderson v. Akers, 7 F. Supp. 924, 928 (W.D. Ky. 1934), aff'd in part, rev'd in part, remanded, Atherton v. Anderson, 86 F.2d 518 (6th Cir. 1936), cert. granted, 300 U.S. 652 (1936), rev'd per curiam on other grounds and remanded for reheg, 302 U.S. 643 (1937); Ringeon v. Albinson, 35 F.2d 753, 754 (D. Minn. 1929).

duties. As such, directors are responsible for violations of both common law duties and statutorily imposed duties. The common law duty imposed and emphasized in the director's oath is "to diligently and honestly administer the affairs of the association."

The degree of care which directors must exercise in the performance of their common law duties is not easily defined. The general rule is presented by the following:

In any view the degree of care to which these defendants [bank directors] were bound is that which ordinarily prudent and diligent men would exercise under similar circumstances, and in determining that the restrictions of the statute and the usages of business should be taken into account. What may be negligence in one case may not be want of ordinary care in another, and the question of negligence is, therefore, ultimately a question of fact, to be determined under all the circumstances.

9. Bowerman v. Hamner, 250 U.S. 504, 511 (1919); Hoehn v. Crews, 144 F.2d 665, 672 (10th Cir. 1944), cert. denied, 323 U.S. 773 (1944); Michelson v. Penny, 135 F.2d 409, 417 (2d Cir. 1943); Atherton v. Anderson, 99 F.2d 883, 896 (6th Cir. 1938); Atherton v. Anderson 86 F.2d 518, 521 (6th Cir. 1936), cert. granted, 300 U.S. 652 (1936), rev'd per curiam on other grounds and remanded for rehearing, 302 U.S. 643 (1937); Hughes v. Reed, 46 F.2d 435, 437 (10th Cir. 1931); Gamble v. Brown, 29 F.2d 366, 370 (4th Cir. 1928), cert. denied, 279 U.S. 839 (1928); Cockrill v. Cooper, 86 F. 7, 11 (8th Cir. 1898); Ringeon v. Albinson, 35 F.2d 753, 754 (D. Minn. 1929).


Problems, mostly restricted to definitions or clarifications of terms and phrases, are encountered in applying this rule.

The first problem encountered deals with the definition of the "ordinarily prudent and diligent man." It is this hypothetical person with whom the director's performance is compared. The

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12. Another difficult duty of a court in this connection is to properly set up for itself this theoretical imaginary "reasonably prudent person" whom the law has adopted as the standard or model in determining the question of negligence. Having succeeded in making the settings for the picture and having drawn the highways, the branching roads, the signposts with their legends — some clearly written and some quite illegible — we are then required to create a reasonably careful and prudent individual to read and understand the signs and to determine the road which should be taken. To accurately describe this individual is not an easy task. It is customary for a trial judge to instruct the jury in cases involving negligence that the standard to be applied is the care exercised by the reasonably prudent and careful person, and appellate courts are usually content to follow substantially that language. Now, in my opinion, it is probable that the trier of the facts, in such a case, whether he be judge or juror, thinks, perhaps unconsciously, of himself as a reasonably prudent individual. If he be considering a subject with which he is familiar, for example, the operation of an automobile, he decides what he would do or refrain from doing under the circumstances presented. If he be a very careful and cautious driver, he is likely to place the standard too high. If he happens to be a careless driver, he places the standard too low. It seems to me that this reasonably prudent person is just the ordinary individual who deals with the particular subject under consideration while he is acting as he ordinarily does act. Thus, if the operation of an automobile be the subject involved, it would seem that the reasonably prudent driver of an automobile would be the ordinary person who drives an automobile, and that if, as here, we are considering bank directors, the ordinary bank director, that is, the person who ordinarily acts as such a director, is the standard of comparison to be used as the criterion by which the requisite care must be measured and determined, and, unless the court keeps that in mind, in such a case as that at bar, there is danger that the court may impose upon the defendants a greater duty than is required by the applicable rule of law. The natural impulse of the judge trying such a case is to expect and demand a high degree of care on the part of such a bank director and to believe that the ordinary bank director is, as the judge is likely to conceive that he himself would be (and perhaps in fact would be), a very careful, conservative, prudent director. It is only natural for a judge to think of himself as a bank director of this ultraconservative type, rather than as a director of the average, ordinary type. He may forget that membership on a board of directors of a large city bank such as is involved here is usually and normally only one of many business activities in which such director is engaged. It may be thought that such a directorship is of sufficient importance to demand that the director give to it all of his thought, energy, and time, but that this is not the usual or ordinary practice is a fact of such general knowledge that the court must take judicial notice of it. It is commonly known that the ordinary director of such a bank devotes only a part of his time to the affairs of such bank and necessarily relies largely on the honesty, judgment, and efficiency of the executive officers to whom the administration of the details of operation of the bank are intrusted. It is well known that many men of ability, character, and business experience and connections are considered to be, and often are, valuable as members of the board of directors of a bank even though they are not able to give a large amount of time to its affairs. There are often, if not usually, other directors who may not have so much ability or experience, but who are able to devote more time to the bank, so that, while the time which they do give may not be so valuable as others', they may compensate for that by the greater amount of time given. Then there are
"ordinarily prudent and diligent man" definition is dependent on the circumstances which are almost never replicated from one situation to another. Therefore, as each circumstance is evaluated and acted upon, the standard used to measure performance will change. Each circumstance can, however, be approximated or assumed equivalent, resulting in a need for "circumstances" being defined. In some instances, a narrow definition is applied. For example, "[i]n determining the duties of bank directors, the custom and usage of similar banks is proper to be considered by the trier of the facts." Therefore, one may need to identify the "customs and usages" of small banks to assess the liability of the small bank director and large banks to assess the liability of the large bank director. Thus, the director's affiliation becomes important in assessing liability if performance standards vary widely within the banking industry.

At this juncture an alternative standard may be advanced. The alternative standard does not look to "similar circumstances" in the banking community but to similar circumstances "in their personal business affairs." Therefore, each director is evaluated in the officer directors, who are paid for their services and who make the work of the bank their regular occupation and are, as they are expected and assumed to be, much more familiar with the details of the various loans and affairs of the bank than the nonofficer directors ordinarily are or can be expected to be. So that, although a court is, of course, anxious to require as high a high standard as is possible with respect to the care to be demanded of every person holding the responsible and important position of bank director, yet it must not lose sight of the legal rule of reasonable care thus applicable nor of the facts and conditions which, in actual practice, do in fact constitute the background and situation of the ordinary, that is, the ordinarily prudent director of a large and busy bank in a great city, such as is under consideration here, who, and not the ideal director or the kind of director which the court would wish, must be accepted by the court as the standard of comparison in determining whether the defendants exercised the degree of care which such ordinary director would have exercised. On the other hand, the court must recognize that the most prudent man is sometimes negligent and that therefore the ordinarily careful and prudent man may be at times careless and legally negligent. This ordinarily or reasonably prudent man cannot have any periods when he falls below this prescribed standard. In other words, the law having fixed that standard, the court must apply it to the particular transactions involved, and if, in connection with these transactions, the person in question falls below that standard, he is guilty of, and liable for, negligence, even if usually, or at all other times, he acts with proper care.

terms of this hypothetical person and the related conduct in handling personal business affairs, resulting in a greater degree of care being imposed on the director. However, this standard has not been adopted by the Kentucky judiciary or the Sixth Circuit Court of Appeals. The other basic problem with the degree of care rule is what constitutes failure on the part of an individual to meet the standard of care required of his position-negligence. Although negligence has been defined in many ways, perhaps the following discussion and resultant definition is the most appropriate:

Treated as a cause of action in favor of the corporation, a liability of this kind should not lightly be imposed in the absence of any element of positive misfeasance, and solely upon the ground of passive negligence; and it must be made to appear that the losses for which defendants are required to respond were the natural and necessary consequence of omission on their part.

And in this connection the remarks of Mr. Justice Bradley in Railroad Co. v. Lockwood, 17 Wall. 357, 382, may well be quoted: 'We have already adverted to the tendency of judicial opinion adverse to the distinction between gross and ordinary negligence. Strictly speaking, these expressions are indicative rather of the degree of care and diligence which is due from a party and which he fails to perform, than of the amount of inattention, carelessness or stupidity which he exhibits. If very little care is due from him, and he fails to bestow that little, it is called gross negligence. If very great care is due, and he fails to come up to the mark required, it is called slight negligence. And if ordinary care is due, such as a prudent man would exercise in his own affairs, failure to bestow that amount of care is called ordinary negligence. In each case the negligence, whatever epithet we give it, is failure to bestow the care and skill which the situation demands; and hence it is more strictly accurate, perhaps to call it simply 'negligence.' And this seems to be the tendency of modern authorities. If they mean more than this, and seek to abolish the distinction of degrees of care, skill and

diligence required in the performance of various duties and the fulfillment of various contracts, we think they go too far; since the requirement of different degrees of care in different situations is too firmly settled and fixed in the law to be ignored or charged.\textsuperscript{17} Thus, negligence is determined by comparing actual performance to the standard performance. If the standard is not met then negligence results.

The director should keep in mind that both the standard established and compliance with it are determined differently with respect to bank directors. This is important since "[t]here are a few cases in which the directors of financial institutions have been held to a somewhat stricter standard of performance than have the directors of ordinary business corporations."\textsuperscript{18} This results in bank directors not being able to seek comfort from corporate directors and their standards of performance.

\section*{C. National Bank Directors' Compliance With State Law}

Some concern could be expressed by national bank directors as to the applicability of Kentucky law to their position. It may be unconstitutional for a state to control a national bank chartered by the federal government. This point was addressed early in the establishment of the banking system. A case originating in Kentucky and ultimately decided by the United States Supreme Court developed the following rule:

They [national banks] are subject to the laws of the state, and are governed in their daily course of business far more by the laws of the state than of the nation. All their contracts are governed and construed by state laws. Their acquisition and transfer of property, their right to collect their debts, and their liability to be sued for debts, are all based on state law. It is only when the state law incapacitates the banks from discharging their duties to the government that it becomes unconstitutional.\textsuperscript{19}

As such, Kentucky national bank directors should concern them-

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selves with the laws applicable to all bank directors operating in Kentucky. At the same time, the general theory of a Kentucky bank director's liability is applicable to national bank directors affiliated with national banks operating in Kentucky.

D. Compliance With Charter and By-law Provisions

Directors are also required to fulfill those responsibilities established by the corporate charter and by-laws. This particular requirement has not been addressed directly by any jurisdiction binding Kentucky directors. However, exceptions to this requirement have surfaced. The major exception is that by-law requirements may be subject to disuse criteria. As stated by the court in Dresser v. Bates:

We see no reason to doubt that the requirements of article 19 might have been waived or their observance omitted by the directors, if regarded by them as no longer necessary, in the absence of special circumstances showing such waiver or omission to have been inconsistent with good judgement and reasonable prudence. Nonobservance of a similar by-law for fourteen years appeared in the above case of Briggs v. Spaulding; the matters covered by it having been left by the directors wholly to the president and cashier, and without any formal amendment or repeal of the by-law. The directors were nevertheless exonerated, although stringent observance of the by-law could hardly have failed to disclose the misdoing of the president and cashier for which it was sought to hold them responsible. It was considered sufficient by the court that the manner of conducting the bank's business, in that and other respects, had been sanctioned by long-continued usage.

The result of this approach is repeal of the by-laws through non-observance. As noted in this case, special circumstances may exist whereby such a waiver or omission could be inconsistent with "good judgement and reasonable prudence." Such was the rule announced in New Jersey:

Another point made was that the fact that the by-law in question had been disregarded and fallen into disuse for so long a time was evidence from which the court might presume a repeal of it. I think the advancement of this argument hurts rather than helps the de-

20. Cockrill v. Cooper, 86 F. 7, 13 (8th Cir. 1898); Michelson v. Penny, 41 F. Supp. 603, 611 (S.D. N.Y. 1941), modified on other grounds, 135 F.2d 409 (2d Cir. 1943); Marshall v. Farmers' & Merchants' Sav. Bank, 85 Va. 676, 8 S.E. 586, 589 (1889).

fendants. If I am right in my conclusion that the by-law is a wholesome and proper one, well contrived to protect the assets of the bank, then its repeal must be considered as a deliberate attempt on the part of the directors to give themselves a license to be negligent in the performance of their duties; and, of course, any conduct which would indicate a repeal by implication is subject to the same criticism.22

One conclusion that may be drawn from both cases is that non-observance of by-laws is permitted as long as no violation of good judgment and reasonable prudence exists. Violations of the charter appear to follow this same logic.23

E. Penalties

A failure on the part of a director to fulfill the responsibilities established by law may result in some penalty being assessed the director or his bank. The penalty is dependent on the source of law creating the responsibility. Usually, when a statute creates a duty, it also creates a penalty for non-performance of that duty. These penalties may vary with the particular statute being considered. The principal penalty for such violation is that “every director who participated in or assented to the same shall be held liable in his personal and individual capacity for all damages which the association, its shareholders, or any other person, shall have sustained in consequence of such violation.” 24 This statement is equally appropriate for common law violations.25 Further, penalties may be in the form of fines ranging from $100 per day to $1,000 per day for each day the violation continues,26 suspension or removal of the director from the position,27 termination of status as an insured bank,28 revocation of the bank’s charter,29 or im-

23. Id. Johnson v. Churchwell, 38 Tenn. 146, 147 (1858).
Fulfillment of the directors’ responsibilities is presumably enhanced by these penalties, although it is not guaranteed.

F. Enforcement

The director is responsible for complying with the law. Enforcement of compliance may be by any number of several groups to which the director owes a duty or by organizations on their behalf. These groups have been identified by the courts in various decisions and by legislators in their enactments.

Bank directors owe a common law duty to more than their respective bank. As stated in one case:

Their contact is not alone with the bank. They invite the public to deal with the corporation, and when any one accepts their invitation he has the right to expect reasonable diligence and good faith at their hands; and if they fail in either, they violate a duty they owe not only to the stockholders, but to the creditors and patrons of the corporation.31

Logic dictates that anyone to whom a duty is owed may attempt to enforce the fulfillment of that duty. As such, enforcement of the common law duty may be accomplished by the bank, the stockholders, the creditors, or the bank’s patrons. Occasionally the patrons’ rights are subrogated. This generally occurs when the Federal Deposit Insurance Corporation “pays or makes available for payment the insured deposit liabilities of the closed institution.”32

Statutes identify the enforcement groups involving statutory duties by identifying the groups to whom the director is liable. Federal statutes state that the director is “liable in his personal and individual capacity for all damages which the association, its shareholders, or any other person shall have sustained in consequence of such violation.”33 Similar language is present in Kentucky statutes.34 However, this only addresses loss recovery. En-


Penalties. — (1) Any person who violates subsection (1) of KRS 287.030 shall be fined not less than twenty ($20.00) nor more than fifty dollars ($50.00) for each day he is engaged in the private banking business.

(2) Any institution that fails to make the report required by KRS 287.420 to the commis-
forcement of other penalties would be by the appropriate

(3) If any person violates subsection (3) of KRS 287.440 his office shall ipso facto become vacant. The president or cashier of any bank or trust company to which any person becomes indebted in violation of subsection (3) of KRS 287.440 shall immediately report such fact to the commissioner of banking and securities, who shall remove the person so offending.

(4) Any receiver of an insolvent institution who fails to comply with the provisions of this chapter shall be subject to the same penalties provided for solvent institutions and officers so offending.

(5) Any directors of a bank who knowingly violate, or knowingly permit any officer or employee of the bank to violate, any of the laws relating to banks, shall be jointly and severally liable to the creditors and stockholders for any loss or damage resulting from such violation. If the loss or damage is not made good within a reasonable time, the commissioner, with the consent of the attorney general, shall institute proceedings to revoke the corporate powers of the bank.

(6) Any deputy commissioner or any examiner who has knowledge of the insolvency or unsafe condition of a state bank or trust company, or that it is inexpedient to permit the bank or trust company to continue business, and who fails to immediately present a signed report of such facts to the commissioner, or who violates any of the provisions of this chapter, shall forfeit his office and shall be fined not less than one hundred ($100) nor more than two thousand dollars ($2,000) for each offense.

(7) Any commissioner who has knowledge of the insolvency or unsafe condition of a state bank or trust company, or that it is inexpedient to permit the bank or trust company to continue business, and who wilfully fails to take the action prescribed by this chapter, or who violates any of the provisions of this chapter, shall forfeit his office and shall be fined not less than five hundred ($500) nor more than five thousand dollars ($5,000) for each offense.

(8) Any bank or trust company that knowingly fails to make a report required by law or by the commissioner within the time designated for the making thereof, or fails to include in such report any matter required by law or by the commissioner, or fails to publish a report within thirty (30) days after it should have been published, or fails to pay when due the fees for filing reports or for an examination of the bank, shall be subject to a penalty of twenty-five dollars ($25.00) for each day of delinquency, but the aggregate penalty for each kind of offense shall not exceed two hundred and fifty dollars ($250).

(9) Each person, bank or trust company that wilfully makes or transmits a false report or refuses to submit its books, papers and assets for examination, or any officer of a bank who refuses to be examined under oath concerning the affairs of the bank, shall be severally fined not less than one hundred ($100) nor more than five hundred dollars ($500).

(10) Whenever any penalty imposed by subsections (4), (6), (7), (8), or (9) is not paid, the attorney general shall institute an action, in the name of the state, in the Franklin Circuit Court or the circuit court of the county in which the offense was committed, for the recovery of the penalty.

(11) Any person violating any of the provisions of KRS 287.225 shall be guilty of a misdemeanor and fined not less than fifty dollars ($50) nor more than two thousand dollars ($2,000).

(12) Any person who willfully makes charges in excess of those permitted by KRS 287.710 to 287.770 shall be guilty of a misdemeanor and upon conviction shall be punished by a fine not exceeding five hundred dollars ($500.00) or by imprisonment for not more than six (6) months, or both.

(13) Any bank which violates any provision of KRS 287.710 to 287.770, except as a result
regulatory agency: the Federal Deposit Insurance Corporation, the Comptroller of the Currency, the Federal Reserve, and the Kentucky Department of Banking and Securities.

Compliance with the law involves little more than fulfilling all duties and responsibilities imposed by statute or common law. The director's primary duties and responsibilities are discussed in subsequent sections.

II. MANAGEMENT OF THE BANK'S AFFAIRS

The primary responsibility of the Kentucky bank director is to manage the affairs of his bank. Both state and federal statutes specifically address this responsibility. As stated in the statute governing Kentucky corporations “[t]he business and affairs of a corporation shall be managed by a board of directors except as may be otherwise provided in the articles of incorporation.” On the federal level, the statutes governing national banks establish the responsibility by stating that “[t]he affairs of each association shall be managed by not less than five directors, . . . .” Further,

emphasis on this responsibility exists in the director’s oath. Directors of state chartered banks are required to file a written oath stating “[t]hat [they] will faithfully discharge the duties of [their] office and administer the affairs of the institution, so far as the duties of [their] office require.”41 For national bank directors, “[e]ach director, when appointed or elected, shall take an oath that he will, so far as the duty devolves on him, diligently and honestly administer the affairs of such association, . . . .”42 The national bank director’s oath is a restatement of a common law duty developed by the courts.43 This responsibility, however simply stated, is not without conflict, because liability may result if the board of directors is negligent in the performance of this responsibility. What constitutes negligent conduct in the fulfillment of this responsibility is subject to interpretation, with the ultimate decision being made by the courts.

Generally, the courts adhere to the following guidelines in evaluating performance:

1. Directors are charged with the duty of reasonable supervision over the affairs of the bank. It is their duty to use ordinary diligence in ascertaining the condition of its business, and to exercise reasonable control and supervision over its affairs.

2. They are not insurers or guarantors of the fidelity and proper conduct of the executive officers of the bank, and they are not responsible for losses resulting from their wrongful acts or omissions, provided they have exercised ordinary care in the discharge of their own duties as directors.

3. Ordinary care, in this matter as in other departments of the law, means that degree of care which ordinarily prudent and diligent men would exercise under similar circumstances.

4. The degree of care required further depends upon the subject to which it is to be applied, and each case must be determined in view of all the circumstances.

5. If nothing has come to the knowledge to awaken suspicion that something is going wrong, ordinary attention to the affairs of the institution is sufficient. If, upon the other hand, directors know, or by the exercise of ordinary care should have known, any facts which would awaken suspicion and put

a prudent man on his guard, then a degree of care commensurate with the evil to be avoided is required, and a want of that care makes them responsible. Directors cannot, in justice to those who deal with the bank, shut their eyes to what is going on around them.

(6) Directors are not expected to watch the routine of every day's business, but they ought to have a general knowledge of the manner in which the bank's business is conducted, and upon what securities its larger lines of credit are given, and generally to know of and give direction to the important and general affairs of the bank.

(7) It is incumbent upon bank directors in the exercise of ordinary prudence, and as a part of their duty of general supervision, to cause an examination of the condition and resources of the bank to be made with reasonable frequency.44 Although these rules enunciate the principles established in the previous section, they specifically address the director's responsibilities in managing the bank's affairs.

The rules provide general guidance for the director in managing the bank's affairs. The courts, legislators, and regulatory agencies have addressed selected areas more specifically. Those areas involve board delegation, bank management and the director's knowledge.

A. Board Delegation

The director, although charged with the bank's management, is not expected "to give all his time and attention to his duties as a director."45 This division of time and attention necessitates that the performance of certain board functions be delegated and generally these delegated acts bind the corporation.46 The princi-
ple of delegation has been addressed by the regulatory agencies, the legislators and the judiciary although uniformity of interpretation and application does not exist. The general rule concerning delegation, as presented in one Kentucky case, states that "in the absence of express or implied authority, the trust delegated by a principal [stockholder] to his agent [director] cannot be delegated by the latter, particularly when the performance of the agency involves the exercise of judgment or discretion." Thus express or implied authority granting the board delegative powers must exist prior to the board exercising such prudence, particularly when judgment and discretion are involved.

Statutes, regulations, charters or by-laws expressly grant or prohibit the delegation of board functions and responsibilities. Statutes and regulations have general applicability to all Kentucky banks while charters and by-laws are only applicable to the director's respective bank. Directors should refer to their respective bank's charter and by-laws for further clarification of the delegation principle as developed by their organization.

Delegation to committees of the board is permitted by the following Kentucky statute:

If the articles of incorporation or the by-laws so provide, the board of directors, by resolution adopted by a majority of the full board of directors, may designate from among its members an executive committee and one or more other committees each of which, to the extent provided in such resolution or in the articles of incorporation or the by-laws of the corporation, shall have and may exercise all the authority of the board of directors, . . . .

Thus, board delegation to committees is permitted but not required. The decision regarding such delegation is left to those having authority over the articles of incorporation or by-laws. Additionally, the extent of such delegation should be identified in the charter, by-laws or board resolutions.

Cir. 1897), aff'd, 176 U.S. 61 (1900); American Convalescent Centers of Ky., Inc. v. Daniel, 514 S.W.2d 192, 193 (1974); Reorganization Committee of Farmers Bank & Trust Co. v. Title Ins. & Trust Co., 265 Ky. 605, ___ , 97 S.W.2d 393, 395 (1936); Catlettsburg & Buchanan Tel. Co. v. Bond, 262 Ky. 106, ___ , 89 S.W.2d 859, 860 (1936); Paducah Newspapers, Inc. v. Goodman, 251 Ky. 754, ___ , 65 S.W.2d 990, 991 (1933); First Nat'l Bank v. Bryan, 215 Ky. 338, ___ , 285 S.W. 239, 240 (1926); Caddy Oil Co. v. Sommer, 186 Ky. 843, ___ , 218 S.W. 288, 290 (1920).


The law is less direct with regard to delegation by the board to management and others outside of the organization. Delegation to management and agents is permitted through a definition of the duties and authority of the officers and agents of the corporation. Their duties and authority are defined as follows:

All officers and agents of the corporation, as between themselves and the corporation, shall have such authority and perform such duties in the management of the corporation as may be provided in the bylaws, or as may be determined by resolution of the board of directors not inconsistent with the bylaws. 49

Delegation to management or agents is then left to the board or those having authority over the by-laws. The extent of such delegations should also be identified by the board or the by-laws.

Even though delegation is permitted, exceptions to the general rule do exist. Most exceptions are explicitly set forth in the statutes. Such is the case in Kentucky in reference to delegation to committees:

[But] no such committee shall have the authority of the board of directors in reference to amending the articles of incorporation, adopting a plan of merger or consolidation, recommending to the shareholders the sale, lease, exchange or other disposition of all or substantially all the property and assets of the corporation otherwise than in the usual and regular course of its business, recommending to the shareholders a voluntary dissolution of the corporation or a revocation thereof, or amending the by-laws of the corporation. 50

Specifically, the board is precluded from delegation in these areas.

The matter of dividend declaration is also exclusively a board function and therefore may not be delegated to any committee or individual. Rather than prohibiting delegation, however, the statute merely reserves this activity for the board of directors. Kentucky banking statutes provide that "[t]he board of directors of any bank or trust company organized under the laws of this state may declare a dividend of so much of the net profits as they deem expedient." 51 Similarly, the business corporation statutes state that "[t]he board of directors of a corporation may, from time

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to time, distribute to its shareholders out of capital surplus of the corporation a portion of its assets, in cash or property...."52 Two judicial decisions support this conclusion by holding this to be a board function.53

National bank directors are also granted the authority to delegate, but on a more restrictive basis. Their authority regarding delegation is primarily granted by regulation which states that the "[b]oard of [a] National bank may not delegate responsibility for duties but may assign the performance thereof."54 Unlike the Kentucky statutes, this regulation allows delegation without reference to charter, by-law or board resolution. However, delegation applies only to performance and not the responsibility for the duty. This results in the national bank director being unable to delegate board responsibilities.

Two other functions have been specifically vested with the national bank board. National banking laws state that the director must prescribe the by-laws of the corporation55 and, like state bank directors, they must also declare the dividends to be paid out of net profits, or capital surplus.56 Thus, the national bank board is specifically assigned these functions and responsibilities.

The Kentucky bank board appears to have authority to delegate the performance of all, or at least most, board functions except those specifically excluded by law. However, the authority for delegating the responsibility for performance of these functions is not uniformly applicable to state and national bank directors. The more restrictive rule holds that national bank boards may not delegate the responsibility for the performance of board functions. Kentucky law appears to be silent on this matter, however. Guidance is provided by the rules established in other jurisdictions. These rules appear to be similar to those established for national bank directors. Thus, directors retain the responsibility for that which is delegated57 and they cannot be excused from

liability because they committed some of their duties to a sub-unit of the board or to management.\footnote{58}

Generally delegation is settled to the extent that the responsibility for delegated acts has been identified. However, the identification of what functions are or are not subject to delegation has only partially been addressed. Two approaches exist for identifying these delegable functions. One approach is to list all functions and specifically indicate which may or may not be delegated. This approach requires periodic review and is generally followed by those having authority over the board. These delegable or non-delegable functions have already been identified.\footnote{59} The alternative approach is to develop a set of principles with which to evaluate all functions to determine whether they are delegable or non-delegable. The judiciary has followed this approach. The director therefore must look to both sources of authority to determine which functions may or may not be delegable.

The principles developed by the judiciary divide all board functions into two categories, those involving discretion and judgment and those not involving discretion and judgment. Presumably, those functions involving discretion and judgment are not delegable while the other functions are. However, there is a jurisdictional split on this point.

On a federal level, discretion and judgment have no impact on delegation.

It is a principle of the common law that the directors of a corporation have the power, without statutory authority, 'to delegate to officers, agents, or executive committees the power to transact not only ordinary and routine business, but business requiring the highest degree of judgment and discretion.' 13 Am. Jur., Corporations, [Sec] 969.\footnote{60}

This results in the director being able to delegate any function not specifically prohibited or addressed by some other authority.


\footnote{59. See supra notes 54-56 and accompanying text.

\footnote{60. Social Security Board v. Warren, 142 F.2d 974, 977 (8th Cir. 1944). See also Lowell Hoit & Co. v. Detig, 320 Ill. App. 179, 50 N.E.2d 602, 603 (1943); San Antonio Joint Stock Land Bank v. Taylor, 129 Tex. 335, 105 S.W.2d 650, 654 (1937).}
Thus, the judiciary on a federal level appears to be consistent with the intent of the regulation permitting national bank directors to delegate board functions while retaining the responsibility for their performance.

On the state level however, the rule appears to be somewhat different. In *Haldeman v. Haldeman* the court stated that "[t]he right of the board of directors to delegate to agents generally the transaction of the ordinary and routine business of the corporation is unquestioned, and indeed is absolutely necessary. But in matters involving discretion there are decisions to the effect that the directors cannot delegate that discretion." The point of contention was whether the board, by resolution, could delegate to an executive committee the management of the corporation's affairs. In reaching its conclusion, the court clearly distinguishes ordinary and routine business from matters involving discretion and, in so doing, gives the impression that the latter cannot be delegated.

Support for this conclusion is found in a Missouri case involving loans and discounts, which are clearly matters involving discretion and judgement. The court concluded that the making of loans and discounts cannot be delegated and held the directors by so doing, were guilty of negligence in the discharge of their duties. The retention of this function by the board is evidenced by the practice of many bank boards to approve loans recommended by a loan committee. However, in many instances this task has become routine to the point of "rubber stamping" approval. Although the loans are approved by the board, the effect may be considered delegation.

Delegation of judgmental and discretionary functions is not uniformly applied in all jurisdictions. The Kentucky director must consider delegation from two view points, that of national bank director and that of state bank director. The national bank director may delegate all functions while retaining performance responsibility. The state bank director can only delegate those functions not involving judgment and discretion while retaining performance responsibility.

Primarily delegation has been viewed thus far from the standpoint of express authority for delegative powers being granted to

62. 197 S.W. at 382.
the board or the board expressly delegating selected functions to others. In either case, delegation was expressly granted or prohibited. In addition, implied authority also exists at these two levels. The distinguishing difference is that express authority requires some action by an authoritative body, while implied authority requires no action by that body.

Implied authority is recognized by the judiciary. From the standpoint of implied board delegation to subordinates, the Supreme Court has noted:

As the executive officer of the bank [cashier], he transacts its business under the orders and supervision of the board of directors. He is their arm in the management of its financial operations. While these propositions are recognized in the adjudged cases as sound, it is clear that a banking corporation may be represented by its cashier—at least where its charter does not otherwise provide—in transactions outside of his ordinary duties, without his authority to do so being in writing, or appearing upon the record of the proceedings of the directors. His authority may be by parol and collected from circumstances. It may be inferred from the general manner in which, for a period sufficiently long to establish a settled course of business, he has been allowed, without interference, to conduct the affairs of the bank. It may be implied from the conduct or acquiescence of the corporation, as represented by the board of directors. When, during a series of years or in numerous business transactions, he has been permitted, without objection and in his official capacity, to pursue a particular course of conduct, it may be presumed, as between the bank and those who in good faith deal with it upon the basis of his authority to represent the corporation, that he has acted in conformity with instructions received from those who have the right to control its operations. 

64. Martin v. Webb, 110 U.S. 7, 14 (1884). See also Crowe v. Gary State Bank, 123 F.2d 513, 516 (7th Cir. 1941); Armstrong v. Chemical Nat'l Bank of City of N.Y., 83 F. 556, 572 (6th Cir. 1897), aff'd, 176 U.S. 618 (1900); American Convalescent Centers of Ky., Inc. v. Daniel, 514 S.W.2d 192, 193 (1974); Reorganization Committee of Farmers Bank & Trust Co. v. Title Ins. & Trust Co., 265 Ky. 605, ____, 97 S.W.2d 393, 395 (1936); Catlettsburg & Buchanan Tel. Co. v. Bond, 262 Ky. 106, ____, 89 S.W.2d 859, 860 (1936); Paducah Newspapers, Inc. v. Goodman, 251 Ky. 754, ____, 65 S.W.2d 990, 991 (1933); First Nat'l Bank v. Bryan, 215 Ky. 338, ____, 285 S.W. 239, 240 (1926); Caddy Oil Co. v. Sommer, 186 Ky. 843, ____, 218 S.W. 288, 290 (1920).
performance was not expressly granted. Therefore, the board should identify those areas where implied authority may exist and expressly grant or prohibit the activity.

The board appears to have some obligation to appoint selected committees composed of board members to perform or enhance the performance of specific board functions. This is especially true where statute, charter, or by-law provisions exist. However, the failure to appoint must be demonstrated to be the proximate cause of the loss before the board can be held responsible. Alternatively viewed, could the loss have been prevented if a functioning committee were in existence? If so, the board is responsible for the amount of loss.

There is also some indication that committee membership imposes a greater responsibility on the board member. At first this appears to be a delegation of responsibility which is consistent with the principles developed for state directors, but contrary to that of national directors. However, this is not necessarily true. The board retains the minimum responsibility while committee members assume greater responsibility. As a committee member, the board member is required to exercise greater diligence, thus he is presumed to be more informed. Therefore, the board member must be aware of the added responsibilities of committee membership and must identify the added duties so they can be fulfilled.

Although delegation is permitted under state and federal law, it should not be viewed as an "end." Delegation is not a means of fulfilling the management function, but instead is an enhancement to its fulfillment. As stated in Briggs v. Spaulding:

we hold that directors must exercise ordinary care and prudence in the administration of the affairs of a bank, and that this includes something more than officiating as figure-heads. They are entitled under the law to commit the banking business, as defined, to their duly-authorized officers, but this does not absolve them from the duty of reasonable supervision, nor ought they to be permitted to be shielded from liability because of want of knowledge of wrongdoing, if that ignorance is the result of gross inattention; . . . .

Directors cannot divest themselves of the duty of general supervision and control by committing such duties to subordinates, nor can they be excused from liability because of such a divestiture.

**B. Management**

The board should not only be concerned with delegation to management, but also the selection of management and other subordinates. The adage, "a chain is only as strong as its weakest link," is applicable. No matter how much care is exercised in fulfilling board delegation principles, such care is wasted if the delegatee is not responsible.

To begin with, it is to be assumed in every case that the directors have not selected any other than a man of good reputation for capacity and integrity. Any other idea assumes that they have been guilty at the outset of a glaring fault. Further, it is a well known fact that a large proportion of the disasters which befall banking institutions come from the malfeasance of just such men.

The board must exercise care in the selection of management since it is assumed that none other than competent, capable and honest individuals have been selected for the positions. Thus management selection policies and procedures should insure that this standard is met.

The bank's board members have a duty to be knowledgeable concerning the bank's affairs. They are to use ordinary care to ac-

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quaint themselves with the condition of the business of the bank. Presumably, a knowledgeable director has the capacity to fulfill the primary responsibility of managing the bank's affairs, while the uninformed director lacks that capacity. Thus, an active duty to inquire exists.

Generally, the director's knowledge is only questioned when some controversy arises and then proof of knowledge and ordinary care become important. The burden of proof is dependent on the parties to the controversy. When the bank is a party to the controversy, directors' knowledge is presumed to exist. This principle and the court's reasoning is presented in an early Kentucky case:

It is the duty of bank directors to use ordinary diligence to acquaint themselves with the business of the bank, and whatever information might be acquired by ordinary attention to their duties they may, in controversies with persons transacting business with the bank, be presumed to have, they can not be heard to say that they were not apprised of facts shown to exist by the ledgers, books, accounts, correspondence, reconciliations, and statements of the bank, and which would have come to their knowledge except for their gross neglect or inattention.

It is not necessary in many cases to show directly that the directors actually had their attention called to the mismanagement of the affairs of the bank, or the misconduct of the subordinate officers. It is sufficient to show that the evidences of the mismanagement or misconduct were such that it must have been brought to their knowledge unless they were grossly negligent or willfully careless in the discharge of their duties.
Thus, the burden of proving the board knowledgable is eased to the extent that one need only demonstrate the existence of the information in the ledgers, books, accounts, correspondence, reconciliations and statements of the bank, rather than prove each board member knowledgable. Such a demonstration may be sufficient to show that the directors were grossly negligent or willfully careless in the performance of their duties if ordinary care and diligence would have brought the information to their attention. The result of this demonstration is to make the bank liable for any losses that resulted from the lack of performance.

When the directors are a party to the controversy, the burden of proof shifts from the directors or bank to the plaintiff. When an action is brought against the directors to make them personally liable, the presumption of knowledge does not exist. The burden is on the plaintiff “to show a want of diligence on the part of the directors. . .”\(^\text{73}\)

The board, as well as the individual directors, may well fulfill their “duty to inquire” and demonstrate “due diligence” by establishing a formal directors' information system. Neither exceptional methods\(^\text{74}\) nor a system of espionage\(^\text{75}\) is required, but the system should be designed in such a way so as to allow for the detection of unapproved practices.\(^\text{76}\) One primary means of securing information concerning the bank’s affairs is to attend board meetings. The board meetings not only provide the director a ready source of information, but since the board is the governing power of the corporation, they can only bind the corporation when acting as a body.\(^\text{77}\) Thus, meeting attendance may be viewed as a requirement to effectively manage the bank’s affairs.

Attendance at meetings may also demonstrate due diligence and care. Nonattendance was addressed by the United States Supreme Court in \textit{Bowerman v. Hamner}:

That ordinarily prudent and diligent men, accepting election to


\(^{74}\) Cory Mann George Corp. v. Old, 23 F.2d 803, 808 (4th Cir. 1928); Warner v. Penoyer, 91 F. 587, 591 (2d Cir. 1889).

\(^{75}\) Warner v. Penoyer, 91 F. 587, 590 (2d Cir. 1889).

\(^{76}\) Brannin v. Loving, 82 Ky. 370, 373 (1884).

\(^{77}\) 12 U.S.C. § 71 (1978); Ky. REV. STAT. § 271A.175 (1981); Paducah Newspapers, Inc. v. Goodman, 251 Ky. 754, ____, 65 S.W.2d 990, 991 (1933); Caddy Oil Co. v. Sommer, 186 Ky. 843, ____, 218 S.W. 288, 290 (1920); Haldeman v. Haldeman, 176 Ky. 635, ____, 197 S.W. 376, 381 (1917).
membership in a bank directorate, would not willfully absent themselves from directors' meetings for years together as Bowerman did cannot be doubted; .... does not exercise ordinary care and prudence in the management of the affairs of the bank is equally clear, and that Bowerman, .... guilty of neglect ...., did not exercise the diligence which prudent men would usually exercise in ascertaining the condition of the business of the bank or a reasonable control and supervision over its affairs and officers is likewise beyond discussion. He cannot be shielded from liability because of want of knowledge of wrong-doing on his part, since that ignorance was the result of gross inattention in the discharge of his voluntarily assumed and sworn duty."

The responsibility of attendance arises from a common law duty as there are no statutory requirements to attend meetings. However, the rule requiring meeting attendance is not wholly rigid

78. 250 U.S. 504, 513 (1919). A more indepth analysis of the duty was presented in Briggs v. Spaulding by Justice Harlan in his dissenting opinion:

One of the breaches of duty complained of was non-attendance by committee-men or directors upon their employment. While conceding that the employment was not one affecting the government, Lord Chancellor Hardwicke said: "I take the employment of a director to be of a mixed nature; it partakes of the nature of a public office, as it arises from the charter of the crown. .... Therefore committee-men are most properly agents to those who employ them in this trust, and who empower them to direct and superintend the affairs of the corporation. In this respect they may be guilty of acts of commission or omission, of malfeasance or nonfeasance." Referring to malfeasance or nonfeasance upon the part of directors, he said: "To instance, in non-attendance; if some persons are guilty of gross non-attendance and leave the management entirely to others, they may be guilty by this means of the breaches of trust that are committed by others. By accepting of a trust of this sort, a person is obliged to execute it with fidelity and reasonable diligence; and it is no excuse to say that they had no benefit from it, but that it was merely honorary; and therefore they are within the case of common trustees. Another objection has been made, that the court can make no decree upon these persons which will be just, or it is said every man's non-attendance or omission of his duty is his own default, and that each particular person must bear just such a proportion as is suitable to the loss arising from his particular neglect, which makes it a case out of the power of the court. Now, if this doctrine should prevail, it is indeed laying the axe to the root of the tree. But if, upon inquiry before the master, there should appear to be a supine negligence in all of them, by which a gross complicated loss happens, I will never determine they are not all guilty. Nor will I ever determine that a court of equity cannot lay hold of every breach of trust, let the person be guilty of it either in a private or public capacity." So, in Land Credit Company of Dreland v. Lord Fermoy, L.R. 5 Ch. 763, 770 Lord Hatherley said: "I am exceedingly reluctant in any way to exonerate directors from performing their duty, and I quite agree that it is their duty to be awake, and that their being asleep would not exempt them from the consequences of not attending to the business of the company."

nor inflexible. For example a director is “not chargeable with neglect of duty [when]... he was physically [ill and] unable to perform.” 79 On the other hand, the distance the director resides from the meeting place has no impact on the duty. 80 Although meeting attendance will not assure the director protection from liability, it is one means of demonstrating due care and diligence in managing the bank’s affairs.

The examination process is also one means of securing information concerning the bank’s operations as well as validating the director’s information system. The directors have an active duty to examine “the books or papers of the bank to determine its condition and the way in which it is being conducted.” 81 A failure to examine is a failure to “exercise care and prudence in the management of the affairs of the bank...” 82 This responsibility effects statutory violations as well. 83 As previously discussed, there is in effect an intentional violation of the law when there is a failure to investigate for which there is a duty to investigate. 84 This duty to examine apparently cannot be discharged by relying on examinations conducted by regulatory agencies. Although no case specifically addresses this matter, it may be inferred from those cases dealing with such examinations. 85 The examinations, however, do not necessarily have to be performed by the directors. 86 The board can engage experts to conduct the examinations on its behalf.

81. Id. See also Briggs v. Spaulding, 141 U.S. 132, 159 (1891); Martin v. Webb, 110 U.S. 7, 15 (1884); Dresser v. Bates, 250 F. 525, 531 (1st Cir. 1918), modified on other grounds, 251 U.S. 524 (1920); Rankin v. Cooper, 149 F. 1010, 1013 (W.D. Ark. 1907); Warner v. Penoyer, 91 F. 587, 591 (2d Cir. 1898); Gibbons v. Anderson, 80 F. 345, 349 (W.D. Mich. 1897); Savings Bank of Louisville v. Caperton, 87 Ky. 306, 8 S.W. 865, 888 (1888).
83. See supra, note 6.
84. Thomas v. Taylor, 224 U.S. 73, 82 (1911).
Exactly what is to be examined is unclear. However, the standard for examining appears to be established by the banking industry itself. The industry standards are dependent, however, on the size of the bank. Once again the directors' banking affiliation becomes important in assessing responsibility.

These examination standards establish the minimum care to be exercised by the directors in managing the bank's affairs. However, should something transpire to arouse suspicion, a different standard applies. The new standard is appropriately stated thus:

If nothing has come to the knowledge to awaken suspicion that something is going wrong, ordinary attention to the affairs of the institution is sufficient. If, upon the other hand, directors know, or by the exercise of ordinary care should have known, any facts which would awaken suspicion and put a prudent man on his guard, then a degree of care commensurate with the evil to be avoided is required, and a want of that care makes them responsible. Directors cannot, in justice to those who deal with the bank, shut their eyes to what is going on around them.

The board therefore may establish examination standards that comply with those of the banking industry, but when their suspicion is aroused they must comply with a standard established by the evil to be avoided, rather than by the industry. Therefore, the board must evaluate the evil to be avoided in each instance so as to determine the degree of care to be exercised.

The management of the bank's affairs is an "active" rather than a "passive" board duty. The board's active role includes supervising delegated functions, selecting capable management, being knowledgeable in the bank's affairs and inquiring into all aspects of the bank's operations and management. A lesser performance may result in the director being held liable for damages.

III. LOYALTY

A directorate bestows a duty upon the individual director to be loyal to the corporation and anyone reposing confidence or trust

88. See Scott v. Young, 231 Ky. 577, 21 S.W.2d 994, 997 (1929); Warner v. Penoyer, 91 F. 587, 591 (2d Cir. 1898).
89. Rankin v. Cooper, 149 F. 1010, 1013 (W.D. Ark. 1907).
in the individual or the position.\textsuperscript{91} This duty is founded in part on the inherent fiduciary relationships of the position.\textsuperscript{92} Specifically, this duty governs the director's conduct in director-related transactions and the utilization of inside information.

