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WHO’S SELLING THE NEXT ROUND: WINES,
STATE LINES, THE TWENTY-FIRST
AMENDMENT AND THE COMMERCE CLAUSE

Thomas E. Rutledge*
Micah C. Daniels**

Once again the Supreme Court has waded into the bog that is the confluence of the Twenty-first Amendment and the Commerce Clause, and from there issued a forceful decision on the relationship of these two provisions, holding that the Twenty-first Amendment does not immunize from Commerce Clause scrutiny state action that discriminates against interstate trade in alcoholic beverages. Herein we review the workings of the “dormant” Commerce Clause, then turn our attention to a more detailed review of the Supreme Court’s jurisprudence on the relationship of the Twenty-first Amendment to the balance of the Constitution. Our focus from there shifts to the various systems in place in the several states regulating interstate wine shipments, the various Commerce Clause challenges made to those laws, and the recent ruling in Granholm v. Heald. We then consider the constitutionality of certain Kentucky statutes regulating wine sales, concluding they are constitutionally infirm.

[T]HERE ARE TWO WAYS, AND TWO WAYS ONLY, IN WHICH AN ORDINARY PRIVATE CITIZEN, ACTING UNDER HER OWN STEAM AND UNDER COLOR OF NO LAW, CAN VIOLATE THE UNITED STATES CONSTITUTION. ONE IS TO ENSLAVE SOMEBODY, A SUITABLY HELLISH ACT. THE OTHER IS TO BRING A BOTTLE OF BEER, WINE, OR BOURBON INTO A STATE IN VIOLATION OF ITS BEVERAGE CONTROL LAWS.1

I. INTRODUCTION

All wineries are concerned with the grape harvest: asking a winemaker if she is ready for the first crush of grapes is like asking a soldier if he is ready for

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However, in recent years all too many smaller wineries have had their focus redirected from the actual production of wine to the compliance with the varying state laws which affect direct-shipment. For example, a California wine producer who ships a case of pinot noir to a Kentucky consumer is concerned not only that the wine will travel poorly and suffer storage conditions either too hot or too cold, but is concerned as well about committing a felony. Kentucky is one of several states that prohibit direct shipment of wine from an out-of-state seller to an in-state consumer, and is one of six states that make the act a potential felony. It is improper for an in-state vintner to ship to a Kentucky customer, but that offense is more likely to be a mere misdemeanor. Other states allow intrastate shipment but either prohibit or impose significant restrictions upon interstate shipment. Still other states had more permissive regimes allowing intra and interstate shipments.

A recent survey of members of The Wine Institute revealed that 37% of the wineries were excluded from selling their wine in some states because there is no

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3. See generally, David P. Sloane, Statement to House Committee on Energy and Commerce (October 30, 2003) (noting that Congress should allow interstate wine commerce “in the absence of good, sufficient reasons to erect barriers.”)
4. Fans of the 2004 movie Sideways will recall that Miles would wax poetically on pinot noir. His views on merlot were rather less poetic. See Nick Fauchald, Sideways Wins One Oscar and Five Independent Spirit Awards, WINE SPECTATOR, Feb. 28, 2005.
   (1) It shall be unlawful for any person in the business of selling alcoholic beverages in another state or country to ship or cause to be shipped any alcoholic beverage directly to any Kentucky resident who does not hold a valid wholesaler or distributor license issued by the Commonwealth of Kentucky. (2) Any person who violates subsection (1) of this section shall, for the first offense, be mailed a certified letter by the department ordering that person to cease and desist any shipments of alcoholic beverages to Kentucky residents, and for the second and each subsequent offense, be guilty of a Class D felony. (emphasis added).
7. See supra note 5.
8. See infra note 388.
10. Id.
11. The Wine Institute describes itself as a public policy advocacy association of California wineries made up of wineries and affiliated businesses which supports “legislative and regulatory advocacy, international market development, media relations, scientific research, and education programs that benefit the entire California wine industry.” Wine Institute, About Us, at http://www.wineinstitute.org/who.htm (last visited Nov. 5, 2005).
wholesaler willing to distribute such small quantities of wine. However, boutique wineries still seek to participate in the market, and given that the traditional wholesaler-retailer network does not include these wineries in the distribution scheme, the only other means available to the wineries to sell and directly ship the wine to the consumer. This endeavor, however, is anything but easy given the varying manners in which state legislations have directed the regulation of the importation and distribution of alcohol.

The Twenty-first Amendment grants to the states the power to regulate the distribution and sale of alcoholic beverages within their respective borders, and the states have highly, although not consistently, regulated the industry. The various regulatory schemes governing the interstate sale of wine fall into one of three general categories: reciprocity states, limited direct shipment and permit states, and anti-shipment states.


14. In a well-publicized incident, one state’s direct shipping ban prevented a sitting governor from receiving a case of wine as payment for a bet. Two governors had bet on Super Bowl XXXVII. The losing governor had agreed to send the winning governor avocados, pistachios, fish tacos, and a case of 1999 Reserve Cabernet Sauvignon. Because the winning governor’s state banned direct shipping, however, the losing governor could not ship the wine directly to him. The losing governor also could not personally deliver the wine to the winning governor because that state restricted personal transportation of wine to one gallon per resident, which is less than a case. Ultimately, the governors agreed that the losing governor would have to deliver the wine personally - at a governors' conference in Washington, D.C. FTC Anticompetitive Barriers, at 25, citing Carol Emert, Bush Can’t Pop Davis' Bottle: Wine Delivery Snafu Screws up Governor’s Super Bowl Bet, S.F. CHRON., Jan. 30, 2003, at A2; Peter Wallsten, No Kindred Spirits: Fight On over Wine-Shipping Rights, MIAMI HERALD, Apr. 9, 2003, at 3B.

15. U.S. CONST. amend. XXI.

16. For a detailed state-by-state analysis of regulatory provisions on direct interstate shipments, see Wine Institute, Analysis of State Laws, at http://www.wineinstitute.org/shipwine/ (last visited Nov. 8, 2005).

17. See id. While the recent judicial battles have been over interstate wine shipments, and this article is written in the context of that debate, the authors do not seek to imply that the same constitutional issues do not apply equally to liquor and beer. This issue was alluded to in the oral argument of Granholm where Justice Ginsburg asked of Mr. Bolick “What about alcoholic beverages other than wine?” Granholm v. Heald, 73 USLW 3350, 13 (2004). See also Prepared Witness Testimony of Juanita D. Duggan before The House Committee on Energy and Commerce (October 30, 2003) (“And this issue isn’t just about wine, it’s about all forms of alcohol - beer, liquor and wine.”); Petitioner’s (Michigan Beer & Wine Wholesalers Ass’n) Brief in Granholm, available at 2004 WL 1720079, at 3 (“If plaintiffs have a constitutional right to import “fine and rare wines,” there is no obvious reason why they should not have a right to import cheap wines, or any other beverage that competes with local wineries for their beverage-alcohol dollars.”). In fact, in light of the ever increasing production of specialty beers and liquors (See, e.g., Melanie Warner and Stuart Elliott, Frothier Than Ever: The Tall Cold One Bows to the Stylish One; NEW YORK TIMES (August 15, 2005) at C1; Vanessa O’Connell, Yo, Ho, Ho and a Fancy New Bottle of ‘Superpremium’ Rum, WALL STREET JOURNAL (December 27, 2005) at A13), it must be anticipated
Of particular concern to vintners are the anti-shipment states, many of which regulate the distribution of alcohol through a mandatory three-tiered system combined with a statutory ban on direct-to-consumer shipment.18 Typically, a three-tiered system involves an out-of-state manufacturer of alcohol who must sell product to a wholesaler who in turn sells product to a retailer.19 In order to ensure that out-of-state manufacturers sell through the three-tiered system, the anti-shipment states, including Kentucky, strictly forbid direct-to-consumer shipments.20 However, several of the states exempt in-state manufacturers from this distribution scheme and permit direct sales to the consumer.21

The disparity in treatment between out-of-state and in-state manufacturers amounts to state enforced economic protectionism, the very scourge the Commerce Clause was intended to prevent.22 It has been repeatedly asserted that these protectionist laws are unconstitutional under the Commerce Clause. However, Section Two of the Twenty-first Amendment has created confusion about the extent to which the Commerce Clause applies to the Constitutionally unique article of commerce, alcoholic beverages, and in this instance wine.23 Herein we review the history of the dormant Commerce Clause and the Twenty-first Amendment and how they have been viewed vis-a-vis one another generally and then in the context of lower court decisions on the propriety of direct shipping schemes leading to the recent decision Granholm v. Heald. We then consider the constitutionality of the existing system in Kentucky regulating intra and interstate wine shipments.

II. THE (DORMANT) COMMERCE CLAUSE

The Commerce Clause reserves to Congress the power “[t]o regulate Commerce . . . among the several States.” 24 While the Commerce Clause speaks only of Congress’s affirmative powers, “the [Supreme] Court long has recognized that it also limits the power of the States to erect barriers against interstate trade.” 25 This alternative interpretation of the Commerce Clause is

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18. See FTC Anticompetitive Barriers at 7-8, 5.
19. Id. at 5.
20. See supra note 13.
21. See FTC Anticompetitive Barriers at 7 (“most states . . . permit intrastate direct shipping.”)
22. U.S. Const. art. I, § 8, cl. 3.
23. U.S. Const. amend. XXI.
25. Lewis v. BT Inv. Managers, Inc., 447 U.S. 27, 35 (1980). As Justice Johnson explained: “If there was any one object riding over every other in the adoption of the Constitution, it was to keep the commercial intercourse among the States free from all invidious and partial restraints.” Gibbons v. Ogden, 22 U.S. 1, 231 (1824). See also John E. Nowak & Ronald D. Rotunda,
known as the “dormant” Commerce Clause. The “dormant” aspect of the Commerce Clause arises from a negative inference of the constitutional grant to Congress under the Commerce Clause. This negative command effectively “create[s] an area of trade free from interference by the States.” While in most areas the states are free to act as long as their actions do not conflict with an affirmative act of Congress in which the federal law controls by virtue of the Supremacy Clause, the dormant Commerce Clause limits the actions of the states even when Congress has not chosen to affirmatively act, thereby preventing a state from “jeopardizing the welfare of the Nation as a whole” by “plac[ing] burdens on the flow of commerce across its borders that commerce wholly within those borders would not bear.”

The U.S. Constitution was based on “the theory that the peoples of the several states must sink or swim together.” The central purpose of the Commerce Clause was to prevent economic “balkanization” among the states. Trade barriers between the states could impede the stream of interstate

**Constitutional Law 137-39 (5th ed. 1995); Camps Newfound/Owatonna, Inc. v. Town of Harrison, 520 U.S. 564, 571 (1997) (citing to Gibbons, 22 U.S. at 224) (“Because each State was free to adopt measures fostering its own local interests without regard to possible prejudice to nonresidents … a ‘conflict of commercial regulations, destructive to the harmony of the States’ ensued.”). This conflict of commercial regulations “was the immediate cause, that led to the forming of a [constitutional] convention.” Id. “[T]he generating source of the Constitution lay in the rising volume of restraints upon commerce which the Confederation could not check.” WILEY RUTLEDGE, A DECLARATION OF LEGAL FAITH 25 (1947).


27. The United States Supreme Court in Merrion v. Jicarilla Apache Tribe, 455 U.S. 130, 154-55 (1982), stated:

> we only engage in this review when Congress has not acted or purported to act. Once Congress acts, courts are not free to review . . . regulations under the dormant Commerce Clause. When Congress has struck the balance it deems appropriate, the courts are no longer needed to prevent States from burdening commerce, and it matters not that the courts would invalidate the state . . . regulation under the Commerce Clause in the absence of congressional action. Courts are final arbiters under the Commerce Clause only when Congress has not acted.

Id.


commerce between them. Thus the framers of the Constitution, by the Commerce Clause, gave the federal government the power to regulate interstate commerce as a means of avoiding trade wars among the states. The Commerce Clause was designed “to avoid the tendencies toward economic Balkanization that had plagued relations among the Colonies and later among the States under the Articles of Confederation.” Implicitly, the Commerce Clause creates a national free market and restricts states from impeding the free flow of goods from one state to another. Unrepresented out-of-state interests will frequently bear the brunt of regulations imposed by another state having a significant effect on persons or operations that state. As such, even when a state law is not directly regulating commerce, if it discriminates against interstate commerce, the courts may strike it down.

Supreme Court jurisprudence utilizes a two-tiered approach to analyzing problems under the dormant Commerce Clause. This approach requires classifying state statutes into one of two categories: (1) those that facially discriminate against out-of-state interests in favor in-state business, or (2) those that regulate evenhandedly and thereby only indirectly burden interstate commerce.

The Supreme Court’s two-tiered approach to analyzing state regulations that affect interstate commerce looks first at whether the law is discriminatory in nature or whether the law merely burdens interstate commerce. When a law has incidental or “indirect effects on interstate commerce and regulates evenhandedly,” the Court examines whether the State’s interests are legitimate and whether the burden on interstate commerce exceeds the local benefits. If a state law burdens, but does not discriminate against, interstate commerce, the standard of review is lower than strict scrutiny. Rather a balancing test, weighing “the nature of the local interest involved, and . . . whether it could be

35. Id.
37. “[W]hen the regulation is of such a character that its burden falls principally upon those without the state, legislative action is not likely to be subjected to those political restraints which are normally exerted on legislation where it affects adversely some interests within the state.” South Carolina State Highway Dept. v. Barnwell Brothers, Inc., 303 U.S. 177, 185 n. 2 (1938).
39. Id.
40. Id.
promoted as well with a lesser impact on interstate activities,“44 is employed. Only when the burden imposed on interstate commerce is excessive compared to the in-state benefits will the non-discriminatory law be considered a Commerce Clause violation.45

On the other hand, when a state statute directly regulates or facially discriminates against interstate commerce, thereby favoring intrastate business interests over interstate commerce, the Court will hold the law invalid per se.46 For example, in City of Philadelphia v. New Jersey, the Court held that where economic protectionism is effected by state legislation, the law is invalid.47 In those situations, the Supreme Court applies strict scrutiny and will uphold the state statute only where it is found to advance a legitimate local purpose which cannot be served by a reasonable non-discriminatory alternative.48 Therefore, a state law which facially discriminates against interstate commerce is constitutional only if the state can justify the legislation both in terms of the local benefits flowing from the statute and the unavailability of alternative legislation adequate to preserve the local interests.49 Although the two tiers of analysis are not clearly distinguishable, “[i]n either situation the critical consideration is the overall effect of the statute on both local and interstate activity.”50

Where the article of commerce is alcoholic beverages, a third tier of analysis taking into account state powers under the Twenty-first Amendment is applied.51 This tier of analysis reviews whether the law at question promotes as core power afforded the state by the Amendment.52 Where temperance, revenue, or orderly administration of the alcoholic industry are not at issue, the law will fail.53 Where they are implicated, the law is further reviewed to ascertain whether it is minimally intrusive upon interstate commerce.54 With the state bearing the burden, it must be demonstrated that less restrictive mechanisms are not available for achieving the state’s objectives.55 Then and only then will a state

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44. Pike, 397 U.S. at 142.
45. See id.
46. See, e.g., C & A Carbone, Inc., 511 U.S. at 392 (holding that a law is “per se invalid, save in a narrow class of cases in which the municipality can demonstrate, under rigorous scrutiny, that it has no other means to advance a legitimate local interest.”)
49. Id.
52. See id. at 713.
53. See Bacchus, 468 U.S. at 276.
55. See id. at 1895.
law impacting interstate commerce be permitted to stand against a Commerce Clause challenge.56

III. PROHIBITION & THE TWENTY-FIRST AMENDMENT

America’s history is replete with conflicting views on the consumption of alcoholic beverages. 57 Prohibition, the “Noble Experiment,” 58 was an effort to nationalize, by enshrinement in the Constitution, state and local prohibition efforts that had been gaining ground over the preceding decades.59 The

56. See id.

57. The first control on liquor sales was a Massachusetts Bay Colony law of 1633 that forbade the sale of wine or strong water without the permission of the colony governor or his deputy. G. Thomann, Colonial Liquor Laws 4-5 (The United States Brewers Association 1887). The maximum price of beer was fixed at a penny a quart in 1634. Id. The earliest distillery was erected by New York Director William Kieft on Staten Island in 1640. Id. at 86. Even as a Harvard master was stripped of his post for having left the school’s students “wanting beer betwixt brewing a week and a week and a half together” (Henry Lee, How Dry We Were: Prohibition Revisited, 16 (Prentice Hall 1963)), Anthony Bezenet’s pamphlet “The Mighty Destroyer Displayed and Some Account of the Dreadful Havoc Made by the Mistaken Use, As Well As the Abuse, of Distilled Spirituous Liquors” warned that such beverages are “liable to steal away a man’s senses and render him foolish, irascible, uncontrollable, and dangerous.” E. H. Cherrington, The Evolution of Prohibition in the United States of America, (American Issue Press 1920).

58. The moniker the “Noble Experiment” has been long ascribed to President Herbert Hoover. See Loretto Winery Ltd. v. Gazzara, 601 F.Supp. 850, 856 n. 7 (S.D.N.Y. 1985) (“President Herbert Hoover, who had some difficulty in deciding whether he was a Wet or a Dry, coined this expression for National Prohibition.”)

59. Maine had been dry since 1851 (Portland having gone dry in 1840), and seventeen other states were to become so by statute or state constitutional amendment through 1915. Edward Behr, Prohibition: Thirteen Years That Changed America 28-29 (Arcade Publishing 1996);

constitutionalization of Prohibition was viewed as necessary to address earlier decisions striking down certain state efforts to effect prohibition within their borders. Adopted in 1918, the Eighteenth Amendment and the related legislation were at best ineffective; beverage alcohol remained available through home distillers, “rum runners,” physicians, and its consumption was widespread.

1913, nearly 50% of America was under prohibition; nine states were entirely dry, and an additional thirty-one states allowed for the local option to go dry. Id. 60. Kenneth C. Davis, Don’t Know Much About History 328-29 (Harper Collins 2003): America’s grandest attempt at a simple solution was also its grandest failure. The constitutional amendment halting drinking in America was supposed to be the answer to social instability and moral decline at the beginning of the twentieth century. It should stand forever as a massive memorial to the fact that complex problems demand complex responses, and Americans balk whenever somebody tries to legislate their private morality and personal habits.


62. The Eighteenth Amendment was effected by the National Prohibition Act (a/k/a the Volstead Act), 27 U.S.C. § 1 et seq., repealed August 27, 1935. The Eighteenth Amendment provided:

Section 1. After one year from the ratification of this article the manufacture, sale, or transportation of intoxicating liquors within, the importation thereof into, or the exportation thereof from the United States and all territory subject to the jurisdiction thereof for beverage purposes is hereby prohibited.

Section 2. The Congress and the several States shall have concurrent power to enforce this article by appropriate legislation.

Section 3. This article shall be inoperative unless it shall have been ratified as an amendment to the Constitution by the legislatures of the several States, as provided in the Constitution, within seven years from the date of the submission hereof to the States by the Congress.

U.S. CONST. amend. XVIII. Rhode Island had the good sense to not approve the amendment. See http://www.house.gov/Constitution/Amend.html (last visited Nov. 10, 2005).

63. See generally LEE, HOW DRY WE WERE, supra note 57 at 72-83.

64. See HUGH BARTY-KING AND ANTON MASSEL, RUM - YESTERDAY AND TODAY 57-60 (William Heinemann Ltd. 1983) noting that the product transported by the “rum runners” was typically Scotch whiskey. After Prohibition, notorious bootleggers such as Joseph Kennedy and Samuel Brofman opened legitimate liquor companies. See EDWARD BEHR, PROHIBITION - THIRTEEN YEARS THAT CHANGED AMERICA 240 (Arcade Publishing, Inc. 1996).

65. Distillers were still able to produce alcohol for industrial, sacramental, and, for those lucky few with a doctor who would prescribe it, medicinal use. See National Prohibition (Volstead) Act, 27 U.S.C. §§ 17-18 (1919), repealed August 27, 1935. See also Robert E. Dundon, KY LING is Ready to Turn Out Whisky, NEW YORK TIMES (Nov. 24, 1929) at E6.

A ... tragic result was the fact that large numbers of normally honest and law-abiding physicians and druggists felt that the [prohibition] law was so drawn that its violation was forced upon them. Their success depends not alone upon their skill, but also upon their good will. If a man asked for a liquor prescription, it was the duty of the physician to refuse it unless he honestly believed that the man was suffering from ‘some known ailment’ for which an alcoholic beverage was a proper remedy. He knew, however, that if he took
widely viewed as socially appropriate.\textsuperscript{66} In the end, while Prohibition did not eliminate beverage alcohol from the nation,\textsuperscript{67} it did foster official corruption\textsuperscript{68} and assist in the creation of organized crime.\textsuperscript{69}

This course, the man would not only resent it but also go to some more accommodating physician for his liquor supply. He feared that he would not only lose the money which he would have received for the liquor prescription, which he was willing to do, but that he would also lose the man’s legitimate patronage, which he was unwilling to do. So he said to himself, ‘Well, he will get his liquor anyway, and I am not going to sacrifice my practice to a sentimental and futile obedience to a foolish law,’ and he lapsed to the status of a bootlegger.

\textbf{FLETCHER. DobyNs, The Amazing Story of Repeal} 291 (Plimpton Press 1940). However, there was a limit on medicinal use to one pint in any ten day period to any one patient. See Lambert v. Yellowley, 272 U.S. 581, 584 (1926). Some eleven million bottles of “medicinal” spirits were prescribed annually by physicians. \textit{G. Ford’s Illustrated Guide to Wines, Brews, and Spirits} 59 (Brown 1983).

\textsuperscript{66} See, e.g., \textit{JOHN D. HICKS, Republican Ascendancy} 178 (Harper & Row 1960) (“People who wished to drink had no notion of being deprived of their liquor…; indeed, it became the smart thing to drink, and many who had been temperate in their habits before were now moved to imbibe freely as a protest against the legal invasion of their ‘personal liberty.’”); \textit{THORNTON, Alcohol Prohibition Was A Failure}; Second, consumption of alcohol actually rose steadily after an initial drop. Annual per capita consumption had been declining since 1910, reaching an all-time low during the depression of 1921, and then began to increase in 1922. Consumption would probably have surpassed pre-Prohibition levels even if Prohibition had not been repealed in 1933 (citing \textit{Clark Warburton, The Economic Results of Prohibition} (New York, Columbia University Press, 1932)).

\textsuperscript{67} See, e.g., Nat’l Comm’n on Law Observance and Enforcement, \textit{Report on the Enforcement of Prohibition Law of the United States} 22 (1931) (“The Census Bureau figures for the year 1919 … indicate that after a brief period in the first years of the [Eighteenth] amendment there has been a steady increase in drinking.”) As observed by Fiorella H. LaGuardia, “It is impossible to tell whether prohibition is a good thing or a bad thing. It has never been enforced in this country.” The National Prohibition Law, Testimony before Committee on the Judiciary, U.S. Senate, 69th Cong., 1st Sess. (1926) at 649-52.

\textsuperscript{68} See, e.g., \textit{EDWARD BEHR, Prohibition - Thirteen Years That Changed America} 235 (Arcade Publishing, Inc. 1996) (asked how to enforce Prohibition in New York, “La Guardia replied that not only would this compel disbanding the existing force and recruiting 250,000 men but the raising of a separate force of 250,000 inspectors to monitor police activities.”).

\textsuperscript{69} The thirteen years after the passage of the Eighteenth Amendment witnessed both the flourishing of a black market in alcohol and an increase of crimes associated with that illegal trade. Radley Balko, \textit{Back Door to Prohibition: The New War on Social Drinking}, Cato Policy Analysis No. 501, http://www.cato.org/pubs/pas/pa-501es.html (last visited Nov. 8, 2005). \textit{See also} Merck Thornton, \textit{Alcohol Prohibition was a Failure}, Cato Policy Analysis No. 157 (July 17, 1991, at http://www.cato.org/pubs/pas/pa-157.html (last visited Nov. 8, 2005): National prohibition of alcohol (1920-33) – the “noble experiment” – was undertaken to reduce crime and corruption, solve social problems, reduce the tax burden created by prisons and poorhouses, and improve health and hygiene in America. The results of that experiment clearly indicate that it was a miserable failure on all counts. Still, there is evidence that there was a reduction during nationwide prohibition of some of the health consequences of abuse of alcoholic beverages. \textit{See} Angela K. Dills and Jeffrey A. Miron, \textit{Alcohol Prohibition and Cirrhosis}, \textit{6 American Law and Economic Review} 285 (Fall, 2004).
While the Twenty-first Amendment clearly repealed the Eighteenth Amendment, the status of alcoholic beverages in the federal system was unclear. Much of the debate has centered on the fact that there is no clear consensus on the intent behind Section 2 and its importance versus the balance of the Constitution. There are two major competing interpretations of the Twenty-first Amendment: the “absolutist” view and the “federalist” view. The

70. U. S. CONST. amend. XXI provides:

Section 1. The eighteenth article of amendment to the Constitution of the United States is hereby repealed.

Section 2. The transportation or importation into any State, Territory, or possession of the United States for delivery or use therein of intoxicating liquors, in violation of the laws thereof, is hereby prohibited.

Section 3. This article shall be inoperative unless it shall have been ratified as an amendment to the Constitution by conventions in the several States, as provided in the Constitution, within seven years from the date of the submission hereof to the States by the Congress.

The Twenty-first Amendment was proposed to the States on February 20, 1933, and was approved on December 5, 1933. Kentucky approved the Amendment on November 27, 1933. See Everett Somerville Brown, Ratification of the Twenty-First Amendment to the Constitution of the United States 166-79 (1938, reprinted 1970). See also Robert E. Dunson, Kentucky Seeking High Whisky Taxes, NEW YORK TIMES (Aug. 27, 1933) at E6. The Amendment was rejected and never subsequently approved by South Carolina. Brown, Ratification at 375-378.

71. Prohibition was to remain in force “thirteen years, ten months, eighteen days and a few hours.” Final Action by Utah, N.Y. TIMES, Dec. 5, 1933, at 1, col. 8. As observed by H.L. Mencken:

Prohibition went into effect on January 16, 1920, and blew up at last on December 5, 1933 -- an elapsed time of twelve years, ten months and nineteen days. It seemed almost a geologic epoch while it was going on, and the human suffering that it entailed must have been a fair match for that of the Black Death or the Thirty Years War.

H. L. MENCKEN, THE NOBLE EXPERIMENT, in A CHOICE OF DAYS: ESSAYS FROM HAPPY DAYS, NEWSPAPER DAYS AND HEATHEN DAYS 307 (Knopf, 1980). The twelve versus thirteen year issue depends on whether one counts the one year phase in period of Section 1 of the Eighteenth Amendment.

72. Susan Lorde Martin, Wine Wars-Direct Shipment of Wine: The Twenty-first Amendment, the Commerce Clause, and Consumers’ Rights 14, 38 AM. BUS. L. J. 1 (2000) (noting that the meaning of Section 2 is not clear despite the fact that the purported purpose behind the provision was to constitutionalize the substance of the Webb-Kenyon Act, but that the “[r]ecords of the state conventions do not indicate a consensus on the meaning of Section 2.”). See also Asheesh Agarwal and Todd Zywicki, The Original Meaning of the 21st Amendment, 8 GREEN BAG 137 (Winter, 2005). An earlier draft of the Twenty-first Amendment included an additional clause providing: “Congress shall have the concurrent power to regulate or prohibit the sale of intoxicating liquors to be drunk on the premises where sold.” Id. at 140. The failure of Congress to adopt this provision has been relied upon by Justice Sandra Day O’Connor to support her view that the Twenty-first Amendment has worked as a repeal of the Commerce Clause as it relates to alcoholic beverages. See 324 Liquor Corp. v. Duffy, 479 U.S. 335, 354-56 (1987) (O’Connor, J., dissenting). See also Aaron Nielson, No More ‘Cherry-Picking’: The Real History of the 21st Amendment’s § 2, 28 HARV. J.L. & PUB. POLICY 281 (Fall, 2004).

