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JAPANESE ANTITRUST ENFORCEMENT: IMPLICATIONS FOR UNITED STATES TRADE

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I. INTRODUCTION

On April 5, 1990 the Japanese Government released its interim report on the negotiations with the United States pursuant to the Bush Administration's 1989 Structural Impediments Initiative. The Interim report contained much that the U.S. negotiators wished to hear. United States Trade Representative Carla Hills characterized it as "a good blueprint, sufficient to call a down payment." The Japanese indeed promised much that the United States had demanded. The principal category in the list of proposed Japanese actions was the strengthening of Japanese antitrust enforcement. Lax compliance with antitrust proscriptions in Japan was a major American concern in the negotiations. In response the Japanese Government agreed to increase staff support for the Japanese Fair Trade Commission ("JFTC"), Japan's exclusive antitrust enforcement agency, as well as to take other actions designed to make penalties more effective and the disclosure of violations and informal measures more frequent.

Each item reflected a shortcoming in Japanese antitrust enforcement, at least as perceived from an American perspective. Lack of staff, restricted investigatory powers, weak sanctions, and reliance on relatively lenient and seldom publicly disclosed informal measures to cure exposed violations have long been noted by American observers as characteristic features of the Japanese enforcement process. The argument that these reforms

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1. For full texts of both the Japanese and United States government interim reports, see 7 INT'L TRADE REP. 527-41 (1990).
2. N.Y. Times, April 6, 1990, at 1, col.1.
were needed to ensure greater antitrust compliance in Japan—much less the premise that such compliance would in turn enhance United States merchandise trade with Japan and improve access to Japanese consumer and industrial markets—rest, however, on several quite debateable assumptions. These include the propositions that serious anticompetitive practices now exist in Japan, that these practices hinder new entry and access to Japanese markets by foreign firms, and that such practices can be controlled by more effective antitrust enforcement, not to mention the assumption that the limitations of Japanese antitrust enforcement can be corrected by strengthening penalties and enforcement capacity. My purpose in this article is to explore these premises in light of Japan’s postwar experience with antitrust controls and to offer an alternative view of the implications of enhanced Japanese antitrust enforcement for United States trade with Japan.

II. ANTITRUST IN JAPAN: THE POSTWAR EXPERIENCE

A. From False Premises

The history of American demands for effective antitrust law in Japan has been one of false premises. United States policy makers have historically and at present overestimated both Japanese propensity for private anticompetitive behavior and the efficacy of legal controls. From the initial imposition of antitrust legislation by Occupation authorities on a recalcitrant Japanese government in 1947,4 a set of largely unsubstantiated assumptions regarding the extent and effect of anticompetitive behavior of

major Japanese enterprises and the effectiveness of regulatory controls has guided American policy.

The American military occupiers of Japan in defeat viewed the experience of prewar Japan in effect as an Asian variation of the European fascist experience. Japan's impetus to aggression and war was explained in part by an alleged alliance of convenience between the military and Japan's Industrial combines. In order to restore—a some would say, to create—an institutional environment in which democratic process could take root, both the military and industrial establishments had to be dismantled. The result was a policy dominated by the twin goals of demilitarization and zaibatsu dissolution. Like the proscription against maintenance of a military establishment in article 9 of the postwar constitution, the 1947 Antimonopoly and Fair Trade Law was intended as a means to preclude the resurgence of the zaibatsu and their perceived anticompetitive evils.

Hindsight permits a more objective view of the predisposition of the Allied reformers. Although many still share their perceptions of Japan, little if any objective evidence supports the conclusion that Germany or other European models fit prewar

5. See E. Hadley, Antitrust in Japan 6-12 (1970). Hadley reports a comment to her by a former War Department officer responsible in part for drafting the Joint Chiefs of Staff Basic Directive of November 1, 1945, JCS 1880, for United States occupation policy in Japan, to the effect that attempts to take a “fresh approach” to Japan were overruled by superiors who insisted that the directive follow the policies adopted in the Basic Directive on Germany (JCS 1067). Id. at 8-9.

6. Hadley, supra, note 5, at 9. As Hadley notes, Japanese desk officers rejected such views in light of the political conflict between military and business interests during the interwar period. Officers in the economic division, however, held the view that eventually guided United States policy. See, e.g., E. Pauley, Report on Japanese Reparations to the President of the United States, November, 1945 to April, 1946, 39 (1946).

7. See Joint Chiefs of Staff Basic Directive of November 1, 1945 (JCS 1380).

8. Constitution of Japan (Nihon koku kenpō) article 9 provides:

Aspiring sincerely to an international peace based on justice and order, the Japanese people forever renounce war as a sovereign right of the nation and the threat or use of force as a means of settling international disputes.

In order to accomplish the aim of the preceding paragraph, land, sea, and air forces, as well as other war potential, will never be maintained. The right of belligerency of the state will not be recognized.

KENPŌ (Constitution) art. IX, (Japan).

9. Shiteki dokusen no kinshi oyobi kōsei torihiki no kakuho ni kansuru hōritsu (Law concerning the prohibition of private monopoly and the preservation of fair trade), Law No. 54 of 1947 [hereinafter AMFTL].

Japan. There is no evidence, for example, that the zaibatsu widely engaged in collusive activities or that prior to the mid 1930's and wartime mobilization, Japan's economy was effectively cartelized. Until then, as a major purchaser of most cartelized commodities on world markets, Japan was far more consumer-victim than participant in the global cartel movement of the interwar era. The limited data that exists suggests that contrary to conventional postwar wisdom, not only was the Japanese economy not significantly cartelized until the mid 1930's, but also that few if any of the cartels that did exist were effective until the advent of mobilization and governmental intervention.

Prewar Japanese markets absent government intervention are more accurately characterized as intensely competitive arenas in which an increasing number of rival zaibatsu conglomerates emerged in lieu of one or two dominate single industry enterprises as in other industrial states. The zaibatsu themselves appear to have been intensely competitive. There may well have been intra-conglomerate trade-offs whereby competitively stronger firms within a particular conglomerate might in effect subsidize weaker ones to enable them to be more competitive, but the notion that extensive collusion existed among competing firms in

11. On Japan's distinctive interwar history, see J. CROWLEY, JAPAN'S QUEST FOR AUTONOMY (1966) and various essays in DILEMMAS OF GROWTH IN PREWAR JAPAN (J. Morely ed. 1971).

12. Nearly all statistics on zaibatsu profits, market shares, and assets compiled under the Occupation cover the period from the late-1930's through 1945 after the introduction of government measures for military mobilization. See, e.g., HADLEY, supra note 5, at 48-55. The limited data on zaibatsu for earlier periods, however, depict in terms of asset growth significantly less concentration and market power. See, e.g., J. COHEN, JAPAN'S ECONOMY IN WAR AND RECONSTRUCTION 508 (1949).

13. On the interwar cartel movement, see G. STOCKING & M. WATKINS, CARTELS OR COMPETITION? 32-41 (1948). During this period, on the one hand, Japan was harshly criticized for competitive pricing of its exports, principally textiles. See, e.g., Takahashi, Japan's Trade and the World, 3 CONTEMP. JAPAN 73 (1934). Yet, on the other hand, Japan relied heavily on imports of agricultural products, chemical fertilizer, and other commodities subject to international cartel controls. See STOCKING & WATKINS at 93, 407.


15. For opposing views, see HADLEY, supra note 5, at 45-60; BISSON, supra note 4, at 11-17. These accounts do not cite empirical evidence and also fail to take into account the increasing number of new zaibatsu conglomerates, and thus the apparent opportunities for new entry and enhanced competition.

16. If extensive, however, such intra-zaibatsu subsidation could have been as dysfunctional as collusion in terms of efficient allocations of resources.
separate zaibatsu is not supported by available empirical data.\textsuperscript{17} In other words, Japan's antitrust legislation was at the outset a product of a misunderstanding of the competitive forces within the Japanese economy. Without government intrusion, such forces were thus quite likely to reappear.

The reformers were otherwise correct in their understanding of wartime Japan. The use of cartel-like control organizations and industry-wide associations as a vehicle for governmental implementation of wartime economic controls was a distinctive feature of Japan's wartime experience.\textsuperscript{18} Revived official promotion of anticompetitive controls, of industrial concentration, and collusion was thus a more realistic threat than private anticompetitive behavior.\textsuperscript{19}

Japan's postwar antitrust legislation, however, was designed to deal with private business conduct not government developmental policies.\textsuperscript{20} Drafted hurriedly in the second year of the Occupation,\textsuperscript{21} the legislation was a rather awkward attempt to combine the disparate and partly overlapping Sherman, Clayton, and Federal Trade Commission Acts\textsuperscript{22} into a single, coherent statute.\textsuperscript{23} Apparently no attempt was made to analyze the suitability of the Japanese legal or administrative environment for American-styled regulatory legislation.\textsuperscript{24} Nor is there any indication that the drafters fully appreciated the difficulty of grafting a law that depended significantly on judicial interpretation and gloss sourced in a common law and liberal economic tradition for substantive content onto a legal system in which judges could

\textsuperscript{17} Occupation documents collected from the zaibatsu reveal extensive inter-zaibatsu transactions, but few if any inter-zaibatsu agreements. See, e.g., Mitsui Contract Collection, University of Washington Law School Library (unpublished material).

\textsuperscript{18} See Cohen, supra, note 12, at 28, 76.

\textsuperscript{19} The possibility of revived 'control' associations was a substantial concern, as exemplified in their prohibition in the Trade Association Law (Jigyosha dantai hō), Law No. 191 of 1948, art. 51.

\textsuperscript{20} On the term "developmental", see C. Johnson, MITI and the Japanese Miracle (1982).

\textsuperscript{21} See Bisson, supra note 4, at 181; see Twenty Year History at 42-46.


\textsuperscript{23} Salwin, supra note 4, at 39.

\textsuperscript{24} See, e.g., Bisson, supra note 4, at 39.
not be expected to give substantive meaning to otherwise vacuous statutory language. 25

A second assumption that American legislation could be tailored to fit the Japanese context was thus as erroneous as the first. Although the statute survived the Occupation with remarkably few amendments, one could hardly expect either Japanese antitrust policy or its enforcement to follow American patterns.

B. The Basic Proscriptions

In addition to specific structural controls, such as the prohibitions against holding companies, 26 interlocking directorates, 27 restrictions on intercorporate shareholdings, 28 and merger control, 29 the Japanese Antimonopoly and Fair Trade Law prescribes three basic types of conduct: private monopolization (shiteki dokusen), 30 unreasonable restraints of trade (futō na torihiki seigen), 31

26. AMFTL, supra note 9, at art. 9(1).
27. AMFTL, supra note 9, at art. 13.
28. AMFTL, supra note 9, at arts. 10 and 11.
29. AMFTL, supra note 9, at arts. 15 and 16.
30. AMFTL, supra note 9, at art. 3. Private monopolization is defined in article 2(5) as follows:

The term “private monopolization” as used in this Law shall mean any business activity by which any entrepreneur, individually, by combination or conspiracy with other entrepreneurs, or in any other manner, excludes or controls the business activities of other entrepreneurs, thereby causing, contrary to the public interest, a substantial restraint of competition in any particular field of trade.

AMFTL, supra note 9, at art. 2(5).
31. See AMFTL, supra note 9, at art. 3. Unreasonable restraints of trade are defined in article 2(6) as follows:

The term “unreasonable restraint of trade” as used in this Law shall mean any business activity by which entrepreneurs by contract, agreement, or any other concerted activity mutually restrict or conduct their business activities in such a manner as to fix, maintain, or enhance prices; or to limit production, technology, products, facilities, or customers or suppliers, thereby causing, contrary to the public interest, a substantial restraint of competition in any particular field of trade.

AMFTL, supra note 9, at art. 2(6).
and unfair business practices (*fukōsei na torihiki hōhō*). The only modification of these provisions has been the change in language under the 1953 amendments from "unfair methods of competition" (*fukōsei na kyūsō hōhō*) to the current phrase "unfair business practices". The definitions for each remain as drafted or, as noted below, by JFTC designation. Subsequent Japanese court decisions and JFTC Practice have further defined these terms.

Private monopolization has become in practice an incoherent term with hardly any predictable content. There have been only six private monopolization cases, the most recent in 1972. Those in which violations were found begin chronologically with a bank's scheme to ensure more effective debt collection by financed silk manufacturers through required sales to a bank-controlled export company. Others in turn involved resale price maintenance and price leadership, collusion among a dairy cooperative, a local bank and the two major dairy products firms denying financing to dairy farmers who sold their product to competing firms,

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32. See AMFTL, supra note 9, at art. 19. Unfair business practices are currently defined in article 2(7) as follows:

The term "unfair business practices" as used in this Law shall mean any act that comes under any one of the following items that tends to impede fair competition and that is designated by the Fair Trade Commission:

(a) Unduly discriminating against other entrepreneurs;
(b) Dealing at undue prices;
(c) Unreasonably inducing or coercing customers of a competitor to deal with oneself;
(d) Trading with another party on such conditions as will restrict unjustly the business activity of said party;
(e) Dealing with another party by unwarranted use of one's bargaining position;
(f) Unjustly interfering with a transaction between an entrepreneur who competes in Japan with oneself or the company of which oneself is a shareholder or an officer and his customers; or, in case such entrepreneur is a company, unjustly inducing, instigating, or coercing a shareholder or an officer of such company to act against the interest of such company.

AMFTL, supra note 9, at art. 2(7).

33. See infra note 47.

34. Judgment of July 13, 1950, JFTC (Decision), Japan, 2 Shinketsushū 74; Judgment of December 29, 1954, JFTC (Decision), Japan, 7 Shinketsushū 108; Judgment of July 23, 1956, JFTC (Decision), Japan, 8 Shinketsushū 12; Judgment of November 15, 1962, JFTC (Decision), Japan, 11 Shinketsushū 1; Judgment of June 1, 1965, JFTC (Recommendation), Japan, 13 Shinketsushū 18; Judgment of September 18, 1972, JFTC (Decision), Japan, 19 Shinketsushū 87.


and the reacquisition by Japan's leading can manufacturer of subsidiaries it had been required to divest under the Occupation dissolution program. In two other cases the JFTC found no violation. Consequently the prohibitions against unreasonable restraints of trade and unfair business practices have been the principal proscriptive provisions of the law.

As construed by the 1953 Tokyo High Court decision in the Asahi Shimbunsha case, the prohibition against unreasonable restraints of trade applies solely to concerted actions by competitors that have substantial adverse effect on competition in a particular field of trade. As a matter of policy, the Japanese FTC has consistently viewed collusive price and output restrictions among competing firms as the most serious form of antitrust offense. Over 70 percent of all formal JFTC enforcement actions since 1947 have been directed at such concerted conduct in restraint of competition either under article 3 in the case of individual enterprises or article 8 in the case of trade associations. Virtually all of these cases have involved collusive price-fixing or output restrictions or both.

Indicative also of Japan's postwar antitrust enforcement emphasis is the next largest category of violations: vertical price-fixing (resale price maintenance). Because of the strict interpretation of article 3 in the Asahi Shimbunsha case, the JFTC has had to resort to the article 19 prohibition against unfair business practices in order to deal with the vertical restraints. Article 19 has been used to control a variety of manufacturer-imposed marketing restrictions. Resale price maintenance, however, has been the only consistently proscribed practice.

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38. Judgment of September 18, 1972, supra note 34.
40. Judgment of March 9, 1953, Saikōsai (Supreme Court), Japan, 6 Kōsai minshū (No. 9) 435.
42. FTC White Paper, supra note 41, at 204-205. See also Tsuji, Regulation of Resale Price Maintenance in Japan, 18 N.Y.L. Forum 397 (1972).
43. See, e.g., cases with analyses in Y. ABE SHINKETSU DOKUSEN KINSHI Hō 567-694 (1974); K. SAMEKATA, KASEN TAISEI TO DOKUSEN KINSHI Hō (Oligopoly and antimonopoly law) (1983). For discussion of the special issues raised by manufacturer-imposed restrictions to create controlled marketing channels, see RYūTSU KEIRETSUKA TO DOKKIN KINSHI Hō
The choice between article 3 and article 19 is significant. As drafted, the Antimonopoly and Fair Trade Law subjected violations of article 3 but not article 19 to criminal penalties. The distinction can be explained by drafting history. Article 19, as noted previously, was modelled after the Federal Trade Commission Act’s prohibition of “unfair methods of competition”. As an independent regulatory agency, the American FTC was not granted criminal enforcement authority; therefore, unfair methods of competition were not subjected to criminal enforcement. Apparently following this example, the American drafters of the Japanese statute choose not to subject violations of article 19 to criminal sanctions.44

By virtue of separate statutes and enforcement processes, American courts have been able to define the prohibitions of disparate American antitrust statutes to cover similar conduct. As a result, the Justice Department and the Federal Trade Commission have overlapping jurisdiction with, however, criminal enforcement the exclusive province of Justice.45 It makes little sense, however, to construe separate substantive prohibitions within a single statute to overlap and cover identical behavior. Consequently, it should have been evident at the outset that the Japanese were likely to depart from American definitions and give separate meaning to the provisions of articles 3 and 19. Only conduct included under article 3, however, could without amendment of the law be subjected to criminal enforcement.

44. See cases reviewed in DOKUSEN KINSHI SEISAKU SANJUNENSHI (Thirty year history of antimonopoly policy) 661-728 FTC ed. 1977 [hereinafter THIRTY YEAR HISTORY].
45. See AMFTL, supra note 9, at art. 89.
46. On the concurrent jurisdiction of the FTC and Antitrust Division of the Department of Justice, see E. KINTNER, AN ANTITRUST PRIMER 146 (1964).
The American drafters of the Japanese law thus generally ignored the problems that the Japanese would eventually encounter with the inclusion of the prohibitions against unfair methods of competition (or unfair business practices) along with unreasonable restraints of trade and private monopolization in a single statute. Their original draft as enacted did include a long list of specific conduct expressly defined as unfair methods of competition with provisions for possible addition by JFTC designation. Those that involved restraints on competition, rather than 'unfair' means of competing, could have been included equally well, however, in the definition of unreasonable restraints of trade. Several of the specific items were repealed—notably refusals to deal—and others were broadened in 1953, but the JFTC promptly issued a notice reinstating all by designation.47

C. Revision

Amendment of the Antimonopoly and Fair Trade Law has been remarkably infrequent. The first revisions were enacted in 1949 under the watchful approval of the Occupation authorities.48 For the most part the 1949 amendments merely modified several of the unworkably stringent provisions, such as the requirement noted below for prior JFTC review and approval of international agreements.49 The shift in United States policy toward Japan coincident with the onset of the Cold War and Communist advances in China led to a reassessment of the desirability of continued dissolution and drastic antitrust measures.50 The principal substantive change weakening the statute was repeal of the provision incorporating potential competition and potential competitors in the definition of "competition", in effect narrowing the scope of most substantive prohibitions.51 The 1949 amend-

49. AMFTL art. 6. See discussion infra notes 131, 132, 133 and accompanying text.
50. HADLEY, supra note 5, at 132. See also Hosoya, Economic Democratization and the "Reverse Course" During the Allied Occupation of Japan, 1945-1952, 11 KOKUSAIAGAKU RONSHI 59 (1983).
51. Substantial adverse effect on competition as defined in the AMFTL is a required element for private monopolization, unreasonable restraints of trade, as well as merger and other structural controls. For commentary on the importance of this 1949 revision, see 1 A. SHODA, DOKUSEN KINSHI Hō (Antimonopoly law) 27 (1980 ed.).
ments further eased the restrictions on intercorporate shareholding, interlocking directorates, and mergers by excluding competition in the supply of goods and services in the application of these provisions.52

The most extensive changes in Japanese antitrust policy coincided with Japan's recovery of full sovereignty at the end of April, 1952. Almost immediately the Japanese government issued a cabinet order repealing the Occupation order prohibiting the use of zaibatsu names53 and sponsored legislation reducing the size and powers of the JFTC54 and substantially amending the Occupation-imposed Trade Association Law.55 In September, 1953 the Antimonopoly and Fair Trade Association Law itself was revised.56 The principal modifications included exemptions subject to JFTC approval for recession (fukyō) and rationalization (gorîka) cartels; complete revision of the provisions on "unfair methods of competition" under the new rubric of "unfair business practices"; procedures for authorized resale price maintenance; further easing of the restrictions on intercorporate shareholding, interlocking directorates, and mergers; repeal of article 4, which prohibited certain specified restraints on competition, article 5, which proscribed the establishment and participation in control organizations, and article 8, which empowered the JFTC to take measures against enterprises to prevent undue disparities in bargaining power. The remaining provisions of the Trade Association Law were repealed and a new article 8 was added to the Fair Trade Law incorporating those that had survived the 1952 amendments.

Full sovereignty regained, the Japanese Diet also enacted the first of a long series of special statutes allowing formation of voluntary cartels. These included the Export Transaction Law of 1952,57 expanded and renamed the Export and Import Transactions Law in 1953,58 that permitted the formation of voluntary cartels.

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52. For commentary, see SHÔDA, supra note 51, at 25-26.
54. Law No. 257, 1952.
55. Law No. 291, 1952. The Trade Association Law, supra note 19, was repealed, as noted below, less than a year later by Law No. 259, 1953.
56. Law No. 259, 1953. For the standard Japanese commentary, see SHÔDA supra note 51, at 28-34. For a critical appraisal of the 1953 amendments in English, see K. YAMAMURA, ECONOMIC POLICY IN POSTWAR JAPAN (1967).
58. Yushutsunyūe torihiki hō, Law No. 188, 1953.
export and import cartels initially subject to JFTC approval but modified in 1953 to require Ministry of International Trade and Industry (MITI) review and merely notice to the JFTC. 59

Although these revisions and the reduction in the JFTC staff and support budgets that accompanied them represented a major reversal of Japanese antitrust policy, they should not be exaggerated. An American-inspired and imposed regulatory statute that had been strongly opposed by government and business leaders alike had survived the end of military occupation. Despite revision, Japan still had one of the most stringent antitrust statutes in the world. More telling, the revisions themselves followed very closely the provisions being proposed in West Germany. Nearly all of the new exemptions, including those for export and import cartels, paralleled those in the West German Government’s 1952 Draft Law Against Restraints on Competition, 60 generally hailed after enactment in 1958 as a major victory for competition policy while similar modifications in Japan were decried as a retreat. 61

The 1953 antitrust revisions presaged Japan’s first Five Year Economic Plan (1955-1960) and the concomitant emphasis on an import substitution and export promotion policy. 62 The result was a decade of governmental intervention to promote concentration for the sake of economies of scale, cartels to stabilize prices and provide a safety net for capacity-expanding enterprises, and export cartels to prevent undue competition among Japanese firms while they competed fiercely for expansion in foreign markets, especially the United States. 63 Japanese economic bureaucrats also transformed emergency Occupation currency, trade, and investment controls into a formidable set of interrelated

59. See Export and Import Transactions Law, Law No. 188, 1953, at art. 34.
63. Id. On the role of MITI, see JOHNSON, supra note 20.
legal barriers to foreign access to expanding Japanese markets.\textsuperscript{64} Although by the mid 1960's these were increasingly criticized by the United States and Japan's other trading partners,\textsuperscript{65} at the time such criticism was muted by the fact that Japan had chronic trade deficits and thus could be excused for having a generally mercantilist approach to foreign trade.\textsuperscript{66}

\textbf{D. The Watershed}

By the end of the 1950's, Japanese antitrust enforcement seemed moribund. With a weak and stagnant JFTC and a spreading number of special statutory exemptions for various price and output restrictions fostered by MITI, Japan's antitrust policy appeared to have almost fully atrophied. The watershed came in 1958 with renewed government onslaught against antitrust controls. That year the Government of Prime Minister Nobusuke Kishi\textsuperscript{67} proposed further and even more drastic revisions. Pursuant to the recommendations of an ad hoc commission formed the year before, the Kishi Cabinet introduced legislation that would have eased even further the standards for approval of recession cartels, broadened the scope of rationalization cartels, and made a variety of procedural changes designed to restrict the independence of the JFTC. The Government's bill never proceeded further than the Diet committee. Consumer groups, labor unions, agricultural organizations, and, most important politically, small and medium enterprise groups combined in opposition.\textsuperscript{68} The ill-fated Kishi proposal was in fact the frontal assault on Japan's antitrust law in the postwar period.

Unable to weaken the antitrust statute itself, the Government then attempted a second measure—the Designated Industries Promotion Special Measures Bill (\textit{Tokutei sangyō shinkō rinji sochi

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\textsuperscript{66} Japan ran trade deficits with the U.S. every year between 1945 and 1965 and trade surpluses every year thereafter. \textit{1987 JAPAN STATISTICAL Y.B.} 339.

\textsuperscript{67} Nobusuke Kishi was Japan's Prime Minister from February 25, 1957 through July 19, 1960.

\textsuperscript{68} SHÔDA, \textit{supra} note 51, at 39-44.
The measure was intended to achieve under MITI tutelage greater concentration and restricted specialization in the steel, petroleum, and automobile industries. Introduction of the bill in the Diet in 1961 over the objections of the affected industries sparked intense debate. Finally after successive attempts to win passage, the Ikeda Government let it die in 1963. Unable to repeal, amend, or avoid antitrust controls through further statutory revision or special legislated exemptions, Japan's economic bureaucracies resorted to evasion. For the next decade after the defeat of the Tokushin hōan, officials in MITI promoted or actively assisted in the formation of a variety of industry agreements to stabilize prices and control over-capacity through concerted restrictions on competition. The era of 'guidance cartels' had begun.

As Chalmers Johnson explains, in the 1950's MITI officials rarely resorted to extralegal, informal means of persuasion to promote its policies. They had no need. MITI could usually implement its policies by resort to the variety of legal controls available under a variety of special statutes designed to promote economic recovery and growth under MITI oversight. The defeat of the Tokushin hōan, however, left MITI with no alternative to achieve its desired goals but extralegal means of influence and direction. Armed with the formidable Occupation exchange, investment, and trade controls, MITI was able to deny access to vital raw materials, technology, and foreign markets to firms that did not follow official direction. Yet, it would be a mistake to conclude that MITI exercised extensive powers of coercion. The illegitimacy of many of the actions MITI sponsored, particularly illegal restraints on competition, meant that public disclosure and resulting political controversy would damage MITI's reputation and consequently undermine its authority. Hence, in addition to direct political influence, enterprises subject to MITI's

69. For summary of the proposal and the political controversy it engendered, see SHÔDA, supra note 51, at 46-48; JOHNSON, supra note 20, at 255-263.
70. Hayato Ikeda succeeded Kishi on July 19, 1960 and served as Prime Minister until November 11, 1964.
71. See Yamamura, Success That Soured: Administrative Guidance Cartels in Japan, POLICY AND TRADE ISSUES IN THE JAPANESE ECON.: AM. AND JAPANESE PERSP. 77 (Yamamura ed. 1982). For statistics on the number of exempt cartels during this period, see FTC WHITE PAPER, supra note 41, at 248-253.
72. JOHNSON, supra note 20, at 266.
guidance did have an effective form of appeal through public exposure, as evidenced by the Sumitomo Metals incident.\textsuperscript{73} Nonetheless, once a majority of firms in an industry—or those with the greatest size and influence—agreed with a particular policy, recalcitrant firms could be more effectively compelled to follow suit.

The mid 1960's marked the peak of cartel activity in Japan. The largest number of formally exempted cartels ever recorded in postwar Japan occurred in 1966.\textsuperscript{74} Except for a slight increase in 1972 and 1973, the number declined each year thereafter.\textsuperscript{75} The mid 1960's also coincided with a resurgence of antitrust enforcement activity. The number of formal JFTC enforcement decisions trebled between 1962 and 1963.\textsuperscript{76} Between 1963 and 1972 the JFTC decided nearly four times as many antitrust actions as it had during the previous decade.\textsuperscript{77} Indeed, in 1973 alone, the Commission entered nearly as many formal decisions as it had during the entire period between 1953 and 1962.\textsuperscript{78} In 1969 the Commission challenged MITI over the Yawata-Fuji Steel merger, the most significant of the postwar period.\textsuperscript{79} Although MITI prevailed in the end with the members of the Commission voting against its staff recommendation, MITI's victory was politically costly. The JFTC ultimately won more than it lost. Its role of active oversight of mergers was not subject to question, and no merger of such proportions was again sought.\textsuperscript{80}

Also, throughout the 1960's the JFTC began to gain back the enforcement resources it had lost in 1953. In 1960 the Commission gained additional staff positions for the first time since 1948, and new lines have been added every year but one since then.\textsuperscript{81} By

\textsuperscript{73} This point is elaborated in Haley, Administrative Guidance versus Formal Regulation: Resolving the Paradox of Industrial Policy, Law and Trade Issues of the Japanese Econ.: Am. and Japanese Persp. 101, 117 (Saxonhouse & Yamamura ed. 1982). For detailed account of the incident, see Johnson, supra note 20, at 268-272.

\textsuperscript{74} FTC White Paper, supra note 41, at 248-53.

\textsuperscript{75} Id.

\textsuperscript{76} Id. at 204-05.

\textsuperscript{77} Id.

\textsuperscript{78} Id.

\textsuperscript{79} Judgment of October 30, 1969, JFTC (Consent), Japan, 16 Shinketsushî 46. See Thirty Year History, supra note 44, at 190-200.

\textsuperscript{80} It should be noted, however, that there was no significant decrease in the number of permitted mergers of large-scale enterprises after 1969. See FTC White Paper, supra note 41, at 237.

\textsuperscript{81} FTC White Papers (1950-1989).
1967 it had more than fully regained all loses. By the mid 1980's the JFTC was one of the few government agencies in Japan that could boast of having doubled its staff from the level of the mid-1950's.82

E. The Era of the 1970's

The pro-cartel era finally came to an end in the early 1970's. The United States government and private actions against Japanese firms for dumping and antitrust offenses were beginning to be brought in increasing numbers. Especially influential were the private damage actions for dumping and antitrust violations filed by two American television manufacturers against nearly the entire Japanese electronics industry and many of its leading international trading companies.83 The consolidate litigation, labeled the Japanese Electronics Products Antitrust Litigation, continued for a decade, ending with dismissal of the antitrust claims by the United States Supreme Court in March 1982,84 but only after enormous cost to the plaintiffs and defendants alike. The litigation also widely publicized MITI's role in fostering export cartels as an instrument of Japan's export promotion policies, which were promptly criticized on both sides of the Pacific for contributing to the ability of firms to charge higher prices in Japan than abroad for the same product.85

Increasing antitrust litigation against Japanese firms in the United States coincided with the Japanese FTC's most significant antitrust action in its twenty-five year history: an article 3 enforcement action against Japan's petroleum industry. The re-

82. The fixed number of budgeted national government employees actually decreased between 1950 and 1988 from 1,503,334 to 1,188,440. Between 1970 and 1988 the number of Ministry of Finance main office personnel decreased from 15,558 to 14,449. MITI experienced a similar decrease from 6,595 to 5,559. 1987 JAPAN STATISTICAL Y.B. 702-703.


85. See, e.g., Yamamura & Vandenberg, Japan's Rapid Growth Policy on Trial: The Television Case, LAW AND TRADE ISSUES OF THE JAPANESE ECONOMY, supra note 74, at 238.
result was an administrative decision against virtually all of Japan's domestic oil companies and two criminal actions in the Tokyo High Court and the Japanese Supreme Court affirmed the illegality of price and production restrictions fostered and supervised by MITI. Although the individual defendants were excused because of their presumed lack of criminal intent by virtue of MITI's participation, the cases removed any remaining doubts regarding MITI's lack of authority to create antitrust exemptions by means of administrative guidance.

The Japanese public mood had undergone significant change by the early 1970's. Pollution and other social ills associated with Japan's rapid economic growth had begun to rupture the postwar consensus giving highest national priority to economic growth and entrusting the economic ministries with the supervisory authority—but rarely the coercive powers—to achieve this task. Concern with rising consumer prices and revelations of illicit pricing practices by major enterprises with official sanction added to the malaise and demand for reform. In September, 1973, Toshihide Takahashi, the new chairman of the JFTC seized the initiative by proposing a major revision in the Antimonopoly and Fair Trade Law, the first serious proposal to strengthen antitrust enforcement. Ten months later a special study group appointed by Chairman Takahashi to examine possible revisions recommended a list of major changes, emphasizing the need for structural changes in the economy. On the basis of the report the JFTC proceeded to draft a nine point proposal. It included new commission powers to order the divestiture of enterprises with monopoly power, to require disclosure of costs in instances of parallel price increases, to order price roll backs in cases of illegal cartels, and to levy surcharges to recoup illegal cartel profits. Also proposed were more stringent restrictions on intercorporate shareholding, the addition of criminal penalties for

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89. SHÔDA, supra note 51, at 62.
The redirection of Japanese antitrust policy in the 1970’s paralleled broader changes in Japanese economic policy. As noted, the cartel era had ended by the early 1970’s. Of all the changes in Japanese industrial organization after the first oil crisis in 1973, Tokyo University economist Masu Uekusa concludes, the

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90. SHÔDA, supra note 51, at 65-66.
91. See Recent Developments, 9 LAW IN JAPAN 151, 159 (1976).
92. SHÔDA, supra note 51, at 71-73. For the official FTC view of the legislative history of the 1977 amendments, see THIRTY YEAR HISTORY, supra note 44, at 322-29.
"most remarkable" was "the decline in cartel-like practices."93 For 1983 the JFTC reported a total of only 310 legally exempt cartels, over half of which (185) were associations of small-scale manufacturers organized under the Law on the Organization of Medium and Small Enterprise Associations.94 This figure represents the smallest number of exempt cartels since 1956.95

One explanation for this decline was a strengthened Japanese FTC in terms of staff, commitment, public support, as well as the added powers of the 1977 amendments. A decline in the powers of the economic bureaucracies relative to Japan's leading enterprises also altered Japanese economic policy. Cartels were no longer as significant a factor for either economic growth and stability as they were in the late 1950's. Nor were Japan's leading manufacturers as dependent as they were on government approvals and licenses. Consequently, the economic bureaucracies were less willing and able to enforce price and output restrictions.

The new era of antitrust control similarly coincided with major revision of Japanese foreign trade policies. By the mid-1960's Japan had begun to achieve modest trade surpluses. As these mounted each year into the 1970's, it became apparent that the problem of chronic deficits had become, at least for Japan's major trade partners, the equally worrisome one of chronic surpluses. As external pressures increased in the late 1960's, Japan began to remove or significantly liberalize most of its barriers to foreign investment and trade. Five rounds of foreign investment liberalization between 1968 and 197396 were followed by continuous reductions in tariffs and quotas. In 1979 the Foreign Exchange and Foreign Control Law was amended97 and the Foreign Investment Law98 repealed, easing without eliminating altogether foreign exchange and investment controls except in exceptional circumstances.99 By the mid 1980's Japan could boast of having

94. Chūsho Kyōdō dantai no soshiki ni kansuru hōeritsu, Law No. 185, 1957.
95. FTC WHITE PAPER, supra note 41, at 248-253.
96. For detailed description of Japanese foreign investment restrictions and their liberalization, see HENDERSON, supra note 64, at 195-290.
99. For a critical appraisal of the amendment in terms of improved access to Japanese
the lowest tariffs and fewest formal barriers to trade of any industrial democracy except Austria.\textsuperscript{100} Trade surpluses continued to increase, however, along with more strident international criticism of Japanese non-tariff trade impediments.\textsuperscript{101}

III. ANTITRUST AND ITS IMPLICATIONS FOR TRADE

\textbf{A. False Premises Redux}

The recent history of Japanese antitrust policy summarized above raises a number of troubling questions for those concerned with trade issues. As noted at the outset of this article, underlying the American arguments in the SII talks for Japanese antitrust reforms are four fundamental premises: (1) that serious anticompetitive practices currently exist in Japan; (2) that such practices hinder access by foreign firms to Japanese industrial and consumer markets; (3) that these practices can be reduced if not eliminated by more effective antitrust regulation; and (4) that increased penalties, expanded enforcement capacity, and greater disclosure of apprehended violations would contribute to the effectiveness of antitrust controls.

Were these premises correct, one should expect that the reduction of anticompetitive collusion, coupled with expanded antitrust enforcement and more stringent sanctions, would have a salutary influence on United States trade with Japan. Yet, contrary to the assumptions underlying the SII negotiations, large surpluses have persisted and little if any change in composition of trade with the United States\textsuperscript{102} has occurred despite the changes in Japanese economic policy and antitrust law in the 1970's and 1980's. For the most of the 1980's the reverse was true. Trade surpluses and American complaints both increased to the consternation of political leaders on both sides of the


\textsuperscript{101} See B. BALASSA & M. NOLAND, JAPAN IN THE WORLD ECONOMY (1988).

\textsuperscript{102} See B. BALASSA & M. NOLAND, JAPAN IN THE WORLD ECONOMY (1988).
Like American Occupation policy, the emphasis on more effective antitrust enforcement as a trade issue, it appears, is grounded on false premises.

American arguments for Japanese antitrust reform as a trade issue in the SII negotiations are flawed by fundamental misconceptions. They reflect the imposition of a peculiarly American vision of the efficacy of legal controls, a failure to appreciate the most basic characteristics of Japan's legal culture, and an inaccurate analysis of the likely effect of improved Japanese antitrust enforcement on United States trade with Japan. The United States position also depends upon an equally erroneous view of the extent of anticompetitive behavior in Japan, particularly the keiretsu—the self-identified groupings of otherwise independent Japanese companies based on various combinations of common zaibatsu origin, president's clubs, cross-shareholding, mutual lead bank relationships, long-term contracting, and associational ties.

First, antitrust enforcement continues to be considered peculiarly weak in Japan for lack of effective sanctions and enforcement capacity despite the 1977 amendments. The prevalence of unpublicized warnings and other informal actions combined with the dearth of criminal cases and private damage actions are highlighted as exemplary of the failure of effective antitrust enforcement. Such criticisms ignore, however, not only the consistency of Japanese practices with other nations, particularly Germany, but also studies on the relative effectiveness of criminal sanctions and private damage actions in United States antitrust control.

With respect to criminal enforcement, Japan

103. See e.g., The Washington Post, March 4, 1990, at A29, col. 3, reporting on the Palm Springs meeting between President Bush and Prime Minister Kaifu and their "personal determination to make progress against the $49 billion trade imbalance".

104. For a recent critical study in English of Japanese keiretsu, see Gerlach, Keiretsu Organization in the Japanese Economy, Politics and Productivity: The Real Story of Why Japan Works 141-174 (Johnson, Tyson, & Zyaman ed. 1989). For an attempt to identify enterprises with keiretsu affiliation, see periodical reports in Industrial Groupings in Japan (Dodwell Marketing Consultants ed.).


107. See e.g., K. Elzinga & W. Breit, The Antitrust Penalties: A Study in Law and Economics 30-43 (1976). Elzinga and Breit recommend fines as the most efficient sanction (Id. at 112-38), which is the approach the Japanese adopted from the German model in the form of an illegal profits surcharge (kachokin) under the 1977 amendments. See Haley, supra note 106; also see Haley, supra note 101.
is one of the few countries besides the United States that subjects antitrust violations to criminal penalties. Moreover, criticism of the lack of criminal actions fails to take into account profound differences between American and Japanese patterns in treatment of offenders. Few of those apprehended or convicted for criminal behavior in Japan, especially economic crimes, are imprisoned. 108 Most are released once they express remorse either as a result of suspended prosecution or suspended sentences. 109 The dearth of criminal convictions or incarcerations for antitrust offenders is not exceptional. Japanese criminal justice authorities and the public are far more reluctant to resort to incarceration for all but the most minor fines for most offenders who are not thought to pose a serious threat to public safety. 110 Nor are judicially imposed requirements for proof of damages evidence of any peculiar failure of antitrust controls. Unusually high standards of proof and low awards—as viewed from an American perspective—apply to ordinary tort cases and antitrust actions alike. 111 Antitrust reform will not reach either of these differences in Japanese and American practice.

Japanese reliance on informal, social controls to regulate social and economic behavior may also seem peculiar to American eyes. Nonetheless, Japanese law enforcement authorities, including Japanese FTC officials, testify to their effectiveness. 112 Thus the use of warnings and other informal actions in antitrust enforce-

108. During 1988, for example, only 28,242 offenders were newly admitted into Japanese prisons, representing about 1.6 percent of all convicted offenders. MINISTRY OF JUSTICE, WHITE PAPER ON CRIME 13, 15 (1989). The number of incarcerated offenders had decreased by more than 50 percent in Japan since 1948. Id. at 35.


111. See, e.g., Judgment of December 8, 1989, Saikōsai, Japan, 43 Minshii 1259, affirming the applicability of the ordinary tort (fuhōkōi) provisions of the Civil Code to a claim for damages resulting from a violation of the Antimonopoly and Fair Trade Law as an alternative to a no-fault claim under AMFTL art. 25, but dismissing the action for inadequate evidence of damages, under accepted standards of proof, applicable to both forms of action.

112. See, e.g., comment by Hiroshi Iyori, FTC Commissioner and former FTC Secretary-General to the effect that denial of imperial honors (kunsho) is one of the most effective available antitrust sanctions in Japan, in Iyori, Antitrust and Industrial Policy in Japan: Competition and Cooperation, POLICY AND TRADE ISSUES IN THE JAPANESE ECONOMY: AM. AND JAPANESE PERSP., supra note 71, at n. 11.
ment reflects usual governmental practice, not exceptional treatment of antitrust violations. For Japan to change these practices and to conform more closely to American practices would thus require either especially harsh treatment for antitrust violations or significant changes in Japanese legal culture. In either case, there is no evidence that an American approach would be more effective.

Even were the demanded reforms to make Japanese antitrust enforcement more effective, however, the prospects for expanded United States trade could not be expected to improve. The most serious impediment to trade is too much not too little competition.

B. Competition As A Trade Barrier

The SII emphasis on Japanese antitrust reforms is grounded on the notion that a variety of collusive restraints on competition by Japanese firms, particularly those with keiretsu affiliation, obstruct foreign firm entry into Japanese consumer and industrial markets.113 Long-term contractual relationships among keiretsu affiliates are argued to have exclusionary effect on competitors. The tendency of Japanese enterprises to prefer other firms within a single keiretsu, it is contended, significantly advantages keiretsu affiliates by providing them with an effectively 'captured' market for their products. Because so many market-dominating Japanese enterprises have alleged keiretsu affiliation, the effect of such preferential treatment is to deny competitors 'fair' access and to impede new entry. This problem is considered to be especially acute in distribution. Intra-keiretsu contracting and exclusive dealing in the distribution of goods and services in Japan is described as a substantial barrier to new entry.114

Aside from the question of whether the concept of keiretsu groups has analytical value115—not to mention, the circularity of positing long-term contracting as both a definitional element and an evil of keiretsu affiliation—the supportive data for such contentions are sparse. There is, in fact, no evidence that any Japanese firms contract to their economic detriment. No credible

113. See, e.g., Hearings on the Structural Impediments Initiative with Japan, 100th Cong., (1989).
114. See, e.g., Gerlach, supra note 104, at 170.
115. See, e.g., M. SASO & S. KIRBY, JAPANESE INDUSTRIAL COMPETITION TO 1990 at 8 (1982).
studies exist showing that Japanese firms regularly purchase from 'related' suppliers goods or services that are not competitive with foreign suppliers in terms of price, quality, terms of payment, or anticipated service. In short, the case for 'unfair' dealing has yet to be proven.

However valid the arguments against such keiretsu practices might be, improved antitrust enforcement would not correct them. All contracting is 'collusive' but few would argue that existing Japanese or American antitrust rules deny even market-dominating enterprises the right to deal with suppliers and customers of their choice. To the contrary, current Japanese antitrust rules define contractual restrictions on such freedom of choice by an enterprise to select suppliers and customers to constitute an unfair business practice. More effective enforcement of existing Japanese antitrust proscriptions would have little effect on the practices in dispute. These practices could only be condemned after major revision of the substantive rules of Japanese antitrust law. Criticism of the American position for these reasons amounts to a quibble, however, in comparison to the principal failure of analysis.

The condemned practices—whether by keiretsu or not—do indeed inhibit new entry, but not because of their alleged anti-competitive effect. Such practices to the contrary make Japanese consumer and industrial markets among the most competitive in the industrialized world. Unfortunately, however, for potential new entrants competition is a major disincentive to entry. If established enterprises have the capacity to meet, with competitive prices, quality, and service, consumer and industrial demands for any goods or services the potential new entrant offers,

116. General Designation Item No. 12, FTC Notification No. 15, 1982, provides:
Supplying a commodity to the transacting party purchasing the said commodity from oneself while imposing, without proper justification, one of the following restrictions:
(a) Causing the said party to maintain the sales price that one has determined for the commodity, or otherwise restricting the freedom of the party to determine the sales price of the commodity; or
(b) Having the said party cause an entrepreneur that purchases the commodity from said party to maintain the sales price that one has determined for the commodity, or otherwise causing said party to restrict said entrepreneurs the freedom to determine the sales price of the commodity.

117. For elaboration of this argument, see Haley, supra note 65. Also J. Bain, Barriers to New Competition 14-17 (1956).
little incentive exists for reentry. In order to attract entry the new market must offer a reasonable prospect for the entrant to recover the costs of investment and to make a reasonable profit. The more competitive the market is, the less attractive it becomes for any prospective entrant.

Most of the alleged structural impediments to access related to keiretsu groups, however defined, in fact function instead to intensify either actual or potential competition among incumbent Japanese firms. Keiretsu practices condemned abroad as anticompetitive tend to enhance firm rivalry by enabling a relatively large number of established enterprises to diversify more rapidly into new fields and subfields. The network of ties that connect established Japanese firms to suppliers, customers, and financial institutions along with the flexibility of long-term relational contracting provide them with nearly all of the supporting assets necessary for diversification: access to information, technology, capital, and distribution channels. The flexibility of labor transfers and supplier relationships intrinsic to Japanese patterns of labor management and subcontractor relationships also facilitate the development of new product lines. Japan's leading enterprises are thus formidable potential if not actual rivals for most new entrants.

Because of the unusual capacity of Japanese enterprises to move into new fields, without a protected market niche, few foreign firms find the Japanese market attractive as new entrants. Unless insulated from potential competition by the peculiar nature of their product, legal protection against use of proprietary technology, or some other means, even incumbent foreign firms generally discover that by the time they even begin to consider investment to increase direct sales to Japan, Japanese

118. Id.; see also, Markowitz, Potential Competition, Limit Price Theory, and the Legality of Horizontal Conglomerate Mergers Under American Antitrust Laws, Wis. L. Rev. 658, 682-90 (1975), on the effectiveness for similar reasons of over-investment as a detriment to new entry. Markowitz notes that 'limit investment' can have the same effect as 'limit pricing'. It follows therefore that the expansion of capacity in Japan in the early 1960's would produce both greater competition among domestic incumbents and function as a barrier to new entry by potential domestic and foreign competitors.


121. See Haley, supra note 65.
rivals have already appeared. Moreover, were Japanese markets excessively cartelized today and as a result prices substantially above competitive market levels, incentives to enter would exist, but the usual response by Japanese competitors would be to end the cartel and compete.

The changes in Japanese economic policy and industrial organization from the late 1960's and early 1970's themselves evidence the effect of Japan's competitiveness on entry. The government's pro-cartel policies could continue only if effective legal barriers to foreign entry existed. Otherwise, as noted, foreign firms should have quickly responded to the allure of a highly profitable market. Once these barriers began to be removed, the number of cartels—illicit or legal—was bound to decline. By the mid-1970's, however, Japan's leading manufacturers had already established their competitiveness in the fierce rivalry of the protected Japanese market. The removal of formal trade barriers thus did not result in displacement of Japanese firms by foreign competitors or any significant change in the composition of trade. Unfortunately for many potential foreign entrants, the elimination of stringent trade controls came too late.

C. Antitrust and Trade

Within the context described above, more effective enforcement of antitrust controls in Japan is likely to have a profoundly negative effect on United States trade. As explained previously, Japan's antitrust authorities have tended to focus their enforcement efforts on two principal practices: horizontal price and output restrictions and resale price maintenance. A third area of considerable enforcement activity has been review of international licensing agreements. Expanded enforcement in any of these areas, however, is more apt to inhibit than to encourage foreign entry.

Few would quarrel with attempts by the Japanese FTC to prevent horizontal price-fixing, the largest category, as noted, of JFTC enforcement actions. Strengthened enforcement measures against horizontal restraints are not likely to have a favorable

impact on United States trade with Japan. Indeed, such measures could become quite counterproductive in terms of United States trade policy. Most antitrust violations as well as exempt cases of price and output restraints among competitors appear to be in industries dominated by small and medium-sized firms.\textsuperscript{123} Moreover, most remaining formal Japanese trade barriers apply to such industries. The inefficiencies and higher than competitive market level prices such restraints and protectionist measures sustain provide attractive profit-making opportunities for foreign firms, but formal barriers prevent their entry. Removal of the barriers, however, would arguably disrupt such anticompetitive collusion as effectively, if not more so, than increased antitrust enforcement. The consequence in either case, however, would be to eliminate the conditions that attracted foreign entry in the first place and thereby to negate any positive trade effect. The issue in such cases, in any event, would remain one of formal restrictions on foreign entry that would almost inevitably have to be negotiated on a case by case basis, not structural impediments to be corrected by antitrust reforms.

Expanded antitrust enforcement in the other areas of current concern to the Japanese FTC could be even more self-defeating in terms of United States trade with Japan. Although still an issue of lively debate in the United States, persuasive evidence links vertical marketing restrictions, including resale price maintenance, with effective strategies for new entry.\textsuperscript{124} By reducing interbrand competition, new entrants are able to provide greater incentives to its dealers for product service and promotional activities. Protection against interbrand price competition may in some instances provide an essential inducement for prospective dealers. Recognition in the United States of the positive effects on interbrand competition of such vertical restraints has led to a significant relaxation of antitrust proscription.\textsuperscript{125} Current Japanese law is thus in theory at least considerably less tolerant of

\textsuperscript{123} See case summaries, in Thirty Year History, supra note 44, at 661-728.


resale price maintenance and other marketing restraints than is United States law. Since, for example, the Japanese Supreme Court's decision in the \textit{Wakōdō}^{128} and \textit{Meiji Shōji}^{127} cases, unauthorized resale price maintenance and associated dealer restrictions of choice of suppliers, customers and sales of competing products have been treated as illegal unfair business practices. In the case of resale price maintenance, no economic justification is accepted to excuse such restriction of dealer's free choice. Similarly, more stringent regulation of exclusive dealing arrangements are likely to advantage established firms. Given the risk intrinsic in marketing any new product, a dealer selling both established products and new ones is more likely to promote the former. Exclusive dealerships enable the new entrant to require concentrated sales efforts on its products.

Consequently, any expansion of Japanese antitrust enforcement against manufacturer-imposed vertical marketing restraints could disadvantage any new entrant attempting to establish an effective distribution network. Moreover, foreign firms would probably be frequent targets of JFTC action inasmuch as they constitute the largest category of potential new firm entrants in need of a distribution system. In addition, their practices are more easily identified than established Japanese firms by virtue of the international contract review process and the status of foreign firms as 'outsiders'.

Finally, more effective antitrust enforcement in Japan, especially staff and budget increases as well as more stringent sanctions, would in all likelihood result in more intense scrutiny of international licensing agreements as well as purely domestic transactions. Among the evils Japan's antitrust legislation was designed to prevent was participation by Japanese enterprises in international cartels. The Antimonopoly and Fair Trade Law

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128. See ABE, supra note 43, at 688.
129. SCAP's November 6, 1945 directive to the Japanese government accepting the proposal for zaibatsu dissolution, also included the following order: "The Imperial Japanese Government will immediately take such steps as are necessary effectively to terminate and prohibit Japanese participation in private international cartels or other restrictive private international contracts or arrangements." SCAPIN 224, paragraph 7, quoted in \textsc{Bisson}, supra note 4, at 244.

The provisions of article 6 of the AMFTL were designed to achieve the aims of the directive. See Kanazawa, \textit{Kokusai karuteru ni taisuru kokunai hôteki kisei} (Domestic legal regulation of international cartels), \textsc{Kôsei Torihiki} (No. 128) 6 (1961).
thus expressly prohibited Japanese enterprises from entering into any international agreement that included either an unreasonable restraint of trade or unfair method of competition. For purposes of enforcement, the statute also mandated prior JFTC review and approval for all international contracts that Japanese enterprises concluded. The impracticality of a prior approval requirement led to amendment in 1949 to simply a filing requirement. Even this proved to be too onerous and during the 1950's and early 1960's, in practice the international contract review provisions were almost totally ignored. In 1968, however, the JFTC revived the review procedures concomitant with termina-

130. AMFTL article 6(1) provides: "No entrepreneur shall enter into an international agreement or an international contract which contains such matters as constitute an unreasonable restraint of trade or unfair business practice." See AMFTL, supra note 9, at art. 6(1).

131. AMFTL article 6(3) as originally enacted in 1947 provided:

Any entrepreneur, when contemplating participation in an international agreement or contract with a foreign entrepreneur, or in an agreement to contract on foreign trade with a domestic entrepreneur, which agreement or contract shall continue for a considerable period of time (excluding such where delivery of the object due to one (1) transaction takes place over a considerable period of time), shall file an application with the Fair Trade Commission and receive its permission.

In such a case as provided by the preceding paragraph, an entrepreneur shall not participate in said agreement or contract for a period of 30 days from the date of filing said application.

AMFTL, supra note 9, at art. 6(3).

As Amended in 1949, the new provision of article 6(3) stated:

Every entrepreneur shall, when he has participated in an international contract (including such agreement or contract coming under the provisions of the preceding paragraph [agreements with negligible effects on competition in any particular field of domestic or international trade] with a foreign entrepreneur or when he has participated in an agreement or contract on foreign trade (including such agreement or contract on foreign trade coming under the provisions of the preceding paragraph) with a domestic entrepreneur, file a report of said fact, together with a copy of said agreement or contract (in case of an oral agreement or contract a statement setting forth therein the contents thereof), with the Fair trade Commission within thirty (30) days from the day of execution or participation in said agreement or contract in accordance with the provisions of such rules and regulations of the Fair Trade Commission as it may establish.