Director-related transactions are those transactions that may place the director in a position of conflict. The conflict is a result of the director having to represent two parties having adverse interests. The Supreme Court has addressed this type of conflict:

It is among the rudiments of the law that the same person cannot act for himself and at the same time, with respect to the same matter, as the agent of another whose interests are conflicting. Thus a person cannot be a purchaser of property and at the same time the agent of the vendor. The two positions impose different obligations, and their union would at once raise a conflict between interest and duty; and, constituted as humanity is, in the majority of cases duty would be overborne in the struggle. \textit{Marsh v. Whitmore}, 21 Wall. 178, 183. The law, therefore, will always condemn the transactions of a party on his own behalf when, in respect to the matter concerned, he is the agent of others, and will relieve against them whenever their enforcement is seasonably resisted. Directors of corporations, and all persons who stand in a fiduciary relation to other parties, and are clothed with power to act for them, are subject to this rule; they are not permitted to occupy a position which will conflict with the interest of parties they represent and are bound to protect. They cannot, as agents or trustees, enter into or authorize contracts on behalf of those for whom they are appointed to act, and then personally participate in the benefits. \textldots \textsuperscript{93}

Directors, therefore, are precluded from sharing in the benefits of said transactions when this court-developed rule is applied. How-

\textsuperscript{91} Henkin, Inc. v. Berea Bank & Trust Co., 566 S.W.2d 420, 423 (Ky. App. 1978); Security Trust Co. v. Wilson, 307 Ky. 152, \ldots, 210 S.W.2d 336, 338 (1948); Warsofsky v. Sherman, 326 Mass. 290, 93 N.E.2d 612, 615 (1950).


ever, this court-established rule has been relaxed by both federal and state statutes.94

The Kentucky statutes provide the following guidance with respect to these type transactions:

No contract or other transaction between a corporation and one or more of its directors or any other corporation, firm, association or entity in which one or more of its directors are directors or officers or are financially interested, shall be either void or voidable solely because of such relationship or interest or because such director or directors are present at the meeting of the board of directors or a committee thereof which authorizes, approves or ratifies such contract or transaction or because his or their votes are counted for such purpose, if:

(a) The contract or transaction is not manifestly unfair to the corporation and the fact of such relationship or interest is disclosed or known to the board of directors or committee which authorizes, approves or ratifies the contract or transaction by a vote or consent sufficient for the purpose without counting the votes or consents of such interested directors; or
(b) The contract or transaction is not manifestly unfair to the corporation and the fact of such relationship or interest is disclosed or known to the shareholders entitled to vote and they authorize, approve or ratify such contract or transaction by vote or written consent; or
(c) The contract or transaction is fair and reasonable to the corporation. . . .95

Therefore, the director-related transactions are permitted so long as the transactions are fair, adequately disclosed, and approved by the shareholders. Federal statutes, however, add one additional requirement, that "the transaction must be made in the regular course of business."96 On the other hand, this statute requires only that the transaction be approved by the board rather than by the shareholders.97 The burden of proving the fairness of any transaction is upon the parties wanting to maintain the transaction.98 Should these requirements go unmet, the court-developed rule will apply.

97. Id.
The director should also be concerned with information gained in fulfilling the responsibilities of the position. Such information is considered an asset of the bank\textsuperscript{99} and the director is prevented from utilizing the information for personal gain.\textsuperscript{100} A recent case addressed inside information in the following manner:

It is well established, as a general proposition, that a person who acquires special knowledge or information by virtue of a confidential or fiduciary relationship with another is not free to exploit that knowledge or information for his own personal benefit but must account to his principal for any profits derived therefrom. (See, e.g., Byrne v. Barrett, 268 N.Y. 199, 197 N.E. 217, 100 A.L.R. 680.) This, in turn is merely a corollary of the broader principle, inherent in the nature of the fiduciary relationship, that prohibits a trustee or agent from extracting secret profits from his position of trust.\textsuperscript{101}

Therefore, any gains so derived accrue to the bank or principal.

Information gained is not solely restricted to information relating to the bank. The courts also include information which relates to bank customers. Such was the case in Henkin v. Berea Bk. & Trust Co. where a bank customer applied for a loan, and information gained through the application process was used for personal gain by a bank official. The court developed the following rule:

If the information furnished by the applicant for a loan is to be seized upon immediately by the bank official to whom it is given and if by the virtue of the information he can purchase the property behind the back of the applicant, then public confidence in such institutions will be seriously impaired if not utterly destroyed. In any error, an applicant for a loan ought not to be subjected to such risks. A bank official to whom an application for a loan is made must act fairly and impartially toward the bank and toward the applicant. He is prohibited from deriving any personal gain at the expense[s] of the applicant.\textsuperscript{102}

Therefore, all such personal gains were properly assignable to the bank's customer.

The fiduciary relationship may also have significant impact on


\textsuperscript{102} Henkin, Inc. v. Berea Bank & Trust Co., 566 S.W.2d 420, 423 (1978). See also Security Trust Co. v. Wilson, 307 Ky. 152, , 210 S.W.2d 336, 338 (1948).
directors' liability from another standpoint. Should a director possess information that would prevent damage to the bank, that director is required to present the information to the remainder of the board and other officials; the source does not have to be disclosed. 103 This requirement further emphasizes the directors' duty to be loyal to the bank.

The director must always be concerned with the "best interests" of the bank. This is especially true when the director has an interest in the transaction. However, the director is not precluded from engaging in transactions with the bank. Information gained as a result of the director's position should never be used for personal gain by the director. A failure by the director to comply with these principles may render him liable for damages suffered by the injured party.

SUMMARY

The Kentucky bank director may be affiliated with either a state or nationally chartered bank. The director's affiliation determines his responsibilities as they are defined by law. However, there exists sufficient commonality in the law governing the various categories of banks that a general theory of the Kentucky bank director's liability can be advanced. Generally, the director is obligated to comply with the law, manage the bank's affairs and be loyal to the position. A failure to fulfill these responsibilities may result in the director being liable, either civilly or criminally.

The responsibility of complying with the law includes both statutory and common law. Additionally, the director may be responsible for noncompliance committed by peers and subordinates. However, noncompliance in all situations must be intentional. Failure to investigate that which is the director's duty to investigate is considered as evidence of intentional violation. Statutory violations are determined exclusively by the standards established by the statute. Common law violations are determined by comparing actual performance to the performance of a prudent and careful person given similar conditions or circumstances. Circumstances vary, but are generally considered like those of a similar bank or similar operation in the case of individuals accused of not meeting the standard. A failure to meet the required standard is negligence which may result in a broad range of penalties being en-

forced by those to whom the duty is owed or by organizations on their behalf.

The primary responsibility of the director is to manage the bank's affairs. Although a great deal of time may be involved in fulfilling this responsibility, the director is not expected to devote full time to its accomplishment. As such, delegation becomes necessary. Delegation is permitted as long as express or implied authority exists. The degree of delegation is not clearly defined, because some functions are specifically prohibited from being delegated, where others are dependent on the amount of judgment and discretion involved. Certain other functions virtually require delegation. No matter what the degree of delegation involved, responsibility for performance is always retained at the board level with supervision a requisite. Therefore, delegation should be viewed as an enhancement to managing the bank's affairs. Success in fulfilling this responsibility also requires the director to be knowledgeable concerning the bank's affairs. Thus, it is incumbent upon the director actively to seek this knowledge. Knowledge may be gained through attendance of meetings and examinations conducted by the board or for the board and through a functioning directors' information system. This places the director in an active, rather than passive, role in managing the bank's affairs.

The director must never use his position in a self serving capacity. The director must always remain loyal to his position and to those placing trust in that position. Director related transactions must always be fair, adequately disclosed, and approved by the appropriate authoritative body. Loyalty also extends to information gained by the director as a result of his position. Information includes both that which relates to the bank and to customers of the bank. The bank's interest should always be kept above the interests of the director.

The Kentucky bank director's liability is a function of all board and individual director activities. The director should be aware of the legal responsibilities of the position and exercise the standard of care commensurate with the activity involved.
THE INVOLUNTARY ACTION DEFENSE TO A CRIMINAL INDICTMENT

by Robert C. Hauhart*

INTRODUCTION

The criminal defense of unconscious or involuntary behavior, also referred to as automatism in some legal writings, has its basis in the common law and has flourished in the United Kingdom. The United States, however, has been generally reluctant to accept and utilize the defense, although there are indications that the defense is gaining both in terms of usage, commentary, and success.© Robert C. Hauhart 1983

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The author would like to thank Dr. Altaf Merchant, M.D., a psychiatrist in private practice in Baltimore, Maryland, for several conversations regarding medical issues relating to automatism.


The Model Penal Code includes one version of such a defense, but its definition embodies some of the difficulties inherent in the general conduct of the defense. Section 2.01(1) provides that: "A person is not guilty of an offense unless his liability is based on conduct which includes a voluntary act or the omission to perform an act of which he was physically capable." More than any other single problem, it has been the failure of the code and similar statutory provisions to adequately delimit the term 'voluntary' which has created confusion and produced dissatisfaction with the automatism defense. Thus, in most instances, it has been left to case law to circumscribe the meaning of "voluntary" within increasingly precise limits. For the most part, this has become a judicial exercise in inclusion and exclusion. Undertaking the defense requires a thorough examination of the several varying categories of conduct for which the defense has been proposed. Although this case law is scattered and fragmentary, it is possible in many fact situations to develop a sound defense on grounds of involuntary conduct.

Given the nature of the involuntary action defense, it is not surprising that in its application it overlaps with the relatively common insanity defense in any of its several variations. There are, however, a series of comparisons that may be made to more effectively distinguish between the two for theoretical purposes. While in any given fact situation there are likely to be some areas of ambiguity, the existence of a majority of the factors associated with either defense in their most common manifestation may indicate which defense can be more successfully applied. This does not imply that in many fact situations it would not be proper to argue both grounds, since an attorney is ethically bound to raise any meritorious position favorable to his client. Only frivolous arguments are proscribed.¹

³. MODEL PENAL CODE § 2.01(1) (1962).
⁴. MODEL CODE OF PROFESSIONAL RESPONSIBILITY EC 7-4 and notes (1976).

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³. MODEL PENAL CODE § 2.01(1) (1962).
⁴. MODEL CODE OF PROFESSIONAL RESPONSIBILITY EC 7-4 and notes (1976).
In general, the involuntary action defense has been more successfully applied in those situations in which the unconscious behavior has occurred in "sane" or "normal" persons. Thus, part of the testimony in such cases may be from individuals who have "never known the accused to act like that before" (or since), or may be testimony regarding the "normality" of the involuntary conduct itself, as in the case of sleepwalking. The insanity defense is more often invoked when individuals with conditions of long-standing insanity are accused of a criminal act, although defenses of temporary insanity clearly do not fit within this parameter.

It is also said that the act in automatism cases must arise from some physical cause. Stating the point in this manner can be misleading unless it is added that the intent of the requirement is to indicate that the cause is \textit{external} to the individual. Thus, the 'physical' cause may embrace the involuntary ingestion of a drug, a blow to the head, or the transference or suggestion of the mens rea—as in hypnosis or coercive persuasion. Conversely, the insanity defense, which in its most common form requires the existence of some inability to know the nature and the quality of the act performed or the failure to know that the act was wrong, is usually thought to arise from some internal, psychological cause—a mental illness or mental defect. Further it may be said that the physical or external cause results in an altered, non-volitional mental state. This is merely the obverse of the first factor. It emphasizes the alteration in the state of consciousness discussed there, but it also distinguishes the quality of the state of mind in the unconscious state as compared to the insane state. Unconsciousness indicates a lack of consciousness while insanity

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6. The action described, however must putatively originate from some extra-volitional source (i.e., uncontrollable addiction, organic psychomotor seizure) and not from purely unrestrained impulsive outbursts. \textit{See} Williams, \textit{Automatism}, in \textit{ESSAYS IN CRIMINAL SCIENCE} (Mueller ed. 1961).


refers to a normal, waking consciousness that is pervaded with a
distorted, abnormal view of reality.

The duration of the unconscious state is generally less than the
Corresponding duration of the mental state in which the insanity
defense is appropriate. Sleepwalking and epileptic seizure are ap-
propriate examples. Again, the defense of temporary insanity
mitigates the importance of this factor in distinguishing certain
fact situations. The combination of factors illustrate the different
characteristics of each defense. Additionally, it may be observed
that the unconscious state causes the individual to temporarily
lose control of both his actions and his awareness of those actions.
In the case of a person in an insane state, the individual may often
remain aware of his actions but may produce a peculiar explana-
tion of the purposes of those acts.

Consistent with the first point above, the unconscious state is
generally followed by a return to the individual's 'normal' state.
For example, a sleepwalker awakens and an epileptic seizure sub-
sides. Alternatively, the insane state often persists and continues
to be demonstrated by the individual's peculiar view of reality.

Finally, both before and after the period of unconsciousness or
automatism the person is able to tell right from wrong, and is only
precluded from such determination during the criminal conduct by
his lack of awareness of his acts. In the case of an insane person,
neither volition nor awareness per se are impaired, but perception
is impaired, as well as the individual's moral and social judgment.

I. THE INVOLUNTARY CONDUCT DEFENSE IN COMMON LAW

The earliest applications of the involuntary action defense
arose, quite understandably, in the course of commonly recurring
situations. Unconsciousness arising from a physical blow to the
head or body or as a result of intoxication were both recognized in
early British common law. In both instances, the obvious require-
ment of involuntary or non-self-administered causation was pre-
scribed.

The subsequent development of the case law in British and
American jurisdictions has done little to alter the early approach
to unconsciousness resulting from physical blows. The essential

10. See 1 W. HAWKINS, A TREATISE OF THE PLEAS OF THE CROWN 2, § 6 (Reproduction
1978). See also Singh, History of the Defence of Drunkenness in English Criminal Law, 49
L. Q. REV 528 (1933).
elements of proof remain that the blow(s) must be the proximate cause of the accused's unconsciousness and that the act he is accused of must have occurred while he remained either in the state of unconsciousness or automatism. In the latter instance consciousness, but not awareness or volition, may be present. Similarly, acts done while under the influence of natural sleep (as distinct from sleepwalking) were defensible since neither awareness nor volition were present.

In contrast to British courts, American jurisdictions have expanded upon the defense available in the case of involuntary intoxication and have used this broad approach to further extend the defense of involuntary action to other areas of behavior. Presently, one may recognize four relatively distinct categories of involuntary intoxication defenses available at common law, as well as the related defense of chronic alcoholism. Cases related to involuntary intoxication are by far the most frequently recurring involuntary conduct cases and therefore deserve a substantial discussion. Additionally, many years ago the cases in the area of involuntary intoxication met many of the evidentiary and substantive questions that more exotic fact situations (such as alleged brain-washing) have more recently brought to the fore. Thus, they provide some tentative approaches to these problems.

One may begin by noting those fact situations which most nearly approach absence of culpability on the part of the accused. Involuntariness, and some degree of lack of awareness of incapacity, present the surest ground for the successful advocacy of the defense. As one attempts to extend the defense beyond its original common law bounds, one may also add the requirement that long-standing public, professional, or scientific acceptance of the causative agent (i.e., hypnotic transference) will contribute

11. See, e.g., K. v. Butterworth, [1945] 173 T.L.R. 191 ("any person, however, who, through no fault of his own, becomes unconscious while driving, for example by being struck by a stone, . . ., ought not to be liable at criminal law")
greatly to the credibility of the defense. Unsuccessful defenses in the following cases invariably delete one of these factors or fail to provide sufficient documentation of a convincing nature.

Intoxication produced by external duress or coercion presents several instances in which the use of the defense has been hampered by a lack of sufficient showing of involuntariness. In *Borland v. State*, appellant contended that prior to the complained of act, he drank whiskey which intoxicated him at the suggestion of a third person and not of his own volition. The court concluded that drinking whiskey at the request of another does not make the drinking or the drunkenness which is a result involuntary. The court went on to point out explicitly that one who drinks at the invitation or mere suggestion of another does so willfully and that one must be coerced to drink before his act or its consequences can be classified as involuntary.

To the same effect is *Perryman v. State*, an Oklahoma case which summarily stated that "... the fact that one person gives another intoxicating liquor, which he voluntarily drinks, and upon which he becomes drunk, does by no means render his intoxication involuntary." This court further implied that, based on Oklahoma law, involuntary intoxication may not be an independent ground for defense, although the court did not explicitly reach the question. The court did point out that such a defense may be merely subsumed under other related defenses.

The defense of involuntary intoxication produced by external coercion does not differ substantively from the simple defense of duress except for the intervening intoxication. Thus, it may be theorized that it was the intoxication which was coerced, but it was both the intoxication and the act which were involuntary, although for different reasons: the intoxication was involuntary due to the coercion and the act was involuntary due to the intoxica-

17. 158 Ark. 37, 249 S.W. 591 (1923).
18. Borland was tried for murder in the 1st degree and was found guilty of murder in the 2nd degree. *Id. at__*, 249 S.W. at 592.
19. *Id. at__*, 249 S.W. at 594.
20. *Id. at__*, 249 S.W. at 594.
22. *Id.*
23. *Id. at__*, 159 P. at 938.
24. *Id. at__*, 159 P. at 938.
Involuntary action defense. As can be seen, many of the cases tried to date on this theory in the United States have been particularly unconvincing.\(^{25}\)

Involuntary intoxication produced by innocent mistake or trickery by another would exonerate the accused. For example, in *Pribble v. People*,\(^ {26}\) the defendant was sentenced to a minimum of twenty years and a maximum of twenty-five years on a second degree murder charge stemming from an incident in which defendant claimed to have been drugged through trickery. The court inferred, based on an earlier Colorado case,\(^ {27}\) that temporary insanity caused by a drug administered without the knowledge of the defendant would be a complete defense to the charge of murder in the second degree.\(^ {28}\)

Intoxication unexpectedly excessive in view of the amount consumed may support a defense of involuntary intoxication. In *Kane v. United States*,\(^ {29}\) the court noted that "... one essential element of such a defense is that the actor does not know he is susceptible to intoxication grossly excessive in degree given the amount of intoxicant."\(^ {30}\) The court pointed out that the evidence in the record was insufficient to establish that the plaintiff had no knowledge of susceptibility. The court stated that his own testimony indicated that he was well aware of the fact that a modest amount of alcohol caused him to black out and to experience amnesia, and that he could not, therefore, have met the burden of the test.\(^ {31}\)

Finally, intoxication may result as an unforeseen side effect of a legitimate medical prescription. In *Perkins v. United States*,\(^ {32}\) the Fourth Circuit reviewed a case where the defendant had taken a medically prescribed dosage of chloral hydrate far in excess of that normally prescribed. Medical testimony established that extreme reactions shown by many of his bodily signs would confirm


\(^{26}\) 49 Colo. 210, 112 P. 220 (1910).

\(^{27}\) Brennan v. People, 37 Colo. 256, 86 P. 79 (1906).

\(^{28}\) 40 Colo. at \(____\), 112 P. at 221. See also, People v. Penman, 271 Ill. 82, 110 N.E. 894 (1915).

\(^{29}\) 399 F.2d 730 (9th Cir. 1968).

\(^{30}\) Id. at 737, quoting the "pathological intoxication" defense from the Model Penal Code § 2.08(4) (1962).

\(^{31}\) 399 F.2d at 737.

\(^{32}\) 228 F. 408 (4th Cir. 1915).
the probability of an excessive dosage. During a period of unconsciousness following the self-administration of the drug, the defendant had shot several people, killing one. The court stated in its jury instructions that:

A patient is not presumed to know that a physician's prescription may produce a dangerous frenzy. But he is bound to take notice of the warning appearing on a prescription... [I]f... the defendant had good reason to infer from the terms of the prescription, or the oral instructions of the physician, or from the effect of the first dose, or from all these together, that he would fall into unconsciousness from a larger dose than prescribed, then he would not be legally responsible for acts committed in a violent frenzy which he had no reason to anticipate.  

On this point Maryland has announced a similar rule. In Saldiveri v. State a 59 year-old chronic alcoholic, inebriated at the time of admission to the hospital under police detention, was given 3.75 grams of sodium amytal. Sodium amytal is one of several drugs known collectively as "truth serums", sodium pentathol probably being the most widely known. Saldiveri was accused of unnatural acts with an eight year old girl who was a patient at the same time in another wing of the hospital, while under the combined influence of both the alcohol and the sodium amytal. The court's opinion said, "it is well settled that voluntary drunkenness is generally not a defense to a crime. On the other hand, involuntary intoxication caused by the unskilled administration of a drug by a physician ordinarily constitutes a valid defense." In the instant case, however, the psychiatric testimony showed that the drug administered did not have an intoxicating effect upon the defendant.  

The Supreme Court of Minnesota has also ruled on the defense but has established slightly different elements anchoring the defense on a state of temporary insanity produced by the intoxication. In the recent case of City of Minneapolis v. Altimus, the defendant made an illegal left turn into an oncoming garbage truck.

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33. Id. at 413-14.
34. Id. at 415-16; See also State v. Rippy, 104 N.C. 752, 10 S.E. 259 (1889); Burnett v. Commonwealth, 284 S.W. 2d 654 (Ky. 1955).
35. 217 Md. 412, 143 A.2d at 70 (1958).
36. Id. at ___, 143 A.2d at 77.
37. Id. at ___, 143 A.2d at 77.
38. ___ Minn. ___ 238 N.W.2d 851 (1976).
Thereupon he immediately backed up and slowly drove away from the scene of the collision in the now badly damaged automobile. Police had observed the accident and stopped the defendant about a block from the scene. Defendant subsequently tried to escape, an altercation ensued, and one officer's nose was broken. The defendant contended at trial that he had unexpectedly lost control of himself due to the effects of valium, a drug which had recently been prescribed by his doctor. The Supreme Court of Minnesota held that involuntary intoxication, in addition to being a defense to crimes of specific intent under the exculpatory rule, is a defense to crimes that require proof of general intent or negligence. In these instances the court indicated that the defendant must prove he committed the criminal act while laboring under such defect of reason as not to know the nature of his act or that it was wrong. This is simply known as the M'Naghten Rule. In effect, the court extended the involuntary intoxication defense to cover not only crimes of specific intent but also crimes of general intent and negligence, by defining the mental state which results from the involuntary intoxication as temporary insanity. The new test set down in Altimus has been summarized as: (1) the defendant must now know, or have reason to know, that the prescribed drug is likely to have an intoxicating effect; (2) the prescribed drug, and not some other intoxicant, is in fact the cause of defendant's intoxication at the time of his alleged criminal conduct; and (3) the defendant, due to involuntary intoxication, is temporarily insane.

The above four forms of involuntary intoxication are the basis upon which new extensions of the doctrine of involuntary conduct have established, either statutorily or judicially, that a chronic tary intoxication cases, at least in one respect, is the defense of chronic alcoholism to a criminal charge. Numerous jurisdictions have established, either statutorily or judicially, that a chronic alcoholic cannot be found guilty of the 'status offense' of public intoxication. On the other hand, some jurisdictions have refused...
to accept the "involuntariness" of chronic alcoholism. The Supreme Court of the United States has upheld the essentially local nature of the criminal law in this regard. While no jurisdiction has seized the opportunity to explicitly hold that chronic alcoholism combined with present inebriation is a sufficient defense to any criminal charge, the groundwork has been established by the involuntary intoxication cases when used in conjunction with the decisions on chronic alcoholism.

In *Driver v. Hinnant*, the question was whether a chronic alcoholic, as appellant Driver confessed to be, can constitutionally be criminally convicted and sentenced for drunkenness in a public place. It was established that appellant Driver was 59 years-old; that his first conviction of public intoxication was at the age of 24; that since that time he had been convicted for the offense more than two hundred times; that for nearly two-thirds of his life he had been incarcerated for this crime; and that while at large on bail pending this appeal he had twice more been convicted of the same charge. The court, after a lengthy discussion of the disease of alcoholism, went on to hold that the state cannot stamp a chronic alcoholic as a criminal if his public display of drunkenness is involuntary as a result of the disease. The court noted that although Driver's deed objectively comprised the elements of a crime, no crime can be committed where the conduct was not actuated by an evil intent nor accompanied with a consciousness of wrong doing. In limiting the holding to the facts of the instant case, the court stated:

This conclusion does not contravene the familiar thesis that voluntary drunkenness is no excuse for crime. . . . [o]ur excusal of the chronic alcoholic from criminal prosecution is confined exclusively to those acts on his part which are compulsive as symptomatic of the disease. With respect to other behavior — not characteristic of confirmed chronic alcoholism — he would be judged as would any person not so afflicted.

The court also stated that it was not intended that the opinion should be read as prohibiting other appropriate detention, such as

44. Texas holds to the contrary and the Supreme Court of the United States has refused to extend the doctrine of Robinson v. California to chronic alcoholism at the national level.
45. 356 F.2d 761 (4th Cir. 1966).
46. *Id.* at 763.
47. *Id.* at 765.
48. *Id.* at 764.
49. *Id.*
for care and treatment, so long as it was not markedly criminal.\textsuperscript{50}

The D.C. Circuit, following the same lines as the \textit{Driver} court, reached a similar conclusion after an equally extensive discussion of alcoholism as a recognized disease in \textit{Easter v. District of Columbia}.\textsuperscript{51} The \textit{Easter} court first quoted the statutory definition that defines a chronic alcoholic as "any person who chronically and habitually uses alcoholic beverages to the extent that he has lost the power of self-control. . . ."\textsuperscript{52} That definition led the court to exclude the merely excessive—steady or spree—voluntary drinker.\textsuperscript{53} The court concluded that in the case of a chronic alcoholic, "an essential element of criminality, where personal conduct is involved is lacking. This element is referred to in the law as the criminal mind."\textsuperscript{54}

In \textit{State v. Fearon},\textsuperscript{55} a similar result was reached after the U.S. Supreme Court’s decision in \textit{Powell v. Texas}, discussed below. Specifically, the \textit{Fearon} court held that the chronic alcoholic could not be convicted under Minnesota’s statute prohibiting intoxication produced by the voluntary consumption of intoxicating liquors because the defendant’s incapacity to restrain himself from drinking alcohol made his drinking and his public intoxication involuntary.\textsuperscript{56} On the basis of the increasingly broad wording in the chronic alcoholic exception to the statutory crime of public drunkenness, it has been suggested that the traditional coerced intoxication defense should be extended to cover the situation of the chronic alcoholic who commits any other criminal offense.\textsuperscript{57} Thus, the defendant relieved of criminal liability in \textit{Fearon} for the so-called "status offense" of public intoxication could potentially be excused for a non-status specific intent crime such as murder or a general intent crime such as the assault in \textit{Altimus}. The disposition of the offender in such a case would mirror the recommendations made in the cases to date for the chronic alcoholic: non-criminalization plus detention for treatment of the disease would be mandated.\textsuperscript{58}

\begin{itemize}
\item \textsuperscript{50} Id. at 765.
\item \textsuperscript{51} 361 F.2d 50 (D.C. Cir. 1966).
\item \textsuperscript{52} Id. at 52 (quoting D.C. Code Ann. § 24-502 (1961)).
\item \textsuperscript{53} Id. at 55.
\item \textsuperscript{54} Id. at 52.
\item \textsuperscript{55} 283 Minn. 90, 166 N.W.2d 720 (1969).
\item \textsuperscript{56} Id. at 55, 166 N.W.2d at 723-26.
\item \textsuperscript{57} Case Comment, supra note 14 at 918-20.
\item \textsuperscript{58} Id.
\end{itemize}
The biggest obstacle to adopting the above approach is the U.S. Supreme Court's decision in *Powell v. Texas*. In that case appellant Powell was arrested and charged with being found in a state of public drunkenness in violation of an article of the Texas Penal Code. He was tried in Austin and found guilty which conviction was affirmed on appeal to the county court. The county court certified the following findings: (1) that chronic alcoholism is a disease which destroys the afflicted person's ability to control the constant, excessive use of alcohol; (2) a chronic alcoholic does not appear in public by his own choice and volition but under a compulsion symptomatic of the disease of chronic alcoholism; and (3) appellant herein is a chronic alcoholic who is afflicted by the disease of chronic alcoholism. The court ruled, however, as a matter of Texas law that chronic alcoholism was not a defense to the charge of public drunkenness. After granting certiorari, the United States Supreme Court affirmed the county court's decision.

Mr. Justice Marshall, writing for the majority, dismissed many of the grounds underlying the several opinions discussed above. He indicated initially that the county court's "findings" were not to be understood as traditionally recognizable findings of fact, but were instead merely premises of a syllogism intended to bring the case within the purview of *Robinson v. California*. Justice Marshall considered the trial record inadequate for this purpose, and refused to extend the principle in *Robinson*—that it was cruel and unusual punishment under the eighth amendment to convict and imprison individuals for acts which were the mere result of their addiction—to the case of the chronic alcoholic. In so doing, he stated that not only is there no agreement among medical experts as to what it means to suggest that alcoholism is a "disease" or "compulsion", but neither is there a generally known and agreed-upon effective methods of treatment or available treatment facilities. Marshall noted that the appellant, as distinguished from appellant in *Robinson*, was convicted not for being a chronic alcoholism.

60. Id. at 517.
61. Id. at 521.
62. Id. at 517-21.
63. Id. at 537.
64. Id at 521 (citing *Robinson v. California*, 370 U.S. 660 (1962)).
65. 392 U.S. at 522-27.
alcoholic, but for being in public while drunk on one particular occasion. In Marshall’s view, this did not amount to a conviction for a mere “status” offense. 65

In a concurring opinion joined by Mr. Justice Harlan, Mr. Justice Black supported Marshall’s position with three separate and distinct additional arguments. First, he recalled the long history of criminalizing public drunkenness in the United States, and reiterated the Supreme Court’s traditional unwillingness to strike portions of a state’s criminal law. 67 Second, he noted that while punishment is not treatment, it does perform a type of treatment by removing the source of the alcoholic’s difficulty, may serve some deterrent functions, and does protect the alcoholic from causing harm or being harmed. 68 Finally, he suggested that the legal decision to criminalize alcoholism does not rest upon the same grounds as the medical decisions of diagnosis and treatment, but still remains a legitimate social response to a problem of both personal and social dimensions. 69

The Supreme Court’s decision in Powell explicitly refused to announce the requested constitutional ruling that conviction for a mere “status” type offense is and will be regarded as cruel and unusual punishment under the eighth amendment. On the other hand, the ruling does not preclude individual state action that strikes sections of its own criminal law which create status offenses on other than constitutional grounds. Similarly, the decision does not preclude rulings based on state law or constitutional grounds that disavow reliance on previously enforced statutory offenses of the type found in the above cases. Thus, while Powell remains in effect, there does not appear to be a federal constitutional ground for declaring status offenses void, but the state avenues of legislative action, court construction, and state constitutional interpretation appear available to defendants.

Maryland illustrates the possibilities inherent in the Powell decision. Under the discussion of insanity, the Maryland statute distinguishes between voluntary intoxication and psychosis resulting from chronic alcoholism. It states:

Regardless of what test is applicable to determine insanity, the

66. Id. at 533-34.
67. Id. at 538-39.
68. Id. at 539.
69. Id. at 539-41.
majority distinguish between (1) the mental effect of voluntary intoxication which is the immediate result of a particular alcoholic bout, and (2) an alcoholic psychosis resulting from long and continued habits of excessive drinking. The first does not excuse responsibility for a criminal act, the second may. This statute was applied in *Parker v. State*, decided after the Supreme Court’s decision in *Powell*.

In *Parker*, appellant had been tried and convicted for murder in the first degree and robbery with a deadly weapon. Appellant’s defense in part was that he was intoxicated at the time of the commission of the crimes. In Maryland, then as now, such a defense is part of the general defense of insanity. The lower court, using phrases reminiscent of *Easter* and *Driver*, gave jury instructions that read:

> [t]he jury [are] advised that you should inquire whether the accused lacked completely the mental ability and willpower to abstain from taking the first drink on December 30, 1966. If you find that he did lack such ability and willpower and further find that after taking the first drink he further lacked the mental ability and willpower to abstain from continued drinking until he reached a state of intoxication, then under those circumstances, his ultimate intoxication would be deemed involuntary and therefore should be considered together with all other evidence in determining his sanity or insanity under the test provided by law.

On appeal, the defendant requested that the jury instruction be held in error since under the lower court’s approach the accused could not be found insane if voluntary intoxication caused or contributed to a mental disease or defect. He argued that the only issue should be whether or not he was insane at the time of the commission of the alleged crime urging that it was immaterial what contributed to an inability to appreciate the criminality of conduct or to conform conduct to the requirements of the law.

In affirming the lower court’s opinion the court on appeal discussed the broad range of issues relating to intoxication as they are understood under Maryland law. First, the court reaffirmed

72. Id. at 384.
73. Id. at 385.
both the general rule and the exculpatory rule with respect to voluntary intoxication. The court said:

[it is the established rule of law in this state that voluntary drunkenness is not a defense to crime, although whenever the actual existence of any particular motive, purpose, or intent is a necessary element to constitute any particular species or degree of crime, the trier of fact may take into consideration the fact that the accused was intoxicated at the time in determining the purpose, motive, or intent with which he committed the act."

Second, the court, in dicta, stated that although delirium tremens is a toxic temporary state which may not produce the permanent, fixed, or settled insanity generally required in cases of involuntary intoxication, such a state would exempt an accused from responsibility for criminal conduct performed while in such condition. Third, the court reaffirmed that chronic alcoholism, without a showing of insanity by whatever test was established by law, would not be sufficient justification to excuse an accused for the responsibility of his acts. Finally, the court agreed with the lower court's view that under the Maryland statute involuntary intoxication which results in a substantial incapacity to distinguish right from wrong or to conform one's behavior to the standards of the law may be deemed by the trier of fact to constitute legal insanity.

Generally, the rule remains that involuntary intoxication factually established to the satisfaction of the jury is a complete defense to a criminal charge. In some states this has been codified; in other states it is set out judicially. Similarly, the more progressive jurisdictions have established that chronic alcoholism or drug addiction alone constitute complete defenses to the status crimes of being in a drunken or addicted state, whether in private or public. There is also a trend to excuse persons in the

74. Id.
75. Id. at 388.
76. Id. at 389.
77. Under the facts of the instant case, however, Parker was determined to be sane and legally responsible. Id. at 390. Accord, Michael v. State, 1 Md. App. 243, 229 A.2d 145 (1967); Dubs v. State, 2 Md. App. 524, 235 A.2d 764 (1967) (as to all or parts of Parker decision).
78. See, e.g. CAL. PENAL CODE § 26 (West 1970).
79. See, e.g. Pribble v. People, supra note 26; Kane v. United States, supra note 29; Perkins v. United States, supra note 32.
80. See, supra notes 45 and 46.
throes of delirium tremens or chronic alcoholic psychosis who are also found to have been insane at the time that they are alleged to have committed criminal acts.\textsuperscript{81}

Finally, the law has consistently and continuously refused to accept the state of voluntary intoxication as a defense. As this has been a recent ground of attack for defense counsel, particularly in those jurisdictions which have liberalized many related sections of the criminal law as discussed above, it is useful to briefly review some of the courts' responses to the defense of voluntary intoxication.

In \textit{People v. Baker},\textsuperscript{82} defendant had been charged with murdering his wife. The accused claimed that he was unconscious and had acted under the twin effects of the aftermath of an epileptic seizure and a voluntary overdose of prescribed medication which caused him to be intoxicated.\textsuperscript{83} The court concluded that although voluntary intoxication may at times amount to unconsciousness, as a matter of law it can only have the effect of negating specific intent.\textsuperscript{84} The court further stated that in the present case there was ample evidence of voluntary intoxication, and there was further evidence that defendant was in the unconscious state as a result of the 'clouded mental condition' produced by an epileptic attack, but that the two situations were not equivalent at law. The court held that defendant's complete defense of unconsciousness was entirely separate from his partial defense based upon voluntary intoxication, and that voluntary intoxication could not be held to be a complete defense to a criminal act.\textsuperscript{85}

Twelve years later in \textit{People v. Conley},\textsuperscript{86} defendant was charged with the first degree murders of Clifton and Elaine McCool who lived next door to defendant's sister. Defendant had been romantically involved with Elaine McCool, but had been told earlier on the day of the killings that she intended to return to her husband. Defendant had been taking medication for a back injured at work which, combined with excessive amounts of alcohol over

\textsuperscript{81} See, e.g., Parker v. State, 7 Md. App. 167, 254 A.2d 381 (1969) (Chronic alcoholic who was also found to be temporarily legally insane under \textit{M'naughten} test would not be criminally responsible for acts committed under such a state.)

\textsuperscript{82} 42 Cal. 2d 630, 268 P.2d 705 (1954).

\textsuperscript{83} Id. at \textsuperscript{81}, 268 P.2d at 708-13.

\textsuperscript{84} Id. at \textsuperscript{82}, 268 P.2d at 720.

\textsuperscript{85} Id.

\textsuperscript{86} 64 Cal. 2d 310, 411 P.2d, 911, 49 Cal. Rptr. 815 (1966).
the past three days, created the state of unconsciousness and intoxication relied upon as a defense. The court reiterated the traditional doctrine that unconsciousness is ordinarily a complete defense to a criminal charge, but voluntary intoxication is not. In reference to the instant case, the court noted that while defendant introduced evidence of intoxication and mental illness and further testified that he had no recollection of the shootings and did not at any time intend to kill the McCools, defendant's voluntary intoxication could not erase his responsibility for the acts. This does not mean, however, that defendant's evidence on these points is of no value. As the court pointed out, it is a long-standing doctrine of California criminal law that evidence of diminished capacity, whether caused by intoxication, trauma, or disease, can be used to show that a defendant did not have a specific mental state essential to commit a particular offense. Thus, implicit in the defense of voluntary intoxication is the basis for the defense of diminished capacity. The jury could well reject the claim of complete unconsciousness which would absolve defendant of all responsibility for the shootings and yet believe that the evidence introduced was sufficient to indicate that defendant's mental capacity was substantially diminished. Similarly, the jury could disbelieve all of defendant's evidence and hold him guilty as charged.

Later decisions, both in California and elsewhere, follow the same approach as Baker and Conley. There appears to be little tendency toward extending the involuntary action defense to fact situations in which the defendant has acted affirmatively in producing his intoxicated state with knowledge of the possible effects.

II. OTHER INVOLUNTARY BEHAVIORS AS CRIMINAL DEFENSES

The principles established at early common law for a defense based upon involuntary acts committed as a result of physical trauma or intoxication have been extended to cover related uncon-
scious and involuntary behaviors as proper fact situations have been presented to the courts. Consistent with the common law approaches, the defense continues to be most successfully applied in situations in which an absence of culpability on the part of the defendant establishes complete unconsciousness or involuntariness of a high degree and widespread public and scientific acceptance of the alleged precipitating agent or condition is shown.

The involuntary action defense has been successfully used in the case of somnambulism, commonly referred to as sleepwalking, but also termed somnolentia in some scientific contexts. The earliest American case documented, and the case most often cited in this area, is *Fain v. Commonwealth.* Appellant and a friend, Welch, went to the Veranda Hotel in Nicholasville, Kentucky in February, 1879. According to witnesses, both sat down in the public room and went to sleep. Welch awoke late in the evening and asked the porter for a bed for himself and Appellant. Welch handed the porter a bill for payment, then unsuccessfully attempted to wake Appellant. Welch told the porter to awaken Appellant but the porter was equally unsuccessful. Welch informed the porter that Appellant was hard to awaken and told him to keep trying. The porter then shook Appellant harder and harder until Appellant looked up and asked what the porter wanted. The porter responded that he wanted Appellant to go to bed since it was late. Appellant said he would not and told the porter to go away and leave him alone. The porter said again that it was late, that he wanted to close up the lobby, and that Appellant should go to bed. At this point Appellant was either lifted up by the porter or raised up on his own strength and threw his hand to his side as if to draw a weapon. A bystander said “Don’t shoot!” Without noticing or giving any sign that he had heard, Appellant drew his pistol and fired three times. The porter fell upon Appellant and grappled with him to keep him from firing again. While Appellant was being held to the ground he hollered very loudly two or three times, calling for Welch’s aid. He asked the porter to let him up, to which the porter responded that he would not because he did not want to be shot again. Appellant said he would not shoot, whereupon the porter released him. Upon standing, the Appellant went out of the room with his pistol still in his hand. He appeared frightened and said to a witness, “Take my pistol and defend me.”

92. 78 Ky. 183 (1879).
He said he might have shot someone but he did not know who or why. When told who it was he expressed regret.\textsuperscript{93}

At the trial, Appellant offered to prove that he had been a sleepwalker since infancy and that he had to be watched over to prevent injury to himself. As a child he was put to sleep in a lower room near one of his parents with a servant man to watch over him. When aroused from sleep, he would appear frightened and attempt to resist as if he were being violently assaulted. For some minutes after such an episode he seemed unconscious of what he did or what went on around him. Appellant also offered medical evidence on unconsciousness resulting from sleepwalking. The trial court refused to receive the evidence.\textsuperscript{94} In ruling on appellant's preferred defense, Justice Cofer said:

It is one of the fundamental principles of the criminal law that there can be no criminality in the absence of criminal intention; and when we ascertain from medical experts or otherwise that there is such a thing in nature as somnolentia or somnambulism... the evidence must be admitted. If, as claimed, the appellant was unconscious when he fired the first shot, it cannot be imputed to him as a crime.\textsuperscript{95}

A later case from the same jurisdiction appears to have muddled the rather clear-cut doctrine laid down in \textit{Fain}. In \textit{Tibbs v. Commonwealth},\textsuperscript{96} Justice Clay dismissed appellant's claim that he had not been afforded the opportunity to present an involuntary action defense based on sleepwalking. Justice Clay said:

[c]omplaint is made of the fact that the court submitted to the jury the question of appellant's insanity. Some evidence was admitted at the trial tending to show that appellant was a somnambulist, and while in this state was without self-control, and committed acts of which he had no recollection. We fail to see how these facts would constitute any defense other than that embraced in a plea of insanity.\textsuperscript{97}

The case was ultimately reversed for reconsideration on other grounds.\textsuperscript{98} This result foreclosed consideration of whether the

\textsuperscript{93} \textit{Id.} at 184-85.
\textsuperscript{94} \textit{Id.} at 185-86.
\textsuperscript{95} \textit{Id.} at 188-89.
\textsuperscript{96} 138 Ky. 558, 128 S.W. 871 (1910).
\textsuperscript{97} \textit{Id.} at 567, 128 S.W. at 874.
\textsuperscript{98} \textit{Id.}
above language should lead one to infer that somnambulism should not be viewed as a complete defense, but rather merely a form of the insanity defense that might ultimately result in commitment.

Application of the involuntary conduct defense to persons who act under the influence of epileptic attacks has produced mixed results. In *People v. Eckert*, the indictment accused the defendant of having caused the death of Dorothy Ann Sager as a result of having lost control of an automobile he was driving when he lost consciousness during an epileptic seizure. It was also set out in the opinion that defendant had prior knowledge that he was subject to such seizures which struck without warning from time to time. On the basis of these facts, the court concluded,

> [T]his conduct arises when the actor has knowledge of the highly dangerous nature of his actions or knowledge of such facts as under the circumstances would disclose to a reasonable man the dangerous character of his action, and despite this knowledge he so acts. . . . These limitations preclude successful prosecution simply upon a showing that a driver killed another while his car was out of control due to a blackout resulting from one of the numerous diseases or afflictions which may cause such a blackout.

Thus, in this instance, it appears that a public safety consideration overshadowed the involuntary nature of the epileptic state. The combination of prior knowledge and dangerous circumstances distinguish this case from the following.