“absolutist” view takes the position that the plain language of the Twenty-first Amendment vests complete control over the regulation of alcohol in the states. The second interpretation, the “federalist” view, takes a contextual approach to interpreting Section 2 and holds the position that the repeal of the Eighteenth Amendment does not grant the states new powers, but rather restores the powers in existence before Prohibition.

State Board of Equalization v. Young’s Market Co., decided only three years after the passage of the Twenty-first Amendment, called upon the Supreme Court to determine the validity of a state statute requiring a $500 license fee, upon those importing beer to any place within California state borders. Acknowledging that apart from the Twenty-first Amendment it would “obviously have been unconstitutional to impose any fee for [the] privilege [of importing beer],” the Supreme Court upheld the license fee against both Commerce and Equal Protection Clause challenges, with Justice Brandeis, writing for the Court, stating:

The Amendment … abrogated the right to import free, as far as concerns intoxicating liquors. The words [of Section 2 of the Twenty-first Amendment] are apt to confer upon the State the power to forbid all importations which do not comply with the conditions which it prescribes.

Brandeis established the Court’s early jurisprudence for the view of Section 2 of the Twenty-First Amendment, writing that the suggestion that the Constitution otherwise required equal treatment of in-state manufacturers and sellers with out-of-state exporters “would involve not only a construction of the

74. Id.
75. It is undisputed that the Twenty-first Amendment returned the situation to the pre-Eighteenth Amendment situation with each state deciding if it wanted to be “wet” or “dry.” Many states did not return immediately to “wet” following the passage of the Twenty-first amendment. See Status of Liquor Around the Nation, NEW YORK TIMES (Dec. 5, 1933) at p. 16 (observing, with respect to Kentucky, “No native drinking; distilleries operate for other States”). Tennessee did not begin to go wet until 1939. 1939 TENN. PUB. ACTS Ch. 49. See also City of Chattanooga v. Tennessee Alcoholic Beverage Comm’n, 525 S.W.2d 470, 472 (Tenn. 1975). Kansas, having adopted a prohibition amendment to its state constitution in 1879, did not repeal that provision until 1948. See Kevin Wendell Swain, Liquor By the Book in Kansas: The Ghost of Temperance Past, 35 WASHBURN L. J. 322 at 327-28, 331 (Spring 1996). Oklahoma did not repeal the prohibition clause of the state’s original 1907 constitution until April 7, 1959, leading to Will Roger’s statement that “Oklahomans will vote dry so long as they can stagger to the polls to vote.” ROBERT WALKER & SAMUEL PATTERSON, OKLAHOMA GOES WET: THE REPEAL OF PROHIBITION 1 (McGraw-Hill 1960). Today Bridgewater, Connecticut remains the only city or town in that state to have not, since 1933, approved some level of sale of alcoholic beverages. William Yardley, A State’s Last Dry Town Asserts a Right to Hold on to Tradition, NEW YORK TIMES A23 (December 26, 2005).
77. Id. at 62.
78. Id. at 60-61.
Amendment, but a rewriting of it.”79 Mahoney v. Joseph Triner Corp., another opinion by Justice Brandeis, examined an Equal Protection challenge to a state requirement that imported liquors containing more than 25% alcohol be registered with the Patent Office.80 Rejecting the challenge, and adopting the reasoning of the defendant state officials, the Court wrote that: “since the adoption of the Twenty-first Amendment, the equal protection clause is not applicable to imported intoxicating liquor.”81

Indianapolis Brewing Co. v. Liquor Control Commission82 involved Due Process, Equal Protection, and Commerce Clause challenges to those provisions of the then Michigan Liquor Control Act which prohibited Michigan dealers from selling beers manufactured in any state which discriminated against beer produced in Michigan.83 In rejecting these challenges and citing the Court’s prior decisions in Young’s Market and Mahoney, this opinion clearly articulated Brandeis’ absolutist view that: “since the Twenty-First Amendment, … the right of a state to prohibit or regulate the importation of an intoxicating liquor is not limited by the commerce clause.”84

Thereafter, in Ziffrin, Inc. v. Reeves,85 the Court determined that the Commerce, Due Process and Equal Protection Clauses of the Constitution would not stand to defeat state regulation of the means of transporting whiskey where “regulation by the state might impose some burden on interstate commerce, this was permissible when ‘an inseparable incident of the exercise of the legislative authority, which, under the Constitution, has been left to the States.’”86

Still, as these early decisions were being rendered, it was acknowledged that the Twenty-first Amendment did not entirely preclude federal interest from

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79. Id. at 62.
81. Id. at 403. This same sentiment was repeated in later cases. See, e.g., Indianapolis Brewing v. Liquor Control Comm. et al., 305 U.S. 391, 394 (1939); Ziffrin, Inc. v. Reeves, 308 U.S. 132, 138 (1939) (noting “The Twenty-first Amendment sanctions the right of a state to legislate concerning intoxicating liquors brought from without, unfettered by the Commerce Clause.”)
82. Indianapolis Brewing, 305 U.S. at 391.
83. See Joseph F. Finch & Co. v. McKittrick, 304 U.S. 95 (1939); decided the same day as Indianapolis Brewing Co., involved a similar challenge to a similar Missouri statute.
84. Indianapolis Brewing Co., 305 U.S. at 394. The Equal Protection and Due Process challenges to the Michigan statute were similarly discarded. Id.
85. 308 U.S. 132 (1939).
86. Id. at 141, quoting South Carolina Hwy. Dept. v. Barnwell Brothers, 303 U.S. 177, 189 (1938). See also McCanless v. Klein, 188 S.W.2d 745, 748 (Tenn. 1945):

It is difficult to conceive of a regulation of the sale and distribution of intoxicating liquor which could be said to be beyond the police powers of the State. Since the power of the State to prohibit such sales altogether is beyond question, no provision for its regulation is beyond the State’s power . . . . The legislature has unlimited powers of regulation and restriction of the liquor traffic and may delegate these powers, as has been done to the commissioner. His exercise of such delegated discretion will not be lightly interfered with by the courts.
application to the alcohol beverage industry. Collins v. Yosemite Park & Curry Co. reviewed California’s ability to apply its Beverage Control Act to a corporation acting within the borders of Yosemite National Park. The Park had been ceded to the Federal government by the state of California in 1919 with the state reserving taxing power over the territory. California’s efforts to apply the Beverage Control Act were rejected as the power to regulate the alcoholic beverage trade had not been reserved in the terms of the ceding of the territory to the Federal government. “Where exclusive jurisdiction is in the United States, without power in the states to regulate alcoholic beverages, the XXI Amendment is not applicable.” The decisions rendered in Jameson & Co. v. Morgenthau and United States v. Frankfort Distillers, Inc. confirmed that the federal interest in the regulation of monopolistic conduct was sufficient for the application and enforcement of the Sherman Antitrust Act to the alcoholic beverage industry notwithstanding Section 2 of the Twenty-first Amendment.

The Federal Alcohol Administration Act was attacked upon the ground that the Twenty-first Amendment to the Federal Constitution gives to the States complete and exclusive control over commerce in intoxicating liquors, unlimited by the commerce clause, and hence that Congress has no longer authority to control the importation of these commodities into the United States. We see no substance in this contention.

Then, in the 1944 decision of Johnson v. Yellow Cab Transit Co., the propriety of the seizure of a shipment of wine in transit to a Federal military reservation was rejected, and the state was ordered to return the seized product. Still, it was not until the 1946 decision rendered in Nippert v. City of Richmond that it was clearly hinted that the power of the states to regulate the alcoholic beverage industry vis-à-vis one another was subject to the limitations of the Commerce Clause. The Nippert Court wrote that: “even the commerce in intoxicating liquors, over which the Twenty-first Amendment gives the States

88. Id.
89. Id. at 519.
90. Id. at 520.
91. Id. at 538.
93. 324 U.S. 293, 299 (1945).
97. 327 U.S. 416 (1946).
the greatest degree of control, is not altogether beyond the reach of the federal commerce power.”98 And there, quiescent, remained the question of reconciling the Twenty-first Amendment with the balance of the Constitution, a state of affairs that lasted some two decades.

The United States Supreme Court returned to Twenty-first Amendment jurisprudence in a pair of 1964 decisions rendered the same day under the authorship of Justice Stewart. Hostetter v. Idlewild Bon Voyage Liquor Corp.99 and Dept. of Revenue v. James B. Beam Distilling Co.100 each struck down state laws which claimed to be within the scope of the state’s authority under the Twenty-first Amendment. Hostetter involved a New York statute that sought to preclude duty free sales from John F. Kennedy International Airport – the beverages in questions were transported outside of New York (indeed outside the United States) under the supervision of the U.S. Customs Service and there delivered to the customer.101 The proponents of the statute argued since the statute in Ziffrin was protected by the Twenty-First Amendment, so should New York be protected in order to prevent the known evils associated with liquor and to secure revenue.102 This view was soundly rejected: “To draw a conclusion from this line of decisions that the Twenty-first Amendment has somehow operated to “repeal” the Commerce Clause wherever regulation of intoxicating liquors is concerned would, however, be an absurd oversimplification.”103

The Beam case involved a Kentucky tax levied on foreign whiskey importers.104 Relying upon the Export-Import Clause, the statute was struck

98. Id. at 425 n. 15. It may be argued that the Court’s shift began even earlier, namely in the 1939 decision rendered in Ziffrin, 308 U.S. 132, in which the Court upheld a comprehensive Kentucky statute originally regulating the transportation and distribution of liquor in Kentucky. While upholding the statute, the decision may be read to apply a reasonableness test thereto. Id. at 139.

Kentucky has seen fit to permit manufacture of whisky only upon [the] condition that it be sold to an indicated class of customers and transported in definitely specified ways. These conditions are not unreasonable and are clearly appropriate for effectuating the policy of limiting traffic in order to minimize well-known evils, and secure payment of revenue.

Id. (emphasis added).

100. 377 U.S. 341 (1964).
102. The proponents argued that Collins v. Yosemite Park, 304 U.S. 518, 538 (1938), in which the Court held that the park was within the distinct sovereignty of the United States and that California is not permitted, considering the Twenty-first Amendment, to control liquor legislation within the park, should be read narrowly to apply only where liquor is en route to a federal reservation. Idlewild Bon-Voyage Liquor Co. v. Epstein, 212 F.Supp 376, 384 (D.C.N.Y. 1962). However, the proponents placed particular emphasis on Ziffrin, Inc. v. Reeves wherein the Court affirmed the state’s decision to deny an out-of-state liquor carrier a special license which is available only to those holding a state common carrier’s certificate. Id. at 384-385.
The Court refused to hold that the Twenty-first Amendment repealed the Export-Import Clause “so far as intoxicants are concerned.” The Court found nothing in the Twenty-first Amendment “freed the state from all restrictions upon the police power to be found in other provisions of the Constitution.”

June 1, 1964, was the turning point in Twenty-first Amendment jurisprudence – for the first time since Prohibition the omnipotence of the Amendment over the balance of the Constitution was soundly rejected by the Supreme Court, which clearly embraced the federalist view. The federalist view grew in acceptance through the 1960’s and in the years since through this day. Wisconsin v. Constantineau saw the Court strike down on procedural due process grounds a statute allowing officials to post public notices stating that a particular person was prohibited from buying or receiving liquor because he has “expose[d] himself or his family to want” or somehow endangered himself or others. The 1976 decision of Craig v. Boren struck down an Oklahoma statute that permitted sales of low-alcohol beer to females over 18 years of age and to men over the age of 21 on Equal Protection grounds. The Court noted the “Twenty-first Amendment does not save the invidious gender-based discrimination from invalidation as a denial of equal protection of the laws.”

105. U.S. CONST. art I, § 10, cl. 2, which provides in relevant part: “No State shall, without the consent of the Congress, bring any imposts or duties on imports or exports.”
107. Id.
108. A small and short lived retreat from the principles of Hostetter took place in Heublein, Inc. v. South Carolina Tax Commission, 409 U.S. 275, 283 (1972) (“by virtue of [the Twenty-first Amendment’s] provisions a State is totally unconfined by traditional Commerce Clause limitations when it restricts the importation of intoxicants destined for use, distribution, or consumption within its borders.”)
110. Id. at 434. Although beyond the scope of this article, based upon the ruling in Constantineau, it may be argued that Ky. REV. STAT. ANN. § 244.070 (West 2005), which provides: No licensee shall sell or agree to sell any alcoholic beverages or cause of permit any alcoholic beverages to be sold to any person who has been reported to the licensee by any court or by any officer acting at the direction of a court as having failed to make proper provision for his family is unconstitutional.
111. 429 U.S. 190 (1976).
112. U.S. CONST. amend XIV, § 1 provides in part: “No state shall make or enforce any law which shall ... deny to any person within its jurisdiction the equal protection of the laws.”
113. Craig v. Boren, 429 U.S. 190, 204-05 (1972). See also Commonwealth Alcoholic Control Board v. Burke, 481 S.W.2d 52 (Ky. 1972) (declaring unconstitutional under the Equal Protection Clause of the Fourteenth Amendment provisions of former KY. REV. STAT. ANN. § 244.100 (West 2005) relating to limitations on employment of women at retail licensees and limitations upon serving of female customers); Costa v. Bluegrass Turf Service, Inc., 406 F.Supp. 1003 (E.D. Ky. 1975) (Requirement that retail licensees employ only residents of Kentucky violates the Equal Protection Clause by infringing upon right of interstate travel); Cooper v. McBeath, 11 F.3d 547 (5th Cir. 1994) (Texas residency requirement for holders of retail permit violates Commerce Clause). On this basis, although certainly outside the scope of this article, it is questionable whether the requirement of Ky. Rev. Stat. § 243.100(1)(b), precluding the issuance of a license to a person who “has not had an actual, bona fide residence in this state for at least one (1) year before
1980 saw the decision rendered in *California Retail Liquor Dealers Ass’n v. Midcal Aluminum, Inc.*114 wherein on Sherman Anti-trust Act grounds state pricing laws were struck down, the Court writing:

The [Twenty-first] Amendment primarily created an exception to the normal operation of the Commerce Clause. Even here, however, the Twenty-first Amendment does not pro tanto repeal the Commerce Clause, but merely requires that each provision "be considered in the light of the other, and in the context of the issues and interests at stake in any concrete case."115

In *Larkin v. Grendel’s Den*116, a Massachusetts statute that allowed a church to veto a liquor license proposed to be issued within five-hundred feet of the church was struck down as a violation of the Establishment Clause of the First Amendment.117

Then came the ruling in *Bacchus Imports, Ltd. v. Dias*,118 a resounding affirmation of the need to reconcile the Twenty-first Amendment to the balance of the Constitution in a manner that limited the states’ retained authority.119 *Bacchus* involved a Hawaii statute that imposed a 20% wholesale level excise tax on liquors, but exempted from the tax liquors produced in Hawaii.120 Hawaii maintained that the purpose of the tax was to raise revenue for general government functions while the exemption existed to “encourage development of the Hawaiian liquor industry.”121 The Court found that the exemption was both discriminatory and protectionist, and then considered whether, notwithstanding these flaws, it was nevertheless permitted under the Twenty-first Amendment.122 In the end it was not; the Court finding that the tax exemption did not “promote temperance or . . . carry out any other purpose of the Twenty-first Amendment.”123 Furthermore, considering the intention that the exemption promote the local Hawaiian industry, the Court held that “[s]tate laws that constitute mere economic protectionism are therefore not entitled to the same

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117. Id. at 120.
119. Id. at 276.
120. Id. at 265.
121. Id. The excise tax was enacted in 1939 without the exemption for local products; the exemption provisions were added in 1971. Id.
122. Bacchus, 468 U.S. at 274-75.
123. Id. at 276.
deference as laws enacted to combat the perceived evils of an unrestricted traffic in liquor.124

It would be an error, however, to assume that all state laws impacting upon the interstate commerce in alcoholic beverages have, since Hostetter v. Idlewild, been struck down. In Joseph E. Seagram & Sons, Inc. v. Hostetter,125 the Supreme Court allowed to stand a price affirmation statute put in place by the State of New York.126 Although the statute had the effect of skewing the market due to the supplier’s inability to respond to local conditions by the requirement to consider the impact of a local pricing decision upon distant sales, the Supreme Court allowed it to remain in place.127 The tide began to turn on price affirmation in the 1983 affirmation, without comment, of the Second Circuit Court of Appeals in U.S. Brewers Ass’n v. Healy128 holding that a Connecticut affirmation statute violated the Commerce Clause. Then, in 1986, the Supreme Court, in Brown-Forman Distillers Corp. v. New York State Liquor Auth.,129 considered whether price affirmation had an impermissible impact upon interstate commerce:

By requiring distillers to affirm that they will make no sales anywhere in the United States at a price lower than the posted price in New York, . . . New York makes it illegal for a distiller to reduce its price in other States during the period that the posted New York price is in effect. Appellant contends that this constitutes direct regulation of interstate commerce.130

124.  Id. See also James Beam Distilling Co. v. Georgia, 501 U.S. 529 (1991) (confirming unconstitutionality under the Commerce Clause of Georgia tax statute similar to that struck down in Bacchus, determining that a distiller was entitled to a refund for taxes paid on prior years prior to determination of unconstitutionality); Div. of Alcoholic Bev. and Tobacco, Dept. of Bus. Reg. v. McKesson Corp., 524 So.2d 1000 (Fl. 1988) (Florida system providing tax exemption for alcoholic beverages made from Florida agriculture products held unconstitutional under Commerce Clause and finding that a tax scheme is not entitled to deference by virtue of the Twenty-first Amendment), rev’d on other grounds 496 U.S. 18 (1990).
126.  See id. at 43-44. Price affirmation involves a requirement by a state that a supplier sell into the state at a price that is no higher than then price charged in other states in either the month of the sale (prospective affirmation) or in the month prior to the sale (retrospective affirmation). See generally Thomas E. Rutledge, The Questionable Viability of the Des Moines Warranty in Light of Brown-Forman Corp. v. New York, 78 Ky.L.J. 209 at 213-16 (1989-90).
127.  Id. at 216-17; Seagram & Sons, 384 U.S. at 41.
128.  692 F.2d 275, 282-84 (2nd Cir. 1982), aff’d without opinion, 464 U.S. 909 [hereinafter Healy I].
129.  476 U.S. 573 (1986). Both authors have at various times been employees of what is today Brown-Forman Corporation, and one of them (Rutledge) serves as counsel to the company. The views expressed in this article are entirely those of the authors, and do not necessarily reflect the views of Brown-Forman Corporation.
130.  Id. at 579-80. New York required that, on the 25th of each month, each supplier file a price schedule to be effective for the second succeeding month. Id. at 575. The supplier was barred from selling the products at a lower price anywhere else in the nation during that future month. Id. at 576, n. 1.
Brown-Forman lost in both the New York Supreme Court and the New York Court of Appeals. On appeal to the Supreme Court, the lower court decisions were reversed and the statute was struck down as violative of the Commerce Clause. The Court identified a two-tier process to test for violations of the Commerce Clause. The first tier looks at statutes that "directly regulate[] or discriminate[] against interstate commerce . . . [or that] favor in-state economic interests over out-of-state interests." These are per se invalid. The second tier looks at those statutes that are not per se invalid to see if the state’s interest is legitimate and if the burden on interstate commerce exceeds the local benefits. Under either level, the “critical consideration is the overall effect of the statute on both local and interstate activity.” Brown-Forman did not maintain that the statute was less than evenhanded; all suppliers were treated equally. But this treatment did amount to “‘simple economic protectionism’ that th[e] Court has routinely forbidden.” In Baldwin v. G.A.F. Seelig, Inc., the Court had struck down a New York law that specified a minimum wholesale price for milk, and banned from resale in New York foreign milk purchased at a lower price. The Brown-Forman Court held that “a State may not ‘establish . . . a scale of prices for use in other states, and . . . bar the sale of products . . . unless the scale has been observed.’” With that

134. Id. at 579.
135. Id.
136. Id.
137. Brown-Forman, 476 U.S. at 579. See also Pike, 397 U.S. 137. Arizona sought to compel a cantaloupe grower to pack the fruit in-state because the packaging carried the name of the state where the fruit was packed. Id. at 139. By contrast, the name of the state where the fruit was grown was not listed. Id. The cost of moving the packaging facility into Arizona, a move of thirty-one miles, was approximately $200,000. Id “Even where the State is pursuing a clearly legitimate local interest, this particular burden on commerce has been declared to be virtually per se illegal.” Id. at 145 (emphasis in original).
139. Id.
140. Id. at 580. (quoting Philadelphia v. New Jersey, 437 U.S. 617, 624 (1978)).
141. 294 U.S. 511. See also Buck v. Kuykendall, 267 U.S. 307, 315 (1925) (state action meant to prevent competition in supply of for-hire vehicles used in interstate commerce violates Commerce Clause); H.P. Hood & Sons, Inc. v. DuMond, 336 U.S. 525, 539 (1949) (state prevention of expansion by a corporation on the grounds that it would reduce milk supplies in the local market and result in destructive competition burdens interstate commerce); New England Power Co. v. New Hampshire, 455 U.S. 331, 339 (1982) (state requirement that utility sell low cost, in-state generated power to state residents or adjust rates for power purchased elsewhere to the same price is protectionist and burdens interstate commerce).
background, the Court then was left to ascertain if the New York affirmation statute did regulate commerce in other states.\footnote{Brown-Forman, 476 U.S. at 582}

The New York statute required that prices be posted each month,\footnote{Id. at 575-76.} in effect allowing changes to those postings only with the approval of the liquor board.\footnote{Id.} Were a supplier to raise or lower its prices in all other affirmation states during a particular posting period, the supplier could not change correspondingly its New York prices without regulatory approval.\footnote{Id.} But were it denied permission to modify its price schedule, the supplier would be in violation of the affirmation requirement.\footnote{Id. at 579-80.} The Court wrote: “Forcing a merchant to seek regulatory approval in one State before undertaking a transaction in another directly regulates interstate commerce.”\footnote{Brown-Forman, 476 U.S. at 582-83.} The practical effect of the law was to regulate liquor prices in other states in direct violation of the Commerce Clause.\footnote{Id. at 583 (“That the ABC Law is addressed only to sales of liquor in New York is irrelevant if the \textit{practical effect} of the law is to control liquor prices in other States.”) \textit{(emphasis added)}.}

New York maintained that the Twenty-first Amendment protected the affirmation law from Commerce Clause analysis.\footnote{Id. at 584.} However, the Court noted that the Twenty-first Amendment refers to the sale of alcoholic beverages within a state, and New York’s law controlled the sale of alcoholic beverages in other states, thereby exceeding the authority granted by the Amendment even if it otherwise completely insulated the affirmation law from the Commerce Clause.\footnote{Id. at 584-85.} Also, by interfering with the alcoholic beverage industry in other states, New York invaded the authority granted to other states by the Twenty-first Amendment.\footnote{Brown-Forman, 476 U.S. at 585. Subsequently numerous other affirmation statutes were struck down. \textit{See e.g.}, Brown-Forman Corp. v. South Carolina Alcoholic Beverage Control Commission, 643 F.Supp. 943 (D.S.C. 1986); Brown-Forman Corp. v. New Mexico Department of Alcoholic Beverage Control, 672 F.Supp. 1383 (D.N.M. 1987); Brown-Forman Corp. v. Delaware Alcoholic Beverage Control Commission, No. 87-20 LON, slip op. (D. Del. December 17, 1987); Brown-Forman Corp v. Tennessee Alcoholic Beverage Commission, No. 3-86-0926 (M.D. Tenn. June 30, 1987) 1987 WL 30303, \textit{revd.}, 860 F.2d 1354 (6th Cir. 1988), \textit{vacated and remanded} 492 U.S. 902 (1989); Brown-Forman Corp v. Bosanko, No. 87-40321-MP, slip op. (N.D. Fla. Sept. 28, 1989). Numerous other price affirmation laws were declared unconstitutional in state attorneys general opinions or unilateral acts of various beverage control commissions. \textit{See also} Rutledge, \textit{supra} note 126. The matter again came to the Supreme Court in Healy v. Beer Institute, 491 U.S. 324 (1989) \textit{[hereinafter Healy II]}, wherein the Connecticut affirmation statute, amended by the legislature after having been struck down in \textit{Healy I}, was again found to be unconstitutional. \textit{Id.} at 343. In \textit{Healy II}, the Supreme Court addressed a matter sadly not disposed of in Brown-Forman,
Shortly after deciding *Healy II*, the United States Supreme Court decided *North Dakota v. United States*, upholding a state law that implemented a labeling and reporting system for the sale of intoxicating liquor to two Air Force bases over which the state and the federal government shared concurrent jurisdiction.\(^{153}\) Much of the Court’s decision focused on issues of intergovernmental immunity, but the decision also dealt with the relationship between the Commerce Clause and the Twenty-first Amendment.\(^{154}\) The Court held that the labeling and reporting regulations fell under the State’s power to regulate distribution under the Twenty-first Amendment as there was no showing of a burden imposed on the federal government.\(^{155}\) However, the Court did not reach the question of the extent of the states’ powers to regulate the importation of intoxicating liquor.\(^{156}\)

In *Capital Cities Cable, Inc. v. Crisp*,\(^{157}\) Oklahoma’s efforts to require cable broadcasters to strip from their signals advertisements for alcoholic beverages were struck down under the Supremacy Clause.\(^{158}\) The Court held:

> a state regulation squarely conflicts with the accomplishment and execution of the full purposes of federal law, and the State's central power under the Twenty-first Amendment of regulating the times, places, and manner under which liquor may be imported and sold is not directly implicated, the balance between state and federal power tips decisively in favor of the federal law, and enforcement of the state statute is barred by the Supremacy Clause\(^{159}\)

The Supreme Court’s last consideration of the relationship of the Twenty-first Amendment to the balance of the Constitution before *Granholm* was *Liquormart, Inc. v. Rhode Island*.\(^{160}\) The Court reviewed Rhode Island’s prohibition of liquor price advertisements.\(^{161}\) When challenged, Rhode Island
asserted that it had the right to do so under the Twenty-first Amendment.\(^{162}\) The statute was struck down for violation of the retailer’s free speech rights.\(^{163}\)

IV. THE WINE WARS AND THE MOTHER OF ALL BATTLES: \textit{GRANHOLM v. HEALD}\(^{164}\)

The repeal of Prohibition far from opened the door to unfettered commerce in alcohol. When structuring the repeal of Prohibition, Congress had considered demands that the Twenty-first Amendment secure states’ power over alcohol.\(^{165}\) As such, Section 2 of the Twenty-first Amendment granted the states certain powers to regulate intoxicating liquors.\(^{166}\) As already reviewed, the Amendment did not delineate the relationship between itself and the Commerce Clause and any possible burden on interstate commerce.\(^{167}\)

With the end of Prohibition, all states enacted a “three-tier” system in order to maximize their control over what had been the mob-run liquor empires.\(^{168}\) Under the three-tier system, beverage alcohol producers sell exclusively to wholesaler distributors, who in turn sell to retailers, who then sell to the ultimate consumer.\(^{169}\) Participants in the various levels are barred from having financial interests in one another.\(^{170}\) The wholesalers who sell to retailers are barred from ownership at this level.\(^{171}\) Manufacturers were further precluded from owning

\(^{162}\). \textit{Id.} at 515.


\(^{164}\). 125 S.Ct. 1885 (2005).