AMFTL, supra note 9, at art. 6(3), (as amended, 1949).

The 1953 amendments (Law No. 259, 1953) revised the language and reorganized these provisions into two paragraphs without, however, any significant change in substance. In 1982 the article was amended further to provide statutory bases for preexisting FTC practice limiting the types of agreements for which filing has been required. The new language limits the applicability of the reporting requirement to those "agreements of contracts that belong to the types prescribed by Fair Trade Commission Rules." Law No. 69, 1982.
tion of MITI's previous practice of reviewing the 'fairness' of royalty payments and other terms imposed by foreign parties licensing the use of industrial property or other rights to technology to Japanese enterprises. \(132\) The JFTC announced the revival of the filing and review requirement with the issuance of a set of guidelines delineating specific licensing restrictions that were stated "to risk" being considered illegal as unfair business practices. \(133\) In effect the JFTC became a substitute for MITI in providing Japanese licensees leverage in bargaining for less restrictive terms. The guidelines themselves were carefully drafted to reflect international practice. \(134\) Few if any departed from their significantly existing American norms. \(135\) Nonetheless, the JFTC had incontrovertedly transformed the review process from its intended purpose. A procedure designed to prevent Japanese enterprises from engaging in international restraints of trade had become a means of protecting them from overreaching foreign licensors. \(136\)

The 1968 guidelines were revised in 1989 to provide greater clarity; \(137\) little in substance was changed. \(138\) The primary aim of

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133. In November 1972 the FTC issued a second set of international contract guidelines applicable to exclusive import agency agreements. Like the licensing guidelines they identify resale price maintenance (item 1-1), customer restrictions (item 1-2), and restriction on sales of previously handled competing goods (item 1-6). The most significant features of the 1972 guidelines were the proscriptions of restrictions on parallel importation of genuine trademarked goods (item 1-4) and exclusive distribution arrangements between competitors where the domestic party has market share of 25 percent or above or, if less, represents the largest share (item 2). Both the 1968 and 1972 guidelines are translated in M. NAKAGAWA, supra note 47, at 124-127.

134. Yoshio Ohara, currently Professor of Law at Kobe University, was one of the principal FTC officials involved in drafting the 1968 Guidelines. In comments to the author, he explained that the drafters used painstaking care to ensure that the Japanese rules conformed to European and U.S. norms. For the context and protectionist purpose of the FTC's 1968 policy change, see Ariga, supra note 132, at 189-190.


136. Although the guidelines have never been fully enforced, FTC review and the leverage it provided Japanese licensors in negotiating more favorable terms have ensured that Japanese licensees of foreign technology have not been as restricted in its use and potential for future competition with the licensor as would have been the case without such intervention.

137. *Tokkyō-nōhō* raisensu keiyaku ni okeru fukōsei na torishiki hōo no kisei ni kansuru
JFTC review continues to be to foster competition by ensuring against the imposition of anticompetitive restraints on Japanese recipients of foreign technology. The effect of improved enforcement in the review process would therefore be to promote even more active competition by domestic Japanese enterprises to the disadvantage of foreign licensors. The only conceivable benefit which expanded Japanese antitrust enforcement in this area might have for United States trade would be to discourage licensing and thereby increase the incentives for foreign firms to exploit their technology by direct entry into the Japanese market. Because most licensors will have previously decided not to enter the Japanese market without a domestic partner, in most instances the foreign licensor will accept JFTC recommendations to modify any offending restrictions rather than choosing the alternative of direct entry. The likely effect of expanded enforcement will be to reenforce even further the competitiveness of Japanese firms.

IV. CONCLUSION

As a matter of trade policy the American emphasis on improved antitrust enforcement in Japan is thus flawed by a fundamental failure to analyze accurately the likely effect such improvements would have on trade. However laudable more effective antitrust enforcement may be in principle, any significant increases in competition in Japanese markets is likely to add to the already substantial disincentives to foreign entry. By decreasing the few protections from Japanese competitiveness that may now exist, particularly through patent and other industrial property rights, American firms are apt to be deterred even more from undertaking the investment risks necessary for active participation in the Japanese market. The success of the SII negotiations may therefore become counterproductive not only

to expanded access to the Japanese markets but also, as a result of the failure to correct persistent trade imbalances, to improve political relations between the United States and Japan.
THE KOAN OF LAW IN JAPAN

Dan Rosen*

A non-Buddhist philosopher said to the Buddha, "I do not ask for words; I do not ask for non-words." The World-honored One remained silent for a while. The philosopher said admiringly, "The World-honored One, in his great mercy, has blown away the clouds of my illusion and enabled me to enter the Way."

Westerners who seek to enter the way of law in Japan often are frustrated by what appears to be a house of mirrors. Texts that seem to speak clearly and directly are routinely evaded. On the other hand, when the law is silent, behavior still conforms (or is expected to conform) to the accepted norm.

Placed in a double-bind, our wayfarers express frustration and anger. Indeed, the harder they study, the less they seem to understand. Perhaps, they say, this is all part of a plot to keep foreigners from fully participating in the benefits of Japan.² Or,

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2. This allegation is made in a variety of trade areas, not the least of which is legal services. In 1987, regulations took effect allowing foreign lawyers to be licensed in Japan. The Japanese government promoted this statute as a great liberalization of the market. However, foreign critics were not nearly as impressed. The law, among other things, restricts foreign lawyers to advising clients solely on matters from the lawyer's home jurisdiction. He cannot, for example, represent his American clients before a Japanese agency or tribunal. What's more, he cannot even establish a partnership with Japanese lawyers or hire them to create a full-service international law office. He is also prohibited from taking full advantage of the name recognition of his law firm: it is the name of the licensed lawyer himself, not his firm, that must be used, although the firm name may be mentioned in a secondary way. See generally R. Wohl, S. Chemtob, G. Fukushima, Practice by Foreign Lawyers in Japan (1989); Symposium, American Lawyers in Japan, 21 Law in Japan 1-218 (1988); Haley, The New Regulatory Regime for Foreign Lawyers in Japan: An Escape from Freedom, 5 Pac. Basin L.J. 1 (1986).

For whatever reason, only 67 foreign lawyers have chosen to become licensed as a Gaikokuho jimu-bengoshi (foreign law solicitor). Japan's Foreign Lawyers Find Barriers at the Bar, Japan Econ. J., July 14, 1990, at 10. Both the United States and the European Community have been pressuring Japan to liberalize the restrictions as part of overall trade negotiations. See EC Trade Officials Cite 15 Items for Market Access Concerns, Kyodo
they may resurrect timeworn cliches about inscrutability.\textsuperscript{3}

The truth resides not in trying to force Japan's legal system into Western categories, but rather in seeing it clearly in its own terms. As with learning the Japanese language, progress does not really begin until the student realizes that there is nothing in his primary language that will help him understand Japanese. Indeed, as long as one keeps looking for, hoping for, an explanation in his terms, he misses the point.

There is an old story of the professor who comes to a meeting with the enlightened master. The professor, ostensibly in search of enlightenment, begins a non-stop monologue of his theses and convoluted approaches to the subject. After listening politely for a long while, the master interrupts to ask the professor if he would like a cup of tea. "Certainly," the professor says, and resumes his speech. The master keeps on pouring as the cup overflows. Finally, the professor exclaims, "How can I drink the tea if you keep pouring?" The master replies, "How can you understand if your mind is full of your opinions?"

So, in setting out on this way, we must empty our cups. The Japanese legal system is no less comprehensible than our own,

\textsuperscript{3} The most notorious recent version of this view comes from Dutch journalist Karl van Wolfereen, who argues, "The Japan problem appears less mysterious, and many of the puzzles are soluble, when instead of the common approach of looking for cultural explanations we ask questions concerning the way power is exercised in Japan." \textsc{K. Van Wolfereen, The Enigma of Japanese Power} 17 (1989). Having rejected one talisman, he thus proceeds to substitute another and views almost everything through the prism of his thesis: that people in Japan are oppressed and suppressed by the powerful. This stereotype may allow Westerners to feel at ease. If they can't beat Japan in business, at least they can be contented by knowing that they are not similarly abused. Perhaps that is why the book is hugely popular amongst powerbrokers in Washington. In the final analysis, however, it simply offers an excuse for not understanding or competing effectively.
and ours seems equally puzzling to them. Until we can see clearly, we have no hope of understanding.

THE KOAN

The quotation at the beginning of this article is a koan, a teaching device employed in Zen Buddhism, particularly the Rinzai and Obaku sects. The purpose of the device is to lead the student to the end of his wits. Asked to explain the meaning of the koan, the student's every answer will be rejected. He remains stuck in duality, the land of abstract logic and right-or-wrong. The meaning is the reality that lies beyond duality. It is in seeing things exactly as they are, not in making them fit existing categories.

The koan cannot be understood by logic. It cannot be transmitted in words. It cannot be explained in writing. It cannot be measured by reason. It is like the poisoned drum that kills all who hear it, or like a great fire that consumes all who come near it.

The Western student of Japanese law finds himself in the same dilemma as generations of students of Zen. The only way out is to treat the law as a koan, and to look for the meaning behind the meaning, and not the superficial comprehension of the literal words. For the law, like the "answer to the koan," cannot be expressed in words. The words are merely signposts. The prob-

4. Japanese Zen Buddhism consists of three principal sects. The Rinzai sect originated with the teaching of Chinese Ch'an (the pronunciation of Zen in Chinese) master Lin-chi. Its teachings stress "satori," or sudden enlightenment, and its methods are designed to bring about that instant breaking of the gateless gate. It was brought to Japan by Eisai in the latter part of the twelfth century. The Soto school, brought back from China by a monk named Dogen, takes the opposite approach and concentrates on a gradual awakening. The Obaku sect, following the example of its founder, Ingen, combines elements of both, although it is closer to Rinzai in style and lineage. However, it has preserved much of the Chinese character of Ch'an Buddhism and serves as a living bridge between Japanese Zen and its Chinese origins. See generally Bukkyo Dendo Kyokai (Buddhist Promoting Foundation), Buddhist Denominations and Schools in Japan (1984).


6. In 1917, a book was published purporting to have the "answers" to the basic collection of Zen koan. It was entitled Gendai Sōjizen Hyōron, roughly translated as a Critique of Modern-Day So-called Zen. An English translation, The Sound of One Hand (Y. Hoffman ed. 1975), is available. The book, however, misses the point. Just as a law student must come up with his own understanding of the case, so too must authentic Zen understanding spring from the personal struggle with the koan. The words in the book may be right, just as the holdings in Legalines or Casenotes sometimes are, but the true teacher of
lem is that people are inclined to cling to the signposts for comfort, instead of making the actual journey.

My goal is to use the koan as a metaphor in order to facilitate an understanding of the law. Seven hundred years ago, a Chinese master had a different ambition: to aid his students in understanding Zen. To achieve that goal, he used the law as a metaphor for the koan.

The koans may be compared to the case records of the public law court. Whether or not the ruler succeeds in bringing order to his realm depends in essence upon the existence of law. Kung (ko), or “public,” is the single track followed by all sages and worthy men alike, the highest principle which serves as a road for the whole world. And “records” are the orthodox writings which record what the sages and worthy men regard as principles. There have never been rulers who did not have public law courts, and there have never been public law courts that did not have case records which are to be used as precedents of laws in order to stamp out injustices in the world. When these case records (koans) are used, the principles and laws will come into effect; when these come into effect, the world will become upright; when the world is upright, the Kingly Way will be well ordered.

Thus, we find ourselves staring face-to-face with this Zen Master: he looking to our discipline to bring about a breakthrough in consciousness; we looking to Zen to do the same for our understanding of the law.

It Can’t Be Swallowed; It Can’t Be Spit Out

On the surface, very little of Japanese law is authentically Japanese. The Constitution was written by Americans; its law or Zen can instantly recognize one who is simply reading or reciting from memory. As one of my own teachers wrote me in commenting about the book, “The answers are sometimes correct and sometimes incorrect, verbally speaking. The truth is not, however, there, as replies to koans are something that comes out from discipliners’ experiences of their zazen.” Letter from Saytak Y. Hirade to the author (Sept. 4, 1988).


8. The Japanese pronunciation, ko, is in parentheses.

9. KOAN, supra note 5, at 4-5.

10. This is one of the traditional capping phrases (jakugo) used by a Zen student to show his complete understanding of a koan. It comes from a centuries-old collection entitled Zenrin Kushū. Most of this originated in Chinese literature. KOAN, supra note 5, at 88.
individual rights reflect the United States Constitution's Bill of Rights, and its organization of government is a Western-style parliamentary democracy (like that of the British). The civil code is based on the French and German codes. Additionally, Japan's criminal law emanated from Europe. Beneath all of this is a strong layer of Chinese Confucianism.

Despite this amalgam of foreign law, Japanese law is distinctly different from any of the systems that it absorbed. This is the koan. How can it be the same and different simultaneously? It is not a question without practical implications. More than one Western lawyer has erroneously concluded that the content of the law will be the same as its Anglo-European form.

In this sense, Japanese law is a metaphor for Japanese history and culture. Very little of what we in the West think of as authentically Japanese in fact originated in Japan. Zen Buddhism is a convenient example. It is thought by many, Japanese and foreigners alike, to be the apotheosis of Japanese culture. Zen originated not in Japan, but rather in China as Ch'an Buddhism. To this day, one of the three Japanese Zen sects, Obaku, retains significant Chinese customs. Another, the Rinzai sect, traces its origin to Ch'an master Lin-chi.

Zen (the Japanese pronunciation of the Ch'an Chinese ideograph) made its way to Japan in the twelfth and thirteenth centuries and was not exactly greeted by adoring masses. Over time, however, it both transformed Japanese culture and was transformed by it. Much of what is now thought of as traditional Japanese culture—simplicity and austerity—grew out of Zen. Indeed, the Japanese Zen masters refined and energized this school in a way that far surpassed their predecessors. It was Hakuin, for example, who in the eighteenth century systematized

12. See generally Y. Noda, Introduction to Japanese Law 41-62 (1976). In 1860, the Meiji government adopted the Boissonade penal and criminal procedure codes, named after Gustave Boissonade, a University of Paris law professor invited by the Japanese government to improve its legal system. By 1891, Boissonade had promulgated a complete civil code, part of which had been adopted two years earlier. Opposition arose, however, and the complete version never became law. Instead it was supplanted by a code based on the German, which took effect in 1898. Id. at 45-51.
the study of koan, which originated in China.\textsuperscript{16} Similarly, the tea ceremony had long been practiced in China, but it was not until the sixteenth century Japanese priest Sen Rikkyu stripped it to its bones that it became something other than an ostentatious ritual.\textsuperscript{17}

With Zen, the Japanese had yielded to the foreign influence, but had overcome it, making it into something of their own. This theme has been played out numerous times in Japanese history. The use of Chinese characters in the language (different pronunciations were used in Japan), the Meiji era penchant for "modernization" soon after Commodore Perry's arrival in the mid-nineteenth century, and the post-World War II remaking of the country in the Occupation's image all exemplify this theme.

Even Japan's legendary quality control, which sometimes parades under mysterious-sounding titles such as Theory Z, is a Western import. It came from W. Edwards Deming, an American, who was a prophet without honor in his own country. The Japanese took his message to heart, however, and now award annual Deming Prizes to companies excelling in maintaining quality.\textsuperscript{18} Thus, the core of Japan's industrial success does not lie in some inscrutable Oriental secret, but rather in a society that found a foreign philosophy that fit its culture. In 1989, The Wall Street Journal asked Deming, then 89, why Japanese business became so successful while American enterprises declined. His answer: "The Japanese top management were willing to learn. They were willing to live by cooperation, not competition."\textsuperscript{19} In other words, the most effective competitor is one who cooperates.

Resolving dualities is a major theme of Zen Buddhism, not choosing this over that, but living with both this and that, and neither this nor that. It also happens to be the theme of Japanese history and its reception of Western law. "Western techniques, Oriental morality"\textsuperscript{20} was the motto of progressives in the late Edo period. It is a koan that persists to this day.

The technique of law in Japan is Western: civil codes, courts, and the like. Even the technique of constitutionalism is Western.

\textsuperscript{16} See \textit{The Sound of One Hand}, supra note 6, at 8-9.
\textsuperscript{17} See S. Sen XV, \textit{Tea Life, Tea Mind} 12-14 (1979).
\textsuperscript{18} A. Morita, \textit{Made in Japan} 183 (1986).
\textsuperscript{20} Y. Noda, supra note 12, at 59-60.
The content, however, is Japanese. Perhaps a key to understanding is found in the Hannya Shingyo, one of Zen's most important sutras: "Form is no other than emptiness; emptiness no other than form." Form, in Japanese law, is an empty vessel, devoid of content. It is a mistake to confuse the bottle with what is inside of it. Pepsi poured into a Coke can is still Pepsi. Japanese law poured into an Anglo-European mold is still Japanese.

Of course, form and content still affect each another. A solid block cannot fit inside a small-mouthed glass bottle. The form we see affects our understanding of what it contains. Commercials aside, how many of us would realize that it was actually Pepsi in the Coke can? It is not surprising, then, that Westerners are often mistaken about Japanese law, for we see what we are conditioned by our own culture to expect. Indeed, our very way of looking may be different.

The great expositor of Zen, Daisetsu Suzuki, illustrated the difference with two nature poems, one by a beloved Japanese poet, the other by one of the best of the West. Basho, the Japanese, wrote of the nanzuna flower:

When I look carefully
I see the nanzuna blooming
By the hedge!

Tennyson also wrote of a flower, but in a very different way:

Flower in the crannied wall,
I pluck you out of the crannies;
Hold you here, root and all, in my hand,
Little flower—but if I could understand
What you are, root and all, and all in all,
I should know what god and man is.21

Suzuki's analysis is so profound and to the point of our discussion of seeing law, that I quote at length:

Basho does not pluck the flower. He just looks at it. He is absorbed in thought. He feels something in his mind, but he does not express it. He lets an exclamation mark say everything he wishes to say. For he has no words to utter; his feeling is too full, too deep, and he has no desire to conceptualize it.

As to Tennyson, he is active and analytical. He first plucks the flower from the place where it grows. He separates it from the

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ground where it belongs .... He must tear it away from the crannied wall, "root and all," which means that the plant must die....

The East is silent, while the West is eloquent. But the silence of the East does not mean just to be dumb.... Silence in many cases is as eloquent as being wordy....

... Basho is not inquisitive at all. He feels all the mystery as revealed in his humble nanzuna—the mystery goes deep into the source of all existence.... Contrary to this, Tennyson goes on with his intellection: "If [which I italicize] I could understand you, I should know what God and man is.... Tennyson's individuality stands away from the flower, from "God and man." He does not identify himself with either God or nature. He is always apart from them. His understanding is what people nowadays call "scientifically objective." Basho is thoroughly "subjective"... Basho stands by this "absolute subjectivity" in which Basho sees the nanzuna and the nanzuna sees Basho.22

We may now substitute the law for the flower. As Westerners, first of all, we are disposed to attach supreme importance to the words of the law. Resort may sometimes be made to the spirit of the law, but in a contest between words and spirit, spirit faces an uphill battle. For example, President Bush said that he nominated David Souter to the Supreme Court because he is a man who will interpret the words of the Constitution, and not legislate from the bench, which, of course, means not seek "spiritual guidance." The debate over Robert Bork's nomination centered around the same theme, although in that case the "spiritualists" prevailed.23

This is nothing new. Chief Justice Marshall, in *McCulloch v. Maryland*,24 engaged in pages full of linguistic gymnastics to turn the word "necessary" in the Constitution (as in the "necessary and proper" clause) into "convenient." Marshall, without a doubt, was a spirit man, but even he felt compelled to frame his argument in literary analysis terms.25

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22. Id. at 3-4.
25. See also the debate between Justices Chase and Iredell in Calder v. Bull, 3 U.S. (3 Dall.) 386 (1798). Chase espoused natural law limitations on the power of legislatures.
In contrast, a Japanese observer is likely to place far less emphasis on the words of the law, or what we might call the form. Instead, he will see it in its context and not try to pluck the words out of their societal roots. He need not choose between form and content, just as, to the amazement of Westerners, he need not choose between Shinto and Buddhism in his religious practice. He is both Shinto and Buddhist and, to make matters more perplexing to a Westerner, probably will say that he is not religious at all.

The Westerner will analyze and dissect the law, thinking that by parsing each sentence, the meaning (God and man) will be revealed. The approach is not wrong, just misplaced in Japan. In another country, the foreigner must keep his eyes open to the entire tapestry, and not open to just the few threads explicitly labelled law. Otherwise, to give but one example, he will be unable to understand how a country whose Constitution explicitly states “land, sea, and air forces, as well as other war potential, will never be maintained” can spend more than 28 billion dollars a year on defense.

Iredell replied:

If ... the legislature ... shall pass a law, within the general scope of their constitutional power, the court cannot pronounce it to be void, merely because it is, in their judgment, contrary to the principles of natural justice. The ideas of natural justice are regulated by no fixed standard; the ablest and the purest men have differed upon the subject. ...

Id at 399.


27. As of the end of 1987, 112,203,000 Japanese were followers of Shinto and 93,396,000 followers of Buddhism. The total population of the country is 122,783,000. Keizai Koho Center, Japan 1990: An International Comparison 92 (1989) (hereinafter cited as Japan 1990).

28. Kenpō (Constitution) art. IX (Japan).


The Persian Gulf crisis of 1990-1991 illustrated the cross-pressures. Japan is completely dependent on imported oil and, in fact, was accustomed to receiving 70 percent of its crude from the Middle East. Thus, it was quick to support the American-led embargo against Iraq. Soon thereafter, however, the government began dithering about the form that support would take. The United States was pressing for military assistance, including the use of minesweepers. Prime Minister Kaifu responded that such direct action was
The Instant You Speak About a Thing, You Miss The Mark\textsuperscript{50}

As is well-known, the Constitution of Japan was written by the Occupation Forces after World War II, although a public charade was enacted to create an illusion of Japanese authorship.\textsuperscript{31}

The result of this process was a list of individual rights that reflected the American Bill of Rights and 150 years of jurisprudence. Chief Justice Marshall, in \textit{McCulloch v. Maryland}, said that a constitution should not "partake of the prolixity of a legal code" but rather "that only its great outlines should be marked..."\textsuperscript{82} By the time of the writing of the Japanese Constitution, however, American experts opted for specificity born of experience, much as the Frenchman, Gustave Boissonade did in his draft of a civil code for Japan in the 1880's. Boissonade wrote:

I want your government to adopt our laws only to the extent they have been proved good by the experience of three-quarters of a century. I will use every effort to incorporate in the draft the improvements that time has shown necessary and particularly those improvements that other Western jurisdictions have adopted in their wisdom and justified by their experience.\textsuperscript{33}

prohibited by article 9 of the Constitution. Instead, he announced a package of financial and humanitarian aid to help Middle East countries hurt by the embargo. Internal critics argued that even that action was unconstitutional. In addition, neighboring Asian nations watched nervously at the prospect of Japan's military becoming active for the first time since World War II.

30. \textit{KOAN, supra} note 5, at 104.

31. The Diet, the parliament of Japan, deliberated on the proposed constitution in 1946, although there was absolutely no doubt that it would approve the revision. \textsc{A. Oppler}, \textsc{Legal Reform in Occupied Japan} 43-55 (1976) (memoirs of legal adviser to General MacArthur, Supreme Commander for the Allied Powers, during the Occupation). Only five members of the House of Representatives voted against the document, and they were Communists who opposed the retention, in any form, of the Emperor. An official count of the votes in the House of Peers was not kept; it was merely announced that the constitution had received the two-thirds support required. \textit{Id.} at 48.

It should be said, however, that from the earliest of times, the Japanese were accustomed to receiving their constitutions, not creating them. And, lest it be said that this constitution differs because of its "foreign" content, it should be remembered that Prince Shotoku's 17-article constitution of the late sixth century was modeled after China's constitution.


Just as Boissonade proposed a new and improved version of the Napoleonic Code for Japan, the American Occupation delivered to Japan an updated version of the United States Constitution, which, unlike the Boissonade code, remains in effect to this day. Thus arises the paradox: Japan, the country of silence, has a prolix Constitution, and America, a nation in which words are crucial, operates under a Constitution primarily made up of generalities. The American Constitution speaks only of equal protection. Japan's states that "there shall be no discrimination in political, economic or social relations because of race, creed, sex, social status or family origin." The right to vote is explicitly guaranteed to all people in Japan's constitution; in America's it was only implied and, in the case of women and racial minorities, created through amendments. Freedom of movement is guaranteed in Japan. This, too, had to be inferred by the Supreme Court of the United States. Japanese workers enjoy a constitutional right to organize and bargain collectively without relying on general language such as the right of association. The Japanese Constitution even guarantees academic freedom, which has, at best, a weak hold on constitutional status in the United States.

34. U.S. CONST. amend XIV. It took nearly a century for that protection to be extended beyond black people. Compare The Slaughter-House Cases, 83 U.S. (16 Wall) 36 (1873) (expressing the view that the Fourteenth Amendment was designed exclusively for blacks) with (ironically) Korematsu v. United States, 323 U.S. 214 (1944) (restrictions on any racial group are immediately suspect).

35. KENPÔ, (Constitution) art. XIV (Japan).

36. KENPÔ, (Constitution) art. XV (Japan).

37. U.S. CONST. art. I, § 2, cl. 1 and art. II, § 1 leave the matter of voting rights to the states, both for state and national elections. In Reynolds v. Sims, 377 U.S. 533, 561-62 (1964), the Supreme Court said that "the right of suffrage is a fundamental matter in a free and democratic society." In effect, if the Constitution did not state it, it should have.

38. U.S. CONST. amend. XV, § 1 ("shall not be denied or abridged ... on account of race ... "); amend. XIX ("shall not be denied or abridged ... on account of sex ").

39. KENPÔ, (Constitution) art. XXIII (Japan).


41. KENPÔ (Constitution) art. XXVIII (Japan). SCAP was strongly in favor of strengthening the rights of workers and labor unions in order to disperse power to the people. By 1948, however, perceived excesses of the labor movement, as well as fears of Communist control, led SCAP to prohibit civil servants from unionizing or striking. Workers in the railroad and monopoly industries were allowed to organize but were prohibited from striking. A OPPLER, supra note 31, at 196-207.

42. KENPÔ (Constitution) art. XXIII (Japan).

43. The Supreme Court has recognized academic freedom as a species of First Amend-
The post-war Constitution of Japan also includes a number of rights that the authors presumably wish had been included in the American Constitution, and to this day have not been accepted by the Supreme Courts "minimum standards of wholesome and cultured living," and "an equal education," among them. Children are even guaranteed freedom from exploitation. 44

With such an articulation of the rights of the people, Japan should be one of the world havens for individual rights. However, the reality is different. Despite the explicit language, the extreme concern for individualism was an American concept that was imposed on a society that emphasized collectivity. In the debates of Japan’s Commission on the Constitution, which operated between 1957 and 1964, there was considerable sentiment that the document overemphasized individual rights at the expense of the well-being of the entire people and the duty to obey the law. 47 In its joint declaration, the commissioners cloaked the criticism in modernism, implying that traditional Japanese values had become the hallmark of the twentieth-century welfare state:

Eighteenth-century-style democratic constitutions arose out of the struggle against the absolutist power and autocracy of the time and went toward minimizing state power and maximizing the rights and freedoms of the individual. This was only to be expected as a part of the process of creation of democracy and of providing it with its essential content.

However, today democratic thought and the place and role of constitutions based on it have had to change in accordance with

44. KENPO (Constitution) art. XXV (Japan).
46. Id. art. XXVII. Surely this resulted from the United States Supreme Court’s decision in Hammer v. Dagenhart, 247 U.S. 251 (1918), that Congress could not regulate child labor, which remained the law of the land until overruled by United States v. Darby, 312 U.S. 100 (1941).
47. JAPAN’S COMMISSION ON THE CONSTITUTION 272-89 (J. Maki ed. 1980). Those who argued for restraints on individual liberties could at least take solace in article 12, which states that the people “shall refrain from any abuse of these freedoms and rights and shall always be responsible for utilizing them for the public welfare,” and article 13: “[The people’s] right to life, liberty, and the pursuit of happiness shall, to the extent that it does not interfere with the public welfare, be the supreme consideration in legislation and in other governmental affairs.”
changes in the form of what is regarded as a desirable human society. That is to say, the nation and state power itself have come to the point where they are structured democratically. State power in itself is not antagonistic to individual rights and freedoms, rather, it is in a position to become their most powerful guarantor. Consequently, in contemporary democracy it must be considered that state power makes manifest to the maximum degree the rights and freedoms of the individual members of the nation....

From the above perspective, it is clear that we shall be left behind in the rapid flux of contemporary society, if emphasis is not placed on the social duties of the people, their solidarity, and their cooperation, as well as on the guarantee of fundamental human rights:....

Viewing Chapter 3 of the Constitution [rights and duties of the people] from the fundamental position, it must be said that its human rights provisions with the individual as the focus have an air of being far behind the times....

The Commission's view notwithstanding, by the late 1980's, women in Japan began to question whether the interpretation of their rights under the Constitution did not have an air of being far behind the times. The upper echelons of Japanese industry remained closed to most women. The majority of women were relegated to short-term careers as OLs (office ladies) until their expected marriage drove them out of the labor pool altogether. As recently as the summer of 1990, the chairman of the ruling Liberal Democratic Party's Executive Board, Takeo Nishioka, urged women to stay home and have three to five children instead of the 1.57 birthrate of 1988. The Japan Times observed, "Nishioka indicated that he considers child rearing the domain of women."49

The LDP, of course, is the party recently headed by Sosuke Uno, whose former mistress—an ex-geisha—went on television to denounce him as "pompous, crude, vain, and cheap." Geishagate, as it surely would have been called in the United States, led to the LDP's loss of a majority in the upper house of the Diet and the rising reputation of Takako Doi, the female leader of the Japan Socialist Party.

48. Id. at 273-74.
After twelve of thirteen women candidates of the JSP were elected in Tokyo municipal elections, and the LDP's defeat in the upper house, Uno was replaced as head of the conservative party by Toshiki Kaifu. Kaifu promptly appointed two women to his cabinet and shortly thereafter, a third to the high position of Chief Cabinet Secretary.\(^5\) That woman, Mayumi Moriyama, had publicly criticized ex-Prime Minister Uno's relations with women, saying, "I don't think they understand why this kind of behavior is no longer acceptable." Once the LDP held onto control of the more powerful House of Representatives in early 1990 elections, Moriyama and the other cabinet women were replaced.

It is against that kind of background that the fledgling women's movement in Japan began to grow. One strong weapon in its arsenal is article 24 of the Constitution:

> Marriage shall be based only on the mutual consent of both sexes and it shall be maintained through mutual cooperation with the equal rights of husband and wife as a basis.

> With regard to choice of spouse, property rights inheritance, choice of domicile, divorce and other matters pertaining to marriage and the family, laws shall be enacted from the standpoint of individual dignity and the essential equality of the sexes.

Despite this language, a Japanese woman's ability to obtain a divorce had not changed much since feudal times. In feudal times, a man could divorce his wife with only a three-and-a-half line writ, but a woman could only wait and hope for her husband to predecease her. The one way out was to enter a convent such as Tokeiji in Kamakura, nicknamed Enkiri-dera (Divorce Temple). Kamakura lore is full of dramatic chases to the temple grounds. It is said "that if a woman, fleeing to the temple with her irate husband in hot pursuit, arrived there at night and found the gate barred, all she had to do was slip off her shoe and toss it over the wall, and she would thereby be regarded as already in sanctuary and inviolate."\(^5\) Few women availed themselves of this safe haven, and even today divorce is still seen as a disgrace for women, whose traditional role was the maintenance of the family. After World War II, Japanese women were allowed to sue for divorce for the

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first time, due to the new Constitution’s provision on equality of the sexes. However, the social stigma, coupled with the lack of employment options, deters unhappy women from leaving. The divorce rate in Japan is only 1.26 per 1,000 population, compared with 4.8 for the United States, leaving few potential partners for divorced women or men.52

Although the rate is low, Japanese women have filed for seventy percent of the approximately 150,000 annual divorces granted in the past ten years.53 Article 770 of the Civil Code allowed the husband or wife to bring a unilateral action for divorce54 for only the following reasons:

* unchastity of the other spouse
* desertion by the other spouse
* a three-year absence of the other spouse, in which it is unknown whether the person is alive or dead
* severe mental disease of the other spouse with no hope for recovery
* other grave reasons.

The commencement of a divorce suit, however, hardly guarantees a divorce. Even if the grounds above can be demonstrated, “the court may dismiss the action for divorce, if it deems the continuance of the marriage proper in view of all the circumstances.”55 In addition, before bringing an action in the district court for the judicial divorce, the petitioning spouse must first proceed through the family court. Attempts are then made to bring about a reconciliation, or at least an agreement to end the marriage with attached conditions.56 Husbands, however, are not agreeable. In 1984, only fifty-five percent of the divorce cases mediated in the family courts yielded an agreement by the husband to divide property and offer consolation money. And even where consolation money was agreed to, it averaged only 3.2 million yen, about $23,000.57

52. JAPAN 1990, supra note 27, at 93.
54. An uncontested divorce can be obtained by registering an agreement. MINPô (Civil Code) art. 763 (1988).
56. The Supreme Court of Japan, Guide to the Family Court of Japan 18, 22-23 (1982).
While the right to divorce is given to women by law, society makes it very difficult to exercise. A dramatic ruling by the Supreme Court in 1987, while seeming to liberalize divorce rights, contributes to the difficulty. The Court expanded the categories for judicial divorce to allow a divorce suit to be brought by an unfaithful spouse. Article 770 only authorized the innocent spouse to sue. Even under the new ruling, however, the Court suggested an unfaithful spouse may only initiate divorce proceedings if "the parties have lived separately for a long time, have no dependent children, and if the defendant spouse is psychologically, economically, and socially secure." 58

The facts of the case reveal that it is no "women's rights" ruling. The plaintiff was a seventy-five year-old man who walked out on his spouse thirty-eight years before and had two children by a mistress of thirty-eight years. The wife's lawyer commented that the ruling reflected the current social trend, but failed to protect the interests of the "wronged" spouse, stereotypically the woman. Japan lacks the extensive legal edifice of the United States and Western European countries used to divide property and set child support payments. Additionally, while women assume custody of children in about seventy percent of the divorce cases in Japan, their average household income is only forty percent of the national average. 59

Thus, despite the clear words of the Japanese Constitution and the Civil Code, women do not stand as equals in divorce. The real meaning of the words cannot be fixed outside of the social context. Some people are more equal than others.

Women are not the only "minorities" with claims of mistreatment in Japan. Professor Upham has carefully documented the plight of the Burakumin, descendants of butchers and leather-tanners who are racially identical to other Japanese, but are to this day treated as a lower caste. 60 Families will routinely inves-

59. See Divorce, supra note 57.
60. F. Upham, Law and Social Change in Postwar Japan 78-123 (1987). The Buraku are concentrated in southern and western Japan. Before the war, their communities could be identified by low-rise houses and narrow roads (to prevent rebellions). Nowadays, it is more difficult for an outsider to determine where the Buraku people live, although an abundance of stores selling shoes and leather goods often is a clue.

The roots of the discrimination against Burakumin involve their profession: slaughtering
tigate a child’s potential marriage partner to make sure he or she is not a Buraku, for such a marriage would be considered a disgrace to the entire family. Those few mixed marriages that have proceeded have at best resulted in social isolation and, at worst, suicide.

The Ainu people of Northern Japan,61 while arguably of different racial stock,62 also are singled out for separate treatment. They are caught in a double-bind. The government refuses to recognize them as a minority, but they continue to suffer discrimination.63 Former Prime Minister Yasuhiro Nakasone unwittingly did more to heighten Ainu consciousness than any of its leaders when he compared Japan to the multi-racial society in the United States, saying that Japan is a homogeneous country.64 In fact, Japan still has an 1899 law on the books, by which the

and handling of the hides of animals, considered an unclean occupation, despite the fact that the Japanese have no ambivalence about using leather. Those who handled dead people historically, the Onbu, also were the objects of discrimination, although they ranked above the Burakumin. See Kuriki, *Buraku Champion*, Chicago Tribune, Aug. 13, 1989, sec. C, at 3.

61. An official survey by the Hokkaido prefectural government estimated the number of Ainu there at about 25,000. The principal Ainu rights groups, however, the Kōdaido Utari Association, puts the number nationwide at between 50,000 and 60,000. *Minority People Face Uphill Task to Secure Recognition, The Financial Times*, Nov. 23, 1989, at v (hereinafter cited as *Minority People*).

62. Just where the Ainu came from is still a matter of debate. One popular theory is that they were originally Caucasians and came to Japan via Siberia and the Korean Peninsula. One of Japan’s leading anthropologists, however, disputes that theory. Based on twenty years of study, Professor Kazuro Hanihara concludes that the Ainu were part of a wave of Mongoloid immigration some three to four thousand years ago, coming from Indochina or Southern China. These people, he says, were the prehistoric Jomon people who eventually located in southern Honshu. Yellowlees, *The Ainu*, PHP INTERSECT, Oct. 1988, at 30-31.

A team of American researchers echoes that conclusion, noting that the Jomon resemble the Ainu much more than they do most modern-day Japanese, who descended from the next wave of immigration from Korea and China, the Yayoi. The Americans, however, take the analysis one step further. Observing that the samurai of feudal Japan had more body hair, lighter skin, and higher-bridged, European-style noses than most Japanese, the research team concluded that these social elites were descendants of the Ainu. Needless to say, this is not a popular view among mainstream Japanese. *Exalted Warriors, Humble Roots*, N.Y. Times, June 6, 1989, at C1, col. 1.

63. A survey by the Hokkaido government revealed that 72 percent of the Ainu believed they had suffered some discrimination in their lives, and 62 percent felt it was continuing. Ainu educational levels are lower than the national average, and their language is fast disappearing, as they are prohibited from speaking it in school. Yellowlees, *supra* note 62, at 33.

Meiji government attempted to assimilate the Ainu by forcing them to abandon their language and traditional occupations. Euphemistically, the law is entitled “Law for the Protection of the Former Natives of Hokkaido.” Activists want it rescinded and replaced by one that protects their culture and promotes their full participation in society.

Then there is the long-standing tension with Koreans. More than 700,000 of them were brought under duress to Japan and its territories before and during World War II. The Japanese occupied Korea at the end of the nineteenth century and later subjected it to thirty-six years of colonial rule until the end of the Second World War. Those who relocated in Japan, and their later-born children, were required to take Japanese names. Koreans are the most vocal critics of Japan’s alien registration laws, requiring foreigners (even life-long residents of Japan who speak fluent Japanese) to be fingerprinted and carry an identification card.

There are now some 700,000 such people, fully seventy percent of the “foreign” population. While everyone is equal under the constitution, there is no doubt that these Koreans are the objects of deep and wide social antipathy, the kind that can only be felt among close relations. It is no secret that many of Japan’s early people and much of its culture, including Buddhism, came from or through Korea. Each country was forced to walk the perilous

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65. See Minority People, supra note 61.
66. At the opposite end of the country, Okinawans feel discriminated against, too. They also are considered to be a separate people from the majority Yamato population of Japan. In their native territory, the islands at the far southwest of the Japanese archipelago, the Okinawans have suffered under constant invasion and occupation. When they come to the cities on Honshu, the main island, they often feel as though they are denied equal opportunity in employment and education. See Yellowlees, Japan’s Stance on Human Rights, PHP INTERSECT, May 1989, at 41, 42.
70. In 552 A.D., the Korean state of Paekche presented Buddhist scriptures and an image to the Japanese Yamato court. See E. Reischauer & A. Craig, supra note 68, at 10-15. Jewelry (magatama) found in tombs from the fourth century are identical to those found in Southern Korean remains from the same period. Pottery figures of warriors (haniwa) from around the same period also bear striking resemblances to Korean soldiers of the time. Id. at 5.
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path of differentiating itself from China without enraging what was then the dominant force in Asia. Since then, they have been rivals for primacy in East Asia. It was not until 1990, when Japan officially apologized to Korea for the pre-World War II exploitation, that the Emperor told Korean President Roh Tae Woo at an Imperial banquet, "I think of the sufferings your people underwent during this unfortunate period, which was brought about by my country, and cannot but feel the deepest regret."\(^{71}\)

The Supreme Court of Japan had a recent opportunity to rule on the constitutionality of the fingerprinting law. Several cases dating from the early 1980's finally made their way to the justices in 1989. The facts were essentially the same: Korean residents refused to submit to fingerprinting upon renewing their alien registrations.\(^{72}\) For almost a decade, observers had been waiting for the Court's decision. However, when the rulings were handed down, nearly everyone was disappointed. The charges against the Koreans were dismissed, but only because of an Imperial pardon declared at the funeral of the late Emperor Showa (Hirohito).\(^{73}\) The result was especially unnerving to the Korean dissidents, for they failed to be declared not guilty, the law remains in effect, and the dismissal of the charges resulted from the legacy of the Emperor who, many of them feel, was responsible for many of the abuses against their home country.

Before being too critical of the Japanese, however, we Americans should remind ourselves of our own Supreme Court's history of avoiding difficult decisions from *Marbury v. Madison*\(^{74}\) to the much reviled "all deliberate speed" language in *Brown v. Board of Education*.\(^{75}\) Indeed, one of our greatest constitutional law

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71. *New Relations Forged by Roh Visit*, The Japan Times Weekly Int'l Edition, June 4, 1990, at 1, 5, col. 1. In 1984, Emperor Showa (Hirohito), who reigned when the abuses of Korea took place, said at an Imperial reception for then-President Chun Doow Hwanto, that the two countries' history involved "an unfortunate past" that called for "regret." The Japanese government referred to this as an expression of regret, but to the Korean public it was insufficient. *WWII Apology Clouds Roh's Visit*, The Japan Times Weekly Int'l Edition, May 28, 1990, at 1, 22, col. 5.

72. A 1988 revision of the law only requires fingerprinting upon the initial registration as an alien. See *Supreme Court Invokes Pardon for First Fingerprint Refuser*, Kyodo News Service, July 14, 1989.

73. Id.

74. 5 U.S. (1 Cranch) 137 (1803).

75. 349 U.S. 294, 301 (1955) (*Brown II*).
scholars described such aversion tactics as "The Passive Virtues." 76

Moreover, our own record on equality is far from spotless, even in the late twentieth century. The Equal Rights Amendment for women failed, and their social inequality persists in our own culture. We should also recall our own experience with the post-Civil War Fourteenth Amendment, which intended to make black people equal. Not until 1954 did it even begin to remedy racial inequality. Our Supreme Court read equal to mean separate before then. 77 Even now, social equality is a distant dream. We have our own koan to ponder.

*When the monks assembled before the midday meal to listen to his lecture, the great Hogen of Seiryo pointed at the bamboo blinds. Two monks simultaneously went and rolled them up. Hogen said: 'One gain, one loss.'* 78

In all of Japanese law, there is no area more puzzling than legislative reapportionment. The Supreme Court has recognized the principle of "one man, one vote." 79 However, it has refused to enforce it. The raw materials are these:

Article 15(1) of the Constitution states, "The people have the inalienable right to choose their public officials and to dismiss them." Article 15(3) provides, "Universal adult suffrage is guaranteed with regard to the election of public officials."

Thus, unlike the American Constitution, the Japanese document explicitly confers the right to vote. This, like all other provisions, are subject to article 14, which states, "All of the people are equal under the law...." Additionally, article 44 provides, "The qualifications of members of both Houses and their electors shall be fixed by law. However, there shall be no discrimination because of race, creed, sex, social status, family origin, education, property or income."

Article 43 states, "Both Houses shall consist of elected members, representatives of all the people.... The number of members of each House shall be fixed by law." Finally, article 47

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77. Plessy v. Ferguson, 163 U.S. 537 (1896). Laws preventing interracial marriages were not struck down until Loving v. Virginia, 388 U.S. 1 (1967).
78. K. SEKIDA, supra note 1, at 89 (Mumonkan case 26).
79. The Court was influenced by the opinion of the United States Supreme Court in Reynolds v. Sims, 377 U.S. 533 (1964).
provides, "Electoral districts, method of voting and other matters pertaining to the method of election of members of both Houses shall be fixed by law."80

While the numbers have changed over the years, Japanese voters currently elect 511 members to the House of Representatives and 252 to the House of Councillors. Although citizens may cast only one vote in a Representatives election, several people will be elected from each district (the top vote getters). One hundred members of the House of Councillors are elected at large by proportional representation, and the rest are apportioned to the prefectures. The result is that each prefecture has from two to eight Councillors apportioned to it.81

When first presented with a claim of malapportionment, the Supreme Court was unimpressed. In a 1964 case, the Court took a hands-off approach, saying that the Diet had discretion to apportion itself as it saw fit, short of an extreme denial of the equal right to vote.82 The Court ruled that the disparity of 1 to 4.09 between districts was not such an extreme case.83 The decision was notable, however, for what it did not say. The Court did not rule out the possibility that it could intervene some day. It did not say that malapportionment could never be constitutionally cognizable. This was simply not the time.

Twelve years later, the law took a different turn. In Kurokawa v. Chiba Election Commission,84 for the first time the Supreme Court held a population variance unconstitutional. The difference in the value of a vote which gave rise to the suit was 1 to 4.99 in the 1972 elections. The Court said not only had the ratio become extreme, it had been that way long before the election. The Diet had not reapportioned itself since 1964, and the Court held this to be unconstitutional at the time of the election.

Then comes the koan. If the election were unconstitutional, then all the laws subsequently passed by the legislature would

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80. These translations are from the official version of the Constitution, reprinted in (to give but one readily available source) THE JAPANESE LEGAL SYSTEM 5, 8 (H. Tanaka ed. 1976).
84. 30 Minshū 223 (1976) (Decision of April 14, 1976, Supreme Court, Grand Bench).
be unlawful. Indeed, as an unlawfully-constituted body, the Diet could not even take the official action to correct the malapportionment. This, the Court said, is a situation the Constitution does not expect. As a result:

[W]e find it proper to vacate the appeal for invalidation of the election itself and only declare it invalid in the text of the judgment, though the election at issue is invalid because it was held on the basis of the rules of apportionment which violated the Constitution.\textsuperscript{85}

In other words, the malapportionment violated the Constitutional voting and equal protection guarantees, the election was invalid, but the invalidity would not affect the validity of acts of the legislature. Commentators were disappointed in the Court's unwillingness to enforce its decision, but they took some solace by construing it as a warning to the Diet.\textsuperscript{86} However, that apparently was not the intent of the Court.

By the time of the 1980 elections, the difference in voting power was 1 to 3.94. The Diet had finally reapportioned five years before (the year prior to the 1976 Court decision) using the 1970 census, so it was not surprising that by 1980, the population variations were significant. Nevertheless, the Supreme Court held that the election was valid. The defects of the 1976 case (based on the 1972 elections) had been corrected, and even though the apportionment was now out of line with the population, the Court was unwilling to say the Diet had failed to do its duty. The ratio was unconstitutional, but the result was acceptable. Apparently, the fact that the legislature had taken some action within recent memory was more important than the fact that the action no longer accomplished its goal. Even the dissenting judges, who viewed the numbers as far beyond the realm of acceptability, were not willing to invalidate the election, although all but one threatened to do so in the future.\textsuperscript{87}

In December of 1983, the Diet dared the dissenters to make good on their threat. Another election was held, just a month

\textsuperscript{85} Id. at 254.
\textsuperscript{86} Matsui, supra note 81, at 41.
after the Court's decision described above. The same apportionment was employed and based on the 1970 census. The difference was that this time, the apportionment was eight years old, not just five. The disparity had by that time reached 1 to 4.40. The Court said the numbers were unacceptable and the legislature had failed to do its duty and reapportion within a reasonable time. Nevertheless, in a 1985 ruling, it once again refused to nullify the election.88

To American lawyers, the meaning of these cases is opaque. A right without a remedy is no right at all in our minds. John Marshall said as much in Marbury v. Madison, although he then, by judicial jujitsu, jettisoned the remedy to create a greater right for the Court. Our own history includes a period of unsuccessful challenges to apportionment under the Guarantee Clause of the Constitution, but eventually a resolution under the Equal Protection Clause. The Court ultimately did its job in protecting the right of the individual.

How, then, to resolve the koan of these cases in Japan, to resolve the duality? To begin, resolving the duality does not mean killing one side of it. The Western intolerance for ambiguity is well-known, as is the Japanese appreciation of it. Rather than resist it, our task is to see it clearly. "Look straight ahead. What's there?" said Bassui Tokusho in the 14th century. "If you see it as it is, you will never err."

Looking straight ahead, without imposing our own acculturation on the process, we see a Supreme Court that is less concerned about individual rights than it is about the continuing stability of the whole. The Japanese "bill of rights" (actually called the "rights of the people" in the Constitution) may have been written by the Occupation Forces after the war, but the

89. 5 U.S. (1 Cranch) 137 (1803).
92. See generally A. Oppler, supra note 31, at 43-64.
words only take on meaning in context. In our country, the
Supreme Court exists to protect the people from the govern-
ment.93 In a country with a history in which the leader was not
only a trusted person, but also a divine incarnation,94 the oppo-
sitional assumption of government versus the people may not
exist, or at least be as strong.95

The value of individuality (on which we place a premium) may
be less important in another culture than protection of the whole.
Chie Nakane, in her classic work, Japanese Society, asserts that
social organization in Japan springs from the model of the house-
hold.96 The functioning of the household is the most important
matter, be it the household of the biological family, the company,
or even the country.97

93. It is for this reason that some argue that the Congress, despite its constitutional
power to control the jurisdiction of the federal judiciary, could not restrict its ability to
hear cases involving protection of the people against the government. See, e.g., Sager,
Forward: Constitutional Limitations On Congress' Authority to Regulate the Jurisdiction
of the Federal Courts, 95 HARV. L. REV. 17 (1981); Ratner, Congressional Power Over the

94. According to Japanese mythology, the Emperor is a descendant of the Sun Goddess
Amaterasu. For one view of how that mythology affected the twentieth century, see E.
BEHR, HIROMITO (1989). Separating the civil and religious functions of the Emperor is
sometimes difficult but necessary under the post-war Constitution. For example, at the
investiture of the current Emperor, the government paid for the secular part of the
proceedings but not those with religious overtones. Allocating the fixed costs, however,
was a dilemma.

95. I do not want to push this argument too far, as Japanese history is replete with
examples of warlords who have seized power and treated their opponents brutally. Even
in these cases, however, the mass public displayed a kind of fatalistic acceptance of the
leader's power.


97. Even in engineering, this difference of mindset can be readily seen. The Wall
Street Journal, in a recent article, described the difficulties the United States has in
converting basic research breakthroughs into marketable products. It quotes a husband
and wife Ph.D. team, both Americans, both now working in Japan—he for the Ministry
of International Trade and Industry (MITI), she for Nippon Telephone and Telegraph
(NTT):

"In graduate school in the United States, everybody wants to be in basic research,"
not commercial research, Ms. Fortune says. "It's more aesthetically pleasing." Graduate
students, she says, believe that "if you join a company, your work may
not be published and you won't advance as a scientist." In Japan, the incentives
are reversed... Scientists and engineers who join those companies aren't expected
to pursue their own scientific curiosity, but rather to work toward breakthroughs
that will help the company.

John Stern, the American Electronics Association's vice president for Asian oper-
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The Supreme Court and the Diet might be viewed as members of the same household, the government. They are comrades in arms, not adversaries. A policy question has arisen about how the group ought to conduct elections. The nature of the process requires a public dialogue. However, a dialogue is all that is happening; there is no setting of demands. The Diet appears disinterested in reapportionment, in part because the malapportionment perpetuates the power of those in authority. The Court, which is essentially equal in stature, disagrees. Yet, the form of disagreement among family members is different from the form of opponents. The Court states its opinion, but refuses to intrude on the Diet's territory. The Diet goes on without paying much heed. The Court states its opinion again; the Diet is slow to change. And the process continues.

The Court's self-conceived role is not to force the change. Instead it is to continue to remind the Diet of its duty, and to hope and expect it to respond eventually. It is a much lengthier, less immediate method than that used in the United States. However, when the Diet comes around, it will have the sense that it decided to change, not that it was forced.98

Farewell—
I pass as all things do
dew on the grass.99

Impermanence is one of the central features of Japanese culture and especially of Zen Buddhism. The poem above is a death poem, written in 1730 by a man named Banzan. His metaphor is especially apt, as Buddhist literature often refers to the world

98. Japan's great unifier, Tokugawa Ieyasu (1542-1616) said as much in his retort to earlier leaders. Oda Nobunaga (1534-1582) once said: "The cuckoo doesn't sing? All right, kill it at once." Toyotomi Hideyoshi (1536-1598) said, "The cuckoo doesn't sing? All right, I'll make it sing." But Ieyasu had the final word: "The cuckoo doesn't sing? All right, I'll wait 'till it sings."

as "a world of dew." With the exception of change, nothing is permanent. Clinging to the way things were only distracts one from the way things are.

There is a koan in this, for while things are constantly new, they are not necessarily different. One of the most sacred sites in Japan, for example, is the Shrine at Ise. It is there that the three symbols of Imperial authority are kept: the sacred mirror, the sword, and the jewels. Every twenty years, the treasures are removed and the Shrine is destroyed, only to be immediately rebuilt. It is always new, but always the same. Always different, but always old. Just like the Emperor himself: many different men over 2,000 years, but all embodying the same blood.

This attitude toward transience is vividly displayed in the Japanese understanding of contract. In the West, a contract is an allocation of risks. It is not to be altered without the consent of both parties, save in the most extreme circumstances. In contrast, the Japanese tend to view contract as an expression of a relationship based on the conditions of the moment. If conditions change, so will the contract. Indeed, almost all contracts in Japan contain some sort of escape clause based on changed conditions.