In *People v. Grant*, defendant was a patron at a tavern in the city of Lincoln, Illinois where he consumed four whiskey-and-cola drinks during a two and a half hour period. The defendant then witnessed an altercation between another patron and the tavern owner. The Lincoln police were called to the scene and they forcibly escorted the other patron outside where he continued to resist arrest. A hostile crowd of approximately forty persons accompanied the police and patron as they left the tavern and approached the officers' automobile. The crowd was cheering for the patron. Suddenly, the defendant, who up until that point had merely been a member of the crowd, burst to the front, striking Officer Vonderache twice in the face. Thereafter, Officer Yarcko placed the defendant under arrest and forcibly led him to the of-

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100. Id. at 128-31, 138 N.E.2d at 796-98, 157 N.Y.S. 2d at 553-56.
ficers' automobile. Yarcko testified that the defendant was very upset and that great force was required to place the defendant in the automobile. Another officer, Monroe, testified that the defendant was excited, agitated and upset. He also confirmed that defendant had not been involved in the altercation prior to his attack on Vonderache. The defendant was transported to the Logan County jail and placed in a cell. Approximately one hour after being arrested, one of the jailers discovered the defendant lying on his cot gasping for breath. Defendant's eyes were fixed and his back formed a rigid reversed arch, typical symptoms of a grand mal seizure. The defendant was immediately transported to a Lincoln hospital by the Lincoln Fire Department. 102

At trial, medical evidence of the defendant's past history of psychomotor seizures was offered. It was rejected by the trial court and on appeal the court said,

Accordingly, we hold that the interests of justice require reversal of the defendant's convictions because the jury instructions are substantially defective in that they do not contain an instruction on the defense of involuntary conduct. ... Thus, the jury, on remand may determine that the defendant attacked Officer Vonderache while in a state of automatism, but that he nevertheless committed an offense for which he is criminally responsible if he had prior notice of his susceptibility to engage in violent involuntary conduct brought on by drinking alcoholic beverages or by some other conscious causal behavior. 103

From Eckert and Grant it is possible to infer that, at least in the case of the epileptic, prior knowledge of the incapacitating condition plus either dangerous conditions or some voluntary precipitating act on the part of the accused may mitigate the success of the involuntary conduct defense. A handful of other epilepsy cases exist, riddled with confused doctrine and burdened with unusual fact patterns. 104

The issue of whether acts committed while in a diabetic coma should be considered involuntary conduct and therefore excusable

102. Id. at 126-27, 360 N.E.2d at 812, 4 Ill. Dec. at ___.
103. Id. at 131-32, 360 N.E.2d at 815, 4 Ill. Dec. at ___.
at law was presented in *Corder v. Commonwealth*. Corder, 63 years-old at the time of the offense, drove to Tennessee with a friend, Perkins, and drank some beer. Sometime between seven and eight o'clock at night Corder entered the store of Leonard Matthews in Pine Knot, Kentucky. According to Matthews, Corder asked where he was, although he had lived within a few miles of Pine Knot for most of his life. Matthews, who had known Corder for many years, testified that he did not act normal, and that "he acted like he was drunk or something wrong with him." He also noted that Corder's pistol was not in his holster.

The next morning, Corder went to the home of the sheriff and told him that he had had some trouble with Perkins the previous evening, in the course of which he fired two shots, and that Perkins may have been killed. Corder took him to Pine Knot where he pointed out the car in front of the store. When the body was removed from the car Corder said that he learned for the first time that the body was not that of Perkins but that of Arthur Herbert Smith. The car belonged to Smith's family. Corder was not acquainted with the deceased and had never had any trouble with him or any member of the family.

It was certified at the trial that Corder had an acknowledged diabetic condition and that for as long as a year before the incident had been considered permanently and totally disabled by the Veterans' Administration. Dr. Haley examined Corder five days after the incident and found his diabetic condition so advanced that he testified that he had never encountered such a condition without it being accompanied by complete unconsciousness. Although Corder had known that diabetes was one of several disabling conditions from which he suffered, he was not taking any treatment for the condition at the time of the incident. After this examination Corder was sent to a hospital where insulin in high dosage was prescribed for his diabetes.

The court on appeal spent a lengthy portion of its opinion discussing the involuntary action defense. First, it re-affirmed the availability of an unconsciousness defense in Kentucky. Second,

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105. 278 S.W.2d 77 (Ky. 1955).
106. *Id.* at 78.
107. *Id.*
108. *Id.* at 78-79.
109. *Id.* at 79, (citing Smith v. Commonwealth, 268 S.W.2d 937 (Ky. 1954)) (subject of "blackouts" of unknown origin, while driving an automobile, killed pedestrian).
it reviewed the evidence tending to substantiate that Corder's insane or unconscious condition was caused by a diabetic coma. In this regard, the court found the evidence unconvincing, stating that while there was some evidence both before and after the incident which might lead one to believe that Corder was so afflicted, that "there is not a shred of evidence in the record that at the time the offense was committed, Corder was without sufficient reason to know the nature and quality of his act or had not sufficient reason to know right from wrong." The court concluded that, under the facts of the case, it was not error to refuse instructions on either insanity or unconsciousness.

The use of the involuntary action defense in the case of amnesia appears to depend upon a showing very similar to that required in diabetic coma; it must be shown that the amnesia had an effect upon the defendant's mind that would allow the defendant to meet the test of insanity. In Thomas v. State defendant was accused of committing criminal acts of which he claimed he was not aware of at the time or able to remember later. The court accepted as authoritative the discussion of amnesia in Attorney's Textbook of Medicine which averred that, "Amnesia, loss of memory, may lead to crimes entirely unknown to the culprit at a later date. That is rare. More frequently, an accused, remembering full well what he has done, alleges amnesia in false defense." The text suggested that instead of accepting amnesia as a complete defense, it may be relevant to the insanity defense, although failure to remember later is in itself no proof of the mental condition when the crime was performed. The court concluded that, "... amnesia, in and of itself, is no defense to a criminal charge unless it is shown by competent evidence that the accused did not know the nature and quality of his action and that it was wrong."

Other cases in which amnesia has been asserted as a defense to crime are to the same effect, although one may again observe that

10. 278 S.W.2d at 79.
11. 301 S.W.2d at 358 (Tenn. 1957).
12. Defendant took a car with its key left in the ignition. Within an hour he wrecked the car and was seriously injured. His only defense was that he was drunk and had amnesia at the time of the incident. For some days prior thereto he had been drinking and uncontradicted testimony, tended to show he had a changed mental condition, diagnosed by a physician as retrograde amnesia. Id. at 361.
14. Id.
many of the fact patterns present circumstances and conduct that are less than wholly credible.116 Where amnesia has been introduced as a defense, the accused has been accorded instructions on all degrees of homicide due to the mitigating nature of probative evidence of a lack of awareness and intent.117 Further, amnesia has been established as a factor that may preclude a finding of competency to stand trial.117

Several arguments analogous to the conditions required in the case of amnesia have been proposed, but few have received a hearing on anything resembling meritorious facts. In a 1981 law review article, Wallach and Rubin vigorously argued for the adoption of a defense based upon the psychological impairment experienced by some women in the time period immediately preceding menstruation.118 The condition, termed premenstrual syndrome, is alleged by the authors to be one of the most common disorders of women, the result of physiological changes in the woman's body just before and during the menstrual period. The article presents evidence that women have substantially higher numbers of admissions to mental hospitals, as well as higher accident and suicide rates, during that time period. Similar evidence with respect to the commission of violent crimes in general is offered.119 The authors suggest that the most appropriate designation for such a defense would be under the general heading of the insanity defense, although unconsciousness and mitigation are also discussed.120 To date, there have not been any rulings on the

120. Id. at 233-90.
defense nor has there been continued literary interest or discussion. Evidence that might either confirm or deny the trends Wallach and Rubin point to has not been readily forthcoming. For now, this would appear to be an untested and relatively novel area of the law.

In a like manner, hypnosis presents difficult problems of substantiation, acceptance, and criminal proof. The more apparent problems are displayed in the case of People v. Marsh. In Marsh, appellant was charged with escape from the Institution for men at Chino, California in violation of that state's criminal code. At trial it was stipulated that appellant had left the prison without permission and traveled to Los Angeles where he was apprehended the next day. Further facts in dispute were developed by appellant's defense.

Appellant's sole defense was that his escape was not under his own volition but was caused by a hypnotic suggestion made by a fellow inmate, Jack Cox. Cox testified that he had obtained his knowledge of hypnosis from books and had hypnotized hundreds of persons including appellant. He further testified that on the night of appellant's escape he had hypnotized appellant and suggested to him while in a trance that he 'go back where he ... was having a good time.' Cox explained that he only intended to induce 'age regression' with this suggestion but evidently appellant interpreted it to mean that he leave prison and return to someplace he found congenial prior to his confinement. Cox went on to testify that he became worried later when he could not find appellant and that his own absence without permission from the prison was to find appellant. Finally, Cox testified that he had no knowledge of appellant's whereabouts but that he decided to travel to where he knew that appellant had previously resided, that he found appellant there, brought him out of a trance, and then shortly thereafter he and appellant were apprehended drinking coffee in a restaurant. Three other prisoners of the institution testified that they had seen Cox hypnotize various persons, including the appellant. Appellant's testimony in his own behalf corroborated Cox's testimony, although he did admit to changing into civilian clothes from his prison garb while absent and that he had read an article about hypnosis in the Reader's Digest.

122. Id. at ___, 338 P.2d at 496.
123. Id. at ___, 338 P.2d at 496-97.
A psychiatrist appointed by the court as an expert witness for the defense testified that while a person under a hypnotic trance may be ordered to perform simple and specific acts, no one could be forced to perform an act contrary to one's basic nature. She further testified that a hypnotist must have a rather forceful personality and that the best subjects for hypnosis are weak, suggestible, compliant, peaceful personalities. She stated that in her opinion neither Cox nor appellant were ideally suited for their roles. Finally, she suggested that Cox's alleged instruction was insufficient to bring about the subsequent actions of appellant. More damaging may have been the fact that several prosecution witnesses impeached portions of both Cox's and appellant's stories in several details.

In reviewing the record, the court concluded:

Appellant's sole defense was that this escape was performed involuntarily while he was in a hypnotic trance. Without ruling on its validity as negating a conscious or volitional act, a reading of the entire record makes it clear that appellant was given a full and fair opportunity to present such a defense and the jury was properly instructed on it. That the jury disbelieved appellant's contentions is manifest and there is ample evidence to support the verdict.

Once again, the above opinion indicates that the court's position on a defense of involuntariness as a result of hypnotic trance is not unequivocally clear. On the one hand, it was presented and admitted as the sole defense in a tribunal in California. Alternatively, the appeals court stated but refused to answer the question of whether such a defense was legitimate. Finally, the credibility of two witnesses and the incredibile nature of the evidence presented mitigated against obtaining a favorable view of the general validity of the defense. These problems do not even touch upon the difficult evidentiary problems which might arise under a different set of facts. Like amnesia and pre-menstrual syndrome, proving to a lay jury the validity of hypnosis, or in the next instance, brainwashing, discussed below, can be a difficult defense burden.

124. *Id.* at ____., 338 P.2d at 497.
125. *Id.* at ____., 338 P.2d at 497.
126. *Id.* at ____., 338 P.2d at 498.
127. This is made unequivocally clear in the Model Penal Code in which "conduct during hypnosis or resulting from hypnotic suggestion" is specifically stated as one of four general conditions that do not constitute voluntary acts under the code's definition. *Model Penal Code* § 2.01 (1962). See also *Comment*, supra note 13.
Coercive persuasion, or more commonly known as brainwashing, is a post-World War II phenomenon first attributed to China. The term “brainwashing” was first used by an American journalist writing during the early cold war years and it is a literal translation of the Chinese characters which purportedly referred to a Chinese method of forced mind control. It is generally defined now as a form of forced attitude change which may effect behavior and is achieved through a combination of both positive and negative reinforcement techniques. Several approaches to constructing a criminal defense based upon coercive persuasion have been proposed.

According to one author, the essence of thought reform with respect to criminal law is substantially the same as the involuntary hypnosis described in Marsh, discussed above. It may be defined as the transfer of mens rea from one party to another so that no volition may be imputed to the ultimate actor. The difficulty lies in establishing when the application of the transferred mens rea defense is appropriate. A second commentator suggests that three elements must be shown: (1) that coercive persuasion actually occurred; (2) that the defendant's unlawful action was the proximate result of the coercive persuasion; and (3) that exculpation for the act committed is morally justified. As in the case of hypnosis, however, the real difficulty is in showing to the satisfaction of a court and jury that these elements existed in a particular set of facts.

This problem does not appear any more insoluble than similar problems of proof encountered in numerous situations. While it may not be possible to reduce the process to a precise set of necessary and sufficient conditions, factors may be enumerated as a guide toward the proper application of such a defense. The following factors have been suggested.

128. See E. HUNTER, BRAINWASHING IN RED CHINA (1951).
129. The first reference to 'brainwashing' in a criminal case may be found in People v. Otis, 174 Cal. App. 2d. 119, 344 P.2d. 342 (1959), where it was used as a contrast to behavior voluntarily performed. There does not appear to be a single definition that is authoritatively accepted. The definition used here is a general, non-technical definition proposed in Comment, Brainwashing: Fact, Fiction and Criminal Defense, 44 UMKC L. REV. 438 (1975-76). See also United States v. Hearst, 412 F. Supp. 873 (N.D. Cal. 1976).
130. See Comment, supra note 129.
133. Delgado, supra note 130, at 19-21.
First, the defendant's mental state must result from unusual or abnormal influences, such as drugs, hypnosis, prolonged confinements, physiological depletion, physical torture, and the deliberate manipulation of guilt, terror, and anxiety. This element may be justified as coerced participation by the above and does not constitute a legitimate mechanism of attitudinal change. It would not be difficult to argue that they constitute unwarranted instances of cruel and accepted breaches of the criminal law.¹³⁴

Second, an obvious corollary of the first requirement is that the state is imposed upon the subject rather than self-induced or voluntarily chosen. Here, proof of resistance, deception, and acquiescence would be warranted. Cases on either side readily come to mind. Prisoners of war, such as the crew of the captured U.S.S. Pueblo, have generally resisted coercive persuasion techniques more successfully than other groups. To the contrary, adherents to religious cults appear to have voluntarily elected to undergo a lengthy process of initiation and indoctrination to become a member of the group.¹³⁵ Psychologically, the difference is crucial.

Third, the induced mental state must represent a clear and significant departure from the individual's previously expressed mode of thinking. An impartial criterion here is the extent of the change and the time period over which the change occurred. The more gradual the change, the more likely it is that the change may be more aptly characterized as the product of education, maturation, or other socio-psychological processes which do not require exculpation. The time criterion cannot be stringently applied, however. It may be more correctly stated that whenever a criminal defendant's state of mind may be shown to be implanted, inauthentic, or simply not of his own choosing, the requirements for this factor have been met.¹³⁶

Fourth, it is suggested that the criminal acts must benefit the captors and not the accused. It is contended that such a showing would further indicate the presence of an abnormal influence.¹³⁷

Fifth, it must be shown that the actor, when informed of the

¹³⁴ Id. at 19-20.
¹³⁵ Id. at 20. See also Delgado, infra note 140.
¹³⁶ Inauthenticity may be evidenced by a number of observable personality and physical features such as reduction of affect as exhibited by monotonous speech patterns and voice inflection, rigid, frozen facial features, lethargy, etc. Delgado, supra, note 131, at 20-21.
¹³⁷ Id. at 21.
manner in which he came to hold his beliefs and act as he did, rejects that mode of thinking as inauthentic or foreign. This criterion presents some difficulty if his rejection is merely based upon some form of inculcation, regardless of how well-meaning, that is simply the reverse of the process most recently experienced. Thus, some standard of spontaneity and genuineness—however ephemeral—might be the actual test once the person is acquainted with the facts of his attitude change. 138

Another approach to the preparation of a defense based on brainwashing has been to examine the presently available defenses in the law and place the thought reform defense within the existing legal framework. Insanity, while broad enough to include an individual like the victim of the thought reform process, is not appropriate given that attitude change of an involuntary nature can exist separate and apart from any accompanying symptoms of mental illness. In fact, a person who has “successfully” undergone a process of thought reform would display an awareness of his acts and their consequences, and the ability to distinguish right from wrong, except for the newly acquired social or political attitudes rationalizing his conduct. 139

As one of the elementary requirements of the criminal law is voluntariness, and one of the essential characteristics of a brainwashed actor is his lack of volition, 140 this author is also favorable to invoking some form of the involuntary conduct defense in the case of coercive persuasion. In particular, it is suggested that a brainwashed actor may come within one of the standards of the Model Penal Code, either the “unconsciousness” designation of subsection 2(b), the hypnotic trance subsection 2(c), or the general catch-all category of “a bodily movement that otherwise is not a product of the effort or determination of the actor, either conscious or habitual”, subsection 2(d). 141

Several problems are inherent in this approach. First, a general criticism has been lodged against some code sections because of their use of undefined or ill-defined terms. 142 Consciousness (and

138. Id. at 21-22.
141. See Comment, supra note 130 at 475-78.
142. See, e.g., id at 438.
unconsciousness) is not defined. The Comments specifically avoid the issue, referring the determination to the individual jurisdictions. Second, the Comments to category 2(d) indicate that this wording is to be restricted to marginal cases which fall outside the Restatement definition of “act”. Thus, presumably the focus is on the actus reus and not on the mens rea of the brainwashed victim.\textsuperscript{143} A response to this objection has been proposed which separates the defense into parts corresponding to the elementary requirements of a (1) criminal intent and (2) a voluntary act. Under this formulation it is argued that there are two possible bases for an involuntary conduct defense. Under the intent analysis, one would argue that defendant’s actions were automatic as a result of a lack of consciousness on the part of the accused. Therefore, he lacked awareness of his acts and could not have formed the requisite intent, whether general or specific. In the case of the “act” analysis, it is argued that while the automatistic individual has committed an act, there was no will or volition, and therefore no criminal act has occurred because of the requirements of voluntariness. This actus reus argument essentially erases the second criticism raised above since the involuntary “act” would not be a result of the “determination of the actor”.\textsuperscript{144} In sum, one may note that a successful brainwashing defense using either theory has yet to be raised.

III. THE BURDEN OF PROOF

Two opposing views have been proposed regarding who should bear the burden of proof in a case in which the involuntary conduct defense is raised. Different jurisdictions have on occasion adopted different rules,\textsuperscript{145} different courts sitting at different times within the same jurisdiction have adopted different standards.\textsuperscript{146} Some courts have evaded the issue by ruling on other

\textsuperscript{143} Id. at 475-76.


\textsuperscript{145} North Carolina and California appear to have ultimately settled on different standards. See State v. Caddell, 287 N.C. 266, 215 S.E.2d 348 (1975); People v. Hardy, 33 Cal. 2d 52, 198 P.2d 865 (1948).

\textsuperscript{146} California cases have adopted both views. See People v. Nihill, 144 Cal. 200, 77 P. 916 (1904) (first view) and People v. Hardy, 33 Cal.2d 52, 198 P.2d 865 (1948). Failure of the state to meet its burden is discussed in People v. Sedeno, 19 Cal.3d 703, 518 P.2d 913, 112 Cal. Rptr. 1 (1974).
grounds. As in every other phase of discussion of the involuntary action defense, the paucity of cases which have confronted the issue, the divergent and variable fact situations encountered in these cases, and the confusion induced by the courts' parallel discussions of the insanity defense do not create consistency and continuity in the law.

The two approaches to the question of placing the burden are set out in State v. Caddell. On the one hand, men are presumed to be conscious when they act as if they were conscious, and if the accused argues that things were not what they seemed, it is his obligation to impart that knowledge to the trier of fact by some affirmative proof. The standard in this view would be that the accused must establish his defense by a preponderance of the evidence. In the alternative view, once the accused has introduced substantial evidence of unconsciousness, the ultimate burden of proving consciousness rests upon the prosecution since an element of the state's prima facie case is the presence of mens rea at the time of the act. In this view the state would need to prove its case beyond a reasonable doubt.

The Caddell case, a landmark case in North Carolina, overruled State v. Mercer where it was said, "unconsciousness is never an affirmative defense [to a criminal charge]." Caddell held: (1) unconsciousness or automatism is a complete defense to a criminal charge, separate and apart from the defense of insanity; (2) that it is by nature an affirmative defense; and (3) therefore the burden rests on the accused to establish his defense to the satisfaction of the jury, unless it arises out of the State's own presentation of the evidence. Thus, North Carolina adopts the first standard.

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149. This is the North Carolina view based upon Caddell 287 N.C. 266, 215 S.E.2d 348 (1975).
150. This is the California standard expressed in Hardy, 33 Cal.2d 52, 198 P.2d 865 (1948).
151. One author asks, "Should a person who . . . voluntarily takes a drug with knowledge of the potentially disabling and disorienting effects on the mind, be completely acquitted of a crime on the ground of insanity because at the time of the act he could not distinguish right from wrong?" Hasse, Drug Intoxication and Criminal Responsibility: Old Dilemmas and a New Proposal, 16 SANTA CLARA L. REV. 249, 250 (1975-76). The burden of proof issue is as important a part of a criminal defense as affirmative defenses and mitigation.
153. Id. at ___, 165 S.E.2d at 335.
154. 287 N.C. at ___, 215 S.E.2d at 363.
accepted the second view. Maryland, as discussed below, has not ruled on the issue with respect to the involuntary action defense.

In Saldiveri v. State,\textsuperscript{155} discussed above with reference to involuntary intoxication as an unintended side effect of a medical prescription, the Maryland court characterized the burden-of-proof issue in the following terms. First, because the involuntary action defense has only been discussed throughout the case as a subset of the insanity defense, this posture is maintained. Next, the court sets out two alternative views similar, if not identical, to those expressed above. In the first view, the accused is required to establish his defense of (insanity) by a preponderance of the evidence. In the second view, the accused is required to produce only enough evidence of a mental disorder to overcome the presumption of sanity, and when this has been done, the state is required to prove sanity beyond a reasonable doubt. The court concluded that the defendant's presentation of evidence was insufficient to meet either standard.\textsuperscript{156}

IV. PUBLIC POLICY AND THE INVOLUNTARY CONDUCT DEFENSE

The general theory which underlies the criminal law in the United States recognizes four ultimate purposes of punishment which jointly and severally contend for dominance. They may be concisely summarized as (1) deterrence; (2) rehabilitation; (3) retribution; and (4) restraint. Conversely, defenses are provided in the criminal law when it is believed that few or none of these purposes will be served by meting out punishment, whether it is styled as punishment, therapy, capital punishment, or confinement.\textsuperscript{157} An analysis of the purposes served by exculpating truly involuntary acts suggests another criticism of the involuntary conduct approach as a complete defense.

Assessing each purpose in turn, it should be quite evident that punishing those who perform criminal acts involuntarily, for whatever reason, serves little deterrent purpose. Regardless of the causal impetus for the unconsciousness or involuntary nature of the conduct, none of the instigating "causes" is likely to be eradicated by punishing the offender. Many of the causes are from such unique events that it is unlikely that they will strike again.\textsuperscript{158}

\textsuperscript{155} 217 Md. 412, 143 A.2d 70 (1958).
\textsuperscript{156} Id. at \_\_, 143 A.2d at 76-77.
\textsuperscript{157} See S. Kadish & M. Paulsen, Criminal Law and Its Processes § A (3d. ed. 1975).
\textsuperscript{158} For example, a chance blow to the head, or intoxication by mistake or trickery.
In instances where an individual embodies the cause in a permanent predisposition (as in epilepsy, diabetes, or somnambulism), one may avoid the definition of some acts as involuntary by the knowledge requirement: if the person so afflicted had knowledge that acting in a particular manner (for example, drinking excessively) might bring on a state dangerous to self and others, then it may be termed voluntary and the individual may be held responsible. Such a standard would not alter disposition of the epileptic (somnambulist, etc.) who did not act so as to voluntarily induce the undesired state.

Similarly, there would appear to be little purpose in rehabilitating the individual in many instances, although victims of chronic alcoholism and thought reform might present two groups which would benefit from some form of rehabilitation. As discussed above, all of the courts holding that chronic alcoholism is a mere status offense and therefore unconstitutional as a cruel and unusual punishment, also specifically state that such a holding does not bar a disposition of the accused for treatment.

Revenge or retribution as a legitimate public policy has fallen into disfavor among many segments of the population in the latter half of the twentieth century, and this is reflected in many criminal statutes and court sentences. Certainly in the case of involuntary behavior it is difficult to justify any form of punishment on the basis of this theory. The lack of culpability inherent in the idea of unconsciousness or involuntariness mitigates criminal responsibility and pleads eloquently for leniency and clemency.

The idea of restraint, presently widely argued as valid in the case of the insane, has some appeal when innocent persons suffer grievously as a result of another's acts, whether voluntary or involuntary. Further reflection, however, would remind one that few of the mental states described in this paper would appear to require restraint of the actor. Again, the rarity of many of the mental states, and the availability of treatment for others, such as diabetes, negate the value of restraint for such conditions. Only in the case of a mental condition such as brainwashing or hypnosis would temporary restraint appear necessary and justified.

159. Query whether revenge is being revived in such states as Maryland by law and order groups.

160. Hasse, supra note 151 and accompanying text.

161. Restraint would appear to be a form of "cruel and unusual punishment" when applied to many of these forms of automatic or involuntary conduct. See Robinson v. California, 370 U.S. 660 (1962).
Generally, it would appear that in truly involuntary or uncon-
scious states the mitigation of criminal responsibility by the invol-
tuntary action defense would be entirely justified with respect to
the purposes served by the criminal law. Only in rare, specifically
designated instances would detention or treatment appear recom-
mended. Medical treatment for unconsciousness arising from
diabetic coma or inadvertent drug intoxication appears
reasonable. Other (criminal) dispositions might be justified in
cases of fore-knowledge on the part of the accused. Thus, the in-
trinsic blamelessness of the involuntary actor combined with the
largely unpreventable and untreatable nature of the causative
agents in these cases supports the ends of justice sought by our
criminal justice system.

CONCLUSION

The involuntary conduct defense to a criminal charge does have
a relatively secure and established basis in United States criminal
law, especially when reference is to the traditional un-
consciousness offenses: involuntary conduct caused by physical
trauma, involuntary intoxication, somnambulism, epilepsy, and
such related physiological ailments as diabetic shock. It would fur-
ther appear that many states are willing to exonerate chronic
alcoholics from criminalization for crimes related to their afflic-
tion, and some jurisdictions have spoken in passing of applying
the defense of chronic alcoholism to other offenses. A similar
trend with respect to voluntary intoxication does not appear in
the cases. This appears unlikely to change—the law and social
mores are too well settled. With respect to amnesia, premenstrual
syndrome, hypnosis, and brainwashing the jury remains out. It
will require additional scientific confirmation and valid eviden-
tiary techniques, as well as increased professional and public ac-
ceptance before these areas receive the consideration in public
forums that they may well deserve. Over time these areas may be
accepted as legitimate grounds for arguing unconsciousness or in-
volutariness, although the degree of success of the arguments
depends to a great deal upon the credibility of the fact situations.
AN AMERICAN LAWYER'S VIEW OF ENGLISH LEGAL EDUCATION

by Kevin M. Teeven*

Many American lawyers have a curiosity about the education of lawyers in the country which gave birth to the common law. Although there are significant differences between the American and the English educational approaches, the two systems currently appear to be moving toward each other. As the academically oriented American law schools expand their offerings of practice courses, practice-oriented English legal education is now placing an increasing emphasis on academic training.

A glance at the early training of English lawyers during the Middle Ages reveals an informal process of practical training and self-help.¹ Law students of that era prepared themselves by attending court sessions, participating in learning exercises at the inns of court,² and obtaining a seat in a lawyer's office. The widespread offering of university law degrees did not occur until the late Nineteenth Century,³ at which time the same phenomenon was occurring in the United States.⁴ There the similarities ended, however. In the United States the law degree soon became the es-

* J.D., 1971, University of Illinois; Associate Professor at Bradley University. The research for this article was done while the author was on a recent sabbatical in England, by auditing lectures and tutorials, interviewing school administrators and discussing the issues informally with practitioners, teachers and students. The author expresses his gratitude especially to the Polytechnic of Central London and the University of London for the privilege of attending classes and gaining access to their facilities. Appreciation is also extended to the faculties of Northeast London Polytechnic, and the Bar Law School and to those students, faculty and practitioners who were helpful to him in his investigations. Copyright © 1984 by Kevin M. Teeven

1. Edward I issued an edict to his judges in 1292 to find "apt and eager" students to assist the court. This is one of the earliest known references to formal concern for legal training. Stein, The Path of Legal Education from Edward I to Langdelg: A History of Insular Reaction, 57 CHI[KENT L. REV. 429, 433 (1981).

2. Every barrister must be a member of one of the four Inns of Court: Lincoln's Inn, Inner Temple, Middle Temple and Gray's Inn. The Inns are like medieval guilds of lawyers. The central governing body of the four inns is the Senate of the Inns of Court and the Bar. CALENDAR, THE COUNCIL OF LEGAL EDUCATION, (THE INNS OF COURT SCHOOL OF LAW) 11-12 (1980-81). The inns were founded by no later than the Fourteenth Century, originally as places of residence for students at the nearby courts. The origin of the phrase inn of court was in reference to the "inns of the men of court". J.H. BAKER, AN INTRODUCTION TO ENGLISH LEGAL HISTORY 138 (2d Ed. 1979).


4. Stein, supra note 1 at 429, 443-49.
sential step in obtaining entry to a fused profession. England, on
the other hand, held on to its centuries-old practical education in
preparation of a bifurcated profession.

Why the American states opted for the university degree is in
part due to the absence of competing inns of court schools and due
to the influence of Dean Langdell at Harvard. Why the American
legal profession was not separated into solicitors and barristers is
due to a variety of factors. In England, the separation of the le-
gal profession into solicitors and barristers was perpetuated by
the view of the inns of court—the controlling organizations for
English barristers—that specialist barristers had a perceived
superior role to that of solicitors. In America's formative years
conditions were not conducive to the development of inns of court.
Unlike the inns of court which had grown up around the cen-
tralized court in London, there was no such central locus for the
early common law courts in the United States. Further, there was
difficulty in finding more than one lawyer for each side of a con-
troversy in sparsely settled Eighteenth and Nineteenth Century
American frontier communities. Finally, the educational function
of the inns had died in England before the American Revolution,
the inns becoming elitist clubs which did not mesh well with the
egalitarian views of the American revolutionaries.

The present state of legal education in England and Wales has
been influenced by a broad based reform movement during the
past decade. The reform movement was fueled both by govern-
ment studies and by reformers urging change. The air has now

5. Id. at 449. Christopher Columbus Langdell was Dean of Harvard's School of Law from
1870 to 1895.

6. Solicitors are mentioned as men with knowledge of affairs and legal counsellors in the
Fifteenth Century. J. H. Baker, supra note 2, at 140. One theory is that they emerged from
the clerkship of Chancery. Stein, supra note 1, at 429, 433. Today, solicitors are primarily
office practitioners and barristers are courtroom advocates. A more thorough discussion of
the roles of the two branches is included in the treatment of in-training apprenticeship in
Section III.

7. Barristers are the older branch, attached to the inns of court by the Fourteenth Cen-
tury, if not earlier, with exclusive rights to try cases in the common law courts. J. H. Baker,
supra note 2, at 138-40.

8. Id. at 141.

9. Id. at 139-40. Professor Baker points out that the educational life of the inns had ended
by 1660. See also Calendar, supra note 2, at 2.

10. Report of the Committee on Legal Education, (Chairman: Mr. Justice Ormrod),
HMSO Cmd 4595 (March 1971) (hereinafter cited as ORMROD REPORT). The Royal Commis-
sion on Legal Services, (Chairman: Sir Henry Benson) HMSO Cmd 7648 (October 1979) (see
Volume 1) (hereinafter cited as BENSON COMMISSION).

11. Training for the Law, DITCHLEY FOUNDATION PAPER No. 11 (1967) (hereinafter cited as
cleared and programs have stabilized since the ferment of the past decade.

There is a general agreement on the delineation of the stages of legal education. These stages are: (a) an academic phase, (b) a vocational course, and (c) an in-training apprenticeship. The following is a discussion of each of these phases in the English legal education.

I. THE ACADEMIC PHASE

Although the Oxford faculty appointed William Blackstone as the first university law professor in 1753, the profession did not generally recognize university law training as a regular part of a legal education until the latter part of the Nineteenth Century. It was not until 1971 that the Royal Commission chaired by Sir Roger Ormrod recommended that the normal academic preparation for both solicitors and barristers be a law degree. The English law degree course is a three year undergraduate program, completed by students at approximately age twenty-one. In 1976 the English Bar discontinued its prior practice of permitting non-university graduates ("school leavers") to be called to the Bar. The Law Society still permits a student to become a solicitor without ever setting foot on a university campus. In 1980 over 19% of the solicitors admitted to practice that year did not have a university degree; that figure includes school leavers and certain mature students, who are permitted exemptions. By 1984, however, the number of such school leavers has become negligible.

The following summary of the pedagogy in the law school classroom is based upon observations during attendance at lectures


12. ORMROD REPORT, supra note 10, at 162. DITCHLEY REPORT, supra note 11, at 42.
13. Stein, supra note at 429, 430, 435. See also 12 W. HOLDSWORTH, A HISTORY OF ENGLISH LAW 77-101 (1938). Blackstone's lectures were ultimately published as his Commentaries.
15. ORMROD REPORT supra note 10, at 103.
17. WILSON & MARSH SURVEY SUPP. 2 supra note 16, at 38.
18. BENSON COMMISSION supra note 10, at 631. In 1979, 9% of Law Society Students were school leavers, but by 1983 the number had dwindled to a trace.
and tutorials at three London law schools on a regular basis over a six month period. The classroom instruction consists of both lectures to groups of from twenty to one hundred or more students and tutorials with groups of from five to ten students.

The lectures of fifty minutes duration, consist primarily of a lecturer presenting a traditional monologue and students assiduously taking notes. The quality of the lectures seems consistently high, perhaps because the English law teacher tenure decisions are based almost entirely on teaching as opposed to American law schools' emphasis on research. Students play a passive role and are not called upon to recite. On the infrequent occasions that a student speaks during lecture, it is usually to ask a question in order to clarify an ambiguity in notes taken from the lecture. The atmosphere is mellow; the lecturer never turns a question back on a student, as so many American law students have experienced. The Socratic method is not used. The lectures are devoted to what the law is rather than the theory of the law and its evolution. The lecturer typically refrains from injecting his or her own opinion about the appropriateness of a rule. Cases are referred to and summarized by the lecturer much as one would tell a story. The students are required to read far fewer cases than their American counterparts, but the memorization of case names and facts is considered of greater importance in this single jurisdiction system. The English law student surely learns more black letter law than an American law student through this spoon feeding process, but it is doubtful that the English student's theoretical grasp of the law is as strong.

The tutorials take place in a smaller classroom or in the lecturer's office. The tutors are usually qualified lecturers rather than graduate students. The tutorial group is typically about six students, although Oxford still prides itself in tutorials of one or two students. The purpose of the tutorial is to review what was

19. English law faculties have excellent overall faculty-student ratios, at least three times better than American law schools (A.A.L.S. only requires American law schools to have a 75 to 1 ratio for accreditation). Stevens, *American Legal Education: Reflections in Light of Ormrod*, 35 MOD. L. REV. 242, 256.


21. Although only Oxford and Cambridge used tutorials before World War II, today all law schools use this approach. *Id.* at 887.

22. Hardly a class goes by that the lecturer doesn't refer to trends in America and their possible application in England.
covered in the lecture and to clarify ambiguities. There is more
give and take between the lecturer and the students here than in
the lectures. Some tutors will confront generally well prepared in-
dividual students with direct questions. The tutorials also include
student presentations of assigned papers, and review of prior
exam questions. The English education system is exam-oriented, and the tutorials frequently focus on the mission of doing well on
the exam. Some experimentation by tutors occurs in the polytech-
nic law schools, such as, engaging the students in role playing.
Experimentation is more common at these newer polytechnics
than at established universities in part due to the youthfulness of
their faculties and also because the polytechnics are not so
steeped in tradition. Further, certain polytechnic law schools have
made a conscious effort to offer an alternative not available at
universities.

The legal training to become a law lecturer is frequently differ-
ent from that required of a practicing barrister or solicitor. The
main difference is the frequency with which aspiring lecturers
skip the two to three year vocational in-training apprenticeship
phase, discussed in Section II. In lieu of that practical experience,
the lecturer typically obtains an L.L.M. degree. A resultant gulf
exists between practitioners and lecturers, one which is even
wider than the one between American law professors and practic-
ing attorneys.

The lectures and tutorials run from September through March,
followed by a month of revision (review) of the material presented
during the year. Lectures cease during revisions and students fo-
cus on preparation for the examinations. There is a single
examination given in each course at the end of the academic year.
Failure of an examination in one course may necessitate repeating
the entire year. The examination questions are set by an examina-
tion board made up of all the law lecturers in that law school.

This writer had the rare opportunity to sit in on a session of
such an examination board. That particular board was considering
proposed examinations in undergraduate law courses and in the
Common Professional Examination course. The lecturers at-

23. Tutors requiring papers assign about 15% of the course grades to the paper and the
remainder is assigned to the final exam.
24. Law schools are found in both the older universities and in the polytechnics, many of
the latter coming into being in the 1960s and 1970s to handle the post-war baby group.
26. The examination board attempted to make the questions for the Common Profes-
tended the meeting having read the suggested examinations in advance. The examinations for each course were individually scrutinized, criticized and revised by the committee as a whole. Any participant could give his or her opinion on the efficacy of a particular question. Thus a tort lecturer may give his or her opinion on a question for the course in trust law, though the comments regarding an examination for a course outside one's field are normally limited to procedural rather than substantive points. The stated objective of the examination board is to assure that the questions are fair and do not prejudice the students. The examinations approved by the examination board are then submitted to examiners external to the law school for final approval. The external examiners for the polytechnics are mainly university lecturers; only 11% of the examiners are polytechnic teachers. However, the external examiners of a university's proposed examination are lecturers at peer universities.

The nature of the examination questions tends toward memory questions, as "What are the requirements for finding fraud?" or "Should the House of Lords be preserved?" Objective questions of the multiple-choice and true-false variety also appear. The problem-oriented questions common to American law schools rarely appear, though they are more apt to appear at university law schools than at the polytechnics and seem to appear more often on examinations drafted by younger faculty members at university and polytechnic law schools. Examination questions will occasionally raise issues decided perhaps only a week before and reported in the London Times. These examination procedures ap-

27. There is a further level of overseeing of the polytechnic law examinations by a group of examiners external to the polytechnic.

28. This procedure can also work to the disadvantage of the student because the examinations are subsequently graded by several faculty members. Thus grades of cannot be changed because the grade is not the grade of an individual faculty member but rather the "grade of the faculty." P.S. James, an English university lecturer, also suggests that these examination board procedures and the review by external examiners "...is to ensure consistency of standards throughout the country..." James, supra note 20, at 881, 889.

29. Marsh, supra note 25, at 73, 95.

30. A lecturer must keep up on recent decisions because they are widely and well reported in the London newspapers, and students are apt to raise questions in the lectures or tutorials about these decisions. The opportunity to generalize about a legal rule, which is possible in the American system of fifty jurisdictions, is not possible in England since there is only one jurisdiction and one answer. Perhaps this partially explains the less theoretical approach in the classroom.
appear to inhibit the freedom of individual faculty members. The faculty member must submit his or her proposed examinations to the faculty for approval and accept modifications to them. Further, if there is more than one section of a course in a given year, then there is a common examination for all of the sections. This forces the lecturer to teach to that examination.

This overseeing of the examining process does not stop with the scrutiny of the law school's examining board and the external examiners. The profession has also entered the process by evaluating the examinations given in certain basic "core" courses, discussed below. There has been a trend toward giving essays during the academic year as a supplement to the traditional three hour final examination. The Bar Council at first opposed this approach, threatening to withhold approval of those courses, and then recanted by stating it would accept a core course graded up to 25% by these essays. The Bar Council indicated that it preferred the three hour final examination and that it would accept the student bringing statutes into the final examination room but was unhappy about the use of other material. This type of minute overseeing of an accredited institution's teaching by the profession is unheard of in America.

The limits on the university lecturer's independence are not limited to the examination process. The Bar and the Law Society require that a law degree program include specified "core" courses in order to obtain an exemption from the one year Diploma Course and its attendant Common Professional Examination (C.P.E.), discussed below. The core courses are contracts, torts, criminal law, land law, constitutional and administrative law, and the law of trusts. These requirements roughly parallel the first year courses of an American law student. Some lecturers object to this exemption provision as an infringement on their province of curriculum development. Supporters of the core requirements argue that a degree is not really a law degree without the core

32. Whatever Happened to Ormrod? supra note 11, at 199, 204.
33. . CALENDAR, supra note 2 at 61, 74.
34. A law degree usually includes 12-15 law subjects taken over three years. Six of them are preempted by the core requirements. Defenders of the core requirements argue that it is not really a "law" degree without this basic coverage and further that the core lends flexibility to the law program because there is complete freedom as to the remaining 6 to 9 courses.
and that the core only effects about half of the students’ course selection. A survey of an academic year indicated 80% of the law students elected to take the core courses, even though their degree programs made them optional.

The exemption system has spurred the interest in “mixed” degree programs. A mixed degree combines the study of the law core courses with study in another discipline such as political science, business economics, finance, psychology, or sociology. In England the study of law is considered a part of a liberal arts program. The mixed degree enhances the liberal arts coverage while providing an exemption from the Common Professional Examination (C.P.E.) by requiring the six core courses.

At first glance one may be inclined to conclude that, in comparison to the American system of requiring four years of liberal arts undergraduate study before entering law school, the English law student’s liberal arts education is being shortchanged. The standard response of English educators is that their advanced level secondary school program for university-bound students is far superior to the American secondary school system.

The C.P.E. course preserves the tradition of allowing non-law graduates the opportunity to become members of the profession. The C.P.E. provides an alternative to the law degree for fulfilling the academic phase. It is open to university graduates without the core courses, qualifying mature students without any university degree.

35. Marsh, supra note 25, at 73, 96-97. Dr. Marsh suggests that it is doubtful whether accrediting Legal Studies Board for polytechnic degrees would approve a new law degree without the core.
37. This combining of the teaching of law with the teaching of other disciplines is referred to as “law in context.”
38. WILSON & MARSH SURVEY SUPP. 2, supra note 16 at 12-14. Table 13 therein shows the total number of graduates in mixed degree programs increasing from 112 in 1970 to 597 in 1980. Id. at 14. This increase is no doubt in part due to the inauguration of the exemption scheme in the middle of that period.
39. After the second year of secondary school, about one-fifth of the students are channelled into a college preparatory program known as Advanced Level (A-level). A-level is similar to a rigorous high school honors program. The remainder of the secondary students quit school or pursue a vocational course for the remainder of secondary school. James, supra note 20, at 881-82.
degree\textsuperscript{40} and a small number of bright young students leaving school after secondary school ("school leavers").\textsuperscript{41} With some variations,\textsuperscript{42} the C.P.E. course consists of taking the six core courses in a one year course. The Ormrod Report, a government report on legal education, recommended that both branches of the profession require the same course in order to formalize commonalities in background needed by both branches to develop greater understanding between the branches, and to allow the student an extra year to decide on which branch he will join.\textsuperscript{43} Each branch asserted its traditional independence, however, and established its own C.P.E. course in the late 1970s,\textsuperscript{44} making the label of "Common" a misnomer. The Bar C.P.E. course is taught in a manner similar to undergraduate law courses to a somewhat more mature student group by the Polytechnic of Central London and by City University. The Law Society’s C.P.E. course is taught by the Society’s College of Law and by seven polytechnics spread across the country.\textsuperscript{45} One category of mature students qualifying for the C.P.E. course, and specifically mentioned in the Ormrod Report,\textsuperscript{46} are Fellows of the Institute of Legal Executives. The legal executive is an invaluable person in a solicitor’s office, similar to a very well prepared and respected American paralegal. To become a Fellow, he or she is required to pass prescribed examinations, some of which are law-oriented.