\(^{166}\). It is oft asserted that Section 2 of the Twenty-first Amendment constitutionalized the Webb-Kenyon Act and that its literal text suggests that it conferred unfettered constitutional authority upon the states to regulate commerce in alcohol. \textit{See Bacchus Imports, Ltd. v. Dias}, 468 U.S. 263, 275 (1984). However, the text is silent on the relationship between Section 2 and the balance of the Constitution. \textit{See id.} (J. White’s opinion states that it is clear that “the [Twenty-first] Amendment did not entirely remove state regulation of alcoholic beverages from the ambit of the Commerce Clause.”).

\(^{167}\). \textit{See supra} notes 99 through 163 and accompanying text.


\(^{169}\). \textit{See North Dakota}, 495 U.S. at 428 (explaining the three-tier system as applied in North Dakota).

\(^{170}\). \textit{See Freedman and Emshwiller, supra} note 12.

\(^{171}\). \textit{Id.}
retailers. Proponents of the three-tier system claimed that it would facilitate tax collection and also prevent underage alcohol purchases.

The “Wine Wars” have arisen out of the rise of small wineries, the contraction of the ranks of wholesalers/distributors, and the disparity that exist between the former’s desire to reach customers and the latter’s focus on larger brands. Smaller wineries, some producing only a few thousand cases per year, simply are not represented by wholesalers. Small wineries have traditionally “hand sold” their wine to vineyard visitors. Obviously, this sales strategy strictly limits the prospective customer base. However, if a sale is made, the vineyard

172. Id.
174. Litigation concerning the anti-direct shipment controversy generated, prior to the Supreme Court’s decision in Granholm v. Heald, 125 S.Ct. 1885 (2005), yielded appellate decisions in six states. Indiana (Bridenbaugh v. Freeman-Wilson, 227 F.3d 848 (7th Cir. 2000)), Florida (Bainbridge v. Turner, 311 F.3d 1104 (11th Cir. 2002)), and New York (Sweedenburg v. Kelly, 358 F.3d 223 (2nd Cir. 2004)) authorized bans on direct shipment under the Twenty-first Amendment. Texas (Dickerson v. Bailey, 336 F.3d 388 (5th Cir. 2003)), North Carolina (Beskind v. Easley, 325 F.3d 506 (4th Cir. 2003)), and Michigan (Heald v. Engler, 342 F.3d 517 (6th Cir. 2003)), found bans violated the Commerce Clause and authorized direct shipment.

175. There are more than thirty-seven hundred wineries in the United States, with over seventeen hundred in California, six in Alaska and one in Delaware. Nick Fauchald, Roster of American Wineries Booms, THE WINE SPECTATOR 14 (Dec. 15, 2004). The advent of the successful American, and in particular, Californian wine industry vis-à-vis the international wine industry can be dated to May 24, 1976 and a wine tasting held in France where leading French oenophiles were invited to a blind tasting of California and French wines. George M. Taber, Message in a Bottle, WALL STREET JOURNAL at A16 (September 22, 2005). Surprising all in attendance, in several categories the California wines prevailed. Id.

Up to that time, the wine world had a blunt hierarchy: France was in a class by itself; and then there was everyone else making interesting but inferior wines. The Spurrier event changed that. Wine makers realized that great wine could be made outside France. As wine critic Robert Parker told me, ‘The Paris Tasting destroyed the myth of French supremacy and marked the democratization of the wine world. It was a water shed in the history of wine.’

Id.

176. As the number of wineries has increased nationwide, the ranks of distributors/wholesalers has shrunk from a high of 20,000 to fewer than 400. See Susan Lorde Martin, Wine Wars - Direct Shipment of Wine: The Twenty-First Amendment, The Commerce Clause, and Consumer Rights, 38 AMERICAN BUSINESS LAW JOURNAL 1, 4 (Fall 2000). The labels “distributor” and wholesaler” are used interchangeably herein.

177. Domaine Alfred, a plaintiff in the Michigan suit decided in Granholm, produces only 3,000 cases per year. Granholm, 125 S. Ct. at 1892. By comparison, Fetzer Vineyards produced 2.2 million cases in its fiscal 2005. Email, T.J. Graven, Brown-Forman Corp., to Thomas Rutledge, author (July 29, 2005) (on file with author). Assuming two hundred fifty work days in the year, Fetzer ships more wine each morning than did Domaine Alfred in a year.


179. See FTC Anticompetitive Barriers at 24.
could hope for repeat sales to that customer.\textsuperscript{180} At the same time, the customer may hope for future supplies of wine shipped to his or her home.\textsuperscript{181} And here the conflict has arisen. Numerous states have adopted laws limiting or entirely precluding shipments, relying upon authority purportedly granted under Section 2 of the Twenty-first Amendment.\textsuperscript{182} The effect of these laws is that if that winery visitor wants more wine upon returning home, in many states he or she may not legally order it from the winery.\textsuperscript{183} A customer in such a state is no longer a potential market for the wineries’ products, and that winery is no longer a possible supplier to that customer. It bears remembering that there is a willing seller and a willing buyer, and that the sole reason that the two will no longer deal is that the distributor, holding a state maintained monopoly or oligopoly position, has not chosen to carry the wineries’ products.\textsuperscript{184}

Wholesalers established an organization called Americans for Responsible Alcohol Access (ARAA) to push for strict prohibition laws which regulate sales and enforcement of those laws, all actions taken in order to protect their coveted monopoly.\textsuperscript{185} Direct-shipment sales effectively bypass wholesalers and represent a direct challenge to their market position.\textsuperscript{186} ARAA asserts the same two justifications as the defendants in the various Wine War cases for the prohibition


\textsuperscript{181} See Granholm, 125 S. Ct. at 1892. See also supra note 17.

\textsuperscript{182} See Granholm, 125 S. Ct. at 1892.

\textsuperscript{183} See, e.g., Michael Barbaro, \textit{Small Wineries May Benefit From Court Ruling}, \textit{Washington Post} (May 17, 2005), 2005 WLNR 7739459:

Every year, tourists pour into the tasting room at Willowcroft Farm Vineyards in Leesburg, Va., sip a glass of the house Riesling, proceed to a cash register and learn that, no, they may not have a case sent to their homes in New York, Michigan, Maryland or other states with restrictive wine shipping laws.

It has further been observed that:

\[\text{Prohibitions on direct shipment to consumers across state lines effectively limit small wineries to on-site visitor sales and intrastate consumer markets. For small wineries seeking to increase their volume, consumer base, and geographic market, direct shipment prohibitions represent a significant obstacle to growth.}\]

\textsuperscript{184} Distributors selfishly guard their position in the three tier system as evidenced by their involvement in the “wine war” cases cited herein. See also Jennifer Dixon, \textit{Illegal Alcohol Imports: Northwest in Hot Water with Wholesalers}, \textit{Detroit Free Press} (February 12, 2005) (2005 WLNR 1988739); Eric Arnold, \textit{Ohio Bill Aims to Cut Mandatory Markups on Wine}, \textit{Wine Spectator} (July 7, 2005).


\textsuperscript{186} See Freedman and Emshwiller, supra note 12.
of direct sales: loss of state tax revenue and impermissible sales to minors. These same concerns would apply to interstate direct shipments of wine as well as intrastate shipments, still some states with prohibition legislation allow intrastate shipments of wine to consumers. It is plain that the motivation behind these prohibition laws is protection of the wholesalers’ monopoly.

The Coalition for Free Trade, an advocacy group that coordinates lawsuits by volunteer lawyers to bring down barriers to interstate shipments, and an organization called “Free the Grapes” represent both the small wineries and consumers interested in receiving those boutique wines available only though the small wineries themselves. Their efforts have met with some success as several states have adopted alternative legislation which has legalized direct interstate sale and shipment to consumers.

States (and the allied wholesaler industry) generally offer two rationales for anti-direct shipment laws. First, the states feel that the legislation will facilitate tax collection from alcohol sales. Out-of-state suppliers are able to avoid the state sales tax by shipping directly to consumers, while in-state suppliers are not able to avoid those same taxes. To the extent untaxed sales are restricted, the purchases that are made pass through the regular, and taxed, three-tier system, providing the basis for sometimes permitting in-state direct shipment.

187. See Apple, Jr., supra note 178.

188. See, e.g., Kim Marcus, Bizarre Coalition Opposes Direct Shipment of Wine, WINE SPECTATOR (Feb. 14, 2005) (“Call it an unholy alliance, or just another example of how politics can make strange bedfellows, but the forces marshaled against the free movement of wine across state lines are truly diverse. The latest coalition unites monopolistic wine and spirits wholesalers with puritanical neo-Prohibitionists.”). Mothers Against Drunk Driving withdrew from ARAA in 1999. See Apple, Jr., supra note 178. The group’s president, Karolyn Nunnallee, said its efforts did not reflect a concern over sales to minors but “a battle between various elements within the alcohol beverages industry.” Id.

189. See Free the Grapes, About Us, at http://www.freethegrapes.org/about_us.html. (last visited Nov. 8, 2005).


191. FTC Anticompetitive Barriers, at 4.

192. Id.

shipment sales while forbidding sales involving shipment from out-of-state.\textsuperscript{194} Second, it is claimed that restrictions on mail-order and Internet sales prevent minors from obtaining access to alcohol.\textsuperscript{195}

Over the course of the Wine Wars, neither the tax revenue nor the access by minors rationales have been found persuasive.\textsuperscript{196} As with other industries, wineries must comply with whatever tax laws are in effect, whether those laws are enacted on a state level or by Congress.\textsuperscript{197} An argument has been made that legislation could authorize direct-shipment conditioned on whether suppliers collect and remit state sales taxes.\textsuperscript{198} For example, the state of Louisiana limits out-of-state shipping to consumers only if the out-of-state winery does not have wholesaler representation in Louisiana\textsuperscript{199} and further requires those wineries to file annual reports with the Louisiana Department of Revenue and Taxation and to remit taxes.\textsuperscript{200}

Similarly, apprehensions about underage purchases of alcohol are unjustified. First, underage drinking has decreased since the early 1980s.\textsuperscript{201} Second, according to National Academy of Sciences’ Institute on Medicine report, young people today prefer beer to other alcoholic beverage choices

\begin{itemize}
\item \textsuperscript{194} FTC Anticompetitive Barriers, at 4.
\item \textsuperscript{195} Recent sting operations were conducted by distributors in Massachusetts and Washington in an attempt to “conjure up the image of teens growing drunk on... chardonnays obtained through a few clicks of the mouse.” See Clint Bolick and Deborah Simpson, Uncorking Freedom: Challenging Protectionist Restraints on Direct Interstate Wine Shipments to Consumers, Institute for Justice Litigation Backgrounder, available at http://www.ij.org/economic_liberty/ny_wine/backgrounder.html. Proponents of the laws also point to a poll sponsored by Americans for Responsible Alcohol Access that found that 85% of Americans believe direct shipment would give minors easier access to alcohol. See Faircloth, supra note 193. Conversely, independent analysis has discarded the notion that direct wine shipment is a realistic source of alcohol by minors. See, e.g., Pacific Institute for Research and Evaluation, Regulatory Strategies for Preventing Youth Access to Alcohol: Best Practices, 13 (1999):
\begin{itemize}
\item No research has been published on the prevalence of young people ordering alcohol through the Internet or by mail order, however, and the risk appears smaller that that for home delivery for at least three reasons: (1) this method of purchase takes a long time (at least a week in most cases); (2) credit cards are usually required; and (3) the products being offered are more likely to be expensive.
\end{itemize}
\textit{See also} FTC Anticompetitive Barriers, at 11.
\item \textsuperscript{197} See id.
\item \textsuperscript{198} See id.
\item \textsuperscript{199} See La. REV. STAT. ANN. § 359(C) (West 2004) (requires direct shippers to report to the state’s Department of Revenue and Taxation.)
\item \textsuperscript{200} A state law allowing direct shipment can require sellers to collect sales tax and forward the revenues to the state. See Boulard, supra note 190.
\end{itemize}
because it is inexpensive. Third, there is little evidence that a serious problem exists regarding mail purchases of wine. In fact, few underage individuals have “the desire, sophistication, financial resources, access to credit cards, and patience necessary to order cases of wine by phone or over the Internet.” The Federal Trade Commission has received and published testimony from states which permit direct-shipping that there are few problems with direct-shipping to minors. The FTC has yet to find a correlation between direct shipping and alcohol consumption by minors.

Following is a review of the types of regulatory systems employed by the states governing inter-state wine shipments. From that background we review the “Wine War” cases leading to Granholm v. Heald.

A. Types of Regulation

All fifty states and the District of Columbia regulate interstate direct sale and shipment of alcohol in some manner. They can be separated into three general categories: reciprocity states, limited direct shipping and permit states, and anti-shipment states.

1. Reciprocity States

There are a total of thirteen reciprocity states. Reciprocity states only allow shipments from other states that afford the same reciprocal privilege. Reciprocal statutes also have the following commonalities: (1) sales are limited to persons over the age of 21, and shipping containers must be clearly marked to indicate that the package cannot be delivered to an individual who is under the legal drinking age or who is intoxicated; (2) shipments made between these states must be for personal consumption only and not for resale; (3) a case shipped cannot contain more than nine liters of product; and (4) reciprocal


203. See, e.g., David P. Sloane, Statement to House Committee on Energy and Commerce (October 30, 2003) (“few, if any problems with interstate shipments of wine to minors.”)

204. Id.

205. See FTC Anticompetitive Barriers, at Appendix B.


207. For a detailed state-by-state analysis of regulatory provisions on direct interstate shipments, see Wine Institute, Analysis of State Laws at http://www.wineinstitute.org/shipwine/ (last checked 11/8/05).

208. Id.

209. Id. The fourteen states are California, Colorado, Hawaii, Idaho, Illinois, Iowa, Minnesota, Missouri, New Mexico, North Dakota, Oregon, Washington, Wisconsin, and West Virginia.

210. Id.
legislation generally applies only to shipments by wineries and not retailers.\textsuperscript{211} Although reciprocity legislation grants those reciprocity states certain privileges, the legislation does not prevent shipments from a reciprocity state to a limited shipment state.

2. Limited Direct Shipment States

A second category of states allow limited direct wine shipments though personal importation laws.\textsuperscript{212} Generally, a personal importation law places some responsibility for compliance with the customer.\textsuperscript{213} Many of these states restrict the quantity of wine available for importing, requiring the out-of-state producer to obtain special permits, or imposing other specific restrictions.\textsuperscript{214} In Nebraska, for example, out-of-state shippers must submit an application fee of $500 to obtain a shipping license.\textsuperscript{215} Generally, these states only allow one-way receipt of product from other states.\textsuperscript{216} Direct shipments may be limited by the buyer’s state by requiring the winery to have a local permit to ensure taxes are paid.\textsuperscript{217} For example, in Wyoming, out-of-state shippers must remit a 12% tax on wine shipments.\textsuperscript{218}

States may also limit shipment to wet-areas only,\textsuperscript{219} or by requiring an initial visit by the consumer to the out-of-state winery.\textsuperscript{220} While various requirements of limited shipment laws impose burdens on trade, such as the required physical visit to the shipping winery, the states still fall short of placing a direct ban on out-of-state shipments.

\begin{itemize}
  \item \textsuperscript{213} See, e.g., NEV. REV. STAT. § 369.490 (2003) (Nevada residents 21 years of age or older permitted to import up to twelve cases of wine per year for household or personal use. Delivery must be accepted by an adult.)
  \item \textsuperscript{214} FTC Anticompetitive Barriers, at 15.
  \item \textsuperscript{215} NEB. REV. STAT. §§ 53-123.15, 53-124 (2001). See also MONT. CODE ANN. § 16-4-801 (2001) (requiring that a consumer obtain a state-issued “connoisseur’s permit” for $50 to receive out-of-state shipments.)
  \item \textsuperscript{216} See FTC Anticompetitive Barriers, at 15 - 16.
  \item \textsuperscript{217} See, e.g., WYO. STAT. ANN. § 12-2-204 (West 2001)
  \item \textsuperscript{218} Id.
  \item \textsuperscript{219} See, e.g. ALASKA STAT. § 04.11.010 (West 2004). Alaska permits its communities to restrict sales/shipments of alcohol by way of local election. Id. It is illegal to ship to those dry communities. Id.
  \item \textsuperscript{220} See, e.g., R.I. GEN. LAWS § 3-4-8 (2004) (permitting out-of-state wineries to ship wine orders that are personally placed by the purchaser at the manufacture’s premises, for shipment to an address in Rhode Island, for non-business purposes).
\end{itemize}
3. Anti-direct Shipment States

The remaining states fall into the category of expressly prohibiting direct shipment whereby direct-to-consumer wine shipments are outlawed.\(^{221}\) Of these states, seven authorize felony punishment of suppliers who violate their direct shipment laws.\(^{222}\) Most of these express prohibition states will not allow even consumers who visit wineries in other states to ship wine, purchased in that foreign state, to their home state.\(^{223}\) To add insult to injury, most if not all of these states will allow in-state wineries to ship directly to consumers.\(^{224}\)

Supposedly, all sales which occur in states with a “three-tier” system must go though the liquor wholesaler before reaching the retailer and final consumer.\(^{225}\) The wholesaler’s margin on wine sold to retailers is eighteen to twenty-five percent.\(^{226}\) Needless to say, wholesaling is big business\(^{227}\) and direct-shipment laws threaten to decrease their revenues.

B. The Wine Shipment Cases Leading to Granholm v. Heald

Before reviewing the Supreme Court’s decision in *Granholm v. Heald*, a review of the recent Court of Appeals decisions on the types of questions presented to the Court is in order.\(^{228}\) We say “types of questions” advisedly - state statutes in this area are unique, and it is upon those wording distinctions that Constitutional distinctions may be drawn.

\(^{221}\) See *State Shipping Laws*, at http://www.wineinstitute.org/shipwine. There are currently twenty express prohibition states: Alabama, Arkansas, Delaware, Florida, Indiana, Kansas, Kentucky, Maine, Maryland, Massachusetts, Michigan, Mississippi, Montana, New Jersey, Oklahoma, Pennsylvania, South Dakota, Tennessee, Utah, and Vermont. Id.

\(^{222}\) Id. The seven felony states are Florida, Georgia, Indiana, Kentucky, Maryland, Tennessee, and Utah.


\(^{224}\) See id.

\(^{225}\) See id.

\(^{226}\) Freedman and Emshwiller, *supra* note 12.

\(^{227}\) The largest wholesaler, Miami-based Southern Wine and Spirits, which does business in twelve states, generates about $2.3 billion in annual revenues, compared to the total amount of direct wine shipments valued at $300 million annually. See James W. Sweeney, *Wholesalers Go Head-to-Head*, DAILY PRESS, August 9, 1998, at E4. See also Associated Press, *Congress Eyes Curb on Online Wine Sales*, ATLANTA JOURNAL, October 12, 1999, at D7; R.W. Apple, Jr., *Order Wine on the Web? Check Laws*, SUN-SENTINEL (Ft. Lauderdale, Florida), May 27, 1999, at 9.

\(^{228}\) The cases are presented in chronological order by date of ruling.
1. Indiana (Seventh Circuit)

Indiana law provides that it is unlawful for a person who sells alcoholic beverages in another state to ship such product directly to consumers in Indiana, while Indiana sellers may do so. The Seventh Circuit, in Bridenbaugh v. Freeman-Wilson, confronted the relationship between the Twenty-first Amendment and the dormant Commerce Clause to determine “how the combination of express grant and implied withdrawal of state power applies to [Indiana’s code].”

The challenged section of Indiana’s code provides that it is “unlawful for a person in the business of selling alcoholic beverages in another state or country to ship or cause to be shipped an alcoholic beverage directly to an Indiana resident who does not hold a valid wholesaler permit.” Indiana, like most states, uses a three-tiered system of alcohol distribution which requires a different class of permit for each level of distribution. This distribution system is meant to foster “orderly market conditions” that facilitate tax collection and reduce market competition. Indiana permits local wineries, but not wineries from another state, to ship directly to Indiana consumers.

The court acknowledged that states may not use their power under Section 2 of the Twenty-first Amendment to discriminate against out-of-state sellers in favor of in-state sellers. Using cases such as Brown-Forman and Bacchus to see the “unconstitutional-conditions approach” use of the Twenty-first Amendment as “eliminating economic discrimination against in-state commerce, . . . without authorizing discrimination against out-of-state sellers,” the court determined that the Twenty-first Amendment “enables a state to do to importation of liquor - including direct deliveries to consumers in original

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229. Bridenbaugh v. Freeman-Wilson, 227 F.3d 848, 849 (7th Cir. 2000); IND. CODE ANN. § 7.1-5-11-1.5 (2004) states that it is unlawful to ship an alcoholic beverage to an Indiana resident who does not hold a wholesaler permit:
   (a) It is unlawful for a person in the business of selling alcoholic beverages in another state or country to ship or cause to be shipped an alcoholic beverage directly to an Indiana resident who does not hold a valid wholesaler permit under this title. This includes the ordering and selling of alcoholic beverages over a computer network (as defined by IC 35-43-2-3 (a)).
   (b) Upon a determination by the commission that a person has violated subsection (a), a wholesaler may not accept a shipment of alcoholic beverages from the person for a period of up to one (1) year as determined by the commission.
   (c) The commission shall adopt rules under IC 4-22-2 to implement this section.

230. Bridenbaugh, 227 F.3d at 849.
232. Bridenbaugh, 227 F.3d at 851.
233. Id.
234. Id.
235. Id. at 853.
236. Bridenbaugh, 227 F.3d at 853.
packages - what it chooses to do to internal sales of liquor, but nothing more." Because Indiana’s Code regulates importation of the sort which prompted the Webb-Kenyon Act, the predecessor of Section 2 of the Twenty-first Amendment, the challenged section therefore falls within the state’s power. The court determined that the section is constitutional unless Indiana has imposed a discriminatory condition on importation, such as in Bacchus, which would favor Indiana sources of alcohol over sources from out-of-state. The court reasoned that all alcohol, wherever produced, must pass through the three-tiered system and be taxed, thus the law did not discriminate between in-state sellers and out-of-state sellers. However, the court failed to explain how shipment from an in-state source passed through the three-tiered system; in fact direct shipment by definition would imply that the shipment bypasses the wholesaler and retailers. Indeed, the court even recognized other anomalies in the Indiana Code.

2. Florida (Eleventh Circuit)

Unlike the Indiana case, which did not involve an out-of-state seller complainant, the Florida court in Bainbridge v. Bush dealt with out-of-state wineries who challenged the constitutionality of Florida’s direct shipment law as violative of the Commerce Clause. Florida’s direct shipment law provided that it is unlawful for any person in the business of selling alcoholic beverages to knowingly ship alcoholic beverages from an out-of-state location directly to any person in this state who does not hold a valid manufacturer’s or wholesaler’s license.

237. Id.
238. Id. at 853.
239. Id.
240. Id. at 854.
241. Bridenbaugh, 227 F.3d at 854.
242. Id. For example, a permitted Indiana wine retailer who is also in the business of selling alcohol in Illinois is permitted to ship directly to Indiana consumers under IND. CODE ANN. § 7.1-3-14-4(c) (2005), but at the same time is forbidden to ship directly to Indiana consumers under IND. CODE ANN. § 7.1-5-11-1.5 (2005). The Bridenbaugh court left it to Indiana’s judiciary to reconcile the anomaly given that the plaintiffs are only concerned with direct shipments from out-of-state sources who do not have an Indiana permit, nor do they especially want one. Id.
243. Plaintiffs in Bridenbaugh were consumers not “in the business of selling alcoholic beverages” and therefore could not violate IND. CODE ANN. § 7.1-5-11-1.5(a) (2005). As such, the court first had to determine whether plaintiffs had standing to challenge the particular section. The court found injury in fact to the plaintiffs and granted them standing. Id. at 849-850.
245. FLA. STAT. ANN. §§ 561.54(1)-(2), 561.545(1) (West 2005).
246. See FLA. STAT. ANN. §§ 561.54(1-2); 561.545(1) (West 2005). Section 561.545 specifically states:

The Legislature finds that the direct shipment of alcoholic beverages by persons in the business of selling alcoholic beverages to residents of this state in violation of the Beverage Law poses a serious threat to the public health, safety, and welfare; to state revenue collections; and to the economy of the
Following the Supreme Court’s two-tiered analysis, the district court first determined whether the challenged statutes violated the Commerce Clause, and then, if it was found to violate the Commerce Clause, whether the statutes were saved by the Twenty-first Amendment. The court found that Florida’s direct shipment law discriminated against out-of-state wineries in favor of in-state wineries by expressly prohibiting out-of-state wineries from shipping their wine to non-licensed Florida residents. Although the court concluded that the statutes violated the Commerce Clause, the court went on to find that the statute is specifically within the ambit of the state’s power to regulate alcoholic beverages under the Twenty-first Amendment. Specifically, the court found Florida enacted the law to address perceived threats, and therefore was upheld. The court further reasoned that, although the Florida direct shipment law may have discriminatory overtones, the State would lose its ability to tax alcoholic beverages without the law in place. The court therefore upheld the statutory scheme as permissible regulation under the Twenty-first Amendment.

The Eleventh Circuit Court of Appeals applied the same analysis as the district court but concluded the record did not clearly demonstrate the ban on direct shipment was closely related to a core concern of the Twenty-first Amendment. Like the district court, the Court of Appeals found the Florida law facially discriminatory because in-state wineries can ship directly to a

state. The Legislature further finds that the penalties for illegal direct shipment of alcoholic beverages to residents of this state should be made adequate to ensure compliance with the Beverage Law and that the measures provided for in this section are fully consistent with the powers conferred upon the state by the Twenty-first Amendment to the United States Constitution.

FLA. STAT. ANN. § 561.545 (West 2005).


249. Id. at 1311. The court additionally notes that Florida’s statutory scheme has the “practical effect of preventing many small [out-of-state] wineries from selling their wine in Florida,” because it is not cost-effective for the wineries to purchase a Florida wholesaler. Id. n.7.

250. Id. at 1312.

251. Id. at 1313.

252. Bainbridge, 147 F.Supp.2d at 1313-1314. The perceived threats were to the public health, safety, and welfare, to state revenue collections, and to preserve the economy of the state, all of which are legitimate concerns protected by the Twenty-first Amendment. Compare, Bainbridge with, Bridenbaugh v. Freeman-Wilson, 227 F.3d 848, 851 (7th Cir. 2000), where the court looked to North Dakota v. United States, 495 U.S. 423, 432 (1990), to find the expanded understanding of what are the “core concerns” of the Twenty-first Amendment. Id. The “core concerns” analysis used by the Florida court is drastically different from the Seventh Circuit’s historical analysis application of Section 2 of the Twenty-first Amendment. Bainbridge, 147 F.Supp.2d at 1313.

253. Id.

254. Id.

255. Id. at 1315.

256. Bainbridge v. Turner, 311 F.3d 1104, 1106, 1115 (11th Cir. 2002).
consumer but out-of-state wineries are banned and found that because Florida’s legitimate interest in generating revenue could be served by a nondiscriminatory alternative, the district court had misapplied the two-tiered analysis. The Court of Appeals next examined whether the law was saved by the Twenty-first Amendment under the North Dakota “core concern” test: “Before the State can successfully raise the Twenty-first Amendment as a shield, it must show that its statutory scheme is necessary to effectuate the proffered core concern in a way that justifies treating out-of-state firms differently from in-state firms.” The Court of Appeals found that the state failed to show as a matter of law that the challenged statutes are sufficiently related to the core concern of raising revenue so as to survive the Commerce Clause analysis; the judgment of the district court was vacated and the case was remanded for further consideration.

3. Texas (Fifth Circuit)

Texas, like Indiana and Florida, prohibits out-of-state wineries from directly shipping alcohol to consumers while Texas wineries are permitted to do so. The trial court in Dickerson v. Bailey tackled the constitutionality of the state law which prohibited Texans from importing for personal consumption more than three gallons of wine without a permit, unless that resident personally transported the wine into the state. Initially, the district court held that the

257. Id. at 1109. The panel noted that, under Florida’s law, domestic producers must ship by their own or by leased vehicles and cannot use common carriers. Id. Thus, even if Florida’s law is unconstitutional, out-of-state producers could not ship by common carrier such as Federal Express. Id. It would seem impractical for distant producers to ship to Florida via their own or leased vehicles, so this is an meaningless victory for the consumer.