Consider, for example, the following official comment to the Uniform Commercial Code of the United States:

Increased cost alone does not excuse performance unless the rise in cost is due to some unforeseen contingency which alters the

100. Id.

101. The Japanese Imperial family is the longest uninterrupted dynasty in the world. See Weisman, Japan's Imperial Present, N.Y. Times, Aug. 26, 1990, at 29, col. 1. In fact, there is some disagreement as to the straightness of the line. In the fourteenth century, two rival brothers' families alternated as the reigning Imperial family. This worked well for a while, until the two sides became allied with different military powers. The Emperor Godaigo was pushed out of Kyoto and took refuge in the southern mountains of Yoshino. There began the Southern Court and 50 years of civil war with those that replaced him, the Northern Court. Godaiigo's grandson decided the constant warring was bad for both sides and signed an agreement with the Northern Court to return to the alternating reign formula. As a gesture of sincerity, he relinquished his claim to the throne to his Northern Court counterpart, who was to serve ten years and then abdicate to the Southern Court crown prince. The Northern Court broke its promise and retained control. To this day, however, a small but determined band of descendants of the Southern Court claims to be the authentic Imperial line. Kubiak, Japan's Other Emperor, KYOTO J., Winter 1989, at 14.

essential nature of the performance. Neither is a rise or a collapse in the market in itself a justification, for that is exactly the type of business risk which business contracts made at fixed prices are intended to cover.\textsuperscript{103}

In Japan, article 546 of the Civil Code excuses performance when it has become impossible,\textsuperscript{104} but the notion of impossibility has come to include impracticality.\textsuperscript{105} Thus Japanese courts have reformed contractual obligations when triple-digit inflation drastically changed the value of the amounts due\textsuperscript{106} and even when prices changed due to Japan's defeat in World II. The courts ruled that no one should have been required to foresee such an unlikely outcome.\textsuperscript{107}

Americans, however, are far less likely to let the other side ''off the hook'' when they have gotten the better of the bargain. The experience of baseball player Randy Bass reveals all. Bass was a journeyman player in the American major leagues before going to Japan and becoming a superstar. A two-time Triple Crown winner,\textsuperscript{108} Bass was the pride of the Hanshin Tigers, whom he helped lead to a Japan Series championship.

As told by author Robert Whiting, in May of 1988, physicians found a tumor in the brain of Bass's eight-year-old son. Bass immediately asked for, and was granted, a leave without pay, which he used to take his son to San Francisco for surgery. Bass delayed his return to the team by a month, and the Hanshin company responded by firing him.

104. "If the performance of an obligation becomes impossible by any cause for which neither party is responsible, the obligor is not entitled to counter-performance." Minpō (Civil Code) art. 536.
108. Bass holds the record season batting average, .389. He also came within one run of beating the homerun record of 55 in one season, held by the legendary Sadaharu Oh. Oh, by then, had become manager of the Yomiuri Giants, whom Bass's Hanshin Tigers faced on the last game of the season in which he threatened to break Oh's record. Each time Bass came up to bat, the Giants pitchers tried to walk him intentionally, depriving him of the opportunity to hit one or two more home runs. See R. Whiting, You Gotta Have WA 293-94 (1989).
Americans, Bass included, wondered why the Tigers would release their star gaijin rather than allow him to return, albeit a bit late. The official version of the time was that Bass would not be able to muster the physical and mental muscle needed to play ball, and many commentators derided him for leaving his team in the middle of the season. Money was the real reason, however, and had nothing to do with ability or loyalty.

Under Bass's contract, Hanshin agreed to cover his medical expenses and those of his family. Thinking that such expenses would be routine and nominal, the team never bothered to take out medical insurance. When Bass presented the bills for his son's radiation treatments, Hanshin balked.

To Hanshin, the serious illness of Bass's son was such an extraordinary departure from the norm, that they could not be expected to pay under a general medical expenses contractual provision. To Bass, medical expenses were medical expenses, and if the team failed to insure against the risk, that was its problem, not his. Bass claimed wrongful discharge, that Hanshin owed him the rest of his salary for 1988 plus a $1.5 million extension for 1989 he had already signed, and the medical expenses. The company claimed that Bass had violated his contract by not returning quickly. In response, Bass produced a tape recording he had made of a phone conversation with a company vice-president, who told Bass that he could stay in the States until his son was in stable condition.

A company man, Shingo Furuya, was dispatched to San Francisco to work things out with Bass. Privately, he was said to be embarrassed by Hanshin's actions. However, Furuya hoped that Bass might behave like a Japanese and find a harmonious end to the acrimony. To that end, he suggested a $1.3 million settlement. Bass, on the other hand, acted like any American and insisted that the contract's clear language controlled. The fact that his team had tried to fire him in his most difficult personal crisis surely did nothing to move him toward compromise. So, Furuya returned to Japan empty-handed.

Caught between the expectations of his employer and his conscience, Furuya took the traditional Japanese way out: suicide. He jumped from the eighth floor of the Tokyo New Otani Hotel to the tranquil Japanese rock garden below. Incredibly, some commentators blamed Bass, saying if he had only been
more cooperative, the suicide would not have happened.\textsuperscript{109}

The point of this story is not to cast blame, but rather to point out the radically different attitudes toward contract in Japan and the United States. Despite their hard-heartedness, the Hanshin Tigers' position was quite understandable in the Japanese context. They had simply never considered the possibility of huge medical expenses and, as such, thought that they could not be held to have agreed to pay them. Bass, on the other hand, read the contract as any American would. Contract, to him, was an allocation of risk. If someone wins and someone loses, that is not a reason to reform the contract. To the contrary, that is what a contract is for: to ensure that the person who made the better bargain gets the benefit of it. The fact that Hanshin could have avoided most of the problem simply by buying medical insurance only underscores the Western insistence that it deserved to pay for its negligence.

Thus, the Western style of contract negotiation is arm's length, while in Japan it could be called "arms linked." Unfortunately, as the Bass episode shows, it is difficult for any foreigner—person or corporation—to make a truly "arms linked" Japanese-style contract. The simple reason is that cultural differences interfere with his ability to create the same kind of close, ongoing relationship that two Japanese people or companies have when they do business. The result, from the American perspective, may be the worst of both worlds: an arm's length relationship with arms linked expectations.\textsuperscript{110}

To say that things change (the central focus of Zen Buddhism and Japanese contract theory) is not to say that all things change all the time. One of the most controversial legal disputes pending before the Supreme Court of Japan involves the People's Republic of China and the government of Taiwan, the Republic of China.

The subject of this major legal and political problem is a humble five-story dormitory, called the Kökaryo, in the city of Kyoto.

\textsuperscript{109} For the details of this story, I rely completely on R. Whiting, id. at 301-06.

\textsuperscript{110} Cf. Making Honda Parts, U.S. Company Finds, Can Be Road to Ruin, Wall St. J., Oct. 5, 1990, at A1, col. 6 (American company unable to meet Honda's quality requirements, forced into bankruptcy, claiming that it was used by Honda as a token to reduce political pressure to buy American parts; Honda claimed the company could not grasp its business philosophy).
Built before World War II, the dormitory served as a residence for Chinese students studying at Kyoto University. In 1952, the University sold the building. It was then registered in the name of the Chinese Nationalist government.

Increasing conflict between Taiwan and a number of pro-PRC residents led to a 1967 lawsuit seeking to evict eight of the PRC sympathizers. In 1972, the Japanese government ended diplomatic relations with Taiwan and recognized one China ruled by the PRC. Hence, the problem: could the ROC, the owners of record, retain ownership when it no longer was a recognized legal entity?

A 1977 district court decision held that the PRC succeeded to all "Chinese" property, but on appeal, the Osaka High Court reversed. The Court said only those properties that represent the state or which involve state sovereignty transfer with recognition. The Court reasoned that the dormitory was not "diplomatic property" because Taiwan bought it to help the students residing there, and because that purchase by Taiwan occurred after the Nationalists were forced to flee from the mainland. Thus, the Court concluded, the Kōkaryo was private, not government, property, and its ownership would be determined in accordance with the normal civil law.111

The question is pending before the Supreme Court, which appears to be in no great hurry to resolve the issue. Surely, the Court would welcome some sort of escape, such as the amnesty used in the Korean fingerprinting case. In the meantime, the government of the PRC has continued to pressure the government of Japan to hand over the building, billing the dispute as one of international relations. Japan's government, in turn, has responded that it is precluded from interfering because of the separation of powers. Article 76 of the Constitution vests "the whole judicial power" in the Supreme Court and the inferior courts. All judges are guaranteed independence by the article and are bound only by the Constitution and the laws.

Of course, all this begs the question of what the law is and whether the "One China" recognition necessarily includes such


property. Article 29 guarantees the right to own property, but "[p]roperty rights shall be defined by law, in conformity with the public welfare." Pursuant to article 73, giving the Cabinet the power to conclude treaties and manage foreign affairs, the government entered into the 1972 China-Japan Joint Communique and the 1978 China-Japan Peace and Friendship Treaty. And article 98 demands that "[t]he treaties concluded by Japan and established laws of nations shall be faithfully observed."

Surely, in a nation as attuned to subtlety as Japan, the Court would defer to the government if the government expressed a real preference on the case's outcome. To that end, ex-Prime Minister Takeshita was quoted as expressing the hope that the judicial process could lead to a "fair and reasonable solution."\textsuperscript{113} Takeshita, however, was two Prime Ministers ago. Therefore, the issue remains in the netherworld of legal process: awaiting Supreme Court decision. The Japanese, it should be recalled, are famous for their ability to wait.

\begin{quote}
\textit{Nansen said, "Mind is not the Buddha; reason is not the Way."}\textsuperscript{114}
\end{quote}

This excursion began with the observation that Westerners frequently are befuddled in their dealings with the Japanese legal system. Those who hoped that this article would lead them out of the wilderness by now are surely disappointed, for no doubt its main effect has been to convince them further that the differences are irreconcilable.

Transcending dualities, however, is one of the central themes of Zen Buddhism. Light and dark, although opposite, are inextricably bound. Each has its place. The challenge is not for one to win but rather for each to know its domain and respect that of the other. Indeed, there is no challenge (hard for us Americans, descendants of the hunting man who either captured dinner or was captured for dinner, to believe), for it follows as night the day, to paraphrase one of our own philosophers.

In Akira Kurosawa's newest film, Dreams, the final vignette takes place in a village of waterwheels. A visitor from the city

\textsuperscript{114} K. SEKIDA, \textit{supra} note 1, at 105 (Mumonkan case 34).
happens upon a village elder, who tells him that here people attempt to live in harmony with nature. "What", the visitor asks, "do you do without electricity? How do you see at night without lights?" The old man replies, "Who needs light when it's supposed to be dark? It only interferes with the view of the stars."

If the law of Japan appears dark to Western readers, I hope I have not shed any light on it. I will be pleased if, instead, I have explored its darkness, told of some of the purple on black forms that appear once the eyes have become accustomed to the lack of illumination. And if, out in the distant sky, a few constellations can be picked out, perhaps we can trust them to be our guides.
“SUBSTITUTE PRISON”: A HOTBED OF FALSE CRIMINAL CHARGES IN JAPAN

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I. INTRODUCTION

It can be said that the criminal justice system of Japan is very efficient and this contributes to her relatively low crime rates. However, any efficient social or state system is apt to cause human rights infringements. Arguably, the Japanese criminal justice system is no exception.

This paper focuses on issues associated with what is known as “substitute prison,” which is a police lock-up cell used for imprisonment, specifically for pretrial detention. This system has been criticized for a long period of time, and is one of the biggest issues in legislation today.

Before discussing the major issues, it is necessary to describe the outlines of pretrial detention, specifically, in the context of the goals of pretrial detention, the time limits set by law and the specific rights of the detainee.

II. THE PRETRIAL DETENTION IN JAPAN

A. The Goals Of Pretrial Detention and “Preventive Detention”

1. The Main Goals of Pretrial Detention

Although the Code of Criminal Procedure does not explicitly state the goals of pretrial detention, it is widely accepted that

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securing attendance of a suspect or defendant\(^2\) at the pertinent proceedings, and the prevention of destruction or concealment of evidence are objectives of detention. However, opinions are divided on the issue of whether or not pretrial detention may additionally serve objectives of "preventive detention." Such objectives include pretrial custody of an accused for the purpose of protecting some other person or the community at large. Additionally, the purposes of interrogation and obtaining a confession may also be served.

The Code of Criminal Procedure\(^3\) authorizes pretrial detention of a defendant only upon a showing that there are reasonable grounds to suspect that the defendant has committed a crime. Additionally, the defendant must fall into one of the following categories: (1) a person who has no fixed dwelling place; (2) a person who is suspected on sufficient grounds that he will destroy or conceal evidence; or (3) a person who has fled or is suspected upon reasonable grounds to flee in the future.

If an accused has no fixed dwelling place, the circumstance is equivalent to the case in which the defendant has fled or will flee. Therefore, both the first and third category justify pretrial detention to assure that the particular accused will subsequently appear at the proceedings.

The second category is justified by a concern that evidence will be destroyed or concealed. The justification is to prevent the accused from impeding the pending investigation, obstructing justice or interfering with prospective witnesses. This category has been criticized for its breadth and ambiguity. However, the majority of pretrial detainees fall within this category.

2. Preventive Detention

The issue of whether the prevention of future crime in the community can be a legitimate ground for pretrial detention has been controversial. Needless to say, while an accused is detained, he has little chance of committing a new offense in the community. In this sense, any pretrial detention may concomitantly result in

\(^2\) A "suspect" becomes a "defendant" after his prosecution. In this article, "accused" will be used to include a suspect.

\(^3\) **Code of Criminal Procedure (Keishōhō),** Law No. 131 of 1948 (hereinafter Code), art. 60(2). This provision also applies to the detention of a suspect. **See CODE art. 207(2).**
"preventive detention." Furthermore, the destruction or concealment of evidence constitutes an offense in the criminal law, which could also be prevented. Thus, pretrial detention of the accused may also serve the objective of preventive detention.

Therefore, the real problem is whether or not the accused can be taken into custody to prevent a future offense in the absence of circumstances which do not place the accused in one of the three categories.

Arguments for the need for preventive detention are based upon the provision of statutory exceptions to bail as a matter of right for the defendant. Article 89 of the Code of Criminal Procedure provides these exceptions in the following circumstances:

1. where the accused is charged with an offense punishable by death or by imprisonment for a minimum period of not less than one year;
2. where the accused has been previously convicted of an offense, punishable by death or imprisonment for a maximum period of not less than ten years;
3. where the accused has habitually committed an offense punishable by imprisonment for a maximum period of three years or more;
4. where there are reasonable grounds to suspect that the accused may destroy or conceal evidence;
5. where there are reasonable grounds to suspect that the accused may threaten or cause injury to the person or property of the victim of an offense, to some other person who is considered to have knowledge necessary for the trial of the offense, or to the relative of such a person;
6. where the name or dwelling of the accused is unknown.

Among these exceptions, the sixth involves instances of non-appearance of the defendant in court. The fourth exception indicates the necessity of preventing the accused from suppressing evidence. Some writers argue that the second, third and fifth exceptions were intended to prevent the accused from repeating offenses, to guard public safety, and to permit the consideration of the defendant's dangerousness in the determination of release.

4. Penal Code (Keihō), Law No. 45 of 1907, art. 105-2.
and bail. These writers conclude that preventive detention is another goal of pretrial custody.

Nonetheless, the seriousness of a crime, presently charged or previously convicted, and the defendant's criminal habit may be related to the goal of securing the attendance of the accused in court. In these cases the deposited bail money is insufficient to prevent fleeing, because of the probability that very severe punishment will be imposed. Furthermore, threatening of the victim or others may justify the detention of the accused. If one can be detained for the objective of the prevention of future offenses, the detention is "purely preventive detention." Such actions are unconstitutional.

3. Detention to Obtain Confession

As described above, it is widely agreed that the objectives of pretrial detention are to secure attendance of a suspect or defendant at relevant proceedings, and to prevent the accused from destroying or concealing evidence. Few writers agree that obtaining a confession from the accused is a goal of pretrial detention. If one can be detained for obtaining a confession or for interrogation, the detention becomes a tool to coerce a confession.

In practice, detention of an accused is used for interrogation and for the obtainment of a confession. This is particularly apparent when the accused denies the charge. In these circumstances, the probability of pretrial detention is substantially high. The perception that "confession is king of evidence" has had strong impact upon the administration of Japanese criminal justice.

B. Time Limits Set By Law

The Code of Criminal Procedure of 1948 adopts two principles which restrict prolonged detention.\(^5\) The first is to provide a specific period of detention as in the German concept. The second is the system of requiring bail as in Anglo-American law. The following will focus on the first principle.

1. The Detention of a Suspect

Under the Japanese system, the arrest of the suspect is a prerequisite of his detention. An arrested suspect is taken into

custody in a police lock-up cell. If the police believe detention is necessary, the police must follow the procedure of sending the arrested suspect with the relevant documents and evidence to the public prosecutor's office within forty-eight hours of his arrest.\(^6\) Otherwise, the suspect must be released immediately. If the public prosecutor considers the detention of the suspect necessary and supported by reasonable grounds, he must, within twenty-four hours after receiving the detained suspect, request a judge to issue a warrant for detention. The request must be made within seventy-two hours of the arrest.

If the judge decides that the suspect should be detained, the maximum term of the detention is initially ten days from the date that the prosecutor petitioned for the term of detention. The term can be extended by the judge to a total of twenty days. Cases which involve insurrection or riot, or when crimes concern foreign aggression or foreign relations can justify another extension, but this cannot exceed five additional days.\(^7\)

2. *The Detention of the Defendant*

When the suspect is prosecuted, the suspect becomes a defendant. At the time of the institution of the prosecution, the suspect has been either: (1) already detained; (2) arrested but not detained; or (3) not yet arrested. If the case is prosecuted while the suspect is detained, detention automatically becomes the detention of a defendant. The term begins on the day of the institution of the prosecution. In order to detain a defendant who has been arrested but not detained or who has not yet been arrested, a warrant must be issued by the court.

The defendant can be detained two months from the day of the institution of the prosecution. However, detention can be prolonged for a one month period by a court decision which states concrete reasons for renewal. Therefore, detention is usually limited to a maximum of three months after the institution of the prosecution.\(^8\) There are exceptions to this limitation on the number of times it can be renewed. First, after the defendant has been sentenced to confinement or a more severe penalty, the

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\(^6\) *Code,* art. 203.

\(^7\) *Code,* arts. 205, 208, 208-2.

\(^8\) *Code,* art. 60(2).
limitation on renewal does not apply. This is primarily beneficial at the appellate level, in order to secure appearance in the subsequent proceedings including imprisonment. Second, the defendant can be detained for more than three months by renewal of detention on a monthly basis in one or more of the following circumstances:

1. the defendant is charged with an offense punishable by death, life imprisonment or a minimum period of imprisonment or confinement for one year or more;
2. the defendant is a habitual offender who has committed an offense punishable with a maximum period of imprisonment or confinement of three years or more;
3. there is adequate reason to suspect that the defendant will destroy evidence of the crime; or
4. the name or residence of the defendant is unknown.

These limits are generally observed in practice. However, it should be noted, that the detention of a defendant can be renewed on a monthly basis in certain circumstances described above and there is no limitation on the total period set by the law. In addition, when the case is complicated, of large scale, or of political backgrounds, it sometimes takes years to get the case to trial. Consequently, in some cases the defendant can be detained nearly as long as, or even longer than, the term of imprisonment which can be imposed upon him.

When the reasons or the necessity for confinement of the accused cease to exist, the court must revoke the detention either upon request or upon its own authority. In addition, when the detention has been unduly prolonged, it must be revoked by the court. This is directly tied to the question of coerced confession.

3. The Bail System and the Suspension of Execution of Detention

The second principle to restrict prolonged detention in Japanese criminal procedure is the system of requiring bail as in Anglo-American law. The defendant under pretrial detention may

9. Code, art. 344.
10. Code, arts. 60(2), 89.
11. Code, art. 87.
12. Code, art. 91.
be released on bail, by the suspension of an execution of detention, or by the revocation of detention.

There are two bail systems in Japan: bail as a matter of right and discretionary bail. A detentioner has the right to request a bail, unless he falls into the one or more of the exceptions described above. His counsel, legal representative, curator, spouse, lineal relatives, and siblings also may request the release on bail. Partially because the exceptions to bail as a matter of right are rather broad, the grant is largely discretionary. Money must be deposited at the court for bail, and someone other than the accused may make the deposit. The bail money should be fixed to an amount sufficient to insure the appearance of the defendant. In granting bail some conditions may be imposed, and the court may revoke bail in certain cases upon the request of a public prosecutor or upon its own authority.

The court may also suspend the execution of pretrial detention in such cases of personal necessity as to attend the funeral service of a family member. Like bail, this is another type of conditional release of detentioner. However, unlike release upon bail, a deposit is not required for the suspension of execution of detention. The system derives from oriental tradition. When deciding on suspension, the court may impose conditions restricting the residence of the defendant or placing him in the custody of relatives or others. When the necessity giving rise to the suspension ends, he is to be reconfined.

III. RIGHTS OF DETAINDEES

A. Specific Rights of Detainees

The Constitution of Japan of 1946 proclaims a number of human rights in criminal justice, reflecting a reaction against the serious infringements of civil liberties in the pre-war and war period. Article 31 is deemed to be the general clause which safeguards due process, providing that no person shall be deprived of life

13. Dando & Tamiya, supra note 6, at 325.
14. Dando & Tamiya, supra note 6, at 334. The exceptions were widened by the amendment of 1953. In particular, it included all offenses punishable with imprisonment of more than one year.
15. CODE, art. 96.
16. CODE, art. 95.
or liberty, nor shall any other criminal penalty be imposed, except according to procedure established by law.

Article 34 of the Constitution sets forth the specific rights of those accused or detained. First, no person shall be arrested or detained without being at once informed of charges against him or without the immediate privilege of counsel; nor shall he be detained without adequate cause; and upon demand of any person such cause must be immediately shown in open court in his presence and the presence of counsel.

Article 36 of the Constitution absolutely forbids the infliction of torture by any public officer. Article 38 also provides that no confession is admissible in evidence if it is made "under compulsion, torture or threat, or after prolonged arrest or detention." This is intended to indirectly control the conditions of detention through limitations on the use of confessions.

In addition, under Article 40, any person may, in the event that he is acquitted after he has been arrested or detained, sue the State for redress. The Criminal Compensation Law was put into effect in 1950, which provides monetary compensation for the period of detention.

These constitutional rights are given concrete form, and extended in specific aspects, by the Code of Criminal Procedure and related legislation. Among them, a detention hearing is a prerequisite to detain a suspect or defendant. The commitment of the defendant must not be done unless and until the court informs the defendant of the case and has heard the defendant's statement with regard thereto. The summons, taking in custody, or commitment of a defendant must be done by issuing a warrant for custody or detention. In the case of detention of a suspect, a court judge in charge issues the warrant and holds the detention hearing.

As shown above, there are two types of conditional release, namely the bail system and the suspension of the execution of detention. The Code guarantees a defendant under detention the right to request release on bail. However, bail is not available to a detained suspect at all, unlike the Anglo-American system.

The Code also provides for the system of obliging disclosure of reasons for detention, which is unique to Japanese criminal procedure. This is in accordance with Article 34 of the Constitution which states that adequate cause of detention must be immediately shown in open court in the presence of the accused
and the presence of counsel. Detainees also have the statutory right to appeal a court's ruling or a judge's order of detention. Needless to say, however, the biggest problem is how and to what extent these rights are observed in practice in the administration of the system.

B. The Right To Counsel

The question here is whether the person arrested or detained is entitled to legal representation from the very beginning. According to the Constitution, the answer is yes. As described above, Article 34 of the Constitution provides that the right to counsel is "an immediate privilege," upon arrest or detention. In addition, Article 37 Section 3 of the Constitution proclaims that the accused shall have the assistance of competent counsel "at all times," and if the accused is unable to secure the counsel by his own efforts, then the State must assign the same to his use.

The Code of Criminal Procedure has several specific provisions which embody the right to counsel for detainees. Article 30 of the Code sets forth that the defendant or the suspect may obtain counsel at any time. Furthermore, Article 36 of the Code states that if the defendant cannot afford to obtain counsel because of poverty or other reasons, the defendant has the right to request the appointment of counsel. This is the "state-appointed counsel," which is in accord with the Constitution, as mentioned above. However, it is apparent in the Constitution as well as in the Code of Criminal Procedure that a suspect does not have the right to "state-appointed counsel." 17

According to requirements for procedure after arrest, the police official or the public prosecutor must immediately inform the arrested suspect of the right to obtain counsel. 18 But arrested suspects do not have the right to the "state-appointed counsel," as described above. When the accused (either suspect or defendant) is detained, he must also be notified of his right to obtain counsel. 19 But if the accused has been continuously detained after

17. Nonetheless, this does not imply that the Code cannot be amended in the future in order to extend the right to a suspect.
18. CODE, arts. 203, 204.
19. CODE, arts. 77, 207.
the arrest or since he was taken into custody, additional notification of the right to obtain counsel is unnecessary. When the defendant or the suspect has been taken by order of the court to a specific place, such as court,\textsuperscript{20} he shall be notified immediately of his right to counsel.\textsuperscript{21} In this case a defendant may also request the court to appoint counsel, if he cannot afford one, but a suspect may not.

Thus, whenever the accused is unable to obtain counsel because of poverty, the court must appoint a counsel either upon a request or upon its own authority. However, this only applies to defendants, not suspects. As many suspects are indigent, they do not have counsel at the very crucial stage of police interrogation.

\textbf{C. Lawyer’s Access To His Detained Client}

Whether a lawyer has unrestricted access to his detained client and whether the lawyer and client can communicate in private has given rise to some questions. The answers are generally yes, but there are some considerable exceptions. A defendant under detention has the free and unfettered right to an interview with counsel without anyone’s attendance and to pass items, such as documents and other matters, to each other.\textsuperscript{22} As this interview is very important to defense preparations, it is usually unrestricted. Therefore, though this right is provided \textit{prima facie} by the Code of Criminal Procedure, it is deemed to be the corollary to Articles 31 and 34 of the Constitution of Japan by which the adversary system of criminal procedure is introduced.

Nonetheless, some rights stipulated by law and administrative rules can be taken by the authorities, if necessary, to prevent the escape of the accused, the destruction or concealment of evidence, or the receipt of matter which could endanger his safe custody.\textsuperscript{23} But even in such a case the accused may not be denied the essential right to an interview with counsel without the attendance of others.

\textsuperscript{20} CODE, art. 58.
\textsuperscript{21} CODE, art. 78. In practice, this right is not necessarily conveyed to the suspect immediately after he is taken into custody. Instead, the notification of the right to appoint counsel is usually postponed until the beginning of the procedure for detention, in which the accused is informed by the public prosecutor of the charges against him and allowed to make a statement concerning them, within 24 hours of being taken into custody. CODE, art. 59.
\textsuperscript{22} CODE, art. 39(1).
\textsuperscript{23} CODE, art. 39(2).
If the accused is not a defendant but a suspect, other restrictions may be imposed upon the counsel’s access to a detained client. Article 39 Section 3 of the Code provides that the day, time and place of the interview or the receipt and delivery of tangible objects may be specified by a public prosecutor, an assistant officer, or a judicial police official, when this is necessary to the investigation. However, this specification is allowed only prior to the institution of prosecution. Furthermore, the right of the suspect to prepare a defense should not be restricted improperly by this specification.

In practice, many lawyers have been denied access to the detained suspect by undue designation prior to police interrogation of the client. More important, the lawyer is not allowed to attend the client’s interrogation.

Japan was democratized after World War II and the Constitution of 1946 is one outcome of that process. It has a number of provisions that protect the defendant’s rights in criminal proceedings.

Needless to say, this is an improvement on the pre-war positions. The protection of rights in the criminal procedures has gradually expanded in many other civilized countries. However, Japan has been left behind, and a number of tasks of reform remain.

Neither the Constitution of Japan nor the Code of Criminal Procedure provide the suspect with state-appointed counsel. They only provide the defendant with the right to state-appointed counsel. Therefore, at the very early stage of the criminal procedure, the suspect usually cannot put forth an efficient defense partially because many suspects are indigent and cannot afford to obtain counsel, and there is no public defender system. In addition, the counsel may not be present with the suspect or the defendant during police interrogation. Finally, more important, “substitute prison” has not been abolished.

IV. “SUBSTITUTE PRISON”: HOTBED OF FALSE CRIMINAL CHARGES AND CONVICTIONS

A. Institutions Of Detention In Japan

Detainees are confined in a police custody cell (ryuchi-jo) or a Detention Center (kochi-sho). A juvenile can also be detained in

a Juvenile Detention and Classification Home (kanbetsu-sho).

The arrested person is first taken into custody in a cell of a police station, if detention is needed. The suspect may be transferred to the Detention Center when further detention is necessary. In Japan, however, unlike many other civilized countries, a police custody cell, which is in a police station and administered not by the Ministry of Justice but by the police authorities, can also be utilized as substitute prison (daiyo-kan-goku).

Therefore, in most cases, the accused who has been taken to the court for detention hearing is sent back to a police custody cell, instead of the Detention Center. The present Prison Law, enacted in 1908, provides that a police cell may be substituted for a prison. The substitute prisons were created as a temporary measure to ease prison overcrowding, but have been utilized for over eighty years. This substitute prison is, in current practice, only used to detain the accused, mostly suspects.

The place of detention is decided on by the judge or court which decides to detain the suspect or defendant. Usually the public prosecutor recommends the place where the suspect is to be detained when the court is petitioned to detain the suspect.

A suspect is more likely to be detained in a police custody cell as a "substitute prison" for the following reasons. First, Detention Centers are far fewer in number (only 115 institutions in the country) than substitute prisons (1,253 institutions for substitute imprisonment in the country), have only limited capacities, and are often located far from police stations and residences of the accused.

In addition, public prosecutors usually prefer to allow the police to interrogate the suspect freely. Therefore, the prosecutor is

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27. Ogawa, Japan in 2 Criminology: A Cross-Cultural Perspective (D. H. Chang ed. 1976). The Prison Law provides for four kinds of penal institution (kangoku, prison): (1) prisons for persons sentenced to imprisonment with hard labor; (2) prisons for persons sentenced to imprisonment without hard labor; (3) houses of penal detention for persons convicted to penal detention under 30 days; (4) detention houses (Detention Center) to detain defendants or suspects. Thus, in Japan, "prison" is, strictly speaking, the general term for all these institutions. Usually each prison has the facilities of all four types. In larger cities separate and independent Detention Centers have been established.
28. Prison Law, art. 1(3).
more likely to recommend custody in a police cell than in a Detention Center. The judge is also inclined to detain the suspect in a "substitute prison" not only for a lack of capacity, but for other reasons as well. Today quite a few judges are unwilling to reject the recommendation of the prosecutor and prefer to support the conveniences of police interrogation rather than protect the rights of the accused.

Today most arrested suspects are detained in ryuchi-jo as the result of substitute imprisonment, while defendants who need to be detained are usually put in a Detention Center. The detained suspect is very often transferred from a ryuchi-jo to a Detention Center after the institution of prosecution.

B. A Hotbed Of False Charges And Convictions

Needless to say, "substitute prison" has been very advantageous to the police. The suspect continues to be under the custody at the police station for a prolonged period, because a transfer to the Detention Center becomes unnecessary until institution of prosecution. If the suspect is detained in a Detention Center, which is run by the Justice Ministry, police interrogation is restrained by the rules and regulations of the Center.

The police can have unrestricted power to interrogate a suspect detained in a "substitute prison" for many hours. Many cases of torture have been reported. It can be inflicted in a closed interrogation room or a custody cell. The police can easily restrict and control the communication between the detainee and those in the outside world, including counsel. Unlike in the United States where Miranda rules prevail, in Japan the presence of an attorney is not required at the police interrogation of the suspect. Even free access between the attorney and the accused client can be controlled by the police in terms of designation of time and place of interview in the interests of police investigation.

31. Id.
33. Igarashi, supra note 32, at 16.
Arrested suspects also suffer from desperate physical conditions in many substitute prisons. Those conditions are often worse than the conditions of the Detention Centers, or of prisons, even though the incarceration of the arrested suspects is not for punishment and the suspects should be treated as innocent until they are convicted and sentenced to prisons. Usually the air-conditioning is bad, the space of a cell is extremely narrow, the bedding is dirty, and the meals are inadequate. In addition, the Chiefs of investigation units have broad discretionary power over what should be permitted for the detainee. Consequently, the detainee's attitude toward the police authorities becomes an important factor in the Chief's use of the power. When the accused denies the charged facts or refuses to confess, the police get bad impressions and this may easily result in conditions disadvantageous to him. In order to avoid these inhuman conditions of substitute prisons, the accused occasionally "confesses" the facts falsely charged.

To make matters worse, statements made by the suspect during police interrogation may easily be presented at the subsequent court trial as an exception to the hearsay rule in evidence. Even if the accused denies the charge against him and insists at the court hearing that the confession was obtained by unduly prolonged interrogation and coercion, judges prefer to accept the prior confession. It can be said, therefore, that the "substitute prison" is the largest hotbed of false charges and convictions in Japan. Recently several convicted prisoners, including four persons on death row, have been acquitted as the result of retrial many years after conviction.

On January 31, 1989, Shizuoka District Court declared that Masao Akabori, fifty-nine years of age, was not guilty. This is

34. Id. at 10.
35. CODE, art. 322 provides as follows:

A written declaration made by the accused or the deposition of the accused which is signed or sealed thereby may be made as evidence only when such declaration contains the admission of facts disadvantageous to the accused, or when it is made under the particularly credible circumstances. The document containing the admission of facts disadvantageous to the accused, however, may not be made as evidence, when it is deemed that such admission is doubtful of having been not made involuntarily.

In practice, court judges have been reluctant to look into whether or not "the particularly credible circumstances" actually existed, or whether or not such admission of facts were made voluntarily.
the fourth case of retrial of an inmate on death row who was convicted. Akabori was arrested on May 28, 1954, for the charged murder of a little girl which took place in Shimada City on May 10, 1954. After arrest, he was incarcerated in institutions with maximum security for more than thirty-four years and threatened with execution of capital punishment. He was convicted and sentenced with the death penalty in 1958. After the Supreme Court upheld his conviction in February of 1960, he applied for retrial several times. In May of 1986, Shizuoka District Court decided to retry the case. In the Shimada case, like in other cases, Akabori confessed to the murder while he was detained in a “substitute prison” in the Shimada Police Station. His confession turned out to be false.


A new Bill of the Penal Institutions Law (the new Prison Law) and A Bill of the Law of Police Custody Facilities have been proposed by the Government in the Diet since 1987. The pro-

36. Menda, Saitagawa, Matsuyama, and Shimada were such cases.
Sakae Menda was sentenced to death on March 22, 1951 by the Kumamoto District Court for conviction of robbery causing death. His sentence was upheld by the Supreme Court on December 25, 1951. He applied for retrial several times but failed. The Fukuoka High Court decided to accept his sixth application for retrial on September 27, 1979. The Supreme Court upheld this decision and ordered retrial in December of 1980. On July 15, 1983, the Yatsushiro Branch of the Kumamoto District Court finally declared that Menda was not guilty. See Kumamoto District Court, Yatsushiro Branch decision, HANJI No. 1090 at 21 (July 15, 1983). As the Public Prosecutor’s Office did not appeal against it, this decision became determinate. He had been incarcerated for more than 34 years since his arrest by the police when he was 23 years old, and had been under the sentence of the death penalty for more than 33 years. When finally acquitted, he became 55 years of age. See IGARASHI, supra note 32, at 9 n. 6.
As to the retrial decisions of non-guilty of the Saitagawa case and the Matsuyama case, see HANJI No. 1107 at 13 (Takamatsu Dist. Ct., March 8, 1984) and HANJI No. 1107 at 1127 (Sendai Dist. Ct., July 11, 1984), respectively.
There have been several retrial cases in which the applicants had been imposed severe penalties including life imprisonment and finally obtained acquittals. See IGARASHI, supra note 32, at 1-30.
In most of these cases, “substitute imprisonment” in police custody cells was a hotbed of false criminal charges and convictions.

37. The first drafts of the Bill of Penal Institutions Law and the Bill of the Police Custody Facilities Law were introduced by the Government in the Diet in April of 1982. But the Diet did not pass the Bills. Meanwhile, the proposals were withdrawn in November of 1983 as a result of dissolution of the Diet.
posed legislation would recognize "substitute prisons," make them permanent institutions, and thus strengthen the power of police to interrogate detainees and keep them from interviews with their lawyers. The Government also has financially supported the police to improve physical conditions of custody cells and created administrative units in charge with custody cells which are "independent" from the division of investigation in police stations, trying to avoid criticism of the public opinion. But these efforts obviously also intend to make "substitute prisons" permanent, and reject proposals to abolish them.

The Japan Federation of Bar Associations and liberal reformers and writers have been campaigning against the proposals very strongly for over ten years. Recently, Japanese lawyers have started an international campaign, arguing that the practices of the Japanese police violate international law, such as Article 5 of the Universal Declaration of Human Rights of 1948, which prohibits infliction of torture, and the Covenant on Civil and Political Rights, which also prohibits infliction of torture and seems to require that pretrial detainees be held in custody by the prison authorities, not by the police which have the power to investigate the case.

V. CONCLUSION

I would suggest the following proposals to solve the problems of substitute imprisonment as a hotbed of false criminal charges and convictions in Japan.

(1) "Substitute prisons" should be gradually replaced by Detention Centers and finally abolished in the near future.

38. See Igarashi, supra note 32, at 1-30.
39. See Feely, supra note 32 (unpublished manuscript at 11).
40. The Covenant, based on the Universal Declaration of Human Rights, was adopted by the United Nations in 1966. The Government of Japan signed it in 1978 and it was ratified in June of 1979 and came into effect in September of 1979.
41. The first sentence of art. 9, § 3 of the Covenant provides that "anyone arrested or detained on a criminal charge shall be brought promptly before a judge or other officer authorized by law to exercise judicial power." The Government is counterarguing that it does not necessarily exclude "substitute imprisonment" in a police custody cell, because it does not mention the subsequent detention. On the other side, the 12th Congress of The International Association of Penal Law (September 1979, Hamburg) passed a resolution that the accused should not be returned to police custody after having been taken before a judge.
(2) The right to state-appointed counsel should be extended to the suspect.
(3) Counsel should be able to be present with the suspect or defendant during interrogation by the police or public prosecutor.
(4) The lawyer’s access to his client, and the client’s access to his lawyer, should not be unduly limited for the convenience of interrogation.
IS THE DOOR HALF OPEN OR HALF SHUT?
JAPAN'S SPECIAL MEASURES LAW CONCERNING
THE HANDLING OF LEGAL BUSINESS BY FOREIGN
LAWYERS

Linda A. Cooper

I. INTRODUCTION

On March 16, 1986, The Special Measures Law Concerning the Handling of Legal Business by Foreign Lawyers (hereinafter Law No. 66) was unanimously approved by the Japanese Diet. When Law No. 66 went into effect on April 1, 1987, it ended a thirty-one year prohibition on foreign legal services in Japan. The legislation allows lawyers who have met certain requirements and have practiced for five years in their country of qualification to be admitted to a limited form of practice.

This paper will first briefly cover the role of the bengoshi (lawyers) in light of Japan's unique history, culture and legal structure. It will then review the laws that regulated foreign lawyer practice in Japan before 1986. Finally, Law No. 66 will be analyzed as to its promulgation, the application and registration process, the scope of practice afforded foreign lawyers and the implementation of law.

II. THE LEGAL PROFESSION IN JAPAN

A. The Paucity of Attorneys

In 1981, Japan had only one attorney for every 9,662 people; in America there was one attorney for every 515 people. Cali-
fornia, with a population one-fifth the size of Japan’s, boasted more attorneys. A later commentator reported that in 1986, Japan had 11,000 attorneys for a population of over 120 million or one attorney for every 10,000 people; the United States had over 400,000 attorneys for a population of 235 million or one attorney for every 500 persons. A 1988 report found that Japan’s population of nearly 118 million people was served by roughly 16,000 lawyers, approximately one attorney for every 7,375 persons. Per capita, Canada had ten times more lawyers; the United States had seventeen times more. Why is there this apparent paucity of attorneys?

B. The Role of Non-Lawyers

First it must be noted that the Japanese bengoshi are only a small part of what would be the equivalent of the legal profession in the United States. Japan has a large number of non-lawyers that provide quasi-legal services which American attorneys routinely perform.

The seven main categories of non-lawyers are: 1) legal specialists employed by the government to draft legislation, rules and regulations for the Diet; 2) in-house legal advisors employed by trading companies to perform all legal work other than litigation; 3) judicial scriveners who draft court documents and do title transactions for land; 4) benrishi who have the power to give legal advice and represent clients in court on patent and trademark work; 5) tax attorneys who give legal advice and represent clients on tax matters before the Tax Court; 6) administrative scriveners who specialize in preparing and recording nonjudicial documents filed with the government; and 7) law professors who rarely practice but are allowed to give opinions on legal matters. In 1982, the estimated number of individuals in these categories totaled 79,000. With the addition of these professionals, the Japanese legal force is approximately 100,000 strong.

5. Id.
8. Id. at 357-58.
9. Michaud, supra note 6, at 28.
10. Id. The totals for the respective categories were: 2,000, 6,000, 15,000, 2,500, 35,000, 16,000, and 2,500.
C. History

Prior to the Meiji Restoration in 1868, the legal profession as such did not exist in pre-modern Japan. There was really no demand for it in a society built on Confucianism. The Japanese belief was that the individual should promote harmony by accepting his position in the world. Conflict and individual rights were inconsistent with societal harmony; litigation equated with disharmony.

With the adoption of a written system of law after 1868, a need slowly grew for a legal profession to interpret such laws. The first kujishi (tax teachers or experts) were innkeepers in the neighboring area of the Japanese Government's Administrative and Tax Office in Tokyo. These early legal counselors developed a practice of giving advice to those persons scheduled to appear before the courts. They quickly acquired a poor reputation because it was believed that they took money to bribe officials and intentionally prolonged litigation to extend their clients' stays at their inns!

It was not until 1872 that representation by counsel in civil cases was given formal recognition. In 1876, the Ministry of Justice set standards for those who wanted to be legal counselors. Unfortunately the legislation was not successful in regulating the profession because those who had not taken the specified exam continued to represent litigants in court.

The first Bengoshiu Ho (Lawyers Law) of 1893, introduced the term bengoshi. It was coined as the nearest equivalent of the English concept of a barrister. Bengo means defense, exculpation
or justification; adding shi to the end of the noun indicates a person who engages in these practices. The main purpose of the 1893 law was not to regulate the profession as a whole but rather to control only those who appeared before the courts and administrative agencies. In practice, the Lawyers Law of 1893 did little to advance the profession because of the numerous exceptions it created to the examination requirements.

After decades of governmental domination, the Lawyers Law of 1949 finally gave control of the bar to the newly-created Nichibenren, the Japanese Federation of Bar Associations (hereinafter JFBA). The Ministry of Justice created the Legal Training and Research Institute in attempts to standardize legal education and create a more cohesive legal profession. For the first time, all three branches of the legal profession - bengoshi, judges and prosecutors were required to have the same training.

D. The Legal Training and Research Institute

A further reason for the scarcity of attorneys can, therefore, be attributed to the fact that there is only one law school in Japan - the Legal Training and Research Institute in Tokyo. Under Article 4 of the Lawyers Law of 1949, a person must graduate from the Institute before he/she can practice law as a bengoshi. Students are compensated as employees of the Ministry of Justice; for this reason the Institute justifies limiting admission to persons of Japanese origin.

Legal education in Japan is initially an under-graduate education; the first degree obtained is a LL.B. Of the roughly 30,000 applicants who annually take the national entrance examination for the Institute, less than two percent are accepted. The two-

20. Shapiro & Young, supra note 11, at 27.
21. Id. at 27-28. To this date, Japan does not have any statutory regulation for the giving of legal advice in nonlitigious settings.
22. Shapiro & Young, supra note 11, at 28-29.
24. Hahn, supra note 4, at 522.
25. Id. at 522-24.
26. Uchtmann, supra note 7, at 357.
28. See Hahn, supra note 4, at 522-23.
year program of instruction and apprenticeship focuses on trial skills and is supervised by the Supreme Court. Of the 500 annual graduates, approximately 370 become attorneys; the balance become judges and prosecutors. Again note the disparity between this number and the thousands of American law school graduates who join the ranks of the legal profession yearly.

E. The Myth of Non-Litigiousness

As one American writer so pointedly put it:

When the time comes in Japan that a man takes pride in having pursued his rights to the point of clear-cut victory over a rival, when discrediting another becomes preferable to a compromise that leaves both parties with their dignity intact, then the government of Japan will be unable to resist the pressure to unleash the hordes of lawyers and judges required to satisfy those demands and perhaps create new ones as well. That day is still far off, if it is to come at all.

Not so many years ago, many commentators explained the lack of Japanese attorneys almost solely upon the non-litigious nature of the people. This unwillingness to litigate was based primarily on a cultural proclivity towards maintaining wa (harmony) in the society; this was considered to be more important than the determination of individual rights.

It is undeniable that some of the doctrines of Confucianism are still revered by many Japanese people. There are, however, other factors which should be considered in the explanation of the lower number of lawyers and law suits per capita. One commentator suggests that there are far fewer transactions of the kind that are most likely to lead to law suits. An example of this can be drawn from the differences in the driving patterns in Japan and the U.S., the discrepancy in the death rates (Japan's being only 20 percent of America's) and the resulting decrease in volume of accident litigation.

The built-in barriers of the legal system are undeniable reasons why the Japanese don't turn to litigation as quickly as their American counterparts. These include the high filing fees, such

29. See Miller, supra note 27, at 205 and Shapiro & Young, supra note 11, at 30.
30. Hahn, supra note 4, at 525.
32. Miller, supra note 27, at 207-08.
as $5,000 for a $1 million suit and the requirement of an initial retainer fee as well as a contingency fee. These fees are based upon a percentage of the economic value of a claim and are set by the JFBA. Under this fee schedule, a $1 million law suit would cost the litigant over $41,000 for the retainer fee.

Furthermore, a Japanese plaintiff does not have the opportunity of presenting a case before a jury to decide the monetary value of his/her claim. "[T]here is fairly widespread reliance on non-official schedules of damages and fault, developed principally by the Japan Federation of Bar Associations based on studies of actual decisions, in determining the value of a claim for purposes of a lawsuit and, most importantly, for purposes of settlement during mediation." If a decision to litigate is made, the backlog of cases makes the wait unreasonable. Japan had fewer lawyers and judges per capita in 1984 than it did fifty years ago; judges attempt to handle caseloads five times greater than those of U.S. federal judges.

These governmental policies and controls remove both the incentive and the avenue for litigation; the cultural nonlitigiousness of the Japanese people is a diminishing factor.

III. REGULATION OF FOREIGN LAWYER PRACTICE

A. The Laws Through 1955

The Advocate Regulations of 1876 were the first to regulate the practice of law by foreign lawyers. The Lawyers Law of 1933 allowed foreign lawyers to maintain offices and handle cases involving foreigners or international matters provided that the lawyers came from countries which recognized reciprocity. The Lawyers Law of 1949, followed World War II and reflected a "broad international viewpoint and extremely open approach."
Article 7 allowed qualified foreign lawyers to practice in matters relating to Japanese law or foreign law without meeting the previous reciprocity requirement. This open door policy led to a steady flow of foreign attorneys into Japan. These junkaiin (associate members) were given membership in the national and local bengoshi associations.

The door shut with a bang, however, with the passage of the Lawyers Law of 1955. The legal market was completely closed to foreign lawyers not already established. This law repealed Article 7 of the Lawyers Law of 1949 and brought about two important consequences: 1) the existing junkaiin were allowed to remain and practice, and 2) all other foreign lawyers' access was limited to establishing themselves as trainees for Japanese law firms. Of the original 68 junkaiin who qualified between 1949 and 1955, a remaining few were still in practice in 1987.


In the beginning of this period, foreign lawyer practice was limited to young lawyers working as trainees in Japanese firms. As time progressed, a number of more senior foreign lawyers were granted visas which allowed them to "engage in professional business activities" for short periods of time. In 1977, Milbank, Tweed, Hadley & McCloy of New York, was given permission to set up a Tokyo office; the government also gave its approval for Johnson, Stokes & McMaster of Hong Kong to establish an office. The JFBA strongly disapproved of these allowances and subsequently, the government did not issue any long term visas to foreign attorneys.

Through the late seventies and early eighties, the American Bar Association (hereinafter ABA) actively lobbied the U.S. government to pressure Japan to lift the barrier against practice by

41. Note, supra note 19, at 1492.
42. Note, supra note 1, at 33.
43. Note, supra note 19, at 1492-93.
44. Note, supra note 1, at 33.
46. Note, Providing Legal Services in Foreign Countries: Making Room for the American Attorney, 83 Colum. L. Rev. 1767, 1767 n.3 (1983).
47. Note, supra note 1, at 35.
48. Id.
foreign lawyers. In March of 1982, the government included this bar on the list of nontariff barriers that it wished Japan to remove. The Japanese government said that the barrier existed because of the difference in the respective legal systems and that the regulation of the bar was left mainly to the profession. It did, however, promise to further talks between the ABA and the JFBA.

In November 1982 and February 1984, representatives from the two bar associations met to exchange information on world practices regarding foreign lawyers. Many bengoshi naturally questioned the right of American lawyers to practice in Japan without going through the same rigorous process as they had. Others were concerned with the ability of the government to monitor and maintain the high quality of legal services to be rendered by foreign lawyers. Some believed that the regulation of the legal profession should be a purely internal matter. Needless to say, thoughts of giving up a monopoly on legal services had to have crossed more than one bengoshi mind.

The American representatives asserted that their practice would not trespass upon the territory of the bengoshi. They contended that the nature of the services which they would provide would be non-litigating ones involving financial transactions, which require skills in document drafting in English and experience in international business practices.

An argument was made that the barring of American lawyers from the practice of law in Japan was an implicit violation of the Treaty of Friendship, Commerce and Navigation which had been entered into in April of 1953. Article VIII, paragraph one reads as follows:

National and companies of either Party shall be permitted to engage within the territories of the other Party, accountants and other technical experts, executive personnel, attorneys, agents and other specialists of their choice. Moreover, such nationals and companies shall be permitted to engage accountants and other technical experts regardless of the extent to which they may have qualified for the practice of a profession within the territories of

49. Shapiro & Young, supra note 11, at 35.
50. Id. at 33.
51. Id. at 33-34.
52. Id.
53. Id.
such other Party, for the particular purpose of making examina-
tions, audits, and technical investigations exclusively for, and ren-
der reports to, such national and companies in connection with the planning and operation of their enterprises, and enterprises in which they have a financial interest within such territories. 64

Although Article 98(2) of the Japanese Constitution states that treaties concluded by Japan shall be faithfully observed,65 the JFBA flatly rejected the treaty violation argument.

After continued pressure by the representatives of the Office of the United States Trade Representative, the exchange of several proposals by a subcommittee of the JFBA, numerous American counter proposals and a plethora of meetings of the representatives of the two countries, an overwhelming majority66 of a general meeting of the JFBA approved a final resolution in December of 1985.67

IV. LAW NO. 66 - 1986

A. Promulgation

The final version of Law No. 66 was introduced into the Lower House of the Diet in late March of 1986; it was unanimously approved by the Upper House on May 16, and went into effect April 1, 1987.68 Article I states the purpose of the law as being:

[T]o open, under guarantees of reciprocity, a path whereby persons qualified as foreign lawyers can handle, in Japan, legal business concerning foreign law, and by providing special measures imposing, inter alia, order similar to that applicable to bengoshi on the handling of such legal business, to promote stability in relation to international business law affairs, as well as to contribute to improvement to the handling, in foreign countries, of legal business concerning Japanese law.69

B. Application and Registration Process

A foreign applicant must submit a written application together with a fee to the Ministry of Justice. The criteria for approval are:

55. Note, supra note 19, at 1494.
56. Shapiro & Young. supra note 11, at 43.
57. Id.
58. Note, supra note 1, at 32.
59. Id. at 38.
1. Applications must have practiced as lawyers in the foreign jurisdiction in which they were originally licensed for more than five years;
2. Applicants must not have been sentenced to imprisonment or a graver punishment by the law of their own country or have failed other ethical or competency standards; and
3. Applicants must have sufficient financial resources to establish themselves as foreign legal consultants and must be capable of indemnifying their clients against loss or damage arising from their performance.60

Upon the Ministry's approval, notice is published and the foreign lawyer has six months to submit an application for registration with the JFBA.61 This is done through the local bengoshi association to which the lawyer wants to be admitted and further requires recommendations from two current bar members. Applications are forwarded to the eight-member Foreign-Law Jimu-Bengoshi Registration Inspection Bar.

The bar may deny registration for a specific reason or because the applicant is "likely to be unsuitable in practicing law as a foreign lawyer."62 The bar may also refuse registration if it is feared that the person will "disturb the order or injure the reputation of a bengoshi association"63 or the JFBA. Furthermore, a foreign lawyer may be refused if he/she is physically handicapped. Notice and reasons must be given to any applicant whose registration is refused; the Tokyo High Court hears any challenges.64

Once admitted to the bar under Law No. 66, foreign lawyers are recognized as Gaikokuho Jimu Bengoshi, foreign legal consultants. They are allowed to attend bar meetings and have voting rights at general meetings.65 The JFBA has sole power to terminate foreign lawyers' registration.

C. Scope of Practice

"The new law permits persons who have qualified and practised for five years in their country of qualification as lawyers to be

60. Note, supra note 19, at 1503-04.
61. Note, supra note 1, at 40.
62. Note, supra note 19, at 1504.
63. Note, supra note 19, at 1504.
64. Id.
65. Note, supra note 19, at 1504.
admitted, subject to certain requirements, including one of reciprocity, to a limited form of practice in Japan." Practice beyond the scope defined not only constitutes grounds for disciplinary action and possible expulsion, but also may subject the lawyer to criminal sanctions.