\textsuperscript{40} A mature student must be over 25 years old and have had life experiences deemed valuable preparation for a practitioner, such as, military experience, business experience, a Fellow of the Institute of Legal Executives, etc.

\textsuperscript{41} The Bar no longer allows entry by young school leavers, but under pressure from roughly half of the solicitors who are not university graduates, the Law Society allows a small number of school leavers with secondary school A-level grades sufficient for entry into university to take a form of the C.P.E. course and then a five year articles of clerkship. In 1979 9\% of Law Society students were school leavers. BENSON COMMISSION \textit{supra} note 10, at 631. That figure had dwindled, however, to a much lower level by 1983 partially caused by higher entry requirements.

\textsuperscript{42} The mature student takes the 6 core courses plus 2 elective courses over a 2 year period. The school leaver also takes 8 courses. WILSON \& MARSH SECOND SURVEY \textit{supra} note 36, at 311.

\textsuperscript{43} ORMROD REPORT, \textit{supra} note 10 at para 113. Such a proposal was consistent with the objective of some that the two branches work toward a fusion of the branches as we have in America. That movement has died for the present to be no doubt reviewed later in the Century.

\textsuperscript{44} The Bar started its C.P.E. Course in 1978 and the Law Society followed suit in 1979. WILSON \& MARSH SURVEY SUPP. 2 \textit{supra} note 16, at 31-33.

\textsuperscript{45} Id. at 26.

\textsuperscript{46} ORMROD REPORT, \textit{supra} note 10, para 112.
The general acceptance of the law degree as a prerequisite for entry into the profession has caused a significant increase in law enrollments at universities and polytechnics.\(^{47}\) From 1970 to 1980 there was a near doubling of the number of law graduates of universities and polytechnics increasing from 1,874 graduates in 1970 to 3,564 law graduates in 1980.\(^{48}\) This increase was only partially foreseen by the Ormrod Report.\(^{49}\) During the same period American law school enrollments mushroomed, perhaps suggesting that the increase was in part attributable to the post-war baby boom. The number of institutions offering law degrees more than doubled from 23 institutions in 1967 to 55 institutions in 1980.\(^{50}\) The increases have been largely accomplished without any serious erosion of the student-faculty ration of about 16 to 1.\(^{51}\)

The increases in the size of law programs have required the development of law libraries for these new programs. The Society of Public Teachers of Law published a “minimum holdings list” as a guide for providing a minimum standard of an acceptable law library. The list would require a holding of 12,000 volumes.\(^{52}\) In 1974 most of the universities were in compliance; only one of the polytechnics, however, had a collection of over 10,000 volumes.\(^{53}\) In 1981 all of the universities were in compliance with only 7 of 23 polytechnics having collections of over 10,000 volumes.\(^{54}\)

47. Another cause was the substantial increase in the availability of legal aid to indigent clients, thus creating a demand for more lawyers.

48. There were 1,449 university law graduates in 1970 and 2,491 university law graduates by 1980. WILSON & MARSH SURVEY SUPP. 2, supra note 16, at 7 (Table 6). There were 425 law graduates from polytechnics in 1970 and 1,073 polytechnic law graduates by 1980. Id. at 11 (at Table 10).

49. ORMROD REPORT, supra note 10, at para. 118-21. Ormrod estimated that the number of law graduates would only increase to 2,000.


51. WILSON & MARSH SURVEY SUPP. 2, supra note 16, at 22. See also WILSON SURVEY, supra note 50, at 22 (Table 15).

52. WILSON & MARSH SURVEY SECOND SURVEY supra note 37, at 277-78. The Society is the university teachers' association. The cost of complying with the Society's list in 1975 was 77,000 pounds initially with a 6,837 pound maintenance cost thereafter.

53. Id. at 276-77.

54. WILSON & MARSH SURVEY SUPP. 2, supra note 16, at 25-26. (Tables 26 and 26A). The libraries at Oxford, the University of London and Cambridge continue to have the superior holdings by far.
Increased enrollment has also resulted in a swelling of the ranks of practitioners. In 1967 there were 22,233 practicing solicitors and 2,333 practicing barristers. By 1980 the number of practicing solicitors had increased to 37,952 and practicing barristers had increased to 4,589.\(^5\) The number of newly admitted solicitors in 1980 represented \(9\%\) of all practicing solicitors.\(^6\) Thirty-four percent of the Bar had less than 10 years experience in 1966; by 1980 55\% of the Bar had less than 10 years experience.\(^7\) The practicing profession has grown so rapidly that there is a well-founded concern about the profession’s ability to absorb the new entrants.\(^8\)

II. THE VOCATIONAL COURSE

English legal education has traditionally included practical training.\(^9\) The reason for requiring such training was well stated in the report of a conference in 1967 on legal education attended by prominent English and American legal scholars, which suggested that a law student needed to be taught “... those skills without which it would be dangerous to let loose the would-be practitioner on society.”\(^10\) Practical training in the form of an in-training apprenticeship had long been required,\(^11\) but the concept of an organized course to teach the practical skills of the lawyer is of recent vintage.\(^12\) In 1971 the Ormrod Report recommended a common 40 week vocational course for both branches of the profession to “... bridge the gap between the academic study and the practical application of the law.”\(^13\) Just as with the C.P.E. course, the two branches proceeded to establish their own separate versions of the course envisioned by Ormrod,\(^4\) the Bar in 1978\(^5\) and the Law Society in 1979.\(^6\)

The Bar’s nine month vocational course is taught by the Inns of

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55. Id. at 35-37, tables 32 and 35.
56. Id. at 37.
60. DITCHLEY REPORT supra note 11, at 43.
62. BENSON COMMISSION supra note 10, at 637.
63. ORMROD REPORT, supra note 10, at para. 133, 164-65.
64. BENSON COMMISSION supra note 10, at 637.
65. Whatever Happened to Ormrod? supra note 11, at 199.
Court School of Law. The Bar excluded the universities from the pedagogical process because of a stated view that as to teaching practical application, practitioners are the experts. There are two elective courses and four mandatory courses, the latter consisting of the practitioner's problems in torts and criminal law, the practitioner's problems in contracts and trusts, a course in evidence and one in procedural law. The Bar course also includes practical exercises in advocacy and pleading and a course in legal ethics. The Bar Final Examination at the end of the course is similar in format to university examinations during the academic phase.

The effectiveness of the Bar's vocational course can be questioned. The testing procedure opens the Bar up to the criticism that the course is merely a warmed over academic course rather than one dealing with practical skills. Further, one of the main reasons for the Bar teaching its own vocational course is to provide students with the insight of seasoned practitioners. Based on interviews that this writer had with individuals involved in the process, the objective appears to have gone largely unrealized. The full-time faculty of the Bar Law School are young and tend to have limited practice experience past pupillage. The practical exercises are taught several hours a week at night by young practicing barristers who need the extra money and usually do not have much practical experience under their belts. The resultant dilemma is that although experienced practitioners dedicated to teaching are needed for the vocational course to succeed, with few exceptions, only inexperienced barristers in need of money appear to be interested in teaching. Until more funds are made available to lure experienced practitioners or unless the Bar recognizes that there is an ethical duty on the part of the membership to participate in the program, a resolution to this problem will not be forthcoming.

67. Whatever Happened to Ormrod? supra note 11, at 199.
68. ORMROD REPORT, supra note 10, at para. 153. DITCHLEY REPORT, supra note 11, at 10.
69. WILSON & MARSH SURVEY SUPP. 2, supra note 16, at 31. Two common electives are revenue law and family law.
70. —. CALENDAR, supra note 2, at 69.
71. Some of the succeeding information on the faculty, though not necessarily the conclusions, was derived from interviews the writer had with Mr. E. Tenenbaum, Sub-Dean of the Bar School, and with faculty and students of the Bar Law School.
72. ORMROD REPORT, supra note 19, at para. 141.
73. THE BAR ON TRIAL, supra note 11, at 87-88.
The Law Society's nine month vocational course is offered by its College of Law and by seven polytechnics throughout the country.\textsuperscript{74} The Law Society desired to but was prevented from teaching all of the courses itself due to the large financial burden on the Society and its members.\textsuperscript{75} The use of polytechnic teachers to achieve the objective of providing practical training poses a problem similar to the Bar vocational course: query whether most full-time teachers possess the practical experience needed here.

The structure of the Law Society's solicitor's course concentrates on the four areas of a solicitor's practice: (1) four papers on the solicitor and his private client, (2) two papers on the solicitor and his practice, one of which is accounts, (3) one paper on the solicitor and his business client, and (4) one paper on litigation.\textsuperscript{76} It has been questioned whether much of Ormrod's recommended practical exercises are actually included in the course.\textsuperscript{77}

III. IN-TRAINING APPRENTICESHIP

Prior to discussing the apprenticeship stage a summary of the roles of the two branches of the English legal profession is appropriate.\textsuperscript{78}

The solicitor is less concerned with settling disputes of the law, and more concerned with facts. He or she\textsuperscript{79} deals directly with the client. Much of his income is derived from real estate transactions, will drafting, formation of companies and family law. If the solicitor's client needs to appear in court, he can represent his client in the lower courts. If, however, it is necessary to appear in the higher courts, where the solicitor has no right of audience, he must brief a barrister. The solicitor does, however, attend trials in the higher courts in a supportive role to the barrister. He also

\textsuperscript{74} BENSON COMMISSION \textit{supra} note 10, at 637. The polytechnics involved are Birmingham, Bristol, City of London, Leeds, Manchester, Newcastle and Trent.

\textsuperscript{75} WILSON & MARSH \textit{SECOND SURVEY}, \textit{supra} note 36, at 296, 304, 312. ORMROD \textit{REPORT}, \textit{supra} note 10, at para. 36, 49. Whatever Happened to Ormrod? \textit{supra} note 11, at 199, 201.

\textsuperscript{76} WILSON & MARSH \textit{SURVEY SUPP. 2}, \textit{supra} note 16, at 33.

\textsuperscript{77} \textit{Id}.

\textsuperscript{78} The reader can find an expanded discussion of the roles of barristers and solicitors by an English law lecturer in James, \textit{supra} note 20, at 881, 891-95.

\textsuperscript{79} Certain chambers have a policy of refusing entry to women. \textit{The Bar on Trial}, \textit{supra} note 11, at 151. Although 8\% of the Bar is female, there is only one woman bencher in each inn, and two of them are a part of the royal family. Of the 70 members of the Law Society, only one was a woman in 1980 (the greater percentage of women joining the profession become solicitors). M. ZANDER, \textit{supra} note 57, at 81.
performs any needed discovery for cases in the higher courts. If an analogy can be drawn to the practice of medicine, the solicitor is the family doctor and the barrister is the specialist. When he needs advice on a technical question of law, he will consult with a barrister specializing in the relevant field.

The barrister has no direct contact with the client. He or she must be instructed to act for a client by a solicitor. He drafts the pleadings, informs the solicitor of what discovery is needed, and he is the advocate at the trial. Some barristers specialize in a given field, such as taxation, and spend most of their time drafting memoranda and documents for the solicitor; however, most barristers are primarily trial advocates. Barristers of distinction can rise from being junior counsel to the rank of Queen's Counsel ("taking silk"), a rank granted by the monarch, which relieves the barrister of tedious pre-trial work.

A. Pupillage

In-training for barristers is called pupillage. The pupillage consists of a one year apprenticeship with a barrister, known as a pupil master, who has at least five years of practice experience. A prospective barrister's road is still not a smooth one once he or she has finished a law degree and the vocational course. There are then difficulties in finding a pupillage, let alone a good one; in landing a first position in practice after pupillage; and in financing the entire process.

The initial problem of obtaining a pupillage in a barrister's chambers, stems partially from a shortage of office space due to the rapid expansion of pupils and barristers during the past fifteen years. Another cause is that family connections are an important factor in landing a pupillage. To help students locate pupillages, each inn of court has instituted a clearinghouse to help match up masters and pupils. The working class student's prospects of landing a pupillage are not bright in light of a 1976

80. Id.
81. "Silk" refers to the silk gown worn by Queen's Counsel rather than the stuff gown of junior barristers.
82. ____, Calendar supra note 2, at 37.
83. The Bar on Trial, supra note 11, at 83-86.
84. Ormrod Report, supra note 10, at para. 159.
85. The Bar on Trial, supra note 11, at 84-85.
86. Id. at 86-87.
survey showing that family connections were the single most common means of locating a pupillage and that only 20% found their pupillage through the inns’ new clearinghouses. 87

Once a pupillage is secured, there is no guarantee that the pupillage will provide a good learning experience. A frequently voiced complaint is that the experience is too narrow because barristers tend to be specialists. 88 Although attempts have been made to answer this complaint by sending a pupil to work with a solicitor for several months 89 and by sending pupils off to learn from other barristers working on different types of cases, 90 some young barristers still find little effort exerted to diversify the pupil’s experience. 91

Another requirement to complete the pupillage is the anachronism known as “keeping terms”. 92 The student is required to eat in his inn’s dining hall three times per four month term for eight terms. 93 The rationale behind “keeping terms” is that it will build an esprit de corps with his inn, will facilitate mixing with established members of the inn, and will provide an opportunity for involvement in the inns’ ancient tradition of “mooting” after dinner. 94 As a practical matter, however, mixing and mooting do not occur as the older members of the inn tend not to mix with the students. 95 The experience is viewed today as merely a membership in a dining club. 96 This writer dined as a guest at Gray’s Inn and did not detect any more sense of collegiality or esprit de corps than one might feel among regulars in any old restaurant steeped in tradition.

The successful completion of pupillage does not pave the way to practice. Only about one-half of those who go through pupillage actually establish themselves in practice. 97 The large number of ap-

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87. Id. at 84.
88. ORMROD REPORT, supra note 10, at para. 158.
89. WILSON & MARSH SECOND SURVEY, supra note 37, at 295.
90. ORMROD REPORT, supra note 10, at para. 158.
91. THE BAR ON TRIAL, supra note 11, at 87-88.
92. ORMROD REPORT, supra note 10, at para. 166.
93. CALENDAR, supra note 2, at 20.
94. BENSON COMMISSION, supra note 10, at 641-42.
95. Id.
96. James, supra note 20, at 881, 893.
97. THE BAR ON TRIAL, supra note 10, at 95-96. The Young Barristers Committee has suggested that a chambers be required to provide the Bar Council with a notice three months before the availability of a tenancy so that outside applications can be made.
Applicants, the shortage of office space, and the reliance on family connections are major causes.

In addition to the problems of gaining entry to the Bar, there are serious financial problems for the middle and lower income aspirants. There are living expenses and admission and call fees to pay. A vast majority of English students rely on government grants to finance their education, but during the vocational course and pupillage, government grants are often unavailable as these phases are professional training outside the normal university educational process. The keeping of terms is financially burdensome for students living outside of London. Perhaps most important, there is little or no income flowing to the young barrister during the first year or so of practice, resulting in extended dependence on his family. In 1975, the Bar Council expressed the view that a barrister could only expect to earn 1,000 pounds (less than $2,000) during his first 18 months in practice.

B. Articles of Clerkship

The Law Society's in-training apprenticeship for solicitors is called articles of clerkship. A university educated student is required to spend two years as an articled clerk under an experienced solicitor, called a principal. All young non-university-educated school leavers must spend five years as an articled clerk. The Ormrod Report's objective that a university education be an integral part of the training to become a solicitor has been largely realized in that the percentage of university graduates increased from 44% of the solicitors admitted in 1966 to 82% of those admitted in 1980.

There have been several persistent complaints about articles of clerkship over the past generation, some of which parallel the shortcomings of pupillage. These complaints include the difficulty in obtaining a clerkship; the questionable learning experience of

98. BENSON COMMISSION, supra note 10, at 659.
100. Id. at para. 166.
102. WILSON & MARSH SECOND SURVEY, supra note 36, at 298.
103. WILSON & MARSH SURVEY SUPP. 2, supra note 16, at 33-34.
104. Id. at 38 (Table 38). The Bar has for many years been largely a group of university graduates.
the clerkship and the low clerkship pay.\textsuperscript{105} Steps have been taken in the recent past to remedy some of these defects. The Law Society now keeps a list of available clerkships and does encourage the payment of a living wage to clerks.\textsuperscript{108} Unlike pupillage, the articled clerk is paid a salary, albeit inadequate. The pressure on principals to pay larger salaries is a double-edged sword. On the one hand, many lower income clerks cannot live for two years without a living wage, but a large salary causes the principal to think more about making the clerk a productive, specialized contributor to the gross revenue of the office rather than about training the clerk through exposure to a broad set of learning experiences.\textsuperscript{107}

CONCLUSION

In keeping with the reverence that the English hold for the past, the present state of English legal education is a blend of the modern emphasis on formal scholastic learning and the ancient custom of learning by doing. Both branches of the profession are now requiring, in most instances, that an applicant have a university degree. The English undergraduate law degree provides the student with a more individualized approach than its American counterpart; and, because the Socratic method is not used and perhaps because the students are less mature, there is more spoon-feeding than in American law schools.

The vocational course has come into being in the last decade as an answer to some of the shortcomings of the in-training apprenticeship. Teaching practical skills in a classroom environment has its pitfalls, and this experiment has not been a grand success. One of the reasons for its mediocre results thus far has been the difficulty in convincing busy, experienced practitioners to take time out to participate. The goal of bringing the two branches closer together by having a common vocational course has fallen on deaf ears as each branch has jealously retained control of separate courses for its respective students.

The long observed custom of requiring an in-training apprenticeship is still strongly supported by the profession. It is well

\textsuperscript{105} ORMROD REPORT, supra note 10, at para. 161. BENSON COMMISSION, supra note 10, at 647.

\textsuperscript{106} WILSON & MARSH SECOND SURVEY, supra note 37, at 304-05.

\textsuperscript{107} Id. at 304-06.
recognized that the value of the training obtained from a dedicated pupil master or principal is beyond words; but, in the same breath, it must be admitted that too often the apprenticeship is a boring, narrow view of the practice and a waste of time. Nevertheless, it is an inexpensive way to do what American law firms in effect finance during the young lawyer’s first year after passing the bar exam.

The English legal profession has expended an enormous amount of thought and time during the past decade refining the framework of legal education. Yet much remains to be accomplished. The strongest criticisms are levelled against the pedagogy during the vocational and in-training phases, though it may be that the non-academic nature of practical training will always make it subject to certain criticisms to which the universities are not subject. No doubt there is room for more cooperation between university law teachers and practitioners. That cooperation will be an important ingredient in further improving English legal education.
COMMENTS

FOREGONE BUT NOT FORGOTTEN: INTEREST FREE LOANS

INTRODUCTION

Starting in 1961 with Dean v. Commissioner1 (hereinafter referred to as J. Simpson Dean), the first case in which the Tax Commissioner asserted the taxability of the economic benefit inherent in interest free loans of money between related parties, the Tax Court has adhered to the irrational policy of denying tax effect to the universally acknowledged benefit of interest free and below market interest rate loans.² The result of the court’s policy has been to provide financial planners a simple method of transferring valuable property between family members and related entities (such as closely held corporations and their stockholders and corporations under common control) without gift or income tax consequence.³

In contrast, transfers of value connected with tangible personal property and real property, such as the rent free habitation of corporate owned airplane⁴ or residence by its major stockholder,⁵ rent free use of corporate boat by stockholder employee⁶, and rent free use of corporate automobile by shareholder for personal use,⁷ have been taxed to the recipients of such benefits consistently and with little opposition by the Tax Court. Different as these various

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1. 35 T.C. 1083 (1961).
2. The term “interest free loan”, when used herein shall refer to both loans without interest and loans with interest at below arm’s length or market rates.
3. Thus, parents have been able to avoid the minimum ten year loss of principal control attending the “Clifford Trust” under grantor trust rules I.R.C. §§ 671-678, by lending their children (or, often, trusts created for the benefit of their children) large amounts of investible principal on a demand note basis. See Helvering v. Clifford, 309 U.S. 331 (1940). In a similar vein, controlling shareholders of closely held corporations have enjoyed the benefits of a corporate existence while avoiding its major pitfall, the so-called double taxation of dividends, by transferring corporate profits to themselves in the form of interest free loans. See, Edwards, What Planning Opportunities Does CA-7’s No-Gift Tax Holding in Crown Open Up?, 50 J. TAXN. 168, 170 (1979).
situations may seem at first glance, they all involve a gain from the use of capital. Why, then, would the courts steadfastly adhere to a policy of non-taxation of rent free use of money, while on the other hand strictly enforce taxation of rent free use of tangible assets?

The answer to this question may be as simple as it is elusive, and it may account for the recent indication of the willingness of the courts to reconsider the issue. The Tax Court has demonstrated a marked lack of understanding of the characteristics of the interest rate markets, the concept of present value, and the methods of measuring fair market value of intangible assets. The majority apparently has not been willing to transfer by analogy its reasoning in other cases on gift tax and income tax issues in more simple and tangible fact situations to the fundamentally more sophisticated scenarios involving financial markets. As a result, the Tax Court has hamstrung the Commissioner's staff in its efforts to close a glaring loophole which is well illustrated by a most creative use of the interest free loan by the Howard Hughes organization in a 1979 case, Greenspun v. Commissioner.

Probably owing to the realization that almost universal academic opposition to a line of decisions indicates a possible error in basic reasoning at the bench, two different courts have elected not to follow the Tax Court's lead. In Dickman v. Commissioner the Eleventh Circuit Court of Appeals reversed the Tax Court decision, holding that an interest free loan between family members does not constitute a gift for gift tax purposes. This decision in favor of the Commissioner was appealed to the Supreme Court, was accepted on writ of certiorari, and is due to be decided in the Supreme Court's current term. In a parallel move, the Court of Claims in Hardee v. Commissioner finally ap-

9. 72 T.C. 931 (1979), aff'd., 670 F.2d 123 (9th Cir. 1982).
11. 690 F.2d 812 (11th Cir. 1982).
12. Appeal docketed No. 82-1041 (11th Cir. Feb. 28, 1983); argued Nov. 1, 1983.
proved the Commissioner's dividend treatment of interest foregone on a loan between a close corporation as lender and its major stockholder as borrower, only to be reversed on appeal by the newly created Federal Circuit Court of Appeals.\(^\text{14}\) Consolidation of Dickman and Hardee in a combined opinion by the Supreme Court would provide a much needed final solution to the questions of tax law presently characterized by a high degree of uncertainty for financial planners and close corporation shareholders. As current court decisions and academic treatises on the subject of gift and income taxation of interest free loans appear to merely repeat arguments already exhaustively set forth in the past without offering novel insights,\(^\text{15}\) the time appears to have arrived for such a disposition.

This article will examine the cases from J. Simpson Dean to Hardee on the income tax issue and from Johnson\(^\text{16}\) to Dickman on the gift tax issue in an effort to show that in both cases the correct disposition should be a holding that interest foregone on interest free loans is a benefit of value to the borrower which should be treated for tax purposes as gross income or gift, depending upon the circumstances of the particular loan transaction. After having presented arguments and data supporting this conclusion, the following questions will be examined for their effects on the application of a possible new rule:

1. Is there statutory authority under I.R.C. § 483 for imputing interest to a taxpayer on a loan which carries no interest?
2. Is there statutory authority under I.R.C. § 482 for reallocating income and deductions between a close corporation and its controlling shareholder?
3. What methods should be employed to arrive at a taxable amount

\(^{14}\) Beginning on October 1, 1982 what was the Court of Claims was replaced by the new United States Claims Court under the Federal Courts Improvement Act of 1982, Pub. L. No. 97-164, 96 Stat. 25, 28 U.S.C.A. §§ 171-177 (West 1988 & Supp. 1983). Whereas in the past the decisions of the Court of Claims were appealable directly to the Supreme Court, now under the Federal Courts Improvement Act of 1982 a new United States Court of Appeals for the Federal Circuit will hear appeals from the United States Claims Court and also appeals filed after October 1, 1982 from the now merged Court of Claims and Court of Customs and Patent Appeals.


of interest for free loans in light of the difference between demand and term loans?

4. If interest foregone on interest free loans is to be taxed to the borrower or lender, what is the appropriate interest rate?

5. What are the policy considerations to be taken into account by the courts in deciding whether to construe the Internal Revenue Code as authorizing the taxation of interest free loans?

I. FROM J. SIMPSON DEAN TO HARDEE

The first instance in which the Commissioner appears to have recognized the value of and, hence, the possibility of taxing the free use of money as gross income, appears in the Tax Court case J. Simpson Dean.\(^{17}\) Originally the case was recognized only as one involving the question of deductibility of interest paid on life insurance policies previously assigned to third parties.\(^{18}\) In an amended answer the Commissioner assessed an additional deficiency in the amount of tax on $224,978.28, representing interest at the legal rate in Delaware\(^{19}\) applied to the outstanding balance of the interest free loans between the taxpayers as borrowers and their closely held corporation as lender during the years in question.\(^{20}\) The Commissioner had apparently gotten the notion to tax interest foregone on the interest free loans at issue in J. Simpson Dean from the memorandum opinion of a companion case, Paulina duPont Dean v. Commissioner,\(^{21}\) in which the court commented in dictum: "Viewed realistically, the lending of over two million dollars to petitioners without interest might be looked upon as a means of passing on earnings (certainly potential earnings) of Nemours [the taxpayers' closely held corporation] in lieu of dividends, to the extent of a reasonable interest on such loans."\(^{22}\) Interestingly, the petitioner taxpayers had stipulated in J. Simpson Dean that, had they paid interest to their corporation on the outstanding loans, the corporation would have made dividend distributions to them in an equal amount.\(^{23}\) Thus, given the same

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17. 35 T.C. 1083 (1961).
18. The Tax Court ultimately held the interest on life insurance policies assigned to taxpayers' children was not deductible to taxpayers for periods after their assignment. 35 T.C. at 1086 (1961).
19. Six percent during 1955 and 1956, the years in issue. Id. at 1087.
20. 35 T.C. at 1087.
22. Id. at 288.
23. Authors Taylor and Schnee give a different version of the situation. They say that the Commissioner founded his argument in favor of taxation of foregone interest of interest
facts, the Tax Court of Paulina duPont Dean, the taxpayers (J. Simpson Dean and Paulina duPont Dean), and the Commissioner all agreed that there is a value which can be placed upon an interest free loan between a taxpayer and his closely held corporation. The taxpayer affirmatively maintained that, were interest paid on such a loan by the taxpayer, he would in all probability see to it that the corporation redistributed such amount to him in the form of a dividend, which was neither deductible by the corporation nor in significant part excludible by the taxpayer from his gross income. Nevertheless, the court held that an interest free loan results in no taxable gain to the borrower and, therefore, the Commissioner is entitled to no deficiency owing to the interest foregone on the interest free loan. The majority distinguished the J. Simpson Dean situation from the cases holding that interest free use of corporate property by a stockholder or officer for personal use is taxable stating that such cases bear only a “superficial resemblance” to J. Simpson Dean in that they involve benefits for which payment by the taxpayer would not be tax deductible. In the case of loans, the majority argued, an offsetting interest deduction exists.

The better opinion is voiced in the dissent. There, Judge Bruce likened payment of interest to “rent” paid for the use of property which is money and noted the absurdity of the contention that the free use of over $2,000,000 did not result in an economic benefit to the taxpayer. Both the dissent of Judge Bruce and the concur-
rence of Judge Opper\textsuperscript{30} correctly observed that, had the loan in question been used to carry obligations on which the interest is wholly exempt from taxation under I.R.C. § 265,\textsuperscript{31} the interest would not have been deductible. One can imagine other situations in which the interest would not be tax deductible. For example, when a loan is taken in one taxable year with interest payable in a subsequent year, no offsetting deduction would result in the taxable year in which the loan proceeds were received. Further, Judge Opper\textsuperscript{32} gave an example of a rent-free use of a corporate owned residence by a shareholder officer where there would be an offsetting deduction to the taxpayer shareholder to offset the foregone rental income, that is, where the shareholder taxpayer in turn rents the residence to third parties. In such a case, under I.R.C. § 212, ordinary and necessary expenses paid or incurred for the production or collection of income are deductible from gross income.

Despite the weak rationalization for the majority holding of J. Simpson Dean and the flaw in reasoning which resulted in the finding that no gross income accrues to a taxpayer where a theoretically related offsetting deduction exists, the Commissioner failed to appeal the case.\textsuperscript{33} It was not until twelve years later that a non-acquiescence was filed.\textsuperscript{34} No reported decisions appeared to relitigate the issue of income taxability of interest free loans between shareholders and their closely held corporations\textsuperscript{35} until

\textsuperscript{30} Id. at 1090.
\textsuperscript{31} I.R.C. § 265 provides, in pertinent part: "No deduction shall be allowed for . . . (2) Interest.—Interest on indebtedness incurred or continued to purchase or carry obligations the interest on which is wholly exempt from the taxes imposed by this subtitle. . . ."
\textsuperscript{32} 35 T.C. 1083 at 1091.
\textsuperscript{33} According to the opinion in Suttle v. Commissioner, 37 T.C.M. (CCH) 1638, 1639 (1978), the Commissioner appealed J. Simpson Dean but subsequently dropped the appeal upon agreement by the parties.
\textsuperscript{34} 1973-2 CB 4. The publishing of a non-acquiescence indicates that the Internal Revenue Service will attempt to relitigate the issue on which the non-acquiescence is filed in future cases. See J. FREELAND S. LIND & R. STEPHENS, FUNDAMENTALS OF FEDERAL INCOME TAXATION, 36 (4th ed. 1992). The Tax Court gave an amusing "slap on the wrist" comment relating to the delay of such filing: "Although we can certainly appreciate respondent's arguments to the effect that the decision in Dean v. Commissioner is laden with some potential for abuse, we think it important to point out that respondent has not aided his position by waiting approximately 13 years to publicly announce his disagreement with the decision." Greenspun v. Commissioner, 72 T.C. 931, 952 n.22 (citations omitted).
\textsuperscript{35} However, in Saunders v. United States, 294 F. Supp. 1276 (1968), rev'd on other grounds, 450 F.2d 1047 (1971) the U.S. District Court, District of Hawaii held that a taxpayer received no taxable compensation for services he rendered in a real estate develop-
1978. In that year, the Tax Court decided *Suttle v. Commissioner* on the basis that its earlier reasoning in the case of *J. Simpson Dean* had been sound and that *Suttle* was not distinguishable.

The next case of importance applying the *J. Simpson Dean* decision was *Greenspun v. Commissioner*. There Howard Hughes loaned a Las Vegas newspaper publisher and property owner $4,000,000 at below market interest rates in exchange for favorable press coverage of Hughes' exploitation of "the strip" in Las Vegas, favorable testimony in front of the Gaming Commission hearings relating to Hughes' application for a gambling license, and favorable treatment in a proposed sale of land and television properties to Hughes. A majority of the Tax Court concluded that the taxpayer had received a favorable loan rate in exchange for services and that the obligation to pay interest at a below market rate is a "valuable economic benefit" comparable to the rent free use of a residence, auto, or boat. After citing well worn
cases for the propositions that, under I.R.C. § 61, "gross income" is to be broadly construed and that shareholders and employees receive economic benefits taxable as gross income from personal use of corporate property, the court nevertheless again refused to overrule J. Simpson Dean.

The decision in Greenspun is all the more illogical by the majority's recognition of most of the reasons J. Simpson Dean should be overruled. In addition to the arguments discussed above, the majority acknowledged that the offsetting interest deduction does not present itself in all interest free loan cases, that nonrecognition of foregone interest income will distort a computation of any deduction limited in amount to a percentage of gross income, and, finally, that the doctrine of non-taxability of interest foregone on interest free loans does not actually put in parity the taxpayer who receives an interest free loan and the taxpayer who receives a bona fide taxable loan plus an interest deduction. Rather than dealing with these problems, the majority elected to base its holding on the fact that none of the complicating factors, such as the holding of tax exempt bonds, was a factor in this case. It must be noted, however, that five of the thirteen judges filed a concurring opinion which would have overruled J. Simpson Dean to the extent of its broad holding that an interest free loan results in no taxable income to the borrower. One judge dissented entirely. Thus, the court lacked only one vote to partially overrule J. Simpson Dean. It must also be noted that the majority stated in dictum that it favors deductibility, as constructive interest, of the eco-

43. The majority gave as examples the medical deductions allowable under I.R.C. § 213 which are limited to those exceeding 3% of adjusted gross income (this amount is raised to 5% for years beginning after 1982 according to the provisions of the Tax Equity and Fiscal Responsibility Act of 1982) and the case of charitable deductions under I.R.C. § 170, most of which are presently limited in amount to a maximum of 50% of the taxpayer's adjusted gross income. Under additional provisions of the Internal Revenue Code adopted since Greenspun, this problem is exacerbated. See, I.R.C. § 163(d) (deductibility of interest on loans to carry indebtedness limited to $10,000 per year plus net investment income for a non-corporate taxpayer); I.R.C. § 189 (necessity of amortization of construction period interest over ten years for certain non-corporate taxpayers); I.R.C. § 312(m) (non-deductibility of interest paid by issuer of bearer bonds issued after December 31, 1982).
45. 72 T.C. 931 at 951.
46. Id. at 953 (Dawson, Fay, Simpson, Irwin, Chabot, J.J., concurring).
47. Id. at 957 (Nims, J., dissenting).
nomic benefit derived from an interest free loan when the taxpayer must report such benefit as income.\textsuperscript{48} The opinion did not, however, address the question whether, when the taxpayer-borrower constructively pays interest, the corporate lender constructively receives interest income.\textsuperscript{49}

Following \textit{Greenspun}, in a series of cases decided during 1979-81, the Tax Court continued to apply the \textit{J. Simpson Dean} holding that interest free loans between closely held corporations as lenders and their majority shareholders as borrowers did not result in taxable income to the borrowers,\textsuperscript{50} despite the apparent willingness of five of the judges in \textit{Greenspun} to overrule this very portion of the \textit{J. Simpson Dean} holding. The court exercised little creativity in reaching its decision in these cases which are, in the main, factually indistinguishable. During this same period the court, in a more considered opinion, addressed the issue of whether there was a taxable benefit associated with an interest free loan to a taxpayer who owned tax exempt securities in \textit{Baker v. Commissioner}.\textsuperscript{51} Here, a majority of the court again declined to overrule \textit{J. Simpson Dean} stating “\textit{Dean} is not rendered inapplicable by reason of petitioners' investments in federally tax-exempt securities.”\textsuperscript{52} A majority of the court determined that the taxpayer in question had actually used the loan to make an estimated tax payment.\textsuperscript{53} It appears, then, that the Tax Court will not reconsider the \textit{J. Simpson Dean} holding by reason of an exception to the deductibility of interest unless it first finds affirmatively that the interest is not deductible. Such a policy creates a procedural problem recognized by the court in \textit{Baker};\textsuperscript{54} it prevents a holding favorable to the Commissioner even in the unusual case in which the government might succeed in establishing the requisite nexus between the loan at issue and the taxpayer's purchase of tax exempt obligations.\textsuperscript{55} The failure of the Commissioner to rec-

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\bibitem{48} Id. at 951.
\bibitem{49} \textit{Greenspun}, 72 T.C. 931 (1979).
\bibitem{50} \textit{Lee O. Ruwe}, 41 T.C.M. (CCH) 1458 (1981); Trowbridge v. Commissioner, 41 T.C.M. (CCH) 1902 (1981); Proctor v. Commissioner, \textit{\textsuperscript{f} 81,436 P.H Memo T.C.} (1981); Estate of Leichtung v. Commissioner, 40 T.C.M. (CCH) 1118 (1980); Parks v. Commissioner, 40 T.C.M. (CCH) 1228 (1980), \textit{aff'd}, 696 F.2d 408 (6th Cir. 1982); Beaton v. Commissioner, 40 T.C.M. (CCH) 1324 (1980).
\bibitem{51} 75 T.C. 168 (1980).
\bibitem{52} Id. at 168.
\bibitem{53} Id. at 171. The parties stipulated to this use of the loan proceeds.
\bibitem{54} Id. at 172.
\end{thebibliography}
ognize the need to allege use of an interest free loan to carry tax exempt securities in the original deficiency notice or in the pleadings prevented the court from considering the issue in *Estate of Leichtung v. Commissioner.* As the majority in *Baker* stated that there is serious doubt whether the issue of gross income created from an interest free loan exists where the taxpayer owns tax exempt securities was properly before the court, for the very reasons stated in *Leichtung,* the apparent holding of *Baker* may in fact be *dictum.*

The Commissioner made another attempt to tax as income the interest foregone on interest free loans in *Marsh v. Commissioner.* There, the Commissioner attempted unsuccessfully to distinguish *J. Simpson Dean* on the basis of the loan's arm's length nature. Similar to *Greenspun* on its facts, *Marsh* involved an interest free loan between a utility company as lender and an oil and gas driller as borrower pursuant to a contract between the two previously unrelated companies. As part of the contract the utility agreed to purchase substantial amounts of gas to be produced in the future by the drilling company in return for the driller's promise to supply all of the gas from its wells to the utility. In an effort to help finance the exploitation of the recent gas discovery by the driller and also because the advancement of such funds was partially compensated for by an accompanying increase in the utility's rate base, the utility agreed to loan the drilling company $12.8 million interest free. In accordance with an oral contract between the parties, prepayments of the principal were made upon the installment basis into an escrow account, the interest on which account was received by the driller taxpayer and reported as interest income. In response to the Commissioner's argument that some additional unnamed benefit must have accrued to the taxpayer from the interest free financing of his drilling operations, the majority stated that because there is no "gain resulting from an exchange of property, payment of indebtedness, relief from liability, or other profit realized from the completion of the transaction," there is in fact no interest income resulting from the interest free loan. If there were imputed interest,* the

56. 40 T.C.M. (CCH) 1118 (1980).
57. 75 T.C. 166 at 171.
58. 73 T.C. 317 (1979).
59. Id. at 328.
60. I.R.C. § 483 imputes a maximum of 10% interest to an installment sale obligation which does not specify an interest factor, thereby necessitating subtraction of a portion of
opinion added, the taxpayer could take an offsetting deduction.

Prior to the Court of Claims overturning the J. Simpson Dean precedent, the Tax Court heard four cases in quick succession, each one in favor of the taxpayer under the traditional close corporation/shareholder interest free loan scenario. The Fifth Circuit Court of Appeals subsequently affirmed all four cases in a consolidated opinion. In two of these cases, Creel v. Commissioner and Parkinson v. Commissioner, which were consolidated at the Tax Court level upon petition of the parties because of their common facts (Creel and Parkinson were the sole shareholders and officers of three corporations from which they obtained interest free loans), the Tax Court took another small step towards income taxation of interest free loans between shareholders and their closely held corporations. One of the three interest free loans which Creel and Parkinson each received was obtained from a company which also acted as borrower in certain third party loans. These arm's length loans were at a market interest rate, were personally guaranteed by the two shareholders, and aggregated an amount in excess of the shareholders' interest free loans plus available earnings and profits of the corporation. Under these circumstances it was held that to the extent that the third party loans were required in order for the corporation to make interest free shareholder loans, the interest actually paid to third party creditors by the corporation would be treated as dividends taxable as ordinary income to the taxpayer. The majority applied agency theory in a “form over substance” approach to reach the

the installment payments from capital asset value for basis purposes and requiring that portion to be treated as interest. See section III. infra.


64. The court did not discuss the ramifications of this decision when, under I.R.C. § 316 the corporation is unable to pay a dividend because its earnings and profits accumulated after February 28, 1913 and the earnings and profits of the corporation's most recent taxable year are less than the so-called “dividend”. To the extent of the shortfall, under I.R.C. § 301(c)(3), the distribution to a shareholder is treated as a return of capital. When a return of capital occurs, there is a reduction in the shareholder's adjusted basis in his stock, but no taxable income. The court also did not consider the effect of this constructive dividend upon the corporation's financial position vis à vis state corporate statutes. Ohio, for example, forbids the payment of dividends except out of the corporation's surplus. OHIO REV. CODE ANN. § 1701.95 (Page 1978).
conclusion that what has actually occurred when the corporation has lent the shareholder money which it must borrow to pay him is that the corporation has negotiated a market rate loan on behalf of and as agent for its shareholder. Then the corporation has subsequently conveyed the proceeds of the loan to its shareholder in the form of an interest free loan. When the corporation makes interest payments to third party lenders on the outstanding principal necessary to carry the shareholder loan, it does so on behalf of the shareholder and, in effect, pays the shareholder a dividend. At the same time the corporation pays this debt service on the arm's length loan, a tax deduction accrues to the taxpayer as principal in the third party loan transaction.\(^5\)

On appeal to the Fifth Circuit Court of Appeals, Parkinson, Creel, Martin, and Zager were affirmed sub nom Martin v. Commissioner in a two to one decision.\(^6\) The majority labeled J. Simpson Dean an "anomaly"\(^7\) and admitted that the dissenting opinion may furnish a more rational approach to the interest free loan problem than does the majority in J. Simpson Dean, but nevertheless concluded that the complexities necessarily involved in computing the fair rate of interest to be charged if J. Simpson Dean is overturned outweighed the lack of logic which must be tolerated if J. Simpson Dean is to be upheld.\(^8\) The majority proceeded to make a "water over the dam" argument, saying that longstanding precedent and a preference for uniformity in the tax laws demand affirmance. The dissenting opinion on the other hand propounded a method of recognizing gross income to the taxpayer in the amount of the fair market interest rate on the interest free loan plus allowance to the taxpayer of a deduction of a like amount in an "imputed or constructive interest."\(^9\)

Finally, for the first time in over twenty years, a court (the United States Court of Claims), in an opinion filed on July 6, 1982, refused to follow J. Simpson Dean in a shareholder/close corporation interest free loan case, Hardee v. Commissioner.\(^7\) The Commissioner here argued that Mr. Hardee received income in the

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\(^{65}\) 72 T.C. at 1179.
\(^{66}\) 649 F.2d 1133.
\(^{67}\) Id.
\(^{68}\) Id. at 1134.
\(^{69}\) Id. at 1142. See section III, infra for a discussion of "imputed" interest and the deductibility of constructive payments.
amount of arm's length interest which would have been paid had he obtained a third party loan for the approximately $500,000 which he in fact borrowed, interest free, on an "open account basis" from his closely held corporation. During the years at issue, 1973 and 1974, the taxpayer also held tax exempt municipal bonds with a fair market value of approximately $500,000, and, so, the Commissioner argued, the taxpayer would have no interest deduction because of I.R.C. § 265(2) non-deductibility of interest on loans used to carry tax exempt obligations. 71

The trial court, in a surprising move, 72 agreed with the Commissioner's position in whole, finding that the taxpayer received imputed income in the amount of fair market interest attributable to the interest free loan he had received from his corporation. Judge Wiese's opinion adopted the traditional view that, while the Commissioner may allocate constructive interest to a taxpayer when it has not actually been paid in order to more closely reflect economic reality, there is no corresponding deductible constructive payment of interest by the taxpayer because a deduction is solely a matter of legislative grace. 73 Therefore, the argument proceeded, there is no such thing as a deductible imputed interest payment outside the realm of installment sales; under § 163(a) interest is deductible only when "paid or accrued" and only when pursuant to a legally enforceable obligation. 74 Hence, as the taxpayer here did not pay or accrue interest pursuant to a legally enforceable obligation to pay a fixed or determinable sum, there was no interest deduction. 75

On May 11, 1983 the United States Court of Appeals for the Federal Circuit issued an opinion reversing the Tax Court holding in Hardee on the basis of stare decisis and longstanding administrative precedent in favor of the taxpayer in interest free loan transactions. 76 The majority opinion stated that it was bound by

71. Id.
72. Surprising because most academic commentary and prior dissenting opinions have adopted the position that some interest deduction, whether it be called "imputed interest", "constructive interest", or some other term, should be allowable to the taxpayer if he is to be held to receive imputed interest income from his interest free loan. See supra, note 10.
73. 50 AFTR 82-5252, 5255 (1982).
75. This argument is the most logical. See infra note 112 (for a suggestion how interest may be "paid or accrued" by a taxpayer).
the J. Simpson Dean precedent. In fact, however, the majority forged new ground when it held that interest free loans result in no taxable income to the borrower based on foregone interest regardless of the deductibility of such interest had it in fact been paid. J. Simpson Dean merely stands for the proposition that if foregone interest in an interest free loan transaction would have been deductible had it been paid by the taxpayer, it is not recognizable as income.