258. Id. at 1110. The Court of Appeals also noted that the state’s concern about alcohol sales to minors could be achieve by an alternative, namely by imposing labeling requirements and enforcing criminal penalties.

259. Id. at 1114-1115.

260. Bainbridge, 311 F.3d at 1115-16.


(a) A Texas resident may import for his own personal use not more than three gallons of wine without being required to hold a permit. . . . A person importing wine . . . under this subsection must personally accompany the wine . . . as it enters the state.

(f) . . . Any person in the business of selling alcoholic beverages in another state or country who ships or causes to be shipped any alcoholic beverage directly to any Texas resident under this section is in violation of this code.

Any § 107.07 violation is punishable as crimes under § 1.05. Tex. Alco. Bever. Code Ann. § 1.05.
Texas law violated the Commerce Clause and was not saved by the Twenty-first Amendment because it failed to serve a core concern which the Amendment was intended to protect. The court looked at the evolution of state liquor regulations, followed by an analysis of the relationship between the Commerce Clause and the Twenty-first Amendment, and found that there is “no bright line between federal and state powers over liquor.” Using the Supreme Court’s two-tiered balancing test, the court found that the statute facially discriminated against out-of-state wineries by requiring them to go through Texas retailers in order to reach consumers as direct shipments to consumers was prohibited. The statutory scheme benefited Texas wholesalers and retailers while negatively impacting Texas consumers through a limited wine selection and higher prices for wines. Because the statute protects in-state liquor wholesalers and retailers at the expense of interstate trade, the court applied the stricter rule of invalidity found in *Bacchus*. The court found that the state of Texas did not provide a legitimate local interest that could not have been preserved by other non-discriminatory means. Finally, the court looked to whether the statute was saved by the Twenty-first Amendment, and found that the statute served no particular temperance goal since “Texas residents can become as drunk on local wines or on wines of large out-of-state suppliers able to pass into the state through its distribution system.” Therefore, the Twenty-first Amendment did not save the statute from being declared unconstitutional under the dormant Commerce Clause.

However, when Indiana’s decision was published, Texas was moved to reconsider its district court decision on appeal. There were several facets of

266. *Id.* quoting *Capital Cities Cable, Inc. v. Crisp*, 467 U.S. 691, 714 (1984). The court is to determine “whether the interests implicated by a state regulation are so closely related to the powers reserved by the Twenty-first Amendment that the state regulation may prevail, notwithstanding that its requirements directly conflict with express federal policies.” *Id.* The courts have increasingly stressed federal interests and scrutinized the actual purpose behind the state’s law. *Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263, 275 (1984).
268. *Id.* at 710.
269. *Id.* The court uses *Bacchus*, as opposed to the more flexible approach in *Pike*, in considering the practical effect and relative burden on interstate commerce, looks to whether legitimate state objectives are credibly advanced, whether there is patent discrimination against interstate commerce, and whether the effect on interstate commerce is direct or incidental. *Bacchus*, 468 U.S. at 270, citing *Philadelphia v. New Jersey*, 437 U.S. 617, 624 (1978).
270. *Dickerson*, 87 F.Supp.2d at 710.
271. *Id.*
272. Dickerson v. Bailey, 212 F.Supp.2d 673, 675-77 (S.D. Tex. 2002). The Seventh Circuit reversed a district court case upon which the Texas district court relied in forming its judgment. *Bridenbaugh v. O'Bannon* 78 F.Supp.2d 828 (N.D.Ind. 1999) (holding that the statute violated the Commerce Clause because permits to distribute alcohol in Indiana were not given to out-of-state residents and that the statute’s purpose was not temperance, the core concern of the Twenty-first
the Indiana decision about which the Texas court was skeptical. First, the Seventh Circuit’s reliance upon the text and history of the Twenty-first Amendment and its relationship with the Commerce Clause was unreliable. Second, the Seventh Circuit failed to follow Supreme Court precedent which requires that a facially discriminatory state regulation of alcohol must be closely related to a core concern of the Twenty-first Amendment. The Seventh Circuit also failed to address the fact that in-state retailers could deliver wine directly to consumers, but that out-of-state wineries had to go through licensed Indiana wholesalers. The Texas court found solace when noting that Florida’s court went through the same analysis as the district court.

The court noted that recent Supreme Court decisions interpreted the Twenty-first Amendment with the Commerce Clause, rather than literally interpreting the Twenty-first Amendment as not limited by the dormant Commerce Clause. Further, the state of Texas failed to show either that the economic advantage given in-state producers served a core concern of the Twenty-first Amendment, or that there was no available non-discriminatory alternative regulation. Once again, the district court, upon reconsideration, found that the Texas statute discriminated against interstate commerce and was not saved by the Twenty-first Amendment. The defendants appealed to the

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273. Dickerson, 212 F.3d at 681-82. First, the court in Bridenbaugh recognized that the view of the Twenty-first Amendment has undergone modification in recognition of some significant limitations placed on the states’ regulation of the importation and distribution of alcohol by the commerce clause, among other constitutional provisions. See, e.g., Bacchus, 468 U.S. at 274 (“Despite broad language in some of the opinions of this Court written shortly after ratification of the Amendment, more recently we have recognized the obscurity of the legislative history of § 2 . . . . No clear consensus concerning the meaning of the provision is apparent.”) (citations and footnotes omitted). Second, Judge Easterbrook did not discuss the last forty years of Supreme Court jurisprudence relating to the balancing and harmonizing of the dormant Commerce Clause and the Twenty-first Amendment, thereby rejecting the “core concerns” analysis under the Twenty-first Amendment. Dickerson, 212 F.Supp.2d at 682. Finally, the legislative history of the ratification debates fails to reveal clearly any unified Congressional intent in enacting the section. Id. at 680-81. The Seventh Circuit resolved this challenge by narrowly construing Section 2 of the Twenty-first Amendment and focusing on what he viewed as Indiana’s absolute right under the Twenty-first Amendment to regulate the importation and distribution of liquor to establish its three-tier system in order to collect tax revenue. Id. at 695.

274. Id. at 682.

275. Id. at 685-686.

276. Dickerson, 212 F.Supp.2d at 687. The Florida court in Bainbridge v. Bush, 148 F.Supp.2d 1306, 1310 (M.D. Fla. 2001), citing Dickerson v. Bailey, 87 F.Supp.2d 691, 693 n.2 (S.D.Tex. 2000), applied the same analysis as the Texas district court did in examining (1) whether Florida’s statute violated the Commerce Clause, and if so, (2) whether the statute was saved by the Twenty-first Amendment.

277. Id. at 694.

278. Id. at 695.

279. Id.
Fifth Circuit where Judge Weiner held that the challenged statute violated the Commerce Clause and that the Twenty-First Amendment did not save the “economically discriminatory provisions” of the Texas statutory scheme.\footnote{280} The Fifth Circuit therefore reaffirmed its district court decision that the Texas ban on direct-shipment from out-of-state wineries is in violation of the Commerce Clause.\footnote{281}

4. North Carolina (Fourth Circuit)

North Carolina is another state which prohibited direct shipment to consumers from an out-of-state winery while permitting in-state wineries to do so.\footnote{282} Eight North Carolina residents, a California winery, and a Michigan resident filed an action challenging the constitutionality of the North Carolina law.\footnote{283} North Carolina, like many other states, regulates the distribution of alcohol through a three-tiered system.\footnote{284} While most alcohol passes through the three tiers, local wine is exempted from this distribution protocol.\footnote{285} North Carolina’s alcoholic beverage code states that it is unlawful to “manufacture, sell, transport, import, deliver, furnish, purchase, consume, or possess any alcoholic beverages except as authorized by the ABC law,” and the direct shipment of alcohol from out-of-state sources to in-state residents is prohibited.\footnote{286} However, North Carolina wineries are exempted from this

\footnote{280} Dickerson v. Bailey, 336 F.3d 388, 410 (5th Cir. 2003).
\footnote{281} Id. at 398. “[T]hat which we call discrimination by any other name would still smell as foul.” Id. The Fifth Circuit found it patently obvious that the Texas statute allows in-state wineries to circumvent the state’s three-tiered distribution system, and both sell and ship directly to consumers, while preventing out-of-state wineries the same privileges. Id. The Fifth Circuit also noted that Judge Easterbrook in Bridenbaugh properly interpreted the relationship between the dormant Commerce Clause and the Twenty-first Amendment. Id. at 401. Unlike the Florida and Texas courts, the Seventh Circuit did not confront the issue of whether the statute discriminated against out-of-state wineries, rather the court confronted out-of-state wineries who were seeking the same “preferential benefits that Texas grants to its in-state wineries.” Id. The exemptions sought in Bridenbaugh were not granted to in-state competition. Id. Therefore, had Judge Easterbrook granted the out-of-state wineries the ability to circumvent the three-tiered distribution system, out-of-state wineries would have had a trade advantage over in-state wineries. Id.
\footnote{283} Beskind v. Easley, 197 F.Supp.2d 464, 475-76 (W.D. N.C. 2002) aff’d in part, vacated in part, 325 F.3d 506 (4th Cir. 2003) (upholding the district court’s conclusion that North Carolina’s ABC laws unconstitutionally discriminated against interstate commerce, but vacating its judgment insofar as it declared five statutes unconstitutional and enjoined their enforcement). Specifically, the California winery would violate N.C. GEN. STAT. §§ 18B-102(a) and 102.1(a) if they filled the shipping requests of a North Carolina resident, and the Michigan resident who would send gifts of wine to family in North Carolina would be in violation of N.C. GEN. STAT. §§ 18B-102(a) and 18B-109(a). Id. at 466 n.1 and n.2.
\footnote{284} Id. at 466.
\footnote{285} Id.
prohibition on direct shipment and may circumvent both the wholesalers and the retailers and sell direct to consumers.\textsuperscript{287}

The court first concluded that the regulation was a “relatively cut and dry example” of direct discrimination on out-of-state wineries.\textsuperscript{288} The court then applied the established Twenty-first Amendment core concern analysis and concluded that the state had not provided any reason for the favoritism provided to in-state wineries.\textsuperscript{289} Although the state proffered numerous legitimate reasons for the existence of the alcohol beverage code, such as efficient administration of tax collection, safety, etc., the state failed to show sufficient reason for the exception of in-state wineries.\textsuperscript{290} Therefore, the court reasoned that economic protectionism is the most likely explanation for the system, and held the law in violation of the Commerce Clause.\textsuperscript{291}

Like the district court in Texas, this court also assessed the implications of Indiana’s decision. However, rather than criticizing the decision, this court distinguished the Indiana case on the facts.\textsuperscript{292} Indiana had determined its law was not discriminatory because, although it prohibited direct shipment from an out-of-state winery, the law applied equally to in-state sources; all alcohol must pass through Indiana’s three-tiered system.\textsuperscript{293} North Carolina law, on the other hand, favored in-state wineries over out-of-state wineries by allowing the former to ship directly to consumers, but not the latter.\textsuperscript{294}

The Court of Appeals approached its review in the same analytical framework established by the Supreme Court.\textsuperscript{295} The court agreed that a facial examination of North Carolina law leaves no doubt that in-state wineries are protected and in fact benefit from its existence, while out-of-state manufacturers are burdened.\textsuperscript{296} The court agreed that such discrimination violates “a central

\textsuperscript{287} N.C. GEN. STAT. §§ 18B-1001(4), 1101 (2005); Beskind, 197 F.Supp.2d at 467.

\textsuperscript{288} Beskind, 197 F.Supp.2d at 471. The district court noted that, in theory, the law permitted consumers to purchase wine directly from out-of-state producers. Id. However, since the process for doing so was so cumbersome, the law had a “chilling effect” on such purchases and thereby placed a “greater burden on goods produced out-of-state than on goods produced in-state.” Id.

\textsuperscript{289} Id. at 472-74.

\textsuperscript{290} Id. at 474.

\textsuperscript{291} Beskind, 197 F.Supp.2d at 475-76.

\textsuperscript{292} Id. at 474.

\textsuperscript{293} Id. at 474-75.

\textsuperscript{294} Id. at 475.

\textsuperscript{295} Beskind v. Easley, 325 F.3d 506, 513-14 (4th Cir. 2003). In contrast, the analytical approach of the Seventh Circuit used the “text and history” to supply the context for § 2. See Bridenbaugh v. Freeman-Wilson, 227 F.3d 848, 851 (7th Cir. 2000).

\textsuperscript{296} Id. at 515. Out-of-state wineries shipping wine into North Carolina, although authorized to operate under a nonresident wine vendor permit, must still sell their products to a licensed wholesaler in the State and have that wine distributed only through North Carolina’s three-tiered structure. N.C. GEN. STAT. §§ 18B-1114, 18B-102.1, 18B-1101(3) (2005). Also, North Carolina’s ABC laws expressly forbid the direct shipment of wine from out-of-state sources to North Carolina residents who are not licensed wholesalers. N.C. GEN. STAT. §§ 18B-1114, 18B-102.1, 18B-1101(3) (2005). In contrast, licensed in-state wineries may sell directly to consumers without
tenet of the Commerce Clause.\textsuperscript{297} Additionally, the court recognized that there were two non-discriminatory alternatives available: ban in-state direct shipment of wine, or permit direct shipment from an out-of-state winery to a particular location in order to ensure tax collection.\textsuperscript{298} Thus, the question remained whether the discriminatory code served a core concern of the Twenty-first Amendment.\textsuperscript{299} The State, “[w]hen pressed for an explanation for th[e] discriminatory treatment, other than the promotion of local industry and protectionism,” only offered that it was possible to regulate in-state wineries without the three-tiered system, as opposed to out-of-state wineries.\textsuperscript{300} The State posited that direct sales, albeit from in-state wineries, were as tightly regulated as the three-tiered system; the Fourth Circuit found that the State’s rationale undercut the very purpose of the three-tiered system.\textsuperscript{301} The Court then concluded that the statutes did not promote a Twenty-first Amendment core concern.\textsuperscript{302}

The Court of Appeals decided that the appropriate remedy was to remove the provision creating a local preference, and leave in place the three-tiered system.\textsuperscript{303} It reasoned that the State would wish for the court to take the least destructive course for the current regulatory scheme which had been put in place pursuant to its powers under the Twenty-first Amendment.\textsuperscript{304} Although this decision frustrated the plaintiffs in their quest for boutique wine, the decision was soundly based on the plaintiff’s right to challenge discriminatory interstate trade practices.\textsuperscript{305}

5. Michigan (Sixth Circuit)

Michigan, like the other states thus far discussed, also prohibited out-of-state wineries from shipping directly to Michigan residents, but allowed Michigan
The Sixth Circuit applied the “traditional” dormant Commerce Clause analysis, and held that the State had both discriminated against out-of-state wineries in violation of the Commerce Clause, and failed to advance the Twenty-first Amendment through its regulatory scheme. The court considered the following facts as suggestive that Michigan’s laws were discriminatory. First, Michigan wineries could avoid the price mark-ups of wholesalers and retailers, whereas out-of-state wineries could not avoid the three-tiered distribution system and its inherent price mark-ups. Second, licenses for out-of-state wineries to sell to wholesalers and retailers were substantially more expensive than licenses for Michigan wineries. Finally, Michigan wineries had greater access to the

306. See Heald v. Engler, 2001 U.S. Dist. LEXIS 24826, No. 00-CV-71438-DT (E.D. Mich. 2001)(unreported), rev’d, 342 F.3d 517, 521 (6th Cir. 2003). The district court noted that this distinction between in-state and out-of-state wineries could only be understood by reading a number of provisions in conjunction with each other. Id. at *4, n.1.


308. Id. at 525. See also Bainbridge v. Turner, 311 F.3d 1104, 1108 (11th Cir. 2002); Dickerson v. Bailey, 336 F.3d 388, 400 (5th Cir. 2003); Beskind v. Easley, 325 F.3d 506, 514 (4th Cir. 2003).

309. Heald, 342 F.3d at 527.

310. Id. at 521, 525.

311. Id. at 521. The cost of a license to an out-of-state winery that enables it to sell to a Michigan wholesaler is $300, while an in-state winery need only purchase a $25 licensing fee that will enable the winery to ship directly to Michigan residents. Id.
Michigan consumer market via direct-to-consumer shipments.\textsuperscript{312} The court further found that the State had provided no evidence that would show that the discrimination would advance the core state powers reserved by the Twenty-first Amendment.\textsuperscript{313} As such, the Sixth Circuit reversed the district court’s judgment and remanded the case with instructions to enter judgment for the plaintiff.\textsuperscript{314}

6. New York (Second Circuit)

New York’s district court also confronted a “Wine War” case, brought by both out-of-state wineries and in-state consumers, which challenged the constitutionality of the State’s Alcohol Beverage Control Law §102(1)(a), which involved a First Amendment challenge, and §102(1)(c), which required that all shipment of wine into New York go through a licensed individual.\textsuperscript{315} New York’s alcohol beverage code also contains the following exceptions to the three-tiered distribution system: (i) a “farm-winery” exception that allows in-state farm wineries to ship directly to consumers;\textsuperscript{316} (ii) an exception that allows in-state wineries to make a direct delivery to consumers for another in-state winery;\textsuperscript{317} (iii) an exception for in-state commercial wineries to obtain an additional license of retail which permits direct sales and shipments to consumers;\textsuperscript{318} and (iv) an exception which permits delivery in vehicles owned by a licensed in-state winery or hired from a trucking company registered with New York’s liquor authority.\textsuperscript{319} Using the two-step approach established by the Supreme Court to determine whether a law violates the dormant Commerce Clause, the court first determined that the law is facially discriminatory.\textsuperscript{320} Then, the court determined whether the law was saved by the Twenty-first Amendment, and found that the law failed to satisfy the Twenty-first Amendment core temperance concern.\textsuperscript{321} The court recognized the central concern of temperance (specifically, prohibiting alcohol sales to minors), but

\begin{itemize}
\item \textsuperscript{312} Id.
\item \textsuperscript{313} Heald, 342 F.3d at 527.
\item \textsuperscript{314} Id. at 527-28. The Sixth Circuit absolved the district court by simply stating that the district court, in its analysis of Supreme Court jurisprudence, placed too much reliance on precedent that specifically upheld the three-tier distribution system as constitutional. Id. at 526; see also North Dakota v. United States, 495 U.S. 423, 431 (1990). Although the district court recognized that Michigan’s distribution system discriminated against out-of-state wineries, the emphasis on North Dakota led the court to conclude that the distribution system was constitutional, and “cannot be characterized as ‘mere economic protectionism,’” because the system furthered a Twenty-first Amendment “core concern.” Id. at 527. Instead, the district court should have conducted the Supreme Court’s more current two-tiered analysis. Id.
\item \textsuperscript{316} N.Y. ALCO. BEV. CONT. LAW § 76-a (McKinney 2005).
\item \textsuperscript{317} Id.
\item \textsuperscript{318} N.Y. ALCO. BEV. CONT. LAW § 76 (McKinney 2005).
\item \textsuperscript{319} N.Y. ALCO. BEV. CONT. LAW § 105-9 (McKinney 2005).
\item \textsuperscript{320} Sweedenburg, 232 F.Supp.2d at 145.
\item \textsuperscript{321} Id. at 148.
\end{itemize}
concluded that there are non-discriminatory alternatives available, such as licensing and regulating out-of-state wineries. The court further found that the State failed to provide evidence that taxes on out-of-state sales could not be collected through a non-discriminatory alternative. Summary judgment therefore was granted for the plaintiffs.

On appeal, the Second Circuit reversed, holding that the direct shipment regulations fell within the authority afforded the state by the Twenty-first Amendment. The court applied the same analytical approach the Seventh Circuit used in Bridenbaugh, in which the inquiry is based on the manner in which the Twenty-first Amendment impacts the dormant Commerce Clause. The Second Circuit noted that their inquiry should be sensitive to the interaction of the Twenty-first Amendment and the Commerce Clause, specifically in light of the impact the Twenty-first has on the dormant Commerce Clause. The Second Circuit court openly disagreed with the Supreme Court’s precedent that the state power is limited to only the core concerns advanced by the Twenty-first Amendment and that the Twenty-first Amendment is subordinate to the dormant Commerce Clause when the two provisions conflict. Taking the position that Section two of the Twenty-first Amendment specifically permits states to circumvent the dormant Commerce Clause providing that the authorities only regulate the “intrastate flow of alcohol,” the court felt that New York’s regulatory regime was well within the State’s authority under the Twenty-first Amendment. Additionally, the court could find no facts that suggested that New York’s regulations favored local interests over out-of-state interests since all wineries are permitted to obtain a license to ship directly to consumers so

322. *Id.* at 148-49.
323. *Id.* at 148. The court also expressed doubt that raising revenue was a central concern of the Twenty-first Amendment. *Id.*
325. *Swedenburg v. Kelly,* 358 F.3d 223, 239 (2nd Cir. 2004). The court also held that New York’s regulatory scheme does not violate the Privileges and Immunities Clause. *Id.* at 240. However, section 102(1)(a) of N.Y. ALC. BEV. CONT. LAW, insofar as it prohibits all commercial speech pertaining to the sale of alcoholic beverages directed to New York consumers by unlicensed entities, was held as violative of the First Amendment of the U.S. Constitution. *Id.* at 227.
326. *Id.* at 231.
327. *Id.* “This [Twenty-first Amendment] grant of authority should not, we think, be subordinated to the dormant Commerce Clause inquiry when the two provisions conflict.” *Id.* at 233.
328. *Swedenburg,* 358 F.3d. at 233. The court felt that the Supreme Court’s Twenty-first Amendment jurisprudence has only limited Section 2’s authority to its plain language, meaning that “a state may regulate the importation of alcohol for distribution and use within its borders, but may not intrude upon federal authority to regulate beyond the state’s borders or to preserve fundamental rights.” *Id.* The court even goes so far as to say that “the drafters of the Twenty-first Amendment crafted section 2 to allow states . . . to circumvent dormant Commerce Clause protections, provided that they were regulating the intrastate flow of alcohol.” *Id.* at 237.
329. *Id.*
long as there is a physical presence in the state.\textsuperscript{330} New York requires “that all wine be shipped through a New York warehouse” as a prerequisite to direct shipments to consumers.\textsuperscript{331} Thus the court reversed part of the district court’s decision which ruled the State’s law as unconstitutional in light of the Commerce Clause.\textsuperscript{332} The Supreme Court granted certiorari and the case was heard in the October 2004 term concurrently with the Michigan case.\textsuperscript{333}

C. The Supreme Court - Granholm v. Heald

Granholm v. Heald\textsuperscript{334} consolidated and decided challenges to the constitutionality of aspects of the Michigan and New York statutes governing intra and interstate wine shipment. Justice Kennedy, writing for five Justices,\textsuperscript{335} summarized the issue as follows:

These consolidated cases present challenges to state laws regulating the sale of wine from out-of-state wineries to consumers in Michigan and New York. The details and mechanics of the two regulatory schemes differ, but the object and effect of the laws are the same: to allow in-state wineries to sell wine directly to consumers in that State but to prohibit out-of-state wineries from doing so, or, at the least, to make direct sales impractical from an economic standpoint. It is evident that the object and design of the Michigan and New York statutes is to grant in-state wineries a competitive advantage over wineries located beyond the States’ borders.\textsuperscript{336}

\textsuperscript{330} Swedenburg, 358 F.3d at 233. The court, however, recognized that the same “physical presence” regulatory scheme, as applied to any commodity other than alcohol, would generate a dormant Commerce Clause problem. \textit{Id}.

\textsuperscript{331} Id. at 238. Even though out-of-state wineries will incur costs associated with establishing a presence in New York, a cost that an in-state winery can and does avoid, all wine must pass through a New York warehouse. \textit{Id}. Therefore, the effect of these costs does not alter the legitimacy of the regulations under the Twenty-first Amendment. \textit{Id}. The court recognizes this “presence” requirement merely as a safety net to which all wineries are held accountable. \textit{Swedenburg}, 358 F.3d at 238.

\textsuperscript{332} Id. at 239.


\textsuperscript{334} Granholm v. Heald, 125 S.Ct. 1885 (2005). The question under consideration was: “Does a state’s regulatory scheme that permits in-state wineries directly to ship alcohol to consumers but restricts the ability of out-of-state wineries to do so violate the dormant Commerce Clause in light of § 2 of the Twenty-first Amendment?” \textit{Id}. at 1891-2.

\textsuperscript{335} Justice Kennedy was joined by Justices Scalia, Souter, Ginsburg, and Breyer. Justice Stevens wrote a dissenting opinion that was joined by Justice O’Connor. Justice Thomas wrote a dissenting opinion that was joined by Justices Stevens and O’Connor and Chief Justice Rehnquist. This division of the Supreme Court’s Justices, based upon a review of the decisions of 1993 to 2004, was unique. See Richard Saltalesa, \textit{The Supreme Court Opens a Case of Vintage Arguments}, May 2, 2005, http://www.informit.com/articles/article.asp?p=169629&rl=1; \textit{The Supreme Court, 2004 Term}, 119 Harv. L. Rev. 415, 424 (Nov. 2005).

\textsuperscript{336} Granholm, 125 S.Ct. at 1891-92.
After reviewing the expansion of small wineries and the consolidation of the wholesaler ranks, a confluence that has kept small wineries out of the traditional three-tier distribution system, the opinion cited the Federal Trade Commission’s conclusion that “[s]tate bans on interstate direct shipping represent the single largest regulatory barrier to expanded e-commerce in wine.”337

The Michigan regulatory system permitted in-state wineries to acquire a license and thereafter make direct shipments to Michigan consumers.338 Non-Michigan wineries were limited to a license that allowed sales only to wholesalers - it did not allow direct to consumer sales.339 The New York scheme allowed New York wineries to direct ship wine made from New York grapes.340 Non-New York wineries could be licensed to make direct sales to New York consumers if they opened a branch factory, office or storeroom in New York.341

Foreshadowing, albeit not subtly, its ruling, the Court wrote:

Time and again this Court has held that, in all but the narrowest circumstances, state laws violate the Commerce Clause if they mandate “differential treatment of in-state and out-of-state economic interests that benefits the former and burdens the latter.”342 This rule is essential to the foundations of the Union. The mere fact of nonresidence should not foreclose a producer in one State from access to markets in other States.343

Turning to the Michigan statute under review, Justice Kennedy wrote:

The discriminatory character of the Michigan system is obvious. Michigan allows in-state wineries to ship directly to consumers, subject only to a licensing requirement. Out-of-state wineries, whether licensed or not, face a complete ban on direct shipment. The differential treatment requires all out-of-state wine, but not all in-state wine, to pass through an in-state wholesaler and retailer before reaching consumers. These two extra layers of overhead increase the cost of out-of-state wines to Michigan consumers. The cost differential, and in some cases the inability to secure a wholesaler for small shipments, can effectively bar small wineries from the Michigan market.344

Discussing the discriminatory operations and effects of the New York statute, he wrote:

337. Id. at 1893; citing FTC Anticompetitive Barriers.
338. Granholm, 125 S.Ct. at 1894.
339. Id.
340. Id.
341. Id.
344. Granholm, 125 S.Ct. at 1896.
The New York regulatory scheme differs from Michigan’s in that it does not ban direct shipments altogether. Out-of-state wineries are instead required to establish a distribution operation in New York in order to gain the privilege of direct shipment. This, though, is just an indirect way of subjecting out-of-state wineries, but not local ones, to the three-tier system. New York and those allied with its interests defend the scheme by arguing that an out-of-state winery has the same access to the State’s consumers as in-state wineries: All wine must be sold through a licensee fully accountable to New York; it just so happens that in order to become a licensee, a winery must have a physical presence in the State. There is some confusion over the precise steps out-of-state wineries must take to gain access to the New York market, in part because no winery has run the State’s regulatory gauntlet. New York’s argument, in any event, is unconvincing.