Article 3 addresses the scope of practice allowed; it is basically that if performance of legal business concerning the law of the country of the lawyer's qualification. There are many exclusions in Article 3. These exclusions primarily extend "to all representation before courts or public agencies, and the preparation of documents the chief purpose of which is the acquisition, loss, or change of real or industrial property rights within Japan and the service of procedural documents for a court or administrative agency of a foreign country." A foreign lawyer cannot express a legal opinion regarding the interpretation or applicability of law other than of his home country. This provision appears to be unworkable as it would limit a lawyer from answering a relatively simple yet crucial question of what law should govern a particular international transaction.

The foreign lawyer must work in conjunction with a bengoshi in some areas of practice. These include matters involving real or industrial property located in Japan, family law involving Japanese nationals and probate matters concerning Japanese nationals or property in Japan. Despite the areas which require joint work, a foreign lawyer may not employ bengoshi or enter into partnership agreements with them; bengoshi can, however, hire foreign lawyers.

The foreign lawyer's office name must include the surname and given name of one or more of the foreign lawyers; it may not include the name of a firm or any other organization or individual. The foreign lawyer is limited to one office in Japan and he/she must live in the country for 180 or more days a year.

66. Note, supra note 1, at 32.
67. Id. at 41.
68. Id.
69. Id. at 42.
70. Goebel, supra note 45, at 484.
71. Note, supra note 1, at 43.
72. Id. at 44.
73. Goebel, supra note 45, at 484.
D. Status of Implementation

The immediate effect of Law No. 66 was the opening of branch offices in Tokyo by over a dozen American firms most of which had been engaged in Japanese-American law practice; many of their attorneys had been trainees with Japanese firms.74 The 1990 Martindale-Hubbell lists 20 law firms under “American Lawyers in Tokyo” and four firms under “English Lawyers.”75

For many of the firms, the most difficult part of operating an office in Japan has been the building of their clientele base to offset the annual $1,000,000 to $2,000,000 operating costs.76 Many offices aren't striving to be self-supporting but rather look at their Tokyo office as being an adjunct to their U.S. practice. One interesting cultural problem in landing new clients has been the tradition of a formal introduction which many small and midsized corporations still require. Some U.S. lawyers have been more successful in attracting large Japanese companies which have been in the international market longer and are more accustomed to American aggressiveness.

V. CONCLUSION

The two largest hurdles confronting a foreign law firm in the operation of a Japanese office appear to be permanent ones - the high operating costs and the restrictions on the type of services which may be rendered. These restrictions are clearly comparable though to those which apply to foreign legal consultants who want to practice in the United States. The Japanese restrictions are also generally in line with the practice allowed in other Asian countries. Although the process is very informal in Singapore, the licensing is handled by the Attorney General and practice is restricted to the law of the attorney's home country.77 In Hong Kong where the Law Society governs admission of foreign lawyers, the practice is limited to “offshore” law - that of non-local matters.78 The requirements are more formal than in Singapore.

74. Id. at 485.
76. Sontag, A Fight for Survival in Japan, Nat'l L.J., Sept. 19, 1988, at 38, col. 1. Office rents which are measured by 18 inch square tatami mats run from $30,000 to $65,000 a month!
78. Id.
because foreign lawyers have been there for a longer period of time.

The reciprocity requirement goes back as far as the Lawyers Law of 1933. In the early negotiations concerning what would become Law No. 66, Japan demanded reciprocity from a majority of states for nations with a federal system. They finally settled for reciprocity from the “most important” states\textsuperscript{79} - those with which Japan had had substantial business contacts.

By 1989, only five American states had statutes providing for practice by foreign legal consultants: California, the District of Columbia, Hawaii, Michigan and New York.\textsuperscript{80} New York and the District of Columbia allow consultants to advise on American law while the other states restrict practice to the law of the foreign jurisdiction.\textsuperscript{81} It is evident from review of the New York statute\textsuperscript{82} that it was one of the models used in the drafting of Law No. 66. Australian lawyers cannot meet the reciprocity requirement of Law No. 66 and are, therefore, limited to practice as trainees or corporate in-house attorneys.

Law No. 66 is scheduled for review. Foreign lawyers, primarily from the U.S. and Europe, have begun to lobby both the JFBA

\textsuperscript{79} Note, supra note 19, at 1500.
\textsuperscript{80} Id.
\textsuperscript{81} Id. at 1501.
\textsuperscript{82} Susan Sayuri Kigawa, in her article \textit{Gaikoku Bengoshi Ho, Foreign Lawyers in Japan: The Dynamics Behind Law No. 66} stated the exemplary requirements of the New York law as follows:

New York allows foreign lawyers to practice in their state without taking the bar examination if they are licensed as “legal consultants.” Applicants must (1) be attorneys in good standing in their country of licensing who have practiced law for five out of the last seven years preceding their application, (2) have the good moral character requisite of a New York bar member, (3) be over twenty-six years of age, and (4) be a resident of the state. Additionally, applicants must obtain professional liability insurance and designate the Supreme Court Appellate division clerk as their agent for service of process.

Legal consultants cannot appear before a court, magistrate, or other judicial officer unless they are representing themselves; they are not to draft documents or issue subpoenas in any action brought in the above forums. They also may not (1) prepare documents dealing with the change of property rights or marital affairs, (2) hold themselves out as bar members, or (3) use any title other than “legal consultant.” They are subject to disciplinary actions of the Supreme Court and the Appellate Division. Legal consultants may (1) give advice on the laws of New York or the United States provided such advice is based on the counsel of a licensed state lawyer and (2) practice under their own name, a firm name, or in conjunction with American lawyers.

\textit{Id.} at 1501-02.
and the Ministry of Justice. They are seeking to liberalize the five-year requirement, the right to use their foreign firm names in Japan, and the restrictions on forming partnerships with or hiring bengoshi.83

Although many international lawyers agree that the passage of Law No. 66 is an opening door to a new market, it remains to be seen how many foreign firms can overcome the high costs and practice restrictions. Phil Sims, a San Jose attorney representing Mitsubishi Company, believes that at the present time, there is more lawyer interest than client need. "[J]ust as a good airplane pilot should always be looking for places to land [though], so should a lawyer be looking for situations where large amounts of money [are] about to change hands!"84 Time will tell how many foreign firms flourish upon their transplant to this foreign soil.

83. Id. at 1520, (quoting from letter of partner of Milbank, Tweed, Hadley & McCloy (Tokyo) to the author, April 7, 1989).
84. K. Vonnegut, God Bless You Mr. Rosewater, or Pearls Before Swine 17 (1965).
THE EUROPEAN DREAM COME TRUE: WHAT WILL BECOME OF AMERICAN BUSINESS (BOEING) AFTER EEC '92

Ronald Griffin*

I. INTRODUCTION

I have a fading picture of my grandfather. His world was a wilderness. Scarcity was a fact of life. Liberty was freedom from scarcity. The Wealth of Nations was everyone's prosperity manual. Mercifully, private institutions (with the help of government) improved everyone's lot. We have to thank businesses like General Motors and United States Steel for that. In the 1990's, as these institutions grow old, stodgy, and unwilling to change, one wonders what will replace them? After EC-92, for example, what will become of the Boeing Aircraft Company? Will it suffer the fate that has befallen the nation's automobile, textile, and steel industries? This article will sketch an answer.

II. OVERVIEW

In the beginning, America was defined by its towns and bucolic settings. Communities were held together by nostalgia. Citizens used the foibles of their neighbors to entertain themselves. The world was both defined and refined by what people saw and heard. The elderly used folksy sayings to teach children about civilization's harsh realities.¹ The world, they proclaimed, was a dying place. Folks and machines slowed down and eventually stopped operating. To cope with pain caused by loss (and it was most certainly that), youngsters had to gather happiness and entertainment in their lives.²

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¹ Storytelling is one of the oldest ways known to mankind for imparting knowledge to children about the world. See, e.g., R. Bradbury, Dandelion Wine 48-52 (Bantam ed. 1990); A. Haley, Roots: The Saga of an American Family 6-8 (1974).

² See R. Bradbury, supra note 1, at 48-52, 180-184.
In an America held together with nostalgia, support of the market mechanism and competition were positive values. Contract law affirmed enterprises that produced things commanding economic value. Damages put people in positions they would have enjoyed if promises had been kept. Community disapprobation, as well as the criminal courts, kept the mavericks in check. Crime wasn't the ubiquitous thing it is today.

This version of the sentient world, at best isolationist, left Americans ill-equipped to deal with world problems. It didn't provide the people with a vocabulary to cope with unruly foreign governments, rapacious corporations, notions about citizenship, job dislocations and "foreigner."

America needed a new vision. Freud and Drucker provided inventors and tinkerers with the raw materials. The world, they wrote, had gone through a westernizing process. Decolonization—local control of events—had taken root in Africa and Asia. The agents of change, by and large Europeans, had retreated to their continent. Europeans nevertheless maintained a strong presence in North America, South America and the southern tip of Africa.

In this century, Europe's civil wars (World Wars I and II) failed to produce a clear winner. Outsiders like the United States and the Soviet Union were the apparent victors. The vacuum, hegemony to be won from decimated European powers, was filled by the aforementioned nations. With the passage of time, the United States and the Soviet Union got sucked into the great Commercial Basin.

The Basin's frontier began in the United States with the state of Washington, and extended east to the farthest European outpost in Russia. Like a Texas oil rig, observers can see the market mechanism pumping riches from the landscape. Lawyers have converted statutory language into intelligible expressions. Commercial discourse has been reduced to conversational English,

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7. Id. at 27-30.
French, Spanish, Russian, and German. America and Canada, England and France have been granted domains. Countries have formed economic unions, like the EEC, to free their people to compete with decolonized rivals like the City State of Singapore, Saudi Arabia, Iraq, and Japan.  

Basinites use commercial laws as conversation pieces to gather understanding and cooperation, from other basinites, in arenas strewn with cultural barricades and ancestral traditions. Utterances and representations prompting detrimental reliance create obligations. Utterers, actors and reacting parties are subject to a duty to act in good faith. Breach of the duty invested the injured party with the power to both modify an obligation and exact specific performance. When an obligation collapses, international conventions, the publication of the utterer's bad reputation, the law of obligations, reliance and balance theories have been invoked to secure an injured party's expectations.

That brings us to the task at hand. Having abandoned nostalgia for the basin concept the question is: what economic calamities will American businesses have to weather following EEC integration? A partial answer will be assembled from the activities of the Boeing Aircraft Company—the nation's largest employer and leading exporter. Section III will be an overview of the aircraft industry and Boeing's role in it. Section IV will survey legal matters like the Convention on the International Sale of

10. Id. at 131-32.
11. See, e.g., G. Roy, The Tin Flute, 297-99 (McClellan & Stewart ed., 1989). Ms. Roy (a brilliant Canadian author) recounts Quebec opposition to Anglo Canadian legal regimes which threatened French culture in Canada. There are other obstacles like rugged individualism, the American obsession with remaking other countries in its own image, and finally, the Western tendency to interpret the actions of other nations as if they were like us. F.L.K. Hsu, Rugged Individualism, 10-11, 407-18 (1983).
Goods (CISG), contract terms, negotiating strategies and government subsidies affecting the Boeing business. Section V will sketch new arenas, like avionic innovations,\textsuperscript{16} where Boeing and Airbus will compete. Section VI will weigh and evaluate the observations made in the previous sections and draw some conclusions.

III. THE AIRCRAFT INDUSTRY AND BOEING'S CURRENT ROLE

The airplane business is both cyclical and quirky. The customer market is small. The demand for change is unending. Energy shortages, fanned by crises in the Middle East, fuel demands for efficient engines.\textsuperscript{17} Concern about noise pollution creates a demand for quieter propulsion systems. Politics, like the government's use of trade legislation to block Boeing's exportations of spare parts to Libya, eschews demand.\textsuperscript{18} Problem laden innovation makes aircraft manufacturing risky.\textsuperscript{19} Finally, the specter of Japan as a rival galvanizes competition between Europe's manufacturer and its American rivals.\textsuperscript{20}

Boeing, Airbus Industries, and McDonnell-Douglas produce most of the world's aircraft. Boeing controls 50\% of the market.\textsuperscript{21} Airbus claims 30\% of the market.\textsuperscript{22} McDonnell-Douglas and smaller firms preside over the rest.\textsuperscript{23} Each company designs and sells airframes. The engines come from Pratt-Whitney, General Electric, Snecma, and Rolls-Royce.\textsuperscript{24}

Boeing views airplanes as a source of revenue to spend on new airframes.\textsuperscript{25} It coddles its customers with a squad of engineers saddled with the mission "solve customer problems."\textsuperscript{26} Its sales-
persons blanket the globe. The company’s large and varied inventory allows Boeing to meet the needs of most airplane purchasers. Its plants are located in the United States. 27 It has subcontracted work with firms in England, Canada, and China in the past. It has flirted with joint ventures in Japan. 28

Airbus Industries is a consortium. 29 It is funded by the governments of England, France, Germany, and Spain. Airbus sees airplanes as a source of employment. 30 Contributing governments see Airbus as an instrument of national policy, that is, an employer of last resort that has slowed the “brain drain” from Europe to the United States. 31 Airbus has helped contributing countries establish favorable trade and payment balances. 32 It sees itself as a builder of variant aircraft as opposed to a family of aircraft like Boeing. It services the needs of European, Far Eastern and Near Eastern airliners. 33 The firm’s goals are stable production, delivery schedules, and market in America. 34

McDonnell-Douglas is the least competitive firm. It is the product of a merger of the McDonnell and the Douglas Aircraft Corporations. In the 1950’s, Douglas was the leading commercial aircraft manufacturer in the world. After Boeing took the lead in the jet aircraft business, Douglas spent huge sums, both borrowed money and its own, to become Boeing’s peer. 35 Debt and a slow return on investment ruined the company. To avoid complete ruin, the Douglas family accepted McDonnell’s offer to buy the firm. 36 The purchaser installed its own management team imbued with the idea that Boeing’s or Airbus’s bad luck, or some ill-considered decision, would turn the acquired firm around. 37

27. Id. at 50.
28. Id. at 45-46, 138.
29. Id. at 33, 36, 193-95; AIRBUS TODAY 6 (1990) (Airbus Industries is a grouping of Europe’s civil aircraft manufacturers: Aerospatiale of France, Duetsche Airbus of West Germany, British Aerospace and Casa of Spain).
30. J. NEWHOUSE, supra note 15, at 34.
31. Id. at 33.
32. Id.
33. Id. at 37-39 (North America is its largest market); see AIRBUS TODAY, supra note 29, at 8; cf. J. NEWHOUSE, supra note 15, at 195.
34. J. NEWHOUSE, supra note 15, at 35, 55-56; see AIRBUS TODAY, supra note 29, at 8.
36. Id. at 135.
37. See id. at 136-37.
A. The Interrelated Aircraft Industry

In the airplane business the start-up cost is one billion dollars. Under most projects, manufacturers have to wait fourteen years for profits. The learning curve—workers repeating production tasks without mistakes—can reduce labor costs by twenty percent. Manufacturers have to cut their prices faster than competitors. They are obliged to coddle and cajole airline employees (engineers and management teams) to glean purchaser needs. They have to design planes with traffic growth patterns on long, middle and short range routes in mind. They have to be wary of the competitive maneuvers of engine suppliers. They can wreak havoc upon the best laid airframe plans. They have to be mindful of the jockeying among airline companies. Their actions can affect a manufacturer’s sales, profits and competitiveness.

Consider the following: Airline carriers will use their flight schedules to net their rivals’ customers. Each will claim that it can transport customers from point to point in the shortest span of time, with or without stops, at attractive prices. If McDonnell-Douglas offers American Airlines an airplane that gives it a speed advantage over rival carriers, like Delta or United Airlines, these rivals will buy a similar aircraft from a competing manufacturer to force McDonnell-Douglas, which needs two airline orders, to withdraw from the field.

The behavior of engine suppliers can topple the best laid plans. The Lockheed fiasco is an example. In the 1960’s, a banking syndicate provided Lockheed with four hundred million dollars to finance the L-1011 project. The planes were to carry a specified amount of weight. Lockheed made a contract with Rolls-Royce to supply 544 engines bearing weights within the project’s weight specification. There was a breakdown in the performance of this agreement. Rolls-Royce, the supplier, had to replace a composite
carbon fibre and resin fan blade with a titanium blade which raised the engine weight. The change dropped the engine’s fuel efficiency, increased the airframe’s weight, and broke the guarantee Rolls-Royce made to Lockheed.

Technical problems, a poor estimate of the actual cost of the engines and other costs, forced Rolls-Royce into bankruptcy.44 The British government purchased the supplier’s military contracts. It made an agreement with Lockheed regarding the late delivery of the L-1011 engines. The Crown promised to perform the Rolls-Royce contract provided Lockheed shouldered half of the additional cost ($288 million).45

With this unfolding of events, Lockheed wandered into the vortex of increasing costs and irate customers who fretted about the timely delivery of their planes. The company could see lost sales, lost profits, shrinking market share or bankruptcy on the horizon. Lockheed had two choices. It could file a contract claim against Rolls-Royce in bankruptcy. It could modify its contracts with purchasers and creditors, hoping both would go along with the deals.

In time, Lockheed got its modifications.46 The British government performed Rolls-Royce’s contract. For consideration, liens in all of Lockheed’s manufacturing assets and other compensation, the United States government provided the British Crown with a guarantee that Lockheed would make its payments.47 After Lockheed completed its performance, installed its engines, paid its creditors, and brought the L-1011 project to a merciful end, the manufacturer got out of the commercial airline business. It left the market to firms like Boeing and McDonnell-Douglas.

B. Boeing Versus The Airbus Miracle

There is marketing. Airbus Industries’ success is a modern day miracle. World War II decimated Europe’s capacity to manufacture commercial aircraft. The world’s airliners purchased American products. Around the world, American firms bore a reputation for efficiency. They, the airliners were told, produced safe aircraft

44. Id. at 175, 177.
45. Id. at 179, 181.
46. Id. at 182 (Lockheed’s customers agreed to pay an additional $640,000 for each of their L-1011 planes).
47. Id. (The government was granted a lien in Lockheed’s assets).
in the sizes and volume needed. Nobody thought that the British or the French could compete with the Americans in development, manufacturing and marketing.

Airbus Industries was Europe's response. It is a multinational entity.\(^4\) It is the titular manager of government owned and subsidized corporations.\(^4\) In a complex business network, each company, like tentacles from a common body, performs acts to fulfill commitments made by Airbus.\(^5\) Airbus makes design, production and marketing decisions.\(^6\) Contributing governments make investment decisions affecting new Airbus aircraft.\(^7\) Airbus services Air France, Lufthansa, Scandinavian and a few non-European carriers like Air India.

In 1976, Boeing made a number of discoveries. First, 70 percent of its airline business came from foreign countries.\(^8\) Second, Airbus was its principal competitor. Third, because Airbus was subsidized by several governments, in a worldwide price war Boeing could lose a handsome number of customers. Fourth, Boeing could not rely upon military contracts, or higher priced domestic airline contracts, to subsidize lower priced aircraft sold abroad. In summary, Boeing had to do something about Airbus.

Since American manufacturers could not act collusively by contracting with one another to make aircraft in competition with Airbus, Boeing had to go abroad to find partners.\(^9\) It adopted

\(^4\) Id. at 33, 49; see Letter from P. Cottle to Ronald Griffin & Teresa Machicao (Oct. 10, 1990) (letter to author from Airbus Industries' legal counsel, including booklet AIRBUS TODAY); AIRBUS TODAY, supra note 29 at 6, 7.

\(^5\) J. Newhouse, supra note 15, at 33, 45.

\(^6\) Id. at 33, 193-94; cf. European Ministers will Discuss Restructuring Airbus Consortium, AVIATION WEEK AND SPACE TECH. 114 (Feb. 15, 1988).

\(^7\) J. Newhouse, supra note 15, at 194.

\(^8\) Id. at 33.

\(^9\) Id. at 37, 138.

\(^1\) Under the Sherman Antitrust Act, 15 U.S.C. § 1 (1982), Congress has forbidden businesses to engage in collusive activity. SULLIVAN & HARRISON, UNDERSTANDING ANTITRUST AND ITS ECONOMIC IMPLICATIONS 71, 81-84 (1988). If arrangements suppress or destroy competition, they are condemnable under the Sherman Act, Id. at 82. The question is one of intent and effect. Id.; see Chicago Bd. of Trade v. United States, 246 U.S. 231 (1918); Appalachian Coals, Inc. v. United States, 288 U.S. 344 (1933). The aforementioned cases advance a rule of broad discretion in favor of courts weighing competitive market factors before reaching an antitrust conclusion. SULLIVAN & HARRISON, supra, at 83 (efficiency and integration of productive capacity are acceptable antitrust inquiries and defenses).

Section 1, The Sherman Act, covers business activity inaugurated by joint ventures.
two strategies. First, Boeing flirted with Rolls-Royce and, later purchased its engines from this manufacturer, to weaken British ties to Airbus.55 Second, Boeing incorporated both British aerospace wing technology and Rolls-Royce engines into aircraft it marketed in Europe.56

There was a change in demand in the 1980's. Airliners urged manufacturers to make planes to replace the Boeing 727. At that time, Boeing could not build new planes without a foreign partner. McDonnell-Douglas could not keep pace with demand. Lockheed had withdrawn from the field creating a vacuum that was filled by Airbus.

Airbus took advantage of the situation. Using appealing loan agreements and credit contracts, Airbus targeted prestigious American airliners, enfeebled by government deregulation, then wooed them to its pen. It derided Boeing's campaign to recapture lost customers. Since Airbus used General Electric technology in its engines, Airbus marketed its airplanes in the United States by claiming that its planes were imbued with American reliability.57

Airbus pressed its campaign in the 1990's. The agreements concluded with Northwest Airlines and America West Airlines corroborating the recent turn of events.58 As of this writing, Northwest was swimming in debt.59 To help the firm relieve itself of debt, Airbus, with the aid of General Electric, provided the airliner with millions of dollars in exchange for a promise to buy a billion dollars worth of Airbus airplanes.60 In recent weeks, America West proclaimed an interest in buying one of Pan

United States v. Addyston Pipe, 85 F. 271 (6th Cir. 1898), aff'd 175 U.S. 1 (1904). Sullivan and Harrison call them entities assembled by two independent firms for research, production, and marketing activity. SULLIVAN & HARRISON, supra, at 100. By gaining skills, spreading risks, achieving certain economies of scale, the joint firms achieve efficiencies and an appetite for research and production which single firms are unwilling to undertake on their own. Id. Lamentably, there is a down side to joint venture activity. There is a potential for price fixing, out-put restrictions, market division, increased monopoly power, and other anticompetition activity. These are temptations faced by the airframe business. They are illegal under the Sherman Act.

55. Id. at 201.
56. Id. at 201-02; see O'Lone, Airframe Manufacturers Seek Sales Opportunities in Eastern Bloc, AVIATION WEEK & SPACE TECH. 112-13 (Feb. 15, 1988).
57. J. NEWHOUSE, supra note 15, at 192.
58. Weiner, Suppliers in Loan to Northwest, supra note 40, at C1, col. 2; Weiner, Unusual Deal by America West Seen, supra note 42, at C5, col. 4.
59. Weiner, Suppliers in Loan to Northwest, supra note 40, at C1, col. 2.
60. Id.
American's shuttle services. The price tag was 200 million dollars. If America West promised to either lease or purchase 100 Airbus planes, Guiness Peat Aviation, the world's largest aircraft-leasing company, and International Aero Engines, a consortium of engine manufacturers that includes Pratt-Whitney and Kawasaki, promised to lend America West the cash.61 

Boeing has responded to this campaign by both attacking the Airbus funding scheme62 and marketing in Eastern Europe.63 Thanks to a subsidy of 13.5 billion dollars (revalued at 29.5 billion) Airbus has become Boeing's principal competitor.64 Boeing has asserted that the subsidy violates GATT.65 If Boeing puts an end to the subsidy or gets it reduced, like Boeing, Airbus will have to beg for money to fund new projects and worry about profits. With the assistance of the United States government, Boeing hopes that it can make Airbus play by its rules. If Airbus has to spend more time marketing for money, Boeing can recapture some of its lost customers.

In Eastern Europe, with the heightened demand for western aircraft, and the slumping demand for Soviet built planes, Boeing

61. Weiner, Unusual Deal by America West Seen, supra note 42, at C5.
63. O'Lone, supra note 56, at 112-13.
64. Field, supra note 62, at D5.
has proposed a sale or a lease of its 767 aircraft to Poland’s state owned airliner (LOT). The company has made offers to Romania and Czechoslovakia. It has picked up Hungary’s proposal to lease aircraft from a western firm like Guinness Peat Aviation, provided the leasing firm has purchased aircraft from Boeing.

What Boeing sees in this strategy (or one hopes it saw) is a way to penetrate “Fortress Europe” in hopes of claiming and maintaining markets there. Across the Atlantic, in the Common Market, twelve nations have coordinated their political and economic policies in ways which threaten Boeing. In Eastern Europe, six liberated nations seek affiliation with the twelve. All have embraced policies that both (a) subsidize key industries and (b) limit off-shore manufacturing influences, to raise the European’s standard of living. This blend is to take place in 1992 and is commonly referred to as EC-92.

When Europe accomplishes some of the aforementioned goals, such as raising everyone’s living standard, introducing a standard European currency, retiring old airplanes, and allocating air routes to sixteen nations, so that each nation’s airliners can reach customers in neighboring states, there will be an explosion in demand for short range and long range aircraft that Boeing will service with a weaker Airbus competitor.

IV. INTERNATIONAL LEGAL MATTERS

Assuming EC-92 is at hand, it will create a large trading arena within the Great Basin. Governments will put refitted market mechanisms in different places. Entrepreneurs will queue on supply curves in accordance with the rules of competitive and comparative advantage. Demand curves will swing left and right. Movement will be dictated by the public consumption of goods, decisions to replenish depleted inventories, and patented inventions and subsidies. Personalty, realty and information will be labeled “property.” Capital will be the aforementioned objects being managed by individuals and firms. People and firms will

68. Id.
become capitalists when they are freed of the obligation to spend themselves on the production of "new" capital. At that moment something wonderful will happen to the capitalist. He, she, or it will receive the power to influence others by imposing any condition upon someone's proposal to use, buy or rent their property. Contracts will become the concessions the capitalist extracts from the offerors.

Across the Basin, contract liability will be based upon a statute, bargain, benefit or reliance theories. A contract, for example, will be the sum of offer and acceptance. Courts will find an agreement when the minds of the parties have met. Where a promise fetches consideration or reliance, there will be a contract. Where a promise fetches nothing, judges will be fitted with the discretion to determine whether a writing is valid. If the writing saddles the people with "rights" and "duties," the court will find implied promises. If a writing proclaims an exchange of "comparable values," the court will treat it like a contract. When a person confers a benefit upon someone else, who knowingly and willingly accepts it, the recipient will be saddled with the duty to pay for it. Where businesses are building a long term relationship—and, in the negotiation, the seller has access to information which his customer cannot access—the seller will be under a duty to disclose all he knows. If he omits something from his report, that will be a misrepresentation. If the customer relies upon the report to his detriment, the seller will have to shoulder the damages.

Any speech, symbolic speech or writing, provoking reliance will create an obligation. The parties will be saddled with the duty to act in good faith and to follow statutes to the letter. Breach of this duty will invest the injured party with the option

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71. See, e.g., Hamer v. Sidway, 124 N.Y. 538, 27 N.E. 256 (1891); Levin & McDowell, supra note 70; see also, Restatement (Second) of Contracts § 211 (1981); P. Atiyah, Rise and Fall, supra note 69, at 731, 734, 764-79.


73. P. Atiyah, Rise and Fall, supra note 69, at 785.

74. Id. at 734.

75. See C. Fried, Contracts as Promise 17, 125 (1981).
to (a) modify the obligation, (b) sue for damages, or (c) petition for specific performance.\(^76\)

Damages will limit the use of traditional contract theory. Plaintiffs will have to sustain injuries cognizable in contract law. In a construction contract case, for example, "substantial performance" will count as a reason for recovering damages.\(^77\) When a contractor has tendered "completed performance" that is "defect free," that will count as a reason for recovering damages.\(^78\) If a contract's liquidated damages clause generates a sum that is twice, or less than twice, the profit the contractor sought from the bargain, the plaintiff (contractor) will have to content himself with actual damages.\(^79\) If the plaintiff is a merchant, and the defendant is familiar with his business, the court will surmise that the defendant knew about the business risks (lost profits) to be borne by the plaintiff. If a writing bonding plaintiff to defendant creates an expectation that, in turn, provokes reliance, defendant must shoulder liability for direct and derivative reliance damage.\(^80\)

In America, we will see a contractual hierarchy. It will look like Figure A. At the base of the pyramid you will find the common law \((K=O+A)\). On the next level, one above the bottom, you will find statutes (UCC). On the next level, you will find conventions like the Paris Patent Convention (PPC) and the Convention on the International Sale of Goods (CISG). At the apex, you will find the law of obligations.

![Figure A](image)

If the contract is for construction or services, disputes will be resolved with the common law. If the agreement covers goods,

\(^{76}\) Convention, supra note 14, arts. 45(1)(a)-(b), 46.


\(^{78}\) See E. Farnsworth, Contracts 562 (1990); Waddams, Restitution for Part-Performance, in Swan & Reiter, Studies in Contracts 151, 152 nn.1-2 (1980).

\(^{79}\) See, e.g., Lake River Corp. v. Carborundum Co., 769 F.2d 1284 (7th Cir. 1985).

disputes will be resolved with Article Two of the Code (UCC). If a buyer or a seller is trying to affix a lien to goods, disputes about attachment, perfection, and remedies will be resolved under Articles Two and Nine of the Code. If someone has pirated someone else's technology in a sister country, the dispute will be resolved under the General Agreement on Tariffs and Trade (GATT) PPC. If the parties come from different nations, disputes will be resolved under the CISG.\footnote{Convention, supra note 14, arts. 1, 6.} If the parties are groping towards contract formation or pondering about a breach, the parties will use the law of obligations to soothe frayed nerves.\footnote{Across the Atlantic, we will find an established hierarchy. Patrick Atiyah has described it best. In England, the law comes from Parliament.\footnote{See Linzer, Uncontracts: Content, Contorts and the Relational Approach, 1988 Annual Survey of American Law 139, 152-68; P. Atiyah, Pragmatism, supra note 70, at 173-74.} That law is glossed by the courts. The law itself is composed of history and experiences, precedent and the work of academics.\footnote{P. Atiyah, Pragmatism, supra note 70, at 150.} Contract law is a good example.}

Across the Atlantic, we will find an established hierarchy. Patrick Atiyah has described it best. In England, the law comes from Parliament.\footnote{Contract law, he has said, is the work of pragmatic lawyers and academic economists.\footnote{It is erected to protect a person's bargained-for expectation.\footnote{We are told that contract law is both general and neutral.\footnote{It is unconcerned about the various types of contracts and the different sorts of people who enter into them.\footnote{If a court is presented with a signed writing, it will treat the document like a contract.\footnote{If the writing saddles the signatories with rights and duties,\footnote{the court will find implied promises. If the writing is executory, the parties are provided with an opportunity to escape their duties.\footnote{If the writing proclaims the exchange of comparable values, the court will say the agreement is valid. If there is a breach, the court will award the injured party damages.}}}}}} If a party wants to make a contract with B. A is an airplane manufacturer. B manufactures parts for
commercial airplanes. A provides B with an airplane plan and specifications for a nacelle (an aerodynamic structure that surrounds a jet engine) that is accompanied by a request that "B supply A with a price." B returns A's specifications with a price. A sends a modified specification to B with the inquiry, "Can I get these changes at your quoted price?" B says, "yes." On September 30th, A faxes B a letter, "Upon your agreement to ship a finished nacelle in six weeks you may begin work." On October 1st, B hired 12 employees and purchased several tons of raw material. On October 8th, A told B to "stop work." A had found a cheaper supplier in England. What are the issues? What is A's position on the issues? What is B's position on the issues?

The problem presents many issues. There are: price quotation, contract formation, breach, compensation and damages. In contract, courts refuse to treat price quotations as offers. If the quotation is accompanied by a positive statement which leaves nothing open for interpretation, a quote will be treated like an offer. In this case, the quote isn't escorted by anything. Given this observation about the facts, it follows that the quote won't be treated as an offer to make a contract.

In practice, however, a person can use both objective and subjective theories to make a contract. The objective theory is composed of offer and acceptance (K = O + A). Since there was no offer in this case, of necessity, there could be no acceptance.

You could try to make a contract out of the correspondence between A and B. If the September 30th letter is treated like an offer, the question is: Did B communicate an acceptance? Generally speaking, offers are composed of promises, solicitations and some instructions about the communication of acceptance. If the instruction is missing, the offeree (B) may either tender a performance or communicate a promise as acceptance. The Restatement proclaims that the performance must be unique—

93. There is a notion that the subjective theory should be confined to face-to-face negotiations. Kabil v. Mignot, 279 Or. 151, 566 P.2d 505 (1977); see G. Gilmore, supra note 70, at 41-43.
94. See Restatement (Second) Contracts §§ 24, 32, 54, 58, 71 (1981); Farnsworth, Contracts 135-36, 150 (1990) (consideration isolates what the parties sought from one another); see also G. Gilmore, supra note 70, at 19-21.
unlike B's performance—to the proposal to make a contract. 96 Since B's performance was generic, we cannot treat it like an acceptance. Since there was an offer, but no acceptance, there was no contract between A and B.

You could assemble a contract with subjective theory (K=M x M). 97 It appears that the minds of the parties met. In this case, however, subjective theory analyses must give way to statutory analyses. Since the subject matter is goods, and the disputants are respectively buyer and seller, the analysis must be done under the Uniform Commercial Code. 98

There is a contract between the parties under section 2-204. The buyer's expectation is a nacelle. The seller's expectation is payment. 99 The seller expected the buyer to act in good faith, that is, to do nothing that blocked or delayed the seller's receipt of payment. 100 In this case, the buyer breached his good faith duty. He (A) both broke his contract with B and made a contract with someone else. Given these observations about the facts, it would appear that B is entitled to damages.

Since the disputants are not from different countries, there is no reason to apply the CISG. Under the law of obligations, borrowing a bit from the English and the Canadians, B could use good faith as a roost to get damages for the employees he hired and the raw material he purchased. 101 If A and B have an ongoing relationship, and A is familiar with B's business, a court might surmise that "A knew about the business risks shouldered by B." If A created expectations upon which B detrimentally relied, A may have to shoulder the damages. In summary, A should hide under the objective theory. B should attack A with either the subjective theory or the U.C.C. Finally, A may be liable to B for consequential damages.

96. Restatement (Second) Contracts § 50(2) (1981); see White v. Corlies, 46 N.Y. 467 (1871).
101. See Swinton, supra note 80, at 69-80; see also P. Atiyah, Rise and Fall, supra note 70, at 460-61.
A. An International Example

Unfortunately, the previous hypothetical doesn't raise international issues. The next, and the last, hypothetical addresses that shortcoming. It is an attempt to put contract theory and modern airplane transactions in focus.

A is an American manufacturer of airplanes. B is a German purchaser. C is an American engine manufacturer. He makes Widget engines for A and B. In July, 1989, A made a contract with B. The airplane manufacturer promised to sell and B promised to buy "Seventy Bubble-1011" with Widget engines. In October, 1989, B initiated a conversation with C. B told C: "Send me the price list for two thousand units of 'knickknacks'... the spare part which goes into Widget engines." C sent B a price list which featured the "knickknacks." They were priced at $200 per 100 units, F.O.B. Plant, Kansas City. Two days later, B sent C a Telex. "We order today Two Thousand (2000) units of Knickknacks for $400,000 F.O.B. Kansas City for immediate delivery to Darmstadt, Federal Republic of Germany." On the same day, C responded by sending its Order Acknowledgement Form to B. In the form, C wrote: "We accept your order to buy Two Thousand units of Knickknacks for $400,000 F.O.B. Kansas City. Goods sold as is and with all faults. This contract is governed by the laws of__(blank)." The form was signed by C.

The Knickknacks were delivered to a Swedish vessel. It shipped the goods to Germany and presented them to B for acceptance. B accepted the goods and paid C. In April, 1990, B performed a minor repair on a Bubble plane. When he tried to install a Knickknack in a Widget engine, B discovered that the spare part did not fit that particular Widget engine or any Widget engine attached to a Bubble plane. B was outraged. A had told B that C was a reputable engine and spare parts manufacturer. After the lament, B secured spare parts with the right dimensions from a rival supplier. B is upset. He comes to you for advice. What do you tell him?

In this case, I would start with a long pause. My response would be preceded by a careful analysis of the issues. They are: battle of the forms (UCC), choice of law, German law, EC-

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102. This problem was assembled with parts from a problem in SPANOOLE, supra note 65, at 57-58.
104. U.C.C. § 1-105 (1989); RESTATEMENT (SECOND) CONFLICT OF LAWS § 188 (1971);
Convention on Contract Obligations, Convention on the International Sale of Goods, warranty, insurance, and damages. As regards the U.C.C., I would use section 2-207 to analyze the correspondence between B and C. Generally speaking, a contract comes into existence when the correspondence of the parties match. Since B and C sent matching correspondence, within several days of one another, there's a contract between the parties.

The next issue is choice of law. Under U.C.C. section 1-105, the law for this contract is either (1) the one chosen by the parties or (2) the one illuminated by the "significant contact test." Since the parties didn't choose a law, we must select one for them. In that regard, the language of section 1-105 accepts, or is broad enough to accommodate, Restatement ideas. Given this observation about the facts, we are free to use section 188 of the Restatement on Conflicts.

104. U.C.C. § 1-105 (1989); RESTATEMENT (SECOND) CONFLICT OF LAWS § 188 (1971); Seaman v. Philadelphia Warehouse Co., 274 U.S. 403 (1927) (outlining the reasonable relations list). Where a transaction bears a reasonable relation to a particular state or nation, section 1-105(1) permits the parties by agreement to make the law of that state or nation applicable to their transaction. Section 1-105(1) further provides that failing such an agreement, "this Act applies to transactions bearing an appropriate relation to this state." U.C.C. § 1-105(1) (1989).

The Code does not specify what constitutes an appropriate relation. Further, it does not indicate whether, and if so, to what extent the appropriate relations provision is intended to depart from traditional conflicts rules. It could be argued that a transaction does not bear an "appropriate relation" to a jurisdiction unless the law of that jurisdiction would be the proper one to apply under normal conflicts-of-law rules. Comment 3 to section 1-105 indicates that the drafters wanted to go further than this. It states that where a purely state statute would be inapplicable, application of the Code may be justified by its comprehensiveness, by the policy of uniformity, and by the fact that the Code reflects the understanding of a business community which transcends state and even national boundaries. BRAUCHER, INTRODUCTION TO COMMERCIAL TRANSACTIONS, 36-37 (1977).

105. See RUSTER, BUSINESS TRANSACTIONS IN GERMANY (FRG), 10-19 (1983).
106. See NORTH, CONTRACT CONFLICTS, in SPANOGLUE, supra note 65, at 137-38, 140-41.
107. Convention, supra note 14, arts. 1, 4, 14, 18, 19.
111. See U.C.C. § 1-105 comment 3 (1989).
Where contract negotiation and performance occur in the same place, the law of "that place" governs formation, validity, interpretation, breach and damages. In this case, negotiations and performance occurred in the United States.\(^{112}\) Given this observation about the facts, one might conclude that the applicable contract law is American law.

The EC-Convention on Contract Obligations says that the disputants must apply the law of the place where the defendant (seller) renders performance.\(^{113}\) Since performance occurs in the United States, Germany (as a member of the EC), and certainly its nationals must look to the United States law to address issues like validity, breach and damages.

The next topic is German law. What is B's position on the contract? In Germany a contract is a product of offer and acceptance.\(^{114}\) Further, under German law, acceptances should not be accompanied by either restrictions or exceptions. In this case, C's acceptance was accompanied by an "as is" restriction. Given this observation about the facts, there would be no acceptance and no contract under German Law.

The next issue is warranty. C can use the "as is" clause to restrict his liability.\(^{115}\) In America, B is under a duty to read a contract to catch clauses like this.\(^{116}\) If B is provided with an opportunity to read this contract, and he did nothing with the opportunity given to him, B is bound by the language he did not read. C can use the "as is" language to block B's recovery of damages.

By contrast, under German law, C would have to bring the disclaimer clause to B's attention and procure B's assent. Since German law is clear on that point, and C didn't do his duty under German laws, the "as is" clause is invalid. B could recover damages from C for breach of warranty.

The United Nations Convention on Contracts for the International Sale of Goods (CISG) might pull us out of the conflict of law quagmire. If America and Germany have signed the Conven-

\(^{113}\) *Id.* at 60. The author cites Article 4(2) of the EEC Convention.  
\(^{114}\) Ruster, *supra* note 105, at 10-19. Spanogel condenses the narrative to four pages.  
tion, the Convention will resolve all disputes. There may be a problem, however, under the offer and acceptance provisions. If C's acceptance alters the terms of the offer—what was solicited by the offeror (B)—there may be no acceptance and no contract between the parties.

In summary, I would tell B the following. First, B's dispute with C is governed by the UCC. Second, American conflict of law principles point to the use of the UCC. Third, German and American laws tell different stories about contract formation and liability. Fourth, the EC-Convention on Contract Obligations commends the use of American law. Fifth, the CISG won't help B. Sixth, B faces a struggle if he pursues warranty damages. Seventh, B could recover consequential damages if B supplied C with his reasons for buying C's Knickknacks. Eighth, B should check his insurance to see if this situation is covered by the contract. Finally, B should apply the law which upholds a contract between the parties.

V. AIRCRAFT INDUSTRY FRONTIERS

In the previous section we examined a delicate web of ideas, legislation, international conventions and policies symbolizing contract practice. What's the reality? Is there a frontier (an unilluminated landscape) where the previous discussion did not go? If reality is larger than theory—which is a true statement in this case—there is turf to be explored. First the landscape looks like a two dimensional, inverted pyramid (Figure B). Along the inverted base, the observer will find that manufacturers have camped at one corner. Purchasers have camped at the other. At the apex, one will find manufacturers and suppliers of airplane parts.

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117. Convention, supra note 14, art. 1.
118. If Article 19 adopts the mirror-image-rule and the offer and acceptance clashes, the Convention may be unavailable to us. See Convention, supra note 14, art. 19.
119. Id.
120. Manufacturers (1)  

Supplier (3)

Purchaser (2)

Figure B
Manufacturers have simple motivations. They want airplane orders which guarantee a steady stream of cash and profits. If the situation presents itself, they will sell planes on credit; lease them; provide purchasers with credit on spare parts; close a deal with the option to replace a purchased plane with an innovative improvement; sell airplanes with the option to buy new or improved models at prices “not fully adjusted for inflation.” They will guarantee the integrity of the airframe and the performance characteristics of the engine. During negotiations some—like Boeing, for example—will present their opinions about engines and rival manufacturers’ claims on topics like turbines, compressors, fuel consumption and efficiency.

Purchasers are interested in both government and private financing, airframe integrity, engine size and reliability, speed, fuel efficiency and spare parts. Competition has come down to “who can provide the best engine for the frame selected by the purchaser.” To date purchasers make separate contracts with engine suppliers. They cover matters like the cost of spare parts, spare engines, and the period of time, typically three thousand miles, during which the engines must perform reliably. In recent years, suppliers, to get more customers, have given into exaggeration. One company has gone into both the brokering and the banking business, causing some to wonder, in these uncertain and troubling days, whether a business alliance be-

First, suppliers (3) and manufacturers (1) make engine purchase agreements (EPA). They take several years to negotiate and govern the purchase orders submitted by the manufacturers to the suppliers.

Next, suppliers (3) and purchasers (2) make general term agreements (GTA). They take several years to negotiate and cover technical data, training and engine guarantees. Purchase orders (POs) submitted by the purchaser to the supplier are governed by the GTA. The POs cover quantity of engines, time of delivery, payment terms and price. Interview with Cynthia Brockman, Contracting Officer Legal Division, General Electric in Cincinnati, Ohio (Oct. 18, 1990). The terms of these contracts, that is GTAs and EPAs, constitute proprietary information. J. NEWHOUSE, supra note 15, at 56.

121. J. NEWHOUSE, supra note 15, at 54-55, 60.
122. Id. at 53.
123. Id. at 54.
124. Id. at 61 (recent developments).
125. Id. at 51, 186.
127. Id. at 54.
128. Weiner, Suppliers in Loan to Northwest, supra note 40, at C1, col. 2; Weiner, Unusual Deal by America West Seen, supra note 42, at C5, col. 4.
tween General Electric and Airbus, and General Electric and a large leasing syndicate like Guiness Peat Aviation selling Airbus products, will harm Boeing and others, that is, cause them to lose a great number of airplane orders?

Alliances between engine suppliers and airframe manufacturers, puffery blended with the sale of an engine, and wired contracts, are not the only thing troubling firms in the airframe business. Boeing, like other multinational businesses, is worried about people pirating their technology and the absence of effective laws or conventions to stop it. In recent weeks, the governments of the United States, France and Germany have accused one another of violating GATT—subsidizing its airframe manufacturers to ward off foreign competition.

The unauthorized use of patented technology is a worrisome problem. It can cost the airframe business billions of dollars in lost revenue. Boeing and its rivals have used contracts, a federal statute and international agreements to protect their property. When Boeing (seller), for example, makes a contract with a purchaser that is controlled by its government, the seller extracts a promise from the purchaser (the government) that it will do nothing to impair the value of the patent in that country. In some cases, the seller extracts a promise that the purchaser will pay a standard royalty for the reproduction and the use of patented technology; or a promise to pay a smaller sum that is offset by a tax credit in the seller's country.

On another level, the United States government has the power to impose sanctions upon, or withdraw trading privileges from, nations which do nothing to protect American patents abroad. Under the Paris Convention, a patentee can impose a licensing agreement and a duty to pay royalties upon an entity that has

References:

131. See Abbott, supra note 129, at 700.
132. Id. at 740.
133. Id.
134. Id. at 707-09.
pirated technology.\textsuperscript{135} Under GATT, there is a pending proposal that "all nations consult, compromise and settle their patent disputes, when doing nothing would cause trade distortions between them."\textsuperscript{136}

It has been said that subsidies of foreign concerns, like Airbus, make it difficult for Boeing to compete. If most of the world's air carriers reside in the United States, and Airbus is free, because of its subsidies, to woo American carriers while Boeing scrounges for money to build the next plane, Airbus is going to have the marketing advantage. Europeans say that extensive Pentagon orders placed with American manufacturers, for planes that are modified versions of civilian airliners, amount to subsidies.\textsuperscript{137} It is money going to Boeing, for example, to finance new planes. It releases time to recapture customers lost to Airbus. The matter of where airframe companies get money to finance the next generation of planes came to a head in September, 1990, and, to everyone's surprise, nothing was done by the concerned governments.\textsuperscript{138}

VI. EVALUATION

There is a sea change just ahead. No one knows whether Boeing will face an ill wind. Boeing is worried about the following:

\begin{itemize}
  \item \textsuperscript{135} Id. at 702-03.
  \item \textsuperscript{136} Id. at 715-17.
  \item \textsuperscript{137} Fields, supra note 70, at D5.
  \item \textsuperscript{138} Id. The United States decided to file a formal complaint with GATT over a German government program to address losses covered by the high value of the Deutsche mark against the dollar. The program provides subsidies, asserted the United States, to Deutsche Airbus (the German partner in Airbus). Carla Hills, the U.S. Trade Representative, said that the German program was "wholly inconsistent" with GATT rules.

  Ms. Hills requested the formation of a GATT panel to rule in this case. American officials said that a GATT ruling, assuming a panel is created, could be handed down within six months. A ruling favorable to the United States could call on the German government to end the subsidies, clearing the way for the United States to seek compensation.

  According to American officials, the German Government paid $240 million in subsidies to Deutsche Airbus and to German component suppliers last year. That sum does not include the $5.8 billion committed to the Airbus program by the German government over the past 20 years. According to a study commissioned by the Commerce Department, total government support provided to all Airbus partner companies amounted to $13.5 billion, or $19.4 billion, if interest costs are included. \textit{U.S. Files Formal Complaint with GATT over German Subsidies for Airbus Industries}, 8 Int'l Trade Rep. (BNA) No. 8, at 262 (Feb. 20, 1991); see Dullforce, \textit{GATT Told of Dollars 257m German Airbus Subsidies}, Fin. Times, Feb. 27, 1991, \S 1, at 7; \textit{International Trade, U.S. EC at Odds Over Which GATT Committee has Jurisdiction in the Airbus Industrie Dispute}, Daily Rep. for Executives (BNA) (Mar. 7, 1991).
\end{itemize}
(1) people pirating its technology; (2) the indeterminate nature of its marketing strategy in Eastern Europe; (3) government funding (subsidies) of Airbus; (4) the economic fallout that will befall Boeing if the American government takes no action on the subsidy issue under GATT; (5) the loss of sales to Airbus; (6) the loss of market share to Airbus; (7) alliances between American engine suppliers, world-wide leasing companies, and Airbus; (8) the use of American engine suppliers like General Electric to broker Airbus products; (9) the use of American engine manufacturers to finance the sale of Airbus products in the United States; and (10) the volatility of the demand for energy.

If Europe is distracted by the crisis in the Middle East, or the "common currency" issue is not resolved under the Rome Treaty (the basic agreement establishing the EEC), there will be less time and attention and, perhaps, less money to spend on Airbus Industries. If you put the matter in a different context, from Boeing's perspective, Airbus looks like a four legged stool. One leg, Germany, is preoccupied with its reunification. It has to spend billions of marks—money it might have spent on Airbus—on the reconstruction of East Germany. France's economy, heavily dependent upon foreign oil, is subject to oil shocks. England is in political and economic turmoil. If anyone of these nations (legs) is unable to carry its consortium load in the near future, Airbus will become Boeing's weak foe. Boeing will exploit its markets in Eastern Europe; it will corner Western European suppliers and customers it lost to Airbus. It will appeal to customers around the globe whom Airbus can no longer reach.

In this setting, because Boeing planes will be in demand, the patent issue will get addressed in GATT. Boeing and the United States government will have some leverage in the next round of


140. Protzman, Slowing Economy Predicted for a United Germany, N.Y. Times, Oct. 23, 1990, at C20, col. 3; see P. Kennedy, supra note 8, at 483-84.

141. Protzman, supra note 140, at C20.

142. P. Kennedy, supra note 8, at 483-84.

143. Id. at 480-82. Spain is the fourth leg of the stool. See International Trade, U.S. EC at Odds, supra note 139.
negotiations. The subsidy issue will get buried in a pile of diplomatic papers—there will be no need to squawk about it. Boeing's markets will show some expansion. There will be some increases in the firm's sales volume. Engine suppliers will have to rethink their positions with regards to alliances with non-engine suppliers. 144 Boeing will have time to fashion its airplane partnership the way it wishes with Japan. 145

This rosy picture rests upon the assumption that Europeans aren't smart enough to sense the ill winds blowing their way. 146 What is their solution to this currency crisis? 147 How would they finesse the Middle East crisis? First, Europe should purchase oil from Saudi Arabia to recoup the oil it lost in Kuwait. Second, France or Germany should open negotiations with the Soviet Union, hoping that nation will sell oil to the West for hard currency. Next, as regards the currency crisis, Europe could embrace the British Chancellor of the Exchequer's plan. 148 As an interim step, a so-called expression of interest, nine nations could create a convertible hard currency. Acting as the 13th currency—value being linked with the currencies belonging to the European Monetary System—the new money could replace The European Currency Unit. 149 Taking these steps would both brighten Europe's future, promote stability, and halt the machinery that would propel Boeing ahead of Airbus. 150

VII. CONCLUSION

In closing, Boeing's future (perhaps the future of other fretting businesses) is neither grim nor generously bright. Snags slowing European unification may weaken Airbus. Political wrangles may provide Boeing with time to fortify itself against the next round of competition and, hopefully, reduce the pressure to accept hasty solutions to nagging subsidy and patent problems. In the final analysis time will tell all.

145. J. NEWHOUSE, supra note 15, at 218; see P. KENNEDY, supra note 8, at 488.
146. P. KENNEDY, supra note 8, at 488.
147. See Moore, Foreign Policy and the Crisis in Oil, in THE RESOURCE WAR IN 3-D: DEPENDENCY, DIPLOMACY AND DEFENSE, 19-28 (World Affairs Council of Pittsburg 1980).
148. Riding, supra note 139, at C4, col. 4.
149. Id.
150. P. KENNEDY, supra note 8, at 432-33.
CHOOSING THE PROPER INTEREST RATE IN
BANKRUPTCY PROCEEDINGS: RESOLUTION OF
SPECIAL ISSUES IN THE SIXTH, EIGHTH, AND
NINTH CIRCUITS

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I. INTRODUCTION

The interest rate that debtors pay on claims outstanding at
the time of a bankruptcy reorganization hearing arguably is the
most debated economic issue in bankruptcy litigation.1 Next to
the appraisal value set as the result of debtor-creditor negotiation
or as a result of a "cramdown,"2 the interest component of a debt

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1. See, e.g., Carbiener, Present Value in Bankruptcy: The Search for an Appropriate
Cramdown Discount Rate, 32 S.D.L. REV. 42 (1987); Note, Bankruptcy: Determination of
an Appropriate Cram-down Interest Rate for the Family Farmer, 41 OKLA. L. REV. 489
(1988) [hereinafter Note, Determination of an Appropriate Cram-down Interest Rate];
Comment, In the Interest of Fairness: Interest Payments in Bankruptcy, 87 Neb. L. REV.
646 (1988) [hereinafter Comment, Interest Payments in Bankruptcy]; Hahn, Chapter 12 —
The Long Road Back, 66 Neb. L. REV. 726 (1987); Harl, Determining "Present Value" in
Bankruptcy, 10 J. Agric. Tax'n & L. 170 (1988); Comment, Cramdown Under the New
Chapter 12 of the Bankruptcy Code: A Boon to the Farmer, A Bust to the Lender?, 23 Land
& Water L. REV. 227 (1988) [hereinafter Comment, Cramdown Under the New Chapter
12].