II. FROM JOHNSON TO DICKMAN

Four years after the J. Simpson Dean decision in the Tax Court, a similar controversy over the gift taxability of intra family interest free loan transactions commenced in the district courts (N.D. Texas) in Johnson v. Commissioner. As was the case in J. Simpson Dean, the Johnson court held in favor of the taxpayer. The reason gift tax is at issue in the Johnson/Dickman line of cases whereas income tax was at issue in the J. Simpson Dean/Hardee line of cases, is the differing relationships between lender and borrower in the two situations. Where the lender and borrower have the relationship of employee/employer or of shareholder/corporation, a gift in the gift tax sense is not at issue, since the gift tax statute does not apply. Further, ordinary compensation received by an employee is salary and the ordinary compensation received by a shareholder is a dividend, both of which are taxable as income to the recipient. On the other hand, in an intra family loan situation, usually there is no employment or ownership relationship and the motive for the transfer is in the nature of benevolence and generosity. The gift tax provisions of the In-

77. Id.
78. 254 F. Supp. 73 (N.D. Texas 1966).
79. Id. at 77.
80. Not only is a true gift of corporate assets by a corporation ultra vires, it is also, like dividends, largely non-deductible under I.R.C. § 274(b).
82. A tax is imposed upon gifts pursuant to I.R.C. § 2501(1). Under the rate table set forth in I.R.C. § 2001(c), the current gift tax rate ranges from 18% on gifts of $10,000 or less to an incremental rate of 50% on amounts over $2.5 million. No definition of gift is provided in the Code for gifts for gift tax purposes, although Treas. Reg. § 25.2511-1(a) specifies that transfer by gift may be direct or indirect, tangible or intangible and involving real or personal property. Reg. § 25.2511-1(c) states that where property rights are gratuitously transferred to another, "regardless of the means or device employed," a gift tax applies. A gift in the gift tax sense is not the same as a gift for income tax purposes. The definition of a gift for income tax purposes is held to be voluntary transfer of property or property right
ternal Revenue Code apply to intra family transfers to the extent an unequal exchange takes place under I.R.C. § 2512 whereby property is transferred for less than adequate consideration in money or money’s worth.

The fact situation in Johnson typifies the intra family interest free loan which is undertaken as a means of transferring wealth between generations, from parent to child, without tax consequences. The Commissioner alleged that the taxpayer/lender should pay gift tax on the value of the interest free loan to her children, calculated annually at a rate of 3.5% of the average annual unpaid balance of the loans in question. The loans involved open account demand loans, occasionally evidenced by notes, in amounts fluctuating between zero and approximately $300,000 to each of three offspring. The court rejected the Commissioner’s position on the grounds that there is no express or implied obligation on the part of the borrowers to pay interest on the outstanding loan balances; neither was there a statutory duty to charge or pay interest. As the transaction in this case was not one which escaped estate tax, ultimately, the court saw no reason to levy a gift tax at this time.

As a response to the unfavorable holding in Johnson, the Commissioner issued Rev. Rul. 73-61 in which he expressed his intent not to follow Johnson in future similar cases. The purpose of this ruling was to provide for gift taxation of the value of both demand and term interest free loans. The position of the Commissioner was that, where the value of the future stream of foregone interest payments can be measured actuarily, as with a term note, the gift tax will be levied at the time of transfer of funds in accordance with Treas. Reg. § 25.2512-5. To solve the problem in this measurement system as applied to demand loans, the Commis-

motivated by detached and disinterested generosity. Commissioner v. Lo Bue, 351 U.S. 243, 246 (1955). A transfer meeting the foregoing requirements is not includible in gross income for income tax purposes under I.R.C. § 162. However, a gift for gift tax purposes takes place whenever a transfer of property or a property right occurs for less than adequate consideration in money or money’s worth under I.R.C. § 2512.

83. 254 F. Supp. at 77.
84. Id. (Citing Harris v. Commissioner, 340 U.S. 106, 107 (1950). See also, Estate v. Lange, 613 F.2d 770 (9th Cir. 1980) (the running of the statute of limitations on an intra family interest free loan results in a gift for gift tax purposes).
86. "Actuarily" meaning that a statistical computation can be made by means of probability analysis.
sioner proposed to measure the value of interest actually foregone during a quarter at the end of such quarter and to levy a tax at that time. In the demand loan scenario then, the loan was treated as successive quarterly loans taxed as to interest rate value determined according to the same methods applied to the J. Simpson Dean/Hardee line of cases.

A back door analysis of the gift tax interest free loan issue took place in the charitable deduction controversy in Mason v. United States,\(^{87}\) in which the taxpayer alleged a value in the interest foregone on an interest free loan. The taxpayer had sold his interest in a blood bank to a charitable institution for cash plus an interest free note. The fair market value of the blood bank was appraised at the sum of the face amount of the note plus the cash downpayment. The taxpayer maintained that the fair market value of the note was only approximately 72% of its face value after discounting it over the term of the loan at a rate which reflected the creditworthiness of the payor, prevailing interest rates, and the term of the loan. The court held that the taxpayer was entitled to a charitable deduction in the year of sale in the amount of the difference between the value of the note plus the charitable institution’s down payment and the fair market value of the blood bank, since there was no evidence that the taxpayer did not intend to make a gift of the shortfall or that the taxpayer received any other benefit from the charity as consideration for the sale.\(^{88}\)

Finally, in the well known case Crown v. Commissioner\(^{89}\) the Commissioner pulled out all stops in setting forth his case in favor of taxing the interest free demand loan at issue, in effect applying the principles set forth in Rev. Rul. 73-61. The Commissioner argued that the transaction is an unequal exchange under I.R.C. § 2512(b), being, in essence, a promise to pay a certain sum in the future on demand for a like amount in the present.\(^{90}\) This argument, analogous to that of the taxpayer in Mason,\(^{91}\) necessitates application of present value principles. The court failed to understand present value analysis and the realities of the securities markets, however, as evidenced in its reply to the Commissioner’s unequal exchange analysis. "The Commissioner has not produced

\(^{87}\) 513 F.2d 25 (7th Cir. 1975).
\(^{88}\) Id. at 26-31.
\(^{89}\) 585 F.2d 234 (7th Cir. 1978).
\(^{90}\) Id. at 237-39.
\(^{91}\) 513 F.2d at 30.
any evidence showing that demand notes systematically trade at a significant discount from face value in the market place." 92 The court did recognize that a present value analysis cannot be applied successfully in the absence of an indication as to the term of the loan. The court also provided justification for not using a present value approach in any interest free loan transaction which is not negotiated at arm's length. 93 The majority is correct in its perception that when the Commissioner applies a one-time present value analysis to interest free term loans and a quarterly in arrears valuation of interest actually foregone on demand loans, the two systems can result in vastly differing measures of value for loans which are, in fact, identical. 94 To equate the two valuation methods is quite like equating an income statement and a balance sheet.

The majority also rejected the Commissioner's attempt to characterize the making of an interest free loan as a tenancy at will in money, saying that the borrower has no protectable interest in the money vis à vis the lender. 95 While this may be true, it is worth noting that the borrower logically would have a legally enforceable right to such funds vis à vis third parties. It appears clear that real property analogies merely exacerbate an already complex valuation and taxation problem without providing any corresponding clarifications.

The Commissioner's final argument was that the interest free loan should be treated as a continuous gift over the indefinite life of the loan. 96 The majority's main objection to this attempt to reach a workable method of measuring the value of a demand loan was that it involved hypothetical interest and constructive transfers which have the effect of measuring what might have happened rather than what did happen. 97 Although many may

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92. 585 F.2d at 238. Demand notes do not systematically trade in the marketplace.
93. Id. See section V, infra. While it logically may make more sense to treat demand and term loans in non-arm's length transactions under the same terms given their practical equivalence it is probably not possible to justify such treatment under the Code.
94. 585 F.2d at 238-39. If nothing else, the fluctuation in interest rates over the period of the loan will make the two methods of figuring foregone interest result in different values, for the present value approach uses a single discounting factor determined at the takedown of the loan, whereas a yearly analysis allows for at least an annual adjustment in interest rates to reflect market values.
95. Id. at 239.
96. Id. at 239-40.
97. Id. at 240.
agree that only what actually "happens" should be taxed, the en-
forcement of the Internal Revenue Code in the courts is rife with
might-have-beens\(^98\) and the majority's hesitancy to deal with con-
cepts of imputed interest and constructive payments merely pro-
longs the inequity in inconsistent enforcement of the tax law.

III. HYPOTHETICAL OR IMPUTED INTEREST: AN ARGUMENT FOR
APPLICATION OF I.R.C. § 483

The most recently published position by the Internal Revenue
Service on the issue of taxability of interest free loans is a tech-
nical advice memorandum dated November 2, 1982\(^99\) addressing
the question whether the "phantom interest" not actually paid by
the borrower/shareholder pursuant to an interest free loan from
his closely held corporation was taxable as interest income. The
Service's rationale for its position that such foregone interest is
not taxable to the corporation is based upon the premise that "im-
puted or hypothetical deduction" to the borrower in such an inter-
est free loan transaction should not cause "imputation" of interest
income to the lender.\(^100\) The District Director's argument to the
contrary "has no basis in law or logic,"\(^101\) according to the memo-
andum, since the clear weight of authority interpreting I.R.C. §
163(a) has held that interest must be actually paid or accrued by
the borrower pursuant to a legally enforceable obligation in order
for such interest to be deductible by him. Presumably, the Service
reasoned that if "imputed or hypothetical" interest does not result
in a deduction on the borrowing side of the transaction, it likewise
should not lead to recognition of such interest on the lending side.

Embodied in this technical advice memorandum are manifesta-
tions of the unsupportability of the court's position in the J.
Simpson Dean line of cases. The Commissioner attempted to ex-
plain the current state of the law on the subject of income taxabil-
ity of interest free loans, and, in doing so exposed the illogic of the
Tax Court's position. The timing of this concession by the Service
as to the taxability to the borrower is questionable in light of the
then favorable Hardee\(^102\) decision rendered nearly four months
earlier in the Court of Claims.

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98. See infra sections III and IV.
99. I.R.S. LETTER RULINGS (CCH) 8309002 (Nov. 2, 1982).
100. Id.
101. Id.
102. Hardee was not reversed until May 11, 1983.
The memorandum's attempt to describe the interest foregone on an interest free loan lays bare the fallacy of the Tax Court's position in support of non-taxability. It terms such interest "imputed or hypothetical interest." The first problem with such a characterization is obvious on its face: is the interest "imputed" or "hypothetical"? If by "hypothetical" the District Director means "constructive" interest, the effort to justify non-taxation of foregone interest on the basis of its theoretical deductibility is lost, for there is no precedent supporting the deductibility of constructive payments as there is conclusive authority for the taxability of constructive receipts.

Imputed interest, on the other hand, exists only as a creature of statute, specifically I.R.C. § 483, a section falling not under "Itemized Deductions" in the organizational scheme of the Code, but rather under "Subchapter E, Part III, Adjustments." Many of the J. Simpson Dean related decisions have used the term "imputed interest" in describing the foregone interest in interest free loan transactions, yet no decision has discussed whether I.R.C. § 483 actually applies in the case of interest free loans between corporations and their controlling shareholders. The implication is that the courts apply the I.R.C. § 483 imputed interest concept only by analogy to the J. Simpson Dean situation. If I.R.C. § 483 does not in fact govern treatment of foregone interest, it is an incorrect utilization of the Tax Code's provisions to hold that imputed interest sections supersede the clear intent of I.R.C. § 163 to render deductible only that interest which is "paid or accrued." In effect, the "Dean rule" does just that.

I.R.C. § 483 was enacted primarily in order to prevent capitalization of that portion of amounts paid pursuant to installment sales contracts for the sale of capital assets which in reality are in payment of interest on such sales. The rule is based upon the economic reality that in an exchange which is truly at arm's length, a seller will charge a buyer more for the property which is the subject of the sale if payment for such property is made in the future rather than on the date of such sale; $100 today is worth

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103. I.R.S. LETTER RULINGS (CCH) 8309002 (Nov. 2, 1982).
106. 50 AFTR 82-5252; 585 F.2d at 238; 73 T.C. at 328; 72 T.C. at 946; 72 T.C. at 1178.
107. I.R.S. LETTER RULINGS (CCH) 8309002 (Nov. 2, 1982).
108. An expression in I.R.S. Letter Ruling 8309002. In light of the disagreement over what, in fact, was the J. Simpson Dean holding, it is unclear just what is the "Dean rule."
more than $100 five years from today. If the seller does not in fact require the prevailing market rate of interest on that portion of the sale price the payment of which is deferred, he is either not behaving rationally, or he is disguising as principal a payment which is in reality a recognition of the time value of money. He might engage in such a manipulation of basis in order to increase the amount of depreciation deduction and investment tax credit available for I.R.C. § 38 property or to convert what would otherwise be taxed as interest to the seller as capital gain to the buyer.

Congress, when enacting I.R.C. § 483, in all likelihood did not contemplate its application to the interest free loan scenario. However, since application of the section on "interest on certain deferred payments" could serve as at least a tolerable solution to the problem of what to do with interest free loans, exploration of its possible relevance is in order. I.R.C. § 483 applies in the case of a "contract for the sale or exchange of property" for more than $3,000 for which part of the sale price is due more than six months after the sale or exchange and not all of which is due within one year of the sale or exchange. Treas. Reg. § 1.483-1(b)(ii) provides that "sale or exchange" includes any transaction treated as a sale or exchange for purposes of the Code. The issue, then, is whether an exchange of a sum certain presently for a promise to pay back that same sum upon demand or at some specified date in the future meets the test of a "contract for the sale or exchange of property" under any provisions found in the Internal Revenue Code. Generally, a sale is a transfer of property for money or a promise to pay money, and an exchange is the transfer of property for property. The fact that a sale is distinguished from an exchange under income tax law would, therefore, seem to indicate that money is not considered "property", at least under some circumstances. Still, if a non-interest bearing loan obligation were "property" for purposes of the Code, the transfer of money in exchange for such obligation would qualify as a sale.

Reported decisions on interpretation of I.R.C. § 483 have not dealt with whether promissory notes qualify as "property", although most accounts summarizing the significance of the section refer to it as applying to installment sales contracts. 109 Seemingly, the only cases in which the property character of payments has

been litigated under I.R.C. § 483 have involved divorces. For example, two taxpayers were denied imputed interest deductions for a portion of their payments of periodic property settlement amounts pursuant to divorce decrees on the grounds that the legislative history of I.R.C. § 483 indicated the section was not intended to apply to such agreements and, in addition, I.R.C. § 215 (relating to the deductibility of alimony) and I.R.C. § 71 (relating to includibility of alimony and separate maintenance payments) were to be exclusively to determine tax treatment in the case of divorce settlements.110

As no precedent exists defining “property” under I.R.C. § 483, one is forced to look elsewhere in the Code for guidance to determine whether cash qualifies as property. The Code itself, unfortunately, is of little assistance in the search for statutory definitions of property which can be generally applied. Under some sections, cash is not considered property111 while under other sections cash is specifically included in the term “property”.112 Given the broadly inclusive wording of Treas. Reg. § 1.483-1(b)(ii) which subsumes “any transaction treated as a sale or exchange for purposes of the Code” under the sale or exchange rules of I.R.C. § 483, there seems to be no good argument against application of I.R.C. § 483 to interest free loans if to do so would carry out the purposes for which the section was conceived.

Referring to Congressional history surrounding enactment of I.R.C. § 483113 in 1964, one is forced to conclude there is no doubt that the purpose of the section was to prevent manipulation of the tax laws to reapportion income and deduction between buyers and sellers in capital asset transfer situations and to prevent capital gain treatment of what would otherwise qualify as interest in-

110. Id.; see also Fox v. U.S., 35 AFTR 2d 75-710, 75-714 (510 F.2d 1330).
111. Under I.R.C. § 317 “property” means money, securities, and any other property. See also Treas. Reg. § 1.317-1.
112. I.R.C. § 203(b)(4). MERTENS, 3 LAW OF FEDERAL INCOME TAXATION 172 cites G.C.M. 2862 CB VII-1 at , in which it was stated: “It is the opinion of this office that the word ‘property’ as used in section 203(b)(4) means property other than money.” In Mertens’ section explaining the requirements for non-recognition of gains or losses on sales of capital assets, it is stated: “[t]he transferor must transfer ‘property’ in the exchange formerly, this term had been held not to include cash [footnote omitted], but the current and sounder rule is that it does [footnote omitted].” MERTENS, 3B LAW OF FEDERAL INCOME TAXATION at 163. GCM 2862 CB VII-1 was revoked by GCM 24415, CB 1944 at 219, according to Mertens.
come. Yet, the fact that Congress did not anticipate a particular application of the tax law provision has never prevented the courts from invoking a rule which, when applied to the new situation, carries out the spirit of the law. The argument can be made that an interest free loan between a corporation and its shareholder has much the same effect as the sale of a capital asset by the same shareholder to his closely held corporation, that is, to shift income from the corporation to the shareholder without tax consequence.

IV. I.R.C. § 482: REALLOCATION OF INCOME

An interesting omission by the courts in their consideration of interest free loans in the J. Simpson Dean line of cases is an analysis of I.R.C. § 482, which is entitled “Allocation of income and deductions among taxpayers.” I.R.C. § 482 authorizes the Commissioner, among other things, to reallocate gross income and deductions among two or more “organizations, trades, or businesses” whether or not incorporated, if he determines that to do so would prevent evasion of taxes or more clearly reflect income of such entities. On authority of this section, the Commissioner has successfully reallocated interest among a holding company and its 450 subsidiaries where different interest rates were charged by the holding company to different subsidiaries depending upon the income of the subsidiaries.\(^\text{114}\) The Commissioner’s decision to increase the interest rate charged on loans extended at lower than prevailing rates was sanctioned and the Commissioner was permitted to allow an additional matching interest deduction to the subsidiaries involved in each such reallocation.\(^\text{115}\)

In B. Forman Co. v. Commissioner\(^\text{116}\) the Second Circuit Court of Appeals created interest for tax purposes on interest free loans between two corporations which each owned 50% of the stock of a third corporation. The decision was later reversed on the issue of control,\(^\text{117}\) yet the question whether creation of interest income is authorized under this section was left open, with a citation of J. Simpson Dean.\(^\text{118}\) Treas. Reg. § 1.482-2 now authorizes the charge

\(^{114}\) Aristar, Inc. v. United States 553 F.2d 644 (Ct. Cl. 1977).
\(^{115}\) Id. at 646.
\(^{117}\) Id. See also, Cayuga Service, Inc., 34 T.C.M. (C.C.H.) 18 (1975).
\(^{118}\) 54 T.C. at 923.
of arm's length rate on interest free and below market rate loans between related taxpayers.\textsuperscript{119}

Some precedent also exists for reallocating income between a corporation and a majority shareholder of the corporation under I.R.C. § 482, although to date such reallocation has occurred only between a stockholder and his personal service corporation.\textsuperscript{120} An extension of this doctrine to other situations may be justified by following the literal words of the statute.\textsuperscript{121} The argument can be made that if a shareholder or even a mere employee of a corporation has the power to cause such corporation to extend to him an interest free loan, he possesses the requisite "control" for purposes of I.R.C. § 482. Assuming the control test is met and extending the personal service corporation precedent, one can arguably justify interest income recognition and corresponding deduction to the borrower and interest income recognition in a like amount to the lender corporation in the \textit{J. Simpson Dean} fact situation.\textsuperscript{122}

\textsuperscript{119} "Where one member of a group of controlled entities makes a loan or advance directly, indirectly to or otherwise becomes a creditor of, another member of such group, and charges no interest, or charges interest at a rate which is not equal to an arm's length rate as defined in subparagraph (2) of this paragraph, the district director may make appropriate allocations to reflect an arm's length interest rate for the use of such loan or advance." Treas. Reg. 1.482-2(a)(1).


Stephen Nechemias, Esq. of the firm Taft, Stettinius & Hollister, Cincinnati, Ohio has related to the author a story of an audit experience during which the Service attempted to invoke I.R.C. § 482 between the client individually and the client's non-personal service corporation. Mr. Nechemias succeeded in preventing a reallocation by citation of case authority for the proposition that such reallocation between an individual and his controlled corporation under § 482 can take place only in the event such corporation is a personal service corporation [see, I.R.C. § 269A (b)(1) for the definition of a personal service corporation]. The author was unable to locate any such case authority.

John Mueller, Esq., Cincinnati, Ohio, on the other hand, has offered a hypothetical fact situation in which he could envision the Service prevailing on the issue of reallocation of income pursuant to I.R.C. § 482 between an individual and his controlled, non-personal service corporation. A farmer controls a corporation in the business of dairy farming which has many employees and does not perform services for a single entity. The farmer also raises dairy cattle for his own account. The farmer becomes aware of the existence of a dairy cow which he can buy for $50,000 and sell for $100,000. He causes his corporation to purchase and sell the cow because he, personally, wishes to avoid recognizing a capital gain on his individual tax return.

\textsuperscript{121} I.R.C. § 482 (1976).

\textsuperscript{122} Another alternative, which would make more sense conceptually, would be to treat the shareholder's loan as a loan of a greater amount than the amount received by him, or a "discount loan." The difference between the amount of the loan and the amount received by
V. A PLAN FOR TAXING INTEREST FREE LOANS

The time is at hand for the courts to devise a comprehensive scheme for the taxation of interest free demand and term loans in both corporate and family settings. Barring legislative action which would set forth a plan for taxation of interest free loans in all such situations in a single section, the treatment of interest free loans must be undertaken under existing Code sections which differ markedly among themselves in approach.

The difference in legal effect between demand loans and term loans necessitates disparate treatment of the two types of transactions for purposes of calculating foregone interest allocable to interest free loans. It is tempting to propound a foregone interest calculation method whereby term loans in non-arm's length transactions (into which category all interest free loans must fall until money ceases to have value) are dealt with as demand loans. The difference between a term and a demand loan between family members or between corporations and their controlling persons is usually a matter of mere formality. A demand loan between such persons or entities may remain outstanding for many years, and a term loan may be rolled over repeatedly. Likewise, where financial circumstances call for an unanticipated transfer of funds from the borrower to the lender, a term loan may be prepaid just as easily as a demand loan may be recalled unless the debt instrument specifies to the contrary. Yet the inclination to accept a

the stockholder would be considered the prepaid interest on the loan over the life of the loan, which the shareholder could actually deduct over the life of the loan as “paid or accrued” during the year. If the loan extends beyond the end of the borrower’s tax year, however, only a portion of such interest is deductible. See Rev. Rul. 72-100, 1972-1 C.B. 122, as clarified by Rev. Rul. 72-562, 1972-2 C.B. 231; Rev. rul. 75-12, 1975-1 C.B. 62; Rev. Rul. 74-607, 1974-2 C.B. 149. The effect of non-deductibility of the entire amount of interest during the year of loan takedown is a situation in which no “wash out,” to use the terms of Hardee, occurs and the taxpayer realizes income in the amount of the difference between the prepaid interest and the amount deductible in the first year. The effect to the corporation upon the shareholder’s repayment of the loan would be not a deduction as urged by the Commissioner in his 1983 technical memorandum on the subject, but a contribution to capital. The following illustration will clarify this method: $1,000 is lent by the corporation to its controlling shareholder at the beginning of year one at 10% prevailing interest rates, due at the end of year two. This is treated as a loan of $826.45 and a prepayment of interest in the amount of $173.55. The taxpayer realizes income of $173.55 and a deduction of only $86.78 in year one. He will deduct $86.77 in interest in year two and repay $1,000 to the corporation. The corporation realizes a non-taxable increase in capital in the amount of $173.55. For a similar method, see, Jacobs, Of No Interest: Truth, Substance and Bargain Borrowing, 9 FLA. ST. U. L. REV. 261, 274 (1981).
INTEREST FREE LOANS

substance over form justification for ignoring the merely theoretical dissimilarities must be overcome unless some common law reason for reformation of the contract at issue can be justified. Even though the real distinction between demand and term loans among related parties occurs merely on paper, the terms of such contracts continue to have effect with respect to third parties and must be respected as legally binding irrespective of the very real power of the parties to ignore their terms without consequence.

Where the provisions of a non-interest bearing term loan do not render actuarial computation impossible (as where, for instance, it is callable upon the firing of the employee/borrower by the employer/lender), a discounted present value computation best measures the value of the interest foregone as of the date of take-down. The terms of the loan are fixed for a measureable period of time, and a single interest (discount) rate should be applied. Term loans which do have contingencies preventing actuarial computation should be treated as demand loans. In the case of a demand loan, as the outstanding period is not fixed, no actuarial computation is possible. In addition, it being a loan which is callable on an unpredictable basis, a floating rate rather than a fixed rate is probably more accurately reflective of a truly comparable arm's length rate in the market place. To analogize this difference to market place transactions one may compare term and demand loans to money market mutual fund investments which have floating rates and can be liquidated on a day to day basis by the investor, and long term bonds which remain outstanding for fixed periods of time (ignoring call provisions for purposes of this analysis) and carry constant rates over their terms. The return on a money market fund investment over a fixed period of time cannot be calculated in advance, while the return on the bond can be determined to the penny on the date of purchase using present value analysis at the fixed rate of interest. The value of the foregone interest on a demand loan, therefore, must be calculated after the fact using the applicable rate multiplied by the average daily balance outstanding and the number of days in the year during which the loan was outstanding. A more complicated formula would be used where a floating rate could be justifiably employed.

The appropriate, or at least fair, interest rate to apply to interest free loans is a real conundrum. Probably, the highest rate which could be justified under present conditions is the rate
levied on overdue tax payments under I.R.C. § 6601\textsuperscript{123} at the rate authorized under I.R.C. § 6621.\textsuperscript{124} Currently the adjusted interest rate on underpayments of tax is 11%. Under I.R.C. § 6621 this rate is the average predominant prime rate at commercial banks (determined by the Board of Governors of the Federal Reserve) during the month of September or March where the rate then in effect is, rounded to the nearest percentage, one percentage above or below the average predominant rate then in effect. In other words, the rate only changes when prime fluctuates more than a full percentage between a given March and September. When the rate changes, the new rate becomes effective on July 1 for rates determined in March or January 1 for rates determined in September. The interest rate on underpayments of tax is lower than the loan rate which would be available to all but the most creditworthy of individual taxpayers, it being the rate quoted by major banks to their largest and best commercial borrowers. While conceptually the ideal interest rate for purposes of computing phantom interest on an interest free loan would be the lender's opportunity interest rate\textsuperscript{125} or the borrower's cost of funds in an arm's length transaction, the fact that there is no actual loan takedown makes a determination of such rates nearly impossible, especially in cases in which the relevant interest rates must be determined after the fact. Perhaps a workable alternative would be to allow the taxpayer to choose from among all of the foregoing values. Then, if a corporation's internal cost of funds were low, for example, and the taxpayer could document that fact, he would be able to utilize the lower rate.

There are other possible interest rates which might be employed to maintain statutory consistency. Depending upon the justification one chooses for taxing the particular interest free loan transaction at issue, a given rate may be statutorily mandated. With the exception of the rate applied to tax underpayments and overpayments, statutory rates of interest under the Code are generally well below prevailing rates. Under the gift tax rate tables in Treas. Reg. § 25.2512-9, a 6%\textsuperscript{126} simple annualized

\textsuperscript{123} I.R.C. § 6601 (1982).
\textsuperscript{124} I.R.C. § 6621 (1982).
\textsuperscript{125} Opportunity interest rate is a finance discipline concept which is the return a given entity realizes on its own internal funds.
\textsuperscript{126} On October 10, 1983 the I.R.S. filed proposed regulations to the estate and gift tax tables, which appear at I.R.C. § 20.2031-10(f) and § 25.2512-9(f), respectively, to raise the
discount rate is applied in the valuation of a stream of equal payments for a term of years. This rate is probably the one to employ for an intra family term loan.

If, in the corporate setting, I.R.C. § 483, dealing with imputed interest on deferred payments, or I.R.C. § 482, dealing with allocation of income between related parties, were to be applied, the rates under the regulations promulgated under these respective sections should be used in the computation of foregone interest. In the case of I.R.C. § 482, Treas. Reg. § 1.482-2(a) provides that, where an interest free or lower than arm's length interest rate loan is made between related parties, the rate of interest to be applied by the Commissioner for current loans is the arm's length rate for similar transactions. Where such a rate is indeterminable because the lender is not in the business of extending loans to unrelated parties, a 12% simple, annually compounded "safe haven" rate is available. Treas. Reg. § 1.482-2 authorizes use of the safe haven rate for demand as well as for term loans and appears to contemplate an annual, as opposed to a discounted present value approach, even in the case of term loans. I.R.C. § 483 provides only for a discounted present value rate to be applied to the stream of payments over the life of the loan at rates falling between 4% and 10%, semiannually compounded, depending upon the date of takedown and modifications in the loan contract, if any. Generally, a 10% rate will be relevant currently. The provisions of this section, by their very nature and for reasons explained above in the discussion of I.R.C. § 483, cannot be applied to demand loans.

To fully appreciate the significance the interest rate and the nature of the obligation (viz., whether a demand or a term loan is involved) make on the amount and timing of an individual's tax liability, one must run a few numbers. The following table is offered as an illustration of the significance of different interest rate computations under present valuing and annual compounding methods. It assumes an outstanding period of ten years for a $100,000 non-interest bearing loan.

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present value interest rate to 10%, effective after November 30, 1983. Such regulations have not been adopted in final form, yet it appears that the I.R.S. will apply the new rates retroactively to November 30, 1983 when they become final.
## TAXABLE AMOUNTS, YEAR ONE

<table>
<thead>
<tr>
<th>Gift tax rate</th>
<th>10% in-</th>
<th>12% in-</th>
<th>16% in-</th>
<th>18% in-</th>
</tr>
</thead>
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</tr>
<tr>
<td></td>
<td>loan</td>
<td>loan</td>
<td>loan</td>
<td>loan</td>
</tr>
</tbody>
</table>

| 0              | $10,000  | $12,000  | $16,000  | $18,000  |

## TAXABLE AMOUNTS, LIFE OF LOAN

| 0              | $100,000 | $120,000 | $160,000 | $180,000 |

| $34,160        | $61,446  | $67,803  | $77,332  | $80,994  |
VI. ON POLICY

The foregoing discussion of *Dickman, Hardee*, and their respective predecessors illustrates the futility of attempts to justify the current policy of nontaxation of interest free loans with statute based rationalizations. As it is true that the federal gift and income tax statutes do not address the specific problem of taxation of phantom interest applicable to interest free loans, so too can it be said there is no indication of a legislative intent to treat transfers of benefits arising from the free use of cash over a period of time any differently from transfers of benefits from the free use of other interests in property.

If, under the *Dickman* and *Hardee* fact situations, the subject of the transfers at issue had been rent free use of a thirty room mansion, tax consequences would have resulted either to the owner, in the case of an intra family transfer, or to the mansion dweller, in the case of a transfer between a corporation and its shareholder or employee. To determine the taxable amount in the mansion example, the rights under the free rent contract would have to be examined. If the mansion dweller/family member had the unfettered right under the contract of transfer to continue to live in the mansion for a definite period of time, the gift tax statute would apply the unified gift and estate tax rate tables to the present value of a stream of rentals (probably on a monthly in advance basis, since in the marketplace rentals for real property ordinarily are payable monthly in advance) in the amount of fair market rental for the mansion, discounted at an annual rate of 6% over the time period the subject of the agreement. If, on the other hand, the mansion dweller/family member had a month to month contract for occupancy of the mansion, the owner of the mansion would be taxed under the unified gift and estate tax tables with the tax rate applied to the fair market rental value during the period of rent free occupancy over the tax year of the owner of the mansion. Whether in the case of a corporate owned mansion provided rent free to a stockholder or employee the discounted present value method would be applied in determining the value of a free rental contract over a term of years is unclear. *Dean v. Commissioner* is an example on point of the taxation of a month to month rent free contract between a close corporation as owner and its.

127. I.R.C. § 25.2512-9 Table B, columns (1) and (2).
majority stockholder as mansion dweller.\textsuperscript{128} There, on authority of I.R.C. \$ 22, the Third Circuit, affirming the Tax Court, rendered taxable as income the fair market rental value of the DuPont mansion for that portion of the taxpayer/stockholder's tax year during which he occupied the mansion.

The rent free mansion illustration and the discussion of I.R.C. \$ 482 and I.R.C. \$ 483 above indicate that, unless some overriding justification for taxing cash differently from other types of property exists, the interest foregone on an interest free loan, whether in the form of compensation for services, compensation for risk capital, or a gift, should be taxed the same as any other benefit under gift and income tax sections of the Tax Code. It is clear that understanding interest free loan transactions and the methods for determining the taxable amount in respect of such transactions is a task to be successfully undertaken only by those capable of dealing with moderately complex accounting and finance concepts. Yet the Code is rife with examples of tax computation rules which are highly complex and which can be thoroughly understood only by highly specialized professionals: the generation skipping tax, the partnership taxation sections in general, and the corporate merger provisions, to name a few. Given the financial sophistication inherent in the use of the tax free loan vehicle and the obvious wealth of the parties involved in all the interest free loans cited in this paper, it is safe to assume such taxpayers had employed tax specialists long before their tax returns were audited. Whether some \textit{de minimus} rule should be invoked administratively to dispense with cases in which amounts less than \textdollar10,000, for example, were loaned without interest is a separate issue, but worth consideration if the hesitancy of the courts to tax interest free loans springs from the fear that implementation of a foregone interest taxation rule would create an administrative nightmare or from a hesitancy to interfere with the efforts of middle class parents to help their offspring get started in purchasing their first home or initiating a new business.

The subject of a possible \textit{de minimus} rule applied to taxation of interest free loans comes full circle to the issue whether, for policy reasons, it is desirable for the courts not to apply traditional taxation rules to phantom interest. The use of tax free loans is a popular device among financial planners and tax advisers,

\textsuperscript{128} 187 F.2d 1019 (3rd Cir. 1951).
owners of profitable controlled corporations, and other individuals in high tax brackets for the avoidance of tax. Whereas other so-called “loopholes”, such as business expense deductions to individuals, depreciation deductions, energy, investment and research and development credit, depletion allowances, charitable deductions, non-taxation treatment of interest from municipal bonds, have some higher purpose to stimulate business investment in the economy and to encourage the voluntary diversion of disposable income into worthy endeavors, the interest free loan “loophole” does not accomplish any such end. In fact, it actually encourages undesirable economic behavior in the case of business involvement in non-arm’s length loans to shareholders and other controlling persons.

Interest free loans by a corporation allow it to retain capital on its balance sheet while actually paying it out to stockholders. What appears at first perusal to be common stock, retained earnings and paid in capital is actually spent money. An obligation by a controlling person of a corporation to reimburse large amounts of loaned cash upon demand is not a liquid asset to the corporation, to say the least. A corporation which could not legally pay dividends to its shareholders due to its inadequate earnings and profits history can, nevertheless, siphon off cash in the form of a loan to its shareholders much to the detriment of creditors, thus avoiding corporate statute provisions in most states which limit payment of dividends in order to protect those very creditors. It is worth noting that corporate loans to shareholders, directors and officers of a corporation by such corporation are actually illegal in some states, whether or not such obligations carry a fair market rate of interest.129 Finally, yet perhaps most important, the corporate interest free loan encourages owners of closely held corporations to intermingle corporate and personal finances, thus subjecting the corporate entity to unpredictable fluctuations in liquidity, questionable accounting practices resulting from attempted obfuscation of the cash drain, and a deception of creditors. All the while, the owners of the corporation are allowed the benefits of corporate existence in the form of limited liability for corporate debts and the lower corporate tax rate. Thus, for ex-

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129. In Ohio, for example, a director who votes for the making of a loan to an officer, director or shareholder of the company other than in the usual course of business is liable to the corporation for the full amount of the loan plus interest at 6% per annum until the loan is repaid. OHIO REV. CODE ANN. § 1701.95 (Page 1978).
ample, a controlled corporation in a deficit earnings and profits position can, in theory, mortgage its capital assets at the bank at prevailing interest rates, pay out the proceeds of the mortgage loan to a shareholder in the form of an interest free loan and, in effect, make an illegal dividend payment which is also non-taxable to the shareholder or a salary payment which could not be justified as "ordinary and necessary" under I.R.C. § 162 and which is also not taxable as income to the employee. The actual taxation of the cash loaned to the shareholder or employee may take place at rates as low as 15% if the corporation is not profitable or enjoys some loss carry forward or other similar tax benefit. The corporation pays deductible mortgage interest to the bank, further draining its resources, and probably never sees the interest free loan principal again. Should the corporation take shelter from creditors under bankruptcy statutes, the trustees may not be able to "pierce the corporate veil" to recover loaned funds to shareholders if the loans are subject to a long term agreement for repayment far into the future. Ironically, though, the shareholder has been able to treat the company's assets as his own while being liable to creditors only in the amount of his original risk capital.

The policy reasons for not levying a gift tax on interest foregone on intra family interest free loans are likewise non-existent. The $10,000 per donee gift tax annual exclusion of I.R.C. § 2503(b), the unlimited interspousal gift provisions of I.R.C. § 2523, and the unified credit against gift tax under I.R.C. § 2505 allow a taxpayer a significant amount of tax free gift giving in his lifetime. The comprehensive nature of the gift and estate tax statutes serves as an indication that all transfers of property between related and unrelated persons, not pursuant to arm's length contracts and not pursuant to legally enforceable obligations to support, are intended to be taxed unless otherwise provided within the statute. It is generally acknowledged that the purpose of the gift tax is to tax those transfers which are not taxed to the transferor's estate when he dies. In the case of an interest free loan, the transferor can divert what would otherwise be taxable to him as income from a capital asset he owns to another person in a lower tax bracket by loaning such asset to the recipient who then enjoys the income from the asset directly. Such income never ap-

pears in the lender's estate, and neither is a gift tax levied, according to Dickman. Were the lender to effect the transfer of the benefit of the use of such loan proceeds in almost any other conceivable manner, the income would be first taxed as income to the lender and then taxed as a gift when he causes it to be transferred to a family member. For example, the creation of a revocable trust or a trust the corpus of which the grantor retains significant control, from which the income is payable to the beneficiary of the trust, results in an almost identical real world situation to an interest free loan. Under Helvering v. Clifford and a host of similar cases, the income from such a trust is taxable to the grantor as income and again as a gift. Only a form over substance argument can rationalize treating these two situations differently for gift tax purposes.

In an opinion handed down on February 22, 1984, the United States Supreme Court affirmed the decision of the United States Court of Appeals for the Eleventh Circuit in Dickman v. Commissioner, holding that a demand loan between family members is taxable as a gift for gift tax purposes. The majority opinion is noteworthy for the most part only in that, in following the logic, reasoning and analyses of the majority of the judges on the Eleventh Circuit Court of Appeals in the lower court opinion, Judge Van Pelt in his dissenting opinion in Crown v. Commissioner, and the Commissioner of the Internal Revenue Service in briefs for the Johnson, Crown and Dickman cases, the Court has made a dispositive statement in favor of taxing interest free loans in gift tax contexts. Chief Justice Burger delivered the opinion of the Court, in which opinion Justices Brennan, White, Marshall, Blackmun, Stevens and O'Connor joined.

Essentially, the thrust of Chief Justice Burger's relatively short opinion is that the legislature's intent in enacting the gift and estate tax was to tax all gratuitous transfers of value between distinct persons or entities except as otherwise set forth explicitly in the Internal Revenue Code. More narrowly stated, the holding of the Court is that an intrafamily interest free demand loan is a "use of valuable property ... itself a legally protectible property interest" which qualifies as a "transfer of property" under I.R.C.

131. 309 U.S. 331, 335 (1940).
133. Id. at 4223.
§ 2501. For reasons which should be clear to the reader, an interest free term loan will be likewise taxable.

That this decision in its broad generalizations to the effect that any gratuitously granted “use” of “valuable” property falls within the purview of the gift tax statute may serve as a catalyst for a spate of Internal Revenue deficiency notices in the routine family setting is clearly the concern of Justice Powell as indicated in his dissenting opinion, in which Justice Rehnquist joined. Powell’s arguments center around laches\textsuperscript{134} based and equity inspired justifications for avoiding the very real questions posed by the majority’s opinion: is there some point of absurdity beyond which the I.R.S. will be precluded from taxing “valuable use” gratuitously transferred? and, how does one measure the value of interest free demand loans?

Powell is also concerned with two “anomalies” in the tax law which he says are created by the majority’s holding.\textsuperscript{135} First, he says it is unclear whether the recipient of an interest free loan would be able to exclude from his gross income, pursuant to I.R.C. § 102, an amount commensurate with the foregone interest taxed to the lender, since the borrower’s use of the loan proceeds may not produce any specifically identifiable income. He misses the point. If the foregone interest is treated for purposes of the lender’s tax situation as a taxable gift, there is no logical reason for it not to be treated as an excludable gift to the borrower under I.R.C. § 102. Then, the borrower would pay tax only on income actually earned from the use of the borrowed funds, a situation analogous to a “real” loan. Even if there is in fact no perfect fit between gift tax consequences to the lender and income tax consequences to the borrower, no new “anomaly” is created by the interest free loan for this reason; because a gift for gift tax purposes is not the same as a gift for income tax purposes, the problem exists irrespective of the phantom nature of the payment and receipt.\textsuperscript{136} The difficult question is whether the borrower can deduct the phantom interest as interest “paid or accrued” under I.R.C. § 163.\textsuperscript{137}

\textsuperscript{134} Laches asserted against the United States Government?
\textsuperscript{135} 52 U.S.L.W. 4222 at 4228.
\textsuperscript{136} See supra note 82 for a discussion of the difference between gifts for income and for gift tax purposes.
\textsuperscript{137} See supra Section III for a discussion of the problems inherent in attempting to justify deduction of “imputed” or “hypothetical” interest.
The second "anomaly" to which Justice Powell refers does in fact exist. Under I.R.C. §§ 170 and 2252 the foregone interest applicable to an interest free loan to a qualifying charity is not deductible from the grantor's gross income or excludible from the grantor's gross taxable gifts, respectively. It should be noted, however, that this "anomaly" is created by virtue of the regulations interpreting I.R.C. § 170 (and by analogy § 2252) rather than by the statute itself. The problem with deduction and exclusion under these sections arises because an example in Treas. Reg. § 1.170A-7(d) indicates that the I.R.S. takes the position an interest free loan is a "partial interest in property" disqualified from operation of the gift deduction provisions by I.R.C. § 170(f)(3).

The I.R.S.'s position seems strained at best. The interest free loan should be seen as the full grant of the use of property (that is, the principal of the loan) over the period of the loan and the absence of any grant of the property itself.

The issue of the value of interest free loans has been treated at length in the preceding discussion. Because the issue of valuation had been remanded to the Tax Court by the Court of Appeals, the matter was not before the Burger Court. However, a footnote of the opinion suggests that in order to establish a liability on the part of a lender taxpayer for tax on a gratuitous interest free loan, the Commissioner does not need to demonstrate that the loaned funds in fact generated a given amount of revenue in the hands of the borrower. Rather, he need only demonstrate that a given yield "could readily be secured." The majority, then, seems to be looking at the value of the loaned funds from the standpoint of the lender, not the borrower, and seems to be suggesting some fair market rate obtainable by the lender, some opportunity interest rate, is appropriate to valuation.

The valuation method propounded in this case by the Commissioner was based on the rate of interest set forth in I.R.C. § 6621 as that chargeable on underpayments and overpayments of tax. On remand, the Tax Court may find the I.R.C. § 6621 rate unacceptable under the guidelines set forth in Burger's footnote, since that rate at a given time lags behind the prime rate by at least three months and is the rate available to the best customers of money center banks rather than one available to a given taxpayer.