The New York scheme grants in-state wineries access to the State’s consumers on preferential terms. The suggestion of a limited exception for direct shipment from out-of-state wineries does nothing to eliminate the discriminatory nature of New York’s regulations. In-state producers, with the applicable licenses, can ship directly to consumers from their wineries. Out-of-state wineries must open a branch office and warehouse in New York, additional steps that drive up the cost of their wine. For most wineries, the expense of establishing a bricks-and-mortar distribution operation in 1 State, let alone all 50, is prohibitive. It comes as no surprise that not a single out-of-state winery has availed itself of New York’s direct-shipping privilege. We have “viewed with particular suspicion state statutes requiring business operations to be performed in the home State that could more efficiently be performed elsewhere.” New York’s in-state presence requirement runs contrary to our admonition that States cannot require an out-of-state firm “to become a resident in order to compete on equal terms.”

In addition to its restrictive in-state presence requirement, New York discriminates against out-of-state wineries in other ways. Out-of-state wineries that establish the requisite branch office and warehouse in New York are still ineligible for a “farm winery” license, the license that provides the most direct means of shipping to New York consumers. (“No licensed farm winery shall manufacture or sell any wine not produced exclusively from grapes or other fruits or agricultural products grown or produced in New York state”). Out-of-state wineries may apply only for a commercial winery license. Unlike farm wineries, however, commercial wineries must obtain a separate certificate from the state liquor authority authorizing direct shipments to consumers and, of course, for out-of-state wineries there is the additional requirement of maintaining a distribution operation in New York. New York law also allows in-state wineries without direct-
shipping licenses to distribute their wine through other wineries that have the applicable licenses. This is another privilege not afforded out-of-state wineries.345

Still, it was recognized that although the Twenty-first Amendment did not protect the statutes at question from Commerce Clause analysis,346 they were assessed as to whether they “advance[d] a legitimate local purpose that cannot be adequately served by reasonable nondiscriminatory alternatives.”347 Michigan and New York maintained that keeping alcoholic beverages out of the hands of minors and tax collection were sufficient justifications.348 However, the access of minors to alcoholic beverages was rejected due to a lack of evidence that they sought alcoholic beverages through this channel.349 Furthermore, the differentiation of intrastate direct shipments that were permitted, and interstate direct shipments that were forbidden, undercut the argument as to minors as they would need only to order home state products.350 The tax collection justification was rejected as well for two reasons: there exist alternative means of collection, such as by permitting and self-reporting; and because federal laws allow federal permit revocation for violation of state law, by which to address the issue.351

With this ruling the various lower court decisions striking down discriminatory interstate shipment statutes are buttressed, those allowing such laws to stand are undercut, and the laws that have to date been unchallenged are open to assault.352

345. Id. at 1896-97 (internal citations omitted).
346. The proponents of the Michigan and New York laws sought a determination that alcoholic beverages have been removed from the scope of the Commerce Clause by the Twenty-first Amendment. Id. at 1902. At the oral argument of Granholm, it was asserted that “The history of the Twenty-[f]irst Amendment in the Webb-Kenyon Act clearly demonstrate – the purpose of the Webb-Kenyon Act was to eliminate alcohol shipments from the Commerce Clause.” Granholm, 125 S.Ct. 1885, Oral Argument, 2004 WL 2937830, 39 (U.S. Nov. 7, 2004).
348. Id.
349. Id. at 1905-06.
350. Id. at 1906.
351. Id. at 1906-07. The Court also observed: “These federal remedies, when combined with state licensing regimes, adequately protect States from lost tax revenue. The States have not shown that tax evasion from out-of-state wineries poses such a unique threat that it justifies their discriminatory regimes.” Granholm, 125 S.Ct. at 1906-07.
352. Michigan and New York initially responded to the Granholm decision in diametrically opposed manners. Michigan liquor control authorities have stated their desire for, and legislation has been introduced, providing that all direct shipments will be prohibited. See Linda Greenhouse, Court Lifts Ban on Wine Shipping, NEW YORK TIMES, May 17, 2005 at A (“Hours after the ruling, the head of Michigan’s Liquor Control Commission, Nida Samona, said at a telephone news conference that she would urge the state’s Legislature to prohibit all direct sales.”); Tara Q. Thomas, Direct Shipping, 24 WINE AND SPIRITS 12 (August, 2005) (“[S]hortly after the ruling was announced, Michigan Liquor Control Commissioner Nida Samona said she would pursue a ban on intrastate wine shipments.”). New York has amended its laws and now allows inter and intrastate shipments, and that legislation has been approved by the Michigan House (H.B. 4959). Michigan’s prohibitions on inter-state shipments have been struck down, it being ordered that foreign wineries be permitted to participate in the market on the same terms as are intrastate wineries. Heald v.
V. THE VIABILITY (?) OF KENTUCKY’S REGULATION OF INTERSTATE WINE SHIPMENTS.

Kentucky’s regulatory system for alcoholic beverages in general, and wine in particular, is largely typical of that seen in many other states, with the atypical degree to which the state has not entirely thrown off Prohibition.\footnote{Of Kentucky’s one-hundred twenty counties, as of this writing, fifty-four are entirely dry (see also KY. REV. STAT. ANN. § 242.230 (West 2005), defining effect of dry territory), and another thirty-six are only partially wet (sometimes referred to as “moist” counties). See KY ABC.} A three-tier

system for the distribution and sale (as well as mark-ups\textsuperscript{354}) is mandated.\textsuperscript{355} Liquor and wine may be sold in package stores (which are generally closed on Sunday\textsuperscript{356}), while beer is sold in package stores as well as in grocery and convenience stores. Limited intrastate shipment of wine to consumers is permitted,\textsuperscript{357} and certain in-state wineries are permitted to make limited sales to retailers.\textsuperscript{358} Intrastate sales that do not meet the requirements of a permissible sale are treated as misdemeanors for the first two violations.\textsuperscript{359} Interstate

\textit{Licensing available at} http://abc.ppr.ky.gov/licensing.html. Of the moist counties, three are so only because of the presence of a winery, and another eight restrict sales to restaurants with seating for at least one-hundred diners and with food sales being at least 70\% of revenues. \textit{Id.} The right of counties and localities to make wet/moist/dry determinations is enshrined in Section sixty-one of the Kentucky Constitution. Alcoholic beverages may be manufactured in dry territories as long as they are shipped from there to locations where they may be lawfully sold. \textit{Ky. Rev. Stat. Ann.} § 242.300 (2005). \textit{See also} \textit{Ky. Rev. Stat. Ann.} § 242.290 (West 2005) (permitting shipment of alcoholic beverages through a dry territory to a place where they may be lawfully sold). \textit{Id.}\textsuperscript{354} Wholesale mark-ups are estimated to be typically 18-25\%. \textit{FTC, Anticompetitive Barriers} at n. 86 and accompanying text. Retailer markup is typically another 25\%. \textit{Florida Wine Company Goes Online to Boost Sales, Miami Herald, December 17, 1999, available at 1999 WL 28718088. See also}, Alan E. Wiseman and Jerry Ellig, Market and Nonmarket Barriers to Internet Wine Sales: The Case of Virginia, 6 Business and Politics 1 at 3 (2004):

\[...\]the case of interstate wine sales and direct shipment bans could arguably be viewed as a textbook example of interest-group rent-seeking. Distributors, wholesales, and other private interests have arguably applied political pressure to general regulatory structures that benefit them. Riekhof and Sykuta (2003), for example, have analyzed the changes in direct shipment laws 1986 and found that private economic interests, more so than public welfare concerns, seem to have driven most of the changes in direct shipment bans.

shipments to either consumers or to retailers are forbidden, and the second violation of the interstate shipment statute is a felony.\textsuperscript{360} Limited on-site sales are also permitted for distillers and micro-breweries.\textsuperscript{361} A March 6, 1997 letter from the Kentucky Department of Alcoholic Beverage Control provides that shipments of wine purchased from and at out-of-state wineries to Kentucky consumers are permissible.\textsuperscript{362}

As have many states, Kentucky has in recent years seen an increase in wineries, a development accelerated in part by efforts to diversify farm economies that had been previously dependent upon tobacco.\textsuperscript{363} Certain Kentucky wineries may qualify for either a “small winery license” or for a “farm winery license.”\textsuperscript{364} In either instance, the license may be issued only to a winery located in Kentucky making wine from fruit grown in Kentucky.\textsuperscript{365} Holders of these licenses may bypass the wholesaler and sell, ship, and deliver wine directly to retail package shops, retail drink license holders, and individual consumers.\textsuperscript{366} A Kentucky winery not holding either a small winery or a farm winery license may not sell directly to consumers or retail licensees, and no winery located out of Kentucky may make direct sales to customers or retailers.\textsuperscript{367}

\textsuperscript{360} K Y.R EV.S TAT.A NN. § 244.165 (West 2005). Kentucky was the first state to adopt such a felony statute. \textit{See} Dana Nigro, \textit{Direct Shipping Timeline}, WINE SPECTATOR (May 16, 2005).

\textsuperscript{361} A “souvenir package” (defined at K Y.R EV.S TAT.A NN. § 241.010(43) (West 2005)) may be sold on site at a Kentucky licensed distillery, provided it be of “Kentucky straight bourbon whiskey.” The transfer from the distillery to the retail outlet located thereat must be treated as made through a licensed wholesaler for purposes of collecting taxes. K Y.R EV.S TAT.A NN. § 243.0305 (West 2005) On premise sales by micro-breweries are permitted, as are direct deliveries to package and retail licensees by micro-breweries. K Y.R EV.S TAT.A NN. § 243.157(1)(b) (West 2005).

\textsuperscript{362} Letter from Pamela Carroll Farmer, General Counsel, Department of Alcoholic Beverage Control, to Mr. Jack Underwood on March 6, 1997 interpreting 804 KY. ADMIN. REGS. 4:330 (available at \url{http://admin.shipcompliant.com/Documents/North%20America/US/Prohibited/Kentucky/kentucky.pdf}). As this letter predates 27 U.S.C. § 124 by some five years, the statute is not cited.

\textsuperscript{363} \textit{See} Marcus Green, \textit{Kentucky Grapes Filling Vines}, COURIER-JOURNAL, June 24, 2005, at A1 (“Vice ran cattle, tried vegetables and even raised ginsing to diversify his farm, but he believes grapes will replace the income he once found with tobacco.”); Susan Reigler, \textit{Winery Stir Up Business with Concerts}, COURIER-JOURNAL, June 24, 2005, at E1 (“Proprietor and Winemaker Chuck Smith of Smith-Berry Winery is tending grapevines where tobacco once grew.”) Marcus Green, \textit{Ruling Could Aid Region’s Wineries}, COURIER-JOURNAL, May 30, 2005, at D1 (“Chuck Smith and his wife, Mary Berry, are Henry County, Ky., farmers who ventured into wine-making five years ago when they saw a bleak future for tobacco.”) \textit{See also} Jerry Nelson, \textit{A Wine Grows on the Prairie}, F ARM JOURNAL, (Jan. 2002), \url{available at http://www.agweb.com/news_show/news_article.asp?articleid=83605&newsca=GN}.

\textsuperscript{364} K Y.R EV.S TAT.A NN. 243.031 (West 2005).

\textsuperscript{365} K Y.R EV.S TAT.A NN. §§ 241.010(46), 243.155(2), 243.156(2) (West 2005).

\textsuperscript{366} \textit{See} KY. REV. STAT. ANN. §§ 243.155(2), 243.156(2) (West 2005).

\textsuperscript{367} K Y.R EV.S TAT. A NN. § 243.020 (West 2005).
An exception to the prohibition of wine shipments from outside the state are shipments made pursuant to federal law. In a limited involvement in the matter of interstate wine shipments, Congress has provided that interstate shipments of wine are expressly permitted during a period in which the Federal Aviation Administration has in effect “restrictions on airline passengers to ensure safety” where (a) the purchaser was physically present at the winery at which the wine was purchased, (b) the winery was provided proof of legal age to purchase alcohol, (c) the shipment was marked to require an adult signature upon receipt, (d) the wine was purchased for personal use and not for resale, and (e) the purchaser could have lawfully brought the wine into their home state into which it is shipped. There exist as well civil sanctions for improperly handled wine shipments. Wine packages must be clearly labeled with the name of the shipper, the nature of the contents, and the quantity. Common carrier employees/agents are subject to federal criminal penalty for delivery of alcoholic beverages to anyone other than the addressee or to anyone acting under a fictitious name.

Before turning to an analysis of the various Kentucky limitations upon wine imports, another federal involvement in the direct shipment debate should be reviewed. The “Twenty-first Amendment Enforcement Act” empowers the various state attorneys general to bring suit in federal court against a person for violations of the state’s alcoholic beverage control laws. While not

368. Id.
370. 27 U.S.C § 124 (2005). See also Dana Nigro, Congress Passes Measure Temporarily Easing States’ Wine-Shipping Restrictions, WINE SPECTATOR (Oct. 4, 2002). KY. REV. STAT. ANN. § 242.260 (West 2005) provides that no public or private carrier may bring alcoholic beverages into a dry territory. See also KY. REV. STAT. ANN. § 242.280 (West 2005). However, a person of legal age is not prohibited, for personal use, from possessing alcoholic beverages in a dry territory; it is simply that alcoholic beverages may not be bought or sold in that territory. See KY. REV. STAT. ANN. § 242.230 (West 2005). As an individual could carry wine into a dry territory, and as 27 U.S.C. § 124 permits the delivery, under the Supremacy Clause, presumably neither KY. REV. STAT. ANN. §§ 242.260 nor 242.280 (West 2005) will apply to prohibit the delivery.
374. 27 U.S.C § 122a (2005).
375. This statute was precipitated by Fla. Dept. of Bus. Reg. v. Zachy’s Wine & Liquor, Inc., 125 F.3d 1399, 1405 (11th Cir. 1997), in which it was held there was no federal cause of action for violations of 27 U.S.C. § 122.
376. 27 U.S.C. § 122a(b) (2005) provides:
If the attorney general [defined at 27 U.S.C. § 122a(1)] has reasonable cause to believe that a person is engaged in, or has engaged in, any act that would constitute a violation of a State [defined at 27 U.S.C. § 122a(4)] law regulating the importation or transportation of any intoxicating liquor, the attorney general may bring a civil action in accordance with this section for injunctive relief
extending to suits brought against a licensee in that state,\(^{377}\) this statute provides a federal forum in which injunctive relief may be sought and, on the proper showing, had against the defendant.\(^{378}\) As recognized by the Supreme Court in Granholm, the threat of a licensee losing a license to produce is an effective threat to improper conduct,\(^{379}\) and the Twenty-first Amendment Enforcement Act provides a realistic threat of the loss of a license by those who stray from proper conduct.\(^{380}\)

A. Permissible and Prohibited Sales by Small & Farm Wineries

Holders of a small winery license must produce wine from Kentucky produced grapes, fruits, grape or fruit juices, or honey.\(^{381}\) In addition to the ability to sell to wholesalers, assuming they are located or acting in a wet territory, a small winery licensee may (a) serve complimentary samples of its wine;\(^{382}\) (b) make on premise retail package and by the drink sales;\(^{383}\) (c) make retail sales at fairs, festivals, and similar types of events;\(^{384}\) (d) make sales directly to retail licensees;\(^{385}\) and (e) ship wine to a consumer if (i) the wine was purchased at the winery, (ii) shipment is by a licensed common carrier, and (iii) the amount is limited to two cases per customer.\(^{386}\)

Holders of a farm winery license, in addition to selling to wholesalers, and assuming they are located or acting in a wet territory, may: (a) serve complimentary samples;\(^{387}\) (b) make on premise package and by-the-drink sales,\(^{388}\) (c) make direct sales to retail package and by-the-drink licensees;\(^{389}\) and

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\(^{378}\) Only injunctive relief is available under this law. 27 U.S.C. §122a(c)(3) (2005).
\(^{379}\) \textit{Granholm}, 125 S.Ct. at 1906.
\(^{380}\) \textit{Id.} This act has been promoted as a means of limiting improper sales to minors by means of Internet purchases (see Statement of Senator Orin Hatch, 145 CONG. REC. S2509 (daily ed. Mar. 10, 1999)) and opened to criticism as a power play by the wholesale industry to enforce their state protected monopolies. See Statement of Senator Robert Byrd, 145 CONG. REC. S5344 (daily ed. May 14, 1999) (citing as supporters of the proposed act the Wine and Spirits Wholesalers of America, the National Beer Wholesalers Association, the National Licensed Beverage Control Association).
\(^{381}\) KY. REV. STAT. ANN. § 243.155(2) (West 2005). An exemption exists if the grapes, fruit, juice or honey is not available. \textit{Id.}
\(^{382}\) KY. REV. STAT. ANN. § 243.155(1)(b) (West 2005).
\(^{383}\) KY. REV. STAT. ANN. § 243.155(1)(c), (e) (West 2005).
\(^{384}\) KY. REV. STAT. ANN. § 243.155(1)(c) (West 2005).
\(^{385}\) KY. REV. STAT. ANN. § 243.155(1)(d) (West 2005).
\(^{386}\) KY. REV. STAT. ANN. § 243.155(1)(f) (West 2005).
\(^{387}\) KY. REV. STAT. ANN. § 243.156(1)(b), (c) (West 2005).
\(^{388}\) KY. REV. STAT. ANN. § 243.156(1)(c) (West 2005).
\(^{389}\) KY. REV. STAT. ANN. § 243.156(1)(d) (West 2005).
(d) make by-the-drink and package sales at fairs, festivals, and similar events.\textsuperscript{390} Furthermore, farm wineries may ship wine to customers provided (i) the wine was purchased at the winery, (ii) shipment is by a licensed common carrier, and (iii) the amount is licensed to two cases per customer.\textsuperscript{391}

Kentucky based wineries not holding either a small or farm winery license and all wineries based in foreign states are subject to statutory sanction for shipping wine to Kentucky consumers. The sanction for a Kentucky based winery making such a sale is a misdemeanor for the first two offenses and a felony for the third offense.\textsuperscript{392} For a winery in a foreign state, the sales are unlawful, with a cease and desist letter being issued on the first offense.\textsuperscript{393} The second and each subsequent offense is a felony.\textsuperscript{394} This penalty is not applicable to any Kentucky based winery.\textsuperscript{395}

\begin{itemize}
\item[390.] KY. REV. STAT. ANN. § 243.156(1)(g) (West 2005).
\item[391.] KY. REV. STAT. ANN. § 243.156(1)(h) (West 2005).
\item[392.] KY. REV. STAT. ANN. § 242.990(1) (West 2005).
\item[393.] KY. REV. STAT. ANN. §244.165 (West 2005). See also 804 KY. ADMIN. REGS. 4:330 § 1. Presumably, although it is not entirely clear, this initial improper sale, in addition to sanction under these provisions, would as well be a misdemeanor. KY. REV. STAT. ANN. § 242.990(1) (West 2005).
\item[394.] KY. REV. STAT. ANN. § 244.065(2) (West 2005). See also 804 KY. ADMIN. REGS. 4:330 § 3. The penalty for a Class D felony is a fine of $1,000 to $10,000 and a sentence of one to five years in prison. KY. REV. STAT. ANN. § 532.060 (West 2005).
\item[395.] KY. REV. STAT. ANN. § 244.165(1) (West 2005); (“any person in the business of selling alcoholic beverages in another state or country….”) (emphasis added).
\end{itemize}
B. Constitutional Issues

The Commerce Clause issues raised by Kentucky’s regulation of wineries and wine importation include: (i) benefits afforded small and farm winery licenses to by-pass the three-tier system to sell directly to retail licenses and consumers, benefits not provided foreign based wineries; (ii) limitations imposed on the fruit source for small and farm wineries; and (iii) the disparate (misdemeanor versus felony) treatment of impermissible intrastate versus interstate shipments. These issues will be considered seratim.

It is incontrovertible that Kentucky wineries holding either a small winery or a farm winery license are afforded access to consumers that is denied to both of larger wineries based in Kentucky and to all wineries based outside of Kentucky as a consequence of the permission they are afforded to by-pass the three-tier system and directly access the consumer through samples, direct sales to consumers at fairs, festivals and similar events, direct sales to retailers, and direct sales to consumers. None of these franchise building activities are permitted a non-Kentucky based winery, even those that meet the size limitations imposed by the license requirements for farm wineries. Rather, wineries based in other states may access Kentucky consumers only through the restrictive mechanism of the three-tier system. For purposes of the Commerce Clause, what is most telling is that these benefits are limited to wineries based in

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396. On May 16, 2005, the day the Granholm decision was handed down, suit was filed in Federal District Court for the Western District of Kentucky challenging the constitutionality of Ky. Rev. Stat. Ann. §§ 244.165, 243.032, 243.155, and 243.156 (West 2005). This suit was styled Huber Winery, William G. Schneider, Jr. and John D. Reilly, Jr. v. Lajuana S. Wilcher and Lavoyed Hudgins. Neither author is counsel to any party to this suit, and as this article is drafted the suit is proceeding. According to Greg Troutman, counsel to the plaintiffs in this action, the filing date was fortuitous, with the plan having been to file the suit that day, even as the Granholm decision was anticipated before the end of the 2004-05 term of the Supreme Court. Wine and Spirits Wholesales of Kentucky, Inc., comprised of nine Kentucky wholesales, has intervened in the Huber action, asserting that the relief sought by the Plaintiffs, “if granted, will constitute a taking of the property of the members of Intervenor-Defendant without just compensation and in violation of their right to due process, in violation of federal and Kentucky constitutional provisions.” Intervenor’s Answer, ¶ 19. On July 21, 2005, the plaintiffs in the Huber action filed a motion for judgment on the pleadings. Efforts had been previously undertaken to reform Kentucky’s direct wine shipment laws. See Patrick Crowley, Wine Collector Irked by Shipping Ban, The Cincinnati Enquirer, December 16, 1999, available at http://www.enquirer.com/ columns/crowley/1999/12/16/per wine collector irked.html; Dana Nigro, Kentucky Collector Campaigns Against Home-Delivery Ban, Wine Spectator, March 31, 2000 at 12. SB 116, introduced to the 2003 Kentucky General Assembly by Senator Ernesto Scorsone, had it been adopted, would have provided a licensing system under which foreign wineries could ship directly to Kentucky consumers. The proposal was not only not adopted, but it never received a committee hearing.

Kentucky. No farm winery based outside of Kentucky can qualify for these benefits, even one conceivably meeting all non-geographic requirements of such a license, for an example by meeting the maximum annual production limits.403 This system has multiple implications. First, Kentucky wineries are afforded special access to consumers in Kentucky, be they citizens or visitors, access denied non-Kentucky wineries.404 Second, Kentucky produced products are afforded benefits not afforded non-Kentucky produced products.405 Third, non-Kentucky based wines and wineries are burdened by the obligation to reach Kentucky consumers exclusively through the three-tier system.406 This obligation effectively precludes many small wineries from participation in the Kentucky market, in effect removing the Commonwealth from the national market for small wines.407

The Supreme Court has repeatedly held that benefits afforded by state law may not be tied to state residence or state of manufacture.408 This line of authority has been applied in the context of the alcoholic beverage industry, and was recently affirmed in *Granholm* when the Court rejected the position of New

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404. *See Granholm*, 125 S. Ct. at 1896 (“The . . . scheme grants in-state wineries access to the State’s consumers on preferential terms.”)

405. *See id.* at 1897 (prohibiting “wine not produced from grapes . . . produced in . . . state” also discriminates against out-of-state wineries because it is “another privilege not afforded out-of-state wineries.”)

406. *See id.* at 1896 (noting discriminatory character is “obvious” where out-of-state wine, but not in-state wine, must pass through the three tier distribution system.)

407. *See id.* (“Laws of this type . . . deprive citizens of their right to have access to the markets of other States on equal terms.”) *See also* Dickerson v. Bailey, 87 F.Supp.2d 691, 695 (S.D. Tex. 2000); Bainbridge v. Bush, 148 F.Supp.2d at 1311 n. 7 (the inter-state shipping ban “has the practical effect of preventing many small wineries from selling their wine in Florida. This result occurs because it is not cost-effective for the smaller out-of-state wineries to acquire a Florida wholesaler.”); *Heald v. Engler*, 342 F.3d 517, (6th Cir. 2003) (“In-state wineries can, for example, bypass the price mark-ups of a wholesaler and retailer, making in-state wines relatively cheaper to the consumer and allowing them to realize more profit per bottle.”), (“Here, it is clear that the Michigan statutory and regulatory scheme treats out-of-state and in-state wineries differently, with the effect of benefitting the in-state wineries and burdening those from out of state. As discussed above, Michigan wineries enjoy . . . greater profit through their exemption from the three-tier system. Out-of-state wineries, on the other hand, must participate in the costly three-tier system, to their economic detriment.”).

408. *See, e.g.*, Cooper v. McBeath, 11 F.3d 547 (5th Cir. 1994); Hunt v. Washington State Apple Adver. Comm’n, 432 U.S. 333, 353 (1977); City of Philadelphia v. New Jersey, 437 U.S. 617, 626-27 (1978) (a state’s objectives “may not be accomplished by discriminating against articles of commerce coming from outside the State unless there is some reason, apart from its origin, to treat them differently.”); C & A Carbone, Inc. v. Town of Clarkstown, 511 U.S. 383, 392 (1994). In *Carbone*, the town of Clarkstown, New York, passed a “flow control ordinance,” that required all non-recyclable solid waste be processed by a local contractor. *Id.* at 390-92. Because all waste was treated the same, the town argued that the ordinance was not discriminatory. *Id.* The Court rejected this argument, however, noting that the relevant article of commerce was not the garbage itself, but rather the service of processing it. *Id.* Because out-of-state garbage processors were not allowed to compete for the opportunity to process Clarkstown’s garbage, this was an ordinance which protected the local processors. *Id.* See also H.P. Hood & Sons, Inc. v. DuMond, 336 U.S. 525, 529 (1949).
York that the benefits afforded in-state wineries were available to foreign wineries who would simply open a bricks and mortar facility in the state.\textsuperscript{409} The courts have also rejected benefits afforded products based upon their state of manufacture, even in the context of the alcoholic beverage industry and protections claimed under the Twenty-first Amendment.\textsuperscript{410} Such efforts at economic protectionism cannot be saved from being struck down under the dormant Commerce Clause by reference to the Twenty-first Amendment.\textsuperscript{411} There is simply no core power afforded the states by Section 2 of the Twenty-first Amendment that will provide a justification for affording domestic producers greater access to consumers than that afforded foreign producers.\textsuperscript{412}

For example, as to arguments of temperance,\textsuperscript{413} the records of the various cases to date, as well as independent investigations,\textsuperscript{414} have not shown that in-state wineries are more diligent in preventing diversion to minors\textsuperscript{415} or that such sales are seen by minors as a viable means of procuring alcohol.\textsuperscript{416} Strict

\textsuperscript{409} See Granholm, 125 S. Ct. at 1897 (“New York’s in-state presence requirement runs contrary to our admonition that States cannot require an out-of-state firm ‘to become a resident in order to compete on equal terms.’”) quoting in part Halliburton Oil Well Cementing Co. v. Reily, 373 U.S. 64, 72 (1963).


\textsuperscript{411} See Bacchus Imports, Ltd. v. Dias, 468 U.S. 263, 276 (1984) (“The central purpose of [Section 2 of the Twenty-first] Amendment was not to empower States to favor local liquor industry by erecting barriers to competition.”) See also Beskind v. Easley, 325 F.3d 506, 517 (4th Cir 2003)

Against the backdrop of its general prohibition of direct shipment of alcoholic beverages, North Carolina’s authorization of in-state direct shipment of wine - which has the effect of increasing access to wine produced only in North Carolina - cannot credibly be portrayed as anything other than local economic boosterism in the guise of a law aimed at alcoholic beverage control.