2. See Note, Determination of an Appropriate Cram-down Interest Rate, supra note 1,
at 490 where "cramdown" is defined as "the court's ability to force creditors to accept a
debtor's reorganization plan if certain prerequisites are met." These prerequisites are
met when the plan is not acceptable to the creditor and the plan is confirmed over the
dissent of the creditor. One essential condition of the cramdown is that the creditor is
given the present value of his claim against the debtor as consideration for accepting
deferred payments. Id. at 489-90.

An illustration from a farm bankruptcy setting is quite instructive in distinguishing
the security status of claims. See Comment, Interest Payments in Bankruptcy, supra note
1, at 648. "A creditor has a secured claim to the extent of the value of its interest in
the collateral securing its claim and an unsecured claim for the balance of the allowed
claim." Id. (citing In re Hall, 752 F.2d 582, 589 (11th Cir. 1985)). "For example, if a creditor
has an Article 9 security interest in a combine valued at $10,000 securing an allowed
claim of $15,000, the creditor will have a secured claim of $10,000 and an unsecured claim
of $5,000. Such a creditor would be recognized as being undersecured. If the combine
was worth $15,000 and the creditor's allowed claim was $10,000, the creditor would have
a secured claim for $10,000 and would be oversecured." Id. In the oversecured situation,
the $5,000 is also called an "equity cushion." Id. at 648 n.15.
payable over two or three decades typically is the largest financial value considered in a bankruptcy proceeding. Finding a rate that promotes the feasibility of a bankruptcy reorganization plan is a critical administrative determination.

Considerable disagreement exists among bankruptcy courts on what is the proper interest rate to discount future values and how that rate should be determined factually. Courts of the Sixth, Eighth, and Ninth Circuits throughout the decade of the 1980's, more so than most federal circuits, have addressed the question of an appropriate rate to use in bankruptcy reorganization plans. The Sixth Circuit discussion has examined when to use either the contract rate or the prevailing market rate in specific fact situations. In the Eighth Circuit the debate has focused on the method of "constructing" a market rate using the Treasury bond rate as a base. Ninth Circuit courts have also emphasized method while employing the prime rate as a base.

This article reviews the analysis of interest rates by courts focusing on use of some rate representing the market rate when the contract rate is not retained in the reorganization plan. It

3. The difference in bankruptcy plan payments over 20 to 30 years can vary substantially with different discount interest rates. One simple calculation is presented to demonstrate that difference: total payments on a $500,000 loan, payable over 30 years, differ by $129,450 for an interest rate of 9 1/2% versus 8 1/2%. See Comment, Cramdown Under the New Chapter 12, supra note 1, at 239.

4. See, e.g., In re Klein, 10 Bankr. 657 (Bankr. E.D.N.Y. 1981); In re Smith, 78 Bankr. 491 (Bankr. N.D. Tex. 1987); United States v. Arnold, 878 F.2d 925 (6th Cir. 1989); In re Caudill, 82 Bankr. 969 (Bankr. S.D. Ind. 1988); United States v. Doud, 869 F.2d 1144 (8th Cir. 1989); In re Patterson, 86 Bankr. 226 (Bankr. 9th Cir. 1988); In re Kloberdanz, 83 Bankr. 767 (Bankr. D. Colo. 1988); Travelers Ins. Co. v. Bullington, 889 F.2d 276 (11th Cir. 1989).


7. In re Patterson, 86 Bankr. 226 (Bankr. 9th Cir. 1988); In re Miller, 4 Bankr. 392 (Bankr. S.D. Cal. 1980); In re Mitchell, 39 Bankr. 696 (Bankr. D. Or. 1984); In re Camino Real Landscape Maintenance Contractors, 818 F.2d 1503 (9th Cir. 1987); In re Welco Indus., 60 Bankr. 880 (Bankr. 9th Cir. 1986); In re Chaney, 87 Bankr. 131 (Bankr. D. Mont. 1988); In re A&L Properties, 96 Bankr. 287 (Bankr. C.D. Cal. 1988).
reviews the strengths and weaknesses as a market rate of the several interest options. It concludes that the market survey rate on loans of similar risk and duration favored by the Sixth Circuit is the most accurate rate to choose if the contract rate is not used and that the major limitation on more widespread use of the survey rate is data availability.

A. The Present Value Concept

The reason for the debtor paying present value is that he cannot now pay the full current value of an outstanding debt or make the payments agreed to in an original contract with a creditor. The specific purposes of an interest payment are stated in In re Willis:³ "(i) it compensates the lender for the delay in receipt of payment of the principal, and (ii) it compensates the lender for the risk that the contract will not be performed according to its terms."³ Present value is the "value today of a future payment, or stream of payments, discounted at some appropriate compound interest — or discount — rate."¹⁰ The

8. 6 Bankr. 555 (Bankr. N.D. Ill. 1980).
9. Id. at 559. The court in In re Benford, 14 Bankr. 157 (Bankr. W.D. Ky. 1981) noted that interest allowed is a better procedure than the alternative of over-inflating the value of secured property. Id. at 158. The Eleventh Circuit concluded in United States v. Southern States Motor Inns, 709 F.2d 647 (11th Cir. 1983), that "[t]he Bankruptcy Courts have almost uniformly ruled that the proper method of providing such creditors with the equivalent of the value of their claim as of the effective date of the plan is to charge interest on the claim throughout the payment period." Id. at 650.
10. J. DOWNES & J. GOODMAN, DICTIONARY OF FINANCE AND INVESTMENT TERMS 303 (1985). The present value concept has been stated in financial and legal sources in a variety of ways, but the essential idea is the same however stated. It is:

  a term of art for an almost self-evident proposition: a dollar in hand today is worth more than a dollar to be, received a day, a month or a year hence. Part of the "present value" concept may be expressed by a corollary proposition: a dollar in hand today is worth exactly the same as (1) a dollar to be received a day, a month or a year hence plus (2) the rate of interest which the dollar would earn if invested at an appropriate interest rate.

5 COLLIER ON BANKRUPTCY ¶¶ 1129.03, 1129-82 - 1129-83 (L. King 15th ed. 1979). Collier goes on to say:

The problem with the corollary proposition is that it only says that a dollar has investment value measured by the amount that the market will pay for the use of the dollar. The actual rate of interest on a dollar is determined by the risks which the lender is willing and able to assume.

Id. at 1129-83.
court in In re Snider Farms\textsuperscript{11} said, "Application of present value payments by use of a discount factor, is not due to any express or implied contractual obligations but is simply the result of the Debtor's deferred payment."

The Congressional mandate in 11 U.S.C. § 1129(a)(9)(C)\textsuperscript{12} to compensate the creditor for the debtor's delayed payment states that the "holder of such claim will receive on account of such claim deferred cash payments ... of a value, as of the effective date of the plan, equal to the allowed amount of such claim."\textsuperscript{13} This mandate has been interpreted consistently to mean that interest payments must be made to compensate the creditor for the lost present use of money.

B. The Basic Interest Rate Issue

The essence of the interest rate issue lies in choice of either the original contract rate or some market rate as the appropriate bankruptcy reorganization rate. The contract rate was the market rate of its day. It carries presumptive weight of fairness since it was the original arm's length rate negotiated between the creditor and debtor from which benefits were gained by both parties. It "reflect[s] the then prevailing cost of money, ... the prospects for appreciation or depreciation of the value of the security, and the risks inherent in a ... loan."\textsuperscript{14}

In In re Loveridge Machine & Tool Co.\textsuperscript{15} the court's support for the contract rate provides an excellent summary of its strengths. A contract rate avoids the error of favoring one party or the other and provides a rule which is easily applied and consistent with authority and reason. "Using any interest rate other than

\textsuperscript{11} 83 Bankr. 977, 988 (Bankr. N.D. Ind. 1988). Explanation of what the discount rate does is found in In re Neff, 89 Bankr. 672, 676 (Bankr. S.D. Ohio 1988). It represents compensation for the decreased value the creditor receives by the passage of time between confirmation and its receipt of the value of its collateral. That decrease occurs because of projected inflation and the creditor's inability to repossess its collateral immediately upon confirmation and reinvest the proceeds from liquidation of that interest.


\textsuperscript{13} Id.

\textsuperscript{14} In re Monnier Bros., 755 F.2d 1336, 1339 (8th Cir. 1985).

\textsuperscript{15} 36 Bankr. 159 (Bankr. D. Utah 1983).
the contract rate, where there is a contract, would produce irrational results." 16 The Loveridge court asked, "Why should bankruptcy law enforce the parties' bargain with respect to fees, costs, and charges but not enforce it with respect to interest?" 17 The court also identified the key contract versus market rate issue:

[Rejecting the contract rate where there is a contract might mean either a windfall to the creditor when the contract rate is less than the rate selected or a windfall to the debtor when the contract rate exceeds the rate selected.] 18

If the contract rate is continued as part of the reorganization plan, however, that rate may itself be part of the debtor's problem. The philosophy of bankruptcy legislation is that the debtor should be afforded relief from a debt burden in order to facilitate his reorganization. That relief may include reconsideration of the interest rate outstanding on the original loan contract if the contract rate is higher than the current market rate. Creditors seek a higher market rate if they have been forced to accept a cramdown. The rate adjustment problem was especially difficult in the 1980's when economy-wide interest rates, which ranged from 15% to 20% early in the decade, fell significantly in the second half of the decade. Other conditions change. The original contract rate cannot reflect today's profit rates, administration costs, industry transactions costs, costs of collection, and risk factors. 19 The implications of changing rates and conditions on continuing a contract rate or adopting a lower market rate are substantial in dollar values and as a general constraint on bankruptcy reorganization plans.

The strengths of the market rate, by comparison, are that it is current, it reflects arm's length transactions of many buyers and sellers, it is responsive to changed conditions, and it is adjustable to the specific circumstances of a bankruptcy proceeding. Despite the merits of the market rate, however, some courts have found it deficient. If it is important to have a nationally consistent rate, as in some national farm legislation, localized markets may be unfair. The rate could "benefit certain creditors

16. Id. at 162-63.
17. Id. at 163.
18. Id. In In re Gladdin, 107 Bankr. 803 (Bankr. M.D. Ga. 1989) the court indicated that an oversecured loan requires use of the contract rate. Id. at 807.
and debtors in certain parts of the nation to the detriment of certain farmers and creditors in other parts of the nation." 20

There is also a problem of use of the market rate in a "coerced loan" situation:

The court believes that the appropriate "market rate" for a loan of a term equal to the payout period, with due consideration for the quality of the security and the risk of subsequent default, is not necessarily or even usually, the rate at which some lender would, if coerced, lend money to a debtor in bankruptcy. If that were the standard, the Court would probably be required to find that no lender would make a loan of this type to any debtor in bankruptcy .... 21

Reservations on use of the market rate are also based on the unavailability of data. The court in In re Foster 22 recognized that there in no commercial interest rate in some instances due to the absence of lending activity. 23 The court in In re Cansler said simply, "Divining the current market rate when no real market for these loans exists is truly an inexact science." 24

The market rate has the advantage of being a generalized average of rates. It can be the most relevant to the bankruptcy condition because it is more current than the contract rate. By definition, it is the most responsive to current market conditions. Its principal limitation is data availability.

II. THE SIXTH CIRCUIT: CONTRACT VERSUS MARKET RATE

The contract versus market rate choice was the key interest rate issue in bankruptcy litigation addressed during the last decade in the Sixth Circuit. Those courts have framed the question as follows: should the contract or market rate be adopted for a "new loan" under a reorganization plan? The issue was examined recently by the United States Court of Appeals for the Sixth Circuit in a Chapter 12 decision, United States v. Arnold. 25 The ruling by the appellate court was that where a

23. Id. at 912.
25. 878 F.2d 925 (6th Cir. 1989).
cramdown occurs under section 1225(a)(5)(B) of the Bankruptcy Reform Act of 1978, a creditor is entitled to receive the current market rate on the "new loan." This decision capped an informative, analytical debate on the point by Sixth Circuit courts in the 1980's. Before examining the Arnold decision further, therefore, it is instructive to survey other Sixth Circuit decisions on interest rate determination for details of the debate.

A. "Pre-Whitman" Case Law

In In re Anderson, the court selected the "consensual contract rate" as the "most acceptable and feasible rate to be proposed by a debtor ...." In Memphis Bank & Trust Co. v. Walker, the bankruptcy court allowed only 10% interest on the court-reduced secured claim of appellant bank in a Chapter 13 case. The creditor sought the contract rate of 15.98%, citing 11 U.S.C. § 1325(a)(5)(B)(ii). The district court examined prime interest rates which had been at a minimum 12% since mid-1979 and concluded that the contract rate in the instant case was about the average of the prime rate during that two-year period. The court thereupon approved the collateral write down and reinstated the contract rate of 15.98%, reasoning that since the bank's secured interest had been diminished and it had to await deferred payments, the original contract rate was appropriate.

A Kentucky bankruptcy court also ruled on the appropriate interest rate in the Chapter 13 case In re Benford. After reviewing the Walker decision, the Benford court considered several

26. 11 U.S.C. § 1225(a)(5) provides that a court cannot confirm a plan unless:
(A) the holder of such claim has accepted the plan;
(B)(i) the plan provides that the holder of such claim retain the lien securing such claim; and
(ii) the value, as of the effective date of the plan, of property to be distributed by the trustee or the debtor under the plan on account of such claim is not less than the allowed amount of such claim; or
(C) the debtor surrenders the property securing such claim to such holder ....
27. 878 F.2d at 930.
29. Id. at 610.
31. Id. at 265.
32. Id. at 266.
33. Id.
34. Id. at 265-66.
interest rate possibilities, including the contract rate, legal rate, tax rate, and Treasury bill rate. It noted that the “touchstone of providing present value of a claim to be paid in the future is responsiveness to current market conditions” and the rule that “the contract rate applies would lack such responsiveness.”

Court decisions in the Sixth Circuit in this “pre-Whitman” era began the focus on the contract rate as the crux of the interest rate issue. No special rate conditions such as a sharply falling current market rate confused the issue, however. Therefore, there were no urgent requests by debtors to adjust the contract rate, and creditors received the negotiated contract rate.

B. Memphis Bank & Trust Co. v. Whitman

In Memphis Bank & Trust Co. v. Whitman the Sixth Circuit advanced the concept of a “new loan” arising in the reorganization process. The debtor in Whitman had purchased an automobile financed by Memphis Bank and Trust Company. The loan contract was to be paid over forty-two months at an interest rate of 21%. The debtor, having made no payments, filed for bankruptcy under Chapter 13 two months after incurring the debt, asking for extension of the loan to sixty months and a corresponding reduction in monthly payments. The bankruptcy court, without explanation, allowed a 10% interest rate on the allowed secured portion of the claim.

The Sixth Circuit said that “[i]n effect the law requires the creditor to make a new loan in the amount of the value of the collateral rather than repossess it, and the creditor is entitled to interest on his loan.” The court determined that rather than applying an arbitrary 10% rate of interest, the bankruptcy court should have used the higher current market rate of interest on similar loans in the region:

The theory of the statute is that the creditor is making a new loan to the debtor in the amount of the current value of the collateral. Under this theory, the most appropriate interest rate is the current market rate for similar loans at the time the new

36. Id.
37. 692 F.2d 427 (6th Cir. 1982).
38. Id. at 430.
39. Id.
40. Id. at 429.
loan is made, not some other unrelated arbitrary rate.\footnote{41} The case was remanded to the bankruptcy court.\footnote{42}

The court in \textit{In re Stratton}\footnote{43} cited \textit{Whitman} approvingly on the “new loan” concept and its use of the market rate. However, the court repeated \textit{Whitman}’s observation that “special circumstances” may justify a departure from the market rate.\footnote{44} A creditor who was secured only by an interest in the debtor’s principal residence “is limited to the contract rate of interest on his claim regardless of whether that rate is higher or lower than the current market rate for similar type loans.”\footnote{45} This ruling’s inconsistency with \textit{Whitman}’s holding that the current market rate governed can be explained in the special circumstances of the primary residence securing the loan.\footnote{46}

\textbf{C. In Re Colegrove And In Re Kain}

\textit{In re Colegrove}\footnote{47} also dealt with a Chapter 13 debtor whose primary residence secured an indebtedness. The bankruptcy court confirmed a plan, approved by the district court, which did not provide for interest on an arrearage.\footnote{48}

The Sixth Circuit in \textit{Colegrove} reviewed the justification of the contract rate by other courts: the contract rate is one “the parties agreed was a fair return to the creditor for the debtor’s repayment of the loan over an extended period of time;”\footnote{49} “the fixing of any other limit might be construed as an impermissible modification of the loan agreement;”\footnote{50} and “simplicity of operation” is served by the contract rate.\footnote{51} However,

the most equitable rate to establish in this type of situation is the prevailing market rate of interest on similar types of secured loans

\footnotesize{\begin{itemize}
\item \footnote{41} \textit{Id.} at 431.
\item \footnote{42} \textit{Id.}
\item \footnote{43} 30 Bankr. 44 (Bankr. W.D. Mich. 1983).
\item \footnote{44} \textit{Id.} at 45.
\item \footnote{45} \textit{Id.} at 46.
\item \footnote{46} The \textit{Stratton} court noted the special treatment accorded debtors’ principal residences: “Section 1322(b)(2) specifically says that the rights of these mortgage holders cannot be modified.... [A] debtor cannot ‘cram down’ a different valuation as ... with other types of secured claims.” \textit{Id.} at 45.
\item \footnote{47} 771 F.2d 119 (6th Cir. 1985).
\item \footnote{48} \textit{Id.} at 120.
\item \footnote{49} \textit{Id.} at 123 (quoting \textit{In re Evans}, 20 Bankr. 175, 177 (Bankr. E.D. Pa. 1982)).
\item \footnote{50} \textit{Id.}
\item \footnote{51} \textit{Id.}
\end{itemize}}
at the time of allowance of the creditors claim and the confirmation of the plan in bankruptcy with a maximum limitation on such rate to be the underlying contract rate of interest. 52

Thus, despite the broad theoretical justification, the contract rate was to be used only to set an upper limit on the market rate for a "new loan." The ruling in Colegrove thereby modified the Whitman ruling by limiting the level of rates. The Whitman rule that the market rate governed was restricted effectively in Colegrove to the situation where the market rate was lower than the contract rate.

Critical analysis of both Whitman and Colegrove was offered in 1988 at the bankruptcy court level in In re Kain. 53 Specifically, it said, the Whitman case involved a Chapter 13 plan that compelled the creditor to accept a cramdown on its collateral value, with only a portion of the total indebtedness secured after the cramdown. 54 In that situation, court allowance of the higher market rate of interest on what was effectively a "new loan" was justified. On the other hand, Colegrove involved a fully secured creditor where a default was to be cured, with interest, and the old loan reinstated. 55 The lower contract rate as per the original agreement was therefore approved.

The Kain court thereby found a basis for distinguishing Whitman and Colegrove that the Colegrove court itself did not identify: the market rate is appropriate in a cramdown situation where the creditor is forced to accept unsecured status for some of its claim and, in effect, make a new loan; the contract rate is appropriate where the creditor remains fully secured and receives payment on its old loan. 56

The Whitman holding prevailed in Kain. Citing Colegrove, the debtors in Kain had sought to pay the contract rate of interest which ranged from 3% to 16% on nine different notes. The creditor, Farmers Home Administration ("FmHA"), relied on Whitman's "new loan" distinction, arguing for the prevailing

52. Id.
53. 86 Bankr. 506 (Bankr. W.D. Mich. 1988). The Whitman position was also affirmed recently in In re Memphis Partners, 99 Bankr. 385 (Bankr. M.D. Tenn. 1989) where the court said the correct rate of interest to give present value under Whitman is the rate charged by institutional lenders for similar commercial transactions. Id. at 387.
54. Whitman, 692 F.2d at 429.
55. Colegrove, 771 F.2d at 120.
56. Kain, 86 Bankr. at 519.
market rates on notes which exceeded the contract rates.\textsuperscript{57} Comparing the facts in \textit{Colegrove} with those in \textit{Whitman}, the bankruptcy court in \textit{Kain} concluded that "\textit{Colegrove} only creates a very narrow exception to the general rule contained in \textit{Memphis Bank} . . . ."\textsuperscript{58} Thus, the \textit{Kain} decision generated in the Sixth Circuit interest debate in two areas: it approved a market rate of interest after cramdown even when it was higher than the contract rate; and it found that a basis for distinction between \textit{Whitman} and \textit{Colegrove} existed in a claim's security status even though the Sixth Circuit itself did not state that distinction explicitly.

The court in \textit{In re Neff} cited \textit{Whitman} approvingly in rejecting the contract rate and selecting the current market rate.\textsuperscript{59} The court said, "Lenders may have rates which are higher than the average rate because of unusually large loans in default, bad management decisions not characteristic of the market segment generally or specific requirements in a lender's charter."\textsuperscript{60}

The concern of the \textit{Neff} court was that it was not sure how such a market rate was to be calculated.\textsuperscript{61} Its analysis of rates

\begin{footnotes}
\footnote{57. Id. at 517.}
\footnote{58. Id. at 519. A lower court in \textit{In re Turner}, 87 Bankr. 514 (Bankr. S.D. Ohio 1988), later critiqued the \textit{Kain} decision by noting that it found no evidence that the \textit{Colegrove} court considered whether the creditor was fully secured or not. Id. at 517. The use of the contract rate as a maximum rate for such a fully secured creditor therefore was not indicated as well. In the case before it involving a partially secured creditor, the \textit{Turner} court then allowed only the contract rate while it acknowledged that the market rate was higher. \textit{Id.} at 518.}
\footnote{59. \textit{In re Neff}, 96 Bankr. 800, 801 (Bankr. S.D. Ohio 1989).}
\footnote{60. \textit{In re Neff}, 89 Bankr. 672, 677 (Bankr. S.D. Ohio 1988). The \textit{Neff} decision was modified and elaborated six months later. \textit{In re Neff}, 96 Bankr. 800 (Bankr. S.D. Ohio 1989). Here the creditor (the Federal Land Bank of Louisville, now the Farm Credit Bank) argued that the market survey rate was inappropriate (too low by about two percentage points). The creditor also suggested that it serviced a significant portion of the agricultural lending market and that its rates were higher than commercial bank rates due to greater lender risk in Chapter 12 loans. \textit{Id.} at 802-03. The court altered its earlier decision by holding that the most appropriate market rate should take into account the bank's internal average rate to the extent of the bank's "share of the market for long-term loans secured by agricultural real property." \textit{Id.} at 803. The market "survey rate" approved in the first \textit{Neff} decision was to be used for all other segments of the market, the court said, "because the commercial bank rates included therein represent a significant share of the market for which information on market rates can be obtained." \textit{Id.} The court insisted, however, that it was not altering its earlier decision that the appropriate rate should be an "average rate for an average borrower," an affirmation of the "market rate" principle. \textit{Id.}
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\footnote{61. 89 Bankr. at 677.}
therefore turned to how rates are established. It questioned specifically whether the market rate is set by past, present, or future contract rates. The court strongly recommended a "survey" rate, as found in studies of the Federal Reserve System on agricultural loans. However, it was silent on the limits of the differential between the two rates that it would accept.

In In re Kratz, this court repeated its Neff reasoning in adhering to the Whitman rule. That analysis led again to choice of the prevailing market rate for a "new loan" on an allowed secured claim. In In re Cansler, the district court also rejected the contract rate in approving the analysis of Whitman. It sustained the lower court's adoption of the prime rate as the market rate, however, since it could not find evidence that another "real market" rate existed. A Sixth Circuit bankruptcy court in In re Miller restated the Colegrove position when the creditor was fully secured (actually oversecured). The Miller court held that "the appropriate rate is the prevailing market rate on similar loans, as long as that rate does not exceed the contract rate of interest." The Miller decision (contrary to the Kain reasoning) suggests that the debtor shall always have the advantage in rate determination, receiving a market rate when it is lower than the contract rate, but never a rate above the contract rate.

D. Reconciling Colegrove with Whitman In United States v. Arnold

It was against this background of Sixth Circuit decisions that the appellate court decided United States v. Arnold. The issue at the bankruptcy court level was whether the interest rate on an allowed secured claim should be the contract rate or, as the

62. Id. at 678.
63. Id.
64. 96 Bankr. 127 (Bankr. S.D. Ohio 1988).
65. Id. at 131.
67. Id. at 762.
68. 98 Bankr. 311, 313 (Bankr. N.D. Ohio 1989).
69. Id. at 313.
70. The same position was adopted in In re Smith, 92 Bankr. 127 (Bankr. E.D. Pa. 1988).
71. 878 F.2d 925 (6th Cir. 1989).
FmHA argued, the current market rate for new loans. Relying on Colegrove, the bankruptcy court held that the interest rate should be the lesser of the contract rate or the current market rate. The district court rejected the bankruptcy court’s interpretation of Colegrove and held that “where there is a new bargain struck, where there is a write-down, the creditor should be entitled to the current interest on that obligation.”

The Arnold court reconciled the decisions in Whitman and Colegrove by adopting the distinction developed in Kain that Colegrove created only a narrow exception to the Whitman decision. That is, the creditor in Colegrove was not forced to accept a write-down since its collateral far exceeded the amount owed by the debtors. The Arnold court said, “It would not have been equitable to allow the creditor in Colegrove to recover interest at a rate in excess of that prescribed in the contract; for then the creditor would have received a windfall because of the bankruptcy.” The Whitman lender on the other hand had experienced the detrimental effects of the cramdown provision when the value of its collateral was reduced. Since what was once a totally secured claim prior to the devaluation was now undersecured, the creditor was entitled to view the secured balance as a new loan deserving protection through the current market rate of interest. Thus, the Arnold court was able to distinguish the Colegrove facts and apply the Whitman holding to the instant Chapter 12 case.

In In re Wright, the bankruptcy court cited the Arnold decision and observed that “present value is paid if the creditor receives the current market rate of interest for similar loans in the region.” The creditor insisted that since it (the Federal Land Bank) was the only lender to farmers on a long term basis, its rate was ipso facto the “relevant market rate.” The Bank noted that its rate was pegged 2% above its changing cost of money,

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72. Id. at 927.
73. Id. (emphasis added).
74. Kain, 86 Bankr. at 519.
75. Arnold, 878 F.2d at 930.
76. Id. at 929.
77. Id.
78. 103 Bankr. 905 (Bankr. M.D. Tenn. 1989).
79. Id. at 907.
80. Id.
making it a current market rate. On this latter point, however, the court said that the bankruptcy code "does not give a creditor the right to shift the risks of future variations in interest rates to a debtor."\[81.

E. Summary and Analysis of Sixth Circuit Interest Rate Decisions

The contract and market rates are the two rates most attuned to the bankruptcy setting. The Sixth Circuit courts have contributed significantly to a rule on how each may be used in changing money market conditions. First, the Sixth Circuit decision in Whitman was pivotal in identifying the cramdown as creating the need for a distinction, the resulting concepts of a "new" versus an "old" loan, and the justification therein for use of either the contract rate or the prevailing market rate of interest.\[82.\] Then the Whitman decision to allow a prevailing market interest rate on what effectively was a new loan in the bankruptcy confirmation plan was elaborated in Colegrove to allow the choice of the market rate so long as it did not exceed the contract rate.\[83.\] Finally, the court in Kain observed a distinction in Colegrove, however implicit it was, that use of the market rate was appropriate where cramdown had occurred and a "new loan" was made that was fully secured. The recent Arnold decision confirmed the distinction developed in Kain as to Whitman and Colegrove and reconciled the two decisions.\[84.\]

A 1990 decision by the Tenth Circuit in \textit{In re Hardzog} reveals the problem arising when the historical relationship of rates changes in the context of old guidelines. Here, the creditor's claim was fully secured after reorganization (an "old loan" condition). However, the court ordered use of the lower market rate (7.5\% versus the original contract rate of 12.5\%): "[W]e hold that in the absence of special circumstances, such as the market rate being higher than the contract rate, Bankruptcy Courts should

\[81.\] Id.
\[82.\] Whitman, 692 F.2d at 429.
\[83.\] Colegrove, 771 F.2d at 123.
\[84.\] Arnold, 878 F.2d at 929-30.
\[85.\] 901 F.2d 858 (10th Cir. 1990).
use the current market rate of interest used for similar loans in the region."86 The creditor is always to be penalized by receiving the lower rate. The creditor might opt with good reason to take possession of the collateral if given that choice.

Although other circuits are not bound by the guidelines developed in Arnold, acceptance of its rationale seems logical and consistent with the overall philosophy of bankruptcy proceedings. If the contract rate is not continued, however, what rate serves best as a replacement rate? The answer provided by bankruptcy courts is some "market" rate. The idea of a market rate has both real and symbolic positive value. It is the "going" rate. It is theoretically a composite of rates determined in arms length negotiations between buyers and sellers of funds in money markets. It is to that extent an accurate assessment of what current money market conditions are. However, there are many market rates at any one time. Even when the market rate is indicated, therefore, there is no firm rule as to which market rate is appropriate in a forced loan situation.

III. MARKET INTEREST RATE OPTIONS

Bankruptcy courts in the past decade have used a dozen or so interest rates to serve as a current market rate when the contract rate is not continued. Those options may be grouped as follows: "formula" and rates; creditor-oriented rates; adjuncts to rate determination; and rates adjusted for use as a market rate. It is the last group of rates — which includes the prime and treasury rates — that courts in the Eighth and Ninth Circuits have employed regularly. It is worthwhile to development of the focus on those rates, however, to consider why fixed or formula rates and rate methods mostly have been rejected. Those rates are examined briefly before more extended analysis of the fourth group of rates most used as market rates is undertaken.

A. The "Formula" Rates

Several rates are identified as formula rates because they are determined periodically using a set statistical procedure. They include (1) the federal tax (section 6621 rate), (2) the federal legal

86. Id. at 860.
rate, (3) state legal rates, (4) the rate on consumer loan contracts, (5) the rate charged by the Federal Land Bank, and (6) averages of several of these rates.

1. The federal tax rate is a statutory interest rate advanced by the Internal Revenue Service as the governing rate to be paid on unpaid federal tax liabilities under 26 U.S.C. § 6621. It is based on an average of the predominant rates quoted by commercial banks to large business as surveyed by the Federal Reserve System, and is revised quarterly.

While the tax rate has been used outside of cases involving tax obligations of debtors, its use most often has been in delinquent tax cases. One court felt that the section 6621 rate, especially the technique provided by statute for deriving the rate, seems to provide an "equitable solution" to finding an appropriate discount factor. It was justified by the court as "reasonably responsive to current economic conditions, is subject to periodic revision, yet it is not an unfair burden on Chapter 13 debtors."
However, the section 6621 has been rejected for similar reasons. It was disapproved in favor of the interest rate on judgments in United States district courts because the section 6621 rate incorporated elements other than those found in bankruptcy such as aspects of "deterrence and sanction" which the court thought were not "marketplace factors." The court in *United States v. Neal Pharmacal Co.* rejected use of the tax rate, saying that "there is no 'market' for the type of involuntary loan involved in the case of deferred payments of federal taxes because the IRS is not in the business of lending money." Further, the section 6621 rate is not current, perhaps lagging three and one-half to nine and one-half months behind other market rates. The court noted that other courts have criticized the rate because it "ignores variations between the length of the payment period, the quality of the security, if any, and the risk of default." The court in *In re Snider Farms* noted the section 6621 rate reflects tax objectives, not those of bankruptcy law.

The use of the section 6621 tax rate is most appropriate where the debtor is tax delinquent. While the rate is simple to find and requires minimum calculation, its value is set only quarterly; it is not very responsive to current market conditions.

2. The *federal legal rate* under 28 U.S.C. § 1961(a) is the statutory interest rate allowed in a district court on a money judgment in a civil case. One court held that "[t]his rate can be

95. 789 F.2d 1283 (8th Cir. 1986).
96. *Id.* at 1286.
97. *Id.* at 1287.
98. *Id.* at 1288. The *Neal Pharmacal* court mentioned two other criticisms of the tax rate which it dismissed as insignificant: the § 6621 rate includes "elements beyond compensation" such as profit and administrative cost and may include a "punitive element" for delinquent taxpayers. *Id.* at 1288 n.12.
100. 28 U.S.C. § 1961(a) (1988): (a) Interest shall be allowed on any money judgment in a civil case recovered in a district court. Execution therefore may be levied by the marshal, in any case where, by the law of the State in which such court is held, execution may be levied on interest on judgments recovered in the courts of the State. Such interest shall be calculated from the date of the entry of the judgment, at a rate equal to the coupon issue yield equivalent (as determined by the Secretary of the Treasury) of the average accepted auction price for the last auction of fifty-two week United States Treasury Bills settled immediately prior to the date of the judgment. The Director of the Administrative Office of the United States Courts shall distribute notice of that rate and any changes in it to all Federal judges.
computed easily and, due to its frequent adjustment, is indicative of \ldots existing economic conditions.\ldots\"^{101} Most commentary on the section 1961(a) rate has been negative, however. Typical is the observation in \textit{In re Loveridge Machine & Tool Co.}^{102} that the rate was \textquote{ill advised and erroneous as a matter of law.}\textquote{.}^{103} It said that section 1961(a) is not applicable to a loan situation involving a risk condition or something other than a one-year loan.\textquote{.}^{104} There is an important difference in the risk-free rate and the rate \textquote{that is to govern a forced loan for a period of years.}\textquote{.}^{105}

The main problem with the federal legal rate is essentially the same as that with the tax rate: debtor loans are not risk free while a statutory rate is often based on treasury rates which are essentially risk free. Moreover, a bankruptcy repayment period is normally for more than one year, so the legal rate does not match the bankruptcy payout term well.

3. The umbrella of legal rates includes \textit{state legal judgment rates}. In \textit{In re Lum}^{106} the court observed that \textquote{[w]here there is no contractual rate of interest courts sometimes allow the \textquote{legal} rate as the proper payment for the loss of use of money.}\textquote{.}^{107} The matter at hand involved an installment sales contract where a legal rate seemed appropriate.\textquote{.}^{108} For essentially the same reasons that the section 1961(a) rate under federal law is considered inadequate, state legal rates also are deemed ill-suited to general bankruptcy conditions. The state legal rate was \textquote{fixed and thus unresponsive to current market conditions,}\textquote{.}^{109} Similarly, the court in \textit{In re Hyden}^{110} criticized the legal rate saying that neither the

103. \textit{Id.} at 169.
104. \textit{Id.} at 170.
105. \textit{Id.} at 169. The \textit{Loveridge} court nonetheless found \textquote{persuasive} the use of a risk-free rate on \textquote{obligations due at the time of the completion of the payments under [the] plan} as the base to which could be added \textquote{extra interest \ldots to compensate for risks,}\textquote{.}^{107} as in \textit{In re Stockdale Corp.}. Bankr. No. 81-01288, transcript of oral ruling, Mabey, J. (Bankr. D. Utah June 23, 1982). \textit{Loveridge}, 36 Bankr. at 170.
106. 1 Bankr. 186 (Bankr. E.D. Tenn. 1979).
107. \textit{Id.} at 188.
108. \textit{Id.}
110. 10 Bankr. 21 (Bankr. S.D. Ohio 1980).
state legal rate nor the rate on judgments in Ohio "bears a direct relationship to the value of money in the market place or in arm's length transactions."111

The legal rate, while simple to use, is neither responsive to current market conditions nor is it especially applicable to bankruptcy. It has little pertinence to the rate creditors and debtors set in arm's length negotiations.

4. The rate on consumer loan (installment) contracts was considered, rejected when used alone, and then used in an "average" of rates in Hyden.112 The court in In re Benford113 adopted the consumer loan contract rate, saying, "This method is most responsive to changing economic conditions, yet provides each debtor and secured creditor with a reasonably certain and uniform method for calculating the long-term equivalent of a claim's present value."114 This consumer loan rate, moreover, is identified as the market rate since it is "the product of supply and demand, and is influenced by the prime rate, discount rate, commercial paper rate, Treasury bill rate and so on. It therefore reflects the interaction of economic variables that affect the cost of lending money."115

The consumer loan contract rate does not apply to bankruptcy outside the context of installment loans. Its limited use there probably is as appropriate as any rate. For general use, however, it is less responsive to current economic conditions than either the tax or legal rate.

5. In In re O'Farrell116 the court approved the interest rate charged by the Federal Land Bank as the "prevailing market rate" for a loan of a term equal to the payout period, with due consideration of the quality of security and risk of subsequent default.117 The court reasoned that the Federal Land Bank is "solely a farm lender, and traditionally has the most favorable

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111. Id. at 27. Referring to the legal rate in Illinois which also was the usury rate, the court in In Re Willis, 6 Bankr. 555 (Bankr. N.D. Ill. 1980) said "[n]either of these figures has any relationship to a secured creditor in a bankruptcy proceeding." Id. at 563.
112. Hyden, 10 Bankr. at 27.
114. Id. at 160.
115. Id.
117. 74 Bankr. at 424 (citing In re Southern States Motor Inns, 709 F.2d 647, 651 (11th Cir. 1983)).
rates available. It is also one of, if not the, largest farm lenders in the country."

Appraisal of the Federal Land Bank rate as an appropriate interest rate is essentially the same as for the consumer loan contract rate. Its use is limited to a specific category of loans and is not appropriate generally for bankruptcy situations.

6. The use of rate averaging attempts to reduce the error in choosing a single rate by spreading that error potential among several rates. Averages typically include one or more of the other special rates previously identified.

The average rate options in case law are imaginative and varied. They include a mix of the interest rate in effect on installment sales contracts (where the security was an automobile), the contract rate, and an arbitrary levelling factor of 6%;119 a blend of farm real estate loans by commercial banks in the Fifth and Seventh Federal Reserve System Districts;120 an average of the legal interest rate in New York state (6%) and the contract rate (19.56%);121 an average of the contract rate and the prevailing rate charged by credit unions;122 an average of the prime rate (9% at the time), the 30-year treasury bond market rate (8.81%), and the 30-year mortgage rate (9.97%) of the Federal Home Loan Mortgage Corporation on the effective date of the (Chapter 12) plan.123

The court in In re Caudill124 noted that while an average of rates "might well provide a more nationally standardized methodology" (than localized "market rates"), it thought its use would "skew the interest rate downward to the substantial detriment of the creditors."125 The reason given was that an average likely

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118. Id.
119. See, e.g., In re Hyden, 10 Bankr. 21 (Bankr. S.D. Ohio 1980).
120. See, e.g., In re Neff, 89 Bankr. 672 (Bankr. S.D. Ohio 1988).
121. See, e.g., In re Klein, 10 Bankr. 657 (Bankr. E.D.N.Y. 1981). The contract rate here was higher than the current market rate. The key issue in use of the contract rate versus the market rate addressed by the Sixth Circuit Court, as discussed supra text accompanying notes 25-86, is critical only to the extent that the contract rate is significantly higher (as in In re Klein) than a subsequent "other" rate such as the legal rate or current market rate at the time of plan confirmation. Otherwise there would be less a problem to the contending parties in choosing an "appropriate" other-than-contract rate.
124. 82 Bankr. 969 (Bankr. S.D. Ind. 1988).
125. Id. at 979.
would include "below-market interest rates offered by governmental entities and agencies, as well as statutory interest rates, Treasury Bill interest rates, and lending institution interest rates."\textsuperscript{126} The court also feared a "statistical quagmire" would result.\textsuperscript{127}

In \textit{In re Breisch}\textsuperscript{128} the court rejected the debtor's use of an 8\% interest rate computed as an average of rates published in the May 17, 1990, edition of the \textit{Wall Street Journal}.\textsuperscript{129} The court said that the debtor's plan did not comply with the law in the district, and that unless the parties could establish the exact amount of the creditor's cost of funds in its business borrowing, the proper rate to apply was a Treasury bill rate plus one percent.\textsuperscript{130}

An average rate theoretically borrows the strengths of the several rates it adopts and so yields a rate more appropriate to a bankruptcy setting than any one of its component rates. Unfortunately the weaknesses of each rate are borrowed also. These weaknesses are compounded if the rates chosen for averaging do not have the same statistical time base.

7. Summary on Special Rates

The principal feature and chief limitation of all special "formula" rates and the averages of rates based on them is that they are designed for one purpose, a purpose not especially related to the bankruptcy condition. They are also fixed by law for some time period and therefore are less responsive to changing economic conditions.

\textbf{B. The Creditor-Oriented Rates}

There are two interest rates designated as creditor oriented or "creditor specific." The designation suggests that rates are set primarily with the creditor in mind, with little attention given to the general market condition.

1. The theory behind the debtor paying an interest rate equivalent to the \textit{cost of funds to the creditor} is that the creditor should

\begin{footnotes}
\item[126] \textit{Id.} at 980-81.
\item[127] \textit{Id.} at 980.
\item[129] \textit{Id.} at 272.
\item[130] \textit{Id.}
\end{footnotes}
be reimbursed for transactions and other costs of acquiring funds to replace those funds not available because of the debtor's default.131 Thus, if the creditor receives an interest rate equal to the cost of funds to replace his investment funds, he does not gain or lose from the deferred access to his collateral.

In In re Hardzog132 the court observed the balancing that occurs in the cost-of-funds approach:

Where the rate paid for funds is less than the contract rate the debtor is afforded some relief and the creditor receives its cost to obtain replacement funds. It can then reinvest the funds, providing it the opportunity to receive profit from another borrower while suffering no continuing loss due to the bankruptcy of the debtor.133

In In re Caudill,134 however, the court noted that the cost-of-funds approach would vary between entities, citing government entities that “are fully funded by taxpayers” and arguably have a zero cost of funds.135 The court opined that “this methodology is unfair and inequitable to all parties ... a poorly run organization would be benefitted to the detriment of an efficient creditor organization.”136 The court in In re Cooper137 rejected the cost-of-funds approach as “misplaced:” “[A] standard reflecting the credit worthiness of the ... creditor rather than the credit risk of the debtor.”138

The cost-of-funds rate supposedly provides equitable treatment to both parties since implicit in the cost-of-funds approach is the assumption that the cost-of-funds rate will be lower than the contract rate. The debtor then stands to gain in the presumed lower cost of funds while the creditor can earn interest at the current rate sufficient to obtain replacement funds and thereby do business with another borrower.

The cost-of-funds rate is not specific to the bankruptcy condition since the interest rate changes with the creditor's business condition. Moreover, the cost of funds to the creditor and debtor typically is not the same.

131. Comment, Cramdown Under the New Chapter 12, supra note 1, at 239.
133. Id. at 703-04.
134. 82 Bankr. 969 (Bankr. S.D. Ind. 1988).
135. Id. at 979.
136. Id.
138. Id. at 394.
2. The rationale for a court allowing the rate at which investors can invest funds is an "opportunity cost" idea not unlike the cost-of-funds approach described above. In an early decision in *In re Smith*\(^{139}\) where the contract rate and the discount rate were presumed to be "equivalent,"\(^{140}\) the court reasoned that General Motors Acceptance Corporation ("GMAC") (the creditor) "would likely invest its money by financing the purchase of another automobile at the same annual interest rate."\(^{141}\)

This rate is imperfectly responsive to particular bankruptcy situations because it reflects primarily the factors that influence business profitability. Acumen in investing differs from business to business. The more astute business person with greater investing skill or luck can command a higher return and therefore impose a higher interest cost on the debtor.

C. Adjuncts To Rate Determination

Two adjuncts to rate determination have been proposed as interest rates. They are the testimonial rate and the variable (or "floating") rate.

1. The *testimonial rate* may mean a specific, widely known interest rate affirmed by an expert or the rate found as the result of surveys of rates actually negotiated between lenders and debtors. Agricultural loan data was not available except through a survey developed by an expert in *In re Paddock*.\(^{142}\) The proceedings in *In re Rott*\(^{143}\) provided a good case study of the use of experts in developing a testimonial rate. Both creditor and debtor experts agreed on the use of a market rate, but differed on the nature and extent of risk and time factors in determining that rate.\(^{144}\)

The court in *Neff* decided against the testimonial rate since it could cause the court's decision to be "unusually sensitive to a party's ability to retain and present a persuasive expert witness ...."\(^{145}\) The court in *In re Wichmann*\(^{146}\) also criticized the use of testimonial rates:

\(^{139}\) 4 Bankr. 12 (Bankr. E.D.N.Y. 1980).
\(^{140}\) Id. at 13.
\(^{141}\) Id.
\(^{142}\) 81 Bankr. 51 (Bankr. D. Mont. 1987).
\(^{144}\) Id. at 169.
\(^{145}\) In re Neff, 89 Bankr. 672, 679 (Bankr. S.D. Ohio 1988).
This Court believes that allowing the discount rate to vary depending upon the quantity and the quality of expert proof simply creates additional problems both for the debtors, the creditor and the Court by eliminating certainty and introducing additional delay and cost into the confirmation process.\(^{147}\)

Using expert testimony on the appropriate rate increases the court time and expense devoted to its determination. The value of expert testimony therefore depends on the improved quality of the data provided thereby, raising again the question of which interest rate after all is appropriate.

2. The variable or floating rate could use any of the other rates as a base, this “rate” being a method of payment rather than a rate theory. It would appear that a variable rate could provide a better future payout matchup than a fixed rate, since payments under a plan could accommodate future interest rate changes. The court in *In re Patterson*\(^{148}\) said, “[w]e think a variable rate particularly appropriate because ... the plan may provide for payment ... over a period exceeding five years.”\(^{149}\) The *Patterson* court found a variable rate appealing because at times it could more accurately reflect market conditions, for example, “the volatility of the agricultural economy ....”\(^{150}\)

However, the Eighth Circuit addressed the variable rate issue in *Neal Pharmacal* and said that a fixed rate of interest better accommodated the requirement in 11 U.S.C. § 1129(a)(9)(C) that present value be determined “as of the effective date of the plan.”\(^{151}\) That court went on to criticize the “floating” rate (approved by the bankruptcy court) as “administratively difficult and would complicate a determination of the feasibility of the debtor’s reorganization plan ....”\(^{152}\) In *In re Claeys* the court said, “A present value calculation simply cannot be made if the discount rate is unknown or to become variable in the future.”\(^{153}\)

The key problem in the use of a variable rate is the inability to determine present value accurately when using a variable rate.

\(^{147}\) *Id.* at 720.

\(^{148}\) *In re Patterson*, 86 Bankr. 226 (Bankr. 9th Cir. 1988).

\(^{149}\) *Id.* at 229.

\(^{150}\) *Id.*

\(^{151}\) United States v. *Neal Pharmacal Co.*, 789 F.2d 1283, 1286 (8th Cir. 1986).

\(^{152}\) *Id.*

The present value sum determined now is assumed to earn at some (single) pre-designated interest rate. Since a present value payment is a composite of principal and interest calculated now for some future years, periodic payments cannot now be adjusted to a changing interest rate.

D. Summary On "Formula" Rates and Methods

Each of the formula interest rates used by bankruptcy courts has some merit in given circumstances. There is justification for use of the section 6621 tax rate in delinquent tax situations, for example, or the installment sales contract rate if the debtor has made an installment purchase. These rates may reflect well the contract rates currently negotiated. The Treasury bond rate initially seems applicable to the large number of farm debtors owing to federal government agencies. None of these rates serves well as a general bankruptcy rate or as a base for a general rate, however, although any one may be useful as a reference in a given fact situation.

The court in *In re Willis* \(^{154}\) rejected all "fixed" rates (the legal rate and Federal Reserve Discount Rate as well as the prime rate and three-month Treasury bill rate) as "not address[ing] the problem, which is, compensating the secured creditor for the delay in enabling him to enjoy the fruits of his security agreement." \(^{155}\) The court in *In re Benford*, \(^{156}\) after reviewing use of several rates, specifically the legal rate, the IRS tax (6621) rate, and the Treasury bill rate, said that all of these methods, "though reasonably responsive to the vicissitudes of the economic marketplace, are wanting in some respect." \(^{157}\) The analysis of rates above suggests that the same comment applies to the rate on consumer loan contracts, the Federal Land Bank rate, and various average rates, which often include formula rates.

The creditor-specific rates identify rates appropriate to different stages in the financial flow of a firm. The cost-of-funds rate measures the ability of firms to attract funds. The rate at which investors can earn measures success in the use of funds. Both

\(^{154}\) *In re Willis*, 6 Bankr. 555 (Bankr. N.D. Ill. 1980).

\(^{155}\) *Id.* at 563.


\(^{157}\) *Id.* at 160.
are limited by their focus on the creditor’s side of a money market. They therefore do not reflect the market condition fully.

Finally, some interest rates professed as rates are not operational rates at all, but methods of payment or judgments on the appropriateness of other rates. The variable or floating rate, for example, is not an operational rate but a method of payment. Various “testimonial” rates are “expert judgments” as to which other rates are appropriate.

IV. RATES ADJUSTED FOR USE AS THE MARKET RATE

In the same way that courts of the Sixth Circuit debated the positions on use of either the contract or market rate, the Eighth and Ninth Circuits have discussed “construction” of rates they feel are representative of market conditions. These constructed rates constitute a fourth category of rates. In place of the generalized formula rates explicitly rejected by both circuits, the constructed rate is found on a case-by-case, individualized basis. Courts adopting this approach emphasize the method of developing the rate, that is, the specific rate adopted by the court is less important than the procedure used to determine the rate.

The construction process is itself relatively simple. Using another rate, specifically the prime rate or Treasury bond rate as a base, these courts then use factors specific to the loan condition, such as risk elements or length of the payout period, to derive a numerical value for these developed rates. The result achieved reflects what courts perceive to be the market rate. The validity of this result as a bankruptcy interest rate is determined by the accuracy of the method.

A. The Eighth Circuit: The Treasury Bond Rate As Market Rate

A United States Treasury borrowing rate158 represents the interest rate at which the federal government borrows in the

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158. The three “Treasuries” or negotiable debt obligations of the U.S. Government of particular interest in this article are: (1) Treasury bills - short-term securities with maturities of one year or less issued at a discount from face value. Auctions of 91-day and 182-day bills take place weekly. The Treasury also auctions 52-week bills once every four weeks. (2) Treasury notes - intermediate securities with maturities from 1 to 10 years. The notes are sold by cash subscription, in exchange for outstanding or maturing government issues, or at auction. (3) Treasury bonds - long-term debt instruments with maturities of 10 years or longer. DOWNES & GOODMAN, supra note 10, at 443.
money markets in competition with other borrowers. The rate is paid on an investment virtually free of default risk and is therefore lower than the rate on an investment instrument that has a higher risk. The court in In re Wichmann\(^{159}\) stated the advantages of a Treasury rate: it is riskless, it can be matched well to annual repayment terms with a variety of maturities, it is relatively simple to find because it is publicly reported in a number of sources, and it reflects national markets reported daily.\(^{160}\) Rarely is the treasury rate used as the bankruptcy discount rate without a risk premium attached.\(^{161}\) The use of risk-adjusted Treasury rates has been especially prominent in the Eighth Circuit.

1. Early "Market" Decisions

An early Eighth Circuit analysis of the appropriate rate occurred in In re Monnier Brothers.\(^{162}\) After considering the debtor's urging of several rates on the court, including the Treasury bill rate, the court allowed the contract rate when the creditor was oversecured, a not uncommon or unreasonable position.\(^{163}\)

The Eighth Circuit in United States v. Neal Pharmacal\(^{164}\) opted for a "prevailing market rate" on a comparable loan but, unable to determine what that rate was, stressed the need to seek an appropriate interest rate in a "case-by-case" approach, not a "uniform interest rate." It remanded to the bankruptcy court with instructions that a hearing be held for evidence on the prevailing market rate.\(^{165}\)

The key elements of this instruction are that the discount rate is based on some interest rate, and that courts must "determine" that rate. The factors listed that must be considered, moreover, mandate the method by which the rate is determined, not a specific rate as market rate. After reviewing both the Monnier and Neal Pharmacal decisions using that instruction, the In re Citrowske court opted for this definition of the market rate:

[The interest rate which the creditor involved would charge to the debtor in the present regular loan market is presumptively

\(^{160}\) Id. at 721.
\(^{161}\) In re Neff, 89 Bankr. 672, 679 (Bankr. S.D. Ohio 1987).
\(^{162}\) 755 F.2d 1336 (8th Cir. 1985).
\(^{163}\) Id. at 1339.
\(^{164}\) 789 F.2d 1283 (8th Cir. 1986).
\(^{165}\) Id. at 1289.
the correct interest rate, keeping in mind, however, that the ultimate decision about the quality of the security and the risk of subsequent default is for the court and not the creditor.\footnote{166. \textit{In re Citrowske}, 72 Bankr. 613, 617 (Bankr. D. Minn. 1987). The court in \textit{In re Edwardson}, 74 Bankr. 831 (Bankr. D.N.D. 1987) provided an interesting commentary on a debtor who, being able to "shed several hundred thousand dollars worth of unsecured debt, is not the severe credit risk that the Bank would have the court believe." \textit{Id.} at 836. The court said effectively that the debtor should be entitled to a lower interest rate because of the writedown. However, the creditor here is losing two ways. He must accept a writedown of an allowed secured claim. Then, because that value has been reduced, the debtor's credit standing must be assumed to have improved, justifying payment of a lower interest rate to the creditor. \textit{Id.}
}{170. 74 Bankr. at 867.
}{171. \textit{Id.}
}{172. \textit{Id.} at 869-70.
}{173. 29 Bankr. 542 (Bankr. D. Kans. 1983).}
Moreover, Treasury bond yields are reported on a variety of maturity dates which permits matching to the average amount outstanding during the term of the allowed claim. The matching found possible in the Doud decision is through the "Carbiener adjustment" as discussed below. In choosing the Treasury bond rate, the Doud court also rejected the Treasury bill rate as being short term, thus not permitting the longer payment matchup desired.