138. 52 U.S.L.W. 4222 at 4226, footnote 14.
139. See supra Section V for a discussion of § 6621.
Under the footnote guidelines, a lender's opportunity interest rate may be acceptable, but whether such a rate is what the taxpayer could have obtained as an investment rate (as with the investment in a stock or bond, for example) or as a loan rate (as with the advancement of a demand loan) is left open. Presumably, if the loan rate were employed, the creditworthiness of the borrower and the duration of or the demand nature of the loan would be important and complicating factors in determining the fair market opportunity interest rate.

According to Justice Powell, the Commissioner urged the use of a fair market interest rate determined on a monthly basis during the outstanding period of the loan and based in part on the creditworthiness of the borrower, in a recently docketed Tax Court case.140 Interestingly, the annualized rates during the period of the loan in that case were determined by the Commissioner's expert to fluctuate between 12.5% and 31.1%.

CAROLYN A. BETTS*

140. LaRosa v. Commissioner, No. 29632-82 cited in 52 U.S.L.W. 4222 at 4227 n. 9.
* J.D., Salmon P. Chase College of Law, Northern Kentucky University, 1984. The author gratefully acknowledges the guidance of John Mueller, Esq., Cincinnati, Ohio, in the writing of this comment.
STRICT LIABILITY AND THE TORTIOUS FAILURE TO WARN

INTRODUCTION

Inspired by Dean William Prosser, the development of § 402A of the Restatement (Second) of Torts and its adoption by the American Law Institute in 1965 represented a major innovation in traditional products liability law. Its publication in 1965 has served as a catalyst to the dramatic growth of products liability law in recent years.

The doctrine of strict tort liability has proved a valuable tool for injured consumers since strict liability abrogates the barriers to establishing liability under the more traditional negligence and warranty theories. Unlike the common law negligence cause of action, strict tort liability focuses upon the condition of the product rather than upon the conduct of the product supplier. The doctrine also abolished the requirement of proving privity of contract in order to prosecute an action in strict tort liability.

The battle that consumers have won, however, has been countered by the inconsistent and ameliorating judicial practices.
in applying the doctrine of strict tort liability on a case-by-case and jurisdiction-to-jurisdiction basis. The battle still rages as the courts attempt to search for the limits of strict products liability. Dean Prosser, in presenting § 402A to the American Law Institute stated, "It is evident that the probable development of the law will carry strict liability to many products other than food. There is still great uncertainty as to whether there are any limits, and if so what."  

Dean Prosser’s predictions have come to pass as § 402A was expanded in 1965 to cover all products “in a defective condition unreasonably dangerous.” Today the outer limits of strict liability remain uncertain as its application is simply a matter of how a particular court perceives the doctrine.

Despite the various limitations imposed by the courts in the application of strict tort liability, the basic elements of the doctrine have remained the same: (1) a defective product; (2) that reaches the consumer without substantial change from the time of sale or manufacture; (3) that contains a defect that renders the product unreasonably dangerous; and (4) causes injury to the ultimate user of the product.

One of the most difficult problems in applying strict liability has been defining what renders a product “defective.” Justice Traynor, the author of the landmark opinion in Greenman v. Yuba


7. The courts have imposed numerous limitations on the application of § 402A. See Phipps v. General Motors Corp., 278 Md. 337, 350-51, 363 A.2d 955, 962 (1976) (court refused to hold a manufacturer strictly liable where plaintiff failed to prove a defect existing in the product at the time it left the seller’s control). See also Raney v. Honeywell, Inc., 540 F.2d 932, 938 (8th Cir. 1976); Garrison v. Rohm & Haas Co., 492 F.2d 346 (6th Cir. 1974) (court refused to apply strict liability where a manufacturer of a product manufactured it to another’s specifications without any input in design). An exception is also made for unavoidably unsafe products on the theory that their benefits to society outweigh the risk of harm. RESTATEMENT (SECOND) OF TORTS § 402A comment k (Tent. Draft No. 6, 1961); See Calabrese v. Trenton State College, 392 A.2d 600, 604 (N.J. Super. Ct. App. Div. 1978) (no duty to include in informational data accompanying distribution of vaccine statistical information about remote danger of side effects). The majority of jurisdictions do not impose liability on a blood supplier for post transfusion hepatitis. There is no duty to warn as the supplying of blood is characterized as a service rather than a sale. See Franklin, Tort Liability for Hepatitis: An Analysis & a Proposal, 24 STAN. L. REV. 439, 457 (1972).

8. RESTATEMENT (SECOND) OF TORTS Note to the Institute at 31 (Tent. Draft No. 6, 1961).

9. See supra note 2 and accompanying text.

10. Sales, supra note 4, at 523.
Power Products, Inc.,\(^{11}\) envisioned that a defect would arise when the product fails to match the average quality of similar products.\(^{12}\) The major criticism of Justice Traynor’s “deviation from the norm” test is that an entire industry may adopt careless standards.\(^{13}\) Therefore, other tests have been devised by the courts such as the consumer expectations\(^{14}\) and risk/utility tests.\(^{15}\)

Since the adoption of §402A by Kentucky in 1966 in Dealers Transport Co. v. Battery Distrib. Co.,\(^{16}\) the courts of Kentucky have also struggled to define the scope of §402A.\(^{17}\) For example, under Kentucky law, a defendant is not required to design the best possible product, or even one as good as other similar products, so long as it is “reasonably safe.”\(^{18}\) Accordingly, industry custom or state of the art was held admissible in Jones v. Hutchinson Mfg. Inc.\(^{19}\) to prove the defendant’s conformity or nonconfor-

\(^{11}\) 59 Cal. 2d 57, 377 P.2d 897, 27 Cal. Rptr. 697.
\(^{13}\) As Judge Learned Hand noted:
[A] whole calling may have unduly lagged in the adoption of new and available devices. It never may set its own tests, however persuasive be its usages. Courts must in the end say what is required; there are precautions so imperative that even their universal disregard will not excuse their omission.

New England Coal & Coke Co. v. Northern Barge Corp., 60 F.2d 737, 740 (2d Cir. 1932).

\(^{14}\) In design defect cases, a court may properly instruct a jury that a product is defective in design if (1) the plaintiff proves that the product failed to perform as safely as an ordinary consumer would expect when used in an intended or reasonably foreseeable manner, or (2) the plaintiff proves that the product’s design proximately caused injury and the defendant fails to prove, in light of the relevant factors, that on balance the benefits of the challenged design outweighs the risk of danger inherent in such design.


\(^{15}\) The risk/utility test requires balancing the utility of the product to society against the possibility of injury and the magnitude of the injury. See Heckman v. Federal Press Co., 587 F.2d 612 (3rd Cir. 1979); See also Keeton, Product Liability and the Meaning of Defect, 5 St. Mary’s L.J. 30, 38-39 (1973).

\(^{16}\) 402 S.W.2d 441 (Ky. 1966).
\(^{17}\) “Though strict liability does not depend upon negligence, a degree of kinship between the two does inhere in the term ‘unreasonably dangerous.’ Both utilize the concept of reasonable foreseeability.” Ulrich v. Kasco Abrasives Co., 532 S.W.2d 197, 200 (Ky. 1976).

For design defect cases, one of the factors to be considered is “the likelihood that the products would cause the claimants [sic] harm or similar harms and the seriousness of those harms.” Nichols v. Union Underwear Co., 602 S.W.2d 429, 434 (Ky. 1980) (Lukowsky J., concurring).

\(^{18}\) Sturm, Ruger & Co., Inc. v. Boyd, 586 S.W.2d 19, 21-22 (Ky. 1979).
\(^{19}\) 502 S.W.2d 66 (Ky. 1973).
mity with industry standards.\textsuperscript{20} The courts of Kentucky qualify this limitation, however, by holding that compliance with industry custom is not conclusive on the issue of whether a product is reasonably safe.\textsuperscript{21} The courts have also refused to impose liability upon defendant manufacturers or sellers of a product where the product has been altered or modified or used in a state of disrepair. The manufacturer of a product is entitled “to rely on the owner of the product to assume the responsibility for keeping it in safe working order.”\textsuperscript{22}

The term “defect” has further been divided into two subcategories: defective manufacture or assembly of the product resulting in a physical flaw and defective design or warnings where the entire product line is inadequate and no physical flaw is necessary for the product to be deemed defective.\textsuperscript{23} The latter has been classified as marketing defects which may involve the total absence of a warning of risks or danger in the use of the product, an inadequate warning, or the failure to provide adequate instructions or directions for the safe use of the product.\textsuperscript{24}

This comment will analyze the origin and justifications for products liability law arising out of the failure to warn as embraced by § 402A.\textsuperscript{25} Negligence and strict liability concepts, pertinent to imposing liability upon product sellers and manufacturers for the failure to warn, will be distinguished, followed by a discussion of the practical problems of devising jury instructions, emphasizing the duty to warn as encompassed by § 402A of the Restatement (Second) of Torts.

I. PRODUCTS LIABILITY: A HISTORICAL BACKGROUND

In order to distinguish strict liability from negligence in products liability and the tortious failure to warn, a review of the

\textsuperscript{20} Id. at 69.
\textsuperscript{21} Id.; See also C.D. Herme, Inc. v. R.C. Tway Co., Inc., 294 S.W.2d 534, 537 (Ky. 1956) (even an entire industry may be acting negligently and can, therefore, not be permitted to set its own uncontrolled standards).
\textsuperscript{22} Ulrich, 532 S.W.2d at 201; see also Head v. Biro Mfg. Co., Inc., 29 K.L.S. 2, 7 (1982) (stating that “[w]e believe that where a reasonably foreseeable or anticipated use of the product involves an unexpected or material alteration to that product after it leaves the hands of the manufacturer and personal injury is due solely to the alteration, as here, the injured party is precluded from recovery against the manufacturer . . .”).
\textsuperscript{23} Carpenter, supra note 3, at 273.
\textsuperscript{24} Sales, supra note 4.
\textsuperscript{25} See supra note 2.
history of products liability and the purposes for which it was developed is essential.

Products liability is a merger of tort and contract principles as it involves the liability of sellers of chattels to third persons with whom they are not in privity of contract. Today, there are basically three theories of liability which are traditionally matters of state law: strict liability, warranty, and negligence.

Historically, an injured consumer did not have these various theories from which to choose. Recovery from such injuries was founded upon negligence and was confined by the strict requirements of privity of contract expounded by the Court of Exchequer in 1842 in Wright v. Winterbottom. Ten years after the decision in Winterbottom was rendered, the United States fol-

27. While theories of liability do not differ, some are not adopted in all states. For instance, some states have not adopted strict liability. See Comment, Strict Liability Recovery of "Economic" Loss, 13 Idaho L. Rev. 29, 34 (1976).
28. Greenman, 59 Cal. 2d 57, 377 P.2d 897, 27 Cal. Rptr. 697. See also supra note 2 and accompanying text.
29. Restatement (Second) of Torts § 402B (1965) provides:
One engaged in the business of selling chattels who, by advertising, labels, or otherwise, makes to the public a misrepresentation of a material fact concerning the character or quality of a chattel sold by him is subject to liability for physical harm to a consumer of the chattel caused by justifiable reliance upon the misrepresentation even though
(a) it is not made fraudulently or negligently, and
(b) the consumer has not bought the chattel from or entered into any contractual relation with the seller.

30. Restatement (Second) of Torts § 388 (1965) provides:
One who supplies directly or through a third person a chattel for another to use is subject to liability to those whom the supplier should expect to use the chattel with the consent of the other or to be endangered by its probable use, for physical harm caused by the use of the chattel in the manner for which and by a person for whose use it is supplied, if the supplier
(a) knows or has reason to know that the chattel is or is likely to be dangerous for the use for which it is supplied, and
(b) has no reason to believe that those for whose use the chattel is supplied will realize its dangerous condition, and
(c) fails to exercise reasonable care to inform them of its dangerous condition or of the facts which make it likely to be dangerous.

31. 10 Mess. & W. 109, 152 Eng. Rep. 402 (Exch. 1842) (holding a passenger who sustained injuries when a mailcoach collapsed did not have a cause of action based upon breach of contract to keep the vehicle in repair because of a lack of privity. The contract was made between the supplier of the coach and the postmaster general and therefore, the duty owed was to the postmaster general alone).
lowed the English trend and adopted a products liability cause of action in *Thomas v. Winchester*, but nevertheless still subjected injured consumers to the rigid privity of contract requirement.

The reason for requiring privity was two-fold. First, the seller's misconduct was not the cause of the damage to the consumer in a legal sense, because no such harm was to be anticipated from any defects in the goods. There was an intervening resale by a responsible party, which "insulated" the negligence of the manufacturer. Second, it was more prudent to let the consumer bear the loss than to place such a cumbersome burden upon manufacturers and sellers by holding them responsible to hundreds of persons whom they did not even know.

This protectionist attitude toward industry was typical during the early period of the Industrial Revolution. In society's eyes, the expansion and prosperity of industry was in the public's best interest as the growing population required additional employment opportunities. The courts employed various legal devices to reduce industry's costs: assumption of risk, the doctrine of common employment, which exculpated the employer from vicarious liability for an injury of a servant inflicted upon a fellow servant; and the doctrine of privity, which screened negligent manufacturers from a claim of injuries sustained by an ultimate consumer. These doctrines were also responsive to the problems of the judiciary. The Industrial Revolution and the new age of technology confronted society with an accident problem of such magnitude that the courts were not equipped to handle the probable flood of litigation arising from the new machine age. The judiciary of the

32. 6 N.Y. 397, 57 Am. Dec. 455 (1852). The defendants were in the business of preparing and selling vegetable extracts. Among these were the extract of dandelion, a harmless medicine, and the extract of belladona, a vegetable poison. The defendants mislabeled one of the jars, which through two druggists, was sold to plaintiff's husband pursuant to a prescription for dandelion extract. The plaintiff alleged negligence by the defendants for the mislabeling of the jar. The court distinguished between an act of negligence imminently dangerous, which would result in liability regardless of privity of contract, and one that is not imminently dangerous. In the latter, the negligence constituted a breach of contract and therefore, each vendor was liable only to his immediate vendee.

33. PROSSER, supra note 26, at 641-42.

34. For instance, the defense of contributory negligence was a great advantage to industry and flourished during the Industrial Revolution. See Maloney, *From Contributory Negligence to Comparative Negligence: A Needed Law Reform*, 11 U. FLA. L. REV. 135, 143 (1958).

35. J. FLEMING, AN INTRODUCTION TO THE LAW OF TORTS 5 (1967).

36. Id.

37. Id. at 6.
early industrial age was concerned with harnessing negligence liability and thereby encouraging the growth of industry. 38

By the twentieth century, there was a change in social policy which is reflected in modern products liability law. With industry well established, there was a major shift toward protecting consumers from defective products. 39 While continuing to uphold negligence theory as the sole basis of recovery, the New York Court of Appeals in MacPherson v. Buick Motor Co. 40 abolished the privity requirement in 1916. Judge Cardozo stated:

If the nature of the thing is such that it is reasonably certain to place life and limb in peril when negligently made, it is then a thing of danger. Its nature gives warning of the consequences to be expected. If to the element of danger there is added knowledge that the thing will be used by persons other than the purchaser and used without new tests, then, irrespective of contract, the manufacturer of this thing of danger is under a duty to make it carefully. That is as far as we are required to go for the decision in this case. 41

It was not until 1960, however, that the courts extended this theory to implied warranty. In Henningsen v. Bloomfield Motors, Inc., 42 the court reasoned that the manufacturers or sponsors of a product are in a better position to absorb the economic burden of losses. 43 The implied warranty was extended from the manufacturer to all foreseeable users, for all products placed in the stream of commerce, regardless of lack of privity. 44

Finally, the shift from a focus on fault to the issue of responsibility and who is more capable of absorbing financial loss was made complete by Chief Justice Traynor in Greenman v. Yuba Power Products, Inc. 45 In his landmark opinion in Greenman, Chief Justice Traynor stated:

38. Id.
39. See Prosser, supra note 6.
40. 217 N.Y. 382, 111 N.E. 1050.
41. Id. at 389, 111 N.E. at 1053.
42. 32 N.J. 358, 161 A.2d 69. The plaintiff purchased a new automobile from the defendant dealer. He instituted suit against the dealer and manufacturer of the automobile as a result of personal injuries sustained by his wife and for his consequential losses due to the failure of the steering mechanism. The complaint was predicated upon breach of express and implied warranties as well as negligence. The court held that privity is not required. 43. Id. at 360, 161 A.2d at 72.
44. Id. at 412-17, 161 A.2d at 99-101.
45. 59 Cal. 2d 57, 377 P.2d 897, 27 Cal. Rptr. 697. Plaintiff purchased from the defendant dealer a combination power tool that could be used as a saw, drill and woodlathe, after
To establish the manufacturer's liability, it [is] sufficient that plaintiff [prove] that he was injured while using the [product] in a way it was intended to be used as a result of a defect in design and manufacture of which plaintiff was not aware that made the [product] unsafe for its intended use.  

The impact of Greenman was an obvious expansion of products liability doctrine—an injured consumer was no longer limited to negligence or warranty theories of liability. A manufacturer of a product which caused injury to a consumer could be held strictly liable in tort simply by placing a defective product on the market knowing it was to be used without further inspection.

In 1965, the publication of the final draft of § 402A of the Restatement (Second) of Torts reflected the Greenman philosophy by stating that sellers of a product "in a defective condition unreasonably dangerous" are strictly liable for harm caused to an ultimate consumer. While the court in Greenman failed to define the scope of the manufacturer's strict liability in tort for physical injuries by defining "defect," the drafters of § 402A provided guidance to the courts through their official comments. First, the drafters attempted to provide a definition for "unreasonably dangerous," the threshold requirement of strict liability. They provided that a product is unreasonably dangerous only if, at the time it leaves the seller's hands, it is in a condition not contemplated by the ultimate consumer and which will make the product unreasonably dangerous. The product must be "dangerous to an extent beyond that which would be contemplated by the ordinary consumer who purchases it, with the ordinary knowledge common to the community as to its characteristics." The drafters also envisioned a duty to warn arising out of strict liability, independent of negligence or warranties made by the product supplier. They provided that in order to prevent a product from being unreasonably dangerous, the seller or supplier may be required to

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46. Id. at 64, 377 P.2d at 901, 27 Cal. Rptr. at 701.
47. Id. at 62, 377 P.2d at 900, 27 Cal. Rptr. at 700.
48. See supra note 2.
49. Traynor, supra note 11, at 373.
50. RESTATEMENT (SECOND) OF TORTS § 402A comment g.
51. Id. at comment i.
provide direction for safe use or a warning of the risks of harm attendant to its use. 52

The duty to warn embraced by § 402A, however, is not absolute. The official comments have incorporated some traditional negligence principles. First, liability is limited to dangers which are not obvious. 53 Second, the drafters also made an exception for products which are unavoidably unsafe given the current state of scientific and technological knowledge. The unavoidably unsafe product may be marketed provided the utility of the product outweighs the risk of harm. Of course, an essential element in mitigating the risk of harm in the balancing process is the provision of an adequate warning to users. 54

Since the publication of § 402A of the Restatement (Second) of Torts 55 in 1965, over thirty jurisdictions, including Kentucky, have adopted Greenman or the Restatement (Second) of Torts, 56 and there has been a virtual explosion of products liability cases. 57

II. DOCTRINAL DIFFERENCES BETWEEN STRICT LIABILITY AND NEGLIGENCE IN THE TORTIOUS FAILURE TO WARN

The application of both negligence and strict liability doctrines in products liability law has caused some confusion as both utilize the traditional negligence concept of reasonable foreseeability. 58

52. "In order to prevent the product from being unreasonably dangerous, the seller may be required to give directions or warnings, on the container, as to its use." Id. at comment j.

53. But a seller is not required to warn with respect to products or ingredients in them which are only dangerous, or are potentially so, when consumed in excessive quantity, or over a long period of time, when the danger, or potentiality of danger, is generally known or recognized . . . . Where [a] warning is given, the seller may reasonably assume that it will be read and heeded; and a product bearing such a warning, which is safe for use if it is followed, is not in a defective condition, nor is it unreasonably dangerous.

Id. This test relieves a product manufacturer or seller of some dangers which are reasonably foreseeable. While strict adherence to the doctrine of strict liability would require assessing a product's safety simply by looking at the product itself, this comment suggests that the manufacturer or product seller's conduct should be considered as well as the conduct of the consumer in failing to read or heed a warning.

54. Id. at comment k.

55. See supra note 2 and accompanying text.


57. The number of reported products liability cases doubled between 1965 and 1976. See Carpenter, supra note 3, at 284.

58. EADES, KY. PRODUCTS LIABILITY, § 5-1.
There is a subtle difference, however, when the concept of foreseeability is used in the context of strict liability, as explained by the Supreme Court of Kentucky in *Ulrich v. Kasco Abrasives Co.*

[N]egligence depends on what a prudent manufacturer ... by the exercise of ordinary care actually should have discovered and foreseen, whereas strict liability depends on what he would have anticipated had he been (but regardless of whether he actually was or should have been) aware of the condition and potentialities inhering in the product when he put it on the market. Where the one is actual, the other is postulated.

Strict liability theory does not require a manufacturer or retailer to foresee the exact accident or danger that may stem from the product, but only the class of people who may be affected by the marketing of the product. For instance, the term "unreasonably dangerous" may take on a new meaning when the class of persons expected to use the product is considered. In *Nichols v. Union Underwear Co.*, an action involving a T-shirt that caught fire and burned a small child, the Kentucky Supreme Court rejected a test for the term "unreasonably dangerous" utilized in other jurisdictions. The court held that an instruction which allowed recovery only if the product was more dangerous than contemplated by "an ordinary adult purchaser ... with ordinary knowledge as to its inherent characteristics" was too restrictive. By imputing knowledge to the manufacturer of the actual condition of the product when it left the manufacturer's hands, the court focused on the central issue in a strict products liability case—whether an ordinary prudent manufacturer, being fully aware of the risk, would have put the product on the market. In essence, under Kentucky law, a supplier or manufacturer is charged with hindsight under strict liability theory, while under negligence theory, liability turns on what the manufacturer knew or foreseeably should have known.

In terms of product defects arising from the failure to warn or the provision of inadequate warnings or directions, a new meaning

59. 532 S.W.2d 197 (Ky. 1976).
60. Id. at 200.
61. 602 S.W. 2d 429 (Ky. 1980).
62. Id at 430-33.
63. Id. at 433.
is given to foreseeability when the focus is upon the class of persons who may be affected by the product. Even if directions for safe use are provided, the failure to follow directions may be foreseeable and will not satisfy the duty to warn. In *Midgley v. S.S. Kresge Co.*, the California Court of Appeals held the manufacturer of a toy telescope strictly liable when the toy was improperly assembled by the user, even though instructions for proper assembly were provided. The court emphasized that the product was "a technically complex product intended for use by technically unsophisticated consumers, to be assembled and used by them in accordance with instructions prepared and supplied by the technically knowledgeable supplier."

Not only may the failure to follow directions be foreseeable, giving rise to a duty to warn, but foreseeable misuses of the product may also render the product defective unless a warning is provided. Kentucky courts have also held that the duty to warn is not dependent upon intended uses of a product alone, but also extends to foreseeable uses and misuses. If the product will be used without perceiving the risk, there is a duty to warn.

Many jurisdictions hold that a manufacturer or supplier of a product is only obligated to warn of dangers that are known or reasonably foreseeable at the time the product is placed in the stream of commerce. The application of the issue of foreseeability of harm as the key element of a duty to warn changes strict liability to a negligence standard. The result in these jurisdictions is that the state of the art is a defense to strict tort liability.

66. Id. at 75, 127 Cal. Rptr. at 221.
67. LeBouef v. Goodyear Tire & Rubber Co., 451 F. Supp. 253 (W.D. La. 1978), aff'd, 623 F.2d 985 (5th Cir. 1980). Plaintiff's son was fatally injured when tire failed while he was operating his vehicle at speeds that exceeded 100 mph. Operation of the vehicle at speeds exceeding 100 mph was an abuse of the product. However, since the vehicle was capable of traveling in excess of that speed, it was held to be a foreseeable misuse. *Id.* at 257.
68. Post v. American Cleaning Equip. Corp., 437 S.W.2d 516, 521 (Ky. 1968).
70. *See* Ezagui v. Dow Chem. Corp., 598 F.2d 727, 733 (2d Cir. 1979) (vaccine manufacturer's knowledge of special risk of harm attendant in normal use of vaccine was required before duty to warn would arise); Harrison v. Flota Mercante Grancolombiana S.A., 577 F.2d 968, 977 (5th Cir. 1978) (foreseeability that liquid chemical isobutyl acrylate would spill on a vessel and injure longshoremen working in the area); Seley v. G.D. Searle & Co., 423 N.E.2d 831, 837 (Ohio 1981) (warnings to medical profession summarizing medical information reasonably known by manufacturers at time ovulen-21 was prescribed would have been sufficient).
71. Lindsay v. Ortho Pharmaceutical Corp., 637 F.2d 87, 91 (2d Cir. 1980); McEwen v. Or-
defense is justified on the basis that "a logical limit must be placed on the scope of a manufacturer's liability under a strict liability theory. To hold a manufacturer liable for failure to warn of a danger of which it would be impossible to know based on the present state of human knowledge would make the manufacturer the virtual insurer of the product . . . ." The Products Liability Act of Kentucky codifies this view by creating a rebuttable presumption that there is no defect "if the design, methods of manufacture, and testing conformed to the generally recognized and prevailing standards or the state of the art in existence at the time the design was prepared, and the product was manufactured."

The state of the art defense to strict products liability and the foreseeability requirement permit defendant manufacturers to argue that they cannot foresee something that has never happened before. That argument seems to be clearly inconsistent with the central issue in a strict products liability action, exemplified in *Nichols v. Union Underwear Co.*, which is whether an ordinarily prudent manufacturer, being fully aware of the risk, would have put the product on the market. The state of the art defense and the foreseeability requirement also abrogate the traditional differences between negligence and strict liability theories—actual knowledge versus postulated knowledge.

Commentators have not been in total agreement with the present case law's treatment of the concept of foreseeability as used in strict liability law. Dean John Wade, an adviser in the formulation of § 402A, would impute to the manufacturer the knowledge and technology available at the time of trial. Rather than focus upon strict liability principles, Dean Wade would compare strict liability in a design defect case to negligence per se. He would not permit the state of the art defense in either negligence or strict liability actions because a manufacturer is negligent simply by placing a defective, unreasonably dangerous product on the market.

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73. KY. REV. STAT. § 411.310(2). For a discussion on how the Products Liability Act of Kentucky affects prior case law and plaintiff's burden of proof, see EADES, supra note 58.
74. 602 S.W.2d 429 (Ky. 1980).
75. Id. at 433.
76. See Ulrich v. Kasco Abrasives Co., 532 S.W.2d 197 (Ky. 1976).
77. See supra note 2 and accompanying text.
78. Wade, supra note 1, at 834-37.
market—sciente... the def... whether the defendant knew or should have known of a safer method of production, but whether such method was feasible. Professor Phillips' view is more favorable to injured consumers as the state of the art defense, which disregards non-utilized safer production methods, may tend to discourage an entire industry's efforts to make a product as safely as is feasible through research and development, or by marketing the product with a proper warning. Dean Page Keeton, like Dean Wade, would allow the jury to utilize hindsight, and determine the existence of a defect on the basis of knowledge available at the time of trial: “If the conduct is unreasonably dangerous, then there should be strict liability without reference to what excuse defendant might give for being unaware of the danger.”

The distinctions between strict liability and negligence and the limited application of the term foreseeability, as well as an abrogation of the state of the art defense, are justifiable when the underlying policies of strict liability in tort are considered. The central

81. Wade, supra note 1.
83. Id. at 115.
85. Wade, supra note 1, at 834-37.
87. For a discussion of policies underlying and in support of strict products liability, see Frosser, supra note 6.
question, when neither party is at fault, is who can best bear the loss.\textsuperscript{88} The courts have generally found that the manufacturer is in a better position to absorb the cost of injuries to consumers as a part of doing business.\textsuperscript{89}

III. THE DUTY TO WARN

As previously discussed, a defect in a product may result from an inadequate warning or the total absence of a warning.\textsuperscript{90} Therefore, in determining whether to market a product, a product supplier should first balance the potential risk of harm presented by the product he plans to market against the product’s usefulness.\textsuperscript{91} In many cases, the burden upon manufacturers to make an unsafe product of minimal usefulness reasonably safe is not great. The task may often be accomplished simply by providing a warning, which can generally be added without diminishing the utility of the product and at minimal additional cost,\textsuperscript{92} or by making a minor revision in the design.\textsuperscript{93}

Product manufacturers and suppliers must consider the obviousness of the danger and the character of the intended or foreseeable user of the product. Where the danger is obvious, there is simply no duty to warn.\textsuperscript{94} However, if the danger is not obvious, and may not be apprehended by the foreseeable user, then “it may be obviated by an adequate warning, so provided or affixed that in the ordinary course of events it will reach and should be understood by that person.”\textsuperscript{95}

\textsuperscript{88} Pound, The End of Law as Developed in Legal Rules and Doctrines, 27 HARV. L. REV. 195, 233 (1914).
\textsuperscript{91} See generally Sales, supra note 4. See also Freund v. Cellofilm Properties, Inc., 87 N.J. 229, 432 A.2d 925, 932 (1981) (court noted that in cases alleging "an inadequate warning as to safe use, the utility of the product, as counter-balanced against the risk of its use, is rarely at issue").
\textsuperscript{92} See Freund, 87 N.J. 229, 432 A.2d 925 (1981).
\textsuperscript{93} See Rhodes v. Michelin Tire Corp., 542 F. Supp. 60 (E.D. Ky. 1982).
\textsuperscript{94} McCabe Powers Body Co. v. Sharp, 594 S.W.2d 592 (Ky. 1960).
\textsuperscript{95} Ulrich, 532 S.W.2d 197 (whether an adequate warning is provided is only one of the factors in determining whether the product is unreasonably dangerous).
As to the character of the intended or foreseeable user of the product, the exceptions to the duty to warn are most harsh. For instance, in workplace accidents a duty to warn of the risk of harm and instructions for safe use are most critical because of the high risk of harm inherent in the operation of heavy industrial equipment. These type of accidents were responsible for fifty percent of all products liability litigation during the years 1971-76. Yet, it is here that the exceptions to the duty to warn are most likely to be imposed by the courts. The purchaser-employer is often knowledgable of the product's capabilities, frequently alters the product, and controls the environment in which the product is used. Where such warnings or instructions would be directed toward an employer who already possesses technical knowledge, no duty arises. Even if the employer-purchaser of the industrial product does not possess technical knowledge, it is not necessary for the manufacturer to warn each employee or place a warning label on the product, as long as the supervising personnel of the company has been warned or is aware of the danger.

The same analysis utilized in workplace accidents has been extended by the Kentucky courts to consumer accidents involving third parties who were totally ignorant of the dangerous propensities of a product. In Sturm, Ruger & Co. v. Bloyd, the Kentucky Supreme Court held that an injury to a third party resulting from a sale of a gun, accompanied by instructions for use to the original owner, was not reasonably foreseeable to the manufacturer. Therefore, the manufacturer owed no duty to the third party to warn of potential dangers. In Montgomery Elevator Co. v. McCullough, the Kentucky Court of Appeals was confronted with the question of whether the failure of a department store to warn its customers of the dangers inherent in escalators was superseding negligence, insulating the manufacturer from liability, as the manufacturer had warned the store management of the

96. Sales, supra note 4, at 532.
97. Carpenter, supra note 3, at 273.
98. Id. at 274.
100. See Hercules Powder Co. v. Hicks, 453 S.W.2d 583 (Ky. 1970) (manufacturers relieved of duty to warn each employee of a product hazard which is known to employee's supervisor); Ulrich, 532 S.W.2d 197 (manufacturer relieved of liability to employee by giving instructions and warning to employer); Bohnert Equip. Co., 569 S.W.2d 161 (warning of danger to plaintiff's supervising personnel sufficient).
101. 586 S.W.2d 19 (Ky. 1979).
102. Id. at 23.
danger.\textsuperscript{104} The plaintiff was a ten-year old boy who got his foot caught in an escalator, causing his foot to be crushed, and resulting in the amputation of his right large toe.\textsuperscript{105} Despite evidence that the manufacturer was aware of 500 accidents involving similar escalators throughout the United States, the court held that the failure of the department store personnel to warn its customers would constitute a superseding cause relieving the manufacturer of liability. The sole issue for the jury in such a case is the adequacy of the warning given by the manufacturer to the department store.\textsuperscript{106}

The result of the defense of superseding, intervening acts or omissions by third parties in both work-related and consumer accidents is that the manufacturer can shift his responsibility to someone else and therefore avoid the costs of safety engineering in the design process. Such a practice is reminiscent of the supposedly antiquated privity of contract requirements, discussed above, and seems particularly inappropriate in a strict liability claim where the central issue is whether an ordinarily prudent manufacturer, being fully aware of the risk, would have put the product on the market.\textsuperscript{107}

Once the decision to provide a warning or directions for use is made,\textsuperscript{108} the manufacturer should determine whether such warnings or directions will adequately inform consumers of the dangers in the use or misuse of the product. It should be kept in mind that the provision of a warning or directions alone may not be sufficient to avoid liability. Marketing defects may arise from: (1) the failure to provide any warning of risk or hazard associated with a product; (2) the failure to provide an adequate warning; or, (3) the failure to provide proper instructions for safe use or directions for avoiding improper use.\textsuperscript{109} Therefore, it is imperative for manufacturers to assess the sufficiency of the warnings or directions they plan to include with the product.

\textsuperscript{104} The warnings given to the department store consisted of two letters written in April 1977 and January of 1979 recommending that the department store clean and spray the skirt panel of the escalator with silicone and install stiffener angles sold by the manufacturer. \textit{Id.} at 2.

\textsuperscript{105} \textit{Id.} at 1.

\textsuperscript{106} \textit{Id.} at 2.

\textsuperscript{107} \textit{Nichols,} 602 S.W. 2d at 433.

\textsuperscript{108} Design defects, which include the failure to warn, are regarded as intended while manufacturing flaws are regarded as inadvertent. Phillips, \textit{supra} note 81, at 103.

\textsuperscript{109} Keeton, \textit{supra} note 85, at 398-99.
In assessing the adequacy of the warnings, the Kentucky courts have provided product suppliers with precise guidelines concerning what constitutes an adequate warning and what gives rise to the duty to warn. The Court of Appeals, in Post v. American Cleaning Equip. Corp., noted that a warning must fairly and adequately notify a user, exercising reasonable care for his own safety, of the possible consequences of use or misuse of the product. The assessment of the adequacy of the warning involves considering the gravity of potential dangers actually known, or which should have been known to the manufacturer, in light of foreseeable use and the foreseeable user of the product. The Post court gave further guidance by providing useful examples of warnings which would be deemed disproportionate to the danger posed by the product:

[It may be doubted that a sign warning, "Keep off the Grass," could be deemed sufficient to apprise a reasonable person that the grass was infested with deadly snakes. In some circumstances a reasonable man might well risk the penalty of not keeping off the grass although he would hardly be so daring if he knew the real consequences of his failing to observe the warning sign. Or, a warning to "Keep in a Cool Place" might not be sufficient if the result of non-observance was a lethal explosion of the container.]

The court further distinguished between directions for use and warnings of danger. By providing directions, a product supplier may not satisfy the duty to warn because the failure to follow directions may be foreseeable. "The issue is whether the totality of directions or cautionary language constituted an adequate warning in the light of the foreseeable use and user of the product."

A similar analysis was made by the Supreme Court of Colorado in Hügel v. General Motors Corp., in which directions on a label to dilute a cleaning solution were found insufficient to warn of dangers that would result if the solution was not diluted. "We think that the duty to warn may not be satisfied by directions which merely tell how to use the product, but say nothing about the inherent and specific dangers if the directions are not followed." The distinction between directions and warnings is that

110. 437 S.W.2d 516 (Ky. 1968).
111. Id. at 520.
112. Id.
113. Id. at 521 (quoting Frummer & Friedman, Products Liability § 8.05 (1961)).
114. 544 P.2d 983 (Colo. 1975).
115. Id. at 988.
directions instruct the consumer as to the efficient and safe use of the product, while a warning communicates dangers inherent in the use of the product.116

A. The Defense of Contributory Negligence in Warning Cases

Perhaps one of the most difficult problems in failure to warn cases is determining whether contributory negligence is a defense. In answering this question, the variety of failure to warn situations must be kept in mind. Cases involving inadequate warnings should be distinguished from those involving the total absence of a warning, and negligence and strict liability theories should also be distinguished. If the courts were to hold true to strict liability theory, the answer would be easy. As strict liability imposes liability upon a manufacturer for injuries caused by his product regardless of the degree of care used,117 strict liability would relieve an injured plaintiff of the harsh consequences of contributory negligence.118 To prohibit the defense of contributory negligence in strict liability cases would also be consistent with social policy of placing the burden on those who are better able to initially prevent the injuries.

The Federal District Court for the Western District of Louisiana in Coburn v. Browning Arms Co.119 held that the underlying policies of strict liability and § 402A preclude the application of contributory negligence.120 Under Louisiana law, the test for determining liability in a strict products liability action is imputed knowledge of the product’s dangers to the defendant. In light of this knowledge, the reasonableness of the defendant’s conduct with respect to the product is then judged.121 The court in Coburn recognized that this standard contained both negligence and strict liability concepts. However, it held that contributory negligence could not be raised defensively by a manufacturer because he oc-

117. See supra note 2 and accompanying text.
118. Restatement (Second) of Torts § 402A comment n (1965).
120. Id. at 748.
121. Id. at 747.
cupies a better position than the consumer to avoid injuries and to spread the risk of harm caused by his product.122

Kentucky utilizes a test similar to the Coburn test—would an ordinarily prudent manufacturer have put the product on the market, being fully aware of the risk?123 However, the court in Post v. American Cleaning Equip. Corp.124 made it very clear that contributory negligence may be a defense even in a strict liability claim for failure to warn:

Contributory negligence, like original negligence, is the failure to exercise the degree of care that an ordinarily prudent person would exercise under the same or similar circumstances. We think the gauge for testing appellant's contributory negligence must be read in the light of the sufficiency of the warning to apprise him of the severity, gravity, and extent of the danger.125

The instruction on contributory negligence was held proper.126 At the same time, the court found that the failure of a plaintiff to use reasonable care to find a defect is not a defense unless the circumstances require him to expect such a danger.127 If a distinction is made between a situation where the warning provided is inadequate and where there is a total absence of a warning, these two statements made by the Post court are consistent. It is possible that contributory negligence may be a defense in the former and not a defense in the latter. Moreover, such a distinction may be justified on the basis that where a warning is provided, even though inadequate, there has been a good faith attempt on the part of the manufacturer to protect the consuming public from the hazards presented by his product.

It should be noted that the central issue in Post was whether the warning provided was "adequate" to alert the user to the dangerous propensities of the product.128 In order to make such a determination, the sufficiency of the warning had to be weighed against the plaintiff's own inattentiveness or contributory negligence.129 However, such a balancing process is not necessary in a

122. Id. at 748.
123. Nichols, 602 S.W.2d at 433.
124. 437 S.W.2d at 516.
125. Id. at 520.
126. Id. at 522.
127. Id. at 521.
128. Id. at 520.
129. Id.
case involving the total absence of a needed warning, because the plaintiff's conduct does not involve the failure to read or follow instructions or heed a warning. Contributory negligence is not applicable in such a case.

Where an adequate warning is provided, the result is an informed choice for the user of the product. He can disregard the warning and therefore be contributorily negligent or he will be encouraged to take further steps to minimize the risk. The presumption is always that no one will voluntarily do or fail to do an act that places his own life in peril; rather, a person will take the necessary precautions for his own safety. Of course, the consumer is at an extreme disadvantage when he purchases a product unaccompanied by a warning or accompanied by an inadequate warning. As long as the defense of contributory negligence is retained as a bar to recovery, however, there will be little incentive for manufacturers to maximize product safety through research, development, and the provision of adequate warnings and directions.

B. The Pitfalls of Devising Jury Instructions in Failure to Warn Cases

Trial judges have frequently experienced difficulties in attempting to devise accurate jury instructions in design defect and failure to warn cases. These difficulties are often compounded by the fact that many causes of action are based upon both negligence and strict liability theories. The result is that the jury instructions mix negligence and strict liability theories, and in the process, fail to inform the jury of the applicable law on strict liability for the failure to warn.

For example, in Barker v. Lull Eng'r Co., an injured consumer won his case on appeal on the grounds that the trial court had erred in instructing the jury that "strict liability for a defect in design of a product is based on a finding that the product was unreasonably dangerous for its intended use . . ." The court noted that in light of various types of product deficiencies, an instruction which requires a plaintiff to prove the existence of a pro-

132. 20 Cal. 3d 413, 573 P.2d 443, 143 Cal. Rptr. 225 (1978).
133. Id. at 422, 573 P.2d at 448, 143 Cal. Rptr. at 231.
duct defect, but which fails to elaborate on the meaning of defect, only serves to mislead the jury. The court then proceeded to define the term "defect" and provided a two-prong test for juries to use in design defect cases:

[In design defect cases, a court may properly instruct a jury that a product is defective in design if (1) the plaintiff proves that the product failed to perform as safely as an ordinary consumer would expect when used in an intended or reasonably foreseeable manner, or (2) the plaintiff proves that the product's design proximately caused injury and the defendant fails to prove, in light of the relevant factors, that on balance the benefits of the challenged design outweigh the risk of danger inherent in such design.]

The court's definition of design defect and instructions combine both the consumer expectations test and the risk/utility test. The initial inquiry for the jury under the Barker test is whether the product met consumer expectations. If not, the product is defective and no further inquiry need be made. However, if the plaintiff fails to meet the first prong of the test for design defect, the jury may utilize a risk/utility analysis and may consider the gravity of the danger posed by the challenged design, the likelihood that such danger would occur, the mechanical feasibility of a safer alternative design, the financial cost of an improved design, and the adverse consequences to the product and to the consumer that would result from an alternative design.

Whether Barker's two-prong test for design defects and jury instructions is correct is not within the scope of this comment. What Barker does demonstrate, however, is that there is a definite need to precisely define what constitutes a product "defect" to a jury. Dean Wade has explained the need for precise instructions elaborating on design defect:

[The natural application of the term defective] would be limited to the situation in which something went wrong in the manufacturing
process, so that the article was defective in the sense that the manufacturer had not intended it to be in that condition. To apply [the term 'defective'] also to the case in which a warning is not attached to the chattel or the design turns out to be a bad one or the product is likely to be injurious in its normal condition . . . [and to] use it without defining it to the jury is almost to ensure that they will be misled.

One very important aspect in instructing the jury on design defects due to the failure to warn in a strict liability action is that the emphasis must be placed on the fact that a product which was flawlessly made may be deemed defective by the mere fact that the product was not marketed with a suitable warning. Therefore, there must be a strict adherence to the proper order and precise wording of instructions. For example, an instruction which defines the duty of a product manufacturer as (1) designing a reasonably safe product for intended uses and for other foreseeable misuses, or (2) in the absence of a reasonably safe product, supplying a warning may not be sufficient to impress upon a jury the degree of care owed. Such an instruction may lead jurors to believe that they must first find a "defect" in the product itself, as that term traditionally connotes, before reaching the issue of whether there was a duty to warn. Moreover, a jury should be instructed that the duty of a manufacturer or seller is not met by merely providing a warning, but by providing an adequate warning.