\textsuperscript{412} Id.

\textsuperscript{413} See, e.g., Loretto Winery Ltd. v. Gazzara, 601 F.Supp. 850, 862-63 (S.D.N.Y. 1985).

\textsuperscript{414} See FTC, Anticompetitive Barriers at 26 (“In practice, many states have decided that they can prevent direct shipping to minors through less restrictive means than a complete ban, such as by requiring an adult signature at the point of delivery. These states generally report few, if any, problems with direct shipping to minors.”). See also Eric Arnold, New Technology Aims to Prevent Online Wine Sales to Minors, WINE SPECTATOR (July 27, 2005).

\textsuperscript{415} Indeed the studies show that minors are generally not interested in wine, preferring beer and spirits. See Federal Trade Commission, Self-Regulation in the Alcohol Industry: A Review of Industry Efforts to Avoid Promoting Alcohol to Underage Consumers at App. A, Fig. 2. http://www.ftc.gov/reports/alcohol/alcoholreport.htm; Pacific Institute for Research and Evaluation, supra note 195.

\textsuperscript{416} See K. Lloyd Billingsley, Ship the Wine in its Time, at 6 (August 2002), available at http://www.pacificresearch.org/pub/sab/techno/winedistribution_brief.pdf (“Juveniles who want to indulge in alcoholic beverages do not order premium wine over the Internet and then wait two or three days for it to arrive.”) Notwithstanding assertions that:

\cite{[T]hose legitimate concerns do not seem to resonate with the handful of wealthy oenophiles who are leading the battle to have limited edition chardonnay shipped directly to their homes. These self-proclaimed
regulation of wine produced out-of-state, and comparatively looser regulation of wine produced in-state, evidences a lack of concern with temperance.417

The tax revenues that might be lost are an infinitesimal portion of retail interstate commerce that goes untaxed in Kentucky,418 and it has been concluded that other effective means of tax collection may be put in place.419

As for arguments that direct sales will diminish the effectiveness of the three-tier system, it must be kept in mind that while the three-tier system is Constitutionally permissible,420 it is not Constitutionally mandated. By permitting limited sales of wine outside the three-tier system,421 Kentucky has already indicated that the three-tier structure is not a mandatory condition to address the evils it is claimed to address.422 Furthermore, the fact that the connoisseurs appear to have their blinders firmly in place and want to ignore the fact that their actions would also open the door for a 15-year-old to buy tequila or grain alcohol over the Internet and have it delivered without question to his door.

Juanita Duggan Testimony, supra note 17. The independent FTC found “few, if any, problems with interstate shipment of wines to minors. . . . [N]one of them report more than isolated instances of minors buying or even attempting to buy wine online.” FTC, Interstate Barriers at 31, 33.

417. Swedenburg v. Kelly, 232 F.Supp.2d 135, 149 (S.D.N.Y. 2002); Beskind v. Easley, 325 F.3d 506, 516-17 (4th Cir. 2003); Dickerson v. Bailey, 87 F.Supp.2d 691, 693 (S.D. Tex. 2000); Loretto Winery, 601 F.Supp. at 863 (“There is no temperance interest served in permitting the unlimited sale of 6% wine product with domestic grapes, while at the same time banning the sale of the same 6% wine product made with grapes grown out-of-state.”). As observed in Granholm, 125 S. Ct. at 1906: “As the wineries point out, minors are just as likely to order wine from in-state producers as from out-of-state ones.”


419. Various of the states have adopted, and the Granholm decisions endorse, systems requiring out-of-state wineries to register with state revenue authorities, to maintain records of shipments into the state, and to remit taxes due on those sales. Other systems require the consumer to remit taxes on their purchases. In this regard it is telling that 804 Ky. Admin. Regs. 4:330 § 4 does not provide a tax collection mechanism. The weight afforded an assertion that broader direct wine shipments will cost the Commonwealth revenues is questionable when the state has not sought to impose an effective collection mechanism on those sales that are expressly permitted.


422. Post-Prohibition the three-tier system was claimed to prevent domination of the alcoholic beverage trade by organized crime. See e.g., supra note 62. Whether such concerns today have any validity is questionable, but even if valid do not have Constitutional weight. In recent years the trade in garbage has found protection under the Commerce Clause notwithstanding repeated allegations that the industry in certain portions of the country is dominated by organized crime (See Organized Crime Links to Waste Disposal Industry: Hearings Before the Subcommittee on Oversight and Investigations of the Committee on Energy and Commerce, House of Representatives, 97th Cong., 1st Sess., May 28, 1991.) the fact is that certain of the major players in the industry have been less than good corporate citizens. See, e.g., Waste Management Founder;
benefits are available to only certain, and not all, Kentucky based wineries, does
not save the disparate treatment from condemnation under the Commerce
Clause. Rather, the discriminatory treatment, benefiting some Kentucky
wineries while providing no equal benefit to foreign based wineries, is clearly
protectionist and as such is a violation of the Commerce Clause.

In addition to the advantages afforded small and farm wineries by reason of
their location in Kentucky, those advantages are conditioned upon the use of
Kentucky grown grapes, other fruit, or honey in their production. As such,
products produced in Kentucky are granted benefits not available to products
produced in other states. This favoritism of Kentucky grown products
precludes non-Kentucky wineries from competing evenhandedly for Kentucky
consumers and discriminates against non-Kentucky sourced products. It is not
relevant to the analysis that the effect of this provision is to simply grant a
benefit to Kentucky manufactured products without imposing any appreciable
burden on the products of the other forty-nine states, the discrimination is none
the less present. Efforts by other states to afford commercial advantage to
locally produced products have been repeatedly struck down as violations of the
Commerce Clause; the reason for such rulings is obvious – the Commerce
Clause was intended to preclude an economic balkanization of the states in
which local products would not compete on a level playing field with those of
some or all of the other states. Furthermore, in conditioning the license upon
the use of Kentucky grown fruit and honey, Kentucky has sought to isolate a
portion of the industry from interstate commerce in those same items.

Five Other Former Top Officers Sued for Massive Fraud, Securities & Exchange Commission
Press Release 2002-44 (March 26, 2002).

423. See, e.g., Dean Milk Co. v. City of Madison, 340 U.S. 349, 356 (1951) (Wisconsin statute
requiring that milk have been pasteurized within five miles of the central square of Madison, while
burdening milk produced within Wisconsin outside of five mile radius, imposed a greater burden
on milk produced in other states, and as such violated the Commerce Clause).

424. Under the Commerce Clause, “discriminate” means “differential treatment of in-state and
out-of-state economic interests that benefits the former and burdens the latter.” Oregon Waste Sys.,

425. See supra notes 401 through 404 and accompanying text.

426. As stated by Justice Kennedy in the course of the argument of Granholm, “Only the
Congress can allow discrimination against out-of-state products.” Granholm v. Heald, 2005 WL

made clear, however, that a tax statute’s “constitutionalitly does not depend upon whether one
focuses upon the benefited or the burdened party.”); See also Bacchus Imports, Ltd. v. Dias, 468
U.S. 263, 273 (1984). The fact that a statute “discriminates against business carried on outside the
State by disallowing a tax credit rather than by imposing a higher tax” is therefore legally

428. See, e.g., Bacchus, 468 U.S. at 272.

429. Id.

430. See Granholm, 125 S. Ct. at 1895 (“States may not enact laws that burden out-of-state
producers or shippers simply to give a competitive advantage to in-state business.”).
another way, while wine may be produced at a small winery, it will not be made from grapes or honey produced in Indiana, Tennessee or any other state, even if industry in those states can produce them at lower cost. 433 Such efforts have been repeatedly found unconstitutional. 434 Again, looking at core Twenty-first Amendment issues of temperance, revenue, and alcoholic beverage industry regulation, 435 none are implicated in conditioning a distribution scheme upon the source of the grapes/fruit/honey used in making wine. 436 While there is certainly nothing inappropriate about Kentucky creating a class of license for small wineries and otherwise promoting the development of a wine industry in the Commonwealth, 437 it may not do so in a manner that creates an uneven playing field that discriminates against interstate commerce. 438 That, however, is just what the native fruit/honey requirement of the small winery category, when combined with the greater consumer access afforded by that license, accomplishes.

Another constitutionally suspect issue is the disparate treatment of improper intra versus interstate wine shipments. 439 A Kentucky based winery will have its first two improper shipments treated as misdemeanors; only upon the third shipment will the winery be liable for a felony. 440 In contrast, upon only its second impermissible sale, a foreign winery is subject to a felony charge. 441 As such, a domestic winery may make two impermissible sales before facing felony treatment while a foreign winery is subject to that level of sanction after only one similar sale. Economically, before reaching the felony threshold, the Kentucky winery gets to make twice as many impermissible sales, and to collect the proceeds thereof, than is a foreign winery. 442 Consequently, another unequal playing field is created between domestic and foreign wineries. 443 While less obvious than that created by the unequal treatment that penalizes foreign wineries versus domestic farm and small wineries as to access to Kentucky consumers and the market for grapes/honey in Kentucky, distinctions in penalties based exclusively upon the foreign versus domestic residence of the

433.  Id.
434. See Cuno, 386 F.3d 738.
436. See Bacchus, 468 U.S. at 276 (“The central purpose of [section 2 of the Twenty-first] Amendment was not to empower States to favor local liquor industry by erecting barriers to competition.”). See also Healy v. Beer Institute, 491 U.S. 324, 344 (1989) (Scalia, J., concurring).
437. It has been claimed that the first commercial vineyard in the United States was in Kentucky. Marcus Green, Kentucky Grapes, COURIER-JOURNAL, June 24, 2005.
438. To that end, property tax abatements on property employed in the state for oenological purposes may be permissible. See Cuno, 386 F.3d at 749.
439. See KY. REV. STAT. ANN. §§ 242.990(1), 244.065(2) (West 2005).
441. KY. REV. STAT. ANN. § 244.065(2) (West 2005). See also 808 KY. ADMIN. REGS. 4:330 § 3.
442. An economic advantage that “benefits the former and burden’s the latter” implicates the Commerce Clause. See Granholm, 125 S. Ct. at 1895.
443. Id.
perpetrator, distinctions advantageous to domestic concerns, constitute
discrimination under the Commerce Clause. 444

Kentucky has cited 804 KAR 4:330445 as a defense to the constitutionality of
its regulatory scheme on wine imports.446 Presumably the argument will be that
as a Kentucky resident may travel to a winery in a foreign state, there purchase
wine and ship it to his or her home in Kentucky, interstate commerce is not
improperly impacted. If this is the state’s position, it lacks merit. The interstate
commerce that is protected by the Commerce Clause must be just that -
interstate. Requiring a Kentucky resident to travel to a foreign state and there
complete a sales transaction is not allowing interstate commerce. Kentucky, by
804 KAR 4:330, is allowing a Kentucky resident to ship his or her property,
namely wine produced and purchased in a foreign state, to his or her home in the
Commonwealth.447 The Kentucky resident is in effect shipping to
himself/herself.448 This accommodation is not responsive to the free trade
concerns that animated the adoption of the Commerce Clause and the dictate that
there should be a free flow of goods among the states.449

Curiously, Kentucky has cited as well “Twenty-first Amendment
Preemption” as a defense to the challenge to its disparate treatment of domestic
and foreign wineries. 450 This position, admittedly not yet fleshed out, appears
specious. The Supreme Court’s jurisprudence has been and has been recently

444. There may be as well implications under the Equal Protection Clause.
445. 804 K Y. A DMIN. RE GS. 4:330 § 4 provides that a Kentucky resident may ship alcoholic
beverages to his home from another state.
447. 804 K Y. A DMIN. RE GS. 4:330 § 4
448. Id.
discriminates both on its face and in practical effect …). It is clear from the Granholm ruling that
both de jure and de facto discrimination are barred by Commerce Clause. See Granholm, 125 S.Ct.
at 1891-92 (“the object and effect of the laws are the same … to make direct [interstate] sales
impractical from an economic standpoint.”) See Granholm, 125 S.Ct. at 1897-98 (rejecting New
York requirement of bricks and mortar facility for foreign wineries seeking to do business in New
York as “additional steps that drive up the cost of their wine.”) It is obvious that he cost of travel
within the state of Kentucky in order to take advantage of the right of a small or farm winery to
ship to the consumer. (KY. REV. ST AT. §§ 243.155(1)(f), 243.156(1)(h)) is far less than the cost of
travel to the Napa Valley of the Fingerlakes region in New York. Therefore, while it may appear
there is no de jure discrimination (i.e., regardless of whether the winery is in or out of state, all you
need do is visit it in order to ship wine home), there is obvious de facto discrimination in that is
may not be economically possible to visit the foreign winery. See, e.g., Dean Milk Co. v. Madison,
down vehicle tax scheme that applied to intra and interstate trucks but disproportionately impacted
intrasate commerce). Positing that Kentucky may require a physical visit to a Kentucky winery as
a precondition to allowing the intrasate shipment of wine back to the Kentucky resident (a
supposition the authors do not here seek to support or disprove), it violates the Commerce
Clause to require a similar visit to an out-of-state vineyard in order to initiate a sale transaction.
Rather, a non-burdensome approach, such as by permitting interstate sales initiated by phone or
Internet ordering, needs to be permitted.
confirmed to be that the Twenty-first Amendment neither supersedes the other provisions of the Constitution nor does it diminish the rule against conduct that discriminates against interstate commerce.451 Only if the regulatory system applied to interstate wine shipments is not discriminatory as contrasted with that applied to intrastate shipments, a proposition the authors reject, would the Twenty-first Amendment be implicated.452

VI. CONCLUSION

Alcoholic beverages hold a singular distinction in the Constitution; they are the only product to be expressly addressed in two amendments. Since the passage of the Twenty-first Amendment, the United States Supreme Court has found itself repeatedly called upon to address the relationship of the amendment to the balance of the Constitution. The last decades have seen a shift in the analysis to one in which state powers under the Twenty-first Amendment are permitted to control over the other provisions of the Constitution in only narrow circumstances. The Wine Wars and the Granholm decision have affirmed this manner of analysis and confirmed that states may not apply disparate regulatory systems to alcoholic beverages based upon whether produced domestically or in a foreign jurisdiction.

The Wine Wars are far from over; challenges to many state systems currently in place will be brought and resolved. Eventually the Wine Wars may morph into the Liquor Wars and the Beer Wars453 as the application of Granholm to these products is considered. Such continuing conflict with ultimate reference to the Supreme Court appears for the foreseeable future to be the fate of the conflict between the neo-prohibitionist to control alcoholic beverages and the rights of those who seek to responsibly partake of a legal product.

451. See, e.g., Granholm, 125 S.Ct. at 1903.
452. See Granholm, 125 S.Ct at 1905 (“State policies are protected under the Twenty-first Amendment when they treat liquor produced out-of-state the same as its domestic equivalent.”).
453. See, e.g., KAN. STAT. ANN. §§ 41-102(i), 41-102(c) (2004) (defining “domestic beer” as being up to 8% alcohol and made from agricultural products grown in Kansas and defining “beer” as being more than 3.2% alcohol).
EXECUTING THE POLITICAL QUESTION DOCTRINE

Jared S. Pettinato*

What's in a name? That which we call a rose  
By any other name would smell as sweet.

William Shakespeare

I. INTRODUCTION

The United States Supreme Court has characterized political questions as non-justiciable questions. The rationale for refusing to decide political questions lies at the heart of the separation of powers concerns and justiciability concerns. Before a court can consider the merits of any issue, the parties must first present a justiciable controversy. Justiciability threshold questions include advisory opinions, feigned or collusive cases, standing, ripeness, mootness, political questions, and administrative questions. Justiciability concerns are usually the only reasons for which courts will refrain from making decisions. As long as the case presents no advisory opinion, no feigned or collusive case, the parties have standing, the issues are ripe, but not moot, and present no political or administrative questions, courts will hear the issue.

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1. WILLIAM SHAKESPEARE, ROMEO & JULIET THE SECOND ACT, sc. 2.
4. See Flast, 392 U.S. at 97. The court provided: Consequently, the Article III prohibition against advisory opinions reflects the complementary constitutional considerations expressed by the justiciability doctrine: Federal judicial power is limited to those disputes which confine federal courts to a rule consistent with a system of separated powers and which are traditionally thought to be capable of resolution through the judicial process.
5. Id at 95; 13 CHARLES ALAN WRIGHT ET AL., FEDERAL PRACTICE AND PROCEDURE § 3529 at 279 (2d ed. 1984).
6. See Flast, 392 U.S. at 95 (explaining the various grounds upon which questions sought to be adjudicated in federal courts have been held not to be justiciable).
7. Despite these justiciability doctrines constituting the inverse set of the Judicial Power, the doctrines of comity, Societe Nationale Industrielle Aerospatiale v. United States Dist. Court, 482 U.S. 522, 533 (1987), and want of equity, Colgrove v. Green, 328 U.S. 549, 551 (1946), may also prevent the judiciary from taking action on any particular issue. These, however are more prudential in nature than structural.
Defining the Political Question Doctrine (PQD) has eluded the judiciary for centuries. The Supreme Court itself cannot recognize the PQD, but, lacking clear identification, addresses the fundamental questions with great effusiveness. This confusion arises from the very name of the doctrine, the PQD, and the seemingly inexplicable doctrine hiding behind that name. Over time, many people have held different perspectives on the PQD. Some believed the question involved the separation of powers, a completely prudential doctrine, or a complete institutional competence issue. Nevertheless, no one has developed a cohesive doctrine that accounts for all the political question decisions.

In the 1962 case of *Baker v. Carr*, Justice William Brennan attempted to create a unified theory. In writing for the Supreme Court that malapportionment cases were not PQDs, Justice Brennan had to turn the traditional description of the PQD on its head. Instead of progressing through any of the scholars’ doctrines, he looked at the other cases in which the Court had decided that the Constitution left the subject to the other branches. Finding this decision failed to comport with those other doctrinal lineages, he decided that malapportionment was justiciable.

Based on those other PQD lineages, Justice Brennan articulated the six prongs of the PQD in *Baker v. Carr*. Since then, the Supreme Court has eroded...
each prong until they have become trivial affectations upon a nebulous standard.\textsuperscript{21} Justice Brennan’s six-part test outlines very unique and discrete considerations useful only in a few cases.\textsuperscript{22} The confusion Justice Brennan’s test has wrought with the judiciary persists beyond its usefulness because of his six-factor test. In the wake of \textit{Baker v. Carr} and over forty years without another substantial declaration of the PQD, entire swaths of lawyers are graduating with only a passing and confusing acquaintance with the PQD. Simply put, the Baker factors have no cohesive guiding principle. Without that guiding principle, lawyers wield the Baker factors like awkward vessels and argue back and forth about meaningless facets and interpretations of the factors.

In proposing a pragmatic view of political questions, Fritz Scharpf made the most cumulative investigation into the PQD and its underpinnings.\textsuperscript{23} Unfortunately, he made that investigation in 1966.\textsuperscript{24} His analysis, then, necessarily excludes the landmark PQD-cases the Supreme Court has decided in the intervening years. These cases have confirmed the classical view with a twist of the very pragmatism he advocated.\textsuperscript{25} Supreme Court precedent since \textit{Baker} has revealed that the Supreme Court will decide an issues is a PQD if, (1) whether the Constitution commits discretion over the action solely to the Legislative and Executive Branches,\textsuperscript{26} or (2) if the political branches have exceeded their discretion under the Constitution, the Judicial Branch, the question escapes judicial competency.\textsuperscript{27}

\section*{II. Separation of Powers}

The PQD delineates a crucial aspect of the separation of powers.\textsuperscript{28} The exercise in determining which powers properly belong to another branch requires the most delicate touch.\textsuperscript{29}

\begin{itemize}
  \item a coordinate political department; or
  \item [(2)] a lack of judicially discoverable and manageable standards for resolving it; or
  \item [(3)] the impossibility of deciding without an initial policy determination of a kind clearly for nonjudicial discretion; or
  \item [(4)] the impossibility of a court's undertaking independent resolution without expressing lack of the respect due coordinate branches of government; or
  \item [(5)] an unusual need for unquestioning adherence to a political decision already made; or
  \item [(6)] the potentiality of embarrassment from multifarious pronouncements by various departments on one question.
\end{itemize}

\begin{itemize}
  \item 21. Scharpf, \textit{supra} note 10, at 548.
  \item 22. \textit{Id.} at 556.
  \item 23. \textit{Id.} at 517 (explaining the different approaches to the Political Question Doctrine).
  \item 24. \textit{Id.}
  \item 25. \textit{Id.} at 538-48.
  \item 26. \textit{Baker}, 369 U.S. at 211 (providing, “whether a matter has in any measure been committed by the Constitution to another branch of government, or whether the action of that branch exceeds whatever authority has been committed”).
  \item 27. \textit{See} Scharpf, \textit{supra} note 10, at 538-48.
  \item 28. \textit{Baker}, 369 U.S. at 210-11.
  \item 29. \textit{Id.} at 211 (explaining that the Constitution created three equal and independent branches of government, gave each separate powers and responsibilities and prohibited each branch from
Taking the strictest approach to the separation of powers literally would lead any member of the judicial branch to read the word “Congress” and to look for an express direction or permission under which the judiciary could control Congress’s delegated authority. The judiciary would find none and end the investigation there without vindicating that right. The judiciary would find no authority to contradict Congress in cases implicating the First Amendment: “Congress shall make no law... abridging the freedom of speech,” and Article I, Section 9, clause 3: “No Bill of Attainder or ex post facto Law shall be passed.” Neither of these provisions expressly directs or permits the judiciary to exercise power over bills enacted in violation of those provisions.

As James Madison explained, “[u]nless these departments be so far connected and blended as to give to each a constitutional control over the others, the degree of separation which the maxim requires, as essential to a free government, can never in practice, be duly maintained.”

[Montesquieu] did not mean that these departments ought to have no partial agency in, or no control over, the acts of each other[, but]... where the whole power of one department is exercised by the same hands which possess the whole power of another department, the fundamental principles of a free constitution are subverted.

Our constitution gives partial control, in the form of checks and balances, to enhance the liberty of every individual by giving each branch partial control over each other branch. Government formed of three co-equal branches, while absolutely necessitating independence, cannot necessitate absolute independence. The United States government is one of enumerated powers. The founders intended no act of any agent to exercise powers beyond those granted to it. The alternative construction, that an agent could interpret the Constitution for itself, would render the Constitution an entirely unenforceable aspirational document. The people could not have intended this. As Hamilton so aptly conveyed:

exercising the power of any other branch without an express authority. When the Constitution gave complete control to either the Legislative Branch or Executive Branch, the Judicial Branch properly should aver discussion and decision).

30. See id.
31. See id.
32. U.S. CONST. amend. I.
33. U.S. CONST. art. I, § 9, cl. 3.
34. See U.S. CONST. amend. I; See also U.S. CONST. art. I, § 9, cl. 3.
36. The Federalist No. 47, at 325-26 (James Madison) (Jacob E. Cooke ed. 1961); See also State ex rel. Hillis v. Sullivan, 137 P. 392 (Mont. 1913) (discussing the separation of powers in the context of inherent powers).
40. Coate, 662 P.2d at 594.
There is no position which depends on clearer principles, than that every act of a delegated authority, contrary to the tenor of the commission under which it is exercised, is void. No legislative act, therefore, contrary to the Constitution, can be valid. To deny this, would be to affirm, that the deputy is greater than his principal; that the servant is above his master; that the representatives of the people are superior to the people themselves; that men acting by virtue of powers, may do not only what their powers do not authorize, but what they forbid.

If it be said that the legislative body are themselves the constitutional judges of their own powers, and that the construction they put upon them is conclusive upon the other departments, it may be answered, that this cannot be the natural presumption, where it is not to be collected from any particular provisions in the Constitution. It is not otherwise to be supposed, that the Constitution could intend to enable the representatives of the people to substitute their will to that of their constituents. It is far more rational to suppose, that the courts were designed to be an intermediate body between the people and the legislature, in order, among other things, to keep the latter within the limits assigned to their authority. The interpretation of the laws is the proper and peculiar province of the courts. A constitution is, in fact, and must be regarded by the judges, as a fundamental law. It therefore belongs to them to ascertain its meaning, as well as the meaning of any particular act proceeding from the legislative body. If there should happen to be an irreconcilable variance between the two, that which has the superior obligation and validity ought, of course, to be preferred; or, in other words, the Constitution ought to be preferred to the statute, the intention of the people to the intention of their agents.

Nor does this conclusion by any means suppose a superiority of the judicial to the legislative power. It only supposes that the power of the people is superior to both; and that where the will of the legislature, declared in its statutes, stands in opposition to that of the people, declared in the Constitution, the judges ought to be governed by the latter rather than the former. They ought to regulate their decisions by the fundamental laws, rather than by those which are not fundamental.41

In Marbury, the Court explained that, “It is emphatically the province and duty of the judicial department to say what the law is.”42 Determining whether the Constitution or the statute controls involves an exercise in judicial power, not legislative or executive power.43 Enacting statutes requires the Legislative

43. U.S. Const. art III, § 2; See also Marbury, 5 U.S. at 177-78.
Branch to exercise its whole power. Vetoing a statute requires the Executive Branch to exercise its whole power. The Judicial Branch clearly cannot exercise those powers belonging to the Legislative or Executive Branches. The judicial branch exerts its partial control by determining whether that statute or action violates the Constitution.

III. BAKER v. CARR\textsuperscript{48} DOCTRINE

When an issue is nonjusticiable, the political branches have free reign to decide those issues without a fear of the judiciary exercising its partial control of judicial review. To determine political questions, the Supreme Court asks not whether the question has political repercussions, but whether the Constitution has committed the question’s resolution to one or both of the political branches instead of committing its resolution to the judicial branch. The Supreme Court decides questions with political overtones as a matter of course.

Chief Justice Marshall first acknowledged the PQD in \textit{Marbury v. Madison}:\textsuperscript{52}

\begin{quote}
Is the act of delivering or withholding a commission to be considered as a mere political act, belonging to the executive department alone, for the performance of which, entire confidence is placed by our constitution in the supreme executive; and for any misconduct respecting which, the injured individual has no remedy. That there may be such cases is not to be questioned; but that every act of duty, to be performed in any of the great departments of government, constitutes such a case, is not to be admitted.\textsuperscript{53}
\end{quote}

To reiterate, after progressing through the major cases implicating the PQD, Justice Brennan spoke for the Supreme Court to adopt a six-factor test to determine whether a question is a political question:

\begin{itemize}
\item 44. U.S. CONST. art I, § 8.
\item 45. U.S. CONST. art I, § 7.
\item 46. U.S. CONST. art III; \textit{See also} Marbury, 5 U.S. at 177-78.
\item 47. \textit{Marbury}, 5 U.S. at 177-78.
\item 49. See \textit{Pellegrino v. O'Neill}, 480 A.2d 476, 481-82 (Conn. 1984).
\item 50. \textit{Pellegrino}, 480 A.2d at 482; \textit{See also} Nixon v. Herndon, 273 U.S. 536, 540 (1927) (“The objection that the subject-matter of the suit is political is little more than a play upon words.”) \textit{but see} Colegrove v. Green, 328 U.S. 549 (1946), overruled by \textit{Baker} (“Courts ought not enter this political thicket.”).
\item 52. \textit{Marbury}, 5 U.S. at 137.
\item 53. \textit{Id.} at 164.
\end{itemize}
Prominent on the surface of any case held to involve a political question is found [(1)] a textually demonstrable constitutional commitment of the issue to a coordinate political department; or [(2)] a lack of judicially discoverable and manageable standards for resolving it; or [(3)] the impossibility of deciding without an initial policy determination of a kind clearly for nonjudicial discretion; or [(4)] the impossibility of a court's undertaking independent resolution without expressing lack of the respect due coordinate branches of government; or [(5)] an unusual need for unquestioning adherence to a political decision already made; or [(6)] the potentiality of embarrassment from multifarious pronouncements by various departments on one question.54

Despite the great length of the opinion, Justice Brennan never related the factors of the PQD to particular concerns or issues in the cases he cited.55 Instead, he seems to have conjured these elements from thin air.56

Most cases put forth the PQD as reconstructed in Baker57 and declare that the case sub judice satisfies the elements of a political question, so it is nonjusticiable. While these Baker elements seem to have force on their own, the Supreme Court has never determined whether the presence of one factor in the issue or the sum of multiple factors with insufficient weight on their own, but whose combined weight can become sufficient establishes a political question. As a result, the doctrine has unclear boundaries and seemingly inexplicable applications. Subsequent Supreme Court precedents have revealed that the Baker prongs are a nonexclusive list of factors to determine whether the political branches have acted within their discretion under the Constitution or whether the judicial branch is incapable of deciding the question.58 To draw a more consistent theme from these factors, one can investigate the origin of the factors and the reasons for which Justice Brennan included them in the PQD.