The Nebraska bankruptcy court soon followed Doud in In re Wichmann in approving the Treasury bond rate plus a risk factor with almost identical reasoning and identical results. It bears repeating that the Treasury bond rate plus 2% for risk considered appropriate in both Doud and Wichmann was a rate announced as the market rate. The market rate itself was unknown, a theoretical construct posited as an ideal by the court. A court was obliged to consider the risk element, quality of security, and payout period in making its judgment as to what rate best represented the market rate. The Treasury bond rate with risk adjustment was deemed to reflect best those attributes of the true market interest rate.

3. In re Claeys and In re Konzak

By contrast, in In re Claeys the North Dakota bankruptcy court said that the use of the Treasury bond rate with risk adjustment was arbitrary and unnecessary, rejecting that approach in favor of a rate based on what a "similar loan to a debtor in similar circumstances would cost in the marketplace." The court repeated the observation in In re Monnier that rates offered in the marketplace, especially to agricultural borrowers as in this case, already have factored into them the prevailing cost of money, prospects for changed valuation of the security, and long term risks.

174. Id. at 543.
175. Doud, 74 Bankr. at 870-72.
176. See the critique of this adjustment infra pp. 490-91 & notes 210-12.
177. Doud, 74 Bankr. at 868.
180. Id. at 993.
181. Id.
In *In re Konzak*\(^{182}\) the same court a few days later reaffirmed the *Claeys* reasoning and decision, adding that the rate charged to a “debtor for such a loan in the marketplace absent the event of bankruptcy” was the appropriate rate.\(^{183}\) While the latter comment is troublesome for other reasons, the basic thrust of the analysis was to establish the market rate as the standard.\(^{184}\) There was no mention of Treasury bond rates.

The *Claeys* and *Konzak* court seemingly had reached the same conclusion as the *Doud* court that the “prevailing market rate” was the appropriate rate. They differed with *Doud* that the Treasury bond rate best represented the market rate, however.

In *In re Underwood*,\(^ {185}\) the Treasury bill rate plus 2% for “generalized” risk factors and another 2 1/2% for the quality of collateral as a “special” risk factor was allowed.\(^ {186}\) The court recited the details of the disagreement between the market rate and treasury rate proponents and observed that the divergence between the two is “largely superficial.”\(^ {187}\) Courts “are all generally considering the factors enumerated by *Collier* and adopted by the Eighth Circuit.”\(^ {188}\) It repeated an observation made in several courts examining the interest rate issue that there is no “market interest rate” for the “coerced loans” made by secured creditors.\(^ {189}\)

In *In re Batchelor*,\(^ {190}\) the Eastern District of Arkansas Bankruptcy Court chose the market rate for loans in circumstances similar to the *Underwood* facts.\(^ {191}\) The court matched up the facts in the case before it with those applicable to a Federal Land Bank “Tier III” loan and determined that loan rate to be the appropriate market rate.\(^ {192}\) It repeated the rule a year later in

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\(^{183}\) Id. at 992.
\(^{184}\) It is questionable if the rate of interest determined in a bankruptcy setting and one determined “absent the event of bankruptcy” can be the same value in any local or regional market.
\(^{186}\) Id. at 601.
\(^{187}\) Id. at 599.
\(^{188}\) Id.
\(^{189}\) Id. at 600.
\(^{190}\) 97 Bankr. 993 (Bankr. E.D. Ark. 1988).
\(^{191}\) Id. at 996.
\(^{192}\) Id.
In re Gore\textsuperscript{193} where it observed specifically that "the contract rate ... is not controlling."\textsuperscript{194} However, the Bankruptcy Court for the Western District of Arkansas in In re Schaal\textsuperscript{196} chose the Treasury bond rate plus 2\% "in principle" but said it was "not necessary" to use that rate in the case before it. Instead it used the FmHA rate on loans secured by real estate.\textsuperscript{196} It did so in reference to In re Doud.\textsuperscript{197} This market rate was lower than the Treasury bond rate. The Schaal court, however, justified the rate on grounds that FmHA's purpose was to provide credit to farmers "as forms of social welfare," to "assist the underprivileged farmer."\textsuperscript{198}

Thus the Minnesota (Citrowske), North Dakota (Claeys and Konzak), Missouri (Fleshman), and Arkansas (Batchelor) bankruptcy courts favored essentially a "case-by-case" market rate approach, meaning they determined in each case a rate based on what it would cost debtors for loans of similar risk and duration. By contrast, the courts in Iowa (Doud), Nebraska (Wichmann and Underwood), and Arkansas (Schaal) favored the Treasury bond rate plus a risk adjustment as representing the market rate.\textsuperscript{199}

\textsuperscript{193} 113 Bankr. 504 (Bankr. E.D. Ark. 1989).
\textsuperscript{194} Id. at 610.
\textsuperscript{195} 93 Bankr. 644 (Bankr. W.D. Ark. 1988). However, in In re Butler, 97 Bankr. 508, 513 (Bankr. E.D. Ark. 1988) the prime rate instead of the Treasury bond rate was chosen as the base rate representing the market rate to which a 2\% risk adjustment was added.
\textsuperscript{196} 93 Bankr. at 647.
\textsuperscript{197} Id. at 646. The Doud court (in allowing the contract rate on certain disputed notes) had observed that since "debtors have borrowed under loan programs designed to provide opportunities to low equity farmers at congressionally-mandated low interest rates," the need for using the market rate approach to an interest rate is obviated. In re Doud, 74 Bankr. 865, 871 (Bankr. S.D. Iowa 1987).
\textsuperscript{198} 93 Bankr. at 647.
\textsuperscript{199} That method is adopted in other circuits. In In re Cassell, 107 Bankr. 536 (Bankr. W.D. Va. 1989), for example, the court used the Treasury bill rate as of the date of filing of the Chapter 13 petition plus a 1\% add-on for risk for the payout of less than 48 months and the Treasury bill rate plus a 2\% add-on for risk for the payout over 48 months. Id. at 541. Likewise, in In re LLL Farms, 111 Bankr. 1016 (Bankr. M.D. Ga. 1990) the court allowed an interest rate of 10.2\% based on a current yield on 15-year Treasury bonds plus a 2\% add-on. Id. at 1022. See also In re Breisch, 118 Bankr. 271, 272 (Bankr. E.D. Pa. 1990). In In re Aztec Co., 107 Bankr. 565 (Bankr. M.D. Tenn. 1989), the court, in observing that absence of a market for a (coerced) loan was not dispositive of the interest rate issue, stated: "No evidence has been offered to upset the conclusion that 200 basis points over applicable Treasury bill rates is minimally sufficient to give FHLMC the present value of its allowed secured claim." Id. at 588.
4. The Eighth Circuit in United States v. Doud

An Eighth Circuit ruling in 1989 settled the dispute over use of a treasury rate with risk adjustment or the "prevailing market rate" with a Solomonesque compromise. In United States v. Doud\(^{200}\) it approved the market rate principle but determined the market rate to be the Treasury bond rate plus 2\(\%\)\(^{201}\). In doing so it reiterated the need for a case-by-case approach as it had done in the Monnier and Neal Pharmacal decisions. The Doud court suggested, in short, that courts should not be bound by any kind of formula rate.\(^{202}\) It repeated the familiar instruction that courts should consider each case separately against the standards previously announced: the length of the payout period, the quality of security, and the risk of subsequent default. The Treasury bond rate with risk adjustment was consistent with the case-by-case analysis used in constructing the market rate.\(^{203}\)

5. Critique of the Treasury Bond Rate

There are several points of critique on use of the Treasury bond rate with risk adjustment. First, arbitrariness in the setting of a risk factor on top of a base rate was retained in the Doud approach. The addition of a risk percentage to the base rate, ostensibly to make it reflect the market rate on loans of similar risk and duration more accurately, compromises the strengths of the Treasury bond rate: its simplicity, certainty, and currency. The risk percentage is not a distinct, objective market value. A court adding a risk percentage thereby effectively shifts the burden of demonstrating appropriateness of an interest rate to the risk component itself.

While some courts have listed the factors that influence risk,\(^{204}\) there is little analysis of why the risk percentage added to the

\(^{200}\) 869 F.2d 1144 (8th Cir. 1989).
\(^{201}\) Id. at 1146.
\(^{202}\) Id. See In re Monnier Bros., 755 F.2d 1336 (8th Cir. 1985); United States v. Neal Pharmacal, 789 F.2d 1283 (8th Cir. 1986).
\(^{203}\) Doud, 869 F.2d at 1146.
\(^{204}\) The court in In re Snider Farms, 83 Bankr. 977 (Bankr. N.D. Ind. 1988) identified the risk component to be tacked on to the Treasury rate as affected by: "[Q]uality of the security, the loan to value of collateral ratio, the feasibility of the plan, including the amount of debt discharged by a confirmed plan, the length of the stretchout, and the
base should be 1%, 2%, or any given percentage. Yet the augmentation of the treasury rate by the risk percentage adds considerably to the interest rate without benefit of the same analysis of market forces underlying the base rate. A fundamental question on rate-constructing procedure remains: why adopt a risk-free market instrument for the simplicity, certainty, and currency of its interest rate and then add to that rate an arbitrary adjustment for risk in an attempt (presumably) to match the risk and security status of an individual debtor?

The second critique of the treasury rate was given by the court in In re Snider Farms. It observed that the coupon yield on Treasury bills represents the cost to government of acquiring funds in the open market. However, since the government is not a borrower but a lender to the debtor in a bankruptcy setting, the treasury rate is too low. The Treasury bill is a short term, low risk investment for any lender. Hence the Treasury bill rate is not appropriate to bankruptcy proceedings where the debtor is the borrower, with substantially higher risks of de-

cost, time and difficulty in liquidating the collateral." Id. at 998.

The court in In re Bergbower, 81 Bankr. 15 (Bankr. S.D. Ill. 1987) noted the risks normally associated with a bankruptcy loan: "[C]ollection costs, the creditors's administrative costs, profit margin and risk of collateral depreciation." Id. at 16. The court in In re Doud, 74 Bankr. 865 (Bankr. S.D. Iowa 1987), aff'd, 869 F.2d 1144 (8th Cir. 1989) listed cost and risks factored into interest rates charged to borrowers normally (i.e., outside of bankruptcy): "[C]ollection costs for locating the debtor, dunning or billing, obtaining a judgment and executing upon the judgment. Interest rates also reflect the creditor's administrative costs, profit margin and risk of collateral depreciation." Id. at 869.

In In re Big Hook Land & Cattle Co., 81 Bankr. 1001 (Bankr. D. Mont. 1988) the court identified the reason for including risk factors in the interest rate: "The risk factor must be determined by considering the nature of security and feasibility of repayment so as to cover a risk of loss." Id. at 1005 (quoting In re Paddock, 81 Bankr. 51, 54 (Bankr. D. Mont. 1987)).

205. In re Snider Farms, 83 Bankr. 977, 993 (Bankr. N.D. Ind. 1988). The court in In re Camino Real Landscape Maintenance Contractors, 818 F.2d 1503, 1506 (9th Cir. 1987) repeated the critique in Snider Farms by noting that this was the government's cost of borrowing, "relatively quite low because to the lender the government's obligation is a short-term, low risk investment." By contrast, the creditworthiness of the private borrower is not the same as that of the federal government. The appellate court said the bankruptcy court in Camino Real "slipped into this [erroneous] position by reasoning that the government could borrow at the treasury rate to replenish its funds while it waited for the debtor to make payments. Congress did not provide for such an approach." Id. "To be properly compensated, [the government] must receive the rate of interest based on the debtor's cost of borrowing, not the government's." Id.

206. 83 Bankr. at 993.
fault.\textsuperscript{207} "There is no indication that Congress meant to subsidize debtors undergoing reorganization by making available to them the government's own favorable rate of interest."\textsuperscript{208} While this critique applies primarily to the base treasury rate, it affects a risk-adjusted rate as well since, as noted above, the risk factor is not scientifically determined. The obverse of the argument is stated in \textit{In re Underwood}: "If there was absolute assurance of repayment then the riskless discount rate, such as the rate payable on treasury bills of comparable maturity, might be appropriate."\textsuperscript{209}

The third critique in use of a treasury rate is that the government's lending rate is often mandated by social policy that advances favorable rates to groups in difficult economic circumstances. If a bankruptcy court is seeking an appropriate market interest rate, ideally it should choose one representing a non-government debtor's cost of borrowing in a bankruptcy setting, not one pertinent to the government as creditor in its social stance.

Finally, Treasury interest is paid in full at the end of the loan term, while in present value determination interest and principal are paid together over the term of the loan. The principal outstanding on the claim is reduced as each payment is made. Hence, the advantage of a time matchup between the Treasury bond rate and debt repayment discount rate in bankruptcy is lost. Frank Carbiener has recommended an adjustment to the Treasury bond rate to handle that problem.\textsuperscript{210} Carbiener suggests calculating the percentage of the average loan amount outstanding during the bankruptcy plan's repayment period and then matching the percentage to a government security with an equal maturity.\textsuperscript{211}

For example, in a case where $10,000.00 in debt is proposed to be paid over 10 years with yearly payments, the average outstanding indebtedness ... is $5,500.00. Stated as a percentage, 55% of the claim is outstanding over the payment period. Since the creditor in this hypothetical proposes to use a ten-year repayment term,

\textsuperscript{207} Id. at 995.
\textsuperscript{208} Id.
\textsuperscript{210} Carbiener, \textit{supra} note 1, at 64-65.
\textsuperscript{211} Id.
the discount rate will be based on a government security with a
duration of 55% of ten years or, in other words, 5.5 years.212

This procedure suggests accuracy in identifying an interest
value. However, the adjustment introduces awkwardness into the
calculation and makes it less simple. When a risk adjustment is
added, there is less certainty about the overall rate. More im-
portantly, the calculation of a single percentage of the loan term
outstanding to represent a longer period yields an arbitrary value
for any one year in the series.

B. The Ninth Circuit; The Prime Rate as Market Rate

The prime rate is defined as the rate charged by commercial
lenders to their most credit worthy business borrowers.213 It is
used as a barometer of the general level of interest rates. The
courts of the Eighth Circuit have adopted the Treasury bond
rate as the base rate to which a risk factor was to be added.
The courts of the Ninth Circuit have settled into rather consistent
use of the prime rate plus a risk factor as the base rate. The
addition of some risk factor to the prime rate by the court
provides the desired, individualized, case-by-case method for in-
terest rate determination. Specifically, the Ninth Circuit Court
Bankruptcy Appellate Panel in In re Patterson214 mandated that
lower courts use a case-by-case analysis to insure that the key
factors determining a rate are considered.215 While alternative
rates have not been specifically rejected in recent Ninth Circuit
decisions, the prime rate is favored, especially in the Montana
bankruptcy court in Chapter 12 cases.216

1. Early Ninth Circuit Cases

The court in In re Miller217 used a "below prime" interest rate
where the collateral evaluation was more than the liquidation
value to the creditor:

suggested by Carbiener).
213. "The rate is determined by the market forces affecting a bank's cost of funds and
the rates that borrowers will accept. The prime rate tends to become standard across
the banking industry when a major bank moves its prime rate up or down. The rate is
a key interest rate, since loans to less-creditworthy customers are often tied to the prime
rate." Downes & Goodman, supra note 10, at 307.
214. 86 Bankr. 228 (Bankr. 9th Cir. 1988).
215. Id. at 228.
216. See cases cited infra notes 229-43 and accompanying text.
[As the Court has valued the collateral higher than the wholesale value, Ford is realizing more by this valuation than it would by repossession and liquidation of the collateral. Therefore, the reason for equating the discount rate with the prime interest rate ... is lost. Equitably, a lower rate should suffice.]

The court in *In re Tacoma Recycling* thought the prime rate should be compared to the “current money market to determine if either proposed rate is responsive to current economic conditions prevailing on or about the date of confirmation.” The analysis behind the choice of this rate moved the court into the mainstream of subsequent Ninth Circuit thinking. By insisting on a method to determine a rate responsive to current market conditions, it was suggesting, albeit implicitly, the case-by-case approach to be adopted later. Its choice of the section 6621 tax rate was but one step removed from the prime rate, since that rate is based on average prime rates. There was, however, no mention of a risk factor to be added to the tax rate.

The court in *In re Welco Industries*, a Bankruptcy Appellate Panel for the Ninth Circuit, opted for the “prevailing market rate.” Without saying that the prime rate was the appropriate rate, the court in remanding the case stated that the prime rate had an “impact on that determination,” and the lower court should determine a rate “more in line with the prevailing market rate ...”

By the time of the *Welco* decision, the preference of Ninth Circuit courts for a market rate seemed well settled. The individual rate chosen to represent the market rate was not agreed upon, however, nor was the emphasis yet placed on the method by which courts should arrive at the appropriate rate.

2. *Camino Real* and the Case-by-case Approach

The Ninth Circuit ruled for the first time on the appropriate interest rate issue in *In re Camino Real Landscape Maintenance*
Contractors, the title of three unrelated cases involving tax claims against debtors. It first rejected the argument that the section 6621 interest rate on deferred taxes should be the rate that the debtor would have to pay to borrow in the commercial loan market. It also rejected use of the treasury rate reflecting a private debtor's cost. Therefore in two of the three cases before it, the court rejected "formula" rates. However, in these rejections it was careful to point out that while neither rate alone represented the market rate, both rates might be considered in determining the market rate. In the third case it did approve the procedure whereby the lower court had increased the base Treasury bill rate by 2% for risk and then decreased it by 1% for the quality of security. When the government as creditor alleged that these adjustments were arbitrary in setting a market rate, the court responded that "rough estimates are better than no estimates." It is clear that the Ninth Circuit in that comment was defining the method of determining the rate as critical, not so much the result. It subsequently made that direction more explicit by stating: "We hold that the bankruptcy court must make a case-by-case determination of what interest rate the reorganizing debtor would have to pay a creditor in order to obtain a loan on equivalent terms in the open market."

3. The Montana Court's Choice of the Adjusted Prime Rate

The bankruptcy court in Montana consistently has chosen the prime rate adjusted by a risk factor as the appropriate interest rate. In In re Robinson Ranch, the court, after reviewing the commercial loan rate as the prime rate plus 2%, found 9% to be the "prevailing market rate" for the type and quality of loan involved, the rate being based on contract for deed sales in the area. In In re Martin the court found that a Chapter 12 plan had to provide for a rate of at least 9%, and since the prime rate was 8 1/4%, additional interest of 3/4% should be added to cover the risk of default. The court said, "The present prime rate..."
rate of 8 1/4\% on secured claims is the market rate of interest" \textsuperscript{232} since "such rate encompasses all the elements which affect the market rate of interest on a current basis in a commercial setting." \textsuperscript{233} Subsequent decisions allowed varying add-on risk percentages. \textsuperscript{234}

In \textit{In re Foster} \textsuperscript{235} the court ruled that creditors were entitled to interest based on the prime rate plus a risk factor, that factor to be determined by the nature and extent of the creditor's security and the feasibility of repayment. \textsuperscript{236} The curious feature of the \textit{Foster} decision was that the court used the principle enunciated to develop an interest rate specific to thirteen different creditors, adjusting the interest rate upward to compensate for default risk in specific cases ranging from no add-on up to 4\%. \textsuperscript{237}

The court in \textit{In re Fowler} \textsuperscript{238} permitted interest at the prime rate plus three-fourths of 1\% for a risk factor. \textsuperscript{239} The low risk percentage was justified in testimony that showed the payments under the plan could easily be made to secured creditors and that the risk of default was therefore minimal. \textsuperscript{240} The Ninth Circuit \textsuperscript{241} approved the use of the "market" approach but thought that the evidence supporting the rates adopted was insufficient. It therefore reasoned that the bankruptcy court had used, in effect, a "formula" approach. \textsuperscript{242} It remanded for more specific findings on how the bankruptcy court determined a risk factor of three-fourths of 1\%. \textsuperscript{243}

Clearly, it was through adjustment of the risk factor in all these cases that the Montana court brought decisions into accord with the "case-by-case" analysis adopted by the Ninth Circuit.
Court of Appeals in *Welco* and *Camino Real*. The same analysis insured that the standards of a "prevailing market" rate were observed as well.

4. *The Ninth Circuit Bankruptcy Appellate Panel in In Re Patterson*

The Ninth Circuit Bankruptcy Appellate Panel (BAP) let stand the bankruptcy court's choice of the prime rate plus 4% risk adjustment in *In re Patterson*. The distinctiveness of this decision was that the court emphasized not so much the result as how the result was developed. The court specifically rejected a "blanket" approach wherein the rate was set at "prime rate plus three percentage points" for loans of less than five years maturity and prime rate plus four percentage points for loans extending beyond five years. It mandated instead a case-by-case determination of the proper rate because that rate is determined "according to the rate the reorganizing debtor would have to pay a creditor in order to obtain a loan on equivalent terms in the open market." Within that mandate, it found that the lower court had in fact used a case-by-case approach, and therefore approved its setting of the rate as prime plus 4%. On use of the prime rate as a base, the *Patterson* court said simply that "since the market rate is influenced by the prime rate, the prime rate may be used as a basis for an interest calculation."

What is not suggested in this analysis is discovery of a general market rate, as through surveys of rates, without "constructing" the rate on an individual case-by-case method. Presumably, such a general market rate would provide an unacceptable formula approach.

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244. *In re Patterson*, 86 Bankr. 226 (Bankr. 9th Cir. 1988). The *Patterson* court noted the factors influencing the prime rate: the general level of money rates, the availability of reserves, general business conditions, size and term of the loan, geographic variations, elements of profit and collection costs. *Id.* at 228. The court then rationalized use of the prime rate plus a risk adjustment: "Because this is generally a lower rate than market it justifies a higher risk factor." *Id.* at 229.
245. *Id.* at 228.
246. *Id.*
247. *Id.*
248. *Id.*
5. Summary and Analysis of Ninth Circuit Interest Decisions

As in other circuits, courts in the Ninth Circuit tried several interest rates before choosing the prime rate as the base for calculating the appropriate rate in bankruptcy proceedings. The touchstone of this search has been the "prevailing market rate" to reflect "existing economic conditions." The use of the prime rate as the base to which a percentage is added for risk adjustment has become routine in the Ninth Circuit, especially in the Montana bankruptcy court.

More pertinent to development of the theory of the appropriate rate is the mandate found in the Ninth Circuit to employ a proper method to determine the rate. That determination is made within the guidelines of the payout period, the quality of collateral, and the risk of default. The mandate for use of a case-by-case approach is in contrast to a formula approach where the rate is predetermined for a court. The case-by-case approach requires that a court exercise independent judgment on the fact situation before it. Typically this amounts to a determination of the appropriate risk adjustment percentage to be added to the base prime rate.

As with the use of the Treasury bond rate in the Eighth Circuit, the main limitation in use of the prime rate is the risk element. Although not a totally risk-free rate, the prime rate by definition reflects an interest rate charged on loans to least risky borrowers, not to the typical bankruptcy borrower with moderate to substantial risk of default.

The adjustment for risk also has been essentially the same as in the Eighth Circuit, that is, a percentage for risk has been added to the base rate to approximate the market condition. The same critique therefore applies to the risk factor here. There is no scientifically determined "market" risk percentage on which the court can rely. Indeed, the existence of such a market percentage would seem to violate the prohibition on formula rates pre-determined for a court. However, in the absence of such a formula, the individualized, case-by-case approach may be without factual foundation. The result may be a certain and accurate base rate with an uncertain and inaccurate risk percentage added to it on an ad hoc basis.

6. The Wider Problem of Data Availability

The risk adjustment problem is part of wider difficulty found in use of statistical data. Ideally a court would have access to
generalized market data to validate the facts before it as consistent with the "prevailing market rate." Indeed, default risk as a "probability of default" may not be discoverable except against a background of actual market experience.

Although comparisons limp, the determination of life expectancy as an adjunct to earning capacity calculation in personal injury litigation can serve to illustrate the statistical dilemma. The victim's individual life expectancy (or work life expectancy) cannot be determined definitively since no one person is guaranteed any span of life. Yet it is precisely this victim's life expectancy that is central to a determination of damages. A case-by-case analysis of individual victims simply does not work. What clearly is needed, and used in this kind of litigation, is a bank of data into which an individual with certain health and personal characteristics can be fitted for probability of survival.

The problem of bankruptcy interest rate validation is similar. The court wishes to know an interest rate reflecting the true market condition. It may profess also an intent to avoid a formula value pre-determining the interest rate it needs, but it cannot escape the market influence that formula represents. The desired distinction between the formula and the case-by-case approach is not as sharp as the court might like.

The argument applies with even greater force to the problem of the risk of default to be factored into the "risk adjustment." There are not even the definitive market transaction values for risk factors to start with as there are for sales of collateral items, for example. The "market" valuation of default risk can be "individualized" only in theory because its factual determination can be made only against known experiences in the wider universe of events. We find an item's value most often in comparison with values previously determined. Determining a value in total isolation from that "market" condition is illusory.

V. CONCLUSION

The initial issue in determining the appropriateness of any bankruptcy interest rate is whether the contract rate should be retained in the reorganization plan or whether some market rate better facilitates reorganization. Courts of the Sixth Circuit have scrutinized that choice and developed rules for use of either based on the security status of the creditor. The market rate is appropriate, even if higher than the contract rate, when the
creditor is fully secured. For unsecured or partially secured claims, the contract rate is the maximum allowed.

When the current market rate is the choice, however, the question is which rate best represents the market at any time. Essentially two approaches have been used by courts to find that rate. The first is adoption of a known "formula" rate, such as the federal tax rate, the federal and state legal rates, the rate on consumer loan contracts, the rate charged by the Federal Land Bank, and various averages based on those rates. Court analysis of those rates has focused on their inherent merits, especially the simplicity of their determination, their certainty, and how well they reflect general economic conditions pertinent to the bankruptcy litigation at hand. The principal shortcoming of these rates is that they are not specifically attuned to the bankruptcy coerced-loan condition. Creditor-oriented rates have seen limited use also because they reflect, at best, only one side of the money market. All of these "surrogate" rates have problems when used as a bankruptcy rate since some of their features, especially their risk components, do not match well with a coerced-loan condition and rate.

The second approach focuses on the method of determining a rate, rather than merits of the rate itself. The standard employed is a "prevailing market rate," an ideal or abstract rate unknown to the court. This approach, used regularly in the Eighth and Ninth Circuits, emphasizes a case-by-case, individualized method to find an appropriate rate within the guidelines of collateral quality, default risk, and matchup of the market instrument with the payout period. Typically two formula rates, the Treasury bond rate (Eighth Circuit) and the prime rate (Ninth Circuit), are used as a base to which a risk factor is added. Thus a "market" rate is constructed. That approach causes the analysis of validity to be changed from the merits of a formula rate to measurement of the risk percentage that is added to the base rate.

Neither of these solutions to the search for the appropriate rate is problem free. Formula rates have rigidity built into them by the statistical procedure used to find them. They are often relevant only to a single industry or situation, not to the general bankruptcy coerced-loan condition. In the individualized, case-by-case method, although there is intuitive appeal in a procedure constructing an interest rate through attention to specialized forces bearing on each bankruptcy proceeding, the choice of a
rate cannot be made without reference to the experience of a larger "market" group.

These attempts at choosing or constructing a market rate are forced by the absence of reliable, current data on bankruptcy lending rates. Validation of an interest rate in the market, a purpose explicit in the adoption of a "prevailing market rate" standard, is therefore difficult. Moreover, those attempts occur at the expense of developing a bank of data on actual "prevailing market rate" transactions.

The development of that data bank is not as prohibitive a task as some might first imagine. A Sixth Circuit court in In re Neff249 approved the use of properly conducted surveys in establishing a statistically reliable market rate. The court cited the work of the Federal Reserve System in its survey of rates charged by commercial banks for agricultural loans as appropriate for a farm bankruptcy proceeding:

A particularly objective and probative measure brought to the Court's attention in this case was the Federal Reserve Bank's Quarterly Survey of Agricultural Credit Conditions at Commercial Banks (the "Survey"). The Survey set forth the most common interest rates for specific geographic locations, further classified by the type of collateral and the length of the loan. . . . Of the various approaches used, the averages set forth in the Survey best comport with the Court's independent perception of current market rates generally.250

250. Id. at 679. Survey data approved by the court in In re Neff is from N. A. WALRAVEN & J. ROSINE, AGRICULTURAL FINANCE DATABOOK (1989). This quarterly publication compiles data from regular surveys by the Board of Governors staff of commercial banks and other financial institutions involved in agricultural lending.

The specific data commended in Neff is Table IV "Federal Reserve Bank Quarterly Surveys of Agricultural Credit Conditions at Commercial Banks," part IV.D., dealing with interest rates charged for farm loans. The July 1989 edition reveals data from five Federal Reserve Bank Districts: Chicago (7th), Kansas City (10th), Minneapolis (9th), Dallas (11th), and Richmond (5th).

The five Bank surveys differ among themselves in subject matter covered, number of commercial banks surveyed, and types of loans made. For example, the Chicago Bank surveys about 900 banks whose farm loans constitute 25% or more of total loans. The Kansas City District surveys a maximum of 188 banks where farm loans represent 50% or more of total loans, with bank representation in that survey from all farm areas. In the Minneapolis District the survey is of banks where farm loans represent 25% or more of total loans. The sample includes 325 banks. The Bank of Dallas surveys about 300 banks where farm loans "are relatively important." The Richmond Bank surveys 43
The Neff court suggested that such a survey rate could be supplemented with testimony relating to unusual [and] recent trends in interest rates, relevant subsidies for the lender or compelling characteristics of the particular debtor or security. Such compelling characteristics might include multiple bankruptcy reorganization attempts, lack of good faith in dealing with the creditor, unusual risk to the value of the real property securing the loan, lack of insurance, or other factors especially relevant to a particular case.\textsuperscript{251}

The direction proposed in Neff arguably is the best procedure available to determining the market rate on bankruptcy coerced loans, that is, loans "of similar risk and duration." Most importantly, that rate would reflect the market condition better than any other rate. It suggests an objective, empirically-determined rate representative of and specific to the bankruptcy condition being litigated. If developed by the Federal Reserve System as part of its interest rate surveys, it would also take on a solid, authoritative reputation immediately.\textsuperscript{252}

The bankruptcy "market rate" so developed may not be a single rate at all but a bracket of values. The high and the low interest values for actual money market transactions theoretically represent the poorest and best debtor risks, respectively, with the average risk borrower falling in the broad middle range. Setting that bracket of market values does not eliminate case-by-case determination of the rate. Instead it sets the limits within which the money market rate applicable to specific bankruptcy proceedings can be determined empirically.
The appropriate bankruptcy interest rate continues to be elusive. Better data, particularly that found in surveys of actual rates employed in these proceedings, should bring bankruptcy courts closer to finding the ideal of a "prevailing market rate."
SECTION 2 OF THE KENTUCKY CONSTITUTION—
WHERE DID IT COME FROM AND WHAT DOES IT MEAN?

by John David Dyche*

I. INTRODUCTION

Section 2 of the Kentucky Constitution boldly declares that "[a]bsolute and arbitrary power over the lives, liberty, and property of freemen exists nowhere in a republic, not even in the largest majority." This clause has been described as "poetic," "idyllic in conception" and "the pole star" of the constitution. It has also been assailed as "untrue in principle and doctrine," "a mere abstract proposition" which "ought never to go into any Bill of Rights anywhere, or anytime." One cannot help but be curious about a constitutional provision of such broad language and as to which such heartfelt, but drastically opposed, opinions are held. A number of significant recent decisions of Kentucky's appellate courts suggest that it is now timely and appropriate to move beyond mere curiosity and undertake a comprehensive and detailed study of section 2's place in Kentucky constitutional jurisprudence. Such is the goal of this article.

Section 2 was initially conceived as a substantive protection for the property right of masters in their slaves. It was retained in the Kentucky Constitution after the Civil War by delegates to a convention focused on the restriction of legislative power. Despite the clearly expressed intentions of section 2's progenitors

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2. Jones v. Rayborn, 346 S.W.2d 743, 748 (Ky. 1961).
5. OFFICIAL REPORT OF THE PROCEEDINGS AND DEBATES IN THE CONVENTION ASSEMBLED AT FRANKFORT ON THE EIGHTH DAY OF SEPTEMBER, 1890, TO ADOPT, AMEND, OR CHANGE THE CONSTITUTION OF THE STATE OF KENTUCKY, at 795 (1890) [hereinafter 1890 DEBATES].
7. 1890 DEBATES, supra note 5, at 795.
as to its function, the courts of Kentucky began early this century to construe section 2 as a guarantee of procedural fairness and equal protection of the laws. Within the last several years, however, it has become apparent that the original purpose of section 2 withstood the demise of substantive due process that occurred at the federal level. Therefore, Kentucky citizens enjoy, or at least have the potential to enjoy, a level of substantive protection for their economic rights which extends well beyond that available under the United States Constitution.

Thus, section 2 now plays two important roles in Kentucky constitutional law. First, it provides the Kentucky courts with a basis in the state constitution for interpreting the concepts of procedural fairness and equal protection more broadly than the federal courts have in construing the fifth and fourteenth amendments of the United States Constitution. Second, in its originally intended role as an "economic due process" clause that protects property rights, section 2 provides a basis upon which litigants in Kentucky can challenge a large body of economic and regulatory legislation. Section 2 accordingly holds almost limitless potential as a tool for judicial protection of individual rights, especially economic rights. The judiciary must therefore take care to clearly articulate the rationale for their section 2 decisions lest such decisions themselves be seen as arbitrary.

This article first examines the history of section 2 by reviewing the debates of the 1849 and 1890 Kentucky constitutional conventions. Judicial interpretation of section 2 is next considered. In this context, emphasis is placed upon the expansion of the section's scope that occurred in the early part of this century as well as recent cases which underscore the potential of section 2 as a protection for economic rights. The article concludes with observations on the current place of section 2 in Kentucky constitutional law and some comments on the future use and development of this significant provision.

II. THE HISTORY OF SECTION 2

A. The Background Of The 1849 Convention

Kentucky has had four constitutions, adopted respectively in 1792, 1799, 1850 and 1891. Section 2 first appeared in the Constitution of 1850. The convention which met in Frankfort during
1849 and 1850 to draft that constitution had the issue of slavery among its foremost concerns. Cassius Marcellus Clay, anti-slavery firebrand and ambassador to Russia under Lincoln, claims in his *Memoirs* that the agitation carried on by him and others against slavery was the impelling cause for the calling of the third constitutional convention. Clay claims to have pointed out the possibility and feasibility of emancipation under the second constitution and states that “the slave holders were anxious to get another Constitution wherein this possibility would be made so remote as to be practically non-existent.” According to Kentucky historian Thomas D. Clark: “In drafting the constitution of 1849, the slavery question bobbed up at every turn.... Every question introduced was of utmost importance — for no one knew what trick phrase or clause would be turned against slavery.” Section 2 thus had its genesis in pre-Civil War efforts to use the Kentucky Constitution to protect slavery.

**B. The Case For Section 2**

Section 2 was introduced and championed by delegate Archibald Dixon of Henderson. Despite Dixon’s stated belief that the section “fully explains itself,” an extended debate took place on Thursday, December 6, 1849. During this debate, the delegates considered some of the timeless and transcendent issues of political theory: the purposes and powers of government, the nature of political sovereignty and the character of the institution of property. The desire of these delegates to perpetuate slavery, however, was never far from the surface.

Dixon described the principle animating section 2 as follows: “But all free republics derive their existence from the people; are created for their protection and happiness, and in the making

13. *Id.*
14. *Id.* at 804-15.
15. *Id.*
of laws, as well as in the execution of them, are restrained by
the very objects and purposes of their creation.”

According to the proponents of section 2, the protection of
private property is prominent, if not foremost, among the objects
and purposes for which people create free governments. The
primacy of this governmental purpose to Kentuckians was ex-
plicitly affirmed by the 1849 convention’s adoption of the present
section 4 which reads in part, “All power is inherent in the
people, and all free governments are founded on their authority
and instituted for their peace, safety, happiness and the protection
of property.” The advocates of section 2 sought to insure that
Kentucky’s government would never operate contrary to these
purposes, especially as to protection of property, and that any
law which threatened rather than protected “the lives, liberty
and property of freemen” would be invalid. Delegate William
Preston of Louisville thus declared: “Establish the principle con-
tained in the proposed section, and you cannot be legislated out
of your property, nor conventioned out of it.”

Delegate Garrett Davis of Paris described private property as
“that most essential principle of civilization, which has contrib-
uted more than all of the other forces wielded by man to bring
him from a state of naked and ignorant barbarism to the highest
improvement in arts, science, and letters.” However, Davis and
his allies had a particular type of private property foremost in
their minds. Advocates of section 2 sought particularly to estab-
lish that the “legal essence and nature” of slave property

is identical with every other class of property whatever — that
the owner of it has the same indefeasible, absolute, and inviolable
right of property in his slaves as he has in his land or horses; and
that no majority has the power to deprive him of it, in any manner,
without compensation.

This view of the identical status of slave and other property was
confirmed by the convention in the adoption of section 3 which

16. Id. at 805.
19. 1849 Debates, supra note 8 at 810.
20. Id. at 808.
21. Id. at 807.
22. Id.
read: "The right of property is before and higher than any constitutional sanction; and the right of the owner of a slave to such slave and its increase, is the same, and as inviolable as the right of the owner of any property whatever."23

Davis succinctly illustrated both the theory and object behind section 2 as follows:24 Persons A, B and C hold property consisting of slaves, land and personalty. Over time, the land and personalty become concentrated in B and C and the slaves become concentrated in A. The sentiments of B and C towards slavery change and they attempt to free A's slaves without making compensation to A. In doing so, according to Davis:

They would subvert the original and fundamental principles upon which they had planted their civil compact. They would not only change their government, but they would overthrow the order, forms, and rights, to secure which it had been framed, and with the surrender and destruction of which it never would have been made.25

The reasoning behind section 2 can thus be summarized as follows: First, protection of property is a fundamental object of government. Second, the constitution should assure that the government never operates contrary to this object. Third, slaves are no different than any other type of property. Therefore, the constitution should protect citizens from any governmental action which threatens slaves and other property.

C. The Case Against Section 2

Objection to section 2 was initially made by Delegate William Mitchell of LaGrange, who alleged a conflict with the previously adopted section 4 which read, then as now: "All power is inherent in the people ...."26 Said Mitchell, "It seems to me there is an absolute power somewhere, wherever there is a political organization."27 Albert Talbott of Danville expressed the similar belief that all power in government was, from the very nature of

23. KY. CONST. of 1850, art. XIII, § 3.
24. 1849 DEBATES, supra note 6, at 808.
25. Id.
27. 1849 DEBATES, supra note 6, at 808.
government, absolute and arbitrary. 28 Talbott stated that such power "is plenary, positive, irresistible power or the right to execute the will or law of the government, contrary to, or without the consent of the citizen." 29 Mitchell further asserted: "In order to maintain the proposition [section 2] it is necessary to demonstrate that the attribute of sovereignty does not belong to a republic." 30 Mitchell feared that section 2 would actually endanger slavery by providing anti-slavery elements with an argument that the institution of slavery was bolstering itself at the expense of popular rights. 31

Mitchell also inveighed against section 2 on the basis of the conventional, rather than natural law, character of private property. 32

The idea of property may exist by the laws of nature; but title to property is conventional and the creature of political association. The same power that created it can destroy it.... [I]t is merely a conventional right. The same power, then, which gives efficiency to that right by enabling the possessor to maintain it, can destroy it. 33

This argument was bolstered by noting that even John C. Calhoun, "the great Ajax Telemon of slavery," 34 acknowledged that power resided in the states to abolish slavery. 35

Section 2 seemed to Delegate Stevenson to be "rather too abstract and not well calculated to have any practical effect." 36 Time has proven that he was in error. Delegate Richard Gholson of Lovelaceville, however, spoke with great prescience in the course of arguing that the "takings" clause already in the Kentucky Constitution adequately protected slave property. 37

In a republican government, majorities must rule, and if the day should come when we [the pro-slavery forces] shall be in a minority on this question, we must either submit or fight. That is the sum

28. Id. at 804.
29. Id.
30. Id. at 811.
31. Id. at 810.
32. Id. at 812.
33. Id.
34. Id.
35. Id.
36. Id. at 806.
37. Id.
total of it. There is no necessity for this provision, and I hope it will not pass.38

Section 2 did pass in 1849 by a vote of 55 to 34.39 Sections 3 and 4 passed as well.40

D. The 1890 Convention

So read Kentucky's Bill of Rights for the next forty years. During this time the fight of which Gholson warned came to pass. Despite the fact that the Civil War and the adoption of the thirteenth amendment to the United Stated Constitution rendered Section 3 of the third constitution invalid on its face, efforts to call a constitutional convention in Kentucky were long unsuccessful. These efforts began in 1867 but did not culminate in a law calling a new convention until 1889.41

The central issue in the constitutional convention of 1890 was the limitation of legislative power. Most of the delegates to the constitutional convention felt that the real root of Kentucky's governmental problems was the almost unlimited power of the General Assembly.42 "One of them even said that ... the principle, if not the sole, purpose of the constitution we are here to frame, is to restrain its [the legislature's] will and restrict its authority."43 Historians of the period in Kentucky describe it as

a day full of distrust and fear of legislators, judges and other state officials. ... [T]he idea of central control was abhorred. The experience with Frankfort and the spirit of localism had nurtured the belief that the powers of state officials should be curbed and restricted. This spirit was carried to the convention.44

According to historian Hambleton Tapp, "After studying each of the state's four constitutions, a reader is likely to be convinced that the fathers of the 1891 document were obsessed with distrust and fear, particularly of the legislature."45

38. Id.
39. Id. at 814-15.
40. Id.
42. LRC BULLETIN, supra note 8 at vii.
43. Id. (referring to an unnamed delegate).
45. Id. at 263.
The debates of the 1890 convention lasted 226 days and fill 6,000 finely printed pages. Debate on the Bill of Rights alone lasted almost a month with the result that the Bill of Rights from the 1849 constitution was “practically taken over bodily into the new document.” Nonetheless, a strong effort was made, to eliminate section 2 from the Bill of Rights. However, as chary of legislative power as these delegates were, any effort to remove a perceived protection of the individual against the state was destined to fail.

E. The Debate Over Retention Of Section 2

In its initial report the 1890 Convention’s Committee on Preamble and Bill of Rights recommended that section 2 be stricken. Committee Chairman Robert Rodes of Bowling Green derided section 2 stating:

The very things we attempt to inculcate and establish by this Constitution (and there is scarcely a section in it wherein we do not touch upon the inalienable, inherent and indefeasible rights of man) are utterly opposed to, and inconsistent with, the idea of arbitrary power, and when you talk about absolute or arbitrary power existing in a Republic, it looks like a solecism, and by the terms of the words themselves it is beyond supposition and misleading and inadmissible. 47

According to Rodes, the principle embodied in section 2 “is a question of disputation” 48 This disputation may be reflected by the 55-34 vote on the section in the 1849 Convention. Rodes desired that as far as possible there be no disputation in the Bill of Rights and that its propositions be “clear as light.” 49 He urged that “abstract and metaphysical” discussion pass away because when arbitrary power is claimed or asserted “we have revolution.” 50

The effort to strike section 2 was resisted by traditionalists desirous of incorporating as much of the 1849 Bill of Rights into the new constitution as possible. Delegate C. J. Bronston of Lexington cried: “Strike it down, and how long will it be before a majority might seek to make abject slaves of a helpless minor-

46. Id.
47. 1890 DEBATES, supra note 5, at 440.
48. Id.
49. Id. at 441.
50. Id.
ity? ... And hence I say to these gentlemen, give me a reason before you ask permission to strike that stone from the wall."51
The irony in the fact that supporters of section 2 in 1890 would cite it as a bulwark against political "slavery" when the section's advocates a mere forty years earlier had promoted it as a bulwark in support of race slavery was apparently lost on most delegates.

Rodes, however, responded by linking section 2 to the slavery issue.

Nothing but the extreme agitation of the slavery question could have gotten them [sections 2, 3 and 4] in there.... Its advocates avowed, on the floor of the Convention, as the debates will show, that they inserted it there hoping that it would be a bulwark and a protection to slavery; and when the slavery question drops out, the question itself drops out.52

Rodes said later: "[T]he second and third clauses [sections 2 and 3] ... ought never to go into any Bill of Rights anywhere, or anytime because they are untrue."53

Despite this entreaty, section 2 was retained upon motion by Bronston. Bronston stated: "[Section 2] is the very first and most important reservation for a man to make when he delegates to government.... It is a thing that is dear and close to every Kentuckian who loves freedom and loves to live in a Republican government."54 Apparent agreement with these sentiments caused section 2 to be readopted with the word "freemen" being inexplicably retained some twenty-five years after the demise of slavery. So stands the present Constitution of Kentucky.

F. Summary

The preceding examination of the history of section 2 reveals that the provision was originally intended as a substantive protection of private property, i.e., section 2 forbade the legislature from impairing the right of an owner in his property in any fashion, regardless of the procedure employed. In 1849 section 2's protection was especially desired for a particular type of property — slaves. The discussion surrounding the readoption of section

51. Id. at 535.
52. Id. at 767.
53. Id. at 795.
54. Id. at 829.
2 by the 1890 Convention does not reveal any contrary intention nor does it reveal any additional motives or purposes associated with the readoption of section 2. That convention had as its primary focus, however, the limitation of legislative power — a goal consistent with according maximum protection to individual rights of all types, including, but not limited to, property rights. Accordingly, after the adoption of the 1890 constitution, Kentucky's courts assigned constitutional functions to section 2 which went beyond the substantive protection of property rights envisioned by the delegates of 1849.

III. JUDICIAL INTERPRETATION OF SECTION 2

A. The Expansion of Section 2

In Howell v. Bristol,⁵⁵ the Kentucky Court of Appeals described a statute which empowered the City of Covington to pave a sidewalk abutting the property of certain citizens and assess the cost of the paving among those citizens based upon their property frontage as "an attempted exercise of 'arbitrary powers' over the property" of a minority of citizens.⁵⁶ Howell confirms that prior to 1890 the protection of the citizens from the exercise of "arbitrary power" was seen as a substantive protection of property. The statute at issue was analogized to a "taking and appropriation of ... private property to the public use without compensation"⁵⁷ and was struck down not on the basis of any procedural defect in its adoption or administration, but rather because "[n]o such power over the property of the citizen can be constitutionally exercised by any department of our state government."⁵⁸ The opinion in Howell contains no explicit reference to section 2 of the Kentucky Constitution, but it nonetheless constitutes the earliest Kentucky judicial recognition (discovered by this author) of the principle originally embodied in section 2.

However, by the turn of the century, the scope of section 2 protections began to expand under the decisions of Kentucky's

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⁵⁵. 71 Ky. (8 Bush) 493 (1871).
⁵⁶. Id. at 499.
⁵⁷. Id.
⁵⁸. Id.
courts. In the 1901 case of *Pratt v. Breckinridge*\textsuperscript{59}, procedural fairness joined the protection of private property as an ideal within the province of section 2. The *Pratt* case concerned the "Goebel Election Law"\textsuperscript{60} pursuant to which election contests were referred to commissioners appointed by the legislature. The court found the law violative of section 2 because, among other reasons, "[t]here is no provision by which the parties can escape a trial before the commissioners, even if ... the members have made up and expressed their opinions."\textsuperscript{61} With this decision the process of bringing procedural due process within the ambit of section 2 was underway.

By 1915 the concept of equal protection of the laws was also brought within the scope of section 2. In *Williams v. Wedding*,\textsuperscript{62} the Kentucky Court of Appeals explicitly linked section 2 to the equal protection and due process clauses of the fourteenth amendment to the United States Constitution.\textsuperscript{63} By mid-century section 2 had grown into a multi-purpose tool with force and application far beyond that envisioned by its original framers and had, despite its unappealing roots, blossomed into Kentucky's very own unique guarantee of procedural fairness and equal protection.\textsuperscript{64} Cases interpreting section 2 in this manner in the twentieth century are legion.\textsuperscript{65} Throughout this period of expansion, however, the "original" section 2 lurked just beneath the jurisprudential surface, occasionally emerging to confront those who would encroach upon the citizens' property rights.

**B. The Return of Section 2 As A Substantive Protection For Property Rights**

It was not until the 1940's that judicial opinions using section 2 as a substantive protection for property rights began to appear,

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59. 112 Ky. 1, 65 S.W. 136 (1901).
62. 165 Ky. 361, 176 S.W. 1176 (1915).
63. Id. at 379, 176 S.W. at 1184.
64. Carolene Products v. Hanrahan, 291 Ky. 417, 164 S.W.2d 597 (1941).
65. See, e.g., Tabler v. Wallace, 704 S.W.2d 179 (Ky. 1986); Bunch v. Personnel Bd., 719 S.W.2d 10 (Ky. App. 1986); Kaelin v. City of Louisville, 643 S.W.2d 590 (Ky. 1982); Commonwealth v. Burke, 481 S.W.2d 52 (Ky. 1972); City of Ashland v. Heck's, Inc., 407 S.W.2d 421 (Ky. 1966); Board of Educ. v. Chattin, 376 S.W.2d 693 (Ky. 1964); Pritchett v. Marshall, 375 S.W.2d 253 (Ky. 1963); Foster v. Goodpaster, 290 Ky. 410, 161 S.W.2d 626 (1942); City of Corbin v. Hays, 244 Ky. 33, 50 S.W.2d 31 (1932).
or reappear, with regularity. In 1940, the Kentucky Court of Appeals held that an ordinance regulating the business hours of barber shops was outside the limits of the state's police powers, arbitrarily restricted the right to acquire property and hence violated section 2. In 1944 an ordinance requiring businesses to close between midnight and 4 a.m. was held to violate section 2 as applied to a restaurant. In 1947 a statute requiring employers to pay employees for up to four hours spent "voting" on election day was struck down on the grounds that section 2 prohibits laws which take property from A and give it to B absent value received or a contract. In a 1948 case, section 2 was deemed to prohibit "whatever is contrary to democratic ideals, customs and maxims... [and] whatever is essentially unjust and unequal or exceeds the reasonable and legitimate interests of the people." This sweeping language proved to be a portent of greater things to come.

A forerunner of the significant modern decisions employing section 2 as a substantive protection for property rights was General Electric Co. v. American Buyers Cooperative. In that case, the Kentucky Supreme Court held that the Kentucky "Fair Trade Act" was violative of section 2 to the extent that it enforced the adherence of third parties to a minimum resale price agreement made between the seller of a product and a second party. According to the court, this provision was "a legislative invasion of the broad constitutional liberty of the people to acquire and protect their property and engage in free trade." However, it was not until the late 1970's that decisions which revived the original purposes of section 2 began in earnest.

In the 1977 case of McGuffey v. Hall, a portion of an act requiring physicians to carry compulsory malpractice insurance was held contrary to Section 2. According to the court, the act was not justified as an exercise of the state's police powers.

69. Sanitation Dist. No. 1 v. City of Louisville, 308 Ky. 368, 375, 213 S.W.2d 995, 1000 (1948).
70. 316 S.W.2d 354 (Ky. 1958).
71. Id.
72. Id. at 361.
73. 557 S.W.2d 401 (Ky. 1977).
74. Id. at 414.
Absent such justification, the court said the act must fall as "[an] interference with the natural right of any individual or group to pursue a legitimate business or profession." 76

In 1979 a portion of the Kentucky Local Industrial Authority Act was ruled unconstitutional to the extent that "it grant[ed] a city or other governmental unit the unconditional right to condemn property which [was] to be conveyed by the local industrial development authority for private development." 77 Said the court:

Naked and unconditional governmental power to compel a citizen to surrender his productive and attractive property to another citizen who will use it predominantly for his own private profit just because such alternative private use is thought to be preferable in the subjective notion of governmental authorities is repugnant to our constitutional protections whether they be cast in the fundamental fairness component of due process or in the prohibition against the exercise of arbitrary power. 77

In what is perhaps the most significant decision in modern section 2 jurisprudence, the Kentucky Supreme Court set aside Kentucky's Milk Marketing Law in the 1985 case of Kentucky Milk Marketing and Antimonopoly Commission v. Kroger Co. 78 The court noted at the outset of its opinion that section 2 expresses a view of governmental and political philosophy that, in a very real sense, distinguishes this republic from all other forms of government which place little or no emphasis on the rights of individuals in a society. . . . While there are numerous cases which have been decided on the basis of this bulwark of individual liberty, the number is relatively few, in view of its potential importance to our jurisprudence. 79

It is therefore apparent that the court recognized the untapped potential of section 2 and the generative impact which a broad opinion based on section 2 might have.

The Kentucky Milk Marketing decision ostensibly turns on the characterization of the statute under consideration as a "minimum mark-up law." 80 Such enactments, said the court, are deemed to

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75. Id.
77. Id. at 5-6.
78. 691 S.W.2d 893 (Ky. 1985).
79. Id. at 899.
80. Id. at 900.
be "an arbitrary exercise of power by the General Assembly over the lives and property of free men." 81 The decision adopts and expands on the reasoning of the 1958 General Electric case in which it was stated that: "It is an established principle that the constitutional guaranty of the right of property protects it ... from any unjustifiable impairment or abridgement of this right, such as depriving the owner of any of its essential attributes or such as restricts or interrupts its common necessary or profitable use." 82 In its most sweeping statement, the Kentucky Supreme Court declared that, "whatever is essentially unjust and unequal or exceeds the reasonable and legitimate interests of the people is arbitrary." 83

The Kentucky Milk Marketing decision provided the court's basis for setting aside the Kentucky Unfair Trade Practices Act by a 4-3 vote in Remote Services v. FDR Corp. 84 In that opinion, the court recognized section 2 as "that part of our constitution which guarantees due process of law to our citizens and extends equal protection of the law to all its citizens." 85 Since there was neither a procedural due process nor an equal protection aspect to the Remote Services case, however, the court's ruling constitutes an implicit acknowledgment that section 2 is a guarantee of substantive due process in Kentucky.