The Court of Appeals of Iowa in *LaCoste v. Ford Motor Co.* addressed these unique problems in its jury instructions on strict liability and the failure to warn. The court noted that most cases involving the failure to warn of product dangers are based upon negligence theories. In those cases, § 388(c) of the Restatement (Second) of Torts governs, which establishes a negligence standard of reasonable care to warn of known dangers. However, the duty to warn arising out of strict liability as embraced by § 402A arises independent of finding a design defect if it is unreasonably dangerous to place the product in the hands of a user without a proper warning. Therefore, the jury must be instructed, and the instructions must emphasize, that the jury may hold the product

141. 322 N.W.2d 898 (Iowa Ct. App. 1982).
142. Id. at 900.
143. See supra note 30 and accompanying text.
144. *LaCoste*, 322 N.W.2d at 900.
supplier strictly liable solely on the basis of an inadequate warning. A mere reference to the failure to warn in the statement of issues or in another instruction which contains a negligence standard will not suffice and constitutes a basis for a new trial. 145

It is imperative that a separate instruction on the failure to warn be given, and that such an instruction be placed prior to any instruction charging the manufacturer with a duty to design a reasonably safe product for intended uses and misuses. Otherwise, the jury will be charged with finding a defect in the product before finding a duty to warn. It is also necessary that the jury be instructed that not only a warning, but an adequate warning, is required.

Post v. American Cleaning Equip. Corp. 146 can be most instructive to practitioners in formulating proper jury instructions to be tendered to the court. In Kentucky, an instruction which tends to mislead the jury constitutes grounds for reversal. 147 Strict adherence to the instructions approved by the Post court may avoid needless new trials. Instructions which improperly impose ordinary care when the highest degree of care is owed are a basis for setting aside a jury verdict. 148

The logic of the Post court is consistent with the logic of the LaCoste court in instructing the jury that the duty of the defendant manufacturer was either:

(a) To give such probable user adequate warning of the danger arising from the use of high voltage in the operation of the equipment, or
(b) In the absence of adequate warning, as set out in (a) hereof, to apply such technology as the jury may believe from the evidence was then available to the defendant to so design the impeller or equip the motor with resistors or inhibitors as to prevent the rupture of the impeller by high rotary speed.
(c) "Adequate warning" as used in these instructions means such degree of warning as will afford to the user of the equipment, by the exercise of reasonable care on his own
part, fair and adequate notice of the possible consequences of use or even misuse of the equipment.\footnote{149. 437 S.W.2d at 522.}

It has yet to be determined how far a court may stray from the warning instructions provided in Post. There may also be a question of whether the wisdom of the Post court is applicable in cases involving the total absence of warning. In Post, the issue was whether a warning which was provided was adequate to bring home to the user the dangers inherent in the use or foreseeable misuse of the product. If narrowly confined to its own facts, Post would not be authority for a situation involving a total absence of a warning. However, it should be noted that the court in Post reasoned that "where the manufacturer is obligated to give an adequate warning of danger the giving of an inadequate warning is as complete a violation of its duty as would be the failure to give any warning . . . . 'An insufficient warning is, in legal effect, no warning.'\footnote{150. Id. at 521.} Therefore, the instructions approved by the court in Post should be of general application to situations where an inadequate warning or no warning at all was provided.

CONCLUSION

It is often difficult to distinguish between products liability founded upon strict liability as embraced by § 402A of the Restatement (Second) of Torts and negligence which is specifically addressed by § 388. Both utilize the term "foreseeability," yet the term may, and should, be used quite differently in the context of strict liability. The problem arises in the individual court's perception of the scope of a manufacturer's liability which often results in the abrogation of the traditional definitions of strict liability and the policy of placing the cost of injuries sustained on those most able to absorb the financial burden.

Perhaps one of the most useful tools in consumer protection and loss prevention is the imposition of strict tort liability upon manufacturers and product suppliers who fail to warn. As long as manufacturers are permitted to plead ignorance as a defense to liability for the failure to warn, there will be little incentive for them to emphasize safety engineering in the design process. The judicial system would be able to provide a stimulus for the pre-
vention of consumer and workplace accidents by imposing strict liability for the failure to warn. Finally, in addition to the utilization of strict liability in failure to warn cases, plaintiffs' attorneys should demand a peculiar set of jury instructions in marketing defect cases in order to serve the underlying purposes of strict liability and to provide a stimulus for the practice of safety engineering by product manufacturers.

JENNIFER JOLLY RYAN
REMEDIES FOR HAZARDOUS WASTE INJURIES

INTRODUCTION

The exponential increase in the use of synthetic chemical products in the United States in the past fifty years has created a pressing problem: what to do with the hazardous waste generated in their production. The history of the problem has been characterized by political scandals and tragic stories of hazardous waste disposal practices. Congress, recognizing the enormity of the problem, acted to control the disposal of hazardous waste by passing the Resource Conservation and Recovery Act of 1976 [hereinafter referred to as RCRA]. RCRA is a comprehensive scheme designed to regulate the life of chemicals from production to final disposal. Unfortunately, the RCRA neglected to provide for the cleanup of the millions of tons of hazardous waste that had already filled lagoons, landfills and barrels throughout the country. Congress, acting to fill the gap left by the RCRA, passed the Comprehensive Environmental Response, Compensation, and Liability Act of 1980 [hereinafter referred to as CERCLA] which was intended to provide for the clean up of the hazardous waste that had been disposed of improperly in the past.

These statutes were ambitious in goal but restricted by administrative apathy and a lack of funding. More significantly, neither of the statutes provided any meaningful relief for those who were injured by improper disposal of hazardous waste. The enforce-

1. Hazardous waste is defined as
   a solid waste or combination of solid wastes whose quantity, concentration, or physical, chemical, or infectious characteristics may-
   (A) cause, or significantly contribute to an increase in mortality, or an increase in serious irreversible, or incapacitating reversible, illness; or
   (B) pose a substantial present or potential hazard to human health or the environment when improperly treated, stored, transported, or disposed of, or otherwise managed.
6. See Wolf, supra note 2, at 369-402.
7. See generally Costle, Introduction, 9 St. Mary's L.J. 661 (1978) (reviews several statutes affecting the environment including the Clean Air Act and the Clean Water Act).
ment of RCRA and CERCLA was left almost entirely to the government. 8 Private citizens were forced to look to ingenious construction of the Federal Tort Claims Act [hereinafter referred to as FTCA] 9 or to the common law actions of nuisance, trespass, negligence or strict liability for relief from injuries caused by improper hazardous waste disposal practices. 10

Although relief for hazardous waste injuries is available in theory, a private individual seeking redress for hazardous waste injuries is faced with overwhelming problems. The injuries caused by hazardous waste usually occur years after exposure making causal proof of the injury very difficult and resulting in a statute of limitations dilemma. 11 Furthermore, the duration of the litigation, which often requires months of extensive documentation search and in-depth scientific analysis, makes the suit too expensive for most private citizens. 12 Adequate redress for injury caused by improper disposal of hazardous waste stresses the inadequacy of current statutory and common law theories of recovery.

I. BACKGROUND

The hazardous waste problem originated in the chemical-industrial revolution during the last five decades. Post-World War II economic prosperity resulted in an increased demand for consumer products whose manufacture depended upon the availability of synthetic chemicals. 13 Industrial production of nylon hose, chemical pesticides, plastic dishware, nonreturnable bottles, aluminum cans, plastic milk jugs, teflon, polyester, and countless other products has made modern life easier and more comfortable. However, the increased reliance on man made chemicals had a price that became increasingly apparent in the last decade. The dangerous nature and astronomical quantities of waste generated

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8. See generally Wolf, supra note 2, at 367-69.
12. Id. at 149-50.
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in the manufacture of synthetic products posed a serious, often irreversable, and long lasting hazard to the environment and thus to human life.\(^{14}\)

It became evident in the late 1970's that uncontrolled and careless disposal of industrial waste threatened the general public with direct exposure to the toxic elements generated as byproducts of the industrial manufacturing processes.\(^{15}\) It also became apparent that even accepted waste management procedures, especially the use of landfills, surface impoundments and lagoons, were inadequate in the face of ever increasing quantities of hazardous waste. Studies conducted by the Environmental Protection Agency [hereinafter referred to as EPA] revealed that the disposal of hazardous waste had left very large quantities of dangerous substances in and on the land.\(^{16}\) Moreover, these wastes were leaking from the disposal sites and contaminating all aspects of the environment.\(^{17}\)

Nowhere in the history of the hazardous waste problem has the inadequacy of the hazardous waste regulatory process become more apparent than in the Love Canal\(^{18}\) incident. The tragedy of Love Canal began in the late 1920's when the Hooker Chemical and Plastics Corporation began using as an industrial landfill a canal that had been built by William J. Love. The canal had been built in an effort to generate cheap power by channeling water between the upper and lower Niagara River.\(^{19}\) For the next twenty-five years Hooker used the site to bury unknown quantities and types of industrial by-products and chemical wastes. In 1953, it filled in the canal with earth, covered it with a clay lid, and sold it to the Niagara Falls Board of Education for one dollar.\(^{20}\) The School Board built a grammar school on one section, and on other sections developers built a community of single family homes which were occupied mainly by Hooker employees. Although clues such as exposed chemical drums, skin rashes, and dead vegetation appeared intermittently, the real danger did not become apparent

\(^{14}\) Id. at 310-11.
\(^{15}\) See Goldfarb, The Hazards of Our Hazardous Waste Policy, 19 NAT. RESOURCES J. 249, 251 (1979) (Mr. Goldfarb quotes the EPA estimate of 41 million tons per year as the amount of hazardous waste improperly disposed).
\(^{16}\) Id. at 250-51.
\(^{17}\) Id. at 252-54.
\(^{18}\) See Wolf, supra note 2, at 403.
\(^{19}\) Id. at 404.
\(^{20}\) Id. at 405.
until 1976 when, after a season of unusually heavy rains, the dormant canal overflowed, releasing toxic chemicals into the surrounding environment.\(^{21}\)

After two years of citizen outrage at the slow response by local and state authorities and the EPA to the hazards of Love Canal, the story became national news when the front page of the New York Times contained a report on the threat of chemical exposure caused by the Love Canal disaster.\(^{22}\) Soon thereafter, the State of New York evacuated the homes located at Love Canal, closed the school, and turned the community into a ghost town. Hundreds of displaced families, millions of dollars in cleanup costs, and the effective condemnation of the entire area highlight the results of a hazardous waste crisis.\(^{23}\)

Also illustrative of the disposal procedure responsible for the origin of the hazardous waste crisis is the incident that became known as the "valley of the drums."\(^{24}\) Seventeen thousand drums of chemicals were stored on a seven-acre site only twenty-five miles south of Louisville, Kentucky.\(^{25}\) As the drums, exposed to the open atmosphere, began to deteriorate, their toxic contents slowly leaked onto the ground and contaminated the groundwater and watershed feeding the Ohio River, a source of drinking water for many communities.\(^{26}\) In 1979, the EPA tested soil and water samples in the area and found approximately 200 organic chemicals and 30 heavy metals contaminating the environment.\(^{27}\) This open storage form of hazardous waste disposal was frequently the result of storage at leased sites, which were later abandoned.\(^{28}\)

The national attention generated by the Love Canal scandal abated despite the fact that hazardous waste continued to be deposited in thousands of disposal sites throughout the country.\(^{29}\)

\(^{21}\) Id.
\(^{22}\) Id. at 406.
\(^{23}\) Id.
\(^{24}\) Id. at 412 (this incident is distinguishable from Love Canal in that it illustrates the hazards of open storage of hazardous waste in drums above ground).
\(^{25}\) Id. at 418 (improper disposal of hazardous waste not only contaminates surface water but also causes air pollution, food chain contamination, ground water contamination and can result in fires and explosions. Id. at 419-22).
\(^{26}\) Id. at 412.
\(^{27}\) Id.
\(^{28}\) Id. (a waste processing firm, in Lowell, Massachusetts, declared bankruptcy and abandoned 20,000 rusty and leaky barrels of hazardous waste).
\(^{29}\) Id. at 414 (In 1979, the EPA estimated that 32,000 disposal sites contained hazardous waste. 20,000 of these sites were active, while the other 12,000 were abandoned. 1200 to
However, on December 16, 1982, the House's contempt citation against Anne Burford, director of the EPA, for refusal to turn over documents relating to the EPA's enforcement of the hazardous waste cleanup program which had been subpoenaed by the Public Works and Transportation Subcommittee initiated a confrontation between Congress and the EPA that again brought national attention to the hazardous waste problem. The controversy eventually lead to Mrs. Burford's resignation amid charges of wrongdoing concerning EPA's hazardous waste cleanup program and allegations of a coverup by the administration. Charges of "sweetheart" deals between the EPA and the industries it is supposed to regulate, suggestions of conflict of interest on the part of high ranking agency officials, and allegations of the use of newly acquired paper shredders to destroy documents in an attempted coverup, highlighted the reports of slow action by the EPA in cleaning up the hazardous waste. This conflict brought the inherent dangers of ineffective hazardous waste disposal to the center of public attention in the same manner that the Love Canal disaster had only seven years earlier. More significantly, it highlighted the lack of effective legal resources for dealing with the generation, handling, disposal and cleaning up of hazardous waste. Both statute and common law may provide some relief to the public and private injuries resulting from hazardous waste disposal, but, as will be discussed below, they are either woefully inadequate or prohibitively difficult to maintain.

II. STATUTORY REMEDIES

In an action to recover damages for hazardous waste injuries, the plaintiff has three principal statutory remedies: RCRA, CERCLA and FTCA. Of these, only the FTCA provides for compensation for personal injuries; RCRA provides only for injunctive relief, and CERCLA provides compensation for environmental clean up.

A. Resource Conservation and Recovery Act

Concern for the environment and the public health led Congress

2000 of the sites presented an immediate danger to the environment). National attention on hazardous waste disposal was reignited with the disclosure of improper disposal of dioxin in Times Beach, Missouri in 1983.
to enact RCRA, 33 RCRA established a complex and extensive “cradle to grave” scheme for the regulation of the generation and disposal of hazardous waste. 34 Treaters, storers, and disposers are required to obtain permits to operate 35 and are required to maintain a manifest system that keeps track of hazardous waste from generation to final disposal. 36 RCRA also established an identification and listing process to aid in enforcing RCRA and a mandatory set of operating standards for generators, transporters, and operators involved in the life cycle of hazardous waste. 37

More importantly, RCRA contains a provision that authorizes the administrator of the EPA to sue to restrain any hazardous waste disposal activity that presents “an imminent and substantial endangerment to health or the environment.” 38 Suits filed by the Justice Department effected a judicial interpretation of RCRA’s “imminent and substantial endangerment” provision as allowing injunctive relief for threatened harm. 39 The statute expressly authorizes private citizen suits. 40 However, only injunctive relief was provided; no right of action for compensation was authorized. 41 This effectively makes the RCRA useless as a remedy for the individual who has been injured by improper hazardous waste disposal practices.

Even when enforced by the EPA, the regulation of hazardous waste that Congress intended has not been achieved by RCRA. The expense and lengthy nature of the extensive litigation required to establish liability for hazardous waste disposal and the difficulty in isolating the cause of the injury can result in years of media debate and court action while the harm caused by the hazardous waste goes unabated. 42 Also, adequate monitoring of the manifest system imposed by RCRA became unmanageable when

34. See Sokolow supra note 13, at 314.
36. Id. at § 6922(5). A manifest system is a log of incoming and outgoing locations.
37. Id. at §§ 6922-6924.
38. Id. at § 6973.
41. See Sokolow, supra note 13, at 315.
42. Id. at 315-16. It should be noted that injunctions are available under § 6973 for imminent and substantial endangerment. 42 U.S.C.A. § 6973.
thousands of manifests were filed yearly. This problem was further complicated when some companies regulated by the RCRA decided to falsify the manifests and write off the civil penalties imposed as a result of falsification as a cost of doing business.

RCRA’s success was also limited by Congress’ failure to include abandoned and inactive disposal sites in the regulatory scheme. RCRA was enacted to prevent future health problems by regulating disposal of hazardous waste generated after enactment and unfortunately did not anticipate problems associated with past accumulation of hazardous waste. Thousands of chemical sites containing tons of highly toxic hazardous waste lie dormant, posing immediate danger to public health and the environment. Thus, RCRA left a gap in hazardous waste regulation that posed an imminent threat to the environment.

B. Comprehensive Environmental Response, Compensation, and Liability Act

Congress attempted to fill the gap left by RCRA in hazardous waste regulation by enacting the Comprehensive Environmental Response, Compensation and Liability Act of 1980. While the thrust of RCRA was to prevent future problems, CERCLA was meant to correct the problems caused by decades of improper disposal methods. CERCLA provides for emergency response to hazardous waste release and clean up of inactive hazardous waste disposal sites by establishing a 1.6 billion dollar trust fund primarily financed by a tax on companies that generate hazardous waste. CERCLA authorizes action whenever there is a release or a substantial threat of a release of hazardous waste that may present an imminent and substantial danger to public health, welfare or the environment. Additionally it provides for identification of

43. See Rea, Hazardous Waste Pollution: The Need for a Different Statutory Approach, 12 ENVTL. L. 443, 457 (1982).
44. Id.
45. See Sokolow, supra note 13, at 316.
46. See Wolf, supra note 2, at 412.
47. See Sokolow, supra note 13, at 316.
49. See Florini, supra note 4, at 319.
50. 42 U.S.C.A § 9631 (West 1983).
52. Id. at § 9604.
past disposal sites and shifts liability for the cost of removing hazardous waste releases, as well as the damage caused to the environment, to the owners and operators of disposal sites.\(^{53}\)

CERCLA's ambitious goal of providing quick cleanup of hazardous waste releases into the environment and remedial cleanup of abandoned disposal sites are appropriate steps in rectifying the problem created by fifty years of careless hazardous waste disposal. Unfortunately, the 1.6 billion dollars allocated is estimated as sufficient to clean up only 170 of 14,000 hazardous waste disposal sites nationwide.\(^{54}\) Also, CERCLA has a liability ceiling of fifty million dollars which seems inadequate in light of immeasurable damage to the environment that can result, such as at the Love Canal.\(^{55}\)

Used together, RCRA and CERCLA provide the government with a regulatory scheme that could prevent some of the egregious hazardous waste disposal practices of the past and clean up the problems those practices created. However, lack of funding for the agencies charged with enforcing the statutes and slow administrative action by those same agencies have hindered the effective use of these statutes.\(^{56}\) Significantly, RCRA and CERCLA allow citizens to sue to force cleanup of hazardous waste sites but not for damages to property or compensation for personal injuries.\(^{57}\) This forces the plaintiff to look for alternative remedies to recover damages from hazardous waste injuries.

**C. The Federal Tort Claims Act**

For recovery of damages from hazardous waste injuries, a plaintiff may elect to sue the United States under the Federal Tort Claims Act\(^ {58}\) for ineffective regulation of hazardous waste generation and disposal. As the United States is only liable under the FTCA to the extent that a private individual would be under the same circumstances, the tort law of the jurisdiction where the injury occurred must be analyzed to determine if a particular


\(^{54}\) See Wolf, supra note 2, at 407-11.


\(^{56}\) 41 Cong. Q. Weekly Reports 452 (1983).

\(^{57}\) 41 Cong. Q. Weekly Reports 204 (1983) (Congress is pushing for legislation that would compensate victims of hazardous waste injuries. Also note that victim's compensation was initially dropped from CERCLA when it was passed).

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theory is available to impose liability on an individual for activities similar to those conducted or omitted by the United States. Generally, one who assumes to act, even though gratuitously, may become subject to the duty to act carefully, if he acts at all. An injured plaintiff could argue that the United States has assumed the supervision of the nation's hazardous waste sites by enacting RCRA and CERCLA and that it has breached its duty of reasonable care by failing to properly control the generation and disposal of hazardous waste.

To recover under the "gratuitous undertaking" theory, the injured plaintiff must show that the actor owed a duty to provide specific services or, absent this factor, that the beneficiary relied on the undertaking of the obligation to his or her detriment. The injured plaintiff must also prove that the undertaking of the obligation increased the intended beneficiaries' risk of harm. As the government did not intend to provide benefits for specific individuals, the injured plaintiff must necessarily argue that the federal government's assumption of the regulatory responsibility for hazardous waste caused private citizens and local health authorities to rely on their competency; that failure to regulate adequately increased the risk of harm; and that the plaintiff relied on the regulatory process to his detriment.

The government would likely raise, in response to a claim of governmental assumption of regulatory responsibility, the discretionary function exception to the FTCA. This exception provides that any claim based upon the performance or the failure to perform a discretionary function by a Government employee or federal agency is not an includable claim in a FTCA action. "Discretionary function" has been found to include the initiation of programs and activities, determinations made by executives or

59. Id. at section 2674 (no interest or punitive damages are allowed).
60. RESTATEMENT (SECOND) OF TORTS § 323 (1965).
61. Id.
62. Id.
65. Id.
administrators in establishing plans, specifications or schedules of operation, and the acts of subordinates in carrying out the operations of Government in accordance with official direction to them. 66 When considering the discretionary function defense, the courts have distinguished between decisions at the planning stage and at the operational stage. 67 Generally, the exception has been applied to decisions made in the planning stage, 68 while decisions made in the operational stage have been considered as the exercise of a discretionary function. 69

Additionally, for claims occurring after January 18, 1967, a tort claim against the United States must be filed within two years after the claim accrues as a prerequisite to recovery under the FTCA. 70 Presumably, this statute of limitations will begin to run when the injured plaintiff discovers, or in the exercise of reasonable diligence should have discovered, the injury and learns of the presence of levels of hazardous waste sufficient to cause the injury. 71

As RCRA and CERCLA do not provide for compensation for personal injuries or for damage to property, the FTCA may be an alternative for citizens seeking relief for hazardous waste injuries. However, even if the plaintiff overcomes the initial barriers discussed above, he still must show the elements of the tort to recover from the government. 72 This often insurmountable burden is shared by common law remedies available to those injured by hazardous waste, discussed in the following section of this comment.

III. COMMON LAW REMEDIES

The common law provides to those seeking relief for hazardous waste injuries the following possible theories for recovery: nuisance, trespass, negligence and strict liability.

68. Blessing v. United States, 447 F. Supp. 1160 (E.D. Pa. 1978 (no liability for damage caused by backed up waters of a dam because the decision to build the dam was made in the planning stage of the project).
72. See generally Maloney supra note 10.
A. Nuisance

The nuisance theory provides a powerful common law remedy that encompasses an infinite variety of wrongs and has served as the backbone of modern environmental law. It is divided into two causes of action: private nuisance and public nuisance. Private nuisance is a substantial and unreasonable interference with the use and enjoyment of an interest in land that results from either intentional, negligent, or reckless conduct or an activity that is abnormally dangerous. The private nuisance theory offers no relief to those personally injured who do not possess the land which is the subject of the alleged nuisance. Furthermore, even those who possess the land can find it difficult to recover under a private nuisance theory as they must demonstrate substantial and unreasonable interference with their use and enjoyment of the land before recovery is permitted.

Establishing that the interference with plaintiff's interest in land is substantial should pose few problems. Prosser noted that "[w]here the invasion affects the physical condition of the plaintiff's land, the substantial character of the interference is seldom in doubt." However, substantial interference, while not usually difficult to demonstrate, has some limitations. The injury must be real and appreciable before the plaintiff can recover. The law does not concern itself with "trifles" such as the occasional whiff of smoke or the temporary muddying of a well. Certainly the pollution of one's drinking water by leachates from buried hazardous waste or the effective condemnation of one's property because of noxious or deadly fumes would be a substantial interference, however.

Determining whether defendant's interference is unreasonable involves balancing the "gravity of the harm to the plaintiff" with "the utility of the defendant's conduct." Factors relevant to bal-

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74. RESTATEMENT (SECOND) OF TORTS § 822 (1979).
75. W. PROSSER, HANDBOOK OF THE LAW OF TORTS 593-94 (4th ed. 1971) (any interest in land is sufficient. Leases, easements, etc. are protected under the nuisance theory. However, a licensee, lodger or employee cannot maintain a nuisance action). See also Rogers, supra note 73, at 108.
77. Id. at 578.
78. Id. at 577-78.
79. RESTATEMENT (SECOND) OF TORTS § 826 (1979). See also, Rodgers supra note 73, at 112.
ancing the equities include the extent and nature of the injury, the social value of the use of the land, the suitability of the locality and the burden of avoiding the harm imposed on the person harmed.\textsuperscript{80} The utility of the conduct is affected by its social value, its suitability to the locality and the impracticality of avoiding invasion.\textsuperscript{81}

Even if an injured plaintiff shows substantial and unreasonable interference, some courts have been hesitant to grant injunctive relief when it would effect large industries that provide jobs necessary for the livelihood of the community. In \textit{Boomer v. Atlantic Cement Co.} the trial court held that Atlantic's emission of dust and other pollutants amounted to a nuisance even though the plant had taken "every available and possible precaution" to prevent the emissions.\textsuperscript{82} The New York Court of Appeals, however, used a "balancing of the equities test" to weigh the harm to local citizens against the economic interest that Atlantic represented to the community.\textsuperscript{83} Instead of shutting Atlantic down, the court granted an injunction conditional upon Atlantic's payment of permanent damages to the landowners to compensate them for the total economic damage caused to their property by the plant's operation.\textsuperscript{84} The court concluded that a complete shutdown of the plant would be too harsh a penalty to demand and that a threat of similar damage suits by others would provide the incentive for Atlantic to develop more efficient pollution control devices.\textsuperscript{85} The court, in essence, granted Atlantic a tax deductible license for a continuing nuisance.

The plaintiff seeking to rid his community of a noxious hazardous waste facility under the private nuisance theory in a court

\begin{footnotesize}
\begin{itemize}
\item \textsuperscript{80} \textit{Restatement (Second) of Torts} § 827 (1979). \textit{See also}, Prosser, \textit{supra} note 71, at 596-97.
\item \textsuperscript{81} \textit{Restatement (Second) of Torts} § 828 (1979).
\item \textsuperscript{83} 26 N.Y.2d 219, 257 N.E.2d 870, 309 N.Y.S.2d 312 (1970). \textit{But see} Whalen v. Union Bag and Paper Co., 208 N.Y. 1,5, 101 N.E. 805, 806 (1913), where the court held that "Although the damage to the plaintiff may be slight as compared with the defendant's expense of abating the condition, that is not a good reason for refusing an injunction."
\item \textsuperscript{84} 26 N.Y.2d at 225, 257 N.E.2d at 873, 309 N.Y.S.2d at 316-17. \textit{But see} Spur Industries Inc. v. Del E. Webb Dev. Co., 108 Ariz. 178, 494 P.2d 700 (1972) (injunction granted closing down stock yard but conditioned upon plaintiff's paying defendant's costs of moving or shutting down).
\item \textsuperscript{85} \textit{Id.}
\end{itemize}
\end{footnotesize}
favoring the "balancing of the equities" rationale faces a difficult burden. Even if he shows the elements of nuisance, the court could simply grant permanent damages, effectively condemning his land. The plaintiff is then forced to live in a noxious, offensive environment or to move elsewhere. Additionally, courts have been reluctant to grant injunctions that require a defendant to move or shut down when the defendant is making a good faith effort to control the problem. Most courts faced with this situation have granted injunctive relief only to the extent that it compels the defendant to use "state of the art technology" to control the pollution.

A public nuisance, on the other hand, is an unreasonable interference with a right common to the general public. Plaintiff's ability to recover using the public nuisance theory in a hazardous waste cause of action may depend on whether damages or injunctive relief is sought. Injunctive relief will be granted only if the litigant has standing to sue as a representative of the general public, a member of a class in a class action, or a citizen in a citizen's action. However, if the litigant seeks damages he must demonstrate that the injury he has sustained is different in kind from that suffered by the general public. In hazardous waste litigation, public nuisance is a rarely used theory due to the difficulty in showing that plaintiff's injury is different in kind from that of the general public.

The effectiveness of a nuisance action for abatement of irresponsible hazardous waste disposal is also limited by the defenses that are available to the defendant. Defendant could argue that the plaintiff assumed the risk of injury by coming to the nuisance when defendant's enterprise predates plaintiff's moving to the area. This can be particularly effective if it can be shown

86. Rogers, supra note 73, at 143-44.
87. Id. at 122-24.
88. Id.
91. W. Prosser, supra note 75, at 587 (there is general agreement that plaintiff's damage must be different in kind, rather than degree, from that shared by the general public).
92. Id.
93. See, e.g. Wasahak v. Moffet, 379 Pa. 441, 109 A.2d 310 (1954) (the court agreed that plaintiffs were suffering from an annoyance but, because they chose to move to the area in order to be closer to their place of employment, reversed a jury award for damages).
that plaintiff knew of the risk and acted voluntarily. Additionally, laches,\(^{94}\) statute of limitations\(^{95}\) and the doctrine of prescriptive rights\(^{96}\) may prevent plaintiff's recovery.

As these limitations demonstrate, the law of nuisance, while broad in scope, may impose a serious burden on the injured plaintiff trying to recover for hazardous waste injuries. The plaintiff bears the burden of showing "substantial and unreasonable interference" with the use and enjoyment of his land. Furthermore, he must consider that the court, using specious reasoning, may "balance the equities" of the situation and leave plaintiff sitting near a potential deadly hazardous waste site. Once proven, the plaintiff must negate a series of defenses that are available to defendant that can limit or usurp his right to redress. Because of these limitations, nuisance can be of only limited value in hazardous waste litigation.\(^{97}\)

B. Trespass

Trespass provides a cause of action through which an injured plaintiff can recover for damage to his property due to a direct invasion of a possessory interest in land. At common law trespass was actionable without proof of intent or negligence.\(^{98}\) However, the strict application of this standard has been judicially eroded to the extent that an intentional or negligent intrusion by the defendant must be proven by plaintiff in order to recover.\(^{99}\) Similarly, it has been suggested that liability should be imposed only in cases of intentional or negligent conduct.\(^{100}\) Once plaintiff has proven trespass, however, the defendant is liable for any visible and tangible damage caused to the land, to the possessor or his family,

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\(^{94}\) See, e.g. Brown v. Allied Steel Product Corp., 273 Ala. 184, 136 So. 2d 923 (1962) (recovery denied because plaintiff waited 18 months after the plant began operation to bring suit).

\(^{95}\) See, e.g. Lynn Mining Co. v. Kelly, 394 S.W.2d 755 (Ky. 1965) (Statute of limitations involving a temporary nuisance not violated by suit). See generally Davis, Tort Liability and the Statutes of Limitations, 33 Mo. L. Rev. 171 (1968).

\(^{96}\) See, e.g. W.G. Duncan Coal Co. v. Jones, 254 S.W.2d 720 (Ky. 1953) (use of stream to vent poisonous mine water for 15 years gave defendant a prescriptive right to continue to use the stream even if overflow damaged plaintiff's crops).

\(^{97}\) See generally Hines, Nor Any Drop to Drink: Public Litigation of Water Quality, 52 Iowa L. Rev. 186, 196-202 (1966).

\(^{98}\) W. Prosser, supra note 75, at 63-66.

\(^{99}\) Id. at 63-65.

\(^{100}\) Restatement (Second) of Torts § 166 (1965).
and to chattels on the land.\textsuperscript{101} Even when there is no tangible damage, the plaintiff can recover nominal damages and, if the defendant's conduct was malicious, punitive damages.\textsuperscript{102}

One restriction which prevents the wide utilization of trespass actions in hazardous waste litigation is that there must be a direct invasion of plaintiff's land by a tangible object that is visible to the naked eye.\textsuperscript{103} Typically, a hazardous waste injury is caused by seepage of micrograms of highly toxic chemicals at a rate measured in inches per year through the ground water system, only to turn up in plaintiff's drinking water miles from the disposal site, or is caused by invisible airborne particles that settle on plaintiff's land over a lengthy period of time.\textsuperscript{104} These circumstances make it impossible to prove that a tangible object visible to the naked eye was responsible for the damage.

There has been some erosion of the "visible tangible object" requirement in recent years. In \textit{Martin v. Reynolds Metals Co.}\textsuperscript{105} a cattle rancher brought a trespass action against Reynold's Aluminum alleging that his cattle had been poisoned by invisible airborne fluoride particles that had escaped from Reynold's manufacturing plant and settled on plaintiff's land and in plaintiff's water supply. Defendant contended that the mere settling of fluoride particles on plaintiff's land was not a direct invasion of property and, therefore, not a trespass.\textsuperscript{106} The Supreme Court of Oregon disagreed with the defendant's contention. Holding for the plaintiff the court stated:

\begin{quote}
It is quite possible that in an earlier day when science had not yet peered into the molecular and atomic world of small particles, the courts could not fit an invasion through unseen physical instrumentalities into the requirement that a trespass can result only from a direct invasion. . . . [W]e may define trespass as any intrusion which invades the possessor's protected interest in exclusive possession, whether that intrusion is by visible or invisible pieces of matter or by energy which can be measured only by the mathematical language of the physicists.\textsuperscript{107}
\end{quote}

\begin{itemize}
\item \textsuperscript{101} W. Prosser, \textit{supra} note 75, at 67.
\item \textsuperscript{102} Id. at 66-68.
\item \textsuperscript{103} Id. at 66.
\item \textsuperscript{104} See generally Murphy, \textit{Environmental Law: New Legal Concepts in the Antipollution Fight}, 36 Mo. L. Rev. 78, 84-85 (1971).
\item \textsuperscript{105} 221 Ore. 86, 342 P.2d 790, cert. denied, 362 U.S. 918 (1960).
\item \textsuperscript{106} Id.
\item \textsuperscript{107} Id. at 93-94, 342 P.2d at 793.
\end{itemize}
Apparently, common law courts required tangible evidence of an invasion because of the uncertainty of proof.\textsuperscript{108} However, modern technological advances in instrumentation and analysis techniques allow scientists to increase the certainty of proof in hazardous waste litigation and lessen the need for the tangible evidence.\textsuperscript{109} As a result, modern courts which recognize the technical advances of the last fifty years could permit recovery for injuries caused by hazardous waste, under the trespass theory.

\section*{C. Negligence}

Negligence is defined as conduct which falls below the standard established by law for the protection of others against unreasonable risk of harm.\textsuperscript{110} Negligent conduct may consist of either an act or a failure to act when there is a duty to do so.\textsuperscript{111} Generally, and in hazardous waste litigation, the plaintiff has the burden of proving all of the following: (a) facts which give rise to a legal duty on the part of the defendant to conform to the standard of conduct established by law for plaintiff's protection (b) failure of the defendant to conform to the standard of conduct (c) the failure is the legal cause of the harm suffered by the plaintiff, and (d) the plaintiff has in fact suffered a legally compensable harm.\textsuperscript{112}

Negligence is often difficult to prove but this can be particularly so in hazardous waste litigation. First, the disposal of hazardous waste may have been in a manner that was reasonable at the time because the harmful effects were not known and did not become evident for decades.\textsuperscript{113} Second, the plaintiff must trace the origin of the hazardous waste and its generator. This poses a difficult problem when several different hazardous waste generators may have disposed of the hazardous waste at the same site. The trace usually requires extensive documentation searches and costly scientific and geological tests, an expense few potential plaintiffs can afford.\textsuperscript{114} Third, the type of injury resulting from hazardous

\begin{itemize}
\item \textsuperscript{108} Id.
\item \textsuperscript{109} See Rogers, supra note 73, at 156-58. \textit{But see}, Note, Trespass-Nuisance-Election of Remedies: Invisible Fluoride Compound Settling Upon Plaintiff's Land Constitutes Trespass Rather Than Nuisance, 39 Tex. L. Rev. 244-45 (1960) (majority of courts have held that invasions by intangible objects, when actionable, constitute a nuisance).
\item \textsuperscript{110} Re\textsuperscript{110} STATEMENT (SECOND) OF TORTS § 282 (1965).
\item \textsuperscript{111} Id. at § 284.
\item \textsuperscript{112} W. PROSSER, supra note 75, at 143-44.
\item \textsuperscript{113} See Wolf, supra note 2, at 368.
\item \textsuperscript{114} See Rea, supra note 43, at 465.
\end{itemize}
waste disposal may make proof of causation even more difficult. These injuries often manifest themselves years after exposure to the toxic elements and can be caused by numerous other elements including incidence of random occurrence in the population. This delay may create difficulties for filing the action within the statute of limitations and makes proof of causation by a particular defendant virtually impossible. Finally, the toxic element causing the injury may have been generated by a synergistic chemical reaction of several hazardous waste elements disposed of in the same site. This makes tracing the liability to a specific generator very problematic, leaving the often bankrupt hazardous waste site operator the only responsible party. All these considerations make recovery using the negligence theory a difficult task for the injured plaintiff in hazardous waste litigation.

D. Strict Liability

A more promising theory of recovery available to an injured plaintiff is that of strict liability for abnormally dangerous activities. This theory abolishes the requirement that the plaintiff, who is seeking damages for injuries resulting from improper disposal of hazardous waste, prove the defendant's lack of due care. The plaintiff need only show that defendant's activities were "abnormally dangerous" and were the cause of plaintiff's injury.

The infamous case of Rylands v. Fletcher established this doctrine of strict liability. Defendants, owners of a mill overlaying abandoned coal mine shafts, constructed a reservoir to contain the water to power their mill. The water burst through the filled-up shaft of an abandoned coal mine and through connecting shafts into plaintiff's adjoining mines. Defendants had no prior knowledge of the latent defect in the shaft and were free from fault. Existing common law actions afforded plaintiff no redress for his injuries. Justice Blackburn saw the need to control dangerous new technologies and imposed liability on other grounds:

116. See generally Sokolow, supra note 13, at 322-34. See also Wolf, supra note 2, at 368-69.
117. Rogers, supra note 73, at 158.
119. Rogers, supra note 73, at 158.
120. Id. (Trespass was unavailable since the flooding was not direct and immediate. Nuisance was unavailable because the conduct was not offensive to the senses and the damages were nonreoccurring).
We think that the true rule of law is that the person who for his purposes brings on his land and collects and keeps there anything likely to do mischief if it escapes, must keep it at his peril, and if he does not do so, is prima facie answerable for all the damage which is the natural consequence of its escape.\textsuperscript{121}

Lord Cairns viewed the problem as a "non-natural" use of the land for which defendants should be liable.\textsuperscript{122} Thus, the injured plaintiff need only demonstrate the dangerous nature of the hazardous waste and prove that his injuries were caused by it.

Although American jurisdictions generally follow the \textit{Rylands} rule, some courts have limited its effectiveness where large economic concerns have dominated the locale. In \textit{Turner v. Big Lake Oil Co.}\textsuperscript{123} the court refused to impose strict liability for damages caused by the escape of salt water from ponds used by defendants in the operation of oil wells. The court's rationale was that the oil business was vital to Texas and that the ponds were a necessary part of the oil industry.\textsuperscript{124} Similarly, Delaware, noted for its chemical industry, refused to hold DuPont strictly liable for injuries caused by the escape of deadly chlorine gas from its chemical plant: "[I]t was not unlawful for DuPont to have on its premises chlorine gas, nor was its presence there unusual, and it cannot be said that the mere possession of chlorine gas by DuPont without more was dangerous per se in light of recognized industrial use."\textsuperscript{125} Thus, strict liability for hazardous waste injuries may be denied when the waste is a necessary by-product of a defendant which is a vital economic entity in the community, a problem shared by the nuisance action.\textsuperscript{126}

Similarly, it has been suggested that strict liability is applicable to a broad range of activities if a balancing test, similar to the "balancing of the equities" test used in nuisance theory, is applied.\textsuperscript{127} The following factors are considered in the balancing test: (a) existence of a high degree of risk of some harm to the person, land or chattels of others; (b) likelihood that the harm that results from it will be great; (c) inability to eliminate the risk by

\begin{itemize}
\item \textsuperscript{121}1 L.R. Ex. 279-80.
\item \textsuperscript{122}3 L.R. H.L. at 338-39.
\item \textsuperscript{123}128 Tex. 155, 96 S.W.2d 221 (1936).
\item \textsuperscript{124}128 Tex. at 170, 96 S.W.2d at 226.
\item \textsuperscript{125}Fritz v. E.I. DuPont de Nemours and Co., 6 Terry (Del.) 427, 437, 75 A.2d 256, 261 (1950).
\item \textsuperscript{126}See supra notes 82-85 and accompanying text.
\item \textsuperscript{127}Restatement (Second) of Torts § 519 (1977).
\end{itemize}
the exercise of reasonable care; (d) extent to which the activity is not a matter of common usage; (e) inappropriateness of the activity to the place where it is carried on; and (f) extent to which its value to the community is outweighed by its dangerous attributes. Plaintiff could argue in hazardous waste litigation that the storage and disposal of hazardous waste is an abnormal use of land since it presents a high degree of risk and a likelihood that escape of hazardous waste will result in great harm. Additionally, the plaintiff can argue that storage and disposal of hazardous waste is not a common use of the land and the danger from it cannot be eliminated by reasonable care. Defendant would likely respond that the benefit gained from the storage and disposal of hazardous waste is greater than the danger it poses. Convincing the court that the equities favor the plaintiff, however, remains a difficult burden. And as with the other common law theories of recovery discussed above, proof of causation and the statute of limitations barrier are the most serious limitations on the strict liability theory.

CONCLUSION

RCRA and CERCLA have not been effective in regulating the disposal of hazardous waste due to lack of funding and administrative neglect which have hindered governmental enforcement of the statutes. Additionally, private plaintiffs seeking redress for hazardous waste injuries are without appropriate remedies. RCRA and CERCLA offer only injunctive relief and provide no compensation for personal injuries of property damage. The FTCA and common law remedies may provide relief but are not without formidable burdens. Proving causation, overcoming the statute of limitations and enduring lengthy and costly litigation are often hurdles the private citizen cannot overcome.

Solving these problems will require congressional action. Loopholes exempting from regulation small businesses that handle less than one thousand kilograms of hazardous waste per month could be closed. Congress could also provide adequate funding for the

128. Id. at § 520.
129. See Sokolow, supra note 13, at 321-31 (often the courts will look to the “deep pocket” theory which emphasizes the defendant’s ability to pay for plaintiff’s injuries through insurance by passing the costs on to customers).
130. 38 Cong. Q. Almanac 457 (1982) (It is estimated that between one and eight percent of the hazardous waste is generated by exempt businesses).
enforcement of the statute by extending the tax until the hazardous waste is cleaned up, not just until CERCLA expires in 1985. Additionally, the victim compensation legislation proposed in the past could be enacted. Senator Stafford proposed legislation that would provide a limited no fault claim against the funds collected under CERCLA and allow damages exceeding the no fault limit to be recovered using traditional common law remedies. These steps, if taken by Congress, should certainly alleviate some of the harm caused by egregious hazardous waste disposal practices.

RAY GUFFEY

131. 41 Cong. Q. Weekly Reports 583-84 (1983) (Senator Hart proposes extending CERCLA 10 years and boosting the fund to 15 million dollars).
132. Id. See 38 Cong. Q. Almanac 457 (1982).
NOTE


by Loretta S. Dunn*

I. INTRODUCTION

On June 24, 1983, the Supreme Court announced its decision in Motor Vehicle Manufacturers Association of the United States v. State Farm Mutual Automobile Insurance Company [hereinafter cited as State Farm]. The case involved the National Highway Traffic Safety Administration's rescission of its most controversial safety standard—the "air bag" standard, which required passive restraints (air bags or automatic seatbelts) in all cars. Rescission of the standard, which had become a target of the Reagan Administration, is one of the first major Reagan deregulatory efforts challenged in court. The Supreme Court's opinion in the State Farm case, which stated that the rescission of the passive restraint standard is subject to the same "arbitrary and capricious" standard as is the promulgation of the standard, will serve as an important guide to future deregulators. This article will outline the Reagan Administration's deregulatory initiatives, focusing on the rescission of the air bag standard, examine the proposed standards for judicial review of that rescission, and discuss the standard set by the Supreme Court in its decision in State Farm on June 24, 1983 and its significance for future deregulatory efforts.

II. BACKGROUND

A. Reagan Administration Deregulatory Efforts

When Ronald Reagan assumed the Presidency in 1981, estimates on the cost of complying with Federal regulations ran as

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high as 100 billion dollars a year. Included in the 1980 Republican party campaign platform was the following promise: "We pledge to cut down on federal paperwork, cut out excessive regulation, and cut back the bloated bureaucracy". Shortly after taking office in January of 1981, President Reagan announced the creation of a "President's Task Force on Regulatory Relief" [hereinafter cited as Task Force]. The Task Force was to be headed by the Vice President and its mission was to "achieve the regulatory relief our economy desperately needs . . . ." 