A. Textual Commitment to a Coordinate Branch

The contours of the textual commitment prong become apparent by comparing two Supreme Court opinions on related topics. Both Powell v.  

55. See Baker, 369 U.S. at 210.
56. Id. at 211. The court provides:
Deciding whether a matter has in any measure been committed by the Constitution to another branch of government, or whether the action of that branch exceeds whatever authority has been committed, is itself a delicate exercise in constitutional interpretation, and is a responsibility of this Court as ultimate interpreter of the Constitution. To demonstrate this requires no less than to analyze representative cases and to infer from them the analytical threads that make up the political question doctrine. We shall then show that none of those threads catches this case.
57. Id. at 217.
McCormack,59 and Nixon v. United States60 apply the “textually demonstrable constitutional commitment of the issue to a co-ordinate political department” prong.61 The former finds no political question62, but the latter does.63 The relevant distinctions give great illumination on the meaning of the prongs.

In Powell, the Eighteenth Congressional District of New York had elected Adam Clayton Powell, Jr., to serve in the House of Representatives.64 Allegations of fraudulent travel expenses and payments to Powell’s wife at Powell’s direction led the House of Representatives to refuse to seat him.65

In its opinion the Supreme Court interpreted the United States Constitution, Article I, Section 5: “Each House shall be the Judge of the Elections, Returns and Qualifications of its own Members . . .”66 After exhaustively searching the legislative history, the Supreme Court decided that, although the House of Representatives could judge the qualifications of its members, the Constitution clearly spelled out which qualifications it could judge.67 Those included only age, citizenship, and residency.68 Powell clearly met those qualifications, and the House could not add another qualification to that list.69 Thus, the textual commitment did not grant plenary power to the House of Representatives, but the Constitution bounded its discretion, and the Supreme Court enforced the Constitution’s limitations.70

In Nixon v. United States, the Supreme Court interpreted the Impeachment Trial Clause of Article I, Section 3, clause 6: “The Senate shall have the sole Power to try all Impeachments.”71 Walter L. Nixon, a former Chief Judge of the United States District Court for the Southern District of Mississippi, sued the United States alleging that the word “try” in the Impeachment Clause required the full Senate to participate in the evidentiary hearings.72 Instead, the Senate had delegated the evidentiary hearing to a committee, so the impeachment was invalid.73 After another exhaustive search of the legislative history, the Supreme Court concluded that “the word ‘try’ in the Impeachment Trial Clause does not

61. Powell, 395 U.S. at 518-22; See also Nixon, 506 U.S. at 228.
63. Nixon, 506 U.S. at 238.
64. Powell, 395 U.S. at 489.
65. Id. at 490.
66. Id. at 519.
67. Id. at 548.
68. U.S. Const. art I, § 5.
69. Powell, 395 U.S. at 548.
70. Id.
72. Id. at 228.
73. See id.
provide an identifiable textual limit on the authority which is committed to the Senate."

Were the existence of a textual commitment sufficient to create a political question, the Court could have answered both of these inquiries at the outset. In each of the relevant clauses, the text clearly identifies the branch of government and its responsibility. By the simplest determination of a textual commitment, the Court should have ended both inquiries summarily, by deciding that both cases were political questions. Nevertheless, in both cases, the Supreme Court analyzed, in great detail, the origins of the clause, the English equivalents, and the original intent. As the Powell Court recognized, “[i]n order to determine whether there has been a textual commitment to a coordinate department of the Government, we must interpret the Constitution.” In other words, we must first determine what power the Constitution confers upon the House through Art. I, § 5, before we can determine to what extent, if any, the exercise of that power is subject to judicial review.

The First Amendment to the United States Constitution provides, “Congress shall make no law respecting an establishment of religion, or prohibiting the free exercise thereof; or abridging the freedom of speech, or of the press; or the right of the people peaceably to assemble, and to petition the Government for a redress of grievances.” The text specifically mandates that Congress shall not make a law, for example, abridging the freedom of speech. Although, in light of this textual commitment, one could argue that Congress has the exclusive power to determine whether its laws abridge the freedom of speech, the Supreme Court has been judicially interpreting that clause for nearly four score and seven years.

Section 5 of the Fourteenth Amendment to the United States Constitution specifically grants that “[t]he Congress shall have power to enforce, by appropriate legislation, the provisions of this article.” That Article, of course, includes the equal protection and due process clauses. Specifically invoking that power, Congress passed the Religious Freedom Restoration Act that directed the courts to exercise strict scrutiny in interpreting facially neutral laws that affect religion. By giving Congress power to devise appropriate legislation, the Fourteenth Amendment implicitly gives Congress the power to define

74. Id. at 238.
75. See Powell, 395 U.S. at 518-48; See also Nixon, 506 U.S. at 233-35.
77. Powell, 395 U.S. at 519.
78. Id.
79. U.S. CONST. amend. I.
80. See id.
82. U.S. CONST. amend XIV, § 5.
83. U.S. CONST. amend XIV, § 1.
“appropriate.” In *City of Boerne v. Flores*, after searching the legislative history, the Supreme Court concluded that Congress had exceeded its authority to interpret the First Amendment of the Constitution and that, despite the specific textual grant of power in Section 5, Congress could not expand the First Amendment protection beyond the Supreme Court’s interpretations.

The depth of these searches suggests a more pervasive inquiry than a mere textual one. The Supreme Court has been looking not for textual commitment to another branch, but for actual commitment to another branch. These Courts searched the traditional avenues for interpreting the Constitution because they were in fact interpreting the Constitution—contrary to the result of a nonjusticiable political question, which would have excluded all Constitutional interpretation and merely dismissed the case. Textual arguments clearly have a force toward determining whether the branch has acted within its Constitutional discretion, but the Supreme Court has shown that they are not dispositive proof of a political question. Thus, textual commitment to a political branch is one non-exclusive and non-determinative factor in determining whether the political branch was acting in its discretion.

B. Lack of Judicially Discoverable and Manageable Standards

This prong of the *Baker* test has less relevance in determining whether the Constitution granted the discretion to political branches than whether the Court has competency to rule on the particular issue. In *United States v. Munoz-Flores*, the Supreme Court dismissed claims that the words “revenue” and “origin” lacked judicially discoverable and manageable standards:

> To be sure, the courts must develop standards for making the revenue and origination determinations, but the Government suggests no reason that developing such standards will be more difficult in this context than in any other. Surely a judicial system capable of determining when punishment is “cruel and unusual,” when bail is “[e]xcessive,” when searches are “unreasonable,” and when congressional action is “necessary and proper” for executing an enumerated power is capable of making the more prosaic judgments demanded by adjudication of Origination Clause challenges.

85. *Id.*
86. *Id.* at 520-24.
87. *See id.*
88. *See Powell*, 395 U.S. at 518-48; *See also Nixon*, 506 U.S. at 233-35.
89. *Id.*
90. *Henkel, supra* note 58, at 605; *see Powell*, 395 U.S. at 519.
91. *See Powell*, 395 U.S. at 518-48; *See also Nixon*, 506 U.S. at 233-35.
93. *Id.* at 395-96.
By making these comparisons, the Supreme Court implied that standards must have meanings more difficult to define than “excessive” or “necessary and proper” before they “lack judicially discoverable and manageable standards.”94 Words more ambiguous than these are difficult to find in constitutions, but one can see them if Congress were to delegate to the courts “[t]o promote the Progress of Science and useful Arts,” or “[t]o provide for the Punishment of counterfeiting the Securities and current Coin of the United States.”95

The Supreme Court has insinuated that the difficulty of defining a republican government contributed to the decision in *Luther v. Borden*.96 No exposition of the PQD can be complete without exploration into *Luther*.97 In that case, the Supreme Court first pronounced the rationale behind judicial refusal to enforce the Guarantee Clause of the United States Constitution, Article IV, Section 4.98 That clause provides that “[t]he United States shall guarantee to every State in this Union a Republican Form of Government.”99 Despite this phrase textually committing the guarantee of a republican government to the whole United States instead of a particular branch, the Supreme Court refused to adjudicate the question.100

In *Luther*, at the time of the incidents in question (1842-43), Rhode Island had continued to govern itself under the charter granted by Charles the Second in 1663.101 Some groups of citizens had become dissatisfied with the charter and longed for a more liberal government.102 They formed associations and held a convention to form a new constitution and for the adoption or rejection by the people.103 The charter government had not authorized these proceedings.104 Upon receipt of the ballots, the convention declared that the people had adopted the new constitution.105

Thomas Dorr, the new constitution’s governor, had assembled people for the forcible overthrow of the Charter government, and:

in order to defend itself from this insurrection, the State was declared by competent authority to be under martial law; that the plaintiff was engaged in the insurrection; and that the defendants, being in the military service of the State, by command of their superior officer, broke and entered [Luther’s] house and searched the rooms for

94. See id.
98. *Id.* at 4-15.
100. *Luther*, 48 U.S. at 39.
101. *Id.* at 34.
102. *Id.* at 35.
103. *Id.* at 34.
104. *Id.*
105. *Id.*
Luther brought the case for trespass alleging, “that government had been displaced and annulled by the people of Rhode Island, and that the plaintiff was engaged in supporting the lawful authority of the State, and the defendants themselves were in arms against it.”

In Luther, the Supreme Court found the question was outside the judiciary’s institutional competence in determining the factual circumstances—not that the judiciary was incapable of defining a republican government. Indeed, Chief Justice Taney, instead of asking whether the Court could divine the truth of the meaning behind “republican,” framed the questions as follows: (1) can the court yield an answer in an appropriate amount of time and (2) can the court yield an answer without subpoenaing the entire countryside? Because he answered “no” to those two questions, he declared the issue a political question. Chief Justice Taney never reached the question whether the Court could define “republican.”

Both questions implicate institutional competence challenges. Only the first two have force necessitating judicial abstention. As Munoz-Flores implies, courts will have a no more difficult time interpreting “republican” than “necessary and proper” or “cruel and unusual.” Judicial abstention is appropriate only inasmuch as a court needs to know which government to determine republican before it can decide whether that government is republican. Determining which of the two Rhode Island governments to judge for that republican quality remains a factual question outside the judiciary’s competence but within the discretion of the political branches. Courts require inordinate amounts of time and evidence to decide the question before the exigent circumstances pass into history. The Munoz-Flores court emphasized the sibylline phrases that the Supreme Court has interpreted. The Luther court emphasized the practical timing and evidentiary constraints that prevented the Court’s mechanisms from operating—instead of the Court’s inability to discern the true definition or founder’s intent behind the word “republican.”

106. Luther, 48 U.S. at 34.
107. Id.
108. Id. at 41-43.
109. Id.
110. Id. at 43.
111. Id.
112. Luther, 48 U.S. at 43.
113. Munoz, 495 U.S. at 396.
114. See Luther, 48 U.S. at 41-43.
115. Munoz, 495 U.S. at 396.
116. Luther, 48 U.S. at 41-43.
C. Impossibility of Deciding without an Initial Policy Determination of a Kind Clearly for Nonjudicial Discretion

To wait for an initial nonjudicial policy determination before the judiciary can decide the issue means a political branch must make a policy determination first. If a constitutional provision requires a political branch to enact legislation or make policy determinations enforcing that provision, the provision is non-self-executing.117 Alternately, if the judiciary can enforce the provision without a legislative enactment or political determination, that provision is self-executing.118 Finally, framers may intend a provision to be self-executing but provide too little guidance for judicial enforcement, so the judiciary must make the provision non-self-executing.119 “If [a provision] is not self-executing, it constitutes merely a declaration of broad public policy and is advisory, and if the legislature fails to act, no remedy is available to anyone.”120

Determining whether the clause is non-self-executing or self-executing raises the same questions inherent in any political question. Non-self-executing provisions imply that either the framers intended a political branch have discretion or that the framers intended the judicial branch have discretion, but execution of the provision evades judicial competence.121 Non-self-executing does not require that, because the framers left the initial policy determination in the hands of the political branches once, all political branch acts pursuant to that provision are valid.122 Instead, as in United States v. Nixon,123 once a branch adopts a policy affecting the rights of individual citizens, the rule of law requires that that policy affect the President as well.124

A court cannot make law from whole cloth based on a non-self-executing provision.125 To that point, the provisions present political questions.126 Once a political branch executes a law pursuant to those non-self-executing provisions, however, that law must conform to the Constitution, and issues concerning that provision of the Constitution no longer present political questions.127

118. Id.
120. Id. at 707.
121. See id. at 700.
122. See United States v. Nixon 418 U.S. 683, 693-96 (concluding that, once the executive branch had positively limited its own discretion, the President could not act contrary to that limitation without promulgating another rule repealing that limitation).
123. Id.
124. Id.
125. Cohens, 19 U.S. at 292.
126. See id.
127. See City of Boerne v. Flores, 521 U.S. 507, 535-36 (1997). Also see Columbia Falls Elementary Sch. Dist. No. 6 v. State, 109 P.3d 257 (Mont. 2005) (deciding that, “(1) once the Legislature has acted, or ‘executed,’ a provision (2) that implicates individual constitutional rights, courts can determine whether that enactment fulfills the Legislature’s constitutional responsibility.”).
political question considerations for non-self-executing provisions remain: have the political branches exceeded the discretion granted by the framers and is the judiciary competent to enforce the provision?

D. Impossibility of a Court's Undertaking Independent Resolution Without Expressing Lack of the Respect Due Coordinate Branches of Government

Generally this prong has little foundational support. If a court, in interpreting a constitution, expresses a lack of respect of another branch, it implies that the other branch has already interpreted the constitution contrariwise.128 Of course, courts can strike down unconstitutional laws,129 so finding laws unconstitutional cannot constitute lack of respect or all constitutional challenges would be political questions for the judiciary. Instead, this prong must be an instruction to the judiciary to exercise circumspection concerning political branch actions within the branches’ discretion.

E. Unusual Need for Unquestioning Adherence to a Political Decision Already Made

There appears to be little support for Justice Brennan’s creation of this prong and the post-Baker Supreme Court has never applied this standard to any political question case.130 Justice Brennan must have derived this principle from Luther: “If the judicial power extends so far [as to require judicial intervention in resolving this issue], the guarantee [of a republican form of government] contained in the Constitution of the United States is a guarantee of anarchy, and not of order.”131 The Luther court found the unusual need for unquestioning adherence to the political branches’ decision based on the critical timing of the situation.132

As previously noted in the analysis of Baker prong two, the extensive time the court required to answer the question combined with the extraordinary evidentiary record the court required created the unusual need to adhere to the political branches’ decisions.133 Courts have inadequate tools to decide legal questions when the answers would necessitate differing military responses.134 Again, the considerations salient in this prong derive from questions of judicial competency.

130. Henkel, supra note 58, at 605-06, n.27.
131. Luther v. Borden, 48 U.S. 1, 44 (1849).
132. Id. at 41-43.
133. Id.
134. See id. at 44 (“Could the court, while the parties were actually contending in arms for the possession of the government, call witnesses before it and inquire which party represented a majority of the people?”).
F. Potentiality of Embarrassment from Multifarious Pronouncements by Various Departments on One Question

Constitutional litigation and judicial decisions, by their very nature, imply the courts are open to adjudicate the excesses of the political branches. Every time a court finds a law unconstitutional, a question of embarrassment cannot arise, or every question would be a political question. To determine what satisfaction of this prong requires, one must, first, determine what it says.

The word “embarrassment” itself has a rather embarrassing quantity of meanings and presents an embarrassing question: “1: to hamper or impede the movement or freedom of movement of,” “2 a: to place in doubt, perplexity, or difficulties,” “c: to cause to experience a state of self-conscious distress,” “d: to impair the activity of or the function of,” “3: to make intricate.” Justice Brennan could not have implied embarrassment’s meaning of intricacy because the Supreme Court’s interpretation of the Constitution is final. Thus, the political branches’ possible alternate interpretations have no force to the extent that the judicial interpretation contradicts them. The intricacy and complexity resulting are common results of legal interpretations, so Justice Brennan could not have meant to prevent that type of embarrassment.

Causing self-conscious distress requires a fear of external interpretations upon oneself. One cannot be embarrassed about oneself except inasmuch as those internal realizations reflect possible or probable external interpretations by others of the embarrassed person’s qualities. So long as the external world cannot view one’s actions, those actions cannot cause embarrassment. Conflicts with only internal repercussions cannot embarrass. Only when the branches make multifarious pronouncements on foreign relations can embarrassment possibly exist.

As a result, for the federal government, such an embarrassing action requires an action of international relations. For the state government, it requires an action concerning a relation between the state and federal government or a relation between states. Consider, for example, the First Circuit case concerning the constitutionality of the United States military involvement in Vietnam and Southeast Asia without a congressional declaration of war. Suppose the Supreme Court had decided the question whether the troops were in Vietnam legally and decided they were not. Further, suppose that the President had

137. See Powell, 395 U.S. 486, 518-49 (1969) (“Our system of government requires that federal courts on occasion interpret the Constitution in a manner at variance with the construction given the document by another branch. The alleged conflict that such an adjudication may cause cannot justify the courts’ avoiding their constitutional responsibility”).
138. See Massachusetts v. Laird, 451 F.2d 26, 26-27 (1st Cir. 1971).
139. See id.
140. See id.
refused to bring the troops home. In that case, the United States government would have had multifarious pronouncements on a single question.\textsuperscript{141}

Such a gross inconsistency in international policy would have created an international outcry against the President’s actions to leave the troops in Vietnam. This situation would have created embarrassment in the meaning of placing in doubt, perplexity, or difficulties, in the meaning of impairing the activity of or the function, and in the meaning of hampering or impeding the movement or freedom of movement of the United States. The multifarious pronouncements by various departments on one question would have made the political branches’ actions more difficult to complete because the proliferation of interpretations makes the less clear questions more complex.\textsuperscript{142} That such issues would be nonjusticiable follows both from the U.S. Constitution’s clear authorization to the political departments to chart the course of foreign affairs and from the ineffectiveness of any judicial decision to change that course.\textsuperscript{143} For these reasons, the political branches have acted within their discretionary and judicial competence wanes in foreign affairs.\textsuperscript{144} Thus, those cases should be nonjusticiable because of intended discretion and lack of judicial competence.

\section*{IV. THE POLITICAL QUESTION DOCTRINE FOR THE TWENTY-FIRST CENTURY}

The interpretation of the Constitution lies in the judiciary.\textsuperscript{145} Under the guise of the separation of powers, the Constitution mandates the PQD because the Constitution assumes that each branch has a sphere of discretion independent from the other branches: the presidential veto,\textsuperscript{146} the legislative power to legislate,\textsuperscript{147} and the judicial power to decide cases and controversies.\textsuperscript{148} Similarly, some branches have better tools and skills at answering particular questions: the President best executes governmental objectives, Congress best makes initial policy determinations, and the judiciary best interprets the laws.

The PQD provides the judiciary a tool for determining whether either of these considerations is present in the instant controversy such that the

\begin{itemize}
  \item See id.
  \item Oetjen v. Cent. Leather Co., 246 U.S. 297, 302 (1918) (“The conduct of the foreign relations of our government is committed by the Constitution to the executive and legislative- ‘the political’- departments of the government, and the propriety of what may be done in the exercise of this political power is not subject to judicial inquiry or decision.”).
  \item Hirabayashi v. United States, 320 U.S. 81, 93 (1943) providing in pertinent part;
    Since the Constitution commits to the Executive and to Congress the exercise of the war power in all the vicissitudes and conditions of warfare, it has necessarily given them wide scope for exercise of judgment and discretion in determining the nature and extent of the threatened injury or danger and in the selection of the means for resisting it.
  \item Marbury, 5 U.S. at 177-78.
  \item U.S. Const. art I, § 7.
  \item U.S. Const. art I, § 8.
  \item U.S. Const. art III, § 2.
\end{itemize}
Constitution mandates the judiciary extricate itself. The PQD contains two inquiries: if (1) the power lies within the discretion of one of the political branches or (2) if the political branches have exceeded their discretion under the Constitution and the question escapes judicial competency, it is a political question.¹⁴⁹

Under a constitution limiting the powers of the government, any branch may act in its discretion if and only if the Constitution does not limit that discretion; alternatively, questions arise requiring answers for which the Judiciary has inadequate tools to assess the origin and repercussions of possible decisions.¹⁵⁰ For the former type of question, of course, judicial determinations are unnecessary and unwarranted.¹⁵¹ For the latter type of question, the people’s representatives in Congress and the White House can undertake studies, consider testimony of whomever they please, and consult their constituents.¹⁵² Those additional implements give the political branches enhanced perspective and superior position to affect the people’s will. As such, the Court will defer in those instances.

To determine whether the Constitution has committed determination of a decision to one of the political branches, the Supreme Court should consider traditional interpretive techniques including, but not limited to, (1) whether the provision is non-self-executing and the responsible branch has not executed it;¹⁵³ (2) whether the text commits the decision to a political branch;¹⁵⁴ (3) in cases of ambiguity, whether the legislative history implies that the delegates, indeed, intended to commit the decision to a political branch;¹⁵⁵ and (4) whether the controversy involves criteria traditionally committed to the judicial branch.¹⁵⁶

¹⁴⁹. See 13A CHARLES ALAN WRIGHT ET AL., FEDERAL PRACTICE AND PROCEDURE § 3534 at 453 (2d ed. 1984); Henkel, supra note 58, at 612. This determination differs from the separation of powers question in Youngstown Sheet & Tube Co. v. Sawyer, 343 U.S. 937 (1952). The Youngstown case questions to which branch did the power belong while it assumed that one of the branches held sufficient discretion under the Constitution.

¹⁵⁰. 13A CHARLES ALAN WRIGHT ET AL., FEDERAL PRACTICE AND PROCEDURE § 3534 at 453 (2d ed. 1984); Henkel, supra note 58, at 612.

¹⁵¹. See id.

¹⁵². See id.


The Supreme Court should first determine whether the provision is self-executing, and, if not, whether Congress has executed it.\textsuperscript{157} If the provision is non-self-executing and Congress has not executed it, the Supreme Court will abstain from adjudicating the question.\textsuperscript{158} Assuming this prong does not bar adjudication, the Supreme Court should interpret the text and the legislative history if the text is ambiguous.\textsuperscript{159} Of course, if these interpretations support the Supreme Court’s involvement, the Supreme Court should involve itself.\textsuperscript{160} If, however, these inquiries lend support to judicial abstention or leave ambiguities as to whether the founders intended the provision to lie within the discretion of the political branches, the Court should look to the nature of the provision.\textsuperscript{161} If the provision involves, for example, individual rights, the Court should feel more comfortable assuming the founders intended the Court intervene, because the founders expected the Supreme Court to protect individual rights.\textsuperscript{162} In every case, the ultimate question is whether the founders intended the question to lie within the discretion of the political branches.\textsuperscript{163}

If the political branches have exceeded their discretion under the Constitution, the Court may still have difficulty deciding the question for reasons beyond its control. To determine whether the issue lies beyond judicial competence, the Supreme Court should consider the nonexclusive list (1) whether the question lacks judicially discoverable and manageable standards for

\textsuperscript{157} Stafford, 132 P.2d at 699-701.

\textsuperscript{158} Id.

\textsuperscript{159} See Marbury v. Madison, 5 U.S. 137, 177-78 (1803).

\textsuperscript{160} Id.

\textsuperscript{161} Id.

\textsuperscript{162} See John Hart Ely, Democracy and Distrust: A Theory of Judicial Review, 103 (Harv. Univ. Press) (1980) (arguing that the Court should involve itself to lubricate the “channels of political change”). Characterizing Court activities, such as redistricting, as protecting individual rights lends credence to the belief that the founders had intended the Supreme Court to decide the issues. Overtly asserting political process theory does not lend any more credence to the belief that the founders intended the Court to decide the issues except inasmuch as they generally intended the three branches to check the others. “Ambition must be made to counteract ambition.” The Federalist No. 51, at 349 (James Madison) (Jacob E. Cooke ed. 1961).

\textsuperscript{163} Hamdi v. Rumsfeld, 124 S.Ct. 2633, 2645 (2004). The Supreme Court balanced “the limited institutional capabilities of courts in matters of military decision-making in connection with an ongoing conflict” against whether “an individual challenging his detention may not be held at the will of the Executive without recourse to some proceeding before a neutral tribunal to determine whether the Executive’s asserted justifications for that detention have basis in fact and warrant in law.” Id. In cases of conflicting constitutional powers, the Court must balance the interests on both sides to determine which branch the founders intended have discretion over the situation. Id. See also id. at 2674, 2684 (Thomas, J., dissenting) (interpreting the intention of the founders to have given the Executive Branch carte blanche to protect the nation, so the majority’s balancing was unauthorized by the founders and asserting that “there is no particular reason to believe that the federal courts have the relevant information and expertise to make this judgment.”).
resolving it,\textsuperscript{164} (2) whether the available time allows for a meaningful decision,\textsuperscript{165} and (3) whether the facts necessitate a judicial determination of legislative facts.\textsuperscript{166} Clearly, if an issue lacks judicially discoverable and manageable standards for resolving it, the judiciary should abstain.\textsuperscript{167} If the judiciary has an insufficient amount of time—if, for example, the tide of war is moving upon the country—the judiciary should abstain.\textsuperscript{168} Finally, questions that necessitate judicial determinations of legislative facts require the judiciary to abstain.\textsuperscript{169} Courts cannot decide if an optician can better fit a lens than an ophthalmologist or an optometrist.\textsuperscript{170} If any of these factors is present, the Supreme Court should conclude the question is a political question.

V. THE SPECIAL CASE OF SECOND-DEGREE NON-SELF-EXECUTING PROVISIONS

At times, courts face a second-degree political question. Non-self-executing provisions are political questions until a political branch has rendered legislation or a policy decision on the provision.\textsuperscript{171} Once a political branch has legislated or made a policy decision, this Court can review it for consistency with the Constitution.\textsuperscript{172} That second-degree review may present another political question in addition to the original political question. Perhaps the most blatant example of this would be: “Congress shall grow the economy.”\textsuperscript{173} Because this clause begins with “Congress shall,” it is non-self-executing, so the courts cannot involve themselves.

Once Congress acts to grow the economy, however, the courts can determine whether Congress acted within its discretion. It can ignore the dilemma posed by the non-self-executing provision and determine whether the law comports with the Constitution. Thus, the issue has passed the first-degree PQD review. In this hypothetical, the courts could decide whether Congress has successfully grown the economy. Of course, no court would determine whether the law actually grows the economy because that question is a political question under


\textsuperscript{165} Luther v. Borden, 48 U.S. 1, 41-43 (1849).

\textsuperscript{166} Id.

\textsuperscript{167} See Baker, 369 U.S. at 217; see Hamdi, 124 S.Ct. at 2673-74.