The year 1990 brought two significant section 2 decisions. In Prestonia Area Neighborhood Association v. Abramson, 86 the Kentucky Supreme Court reversed a trial court decision that had affirmed a finding by the Louisville Board of Aldermen that certain neighborhoods were "blighted" so as to permit the condemnation of the neighborhoods for the purpose of expanding the Louisville airport. 87 The supreme court held that the finding of neighborhood blight by the Board of Aldermen was not supported by "substantial evidence" and was therefore arbitrary and in violation of section 2. 88 In Commonwealth v. Foley, 89 an election

81. Id.
82. Id. (quoting General Electric Buyers Co. v. American Buyers Coop., 316 S.W.2d 354, 360-81 (1958)).
83. Id. at 899.
84. 764 S.W.2d 80 (1989).
85. Id. at 82-83.
86. 797 S.W.2d 708 (Ky. 1990).
87. Id.
88. Id. at 712.
89. 798 S.W.2d 947 (Ky. 1990).
reform law enacted as a response to concerns about vote-buying and vote fraud was deemed violative of section 2. The court relied on the broad "contrary to democratic ideals, customs and maxims" language of the Kentucky Milk Marketing decision which it found to be "directly applicable to the case at bar."

Having traced the origins of section 2 and its development in the courts, attention can now be turned to a critical analysis of the role of section 2 in Kentucky constitutional jurisprudence.

IV. THE PLACE OF SECTION 2 IN KENTUCKY CONSTITUTIONAL LAW

A. Section 2 As A Guarantee of Procedural Fairness And Equal Protection of The Laws

The cases discussed above demonstrate that section 2 plays a dual role in modern Kentucky constitutional jurisprudence. First, section 2 serves as a state-level guarantee of procedural due process and equal protection of the laws. Although the debates of the constitutional convention of 1849 reveal that those who originally advanced section 2 did not contemplate that the section would fulfill this purpose, its doing so is not inconsistent with the context and content of the 1890 constitutional convention which readopted section 2 in an environment suspicious of legislative power. In any case, the courts of Kentucky have consistently interpreted section 2 in this manner and the principals of federalism provide a compelling justification for their doing so.

In 1977, then-Justice William Brennan of the United States Supreme Court persuasively argued that state courts and state constitutions occupy a position at least as important as the federal courts and the United States Constitution as guardians of the individual rights of citizens. Brennan stressed that

state courts cannot rest when they have afforded their citizens the full protections of the federal Constitution. State constitutions, too, are a font of individual liberties, their protections often extending beyond those required by the Supreme Court's interpre-

90. Id. at 953.
91. Id.
tation of federal law. The legal revolution which has brought federal law to the fore must not be allowed to inhibit the independent protective force of state law — for without it, the full realization of our liberties cannot be guaranteed....

Of late, however, more and more state courts are construing state constitutional counterparts of provisions of the Bill of Rights as guaranteeing citizens of their states even more protection than the federal provisions, even those identically phrased.93

Section 2 is a vehicle by which the Kentucky courts can give practical effect to this federalist vision.

The Kentucky Constitution does not contain either a due process clause or an equal protection clause. The context and debates of the 1890 constitutional convention, however, clearly indicate that maximum protection of the individual from legislative power was the primary intent of the resulting constitution. In order to achieve that goal in respect to the ideals of procedural fairness and equal protection, the courts of Kentucky must look to some clause of the state constitution. Otherwise, Kentucky citizens could enjoy no greater security in these regards than that afforded by the federal due process and equal protection clauses as interpreted by the United States Supreme Court. Thus, section 2 has become the locus of Kentucky's independent standards of procedural fairness and equal protection. This is understandable and justifiable not only because of the language and history of section 2, but also because of the lack of any more suitable constitutional provision to serve the purpose.

To date, the decisions of Kentucky's appellate courts which construe section 2 as a safeguard of procedural fairness and equal protection with meaning independent of federal Constitutional guarantees have not extended individual rights significantly beyond the level assured by the United States Supreme Court. As the United States Supreme Court grows (or reputedly grows) more conservative, however, occasions for giving a more expansive interpretation to state constitutional rights may become more frequent. For example, the Fayette Circuit Court recently affirmed a decision of the Fayette District Court which held Kentucky's sodomy statute94 violative of section 2.95 This holding

93. Id. at 491, 495.
95. Commonwealth v. Wasson, Fayette Circuit Court No. 86-X-48, now pending in the Kentucky Supreme Court, No. 90-SC-000558.
came in the face of the United States Supreme Court's decision in *Bowers v. Hardwick*\(^9\) which upheld Georgia's sodomy law in the face of due process and equal protection challenges.\(^9\) The case is now pending before the Kentucky Supreme Court which may soon determine whether section 2 guarantees the individual greater liberty in this regard than does the federal Constitution. There will doubtless be other such instances in the future.

**B. Section 2 As A Substantive Protection of Property Rights**

Although historical support for the use of section 2 as an independent, state-level guarantee of procedural fairness and equal protection can be drawn only from the context of the 1890 constitutional convention rather than the explicit words of the delegates, the general proposition that such use is appropriate will likely meet with general agreement. As indicated above, however, section 2 is also used by the Kentucky courts as a substantive protection of property rights. Such use may be referred to as substantive or "economic" due process.\(^9\) While use of section 2 in this fashion is amply supported in the debates of the 1849 constitutional convention, the general concept of economic due process has been discredited and abandoned by the United States Supreme Court\(^9\) and the vast majority of commentators since the mid-1930's.\(^10\) The continuing, if not increasing, vitality of substantive due process under the Kentucky Constitution therefore merits very close consideration.

A bit of political theory and federal Constitutional history is essential to an understanding of this issue. The debates of the 1849 constitutional convention reveal that section 2 was originally intended as an embodiment in Kentucky's fundamental law of a doctrine which professor Edward S. Corwin has denominated "the doctrine of vested rights."\(^11\) The origins of the doctrine of vested rights reach back to Cicero,\(^12\) but the doctrine was given

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97. Id.
99. Id.
100. See id. at 1363 n.1.
102. Id. at 14-15.
its most eloquent theoretical exposition in John Locke's *The Second Treatise of Government*. According to Corwin, the doctrine of vested rights predicates "that there are certain principles of right and justice which are entitled to prevail simply because of their own intrinsic excellence, and without regard to the attitude of those who wield the physical resources of the community." Locke included property among these intrinsically excellent principles, deeming it a substantive right of an individual, implied in the basic arrangements of society at all times and in all places. According to Locke, "the community perpetually retains a supreme power of saving themselves from the attempts and designs of anybody, even their legislators, whenever they shall be so foolish or so wicked as to lay and carry on designs against the liberties and properties of the subject." In section 2 of the Kentucky Constitution, one encounters a frontier expression of this venerable natural law principle.

Whether consciously or unconsciously, opposition to section 2 was grounded upon principles first articulated in 1651 in Thomas Hobbes' *Leviathan* and refined by Sir William Blackstone in his *Commentaries*, which were available in an American edition as early as 1771-72. The ideas of Hobbes and Blackstone are essentially those of legislative sovereignty. These ideas are exemplified in the supreme authority of the British Parliament and the "police powers" which provide the jurisprudential or theoretical underpinnings for much of the economic regulation so common in modern America. The 1849 debate over section 2 in the Kentucky Constitution as well as much of American Constitutional law in the first half of this century were representative of the practical struggle between adherents of the opposed political theories of Locke and Hobbes; that is, the vested, "economic"

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103. See id. at 44-51.
104. Id. at 11.
105. See id. at 172.
107. In their underlying motive, however, the proponents of Section 2 suffered from what Corwin has characterized as "obtuseness" to the conflict between the idea of the equality of all men, a basic premise of the natural law theories at the core of Section 2, and the institution of slavery. Corwin, supra note 101, at 20.
109. Id. at 53.
rights of the individual versus the inalienable legislative and regulatory powers of the state.

Between 1905 and 1934 substantive or economic due process under the fourteenth amendment to the United States Constitution experienced an era of ascension followed by a precipitous decline. Judicial recognition of the doctrine of vested rights which underlies substantive due process occurred as early as 1798 in Justice Chase's opinion in Calder v. Bull. The 1905 case of Lochner v. New York solidified the doctrine in Supreme Court jurisprudence. "In the thirty years after Lochner, the Court invalidated many federal and state statutes on economic due process grounds" including predominately "(1) measures designed to remedy perceived inequalities in bargaining power between employer and employee; (2) measures directly regulating the manufacture, pricing, and marketing of goods and services; and (3) measures limiting access to particular businesses or occupations." Thus, from the turn of the century until the mid-1930's the doctrine of substantive or economic due process was "the [federal] judiciary's most important tool for protecting economic rights."

In 1934, however, the Supreme Court upheld a retail milk price-fixing statute against a Constitutional challenge based on substantive due process in Nebbia v. New York. Since 1937, the United States Supreme Court has not invalidated a single law on the grounds of substantive or economic due process. "Economic and social legislation must now survive only a rational basis test - that is, the law must bear a 'reasonable relation' to a 'legitimate purpose'." This test is applied "so tolerantly that no law [is] ever likely to violate it." The theoretical basis for the federal overthrow of substantive due process is found in Justice Holmes' famous dissent in Lochner: "The Fourteenth Amendment does not enact Mr. Herbert Spencer's Social Stat-

111. 3 U.S. (3 Dall.) 269 (1798).
112. 198 U.S. 45 (1905).
113. Note, supra note 98, at 1366.
114. Id. at 1366 n.26.
115. Id. at 1363.
117. Note, supra note 98 at 1363, 1367.
118. Id. at 1367 (footnote omitted).
119. Id.
ics.... [A] Constitution is not intended to embody a particular economic theory, whether of paternalism ... or of laissez faire."\textsuperscript{120} As Justice Brennan has stated: "[C]ourts do not today substitute their personal economic beliefs for the judgments of our democratically elected legislatures ...."\textsuperscript{121} Thus, the demise of economic due process on the federal level was due to the perceived arbitrariness of allowing the courts to override the legislature on the basis of a mere judicial preference for laissez faire capitalism and the free enterprise system.

It is ironic that the case which marked the demise of federal economic due process, \textit{Nebbia}, and the case which marked the resurgence of economic due process under the Kentucky Constitution, \textit{Kentucky Milk Marketing}, both dealt with retail milk pricing statutes. Excerpts from these two opinions clearly demonstrate the two opposed approaches to the economic due process issue which the respective courts have taken. In \textit{Nebbia}, the United States Supreme Court stated that:

\begin{quote}
Equally fundamental with the private right is that of the public to regulate it in the common interest.... The Constitution does not guarantee the unrestricted privilege to engage in a business or to conduct it as one pleases.... Legislation concerning sales of goods, and incidentally affecting prices, has repeatedly been held valid. In this class fall laws forbidding unfair competition by the charging of lower prices in one locality than those exacted in another, by giving trade inducements to purchasers, and by other forms of price discrimination.... The due process clause makes no mention of sales or of prices any more than it speaks of business or contracts or buildings or other incidents of property. The thought seems nevertheless to have persisted that there is something peculiarly sacrosanct about the price one may charge for what he makes or sells, and that, however able to regulate other elements of manufacture or trade, with incidental effect upon price, the state is incapable of directly controlling the price itself. This view was negatived many years ago.... But there can be no doubt that upon proper occasion and by appropriate measures the state may regulate a business in any of its aspects, including the prices to be charged for the products or commodities it sells.... Where the public interest was deemed to require the fixing of minimum
\end{quote}

\textsuperscript{120} 198 U.S. at 75 (Holmes, J., dissenting).
\textsuperscript{121} Brennan, \textit{supra} note 92, at 490-91.
prices, that expedient has been sustained.122

In Kentucky Milk Marketing, however, the Kentucky Supreme Court declared that

[t]he effect of the Kentucky Milk Marketing Law is price fixing by requiring minimum mark-ups. This certainly, by any criteria, is arbitrary and is inimical to the public interest. It is an invasion of the right of merchants to sell competitively, and of the public to buy competitively in the open market.... It is an arbitrary interference with the free flow of commerce — the free enterprise system — and is not justified ... by the police power of the state. It is clearly a violation of the letter and spirit of section 2 of our Bill of Rights.123

The Supreme Court of Kentucky apparently believes that section 2, unlike the United States Constitution, does embody a particular economic theory known as the “free enterprise system.” Although this belief is not devoid of historical support, it is directly at odds with the prevailing federal Constitutional jurisprudence of this century. The Kentucky Supreme Court has acted in regard to economic liberty just as Justice Brennan would have state courts act in regard to non-economic rights like procedural fairness and equal protection, i.e., extending greater protection under the state constitution than is available under the federal Constitution. Whatever be the basis upon which the Kentucky Supreme Court relies for its section 2 decisions in this area, however, the logic and broad language of its opinions carry the potential for a transfer of considerable political power from the legislature and executive to the judiciary.

There are certain difficulties inherent in the use of section 2 as an instrument of economic due process. The Kentucky Milk Marketing decision is grounded on the conclusion that a “minimum mark-up law” is contrary to a property right, the right to determine pricing, which is inherent to the free enterprise system. Such a law, opines the court, is therefore contrary to section 2. This holding, however, leaves open the question: To what extent are other economic rights protected by section 2? Economic regulation by the state is pervasive in modern society and affects matters such as wages, hours, advertising and product content, to name just a few, which are seemingly as fundamental to the

122. 291 U.S. at 523, 527-8, 529, 532, 537 and 538.
123. 691 S.W.2d at 900.
property right as is pricing. Are these laws fair game for judicial condemnation under section 2? If not, what is the distinction between a minimum wage or a maximum hour law and an unconstitutional minimum mark-up law? If so, how is the slippery slope of invalidating all economic regulation to be avoided? The Kentucky Supreme Court has not provided a reasoned analysis of these issues.

Moreover, the court in Kentucky Milk Marketing and Commonwealth v. Foley incorporated language in its decision to the effect that, "Whatever is contrary to democratic ideals, customs and maxims is arbitrary. Likewise, whatever is essentially unjust and unequal or exceeds the reasonable and legitimate interests of the people is arbitrary." This language is exceptionally broad and vague. No standards for the application of this principle have been articulated. This formulation provides the court with an incredible reservoir of uncircumscribed discretionary power. Under such conditions, or lack of conditions, the court operates untethered to any principled basis for the decision of individual cases.

V. CONCLUSION

Although there is both historical and theoretical support for the Kentucky Supreme Court's use of section 2 as a tool of substantive or economic due process, the problems just discussed are indicative of why this concept has long been out of favor in federal Constitutional jurisprudence. If the court desires to continue employing section 2 as a substantive protection of property rights it must articulate the rationale and standards on which it does so. Arguments in support of a revival of substantive due process have been advanced by scholars on grounds including economic efficiency and institutional competency as well as history and political theory. The Kentucky Supreme Court should recognize and address these arguments. Unless it does so, the court itself will appear to be arbitrary in its interpretation of a constitutional provision which denies the existence of arbitrary power.

124. Foley, 798 S.W.2d at 953 (quoting Kentucky Milk Marketing, 691 S.W.2d at 899).
125. See, e.g., Note, supra note 98, at 1364 & n.5.
THE LIMITATIONS OF 30 U.S.C. § 902(f)(2) ON BLACK LUNG LAW - FROM SEBBEN TO PRESENT

Michael O'Neill*

I. INTRODUCTION

Interpretation of section 902(f)(2) in Title 30 of the United States Code has left federal black lung law in considerable turmoil in recent years, making it uncertain which set of regulations apply. The section prevents criteria in part 727 of Title 20 of the Code of Federal Regulations from being more restrictive than criteria in section 410.490 of Title 20 of the Code of Federal Regulations. Having already interpreted section 902(f)(2) once, the Supreme Court has granted a writ of certiorari for three cases involving the section.1 Part of the difficulty of interpretation arises from section 902(f)(2) itself, but the problem is compounded by the unfortunate drafting of section 410.490. This article will explore section 902(f)(2) and the two sets of black lung regulations to which it refers: section 410.490 and part 727, both found in Title 20 of the Code of Federal Regulations. Beginning with a quick history of federal black lung law, I will then explain what section 902(f)(2), section 410.490, and part 727 literally state. Next, I will trace interpretation of section 902(f)(2)

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The views and opinions expressed in this article are solely those of the author and do not reflect the official position of the United States Department of Labor. In addition, this article is based upon public information and not upon any confidential source of information internal to the Office of Administrative Law Judges or the Department of Labor.

II. HISTORY OF THE ACT

Title IV of the Federal Coal Mine Health and Safety Act established the federal black lung program. This act was designed to provide benefits to those miners who are totally disabled by pneumoconiosis (black lung). Initially, the Act was administered by the Department of Health, Education and Welfare. Because it was felt that too few claims were being processed under the original regulations, a set of interim presumptions were established under section 410.490. Then, in the Black Lung Reform Act of 1977, the responsibility for administering the Act was transferred to the Department of Labor. While the Department of Labor was to ultimately establish a set of permanent regulations, it too initially established interim regulations under part 727. Part of the law transferring responsibility to the Department of Labor is codified in Title 30 of the United States Code at section 902. That provision is entitled Definitions, subsection (f) of which refers to “total disability.” Subsection (f)(2) states that “criteria applied by the Secretary of Labor [part 727] in the case of... any claim... shall not be more restrictive than the criteria applicable to a claim filed on June 30, 1973 [section 410.490].”

III. SECTION 410.490 AND PART 727

Section 410.490 was drafted in a most confusing manner and is internally inconsistent. Section 410.490 provides in part that

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4. Id.
7. Id. at 109-11.
a miner who meets certain criteria will be presumed to be totally
disabled due to pneumoconiosis. Under section 410.490(b)(1), a
miner must first meet certain medical criteria. He must show
the existence of pneumoconiosis by x-ray, biopsy, or autopsy
evidence, or he must have at least 15 years of coal mine employ-
ment and produce qualifying values on a pulmonary function
study.10

(b) Interim presumption. With respect to a miner who files a claim for benefits
before July 1, 1973, and with respect to a survivor of a miner who dies before
January 1, 1974, when such survivor timely files a claim for benefits, such miner
will be presumed to be totally disabled due to pneumoconiosis, or to have been
totally disabled due to pneumoconiosis at the time of his death, or his death will
be presumed to be due to pneumoconiosis, as the case may be, if:
(1) One of the following medical requirements is met:
   (i) A chest roentgenogram (X-ray), biopsy, or autopsy establishes the existence
       of pneumoconiosis (see § 410.428); or
   (ii) In the case of a miner employed for at least 15 years in underground or
       comparable coal mine employment, ventilatory studies establish the presence of a
       chronic respiratory or pulmonary disease (which meets the requirements for du-
       ration in § 410.412(a)(2)) as demonstrated by values which are equal to or less than
       the values specified in the following table:

       +-----------------+---------+---------+
       | FEV             | MVV     |
       +-----------------+---------+---------+
       | 67" or less      | 2.3     | 92      |
       | 68"              | 2.4     | 96      |
       | 69"              | 2.4     | 96      |
       | 70"              | 2.5     | 100     |
       | 71"              | 2.6     | 104     |
       | 72"              | 2.6     | 104     |
       | 73" or more      | 2.7     | 106     |

   (2) The impairment established in accordance with paragraph (b)(1) of this section
       arose out of coal mine employment (see §§ 410.416 and 410.456).

(3) With respect to a miner who meets the medical requirements in paragraph
   (b)(1)(ii) of this section, he will be presumed to be totally disabled due to pneumo-
   coniosis arising out of coal mine employment, or to have been totally disabled at
   the time of his death due to pneumoconiosis arising out of such employment, or
   his death will be presumed to be due to pneumoconiosis arising out of such
   employment, as the case may be, if he has at least 10 years of the requisite coal
   mine employment.

(c) Rebuttal of presumption. The presumption in paragraph (b) of this section may
be rebutted if:
   (1) There is evidence that the individual is, in fact, doing his usual coal mine
       work or comparable and gainful work (see § 410.412(a)(1)), or
   (2) Other evidence, including physical performance tests (where such tests are
       available and their administration is not contraindicated), establish that the indi-
       vidual is able to do his usual coal mine work or comparable and gainful work (see
       § 410.412(a)(1)).
He must then show that the impairment established under (b)(1) arose out of coal mine employment.\textsuperscript{11} This section refers to sections 410.416 and 410.456, which state that a miner may show that his pneumoconiosis arose out of coal mine employment either by direct evidence or by invoking a rebuttable presumption based upon 10 or more years of coal mine employment.\textsuperscript{12}

The inconsistency emerges under (b)(3), which states that a miner who has met the medical requirement of (b)(1)(ii) (the pulmonary function study) and has at least ten years of coal mine employment will be presumed to be totally disabled due to pneumoconiosis arising out of coal mine employment. Thus, a miner with more than 15 years of employment and qualifying pulmonary function studies must then establish that his impairment arose out of coal mine employment under (b)(2). If he fails under (b)(2), he would still succeed under (b)(3), where he need only establish 10 years of coal mine employment to get the same presumption. Similarly, a miner with greater than 10 but less than 15 years of coal mine employment cannot invoke the presumption by pulmonary function study under (b)(1)(ii), but can invoke it under (b)(3).

The regulations explicitly provide for two methods of rebuttal. The presumption may be rebutted if the miner is currently performing or is capable of performing his regular coal mine employment or comparable work. As can be seen, under this scheme, a long term miner with a qualifying pulmonary function study will be entitled to benefits even if his impairment is unrelated to pneumoconiosis.

The Labor interim presumptions were set forth in part 727.\textsuperscript{13}

\textsuperscript{13} 20 C.F.R. § 727.203 (1990). Section 727.203 reads as follows:

(a) Establishing interim presumption. A miner who engaged in coal mine employment for at least 10 years will be presumed to be totally disabled due to pneumoconiosis, or to have been totally disabled due to pneumoconiosis at the time of death, or death will be presumed to be due to pneumoconiosis, arising out of that employment, if one of the following medical requirements is met:

(1) A chest roentgenogram (X-ray), biopsy, or autopsy establishes the existence of pneumoconiosis (see § 410.428 of this title);

(2) Ventilatory studies establish the presence of a chronic respiratory or pulmonary disease (which meets the requirements for duration in § 410.412(a)(2) of this title) as demonstrated by values which are equal to or less than the values specified
They too provided for a presumption of total disability due to

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<th>FEV</th>
<th>MVV</th>
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<td>67&quot; or less</td>
<td>2.3</td>
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<tr>
<td>68&quot;</td>
<td>2.4</td>
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<td>69&quot;</td>
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<td>2.6</td>
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<td>72&quot;</td>
<td>2.6</td>
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<tr>
<td>73&quot; or more</td>
<td>2.7</td>
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(3) Blood gas studies which demonstrate the presence of an impairment in the transfer of oxygen from the lung alveoli to the blood as indicated by values which are equal to or less than the values specified in the following table:

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<tr>
<th>Arterial pCO2</th>
<th>Values</th>
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<tbody>
<tr>
<td>30 or below</td>
<td>70</td>
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<td>31</td>
<td>69</td>
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<td>39</td>
<td>61</td>
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<tr>
<td>40-45</td>
<td>any value</td>
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</table>

(4) Other medical evidence, including the documented opinion of a physician exercising reasoned medical judgment, establishes the presence of a totally disabling respiratory or pulmonary impairment;

(5) In the case of a deceased miner where no medical evidence is available, the affidavit of the survivor of such miner or other persons whose knowledge of the miner’s physical condition, demonstrates the presence of a totally disabling respiratory or pulmonary impairment.

(b) Rebuttal of interim presumption. In adjudicating a claim under this subpart, all relevant medical evidence shall be considered. The presumption in paragraph (a) of this section shall be rebutted if:

(1) The evidence establishes that the individual is, in fact, doing his usual coal mine work or comparable and gainful work (see § 410.412(a)(1) of this title); or

(2) In light of all relevant evidence it is established that the individual is able to do his usual coal mine work or comparable and gainful work (see § 410.412(a)(1) of this title); or

(3) The evidence establishes that the total disability or death of the miner did not arise in whole or in part out of coal mine employment; or

(4) The evidence establishes that the miner does not, or did not, have pneumoconiosis.
pneumoconiosis.\textsuperscript{14} Beginning with a threshold requirement that the miner have more than 10 years of coal mine employment, they then provided for four methods of invocation of the presumption.\textsuperscript{15} The presumption could be invoked by x-ray evidence, pulmonary function study, blood gas study, or by a narrative medical report.\textsuperscript{16} Once invoked, the presumption could be rebutted by four methods as well.\textsuperscript{17} It could be rebutted by evidence that the miner was still doing his regular coal mine job or comparable work, or that he was capable of doing such work. In addition, the presumption could be rebutted by showing that the miner was not totally disabled, even in part, by pneumoconiosis, and finally, by showing that the miner did not have pneumoconiosis.\textsuperscript{18}

As can be seen, they provide for two methods of invocation and two more methods of rebuttal than section 410.490.

\section*{IV. \textsc{Pittston Coal Group v. Sebben}}

In \textit{Pittston Coal Group v. Sebben},\textsuperscript{19} the Supreme Court addressed the issue of whether the part 727 invocation criteria were more restrictive than the section 410.490 criteria.\textsuperscript{20} Justice Scalia provided the majority opinion.

\textit{Sebben} involved the consolidation of a number of cases from the Fourth and Eighth Circuits. In \textit{Broyles v. Director, OWCP},\textsuperscript{21} the Fourth Circuit Court of Appeals held that part 727 was more restrictive than section 410.490, so that Broyles was entitled to have his claim adjudicated under the latter criteria.\textsuperscript{22} In \textit{In re Sebben},\textsuperscript{23} the Eighth Circuit Court remanded the case after the district court had refused to compel the Secretary of Labor to readjudicate previously denied part 727 claims.\textsuperscript{24} The Eighth Circuit Court found part 727 more restrictive.\textsuperscript{25}

\begin{thebibliography}{9}
\bibitem{14} 20 C.F.R. \textsection 727.203 (1990).
\bibitem{15} \textit{Id.}
\bibitem{16} 20 C.F.R. \textsection 727.203(a) (1990).
\bibitem{17} 20 C.F.R. \textsection 727.203(b) (1990).
\bibitem{18} \textit{Id.}
\bibitem{20} \textit{Id.} at 107.
\bibitem{21} \textit{Broyles v. Director, OWCP}, 824 F.2d 327 (4th Cir. 1987).
\bibitem{22} \textit{Id.} at 328.
\bibitem{23} \textit{In re Sebben}, 815 F.2d 475 (8th Cir. 1987).
\bibitem{24} \textit{Id.}
\bibitem{25} \textit{Id.} at 481.
\end{thebibliography}
Before determining whether the part 727 criteria were more restrictive than the section 410.490 criteria, the Court had to first determine what those criteria are. As stated above, a literal reading of the regulation produces an inconsistency in the criteria. The Court rewrote section 410.490 criteria to resolve this inconsistency. Under the Court's interpretation, there are two routes under which presumptive entitlement could be established.

First, a miner may invoke the presumption if he establishes the existence of pneumoconiosis by x-ray, biopsy, or autopsy if he establishes that the impairment arose out of coal mine employment. This causality may be established by direct evidence or by invoking a rebuttable presumption through having 10 years of coal mine employment. The Court also stated that, to be sure, these sections permit rebuttal of the presumption of causality, but it was plainly not the intended purpose of (b)(2) to serve as a rebuttal provision rather than as a substantive requirement. The second method enables a miner to obtain presumptive entitlement if he has at least 10 years of coal mine employment and establishes the presence of a chronic respiratory or pulmonary disease as demonstrated by specified pulmonary function study values.

With the interpretation of section 410.490 invocation settled, the Court then addressed the issue before it. Under the Department of Labor's interim regulations in part 727, a miner could invoke a presumption of total disability due to pneumoconiosis if he had 10 years of coal mine employment and established certain medical criteria. Because none of the miners before the Court had 10 or more years of coal mine employment, they were not entitled to invoke under part 727 even if they met the medical criteria. The central issue of the case became the meaning of

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26. See supra notes 10-12 and accompanying text.
28. Id.
29. Id. See also 20 C.F.R. § 410.490(b)(1)(i), (b)(2) (1990).
31. Id. at 120.
32. Id. at 109. The Sixth Circuit and Third Circuit have adopted this interpretation in subsequent cases: Saginaw Mining Co. v. Ferda, 879 F.2d 198 (6th Cir. 1989); Bethenergy Mines v. Director, OWCP, 890 F.2d 1295 (3d Cir. 1989).
the term "criteria" in section 902(f)(2). The Secretary of Labor believed the term was limited, first arguing that the term "criteria" referred to those criteria bearing on total disability. Because the 10 year requirement goes to causation, not total disability, the Secretary asserted it is not criteria. Acknowledging that there may be some merit to that argument, the Court disagreed, stating that while the 10 year requirement bears proximately upon causation, it ultimately bears upon total disability as well. Section 410.490 provides that if the miner proves pneumoconiosis and causation, total disability is presumed. By making the causation criteria more restrictive, part 727 made the total disability criteria more restrictive as well. In addition, contrary to the Secretary's view, the Court found the term "criteria" is not limited to medical criteria. Even if it were, the medical criteria would be more restrictive because of the 10 year requirement. Consequently, the Court found that the 10 year requirement made part 727 more restrictive than section 410.490.

Because the miners conceded the validity of the rebuttal provisions, the Court declined to comment on their validity or reconcile the decision to the putative validity of the rebuttal provisions. It did, however, note that part 727 contains more rebuttal methods than does section 410.490.

Finally, the Court addressed which remedy would be appropriate. For Broyles, the Court remanded the case for application of criteria no more restrictive than section 410.490 only as to the affirmative factors of entitlement, but not the rebuttal factors, because their validity had been conceded. For Sebben, the Court found that mandamus would not be appropriate because those

34. Id. at 113.
35. Id. at 114.
36. Id.
37. Id.
38. Id.
39. Id.
40. Id. at 115.
41. Id. at 116-117.
42. Id.
43. Id. at 119.
44. Id.
45. Id. at 121.
46. Id.
claims had been finally denied and respondent failed to establish the duty to reopen those determinations.\footnote{47}

Justice Stevens, joined by three other Justices, dissented. First, he discussed section 410.490, then he discussed the context of the statute's enactment which indicated that Congress intended it to refer to medical criteria, and finally he argued that the majority's view was inconsistent with standard principles of deference.\footnote{48}

Thus, while the Court clearly resolved the issue before it, the scope of the holding was left open to speculation. Only two things could be said for certain. First, section 410.490 was rewritten. Second, the Court found that the 10 year requirement was more restrictive for short term miners, and ordered that invocation criteria not more restrictive than section 410.490 be used for those miners. The Circuit courts were left to fill the gaps, deciding how broadly \textit{Sebben} applied and what criteria to apply.

Depending on how broadly one wanted to read \textit{Sebben}, several options presented themselves. First, \textit{Sebben} could stand for the proposition that the 10 year requirement is invalid and part 727 should be used for both short and long term miners. Second, \textit{Sebben} could indicate that part 727 invocation is entirely invalid. The question would then be what criteria to use, those of section 410.490 or some new criteria not more restrictive than section 410.490. Third, the Court could have intended part 727 invocation is invalid for short term miners, but valid for long term miners.

In addition, the circuit courts were presented with the problem that \textit{Sebben} left specifically unanswered: the validity of the part 727 rebuttal provisions. Since \textit{Sebben}, the circuit courts have attempted to resolve these problems, but have arrived at divergent results.

V. CIRCUIT COURT CASES

A. Sixth Circuit

Before \textit{Sebben}, the Sixth Circuit had decided \textit{Kyle v. Director, OWCP}.\footnote{49} In \textit{Kyle}, the court held that part 727 was more restrictive

\footnotesize{\begin{itemize}
\item \textit{Sebben} v. \textit{Director, OWCP}, 819 F.2d 139 (6th Cir. 1987).
\end{itemize}}
than section 410.490 for short term miners, and so their claims should be analyzed under the latter section.50

After Sebben, the Sixth Circuit decided Youghiogheny and Ohio Coal Co. v. Milliken.51 Milliken involved a long term miner who argued that the part 727 rebuttal provisions are more restrictive than the section 410.490 rebuttal provisions because they allow for more methods of rebuttal.62 The court stated that the holding of Kyle was limited to invocation, and that the Sixth Circuit Court of Appeals has "explicitly declined, however, to extend our holding in Kyle to the regulations governing rebuttal of the interim presumption."53 Citing the Joint Explanatory Statement of the Committee of Conference, the court stated that it is the legislative intent that all medical evidence be considered in adjudication claims.54 Therefore, Congress did not intend for the "not more restrictive" language in section 902(f)(2) to require the same evidentiary rules in part B (410.490) and part C (part 727) cases.55 Rather, these rules were intended to change over time.56 Because the miner was treated equally under part 727 and section 410.490 invocation, nothing in Kyle mandated the application of the section 410.490 rebuttal provisions, and so part 727 rebuttal should be used.57 In a footnote, the court noted Sebben and stated that while the case effectively affirmed the holding in Kyle, it shed no light on the present issue because the Supreme Court specifically declined to consider the validity of the rebuttal provisions.58 The rule of Milliken has been upheld in subsequent decisions.59

As can be seen, in the Sixth Circuit, Sebben applies to short term miners only. Long term miners invoke the presumption of total disability due to pneumoconiosis under part 727. Both sets of miners rebut the presumption under part 727.

50. *Id.* at 142-44.
51. Youghiogheny and Ohio Coal Co. v. Milliken, 866 F.2d 195 (6th Cir. 1989).
52. *Id.* at 199.
53. *Id.* at 201. See Grant v. Director, OWCP, 857 F.2d 1102 (6th Cir. 1988); Warman v. Pittsburgh and Midway Coal Mining Co., 839 F.2d 257 (6th Cir. 1988).
56. *Id.* at 202; See also Kyle v. Director, OWCP, 819 F.2d 139, 144 (6th Cir. 1987); Ramey v. Kentland Elkhorn Coal Corp., 755 F.2d 485, 490 (6th Cir. 1985).
57. Milliken, 866 F.2d at 202.
58. *Id.* at 199, n.1.
59. See, e.g., Couch v. Director, OWCP, 893 F.2d 130, 131 (6th Cir. 1990).
B. Eighth Circuit

In Oliver v. Director, OWCP, the Eighth Circuit Court of Appeals implicitly found that Sebben was limited to short term miners by stating that part 727 invocation applied to the claimant, a long term miner. It did not consider the validity of the rebuttal provisions.

C. Third Circuit

In Bethenergy Mines, Inc. v. Director, OWCP, the Third Circuit Court of Appeals decided that section 902(f)(2) was not intended to apply the rebuttal provisions in part 727. First analyzing the claim under part 727, the trial court found no entitlement because while the miner had pneumoconiosis and was totally disabled, the disability did not arise, even in part, out of pneumoconiosis. Next analyzing the claim under section 410.490, the court found that section 410.490(c) only allowed rebuttal by showing that the miner was currently doing his usual coal mine work, or that he was able to do that work, or comparable work. The miner was entitled to benefits under section 410.490 but not under part 727. Given that the purpose of the Black Lung Benefits Act is to compensate miners who were totally disabled at least in part by pneumoconiosis arising out of coal mine employment, the court declined to adopt what it deemed to be “an unjust result.”

The court noted that in its previous decision in Halon, it had held that the part 727 limitation to long term miners violated section 902(f)(2), because no such limitation exists under section 410.490(b)(1)(i). In addition, the Halon court rejected the proposition that section 902(f)(2) was limited to medical criteria, and concluded that “criteria” referred to adjudicatory as well as medical eligibility criteria. The Bethenergy court then noted that

60. Oliver v. Director, OWCP, 888 F.2d 1239 (8th Cir. 1989).
61. Id. at 1240-41.
63. Id. at 1300-02.
64. Id. at 1296.
65. Id. at 1296-97. The judge considered § 410.490 pursuant to Halon v. Director, OWCP, 713 F.2d 30 (3d Cir. 1982), reinstated on rehearing, 713 F.2d 21 (3d Cir. 1983).
66. Bethenergy, 890 F.2d at 1300.
67. Id. See also Halon v. Director, OWCP, 713 F.2d 30 (3d Cir. 1982), reinstated on rehearing, 713 F.2d 21 (3d Cir. 1983).
68. Bethenergy, 890 F.2d at 1301.
**Sebben** agreed with *Halon* in that it found the 10 year requirement in part 727 conflicts with section 902(f)(2). Because the Court in *Sebben* was not dealing with the rebuttal provisions, the *Bethenergy* court found *Sebben* to not be controlling. The court examined the positioning in section 902(f) which deals with total disability. It found the requirement of "not more restrictive criteria" indicates that rebuttal criteria are not limited by section 902(f)(2). Had Congress intended the term "criteria" in section 902(f)(2) to apply to rebuttal criteria, or to criteria relating to non-total disability matters, the court believed Congress would have said so directly. Therefore, part 727 rebuttal applies, not section 410.490.

Continuing, the court stated that the application of section 410.490(c)(1) and (2) would not change the result. Both sections refer to section 410.412(a)(1) which refers to a miner being totally disabled due to pneumoconiosis. This reference was made to permit rebuttal by showing that the miner's disability did not arise even in part from coal mine employment. Additionally, the court noted that such a construction is surely required to carry out the purpose of the Act.

**D. Seventh Circuit**

In *Taylor v. Peabody Coal Co.*, the Seventh Circuit Court of Appeals found that *Sebben* had invalidated part 727 invocation, and that the same reasoning dictated that part 727 rebuttal was invalid as well. After considering the Sixth Circuit's approach in *Milliken*, the court rejected that view. The court noted that the Supreme Court in *Sebben* "determined that the text of section 902(f)(2) 'plainly embraces criteria of more general application'.

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69. Id.
70. Id.
71. Id.
72. Id.
73. Id. at 1301-02.
74. Id. at 1302.
75. Id.
76. Id.
77. Id. The purpose of the Act is to provide benefits to miners totally disabled due to pneumoconiosis.
78. Taylor v. Peabody Coal Co., 892 F.2d 503 (7th Cir. 1989).
79. Id. at 506.
80. Id. at 506-507.
than medical criteria."\textsuperscript{81} This includes evidentiary rules and adjudicatory standards, whether they be applied on invocation or on rebuttal.\textsuperscript{82} Moreover, the court noted that even if the text of section 902(f)(2) conflicts with its legislative history, there is no rule limiting a statute's effects to those explicitly mentioned in its legislative history.\textsuperscript{83} The court found that part 727 rebuttal rules violate section 902(f)(2).\textsuperscript{84} The court concluded by stating that \textit{Sebben} indicates that section 410.490 invocation rules apply to this case.\textsuperscript{85} Because Taylor mined for more than 10 years, the court found that the rule of \textit{Sebben} applied to long term miners as well as short term miners for invocation.\textsuperscript{86}

\textbf{E. Fourth Circuit}

In \textit{Taylor v. Clinchfield Coal Co.},\textsuperscript{87} the Fourth Circuit Court of Appeals decided the issue of rebuttal, but left the scope of \textit{Sebben} on invocation undefined. Because the presumptions invoked by part 727 and section 410.490 are identical, the court found the fact of invocation, not the number of methods to invoke, to be the fact of consequence.\textsuperscript{88} While on the face of the two regulations, part 727 has two more methods of rebuttal than section 410.490, upon closer inspection, the court concluded that there was only one difference in the methods of rebuttal.\textsuperscript{89} Both regulations allow rebuttal by establishing that the miner is doing his usual coal mine work or by showing that the miner is capable of doing his usual coal mine work, or comparable work.\textsuperscript{90} The court noted that section 410.490(b)(2) refers to sections 410.416 and 410.456.\textsuperscript{91} These

\begin{itemize}
\item \textsuperscript{81} \textit{Id.} at 507.
\item \textsuperscript{82} \textit{Id.} See also Halon v. Director, OWCP, 713 F.2d 21, 24 (3d Cir. 1983).
\item \textsuperscript{83} \textit{Taylor v. Peabody Coal Co.}, 892 F.2d 503, 507 (7th Cir. 1989) (citing Pittston Coal Group v. \textit{Sebben}, 488 U.S. 105, 115 (1988)).
\item \textsuperscript{84} \textit{Taylor}, 892 F.2d at 507.
\item \textsuperscript{85} \textit{Id.} at 508.
\item \textsuperscript{86} \textit{Id.} at 507, 508.
\item \textsuperscript{87} \textit{Taylor v. Clinchfield Coal Co.}, 895 F.2d 178 (4th Cir. 1990).
\item \textsuperscript{88} \textit{Id.} at 182. Both sections involve a presumption of total disability due to pneumoconiosis. (The appeal apparently did not involve the issue of whether \textit{Sebben} applied to long term miners. If it did, then Taylor could not have invoked the presumption he invoked under a method available under part 727 but not under § 410.490. \textit{Id.} at 179).
\item \textsuperscript{89} \textit{Id.} at 182-83.
\item \textsuperscript{90} \textit{Id.} at 183.
\item \textsuperscript{91} \textit{Id.}
sections provide for a presumption of causation and its rebuttal.  

The court also stated that the Supreme Court noted this reference in its decision in Sebben.  

Interpreting this rebuttal method to be parallel to section 727.203(b)(3) the court was left with only one difference in rebuttal between section 410.490 and part 727: section 727.203(b)(4).  

The court declared this last method of part 727 rebuttal to be more restrictive than section 410.490 rebuttal in violation of section 902(f)(2).  

The claim was then remanded for determination of whether employer established rebuttal under section 410.490(c) or under the causality rebuttal provisions of section 410.416 if the miner claimed under that section.  

The dissent in this case preferred the approach of Milliken and Bethenergy.  

The Fourth Circuit has not given its interpretation of Sebben’s holding regarding invocation. Taylor involved a long term miner and assumed the invocation of the presumption. The Court invalidated part 727 rebuttal, directing that section 410.490(c) rebuttal should be used, and that section 410.416 should be used if the miner invoked using that section.  

VI. DISCUSSION  

This controversy involves three major issues. The first is the scope of the Sebben decision. The second is whether section 902(f)(2) applies to part 727 rebuttal. The third is how should section 410.490 be interpreted.  

The scope of the Sebben holding refers to the scope of section 902(f)(2) on invocation, as the Court expressly limited the holding of Sebben to invocation. In addition, the Court held that because the 10 year requirement makes invocation of the presumption of  

94. Taylor, 895 F.2d at 183. Rebuttal by showing the absence of pneumoconiosis.  
95. Id.  
96. Id.  
97. Taylor, 895 F.2d 178, 183 (Ervin, C.J., dissenting).  
98. See supra notes 30-31 and accompanying text.
total disability more difficult for short term miners, part 727 is more restrictive and therefore invalid. The same reasoning does not apply to long term miners. Because part 727 allows invocation in methods virtually identical to section 410.490 methods, the purpose of "not more restrictive criteria" would not be accomplished by invalidating part 727 for long term miners. By creating additional methods of invocation, the Secretary of Labor established more generous criteria for long term miners. To apply the holding of *Sebben* to long term miners would not further the purpose of 902(f)(2) and would do violence to the Secretary of Labor's regulatory scheme. Thus, the invocation views of *Milliken* and *Bethenergy* are in keeping with both the intent behind part 727, and the holding in *Sebben*.

The next issue is the applicability of section 902(f)(2) on rebuttal. Because the additional part 727 rebuttal provisions pertain to causation and pneumoconiosis, the threshold question is whether section 902(f)(2) is limited to total disability.

Two arguments support limiting the section to total disability. The first argument is the organizational structure in which the section is found. Section 902 is entitled "Definitions" and subsection (f) is the definition of "total disability." The obvious inference is that the limitation found in section 902(f)(2) refers to total disability, the subsection in which the provision is found. In *Sebben*, the Court stated that there is much to be said for the argument that the limitation in section 902(f)(2) pertains to total disability. The Third Circuit was persuaded by this argument.

The second argument derives from the purpose of the Act, which is to provide benefits to miners totally disabled by pneumoconiosis. As the facts of *Bethenergy* point out, the section 410.490 presumption may be invoked by a miner who has pneumoconiosis, but is totally disabled by something other than pneumoconiosis. For the purpose of the Act to be served, this presumption must be capable of being rebutted by showing that the impairment did not arise out of pneumoconiosis. If section 902(f)(2) is limited to total disability, then the additional rebuttal methods are not affected as they go to elements other than the existence of total disability. These additional rebuttal provisions further the purpose of the Act by allowing the issues of causation and the existence of pneumoconiosis to be clearly addressed.

Several problems appear if section 920(f)(2) is not limited to total disability. The first problem is how to compare the part 727 criteria with the section 410.490 criteria. Because, for long
term miners, part 727 contains more methods for both invocation and rebuttal than does section 410.490, it is difficult to say whether the part 727 criteria are more restrictive. Do the additional invocation methods outweigh the additional rebuttal methods? How much deference is the Secretary of Labor to be accorded?

The second problem is that the Supreme Court will be forced to further interpret section 410.490. This will be necessary for comparison with part 727 and to solve the problem posed by the facts in Bethenergy. As will be discussed below, interpretation of the section will have to go beyond the literal language and elaborate on the references to other code sections.

Section 410.490 is inconsistent and needs to be revised. The Supreme Court's majority view in Sebben needs clarification in the area of causation, i.e. total disability due to pneumoconiosis. Under the Court's interpretation, if one has x-ray evidence of pneumoconiosis, he must then show causation by either 10 years of coal mine employment or by direct evidence. In dicta, the Court states that the reference in section 410.490(b)(2) to sections 410.416 and 410.456 is not meant to be a rebuttal provision, but rather a substantive requirement. This causes problems in factual situations such as that in Bethenergy where a miner's total disability is not due even in part to pneumoconiosis.

The second method of invocation also has problems. A long term miner may invoke the presumption by showing total disability through qualifying pulmonary function study scores, without having pneumoconiosis. The employer will not be able to rebut the presumption because rebuttal is limited to the existence of total disability.

Two Circuit Courts have addressed this problem. In Taylor, the Fourth Circuit found that the 10 year presumption in sections 410.416 and 410.456 is rebuttable. Consequently, if a miner invokes by x-ray, and therefore uses (b)(2) for causation, the employer may rebut the presumption by showing that the impairment did not arise out of coal mine employment.

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100. See supra notes 88-99 and accompanying text.
101. Because pneumoconiosis is defined as a chronic dust disease arising out of coal mine employment, showing that there is no pneumoconiosis is the same as showing that the disease did not arise out of coal mine employment.
view may account for the problem posed by x-ray invocation, it
does nothing to solve the problem posed by pulmonary function
study invocation.

In *Bethenergy*, the Third Circuit noted that section 410.490
rebuttal provisions refer to section 410.412 which, in turn, re-
ferred to total disability due to pneumoconiosis. The court then
found that this reference provided another rebuttal method; the
presumption could be rebutted by showing that the miner's
impairment did not arise, even in part, from pneumoconiosis.

Looking at the purpose of the Act, to provide benefits to
miners totally disabled due to pneumoconiosis, and looking at the
problem posed by *Bethenergy*, this solution alleviates the prob-
lems posed by both methods of invocation. Consequently, it is
likely to be adopted. Therefore, if the Court chooses to apply
section 902(f)(2) to all elements of entitlement, part 727 will only
have one additional rebuttal method. For short term miners, the
part 727 rebuttal methods would be more restrictive, since they
are limited to the section 410.490 methods of invocation. For long
term miners, however, there are two additional invocation meth-
ods under part 727 as compared to only one additional rebuttal
method. For long term miners, part 727 rebuttal is unlikely to
be viewed as more restrictive.

VII. CONCLUSION

In conclusion, the holding in *Sebben* is limited to short term
miners, and therefore long term miners may invoke under part
727. In addition, given the structure of section 902, section 902(f)(2)
refers to total disability. Therefore, because the additional re-
buttal methods do not pertain to total disability, the section is
inapplicable. If the Court chooses to apply section 902(f)(2) to all
elements of entitlement, it will be forced to further explain
section 410.490 to keep that section consistent with the purpose
of the Black Lung Benefits Act. If the Court addresses section
410.490, it will most likely adopt a version of the *Bethenergy*
approach and include a method of rebutting the presumption on
the basis of causation.

102. See supra notes 57-71 and accompanying text.
GREELEY V. MIAMI VALLEY MAINTAINANCE CONTRACTORS, INC.: HAS OHIO GONE TOO FAR IN CREATING A PUBLIC POLICY EXCEPTION TO THE EMPLOYMENT AT WILL DOCTRINE?

Lisa A. Love

I. INTRODUCTION

Absent any statutory or collective bargaining limitation, a large percentage of the workers in this country today are not protected from termination at will by their employers. In the private sector, the courts have been reluctant to interfere with the right of private parties to contract freely for employment. Where protection from termination at will is not secured through private contract, the courts historically have rarely disturbed the employer's absolute right to terminate "for good cause, for no cause, or even for cause morally wrong." Recently, a growing number of state courts have created a remedy for wrongful discharge by recognizing certain narrow exceptions to the common law employment at will doctrine. Generally, these courts have recognized three specific exceptions, allowing recovery when the discharge is: 1) clearly contrary to public policy; 2) a breach of an implied covenant of good faith and fair dealing; or 3) a breach of an implied-in-fact contract.


2. Payne v. Western & Atl. R.R., 81 Tenn. 507, 519-20 (1884), overruled on other grounds, Hutton v. Watters, 132 Tenn. 527, 179 S.W. 134 (1915). This decision is generally cited as the first judicial pronouncement recognizing the at-will concept in this country.


With the Ohio Supreme Court's decision in *Greeley v. Miami Valley Maintenance Contractors, Inc.*, Ohio joins thirty-nine other states which recognize a public policy exception to the employment at will rule. While Ohio joins the majority of states by recognizing this exception, by not founding its decision on a clear expression of public policy, Ohio has created an exception significantly broader than the previously recognized narrowly drawn exception to the employment at will doctrine, opening the door for increased litigation in this area and quite possibly the demise of the doctrine itself.

II. HISTORY OF THE EMPLOYMENT AT WILL DOCTRINE

Prior to the acceptance of the employment at will doctrine, the relationship between employer and employee was one of master-
servant: the servant provided labor for the master, and in return, the master provided shelter, food, and protection for the servant. This protective system of employment was rejected in America and was replaced by the nineteenth century contractual approach which was based upon prominent laissez-faire social attitudes. The American employment at will doctrine recognized that an employment agreement without fixed duration could be terminated at the will of either the employer or the employee. This approach stemmed from a rule which was first stated in a treatise on the law of master and servant: "[T]he rule is inflexible, that a general or indefinite hiring is prima facie a hiring at will . . . a hiring at so much a day, week, month or year, no time being specified is indefinite hiring."

The exact reasons for the shift from the status-oriented, master-servant employment relationship to contractual at will employment have long been a source of speculation. One commentator has

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7. The laissez-faire concept was based on the assumption that the individual should have complete social freedom to contract not only in his personal affairs but also in his business relationships. The new rule was ushered in by the industrial revolution and its companion notions of social freedom and freedom of contract. See Comment, A Common Law Action For the Abusively Discharged Employee, 26 Hastings L.J. 1435, 1438-41 (1975) [hereinafter Comment, Abusive Discharge]. Under this contractual approach to employment, the parties were bound only by obligations clearly intended; the parties set their own terms and any implied obligations became secondary to the employee's basic freedoms. See Mallor, supra note 3, at 454; Comment, Thompson v. St. Regis Paper Co.: Three New Exceptions To The Employment At Will Doctrine, 60 Wash. L. Rev. 209 (1984) [hereinafter Comment, Three New Exceptions].

8. The employment relationship in the late nineteenth century was considered to be strictly contractual in nature and the absence of expressed terms or a written contract created the at will arrangement. This contract based theory was a repudiation of the English rule which required just cause for the termination of at will employment. Under the new rule, the employer's freedom to discharge was absolute. See Mallor, supra, note 3, at 454; Comment, Abusive Discharge, supra note 7, at 1440.

9. H. Wood, A Treatise on the Law of Master and Servants § 272 (1877); see also Mallor, supra note 3, at 454; Comment, Abusive Discharge, supra note 7, at 1439.

10. The freedom of contract theory in American social thought preceded the start of the industrial revolution by approximately thirty years. (The employment at will rule is generally dated with the H. Wood treatise in 1877.) With the developing notions of contract came the need to protect the growing economic base that would support the industrial boom of the twentieth century. The cornerstone of legal policy during the early industrial period was a laissez-faire social ideology. The strict employment at will doctrine reflected this theory in the industrial marketplace. Comment, Towards a Property Right in Employment, 22 Buffalo L. Rev. 1081, 1083-85 (1973); see also Feinmann, supra note 6, at 122-29.
argued that the industrial revolution created different labor and capital needs for the employer that were reflected in the changed status of the employee. The employment relationship became one of contract, and the payment of wages as compensation for labor replaced the employer's food, shelter, and protection to the employee. The employee, working for money only, thereby assumed the risks of his own health and well-being.

During the late 1800s, at will employment was compatible with the employment setting in pre-industrial America. The employment relationship was seldom long term and was generally secondary to the land and the family. The steady job supplemented the security and income of the family farm and the extended family. The protection afforded by the employment at will doctrine to employees working in this setting was adequate both for their needs and for the needs of their employers. By the turn of the century, the employment at will rule was firmly established in American law.

With the onset of the industrial revolution and the demise of agrarian society, the concept of job security gained new significance. Therefore, the balance of power in the employment context shifted, becoming extremely inequitable for the employee. The

11. Industry took big risks in developing its own economic base. Business failures were common and capital investment was risky in such an unknown venture. The government, eager to promote economic expansion, sought to protect the employer by maintaining a close parallelism between the developing law of contract and the law of employment. See Comment, Abusive Discharge, supra note 7, at 1410 (footnotes omitted).

12. The concepts of security and mutuality were abandoned under the contract theory and the status of the employee was redefined as an independent agent in the marketplace. Comment, Protecting At Will Employees Against Wrongful Discharge: The Duty to Terminate Only in Good Faith, 93 HARV. L. REV. 1816, 1824-25 (1980) [hereinafter Comment, Protecting At Will Employees].