James C. Miller III, Executive Director of the Task Force, testified at hearings held by the Senate Judiciary Committee in 1981 that "regulatory relief" is "one of the four cornerstones of President Reagan's economic recovery program . . . [and is] clearly one of the top priorities of this Administration". Murray Weidenbaum, Chairman of the Council of Economic Advisors, echoed those sentiments. "Regulatory reform is a key component of the President's Economic Recovery Program . . . [t]his Administration from the President on down is dedicated to achieving meaningful lasting regulatory reform." With this goal in mind, the Task Force set out on its mission to explore the regulatory world, seek out unnecessary regulations and eradicate them. One of the first actions of the Task Force was to target thirty-six rules for "postponement." Vice President Bush noted, in his announcement of


7. Id. at 41 (statement of Murry Weidenbaum).

8. These 36 rules were (by agency):

DEPARTMENT OF AGRICULTURE

1. Revision and Redesignation of Section 502 Rural Housing Loan Policies, Procedures, and Authorization (Farmers Home Administration).
the first regulatory "hit list", that these thirty-six were "midnight" regulations that had been caught in the President's regulatory "freeze," in reference to the proposal or promulgation

DEPARTMENT OF COMMERCE
2. Federal Interaction with Voluntary Standards Bodies; Procedures.
3. The Channel Islands National Marine Sanctuary.
4. The Point Reyes-Farallon Islands National Marine Sanctuary.
DEPARTMENT OF EDUCATION
5. Assistance to States for Education of Handicapped Children.
DEPARTMENT OF INTERIOR
6. Prime Farmlands.
7. Prime Farmlands.
8. Extraction of Coal, Two Acres or Less.
10. FLPMA Exchange Authority for Public Land.
12. Leases, Permits, Easements Through Public Lands.
13. Hawaiian Tree Snail.
15. Glacier Bay National Monument; Protection of Humpback Whale.
DEPARTMENT OF JUSTICE
DEPARTMENT OF LABOR
17. Walkaround Compensation.
18. Occupational Exposure to Lead.
19. Procedures for Pre-determination of Wage Rate under Davis-Bacon.
20. Payment of Membership Fees.
22. Salary Test Levels to Determine Eligibility for Exemption from Overtime Provisions.
25. Certification Process and Adverse Effect Wage Rate.
DEPARTMENT OF TRANSPORTATION
27. Addition of Water to Pipelines Transporting Anhydrous Ammonia.
29. Carpool and Vanpool Projects.
31. Emergency Stockpiling of Buses.
32. Urban Initiatives Program.
DEPARTMENT OF TREASURY
33. Revenue Sharing Handicapped Discrimination Regulations.
ENVIRONMENTAL PROTECTION AGENCY
34. Timber Products Effluent Guidelines: BPT and BCT.
35. Amendments to General Pretreatment Standards.
36. Pesticides: Classification of Uses of Active Ingredients and State Registration of Pesticide to Meet Local Needs.

9. Id.
of some of these rules in the last days of the Carter Administration and the freeze placed on implementation of them by President Reagan in January of 1981.\(^\text{10}\)

The Task Force then turned its attention to the automobile industry.\(^\text{11}\) In 1981, at a hearing before the Senate Commerce, Science and Transportation Committee, representatives of the automobile manufacturers testified concerning government regulations affecting the auto industry.\(^\text{12}\) The Ford Motor Company, for example, listed eighteen regulations as “Top Auto-Specific Regulatory Relief Issues”—fourteen were EPA regulations dealing with pollution standards and four were auto safety regulations.\(^\text{13}\) The most costly and apparently most objectionable safety regulation was Federal Motor Vehicle Safety Standard 208 [here-

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\(^{10}\) Some of President Carter’s more liberal appointees had been accused of promulgating rules on the eve of Reagan’s inauguration. Memorandum from the White House to the Cabinet on Postponement of Pending Regulations (January 29, 1981), reprinted in Hearings on the Role of OMB in Regulation before the Oversight and Investigations Subcommittee of the House Energy and Commerce Comm., 97th Cong., 1st Sess. 39 (1981).

\(^{11}\) There is no doubt the auto industry was in serious financial trouble in January of 1981. U.S. car sales for 1980 had been the lowest in 19 years and U.S. car manufacturers had incurred losses of 4.3 billion dollars in 1980. Office of the Press Secretary, The White House, Fact Sheet (April 6, 1981). The auto industry, including suppliers and dealers, had an estimated 580,000 unemployed persons. Id.


\(^{13}\) Id. at 45-59. These rules were:
1. 1984 Clean Air Act High Altitude Emission Requirements.
2. 1982-83 Interim High Altitude Regulations.
4. Passenger Car HC and NO\(_x\) Emission Standards.
5. 1984 Heavy Duty Truck Exhaust Emission Regulations.
8. Medium and Heavy Truck Noise Emission Regulation.
10. 1985 Light Duty Truck Oxides of Nitrogen (NO\(_x\)) Emission Standards.
11. Diesel Exhaust Particulate Requirements.
12. Lead Time for Promulgation of Regulations/Standards.
13. FMVSS 208—Occupant Crash Program.
in after referred to as FMVSS 208], the “passive restraint” standard administered by the National Highway Traffic Safety Administration [hereinafter referred to as NHTSA],14 which required installation of passive restraint protection in the front seat of all passenger cars beginning with full-size cars in model year 1982, including mid-size cars in model year 1983 and all cars in model year 1984.15 The term “passive restraints” includes (1) the “air bag” which is an inflatable cushion contained in the steering wheel and under the dashboard and which inflates during a collision and (2) the “passive seat belt” which is attached to the door of a car so that when the door is closed the belt automatically surrounds the occupant.16 Seat belts currently in use in cars are known as “active restraints” because the occupant must take action himself to buckle the belt.17

On April 6, 1981, the White House disclosed that the Administrators of the Environmental Protection Agency and NHTSA had submitted notices to the Federal Register of intent to rescind, revise or propose again a total of thirty-four auto industry related regulations.18 The possible savings to the auto industry by this “White House automobile industry relief package” in capital outlays were estimated at 1.3 billion dollars.19 The purpose of the announcement was to describe the specific immediate and longer term actions by which NHTSA intends to reduce unnecessary regulatory pressures on the auto industry.20 NHTSA’s first proposal was to delay implementation of the first phase of FMVSS 208, which applied to full-size, 1982 model year cars, and to publish a notice of proposed rulemaking requesting comment on alternatives for protection of the occupant automatically.21 In an accompanying fact sheet, NHTSA noted that “this rule [FMVSS 208] has the largest capital cost impact of any current safety standard”.22

17. Id.
19. Id. at 4.
21. Id.
22. NHTSA, Fact Sheet on Individual NHTSA Actions #1 and #2, Final Administrative Action to Delay for One Year Implementation of the First Phase of the “208 Standard” (1981).
B. History of FMVSS 208

With the delay in implementation of FMVSS 208, Reagan administration deregulators interjected themselves into a controversy that had been brewing for almost 30 years. Between 1969 and 1981, alone, the FMVSS 208 standard "was the subject of approximately 60 notices of proposed rulemaking, hearings, amendments and the like."4

In 1966, Congress enacted the National Traffic and Motor Vehicle Safety Act of 1966 [hereinafter referred to as the Safety Act] to reduce traffic accidents and deaths and injuries to persons resulting from traffic accidents. The Safety Act directs the Department of Transportation [hereinafter referred to as DOT] or its delegate, NHTSA, to establish "by order, appropriate Federal motor vehicle safety standards."26

In 1967 FMVSS 208 was issued, requiring the installation of seatbelts in all automobiles. However "[i]t soon became apparent that the level of seatbelt use was too low to reduce traffic injuries to an acceptable level. The Department therefore began consider-


ation of passive occupant restraint systems.\textsuperscript{28} In 1968, the technical development progressing, Eaton, Yale and Towne, developers of the air bag, demonstrated the air bag to the (then) National Highway Safety Bureau, estimating that the system could be ready in three to four years.\textsuperscript{29} The NHTSA estimated that approximately 12,000 deaths and 100,000 serious injuries could be avoided by use of passive restraints.\textsuperscript{30} In 1969, DOT issued a notice of proposed rulemaking to require passive restraint systems in all cars.\textsuperscript{31} FMVSS 208 went through a number of modifications and a final rule was promulgated in 1972.\textsuperscript{32} This rule required full compliance by 1975 and interim compliance with either passive restraints or seat belts with an ignition interlock which would prevent starting the vehicle without buckling the seat belts.\textsuperscript{33} In 1975 NHTSA postponed the standard's effective date for a year\textsuperscript{34} and finally in 1976 DOT Secretary Coleman suspended the standard.\textsuperscript{35} In place of the standard, Secretary Coleman initiated a demonstration project which called for equipping 500,000 cars with passive restraints.\textsuperscript{36} Shortly thereafter, in 1977 new DOT Secretary Adams reopened the passive restraint rulemaking.\textsuperscript{37} Adams did away with the demonstration project and issued a new FMVSS 208.\textsuperscript{38} The modified FMVSS 208, which was upheld by the District of Columbia Circuit Court of Appeals,\textsuperscript{39} ordered passive restraints in all large cars by model year 1982, in mid-size cars by model year 1983, and in all cars by model year 1984.\textsuperscript{40}

\textsuperscript{28} 103 S. Ct. at 2862.
\textsuperscript{29} See, Insurance Institute, supra note 23.
\textsuperscript{33} Id. See also 36 Fed. Reg. 19,266 (1971).
\textsuperscript{34} 40 Fed. Reg. 33,977 (Aug. 13, 1975) The extension was first proposed at 40 Fed. Reg. 16,217 (April 10, 1975) because a decision had not yet been made on the long term requirements for occupant crash protection and manufacturers needed to be informed of the requirement.
\textsuperscript{35} Department of Transportation, The Secretary's Decision Concerning Motor Vehicle Occupant Crash Protection at 8 (December 6, 1976).
\textsuperscript{36} 42 Fed. Reg. 5,071 (1977) (to be codified at 49 C.F.R. 571.208).
\textsuperscript{39} Pacific Legal Foundation v. Dep't. of Transp., 593 F.2d 1338 (D.C. Cir. 1979), cert. den., 444 U.S. 830 (1979).
\textsuperscript{40} Id. at 1342. Brock Adams, the new Carter appointee, disagreed with prior Secretary Coleman's concern that the public might not accept a passive restraint mandate. Adams, in reinstating the standard, estimated that it would save 9,000 lives a year once all cars were equipped.
Though there was extensive scrutiny of the rule by the Senate and the House in 1977, 1978, 1979 and 1980, the rule was not vetoed by Congress, even though the amendments in 1974 to the Safety Act in 1974 had added a provision giving both Houses of Congress the opportunity to pass a resolution disapproving any passive restraint requirement.

On April 6, 1981 when the White House announced its automobile industry relief package and DOT Secretary Lewis ordered a one year delay in implementation of FMVSS 208 and proposed possible rescission of the standard, the automakers had already spent almost 200 million dollars tooling up to meet the standard.

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41. S. Rep. No. 481, 95th Congress, 1st. Sess. 2 (1977) “Subcommittee and full committees of both Houses of Congress have voted with bipartisan support to uphold Secretary Brock Adams’ decision.”


43. Pub. L. No. 96-131, 93 Stat. 1023, 1039 (1979), § 317(a). None of the funds provided in this act may be used to implement or enforce any standard or regulation which requires any motor vehicle to be equipped with an occupant restraint system (other than a belt system).

44. H.R. Rep. No. 1371, 96th Cong. 2d Sess (1980). The House amendment provided that none of the funds authorized to be appropriated under the bill may be used to enforce or otherwise administer the passive restraint standard unless such standard also permits the purchaser to select an active belt system.

45. Congress had authority to veto any passive restraint standard under the 1974 Amendments, 15 U.S.C. § 1410 (1976). Congress had the opportunity in 1977 to veto the Adams decision and did not. In the House, a resolution of disapproval was co-sponsored by 160 members, but the House Energy and Commerce Committee voted 16-12 to table the resolution. The issue was never voted on by the full House. In the Senate, the Commerce Committee reported a resolution of disapproval to the Senate with a recommendation that the resolution be defeated. The Senate ultimately tabled the resolution of disapproval on a vote of 65-31. State Farm v. Dep’t. of Transp., 680 F.2d 206, 223-24, nn. 21-23 (D.C. Cir. 1982).


In 1980, in the reauthorization process for NHTSA, a number of proposals were forwarded. The Conference Committee removed a Stockman amendment (which would have eliminated the mandatory element of 208) and reversed the standard’s implementation schedule, requiring small cars to comply first. Further, the conferees added a provision requiring all major car manufacturers to offer airbags for sale in at least one car “line”. The conference bill passed the Senate, but did not pass the House. Conf. Rep. No. 1371, 96th Cong., 2d Sess. 15-17 (1980).

Insurance companies and consumer groups, the major proponents of passive restraints, protested strongly, arguing that implementation of the 208 standard would save 9,000 lives per year. Nevertheless, NHTSA, maintained that it was unable to find that the passive restraint requirement would produce significant safety benefits and issued a final rule rescinding the passive restraint standard on October 29, 1981. Thereafter State Farm Mutual Auto Insurance Company and the National Association of Independent Insurers sued DOT and NHTSA in the U.S. Court of Appeals for the District of Columbia Circuit, charging that NHTSA had acted arbitrarily in rescinding the standard.

III. THE CIRCUIT COURT'S RULING

A. The Administrative Procedures Act

The D.C. Circuit Court of Appeals faced the threshold question of the proper scope of judicial review of the agency's rescission of the standard—a matter of first impression. As Judge Mikva stated, "the appropriate scope of judicial review remains the most troublesome question" because the court is "called upon to review the rescission rather than the promulgation of an agency rule." With regulatory relief a prime goal of the Reagan Administration and with its Task Force targeting more and more rules for rescission and revision, the judicial scrutiny accorded NHTSA's action would be an important factor in the ultimate success or failure of the Task Force. The rescission of FMVSS 208, as one of the first actions to undergo judicial scrutiny, would af-

47. It is estimated that the standard with full compliance could also avert 65,000 serious injuries per year. The economic costs of crash injuries may be well beyond the conservative estimate of $24 billion—$30 billion per year. Graham & Gorham, NHTSA and Passive Restraints, 35 ADMIN. L. REV. 193 (1983).
51. Id. The Supreme Court did not agree with Judge Mikva. Justice White had no problem finding the appropriate standard. See 103 S. Ct. 2681.
52. The Task Force published a progress report in June 13, 1981 and the auto relief issues were noted, the Vice President claimed savings to the industry of 1.4 billion in capital costs due to the changes in regulations. Office of the Press Secretary, The White House at 4 (June 13, 1981).
ford a strong indication as to how these deregulatory actions would fare in court.\textsuperscript{53}

The Safety Act provides that "$[t]he APA [Administrative Procedure Act] shall apply to all orders establishing, amending or revoking a Federal motor vehicle safety standard..."\textsuperscript{54} The judicial review provision of the Administrative Procedure Act [herein-after cited as the APA] provides that the reviewing court shall "hold unlawful and set aside agency action, findings, and conclusions found to be—

\begin{itemize}
\item[(A)] arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law;
\item[(B)] contrary to constitutional right, power, privilege, or immunity;
\item[(C)] in excess of statutory jurisdiction, authority, or limitations, or short of statutory right;
\item[(D)] without observance of procedure required by law;
\item[(E)] unsupported by substantial evidence in a case subject to sections 556 and 557 of this title or otherwise reviewed on the record of an agency hearing provided by statute; or
\item[(F)] unwarranted by the facts to the extent that the facts are subject to trial de novo by the reviewing court.\textsuperscript{55}
\end{itemize}

Subsections (B), (C) and (D) must always be addressed in reviewing agency action and are not at issue here; subsection (F) is reserved for agency adjudicatory action where the agency's fact finding procedures are inadequate or where issues that were not before the agency are raised in a proceeding to enforce nonadjudicatory agency action.\textsuperscript{56} The focus of the question became the standards in subsections (A) and (E).\textsuperscript{57}

\textbf{B. Minimum Rationality}

The "Federal Parties", which included DOT, NHTSA and the Department of Justice [herein-after cited simply as DOT], acknow-

\textsuperscript{53} There are two other cases which may reach the Supreme Court soon. They are cases involving Secretary Donovan's relaxation of the Davis-Bacon Act's Wage requirements and EPA's use of the "bubble" concept to measure air pollution. See Part IV infra.


\textsuperscript{57} These standards—(A) the "arbitrary and capricious" test and (E) the "substantial evidence" test have usually been considered mutually exclusive. This may no longer be true, see Part III. D. infra.
ledged that the "arbitrary and capricious" test of subsection 706 (2)(A) was the standard of review for this rescission. However, DOT defined the "arbitrary and capricious" test in such a manner as to severely limit the scope of judicial review. DOT argued that the legislative nature of agency action militates for the narrowest meaning of "arbitrary"—that is, "willful irrationality, randomness, whim or impropriety". It noted that the Senate Judiciary Committee in discussing the draft APA in 1947, compared the standards of review established under the APA to the minimum standard found under the Due Process Clauses of the Constitution. That due process standard provides that absent contravention of a Constitutional provision, a court may strike down a statute only if it is not "rationally related to a legitimate purpose". DOT further argued that "absent invidious purpose or classification, the Constitution imposes no restrictions on the authority of a legislature to repeal a statute—even though a rational basis would have been necessary to support enactment of the statute". It suggested that the reviewing court must be "extremely reluctant" to set aside rescission of a regulation which was not required by statute, regardless of the standard which would apply to promulgation.

The due process "minimum rationality" standard, normally reserved for review of statutes, is a highly deferential standard, and is appropriate when one branch of the government is reviewing the actions of another. It represents a reversal of the activist, interventionist stance taken by some courts in the late 19th and early 20th century (particularly the Supreme Court) which led to President Roosevelt's plan to change the membership of the Court in 1937. Judicial review of agency action does not carry that historical baggage. Courts must take into account the origin of the

59. Id. at 23.
60. Id. at 26.
61. After abandonment of the strict economic due process review employed in the early New Deal Cases, the Court adopted this lenient approach in reviewing statutes in NLRB v. Jones and Laughlin, 301 U.S. 1 (1936).
62. DOT Brief, supra note 58 at 28.
63. Id.
64. See NLRB v. Jones and Laughlin, 301 U.S. 1 (1936).
APA, chronicled in the entire legislative history of the APA, which clearly shows Congress' general dissatisfaction with the existing administrative agencies and its desire to put judicial constraints on them.67

Judge Leventhal, in *Ethyl Corp. v. EPA*,68 points out the difference between agencies and legislatures:

In the case of legislative enactments, the sole responsibility of the courts is constitutional due process review. In the case of agency decision-making, the courts have an additional responsibility set by Congress. Congress has been willing to delegate its legislative powers broadly . . . because there is court review to assure that the agency exercises the delegated power within statutory limits, and that it flushes out objectives within those limits by an administration that is not irrational or discriminatory.69

C. Agency Refusal to Promulgate

The Court of Appeals stated in *State Farm*: "at first view, rescission more closely resembles agency refusal to act . . . and it is only in the rarest and most compelling circumstances that courts overturn an agency's expert determination not to pursue a particular program of policy. . . ."70 The Court of Appeals cited as ex-

69. Id. at 68.
70. 680 F.2d 206, 218 (D.C. Cir. 1982). The Motor Vehicle Manufacturers Association, petitioners in the Supreme Court, argued that the rescission is comparable to a decision not to promulgate:

NHTSA's October 29, 1981 order rescinded the passive restraint requirement twenty-two months before the effective date for small cars and ten months before the effective date for other cars. This is the first case of which we are aware where a court has been called upon to review a rescission of a rule before its effective date. Petitioners submit that the decision here not to let a rule become effective should be treated as analytically equivalent to a decision not to promulgate in the first instance. Such decisions are subject only to a narrow scope of judicial review. The court of appeals rejected the idea that 'rescission more resembles agency refusal to act than an agency decision to act' on the ground that the agency had 'rescinded a rule that [was] already . . . promulgated'. The court did not consider the crucial fact that the rule had not yet become effective and would not become effective for a substantial period of time. A rescission so far in advance of the effective date is very
amples, *Natural Resources Defense Council v. SEC*\(^71\) and *WWHT, Inc. v. FCC.*\(^72\)

In *NRDC*, the SEC granted a petition for rulemaking and then declined to promulgate a set of rules on corporate disclosure after seven years of rulemaking proceedings.\(^73\) This action was challenged in court and the SEC claimed that the denial to promulgate a rule was nonreviewable because the action was one committed to agency discretion under 5 U.S.C. § 701(a)(2).\(^74\) The Court, in its determination that the action was reviewable, looked at three factors: the need for judicial review, impact of judicial review on the effectiveness of the agency in carrying out its duties, and the appropriateness of the issues raised for review.\(^75\) The court acknowledged that judicial review would interfere with agency performance by requiring the agency to divert its scarce institutional resources to defend in court its decision not to adopt the proposed rules.\(^76\) However, the court distinguished between initial denial of a rulemaking petition and granting of a rulemaking petition and then denial to promulgate a rule.\(^77\) The court held that in the latter case, judicial review would not “seriously interfere with the agency’s budget and personnel planning”, because the agency, by agreeing to conduct rulemaking proceedings, had evidenced its view that the proposals warranted further study and in the course of the proceedings had compiled a record focused on the sug-

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\(^71\) 606 F.2d 1031 (D.C. Cir. 1979).
\(^72\) 656 F.2d 807 (D.C. Cir. 1981).
\(^73\) 606 F.2d 1031, 1037 (D.C. Cir. 1979).
\(^74\) Indeed, the legislative history of the APA and the Attorney General’s Manual conflicts here. The Manual interpreted § 553(e) of the APA, the section requiring agencies to accept and act on petitions, as precluding judicial review of the denial of a petition to promulgate a rule. In a footnote, the Court attempts to distinguish the Manual’s conclusion on the basis that it deals with an agency’s failure to grant a rulemaking petition and that the present case dealt with an agency’s declination to promulgate a rule after granting a petition for rulemaking. See 606 F.2d 1031, 1043, n. 14 (D.C. Cir. 1979). The Senate Committee Report on the APA contains language that implies that judicial review would be available. S. REP. NO. 752, 79th Cong., 1st Sess. 26 (1945), *reprinted* in *Administrative Procedure Act: Legislative History, S. Doc. No. 248, 79th Cong., 2d Sess. 185, 201-202 (1946).*
\(^75\) 606 F.2d 1031, 1044 (D.C. Cir. 1979).
\(^76\) *Id.* at 1044.
\(^77\) *Id.* at 1045-46.
gusted rules. While declining to hold that an agency decision not to adopt rules is reviewable per se, the court held that the SEC's action in this case was subject to review under 5 U.S.C. § 706(2)(a), the "arbitrary and capricious" test. The "arbitrary and capricious" language "rather than denoting a fixed template to be imposed mechanically on every case, requires that a flexible approach should be employed. The court saw its duty to review as a narrow one: "the considerations that counsel against judicial review of a decision not to adopt rules by informal rulemaking also call for us, when we do review to exercise special deference."

In WWHT v. FCC, the FCC had denied a rulemaking petition to promulgate a rule. The court carried one step further, and held that the decision to deny the rulemaking petition after some preliminary consideration was reviewable but under a very narrow standard. The court noted that judicially imposed rulemaking is rare and that it is only in the "most compelling of circumstances" that a court overturns an agency decision not to institute rulemaking.

The judicial reluctance to overturn an agency decision not to promulgate a rule is understandable. Review of such decisions should be limited. However, rescission of a rule already promulgated does not fall squarely within that same policy. The three elements set down by the court in NRDC are met automatically in the case of a rescission. The first element—the need for judicial supervision to protect the public's interest—is satisfied because the status quo is radically altered by rescission. The second ele-

78. Id. at 1046-47.
79. Id. at 1047.
80. Id. at 1049.
81. Id.
82. 656 F.2d 807, 809 (D.C. Cir. 1981).
83. Id. at 817.
84. Three cases were cited where the court intervened to overturn a rejection of a rulemaking petition. The first was Geller v. FCC, 610 F.2d 973 (D.C. Cir. 1979), where the court, in finding that certain rules of the FCC adopted on the basis that they served the public interest, could not be adhered to once a showing had been made that they no longer served that interest. The court did not hold that new rulemaking proceedings had to be instigated, but rather left to the FCC's discretion how to comply with its decision. The other two cases involved rejections of rulemaking requests on the mistaken ground that the agency involved lacked jurisdiction. NAACP v. FPC, 520 F.2d 432 (D.C. Cir. 1975), aff'd, 425 U.S. 662 (1976) and National Org. For Reform of Marijuana Laws v. Ingersoll, 497 F.2d 654 (D.C. Cir. 1974).
85. If review is not limited the reviewing court will be in the awkward position of telling the agency how to allocate its resources and how best to fulfill its mandate.
ment, the impact of review on agency effectiveness, is not really implicated because rescission requires § 553 notice and comment just as in promulgation. The agency is already required to use its funds to rescind, therefore, limited diversion and interference will occur. The third requirement, appropriateness of the issues for review, is fulfilled because the issues will already be framed for review by the § 553 rescission proceedings.86

In *State Farm* the Court of Appeals had far too much trouble distinguishing an internal, administrative, managerial decision by an agency not to promulgate a rule and the rescission of a regulation which is already “on the books.” In the latter, fear of interference with agency internal affairs should not be heavily weighted—instead the interest of the public which may have relied on the regulation should be paramount and should call for as stringent a review as employed in promulgation, which also represents a change in the status quo.

**D. Substantial Evidence**

Judge Mikva, in his opinion for the Court of Appeals, noted that prior decisions concerning NHTSA’s issuance of passive restraints had been judged under the “substantial evidence” test.87 In *Chrysler Corp. v. Department of Transportation*,88 automobile manufacturers took NHTSA to court after promulgation of a final rule requiring passive restraints in cars. In reviewing the agency’s decision, the Sixth Circuit applied the test set out in APA’s § 706(2)(E) which requires the reviewing court to determine whether a standard is supported by substantial evidence on the record as a whole.89 The Sixth Circuit noted in particular the requirement in the Safety Act that the Secretary of Transportation file in the Court of Appeals the record of the proceedings on which he based his order in accordance with § 2112 of Title 28 of the U.S. Code.90 This section provides that “all of the evidence before the agency shall be included in the record.”91 Under the APA,

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86. 606 F.2d 1031, 1049 n.23 (D.C. Cir. 1979).
88. 472 F.2d 659 (6th Cir. 1972).
89. *Id.* at 668. 5 U.S.C. § 706(2)(E) is normally used in reviewing formal adjudications or formal rulemakings.
90. 472 F.2d at 668.
where statutory provision is made for review on the record, the agency's action must be supported by substantial evidence. Since DOT had to file a record, the Sixth Circuit reasoned that this brought safety standards under the “substantial evidence” standard.

The D.C. Circuit, faced with the same question, in Automotive Parts and Accessories Association v. Boyd held that the requirement that the Secretary file the “record” with the court did not bring safety standards within the application of § 706(2)(E), but left the standards subject to the arbitrary and capricious test of § 706(2)(A).

The difference between “substantial evidence” review and the “arbitrary and capricious” test may be more apparent than real, however. In the 1970's, the D.C. Circuit and other courts of appeals began to take a “hard look” at agency's informal rulemaking. Judge Leventhal of the D.C. Circuit believed that courts should apply tougher substantive review to agency action, while Judge Bazelon of the same Circuit argued for tougher review of agency procedures. The Supreme Court's 1978 decision in Vermont Yankee that additional procedures could not be judicially grafted onto the APA seemed to foreclose the Bazelon approach. Judge Leventhal articulated his hard look doctrine in Greater Boston Television Corp. v. FCC:

The function of the court is to assure that the agency has given reasoned consideration to all the material facts and issues. Its supervisory function calls on the court to intervene ... if the court becomes aware, especially from a combination of danger signals, that the agency has not really taken a hard look at the salient

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94. Id. at 337.
95. The two tests developed under rigid distinctions of formal agency action (“substantial evidence” review) and informal agency action (“arbitrary and capricious” review). With the development of hybrid rulemaking, such as in the FTC's Magnuson—Moss Act, the courts have begun to lose patience with these inflexible distinctions.
98. 444 F.2d 841 (D.C. Cir. 1970).
problems and has not genuinely engaged in reasoned decision-making."

With the advent of the "hard look" doctrine, the two standards of "arbitrary and capricious" and "substantial evidence" may have become indistinguishable.

Indeed, many commentators and judges, including Judge Friendly of the Second Circuit Court of Appeals, have said that, in review of policy decisions, "the substantial evidence test tends to converge with the arbitrary and capricious test. . . ."100 In 1973, in International Harvester101 the test which Judge Leventhal employed to review the agency action was not the traditional APA "arbitrary or capricious" test or the "substantial evidence" standard but an amalgam of the two which he called—"reasoned decision-making."102 In accord is Professor Verkuil, who has suggested that

[the more productive course is that suggested by the First Circuit in the Buney Bear case and the Second Circuit in the Associated Industries case which is to assume that, substantial-evidence-without-a-[formal]-record is identical to the arbitrary and capricious test and that it requires the record to contain reasons and a factual basis for the agency's informal rule.]103

The Supreme Court has also made it clear in Overton Park,104 discussed in Part IV of this article, that the arbitrary and capricious standard "require[s] the reviewing court to engage in a substantial inquiry."105

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99. Id at 851.
102. Id. at 648.
105. Id. at 415 (emphasis added).
However, to the extent that the "substantial evidence" test may still be considered by some Courts of Appeals as more obtrusive and more rigidified than the "arbitrary and capricious" test it should be reserved for true on-the-record proceedings—adjudicatory actions and agency actions where it has been explicitly imposed by statute.

E. Intensified Scope

After a long, detailed examination of the legislative "history" of the passive restraint standard, Judge Mikva concluded that,

judicial scrutiny of agency action—including the rescission of a rule—depends on the extent to which the agency has deviated from congressional expectations. An agency is seldom locked on course, but it must have increasingly clear and convincing reasons the more it departs from the path marked by Congress.106

The "path marked by Congress" that Judge Mikva referred to in his opinion, consisted of a series of legislative actions and inaction beginning in 1974 with passage of the 1974 amendments to the Safety Act which contained a Congressional ban on the use of ignition interlocks in conjunction with the 208 standard.107 Also included in the "path" was inaction by Congress in 1977, when NHTSA submitted the standard to both Houses of Congress in accordance with the legislative veto provision set up in the 1974 amendments to the Safety Act.108 Judge Mikva noted that in 1980 Congress considered, but did not pass, modifications to the 208 standard.109

Normally, post-enactment legislative activities are not a recognized way of ascertaining the meaning of an agency's organic statute.110 Post-enactment activities which are not statutory are even more suspect. The Supreme Court's view in this regard was articulated in the Regional Rail Reorganization Act Cases111: "post-passage remarks of legislators, however explicit, cannot serve to

106. 680 F.2d 206, 229 (D.C. Cir. 1982).
108. See supra, note 45. Legislative veto was recently declared unconstitutional in Immigration and Naturalization Service v. Chadha, 51 U.S.L.W. 4907 (1983).
change the legislative intent of Congress expressed before the Act's passage.\footnote{112} In \textit{Consumer Product Safety Commission v. G.T.E. Sylvania},\footnote{113} the Court, interpreting a statute, rejected interpretive language in a subsequent Conference Report on an enacted bill amending that statute.\footnote{114} The Court noted in \textit{United States v. Rutherford}\footnote{115} that once an agency's statutory construction has been fully brought to the attention of Congress and it has not sought to alter that interpretation although it has amended the statute in other respects, then presumably the legislative intent has been correctly discerned.\footnote{116} This is wandering far afield from the case of FMVSS 208, however—the only treatment of the passive restraint standard in any \textit{enacted} legislation was in the 1974 amendments to the Safety Act where Congress retained a close supervisory role by providing for a legislative veto over any passive restraint standard.\footnote{117} As the D.C. Circuit noted in \textit{Kay v. FCC}\footnote{118}, legislative silence is not necessarily equivalent to legislative approval.\footnote{119} Further, where pre and post-enactment legislative history contains inconsistencies, the legislative history should not be dispositive.\footnote{120} That is the case with standard 208—one must balance the 1974 amendments and the Senate Committee resolution of approval of the standard in 1977 against the riders to the DOT Appropriation bills in 1978 and 1979 prohibiting funds to enforce Standard 208. Since no clear inferences can be drawn, the Court of Appeal's heightening of the standard of judicial review in the \textit{State Farm} case is particularly inappropriate.\footnote{121}

Judge Mikva's opinion, heightening the standard of judicial review by reference to unenacted legislative acts and omissions to act, has been justly criticized.\footnote{122} The only applicable provision for review is contained in the organic act itself, the Safety Act.

\begin{itemize}
  \item \footnote{112} \textit{Id.} at 132.
  \item \footnote{113} 447 U.S. 102 (1980).
  \item \footnote{114} \textit{Id}.
  \item \footnote{115} 442 U.S. 544 (1979).
  \item \footnote{117} 15 U.S.C. 1410 b(d) (1976).
  \item \footnote{118} \textit{Kay v. FCC}, 443 F.2d 638 (D.C. Cir. 1970).
  \item \footnote{119} \textit{Id.} at 646.
  \item \footnote{120} \textit{See} Teamsters v. U.S., 431 U.S. 324 (1977); Haire v. Calloway, 526 F.2d 246 (8th Cir. 1975). \textit{For a different solution, see} Woodwork Manuf. v. NLRB, 386 U.S. 612, 639-640 (1967).
  \item \footnote{122} \textit{Id.} at 193.
\end{itemize}
Nothing short of a subsequently enacted amendment to that Act can change its standard of review.

Applying the arbitrary and capricious test to rescissions of prior agency regulations, and intensifying the scope of its review based upon its reading of legislative events, the Court of Appeals held that the agency’s rescission was arbitrary and capricious for three reasons. First, the NHTSA’s conclusion that the increase in belt usage under the Standard could not be predicted was not sufficiently supported. Second, NHTSA did not adequately consider the substitute of nondetachable seatbelts for detachable passive seatbelts. Third, NHTSA failed to consider the installation of airbags as a method by which to comply with the standard. NHTSA was given thirty days for submission of a schedule to resolve these three questions. On October 1, 1982, it informed the court that compliance could not be reached until September 1985. Thereafter on November 8, 1982, the Supreme Court granted certiorari.

IV. THE SUPREME COURT’S DECISION

While Judge Mikva may have mentioned in passing the substantial evidence test, all of the parties before the Supreme Court agreed that the correct standard of review was the APA’s “arbitrary and capricious” test. Of course, each of the parties had their own definition of “arbitrary and capricious.” The Random House Dictionary defines arbitrary as “not fixed by rules but left to one’s judgment or choice; discretionary based on one’s preference, notion, whim, etc; capricious.” The leading case drawing the boundaries of the “arbitrary and capricious” test is Citizens to Preserve Overton Park v. Volpe, decided by the Supreme Court in 1970. The case involved

124. Id. at 240.
125. Id. at 236-38.
126. Id. at 242.
127. 103 S. Ct. 2865 (1982).
129. 103 S. Ct. at 2866-67 (1982).
informal action, not informal rulemaking, but the test under the APA remains the same. The Court was presented with a decision by the Secretary of Transportation to allow construction of an interstate highway through a public park in downtown Memphis. Under the relevant statute, the Secretary was prohibited from authorizing use of federal funds to finance highway construction through parks if a "feasible and prudent" alternative route existed. The Secretary's decision that the highway could go through the park was challenged. The Supreme Court articulated the task of the reviewing court—"[t]he generally applicable standard of § 706 requires the reviewing court to engage in a substantial inquiry. . . [a]lthough this inquiry into the facts is to be searching and careful, the ultimate standard of review is a narrow one." While agency action is "entitled to a presumption of regularity. . . that presumption is not to shield action from a thorough, probing, in-depth review." As one commentator put it—"Overton Park [was] the Court's first attempt to outline the role of the lower Courts in reviewing informal agency action. . . [t]he significant role for reviewing courts outlined by Overton Park requires careful consideration of both the factual basis of the agency decision and the reasons behind it." This sounds quite similar to Judge Leventhal and Judge Mikva's "reasoned decision-making."

The additional question posed by NHTSA's action in rescinding the air bag rule was addressed in Atchison, T. & S.F.R. Co. v. Wichita Board of Trade. In that case, the Court addressed the question of the level of scrutiny a reviewing court should employ in a case where the agency departed from a prior policy.

A settled course of behavior embodies the agency's informed judgment that, by pursuing that course, it will carry out the policies committed to it by Congress. There is, then, at least a presumption that those policies will be carried out best if the settled

133. 401 U.S. at 406-407.
135. The decision was challenged by environmentalists, see Kalven, The Supreme Court 1970 Term, 85 HARV. L. REV. 3, 315 (1971).
136. 401 U.S. at 416.
137. Id. at 415.
140. 412 U.S. 800 (1973).
rule is adhered to. From this presumption flows the agency’s duty to explain its departure from prior norms... Whatever the ground for the departure from prior norms, however, it must be clearly set forth so that the reviewing court may understand the basis of the agency’s action and so may judge the consistency of that action with the agency’s mandate.141

*Overton* and *Atchison* form the basis for the decision of the Court in *State Farm*. The Court held that NHTSA had a duty in rescinding to supply a “reasoned analysis” for its decision.142 It noted the difference between the minimal rationality required of statutes under the Due Process Clause and the tighter standard of review for agency action:

The Department of Transportation suggests that the arbitrary and capricious standard requires no more than the minimum rationality a statute must bear in order to withstand analysis under the due process clause. We do not view as equivalent the presumption of constitutionality afforded legislation drafted by Congress and the presumption of regularity afforded an agency fulfilling its statutory mandate.143 The Court’s view was to adopt a “minimal” rationality test for the review of agency action would be an abdication of the judiciary’s duty under § 706(2).

The Court also rejected, however, the Court of Appeals heightened standard of review. “This Court has never suggested that the standard of review is enlarged or diminished by subsequent Congressional action. The Court of Appeals... erred in intensifying the scope of its review based upon its reading of legislative events.”144

The Court’s duty was to determine whether NHTSA’s rescission was arbitrary and capricious. Justice White stated:

Revocation constitutes a reversal of the agency’s former views as to the proper course... the forces of change do not always or necessarily point in the direction of deregulation... If Congress established a presumption from which judicial review should start, that

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141. *Id.* at 807-08.
143. *Id.* at 2866; *see also* *Pacific States Co. v. White*, 296 U.S. 176 (1935). A more recent statement concerning the distinction can be found in *Indus. Union Dep’t. v. American Petrol. Inst.*, 448 U.S. 607, 671 (1980) (Rehnquist, J. concurring).
144. 103 S.Ct. at 2866.
presumption is not against safety regulation, but against changes in current policy that are not justified by the rulemaking record.\textsuperscript{145}

The Court then examined in detail NHTSA's reasons for rescinding the standard. The Court found fault in two areas:

\begin{enumerate}
\item that NHTSA gave no consideration to modifying the Standard to require that air bags only be used once it found that detachable passive belts would not achieve the anticipated safety benefits. The Court said that that did not cast doubt on the need for a standard, and that the logical response to the faults of detachable belts would be to require compliance using air bags only;\textsuperscript{146} and
\item that NHTSA found that if detachable passive belts were used to comply with the standard, it could not predict any increase in seat belt usage. The Court noted that all of the evidence in the record showed an increase in usage.\textsuperscript{147}
\end{enumerate}

The Court took a 'hard look' at NHTSA's action—it was not persuaded that deregulation carries enough merit entirely on its own. Where deregulation represents a change in policy, it is not enough of an explanation to state that the aim is regulatory relief, the change must be justified. The test to be applied is "arbitrary and capricious" and that test requires a reasoned decision, not a mere recitation of deregulatory tenets.

\section{Conclusion}

In \textit{State Farm}, the Supreme Court held that NHTSA had acted arbitrarily and remanded the case to the D.C. Circuit Court of Appeals with instructions to remand to NHTSA.\textsuperscript{148} NHTSA must consider the rescission in light of the Court's holding that it must submit reasons for dismissing the option of an air bag-only standard and for finding that it could not reliably predict "even a 5 percentage point increase" in use of passive seat belts.\textsuperscript{149} The next move is now up to the Administration and the agency; Mrs. Dole, the new Secretary of Transportation, has said that she welcomes "the opportunity to fully review this matter under the guidance pro-

\begin{figure}
\begin{itemize}
\item \textsuperscript{145} \textit{Id.} at 2866-67.
\item \textsuperscript{146} \textit{Id.} at 2868-71.
\item \textsuperscript{147} \textit{Id.} at 2871-74.
\item \textsuperscript{148} \textit{Id.} at 2874.
\item \textsuperscript{149} \textit{Id.} at 2872-74.
\end{itemize}
\end{figure}
vided by the Supreme Court." 150 This comment provides no indication as to what further action DOT will take.

Whether or not all cars will ever be equipped with air bags, this case may well represent a significant roadblock to the Reagan Administration's Regulatory Relief Program. The Court's 9-0 opinion sets limits on the Administration by establishing that rules cannot be scrapped without sound evidence. 151 Rescission or amendment of an existing rule requires a reasoned analysis of the regulatory alternatives to the agency.

The first casualty of the decision may be another major deregulatory action: EPA's "bubble rule" which allows regulators to limit air pollution from entire factories rather than from each source within a plant. The D.C. Circuit Court of Appeals overturned the EPA's action in amending the rule. 152 In a footnote, Judge Ginsburg cited the Circuit Court's opinion in State Farm in noting that EPA "has some burden . . . to show that a regulation once considered to [effectuate policy] efficiently can no longer be expected to do so" in order to rise to the level of reasoned decision-making. 153 Employment of the bubble approach was one of the centerpieces of the Reagan Administration's Regulatory Relief Task Force. 154 The Supreme Court has agreed to hear an appeal from the Administration. 155 While C. Boyden Gray, counsel to the Task Force, may contend that the Administration is pleased with the decision in State Farm and that "by and large [the Task Force has] done things right," it is not entirely clear that all of the deregulatory initiatives of the Task Force will pass muster under State Farm. 156 Another action taken by the Civil Aeronautics Board rescinding certain smoking regulations and promulgating relaxed rules was also overturned by the D.C. Circuit Court of Appeals. 157 In its opinion, the court held that "an agency's obligation

150. Young, Passive Restraints Urged for Cars by '85, J. COM. (June 27, 1983).
151. Wines, High Court's Air Bag Ruling May Affect Other Deregulation Moves, NAT'L J. at 1371 (July 2, 1983).
153. Id. at 727, n. 41.
156. Id.
to explain its actions is not reduced when it rescinds rather than promulgates a regulation.” The court went on to say, this does not prevent an agency from altering its course when circumstances or attitudes shift, it “merely ensures that those changes reflect reasoned consideration of competing objectives and alternatives.”

The Administration can point to one recent victory. The D.C. Circuit Court of Appeals upheld the Labor Department’s promulgation of new, relaxed rules governing wages paid to workers on federally financed construction projects under the Davis-Bacon Act. Labor unions appealed the decision and the Supreme Court denied cert. A D.C. District Court judge had held that Secretary Donovan’s decision to alter a long-standing prior policy, “must at a minimum show that the earlier understanding of the statute was wrong or that experience has proved it to be defective.”

The Supreme Court in State Farm has clearly “made it tougher for all regulatory agencies to change course” and it means federal officials cannot rescind regulations “simply because the Reagan administration prefers a climate of deregulation.” The decision, as the first major Supreme Court test of the effort to ease government regulation of business, is “likely to make government officials think harder and longer and . . . make deregulation more vulnerable to court challenge.” Consumer activist Ralph Nader commented: “the Court has told Reagan that there are limits beyond which it will not tolerate deregulatory fanaticism.” Whether or not one believes the Task Force is composed of deregulatory fanaticists, the Supreme Court has sent a strong message to them: “winning an election doesn’t mean free rein in rewriting regulatory policies established in previous administrations.”

158. Id.
163. Id.