13. See Feinman, supra note 6, at 124.

14. Two Supreme Court cases decided shortly after 1900 gave constitutional protection to the employment at will doctrine. In Adair v. United States, 208 U.S. 161 (1908) and Coppage v. Kansas, 236 U.S. 1 (1915), the Supreme Court prohibited the regulation of the employment relationship as a violation of the parties' freedom to contract. The Court reasoned that any regulation of the freedom to work at will could destroy the mutuality of obligation requirement of developing contract law theory. The Court refused to protect either party by creating extra rights or obligations without additional consideration. "These opinions represent the high water mark of the Court's insistence on laissez-faire principles in the labor area ...." Comment, Protecting At Will Employees, supra note 12, at 1826.

15. Industrial jobs became the primary source of income and financial security in the non-agrarian sections of America. The employee's financial dependence centered on the employer's absolute right to terminate any employee at will. See Comment, Three New Exceptions, supra note 7, at 1444.
employer held “absolute sovereignty in the workplace”\textsuperscript{16} and dictated the terms under which the employee worked. The inability of the employee to protect himself from oppressive treatment, inadequate benefits, and worsening labor conditions resulted in a public interest in the regulation of the employment relationship.\textsuperscript{17} The employer's absolute power to terminate employees at will was one of the primary reasons for the rise of labor unions and protectionist legislation in the field of labor at both the national and state levels: \textsuperscript{18} "As the number of employees in the workforce increased and the power of large corporations became secure ... Congress and state legislatures responded to the shifting balance of political power and the need for stability in labor relations by enacting statutes promoting collective bargaining."\textsuperscript{19} The collective goal of these statutes was to create an equitable balance of power between employer and employee.\textsuperscript{20}

III. DEVELOPMENT OF THE PUBLIC POLICY EXCEPTION

Despite the movement towards collective bargaining as a means of balancing the developing inequities in labor relations, state courts began searching for judicial remedies to limit the abuses of the employment at will rule. The first court to find an exception to the employment at will rule and to allow a cause of action for wrongful discharge was the California Court of Appeals in Petermann v. International Brotherhood of Teamsters.\textsuperscript{21} Based on an analysis of what constituted “public policy,” the court held: ‘By ‘public policy’ it is intended that principle of law which holds that

\begin{itemize}
  \item \textsuperscript{16} Mallor, supra note 3, at 455; Feinman, supra note 6, at 132.
  \item \textsuperscript{17} See Comment, Three New Exceptions, supra note 7, at 210; Comment, Abusive Discharge, supra note 7, at 1444.
  \item \textsuperscript{18} See Comment, Abusive Discharge, supra note 7, at 1448; Comment, Protecting At Will Employees, supra note 12, at 1827 (text and footnotes outlining specific statutory actions and their effect on employment).
  \item \textsuperscript{19} Mallor, supra note 3, at 455 (footnotes omitted).
  \item \textsuperscript{20} The statutory protections have largely centered around those workers covered by collective bargaining agreements. Only 25\% of American workers were unionized as of 1980, down from 31\% in 1970. See U.S. Bureau of the Census, Department of Commerce, Statistical Abstract of the United States, 1984, 440 (194th ed.) (table 728). While it is true that statutory protection extends to prohibit discharges because of sex, race, political or religious affiliation, or union membership, few states have statutes protecting non-union workers who are discharged without cause. See Hockstra, Palmateer: A Further Extension To Retaliatory Discharge In Illinois, 71 Ill. B.J. 298 (1983).
  \item \textsuperscript{21} 174 Cal. App. 2d 184, 344 P.2d 25 (1959).
\end{itemize}
no citizen can lawfully do that which has a tendency to be injurious to the public or against the public good." The public policy exception allows the court to fashion a private right and remedy for an employee injured by an employer's breach of a statutorily expressed public policy.

The public policy exception to employment at will provides the courts with the broadest interpretational basis for giving protection to at will employees who are wrongfully terminated. Some courts have used this public policy exception as the basis for tort actions for retaliatory discharge as well as contract actions based on implied terms or on implied covenants of good faith. In order to maintain an action in tort, the employee must first identify the specific expression of public policy upon which the claim is based. Absent an express declaration of that public policy in a statute, however, some courts have defined the cause of action based on the facts of each case.

The majority of courts, however, have rejected the case-by-case approach to allowing a cause of action based on judicially determined public policy. Rather, the majority of courts require the employee to identify a clearly defined public policy that is evidenced by statute or recognized as being of sufficient importance to override the employer's interest in the unfettered operation of business. As is frequently observed, "the public policy stated in

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22. Id. at 188, 344 P.2d at 27 (citations omitted).
23. The Petermann court chose to effectuate the state's statutorily declared policy against perjury embodied in the state's penal code at Cal. Pen. Code §§ 118 and 653 (f) by declaring that a discharge based on the employee's refusal to perform an act specifically enjoined by the statute was an insufficient ground for the employer to invoke the at will protection. Petermann, 174 Cal. App. 2d at 188, 344 P.2d at 27. Other courts have followed similar reasoning to find a private cause of action based on an employer's actions which were contrary to a statutorily defined public policy. See, e.g., Perks v. Firestone Tire & Rubber Co., 611 F.2d 1363 (3d Cir. 1979); Tameny v. Atlantic Richfield Co., 27 Cal. 3d 167, 610 P.2d 1330, 164 Cal. Rptr. 839 (1980); Harless v. First Nat'l Bank, 246 S.E.2d 270, 162 W. Va. 116 (1978).
24. Mallor, supra note 3, at 461.
27. Id.
28. Mallor, supra note 3, at 461. Courts that have found a cause of action for wrongful discharge have identified public policy in a variety of ways. Some have required the employee to present a "clear mandate of public policy." See, e.g., Percival v. General Motors Corp., 400 F. Supp. 1322 (1975); Palmateer v. Ortho Pharmaceutical Corp., 84 N.J. 58, 417 A.2d 505 (1960); Geary v. United States Steel Corp., 456 Pa. 171, 319 A.2d 174 (1974). Other
criminal and regulatory statutes is clear, and a high degree of public interest exists in enforcing those statutes. Therefore, courts are more receptive to exceptions to the employment at will doctrine when there is a specific statutory expression of public policy than when judicial interpretation is necessary. In Petermann v. International Brotherhood of Teamsters, and more recently, Tameny v. Atlantic Richfield Co., the California courts held that "an employer's authority over its employee does not include the right to demand that the employee commit a criminal act to further its interests ...." In Petermann, the relevant public policy was based on the statutory prohibition of perjury. In Tameny, the court looked to the antitrust statutes to find the necessary expression of public policy.

Based on similar reasoning, other courts have held that when an employee is wrongfully terminated for exercising a legal right or duty, such as missing work to serve on a jury, or for filing a worker's compensation claim, public policy is contravened. In

29. Mallor, supra note 3, at 463.
32. 27 Cal. 3d at 178, 610 P.2d at 1336, 164 Cal. Rptr. at 846.
33. Id. at 178, 610 P.2d at 1340, 164 Cal. Rptr. at 839.
34. The employee was discharged for refusing to lie to a governmental investigations committee. The court found that the employer's actions frustrated the clearly defined statutory prohibition against perjury by making the plaintiff's continued employment contingent upon an illegal act. 174 Cal. App. 2d at 189, 344 P.2d at 27.
35. The employee in Tameny was discharged for refusing to go along with a gasoline price fixing scheme designed to increase his employer's profits. Based on a statutory authority proscribing such antitrust violations, the court held that when "a discharge principle of public policy ... an employer's traditional broad authority to discharge an at will employee 'may be limited by statute ... or by considerations of public policy.'" 27 Cal. 3d at 172, 610 P.2d at 1332-33, 164 Cal. Rptr. at 842 (quoting in part Petermann v. International Brotherhood of Teamsters, 174 Cal. App. 2d 184, 188, 344 P.2d 25, 27 (1959)).
these situations, some courts have favored the public desire for community involvement in the judicial process, as well as the public interest in providing compensation to injured workers. The courts have recognized that without a private remedy to protect these rights, the societal goals reflected in statutorily defined public policies would be frustrated by the discharge of employees who took advantage of them.\(^{38}\) The employer's right of termination at will is generally subordinated to the employee's exercise of his statutorily recognized legal rights or duties, especially when that exercise does not seriously interfere with the employer's interest in operating his business.\(^{39}\)

A statutorily supported expression of public policy is not always required, however. Employees discharged for conduct that is beneficial to society have not been held to the rigid standard of showing a statutorily defined public policy when the courts could identify a clear public policy supporting the employee's conduct.\(^{40}\) In \textit{Palmateer v. International Harvester Co.},\(^{41}\) an employee was fired for supplying information to the local police concerning the possible illegal activity of a fellow employee. In holding for the employee the Illinois Supreme Court broadly defined public policy as "what is right and just and what affects the citizens of the State collectively."\(^{42}\) Although it found no statute that afforded citizens a right or duty to turn in suspected criminals, the \textit{Palmateer} court did find that public policy supported the employee's conduct, and therefore allowed the employee a remedy.\(^{43}\) The court stated that "[t]here is no public policy more basic, nothing more implicit in the concept of ordered liberty, than the enforcement of

\(^{1973}\) did not provide for a private cause of action if an employee was discharged for filing a claim, its enactment was evidence of sound public policy, and "that to uphold and implement this public policy, a cause of action should exist for retaliatory discharge." \textit{Id.} at 181, 384 N.E.2d at 357.

\(^{38}\) In each case, provisions for jurors and jury service were contained in the state constitution or statutes.


\(^{41}\) 85 Ill. 2d 124, 421 N.E.2d 876 (1981). The employee had agreed to continue collecting evidence against the subject and to testify at trial. Following his discharge, the employee brought an action in tort based on retaliatory discharge. \textit{Id.} at 127, 421 N.E.2d at 877.

\(^{42}\) \textit{Id.} at 130, 421 N.E.2d at 878.

\(^{43}\) \textit{Id.} at 132, 421 N.E.2d at 880.
a State's criminal code." Palmateer applied a broad definition of public policy without the authority of a statute, in order to protect an employee whose activities clearly furthered the established public interest in crime prevention.

When the public policy is clearly mandated, courts have expanded this broad definition even further. In Harless v. First National Bank, the West Virginia Court of Appeals held that a "substantial policy principle" was frustrated by the employer's retaliatory discharge of the employee. The employer bank discharged its employee when he attempted to secure his employer's compliance with state and federal consumer credit and protection laws. The employee relied on the statutory credit laws and the court implied from its language "a clear and unequivocal public policy that consumers of credit were to be given protection." The Harless court held that because the statute itself provided penalties for this violation, any act of an employer to frustrate its purpose would also be contrary to the public interest.

Relying on a "clear mandate of public policy" standard, the New Jersey Supreme Court in Pierce v. Ortho Pharmaceutical Corp. denied an employee a remedy for wrongful discharge based on the specific facts of the case rather than on policy considerations. The employee, a doctor, based her refusal to obey company directives on a personal interpretation of the Hippocratic oath. The employee claimed she was constructively discharged because of a professional disagreement with her employer over drug testing procedures. Her argument was that her discharge contravened a public policy that supported her position as an extension of society's desire to regulate the safety of drugs. Admitting that the employee's claim based on the oath might state a cause of action for wrongful discharge "when the discharge is contrary to

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44. Id. 421 N.E.2d at 879 (citing Palko v. Connecticut, 302 U.S. 319, 325 (1937)).
45. Palmateer, 85 Ill. 2d at 131-134, 421 N.E.2d at 879-80.
47. Id. at 275-76.
48. Id.
49. Id. at 276.
50. Id.
51. 84 N.J. 58, 417 A.2d 505 (1980).
52. Id. at 72, 417 A.2d at 512.
53. Id. at 63, 417 A.2d at 508.
54. Id.
55. Id.
a clear mandate of public policy," the Pierce court held that the dispute before it constituted a private disagreement over company policy rather than a threat to the public interest. A sound argument might be made for the public interest overtones in Pierce without identifying a specific expression of public policy that denied the employee a remedy and respected the employer's traditional right to discharge at will.

In summary, courts have allowed a public policy exception to the employment at will doctrine in only a few, narrowly defined situations: 1) where an employee is discharged for refusing to commit a criminal act; 2) where an employee is discharged for exercising a statutory right (compensation claim); and 3) where the employee is discharged for conduct which is clearly beneficial to society at large. Outside these narrow parameters, courts have not expanded the public policy exception to the employment at will rule, and have instead upheld the employer's traditional right to terminate at will.

IV. EROSION OF THE EMPLOYMENT AT WILL DOCTRINE IN OHIO

Historically, the state of Ohio has recognized the existence of the employment at will doctrine, and has held that an at will employee can be terminated for any cause. This theory of unrestricted employment at will, however, has been eroded by recent decisions of the Ohio Supreme Court.

In Mers v. Dispatch Printing Co., the Ohio Supreme Court held that employee handbooks, company rules, and oral representation could in fact alter the concept of employment at will on a theory

56. Id. at 75, 417 A.2d at 512.
57. Id. See also Geary v. United States Steel Corp., 456 Pa. 171, 319 A.2d 174 (1974). In Geary, the Pennsylvania court found no clear public policy violated by the discharge of a salesman who had raised questions about safety of a particular product. The employees in both Geary and Pierce relied on the general notion that it was the public policy of the state to promote safe products, but in both cases, the courts found this motivation insufficient to support a "clear mandate of public policy." Geary, 456 Pa. at 180-81, 319 A.2d at 178-79; Pierce, 84 N.J. at 64, 417 A.2d at 508.
58. See Phung v. Waste Management, Inc., 23 Ohio St. 3d 100, 102, 491 N.E.2d 1114, 1116 (1986); Mers v. Dispatch Printing Co., 19 Ohio St. 3d 100, 103, 483 N.E.2d 150, 142 (1985).
59. 19 Ohio St. 3d 100, 483 N.E.2d 150 (1985).
of promissory estoppel. The Mers court further recognized that an employer's power to discharge at will was limited by statute. “For example, Congress and the General Assembly have enacted laws forbidding retaliatory discharge for filing workers' compensation claims and for union activity, and discriminatory firings based on race, sex, or physical handicap.” While the court conceded “that there are occasions when exceptions to the general rules are recognized in the interest of justice,” it nevertheless refused to abolish the long-standing doctrine of employment at will or add a blanket “just cause” requirement to at will discharges.

One year later, the court was again invited to examine the employment at will doctrine and to create a public policy exception to the general rule by extending the promissory estoppel theory of Mers. In Phung v. Waste Management, Inc., the plaintiff-employee was discharged when he reported to his employer that it was conducting business in violation of law. The court noted that “Ohio has not yet recognized any public policy exceptions to the employment-at-will doctrine,” and went on to hold that “[p]ublic policy does not require that there be an exception to the employment-at-will doctrine when an employee is discharged for reporting to his employer that it is conducting business in violation of law.” The court, however, left the door open by indicating that a cause of action might be created if a discharge of an at will employee violated “a sufficiently clear public policy.” The plaintiff-employee’s “vaguely alleged violations of societal obligations” were held not to state a violation of a “sufficiently clear public policy.”
In refusing to create a public policy exception to the employment at will doctrine, the court noted that "the Ohio Constitution delegates to the legislature the primary responsibility for protecting the welfare of employees,"\(^{71}\) and that "in the past, this court has deferred employment matters to the legislature."\(^{72}\) According to the Ohio Supreme Court: "There can be no better expression of the public policy of a state than duties specifically imposed by statute."\(^{73}\)

V. THE GREELEY CASE

In early 1990, the Ohio Supreme Court was again given the opportunity to consider the employment at will doctrine in *Greeley v. Miami Valley Maintenance Contractors, Inc.*\(^{74}\). The specific issue before the court was "whether a violation of [Ohio Revised Code] section 3113.213(D) gives rise to a civil cause of action for damages when an at will employment relationship is terminated by an employer solely because of a court-ordered child support wage assignment of the employee's wages."\(^{75}\)

A. Facts and Procedure Below

In *Greeley*, the employee was fired when his employer was made subject to the Butler County Court of Common Pleas wage withholding order pursuant to Ohio Revised Code section 3113.213(D) (hereinafter referred to as R.C. 3113.213(D)) to ensure payment of Greeley's child support obligation.\(^{76}\) As a result of his discharge, Greeley suffered lost wages and mental and emotional injury.\(^{77}\) Miami Valley Maintenance Contractors, Inc. ("MVMC"), the employer, was found by the Butler County Court of Common Pleas to be in violation of R.C. 3113.213(D) for discharging Greeley because of the wage assignment order, and was fined $500 by that

\(^{71}\) Id. at 103, 491 N.E.2d at 1117.

\(^{72}\) Id.

\(^{73}\) Id. (citing Mers v. Dispatch Printing Co., 19 Ohio St. 3d 100, 103, 483 N.E.2d 150, 153 n.2 (1985).

\(^{74}\) 49 Ohio St. 3d 228, 551 N.E.2d 981 (1990).

\(^{75}\) Id. at 229, 551 N.E.2d at 982.

\(^{76}\) Because the case was heard pursuant to Civil Rule 12(b)(6) motion to dismiss for failure to state a claim upon which relief can be granted, the court is required to accept the allegations of the plaintiff's complaint as true. Id. (citation omitted).

\(^{77}\) Id. at 229, 551 N.E.2d at 983.
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court and ordered to pay the back child support which it had refused to withhold.78

Greeley filed a complaint for wrongful discharge sounding in tort.79 The basis for MVMC's Civil Rule 12(B)(6) motion to dismiss the complaint was that "no claim sounding in tort exists in Ohio for wrongful discharge and/or no facts were pleaded stating a clear legislative exception to the doctrine of employment at will."80 The trial court granted MVMC's motion and dismissed Greeley's complaint.81 Greeley appealed contending that the trial court erred in granting the motion to dismiss because R.C. 3113.213(D) gives rise to a civil cause of action.82 The Court of Appeals for Butler County rejected Greeley's contention and affirmed the judgment of the trial court.83 Greeley then appealed to the Ohio Supreme Court.84

B. The Court's Decision

The Ohio Supreme Court began its analysis with an examination of R.C. 3113.213(D) which provides in relevant part:

No employer may use an order to withhold personal earnings [for enforcement of the obligor's child support obligation] as a basis for discharge of, or for any disciplinary action against, an employee, or as a basis for a refusal to employ a person. The court may fine the employer who so discharges or takes disciplinary action against an employee, or refuses to employ a person, not more than five hundred dollars.85

Exploring the legislative history of R.C. 3113.213(D), the court noted the federal enactment of the Child Support Enforcement Amendments of 198486 which required states to provide for mandatory income withholding as a means of collecting child support and fines against any employer who, among other things, discharges an employee subject to wage withholding because of the

78. Id. at 229, 551 N.E.2d at 983. The fine was suspended when MVMC paid the back child support. Id.
79. Id.
80. Id.
81. Id.
82. Id.
83. Id.
84. Id.
85. OHIO REV. CODE ANN. § 3113.213(D) (Baldwin 1989).
withholding, and the obligations or additional obligations it imposes on the employer. In 1985, in response to the federal legislation, Ohio's General Assembly amended its child support withholding statute to penalize employers found in violation of the statute by establishing a fine of not more than two hundred dollars as well as an order to make full restitution to the aggrieved employee, including reinstatement and back pay. Then, in 1986, the General Assembly again amended its child support withholding statute penalty provisions by increasing the fine to a maximum of five hundred dollars, and deleting the employee restitution provision in its entirety.

After reviewing this history, the Ohio Supreme Court rejected the interpretation of the appellate court that with the 1986 amendment, the General Assembly intended to limit the remedy to a maximum fine of five hundred dollars, thereby expressing its intention to bar civil remedies for violation of R.C. 3113.213 (D). Instead, the supreme court found that the "express purpose" of the 1986 amendment was "to conform the existing child support enforcement withholding mechanism to certain mandates of the federal Child Support Enforcement Amendments of 1984." As a result:

The only logical inference to be drawn from the [available legislative history] is that the General Assembly enacted R.C. 3113.213(D) without the reinstatement and back pay remedies in order to specifically conform to the federal mandates.... Nothing in the legislation or its history indicates that it was the intent of the General Assembly to foreclose the rights of an affected employee.

According to the Ohio Supreme Court, the deletion of the reinstatement and backpay remedies from R.C. 3113.213(D) did not manifest a clear legislative intent to foreclose civil remedies available to an employee discharged in violation of that statute.

The supreme court also rejected the argument that the "permissive imposition of a fine for violation of R.C. 3113.213(D) indi-

89. 1986 Ohio Laws 4786, 4798-99.
90. 49 Ohio St. 3d at 231, 551 N.E.2d at 984.
92. 49 Ohio St. 3d at 231, 551 N.E.2d at 984.
93. Id.
cates a legislative intention to foreclose all other remedies available to an aggrieved employee.” 94 The court reasoned that a fine imposed against an employer was a matter between the employer and the government and had nothing to do with any remedies available to the aggrieved employee. 95 Because the General Assembly was silent on the matter of foreclosing civil remedies, the court declined to infer such an intent, noting that “deriving intent from ... legislative inaction is a weak reed upon which to lean in determining legislative intent.” 96 Again, because the General Assembly did not expressly bar civil remedies for violation of R.C. 3113.213(D), the court concluded it did not intend to do so.

To hold otherwise, the court said would be to “condone an absolute frustration of the legislative scheme for enforcement of a policy and allow the courts of this state to be stripped of their powers to enforce an order ....” 97 The court went on to say that R.C. 3113.213(D) was designed to protect children who are recipients or beneficiaries of child support. To disallow a civil remedy for violations of R.C. 3113.213(D) frustrates the policy and purposes of the statute. Therefore, the only logical conclusion is that the General Assembly did not intend to foreclose a civil remedy for violations of R.C. 3113.213(D). 98

Having concluded that the General Assembly did not intend to foreclose a civil remedy for discharges made in violation of R.C. 3113.213(D), the court next considered whether a common law cause of action in tort for wrongful discharge was a remedy available to Greeley. The court reiterated its holding in Phung: “[P]ublic policy does not require that there be an exception to the employment-at-will doctrine, absent a sufficiently clear public policy warranting the creation of a cause of action.” 99 The court reasoned that because the General Assembly enacted the statute prohibiting the conduct in question; and had not foreclosed civil remedies, the statute was “clearly sufficient authority to warrant the exception referenced in Phung.” 100 Thus, the court held that

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94. Id.
95. Id.
96. Id., (citation omitted).
97. Id. at 232, 551 N.E.2d at 984.
98. Id. at 233, 551 N.E.2d at 985-86.
99. Id. at 233, 551 N.E.2d at 986 (citing Phung v. Waste Management, Inc., 23 Ohio St. 3d 100, 102, 491 N.E.2d 1114, 1116-17 (1986)).
100. Id. at 233, 551 N.E.2d at 986.
"public policy warrants an exception to the employment-at-will doctrine when an employee is discharged or disciplined for a reason which is prohibited by statute."\textsuperscript{101} As a result, the court reversed the court of appeals and held that a civil cause of action for wrongful discharge may be brought in tort for termination made in violation of a statute.\textsuperscript{102}

In dicta, the court stated that in this case it decided only the question of a public policy exception to the employment at will doctrine based on violation of a specific statute.\textsuperscript{103} The court went on to say that there may be other public policy exceptions if such exceptions were of "equally serious import as the violation of a statute."\textsuperscript{104}

VI. ANALYSIS

While the \textit{Greeley} court joined the majority of states in recognizing a public policy exception to the doctrine of employment at will, it has done so by extending a heretofore narrowly drawn exception into one with seemingly unrestricted boundaries. Other jurisdictions have allowed a public policy exception only in cases where an employee has been discharged for refusing to commit a criminal act;\textsuperscript{105} where an employee has been discharged for exercising a statutory right;\textsuperscript{106} or where the employee has been discharged for conduct which is clearly beneficial to society at large.\textsuperscript{107}

The \textit{Greeley} case falls into none of the previously established categories. First, \textit{Greeley} was not fired for refusing to commit a criminal act. Second, \textit{Greeley} was not fired for exercising a statutory right. Unlike the statutory right to file a worker's compensation claim, it cannot be argued seriously that an employee has a statutory right to have his wages garnished in order to have a court ordered child support obligation enforced. Last, the employee's conduct, namely his failure to pay child support, was not conduct beneficial to society. Clearly, the \textit{Greeley} decision breaks new ground. The criteria for the public policy exception before \textit{Greeley} focused on rights of the "aggrieved employee." In previous

\begin{itemize}
  \item \textsuperscript{101.} \textit{Id.} at 234, 551 N.E.2d at 987.
  \item \textsuperscript{102.} \textit{Id.} at 234-35, 551 N.E.2d at 987.
  \item \textsuperscript{103.} \textit{Id.}
  \item \textsuperscript{104.} \textit{Id.} at 235, 551 N.E.2d at 988.
  \item \textsuperscript{105.} \textit{See}, \textit{e.g.}, Petermann, 174 Cal. App. 2d 184, 344 P.2d 25 (1959).
  \item \textsuperscript{106.} \textit{See}, \textit{e.g.}, Kelsay, 74 Ill. 2d 172, 23 Ill. Dec. 559, 384 N.E.2d 353 (1978).
  \item \textsuperscript{107.} \textit{See}, \textit{e.g.}, Harless, 246 S.E.2d 270, 162 W. Va. 116 (1978).
\end{itemize}
cases, the employees were fired because they were law-abiding, because they were exercising a right to which they were statutorily entitled, or because of some conduct on their part which was clearly beneficial to society. In contrast, Greeley had failed to make his child support payments. As a result, a court ordered the garnishment of his wages.\(^\text{108}\) As a further consequence of Greeley’s failure to meet his child support obligation, his employment was terminated. While this is not addressed in the opinion, it is possible that MVMC fired Greeley, not because of the additional paperwork required by the garnishment order, but because of the character Greeley displayed in failing to make his child support payments. By allowing Greeley a cause of action, the court is rewarding Greeley for his bad conduct rather than requiring him to reap the unpleasant consequences directly attributable to his own conduct.

Moreover, the court’s analysis of the intent of the General Assembly in the enactment of R.C. 3113.213(D), which allows it to create a cause of action for violation of that statute is contradictory. The court reiterated the Phung requirement that there be a “sufficiently clear public policy” in order to allow an exception to the employment at will doctrine.\(^\text{109}\) However, the court found such “sufficiently clear public policy,” first by refusing to imply that the General Assembly intended to foreclose a civil remedy\(^\text{110}\) and therefrom implying that the General Assembly intended a tort remedy be available to enforce the policy of the statute.\(^\text{111}\) According to the court, it was the only logical conclusion to be drawn.\(^\text{112}\) Thus, the court found a “sufficiently clear public policy” by its own judicial implication in a statute in which the General Assembly had purposely deleted a then-existing provision for civil remedies. Such can hardly be said to be “clearly sufficient legislative authority to warrant the exception . . . .”\(^\text{113}\)

Furthermore, the broad language of the court’s holding along with the invitation contained in dicta, opens the floodgates to significantly increased litigation in this area. Today, the law in Ohio is that any employee discharged where the employer violates

\(^{108}\) Greeley, 49 Ohio St. 3d at 229, 551 N.E.2d at 982.
\(^{109}\) Id. at 233, 551 N.E.2d at 986.
\(^{110}\) Id. at 233, 551 N.E.2d 986.
\(^{111}\) Id. at 234, 551 N.E.2d 987.
\(^{112}\) Id. at 233, 551 N.E.2d at 986.
\(^{113}\) Id.
any statute which does not on its face bar a civil remedy, is per se entitled to a tort recovery. The litigation has already begun in \textit{Shaffer v. Frontrunner, Inc.}\textsuperscript{114}. The Defiance County Court of Appeals allowed a wrongful discharge action by an employee who claimed she was fired in retaliation for her daughter's attendance at jury duty.\textsuperscript{115} The court said that even though the employee was not the one called to jury duty, "such a retaliatory discharge would in our view, surely constitute a public policy exception ... of equally serious import as the violation of a statute and thus be actionable under \textit{Greeley} ...."\textsuperscript{116}

Certainly, the legislature cannot have intended civil remedies for persons not intended to be protected by the statute in question, especially when the discharge was not in violation of that specific statute. The broad view of the public policy exception to the employment at will doctrine, as expressed in \textit{Greeley}, has developed because the \textit{Greeley} court forged the exception without a "sufficiently clear public policy." It seems obvious that the "sufficiently clear public policy" can only be created expressly by the General Assembly. It certainly should not be based on the court's own guess, however "logical," absent express direction from the General Assembly.

\textbf{VII. CONCLUSION}

Even the \textit{Greeley} court recognizes that "the employment-at-will doctrine in Ohio is alive and well...."\textsuperscript{117} That means that there is still not a common law cause of action for wrongful discharge "absent a sufficiently clear public policy." The court cannot create the public policy. Public policy can only be established by a clear legislative expression which recognizes a policy beneficial to society at large. Because no "sufficiently clear public policy" was expressed in the statute or its legislative history, the Ohio Supreme Court should not have created a public policy exception to the employment at will doctrine in this case. Because it did, in order to effectuate its actual intent, the General Assembly will have to reverse the court's action by legislative fiat.

\textsuperscript{114} 57 Ohio App. 3d 18, 566 N.E.2d 193 (1990).
\textsuperscript{115} \textit{Id.} at 20, 566 N.E.2d at 195.
\textsuperscript{116} \textit{Id.} at 21-22, 566 N.E.2d at 196 (quoting \textit{Greeley}, 49 Ohio St. 3d at 235, 551 N.E.2d at 987).
\textsuperscript{117} \textit{Greeley}, 49 Ohio St. 3d at 234, 551 N.E.2d at 987.
I. INTRODUCTION

In June, 1990, the United States Supreme Court decided Illinois v. Perkins,¹ which resolved one of the many controversies brought about by the Court's decision in Miranda v. Arizona.² The Court, per Justice Kennedy, held that the use of undercover jail plants to elicit incriminating statements from incarcerated suspects does not constitute "custodial interrogation" as defined by Miranda.³ An undercover agent, therefore, need not give Miranda warnings before engaging in conduct likely to elicit an incriminating response from a suspect.

This Note examines the historical development of the phrase "custodial interrogation" and why the Court found the jail plant situation beyond the scope of the Miranda decision.

II. BACKGROUND

A. Custodial Interrogation Under Miranda

In Miranda v. Arizona, the Court held that the Fifth Amendment privilege against self-incrimination prohibits the admission of statements given by a suspect during "custodial interrogation" without certain prior warnings.⁴ This rule applies to all such

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³ 110 S. Ct. at 2399. Note that once formal adversarial proceedings have been initiated for the case under investigation, Massiah v. United States, 377 U.S. 201 (1964) bars police from "deliberately eliciting" an incriminating response. Id. at 206.
⁴ 384 U.S. at 479. The Court stated that the suspect "must be warned prior to any questioning that he has the right to remain silent, that anything he says can be used against him in a court of law, that he has the right to the presence of an attorney, and that if he cannot afford an attorney one will be appointed for him prior to any questioning if he so desires." Id. These warnings were deemed necessary to protect a suspect's Fifth Amendment right against self-incrimination. Id.
interrogations regardless of the severity of the offense. The Court in *Miranda* set forth a prophylactic rule designed to protect the suspect from the "compelling atmosphere of the in-custody interrogation." Any self-incriminating statement, therefore, would be the result of an independent decision on the part of the suspect rather than any coercive police tactics.

Custodial interrogation was defined by the Court in *Miranda* as "questioning initiated by law enforcement officers after a person has been taken into custody or otherwise deprived of his freedom of action in any significant way." Application of that seemingly straightforward definition in various factual settings, however, has proved to be a daunting task for the courts. Subsequent case law has therefore refined that definition by focusing separately on each component part: "custody" and "interrogation."

**B. Custody**

Regarding the "custody" aspect, the Court in *Miranda* stated "that when an individual is taken into custody or otherwise deprived of his freedom by the authorities in any significant way and is subjected to questioning, the privilege against self-incrimination is jeopardized." Therefore, a suspect in police custody

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6. 384 U.S. at 465.
7. See Minnesota v. Murphy, 465 U.S. 420, 430 (1984) (a scheduled probation interview does not constitute a coercive atmosphere so as to invoke *Miranda*’s protection.); Estelle v. Smith, 451 U.S. 454, 467 (1981) (holding that *Miranda* applies to the penalty phase of a trial to prevent the suspect from becoming a “deluded instrument” of his own execution); Rhode Island v. Innis, 446 U.S. 291, 298-302 (1980) (expanding *Miranda*’s definition of “custodial interrogation” to include conduct by state agents that is reasonably likely to elicit an incriminating response from a suspect); United States v. Washington, 431 U.S. 181, 187 n.5 (1977) (*Miranda* does not require that a witness be warned that he is a target of a grand jury investigation, as the warnings need not be given to a ‘potential defendant’); Miranda v. Arizona, 384 U.S. 436, 445-58 (1966).

See generally Berkemer v. McCarty, 468 U.S. 420 (1984) (“The purposes of the safeguards prescribed by *Miranda* are to ensure that the police do not coerce or trick captive suspects into confessing, to relieve the ‘inherently compelling pressures’ generated by the custodial setting itself, ‘which work to undermine the individual’s will to resist,’ and as much as possible to free courts from the task of scrutinizing individual cases to try to determine, after the fact, whether particular confessions were voluntary.” Id. at 433 (quoting *Miranda* v. Arizona, 384 U.S. at 467)).
8. 384 U.S. at 444.
9. Id. at 478.
must be given the Miranda warnings prior to any interrogation.  

In Mathis v. United States, however, the government attempted to narrow the scope of Miranda by asserting that the holding applied only to suspects in custody in connection with the case being investigated. The Court found no merit in the government's assertion, however, and refused to curtail the warnings required to be given suspects under police interrogation based on the reason they are in custody. Although what constitutes "custody" has been the primary issue in several other decisions, the impact of the Mathis holding on the undercover jail plant situation seems quite clear. If a suspect is under full custodial arrest and lawfully incarcerated at the time of an interrogation, the "custody" requirement of Miranda should be satisfied.

C. Interrogation

The Court in Miranda specifically contemplated direct questioning as the form of interrogation that would invoke the suspect's right to counsel and the right to remain silent. However, in Rhode Island v. Innis the Court expanded the scope of police conduct which would trigger a suspect's Miranda rights. In Innis, the Court held that the term "interrogation" under Miranda included not only direct questioning, but also "any words or actions on the part of the police (other than those normally attendant to arrest and custody) that the police should know are"

10. Id. at 479. Because one could not seriously contend that an incarcerated suspect is not in police custody, the "custody" aspect of the Miranda decision is not vital to any discussion of the jail plant situation. It should be noted, however, that an interrogation generally will be considered "custodial" if the suspect is not free to leave. See Orozco v. Texas, 394 U.S. 324 (1969) (defendant was surrounded by four police officers in his bedroom at 4:00 a.m., which produced a 'police-dominated atmosphere' similar to a police station interrogation); Mathis v. United States, 391 U.S. 1 (1968) (suspect in jail on another charge). But see Beckwith v. United States, 425 U.S. 341 (1976) (IRS investigation is not custodial merely because it focuses on a particular individual); Oregon v. Mathiason, 429 U.S. 492 (1977) (voluntary compliance with request to come to the station is not custodial); Berkemer v. McCarty, 468 U.S. 420 (1984) (traffic stops, or more generally investigatory field stops, are not custodial).

12. Id.
13. Id. at 5.
reasonably likely to elicit an incriminating response from the suspect."\(^{16}\)

This broader definition was "designed to vest a suspect in custody with an added measure of protection against coercive police practices, without regard to objective proof of the underlying intent of the police."\(^{17}\) To constitute an interrogation, therefore, all that is required is that the officers should have known that words or actions on their part were reasonably likely to elicit an incriminating response.\(^{18}\)

When applied to the jail plant situation, it would seem that police should know that placing an undercover agent in the same cell with the suspect would be reasonably likely to elicit an incriminating response. In fact, that is most often the sole purpose behind any such scheme. Before Illinois v. Perkins, however, it was not clear whether the Court would find that the jail plant situation constituted "custodial interrogation" as defined by Miranda. There were two schools of thought on the issue.

One argument was that confinement alone increases a suspect's anxiety to the point that he is more likely to relieve that anxiety by discussing his situation with another.\(^{19}\) In addition, the suspect's vulnerability to the "psychological pressures inherent in confinement" is coupled with another factor present in any custodial setting.\(^{20}\) By the very nature of incarceration the police have complete control over a suspect's ability to select people with whom he can confide.\(^{21}\) The police, therefore, have a "unique opportunity to exploit" that vulnerability.\(^{22}\)

The logical conclusion of this argument is that the jail plant situation constitutes "custodial interrogation" as defined by Miranda and Innis. This conclusion is based on Miranda's concern

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16. Id. at 301.
17. Id.
18. Id. But see Arizona v. Mauro, 481 U.S. 520 (1987) (no "custodial interrogation" when police allowed suspect's wife to converse with suspect in presence of an officer who was taping the conversation, even after suspect had asserted his right to counsel); New York v. Quarles, 467 U.S. 649 (1984) (creating the 'public safety' exception to Miranda); Pennsylvania v. Muniz, 110 S. Ct. 2638 (1990) (recognizing the 'booking question' exception to Miranda).
21. Id. at 605.
22. Id.
with the development of relatively subtle interrogation techniques which rely principally on psychological domination of the suspect rather than outright physical intimidation.\footnote{Miranda v. Arizona, 384 U.S. 436, 457 (1966).} Adherence to this doctrine, however, would strike a fatal blow to the use of undercover jail plants because a suspect would have to be informed of his \textit{Miranda} rights before any action likely to elicit an incriminating response could be taken by the police agent.

The other view requires some interplay between “custody” of the suspect and any “interrogation.”\footnote{See Kamisar, \textit{Brewer v. Williams, Massiah, and Miranda: What is “Interrogation”? When Does it Matter?}, 67 GEO. L.J. 1, 63 (1978).} The bare fact that police actions elicit an incriminating response is not entirely dispositive of whether there was an “interrogation” under \textit{Miranda}. Proponents of this view maintain that “unless a person realizes he is dealing with the police, their efforts to elicit incriminating statements from him do not constitute ‘police interrogation’ within the meaning of \textit{Miranda}.”\footnote{Y. Kamisar, \textit{Police Interrogation and Confessions: Essays on Law and Policy} 195-96 (1980).} This is due to the nature of a successful jail plant scheme, which requires that the suspect have no such realization. The suspect should therefore perceive no nexus between his custody and his interrogation. Without such a nexus there can be no coercive police activity because, from the suspect’s perspective, there is no “police-dominated atmosphere.”\footnote{384 U.S. at 456.} “If it is not ‘custodial police interrogation’ in the eye of the beholder, then it is not such interrogation within the meaning of \textit{Miranda}.”\footnote{Kamisar, supra note 25, at 195-96. See also Note, 87 MICH. L. REV. 1073, 1116-17, 1123 (1989).}

Proponents of the latter view do not deny that the jail plant situation constitutes “custodial interrogation” as strictly defined by case law subsequent to \textit{Miranda}. They do contend, however, that the \textit{Miranda} Court’s concerns stem from coercive police tactics and are not implicated when the subject is unaware he is being interrogated.\footnote{Illinois v. Perkins, 110 S. Ct. 2394, 2397-98 (1990). See also Kamisar, supra note 25, at 195-96.} An undercover police agent therefore has
no responsibility to inform a suspect of his *Miranda* rights in the jail plant situation.

Faced with these two conflicting theories, the Illinois Appellate Court held that *Miranda* prohibits all undercover contacts with incarcerated suspects which are reasonably likely to elicit an incriminating response.\(^{29}\) The United States Supreme Court granted certiorari to decide whether *Miranda* applies in the undercover jail plant setting.

### III. FACTS

Richard Stephenson was murdered at his East St. Louis, Illinois, home in November, 1984.\(^{30}\) The case remained unsolved until March, 1986, when Donald Charlton informed police that Lloyd Perkins had made certain statements regarding the murder while the two were incarcerated at the Graham Correctional Facility.\(^{31}\) The police treated Charlton's story as a credible one due to the details recounted by Perkins, which relayed specific information about the crime not generally available to the public.\(^{32}\)

Perkins had been released from Graham at the time police heard Charlton's story.\(^{33}\) He was traced by police to another jail in Montgomery County, Illinois, where he was being held pending trial on an aggravated battery charge unrelated to the Stephenson homicide.\(^{34}\) As part of the Stephenson homicide investigation, police decided to place an undercover police agent (John Parisi, using the alias "Vito Bianco") and Charlton in the cell block with Perkins.\(^{35}\) Charlton and Parisi posed as escapees from a work-release program and were instructed to befriend Perkins so that he might utter some incriminating remarks relating to the Stephenson homicide.\(^{36}\)

The cell block consisted of twelve separate cells that opened into a common room.\(^{37}\) Charlton and Perkins greeted each other,
at which time "Vito" was introduced to Perkins. Later, "Vito" proposed an escape plan, at which point Perkins told his comrades that his girlfriend could smuggle in a pistol to assist in the fictitious escape. "Vito" then asked Perkins if he had ever "done" anybody. Perkins responded that he had, and proceeded to describe the Stephenson murder in great detail. Of course, gave no Miranda warnings to Perkins.

Perkins was subsequently charged with the Stephenson murder based on his statements to Agent Parisi. The State appealed the trial court's suppression of Perkin's statements to Parisi. The Appellate Court of Illinois affirmed, holding that Miranda v. Arizona "prohibits all undercover contacts with incarcerated suspects which are reasonably likely to elicit an incriminating response."

IV. HOLDING

The Supreme Court held "that an undercover law enforcement officer posing as a fellow inmate need not give Miranda warnings to an incarcerated suspect before asking questions that may elicit an incriminating response." In doing so, the Court endorsed the use of undercover agents as an effective and acceptable law enforcement technique that has become a frequently employed tool "in the prison context to detect violence against correctional officials or inmates," as well as a useful evidence gathering device. "The interests protected by Miranda are not implicated in these [jail plant] cases, and the warnings are not required to safeguard the constitutional rights of inmates who make voluntary statements to undercover agents."

38. Id.
39. Id.
40. Id.
41. Id.
42. Id.
43. Id.
45. Id. at 443, 531 N.E.2d at 146.
47. Id. at 2399.
48. Id.
49. Id.
V. ANALYSIS OF THE OPINION

A. The Majority Opinion

In his opinion, Justice Kennedy was careful to emphasize that no attempt was being made to refine or alter the Miranda framework.\(^{50}\) The Court held steadfast to the requirement that law enforcement officials give a suspect prior warning of his Fifth Amendment rights before any custodial interrogation takes place.\(^{51}\) Warnings are necessary to alleviate the "inherently compelling pressures which work to undermine the individual's will to resist and to compel him to speak"\(^{52}\) during an "incommunicado interrogation in a police-dominated atmosphere."\(^{53}\) Strict adherence to the Miranda doctrine is therefore necessary, "[b]ut only in those types of situations in which the concerns that powered the decision are implicated."\(^{54}\)

The Court found that the jail plant situation does not involve the type of coercive police activity that so concerned the Court in Miranda.\(^{55}\) Relying on Innis, the Court re-stated that "[c]oercion is determined from the perspective of the suspect."\(^{56}\) That being the case, "[t]he essential ingredients of a 'police-dominated atmosphere' and compulsion are not present when an incarcerated person speaks freely to someone that he believes to be a fellow inmate."\(^{57}\)

The Court agreed with the position taken by Kamisar that "when the agent carries neither badge nor gun and wears not 'police blue,' but the same prison gray" as the suspect, there is no "interplay between police interrogation and police custody."\(^{58}\) In future applications of the Miranda doctrine, therefore,

\(^{50}\) Id. at 2397-99.
\(^{51}\) Id. at 2397.
\(^{53}\) Id. at 445.
\(^{55}\) Id.
\(^{56}\) Id.
\(^{57}\) This is not to say that no "custodial interrogation" occurred, however. Id. In fact, the Court seemed to accept that the jail plant situation constitutes custodial interrogation, but that because of the particular circumstances Miranda was inapplicable. Id.
\(^{58}\) Id. (quoting Kamisar, Brewer v. Williams, Messiah and Miranda: What is "Interrogation"? When Does it Matter?, 67 Geo. L.J. 1, 67, 68 (1978)).
courts may find the existence of a coercive atmosphere only if the suspect perceives a nexus between his custody and any interrogation by police officials.

To the Majority there was a cognizable difference between coercion and "strategic deception," the jail plant representing a fine example of the latter.\textsuperscript{59} In such situations, the touchstone is voluntariness. "Confessions remain a proper element in law enforcement. Any statement given freely and voluntarily without any compelling influences is, of course, admissible in evidence."\textsuperscript{60}

As a result, braggadocio such as that exhibited by Defendant Perkins remains unprotected by \textit{Miranda}. Provided that a suspect has no reason to feel that the undercover agent has any "legal authority to force him to answer questions" or affect his future treatment, \textit{Miranda} will give no protection.\textsuperscript{61}

The Court cited \textit{Hoffa v. United States} as precedent for applying the general framework set forth in \textit{Perkins}.\textsuperscript{62} The cases are quite similar. In \textit{Hoffa}, the Court held that the Fifth Amendment was not violated by placing an undercover agent near a suspect in order to gather incriminating information.\textsuperscript{63} Although Hoffa was not incarcerated, the purpose behind planting a police informant was identical; to trick the suspect into "hanging himself" based on the suspect's misplaced trust in one who was in fact a government agent.\textsuperscript{64} Assessing the facts in \textit{Hoffa}, the Court "found that the fact that Partin had fooled Hoffa into thinking that Partin was a sympathetic colleague did not affect the voluntariness of the statements."\textsuperscript{65}

That Perkins was incarcerated was the only factual difference in the two cases. "[B]ut detention, whether or not for the crime in question, does not warrant a presumption that the use of an undercover agent to speak with an incarcerated suspect makes any confession thus obtained involuntary."\textsuperscript{66}

\begin{itemize}
  \item \textsuperscript{59} Id. at 2397.
  \item \textsuperscript{60} Id. (quoting \textit{Miranda v. Arizona}, 384 U.S. 436, 478 (1966)).
  \item \textsuperscript{61} Id. at 2398.
  \item \textsuperscript{62} Id.
  \item \textsuperscript{63} \textit{Hoffa v. United States}, 385 U.S. 293, 304 (1966).
  \item \textsuperscript{64} \textit{Illinois v. Perkins}, 110 S. Ct. 2394, 2398 (1990).
  \item \textsuperscript{65} Id.
  \item \textsuperscript{66} Id. As indicated by the decisions in \textit{Mathis} and the instant case, however, it is the incarcerated suspect's awareness that his interrogator is a government agent which envelops him with \textit{Miranda}'s protections.
\end{itemize}
The Court quickly dispatched with Perkin's argument that the police had interfered with his Sixth Amendment right to counsel.67 Perkin's argument was based on prior cases holding that the government may not deliberately elicit an incriminating response from a suspect after formal adversarial proceedings had been initiated.68 This argument was entirely without merit because no charges had been filed against Perkins relating to the Stephenson homicide at the time of the proposed fictitious escape plan.69 Perkins was in police custody based on a different infraction and had not yet been charged with the Stephenson homicide.70

Finally, the Court found Perkin's contention that law enforcement officials needed a "bright line" rule for the application of Miranda to be meritless.71 The holding in Perkins is clear enough for straightforward application; undercover agents are not required to warn incarcerated suspects of their Miranda rights.72 Coercion can be present to render an admission involuntary only if a suspect realizes that he is being interrogated.73 Therefore, an ad hoc approach is an appropriate method for assessing the voluntariness of a suspect's self-incriminating statements. To hold otherwise would destroy the effectiveness of undercover agents in the jail plant setting.

B. The Minority Opinion

Justice Marshall was the lone dissenter, and was satisfied with a rather blind application of the Miranda doctrine.74 He advocated the "bright line" approach. Because Perkins was subjected to

67. Id. at 2398-99.
68. Maine v. Moulton, 474 U.S. 159 (1985) (incriminating statements pertaining to pending charges are inadmissible at the trial of those charges, notwithstanding the fact that the police were also investigating other crimes. In obtaining the evidence, the state violated the Sixth Amendment by knowingly circumventing the accused's right to the assistance of counsel); United States v. Henry, 447 U.S. 264 (1980) (affirming a subjective test for the Massiah doctrine in the jail plant setting); Massiah v. United States, 377 U.S. 201 (1964) (once formal adversarial proceedings have been initiated, state agents may not deliberately elicit incriminating statements from a suspect).
70. Id. at 2396.
71. Id. at 2399.
72. Id.
73. Id. at 2397.
police conduct likely to elicit an incriminating response while he was in custody, "Miranda required that the officer inform him of his rights." 75 To Justice Marshall, the suspect's perception of a nexus between police custody and police interrogation is not necessary to constitute "custodial interrogation" as defined by Miranda. 76

Justice Marshall interpreted the Miranda opinion expansively, holding that it was not "concerned solely with police coercion" as perceived by the suspect. 77 Citing the "psychological pressures inherent in confinement," 78 Miranda must apply to "any police tactics that may operate to compel a suspect in custody to make incriminating statements without full awareness of his constitutional rights." 79

To Justice Marshall, the custodial environment is so likely to drastically increase a suspect's anxiety level that any questioning structured by a government agent is inherently coercive. 80 Therefore, any "ploy" or "strategic deception" on the part of police agents without prior Miranda warnings is impermissible. 81 This is so without any realization on the part of the suspect "of his interrogator's true identity. The Court therefore need not inquire past the bare facts of custody and interrogation to determine whether Miranda warnings are required." 82

Justice Marshall was not extremely concerned with the Majority opinion as applied to the fact pattern in the instant case, however. 83 His concerns, rather, centered around the "outer boundaries of the exception created by the Court" in the decision, which "are by no means clear." 84 "Indeed, if Miranda now requires a police officer to issue warnings only in those situations in which

75. Id. at 2402.
76. Id. at 2403.
77. Id. at 2402. See Estelle v. Smith, 451 U.S. 454, 467 (1981) ("The purpose of these [Miranda] admonitions is to combat what the [Miranda] Court saw as 'inherently compelling pressures' at work on the person and to provide him with an awareness of the Fifth Amendment privilege and the consequences of foregoing it.").
78. Id. at 2403.
79. Id. at 2402.
80. Id. at 2403-04.
81. Id.
82. Id. at 2403.
83. Id. at 2404.
84. Id.
the suspect might feel compelled 'to speak by the fear of reprisal for remaining silent or in the hope of more lenient treatment should he confess,' presumably it allows custodial interrogation by an undercover officer posing as a member of the clergy or a suspect's defense attorney.\textsuperscript{85} To Justice Marshall, the possibility that \textit{Perkins} could be construed in that fashion represents "the adoption of a substantial loophole in our jurisprudence protecting suspects' Fifth Amendment rights."\textsuperscript{86}

\textbf{C. Critique}

The Supreme Court in \textit{Miranda} and subsequent case law fashioned a doctrine which has protected suspects from the peril of making self-incriminating statements. The required warnings apprise suspects of their Fifth Amendment rights and emphasize the potential dangers inherent in waiving those rights.\textsuperscript{87} In developing this mandated warning system, the Court has explicitly recognized that custodial interrogations generate a highly coercive atmosphere.\textsuperscript{88} \textit{Miranda} and its progeny have served to mitigate the inherently coercive atmosphere to insure that any self-incriminating statements will be made voluntarily.\textsuperscript{89}

Another obvious effect of the \textit{Miranda} doctrine, however, has been to limit the permissible means by which state agents have been able to work towards a criminal conviction. These limitations are not undesirable, and in fact have become ingrained in our concept of ordered liberty. But the overriding purpose behind the \textit{Miranda} decision was to deprive the state from any benefits realized through the coercive activities of its agents. \textit{Miranda} was "not intended to hamper the traditional function of police officers in investigating crime."\textsuperscript{90}

The holding of the Court in \textit{Perkins} yields little foundation for Justice Marshall's concerns. The Majority opinion specifically contemplates that the undercover agent will be "a fellow inmate" rather than \textit{any} individual whom the suspect fails to recognize

\textsuperscript{85} Id. (quoting the Majority opinion at 2397).
\textsuperscript{86} Id.
\textsuperscript{88} Id. at 457-58, 467-68.
\textsuperscript{89} Id. at 478-79.
\textsuperscript{90} Id. at 477.
as a law enforcement agent.\textsuperscript{91} The holding of the dissenting opinion therefore places an undue burden on law enforcement officials in the evidence-gathering process, as the required \textit{Miranda} warnings would destroy the effectiveness of the undercover agent.

The Court’s holding strikes a balance between the competing concerns, while maintaining the integrity of the \textit{Miranda} decision. Police officials are not arbitrarily precluded from using the undercover agent in the evidence-gathering process. During any undercover investigation, however, the basic precepts of \textit{Miranda} may not be violated. The retention of the requirement that coercion be determined from the suspect’s perspective assures that compulsive or coercive tactics may not be used by police to elicit incriminating statements from incarcerated suspects in violation of their Fifth Amendment rights.

\textbf{VI. CONCLUSION}

Two aspects of the Court’s decision in \textit{Illinois v. Perkins} are of primary import. First is the narrow holding of the case. \textit{Perkins} allows police to conduct undercover jail plant investigations without warning a suspect of his \textit{Miranda} rights so long as the suspect has no realization that his “cellmate” is in fact a state agent. The holding properly balances the state's interest in investigating crime with the suspect’s Fifth Amendment right against self-incrimination.

The general framework employed by the Court in reaching its decision, however, is undoubtedly of much greater significance than the narrow holding of the case. The Court made clear that \textit{Miranda} will be interpreted so as to preclude police from coercive activity. Whether or not a coercive atmosphere exists will be determined from the suspect’s point of view. This aspect of the case should be of great assistance to future litigants in circumstances involving custodial interrogation.