\textsuperscript{168} Luther, 48 U.S. at 41-43.

\textsuperscript{169} Id.


\textsuperscript{171} Baker, 369 U.S. at 217 (“the impossibility of deciding without an initial policy determination of a kind clearly for nonjudicial discretion”); See also City of Boerne v. Flores, 521 U.S. 507, 520-24 (1997) (“It is for Congress in the first instance to ‘determin[e] whether and what legislation is needed to secure the guarantees of the Fourteenth Amendment,’ and its conclusions are entitled to much deference.”).

\textsuperscript{172} See City of Boerne, 521 U.S. at 520-24.

\textsuperscript{173} U.S. Const. art I, § 8.
the second type of PQD, whether the issue escapes judicial competency. The conscientious court will re-classify the question as a political question and refuse to decide it. The issue fails the second-degree PQD review.

This second-degree-PQD occurred in *Montana Stockgrowers Assoc. v. Dept. of Revenue*174. In that case, the Montana Supreme Court confronted Article XII, Section 1: “[t]he legislature shall provide for a Department of Agriculture and enact laws and provide appropriations to protect, enhance, and develop all agriculture.”175 Because “[t]he language provides a broad directive whose specifics are implemented through legislative decision,” the Montana Supreme Court decided that was a non-self-executing provision.176 Despite enacting a law executing this provision, the phrase “protect, enhance, and develop all agriculture” creates policy decisions so far beyond judicial competency that further explanation is unnecessary.177 As a result, the PQD prevented the court from adjudicating this question.

VI. CONCLUSION

When courts apply a test that fails to illuminate the considerations operative in the decision, they obscure transparency and confuse their own applications. Justice requires tests that clearly and accurately describe the operative judicial considerations. Impenetrable legal analysis harms the understanding of the lower courts, the lawyers, the party, and later courts attempting to use the opaque reasoning. Whether or not the parties raise such issues, courts have duties to clarify their reasons, their internal tests, and their considerations. Abandoning that means abandoning the very reason for which we have precedent to expand the knowledge of the law and prevent re-inventing the wheel.

Lawyers name doctrines so that, upon their utterance, a cascade of precedent, principles, and, indeed, legal theory may fall unto the reader that he may better understand the seamless web of the law. By abandoning the time-tested shortcut of giving names to nouns, we lose invaluable connotations, necessary connections to similar nouns, and efficient abstractions of detailed analysis. The Supreme Court left these considerations behind by forming the clunky and awkward definition of the PQD. *Hamdi v. Rumsfeld*179 has shown the inefficiency inherent in the nameless system and the stifling effect that system has on clear, effective debate. The majority and both dissents discuss the political question doctrine without naming it.180 We could as easily discuss a sweet smelling flower with thorns and velvet petals, sometimes red, white,
yellow, or black; or we could discuss a rose. While both conceptions mean the same thing, the name, “rose”, brings the flood of memories about roses, so it is more useful.

Questions implicating the separation and balance of powers and the interpretation of the will of the founders will persist in this perpetual War on Terror, in the immediate future, and into the distant future. The Supreme Court should have a functional framework to use to decide cases of such profound importance. Instead of wandering in the dark looking for a way to balance the different values inherent in the questions, they should call a spade a spade and recognize the method of their own cognition; in this case, they call it the Political Question Doctrine.
A “FEEBLE EFFORT TO FABRICATE NATIONAL CONSENSUS”:  
THE SUPREME COURT’S MEASUREMENT OF CURRENT SOCIAL ATTITUDES 
REGARDING THE DEATH PENALTY

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Twice in recent years the U.S. Supreme Court has faced questions regarding the constitutionality of death sentences imposed upon members of a group of arguably lower culpability. In response to both the execution of the mentally retarded and juveniles the Court’s rulings hinged on whether contemporary public sentiment would consider the imposition of death to be cruel and unusual punishment and therefore barred under the Eighth Amendment.1 While the Court generally maintains no direct interest in societal attitudes, the Court has held for almost a century that public notions of propriety are central to the operative meaning of cruel and unusual punishment.2 Thus, in both Atkins and Simmons the Court overturned precedents from the 1980s when it concluded that a new national consensus had emerged regarding the breadth with which the public believed death sentences should be imposed.3

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3. Simmons, 125 S. Ct. at 1189.
In *Atkins*, public opinion data was marshaled in support of the majority’s contention that contemporary public sentiment revealed consensus opposition to the execution of the mentally retarded.\(^4\) However, this survey evidence was referenced only in the most tangential way. But even this modest nod toward a scientific measure of community sentiment was met with scorn from Chief Justice Rehnquist and Justice Scalia, both of whose dissents were joined by Justice Thomas.\(^5\)

In his dissent, Scalia wrote that the majority’s use of public opinion results earned it “the Prize for the Court’s Most Feeble Effort to fabricate ‘national consensus.’”\(^6\) The majority’s conclusion regarding the people’s view of executing the mentally retarded, Scalia suggested, was “empty talk.”\(^7\)

In his dissenting opinion, Chief Justice Rehnquist piled on the criticism, arguing that *Atkins* was “a post hoc rationalization for the majority’s subjectively preferred result rather than any objective effort to ascertain the content of an evolving standard of decency.”\(^8\) He explained that it was necessary for him to write a separate dissent “to call attention to the defects in the Court’s decision to place weight on . . . opinion polls in reaching its conclusion.”\(^9\)

Although Rehnquist, Scalia, and Thomas were not in the majority, *Atkins* nevertheless represents a continuing triumph for a vision of the Eighth Amendment free from the limitations of accurately measured public sentiment. Indeed, their position was only further bolstered three years later in *Simmons* when the majority opinion identified a “national consensus” against the execution of juveniles without mention whatsoever of public opinion.\(^10\)

This is a puzzling development. The Court has long held that the Eighth Amendment draws its meaning from the “evolving standards of decency” of the American people.\(^11\) Yet none of the current members of the Court endorse the notion that the way we learn what people think is to ask them.

This article, examines the Court’s hostility toward public opinion when it grapples with questions of community sentiment. This article also demonstrates that public opinion is a more reliable gauge of “evolving standards of decency” than either of the measures upon which the Court currently relies. In Part I, we explore the Court’s use or disregard of social scientific evidence in a number of death penalty decisions. Over the past decades, the Court has grown increasingly hostile to social scientific research; indeed, a number of recent decisions have not only explicitly ignored social scientific evidence, but have outright attacked its validity. In Part II we examine the Court’s discussion of

\(^4\) *Atkins*, 536 U.S. at 316 n.21.

\(^5\) *Id.* at 322 (Rehnquist, C.J., dissenting); *Id.* at 347 (Scalia, J., dissenting).

\(^6\) *Id.* at 347 (Scalia, J., dissenting).

\(^7\) *Id.* at 348.

\(^8\) *Id.* at 322 (Rehnquist, C.J., dissenting).

\(^9\) *Id.*

\(^10\) *Simmons*, 125 S. Ct. at 1184.

locating a “national consensus” in Eighth Amendment cases, paying particular attention to the dissents of Chief Justice Rehnquist and Justice Scalia in Atkins. Those dissents reveal an extreme (and unfounded) opposition to public opinion polling, especially given the Atkins majority’s tepid reference to survey data. Indeed, what is revealed is a remarkable overreaction to public opinion data.\footnote{Simmons, 125 S. Ct. at 1230 (Scalia, J., dissenting).} This overreaction, of course, is instructive for a number of reasons. In Part III we review the two measures of public sentiment about which the Court is in agreement—state legislative action and jury verdicts in death penalty cases. These two measures are not only inappropriate (and inaccurate) measures of public sentiment, but they are also biased in favor of the death penalty. In Part IV, we discuss the utility of public opinion polling as a measure of public sentiment. Public opinion polling, we demonstrate, produces valid and reliable evidence of public sentiment—evidence that the Court should consider when it must, according to its own decisions, locate the prevailing public sentiment.

I. THE COURT’S USE OF SOCIAL SCIENCE EVIDENCE

In \textit{Weems v. United States}, the Court established the important role that public sentiment plays in determining the meaning of the Eighth Amendment’s prohibition against cruel and unusual punishments.\footnote{See Weems v. United States, 217 U.S. 349 (1910).} Writing for the Court, Justice McKenna declared that the meaning of the Eighth Amendment would change with changes in public attitudes about previously accepted forms of punishment. He noted that “[t]he clause of the Constitution [the Eighth Amendment] . . . may be therefore progressive, and is not fastened to the obsolete, but may acquire meaning as public opinion becomes enlightened by a humane justice.”\footnote{Id. at 378 (emphasis added).} Justice McKenna emphasized the importance of the notion that the Eighth Amendment was an evolving protection, noting that “our contemplation cannot be only what has been, but of what may be.”\footnote{Id. at 373.}

Nearly fifty years later, in \textit{Trop v. Dulles}, the Court’s plurality reemphasized the \textit{Weems} notion that any definition of the Eighth Amendment, or any indicator of public sentiment on the Amendment’s meaning, must be contemporary because the definition of cruel and unusual was not only changing but improving.\footnote{Dulles, 356 U.S. at 127.} Writing for the plurality, Chief Justice Warren stated that,

\begin{quote}
The basic concept underlying the Eighth Amendment is nothing less than the dignity of man. While the State has the power to punish, the Amendment stands to assure that this power be exercised within the limits of civilized standards . . . . The Amendment must draw its
meaning from the evolving standards of decency that mark the progress of a maturing society.  

Thus the cornerstone of Eighth Amendment jurisprudence, and what it means to prohibit cruel and unusual punishment, is inextricably linked to the American people’s “evolving standards of decency.” The Eighth Amendment, then, becomes atypical in a constitutional interpretive sense. Where the Court typically eschews the vagaries of public sentiment when determining the meaning of the Constitution, the Court explicitly looks to public attitudes when interpreting the Eighth Amendment.

As one commentator noted, the effect of defining cruel and unusual punishment in light of public attitudes and an evolving standard of decency is that “[J]ustices in these Eighth Amendment cases become transformed into social scientists: They must gather, categorize, analyze, and draw conclusions” from data. Indeed, public opinion data played a significant role in two landmark death penalty decisions in the 1970s. The majority in Furman v. Georgia issued five separate concurring opinions with the ultimate result that existing death sentences and death sentencing practices in the United States were invalidated. Public opinion played a central role in Justice Brennan’s and Justice Marshall’s concurrences – the two most far reaching opinions in the case. Justice Brennan’s concurrence concluded that the death penalty violated the Eighth Amendment because “society has in fact rejected this punishment,” and cited “polls and referenda” as evidence. Justice Marshall similarly noted that

17. Id. at 100-101.
18. Roper v. Simmons, 125 S. Ct. 1183, 1190 (2005). In Simmons, Scalia acknowledged that the modern Court had defined the Eighth Amendment as “an ever-changing reflection of the ‘evolving standards of decency’ of our society,” but he continued to find the holding “mistaken.” Id. at 1222 (Scalia, J., dissenting). “Nothing in the text,” Scalia concluded, “reflects such a distinctive character.” Id. at 1228 n.9 (Scalia, J., dissenting). Moreover, “this is no way to run a legal system.” Id. at 1230 (Scalia, J., dissenting). Instead, Scalia suggested the Eighth Amendment should retain its meaning as fixed at the time of ratification. Id. at 1230 (Scalia, J., dissenting). Scalia made that assertion while acknowledging “At the time the Eighth Amendment was adopted, the death penalty could theoretically be imposed for the crime of a 7-year-old.” Id. at 1218 n.1 (Scalia, J., dissenting). In stark contrast, and reflecting the more typical conclusion of her colleagues, O’Connor wrote in Simmons,

It is by now beyond serious dispute that the Eighth Amendment’s prohibition of ‘cruel and unusual punishments’ is not a static command. Its mandate would be little more than a dead letter today if it barred only those sanctions–like the execution of children under the age of seven–that civilized society had already repudiated in 1791.

Id. at 1206-7 (O’Connor, J., dissenting).
22. Furman, 408 U.S. at 238.
23. Id. at 299-300 (Brennan, J., concurring).
the death penalty violated the Eighth Amendment because “popular sentiment abhors it.”24

Even the dissenting justices in Furman – including then-Justice Rehnquist – consulted public opinion to support their argument that the death penalty did not violate the Eighth Amendment because the American people had not rejected execution.25 The dissenters noted that “polls...have shown nothing approximating the universal condemnation of capital punishment.”26 And in a separate dissent also joined by Justice Rehnquist, Justice Powell noted that public “opinion on capital punishment is ‘fairly divided’” and that state referenda on the death penalty had not consistently rejected the practice.27

Four years later, in Gregg v. Georgia, public opinion remained relevant as the Court in effect reinstated the death penalty.28 In a plurality opinion, Justice Stewart noted the results of public opinion polls and various state referenda that demonstrated majority support for the death penalty. Justice Stewart concluded that “a large proportion of American society continues to regard it [the death penalty] as an appropriate and necessary criminal sanction.”29 Given the centrality of social scientific evidence to the questions the Court was dealing with, a number of scholars expected social science evidence not only to continue to play a role in Court decision making on the death penalty, but will play an increasingly significant role.30 Indeed, these scholars appeared to be correct when, one year after Gregg, the Court considered whether a convicted rapist could constitutionally be sentenced to death.31 Justice White, writing for the Court in Coker v. Georgia, acknowledged that “attention must be given to the public attitudes concerning a particular sentence.”32 Accordingly, Justice White continued, interpretation of the Eighth Amendment “should be informed by objective factors to the maximum possible extent.”33 But in a departure from previous Supreme Court decisions, Justice White limited the “objective factors” necessary to gauge public sentiment to state legislative action and jury decisions.34 Justice White repeatedly cited Gregg in support of his decision to limit evidence of public sentiment to state legislative action and juror decisions despite Gregg’s numerous references to more direct measures of public thought such as public opinion polls and state referenda results. White made no effort to

24. Id. at 332 (Marshall, J., concurring).
25. Id. at 385 (Burger, C.J., dissenting).
26. Id. at 386 (Burger, C.J., dissenting).
27. Id. at 441 n.36 (Powell, J., dissenting).
29. Id. at 179.
32. Id.
33. Id.
34. Id. at 595-96. Future cases would refer to those two measures as the “objective indicia” of public preferences. See Simmons, 125 S.Ct. at 1192; Atkins, 536 U.S. at 324.
explain the sudden disappearance of public opinion beyond his assertion that there simply is no difference between popular opinion and legislative action: “This public judgment as to the acceptability of capital punishment” is “evidenced by the . . . legislative reaction in a large majority of the States.”

Thus in *Coker* the Court unexpectedly moved away from consulting social science for measuring “evolving standards of decency.” And it has not returned to consider public opinion in any substantial fashion since. Indeed, under Chief Justice Rehnquist, the Court has all but eliminated any contemplation of public opinion from its work.

A chorus of social scientists and legal scholars has lamented the Court’s unwillingness to consider and apply relevant public opinion polls and other social science evidence in death penalty cases since *Coker*. For instance, some commentators note that there is available valid social science research that speaks to such questions as whether the death qualification of jurors creates biased capital juries and whether death penalty prosecutions are racially biased. Others note that while social science evidence is slowly changing the public debate about the death penalty by increasing public awareness of such issues as deterrence, bias, cost, and innocence, the Court has only grown more hostile to available scholarship. Indeed, some argue that the Court has not only ignored social science evidence, but has increasingly come to conclusions in

35. *Id.* at 594. Scalia would later similarly equate public preferences with legislative action. In *Stanford*, he wrote for the Court that a “national consensus” can be found by scrutinizing “the operative acts (laws and the application of laws) that the people have approved.” *Stanford v. Kentucky*, 492 U.S. 361, 377 (1989). The mechanism for the people to approve such laws was not specified.


conflict with available data\textsuperscript{43} even while spending more energy attacking research findings than considering them.\textsuperscript{44}

As scholars have pointed out, however, it should come as no surprise that the value of social scientific evidence waned with the ascendancy of Rehnquist to Chief Justice.\textsuperscript{45} Rehnquist’s open objection to social science evidence in the courts dates back to his memos supporting segregation in the 1950s. As a clerk to Justice Jackson, Rehnquist wrote that there was no place for “sociological views”\textsuperscript{46} in the landmark \textit{Brown v. Board of Education} decision.\textsuperscript{47} In a separate memo, Rehnquist noted that discrimination was not a subject the government should pay any attention to because the Court does not have a role as a “sociological watchdog.”\textsuperscript{48}

In various decisions related to the death penalty, Chief Justice Rehnquist has not been satisfied with merely ignoring social scientific evidence; he has spent considerable energy attacking it in his opinions. In \textit{Lockhart v. McCree},\textsuperscript{49} which addressed whether death-qualifying a jury produces a jury more likely to impose a sentence of death, Rehnquist dismissed the social science studies before the Court as “too tentative and fragmentary.”\textsuperscript{50} He then concluded that the citation of public opinion polls, whose respondents “were not actual jurors sworn under oath to apply the law to the facts of an actual case involving the fate of an actual capital defendant,” tells us nothing about the differences between those who would be death qualified and those who would not.\textsuperscript{51}

But the Chief Justice did not stop there. He wrote that he would disregard even valid social scientific evidence because he deemed it to be irrelevant.

Having identified some of the more serious problems with McCree’s studies, however, we will assume for purposes of this opinion that the studies are both methodologically valid and adequate to establish that ‘death qualification’ in fact produces juries somewhat more ‘conviction-prone’ than ‘non-death-qualified’ juries. We hold, nonetheless, that the Constitution does not prohibit the States from ‘death qualifying’ juries in capital cases.\textsuperscript{52}

\textsuperscript{43} See Haney & Logan \textit{supra} note 37.
\textsuperscript{44} See Acker \textit{supra} note 37.
\textsuperscript{45} See Haney & Logan \textit{supra} note 37.
\textsuperscript{48} YARBROUGH \textit{supra} note 46, at 2.
\textsuperscript{50} \textit{Id.} at 171 (quoting Witherspoon \textit{v. Illinois}, 391 U.S. 510, 517-18 (1968)).
\textsuperscript{51} \textit{Id.} at 171.
\textsuperscript{52} \textit{Id.} at 173.
In short, Rehnquist questioned the validity of the social science submitted to the Court in *Lockhart* and then concluded that he would ignore social scientific evidence regardless of its validity.53

Justice Scalia’s appointment to the Court the same year that Rehnquist was named Chief Justice served to further embolden the Court’s hostility toward social science evidence. Yet even a quick perusal of Justice Scalia’s opinions reveals that his reasoning, ironically, has often made a strong case for attending to public opinion.

In *Stanford v. Kentucky*, Justice Scalia wrote that “We emphasize that it is *American* conceptions of decency that are dispositive” in defining what is acceptable under the Eighth Amendment.54 Indeed, the Eighth Amendment is given meaning by “demonstrable current standards of our citizens.”55 Scalia went on to write that, “[t]he punishment is either ‘cruel and unusual’ (i.e., society has set its face against it) or it is not. The audience for these arguments, in other words, is not this Court but the citizenry of the United States. It is they, not we, who must be persuaded.”56

Scalia reiterated this position when the Court again dealt with the juvenile death penalty in *Simmons*.57 “[T]he only legitimate function of this Court is to identify a moral consensus of the American people.”58

Scalia, then, acknowledged that “evolving standards of decency” are determined by what American citizens think, yet he dismissed any means of direct measurement of those thoughts. The Court cannot rely on “socioscientific, ethicoscientific, or even purely scientific evidence,”59 but instead should limit itself to the two “objective indicia” of community sentiment suggested in *Coker*: legislative action and capital jury decisions. Public opinion polls, ironically, are not “objective indicia” of community sentiment, but rather, only part of a lesser category Scalia labels “other indicia.”60

One commentator has argued that Scalia’s move, which has been joined by the other members of the Court, to delegitimize any other indicator of community sentiment represents an indefensibly illogical method of analysis.61 Instead of considering the full range of available evidence, or focusing on the best and most representative measures available, Scalia summarily strikes

53. *Id.* at 170.
55. *Id.* at 379.
56. *Id.* at 378.
57. Roper v. Simmons, 125 S. Ct. 1183, 1222 (Scalia, J., dissenting).
58. *Id.* Even what amount to questions of fact are, in Scalia’s view, to be seen through the lens of public opinion. In *Callins v. Collins*, for example, Scalia concluded that the deterrence effect of the death penalty, if any, is not a question for the Court to answer. Instead, it is left to “the people” to conclude whether future deaths “may be deterred by capital punishment.” Callins v. Collins, 510 U.S. 1141, 1143 (1994) (Scalia, J., concurring).
60. *Id.* at 377.
61. See Finkel supra note 20.
information, including public opinion polls, based largely on whim. A similar maneuver by a social scientist to summarily ignore readily available relevant and valid measures would likely lead to professional ridicule.62

The Court’s decisions in Atkins v. Virginia and Roper v. Simmons are illustrative, not only of Scalia’s and Rehnquist’s revulsion toward public opinion data as evidence of public sentiment, but also of the nearly complete absence of public opinion from the debate.

II. DEFINING CONSENSUS

A. Conservative Dissents in Atkins

When the Court decided that the state of Virginia could not execute Daryl Atkins, a mentally retarded man, because it would violate the Eighth Amendment’s prohibition of cruel and unusual punishment, Justice Scalia was aghast.63 Scalia said the decision “does not even have support in current social attitudes regarding the conditions that render an otherwise just death penalty inappropriate.”64 Scalia faulted the majority for not paying proper heed to what he considers the single best indicator of current social attitudes: state legislative action.65 His Atkins dissent cited his earlier opinions supporting the notion that state legislatures are the most legitimate arbiters of public thought: “[S]tatutes passed by society’s elected representatives”66 must be used as indicators of community sentiment “because it will rarely if ever be the case that the Members of this Court will have a better sense of the evolution in views of the American people than do their elected representatives.”67 In Simmons, Scalia added that relying upon “legislative primacy is obvious and fundamental.”68

According to Scalia, “[t]he Court pays lip service” to the value of legislative action “as it miraculously extracts a ‘national consensus’ forbidding execution of the mentally retarded.”69 The miracle Scalia refers to is the Court’s finding that most states do not allow for the execution of the mentally retarded. Instead,
according to Scalia, only 47% of states prohibited the execution of the mentally retarded.  

Scalia does not state precisely what the cutoff point is for demonstrating a national consensus, but he implies it requires something approaching unanimous agreement of the states. He noted that when the Court found death sentences for rapists unconstitutional, only one state provided for non-murderers to face death. Further, Scalia pointed out that when the Court ruled that the insane could not be executed, not a single state law provided for the execution of the insane. Meanwhile, according to Scalia’s reckoning, “the population of the death penalty States that exclude the mentally retarded is only 44% of the population of all death penalty States.”

While the Atkins majority cited the fact that legislation banning the execution of the mentally retarded reflected a trend, with each of the state statutes having been passed within the last fourteen years, Scalia scoffed. “Few, if any, of the States have had sufficient experience with these laws to know whether they are sensible in the long term . . . . [R]eliance upon ‘trends’ even those of a much longer duration than a mere fourteen years, is a perilous basis for constitutional adjudication.”

In a larger sense, Scalia feared the watering down of cruel and unusual standards. Scalia stated “The Eighth Amendment is addressed to always-and-everywhere ‘cruel’ punishments, such as the rack and the thumbscrew.” He wondered if there will one day be a need to exclude “just plain stupid people, inarticulate people, even ugly people” from the death penalty.

The majority’s opinion in Atkins was similarly dismissed by Chief Justice Rehnquist. Rehnquist again asserted the primacy of two measures of community sentiment: state legislatures and juries.

70. Id.
73. Atkins, 536 U.S. at 346 (Scalia, J., dissenting).
74. Id. at 344-45. Justice Scalia displays some inconsistency here. He claims that legislative action is an objective indicator of public sentiment, yet when confronted with state legislative action prohibiting the execution of the mentally retarded, he suggests a new requirement: that states must determine if such a policy is “sensible.” He makes no suggestion why the Eighth Amendment would require a “sensible” test, nor does he suggest a way to measure the “sensibility” of public policy. Thus, in Scalia’s view, it is not enough that state legislatures prohibit a particular form of punishment, they must also spend some unspecified amount of time logically evaluating their new prohibition before the Court will consider it an indicator of the public’s view regarding a particular form of punishment.
75. Id. at 349.
76. Id. at 352.
77. Id. at 324 (Rehnquist, C.J., dissenting).
78. Id. Rehnquist’s dissent says “In my view, these two sources – the work product of legislatures and sentencing jury determinations – ought to be the sole indicators by which courts ascertain the contemporary American conceptions of decency for purposes of the Eighth Amendment.” Atkins, 536 U.S. at 326.
Rehnquist then castigated the majority for its “blind-faith” in survey results. 79 Public opinion polls should be ignored: “none should be accorded any weight on the Eighth Amendment scale when the elected representatives of a State’s populace have not deemed them persuasive enough to prompt legislative actions.” 80 He continued, arguing that “[f]or the Court to rely on such data today serves only to illustrate its willingness to proscribe by judicial fiat – at the behest of private organizations speaking only for themselves – a punishment about which no across-the-board consensus has developed through the workings of normal democratic processes in the laboratories of the States.” 81

1. Majority Opinion in Atkins

Justice Stevens, writing for a six-three majority, found that a national consensus against executing the mentally retarded had developed. What is most notable about the decision, however, given the vigorous attacks lobbed against it by Rehnquist and Scalia for its “feeble” use of public opinion polls as an indicator of public sentiment, is the near complete deference it shows to the “objective indicia” trusted by Scalia and Rehnquist. That is, Stevens and colleagues concluded that national sentiment generally opposed execution of the mentally retarded while limiting themselves to the measures Scalia and Rehnquist consider worthwhile.

Stevens wrote that this decision was made “in light of the dramatic shift in the state legislative landscape that has occurred in the past 13 years.” 82 Just as Scalia and Rehnquist would, he noted that consulting state legislative action is the preferred avenue for testing contemporary values. 83 Stevens acknowledged that the public’s sympathy for criminals is modest, thus legislation that limits use of the death penalty must be paid extraordinary accord.

Given the well-known fact that anticrime legislation is far more popular than legislation providing protections for persons guilty of violent crime, the large number of States prohibiting the execution of mentally retarded persons (and the complete absence of States passing legislation reinstating the power to conduct such executions) provides powerful evidence that today our society views mentally retarded offenders as categorically less culpable than the average criminal. 84

It is only in a single footnote in a seventeen page decision that Stevens noted “polling data shows a widespread consensus among Americans, even those who support the death penalty, that executing the mentally retarded is wrong.” 85

79. Id.
80. Id.
81. Id. (emphasis added).
82. Id. at 310.
83. Atkins, 536 U.S. at 312.
84. Id. at 315-16.
85. Id. at 316 n.21.
that same note, however, Stevens essentially dismissed the polls, noting that public opinion data are “by no means dispositive.”

The essential nature of state legislative action to the majority’s thinking is illustrated by the shift of Justice O’Connor on this issue. In 1989 O’Connor wrote the majority opinion in Penry v. Lynaugh, which upheld executions of the mentally retarded. At the time, O’Connor noted the existence of “strong public opposition to execution of the retarded.” That public opposition, however, was not relevant to the case. “The public sentiment expressed in these and other polls . . . may ultimately find expression in legislation, which is an objective indicator of contemporary values upon which we can rely.” Thus it was, thirteen years later, that O’Connor joined the majority in overturning a decision she wrote. Public opinion had not changed: it was against executing the mentally retarded in 1989, and remained against executing the mentally retarded in 2002. What had changed was that state legislative action -- the “objective indicator of contemporary values” -- was closer to public opinion in 2002, and therefore allowed O’Connor and the other five members of the majority to finally reflect the will of the people in a matter they say hinges on the will of the people.

When the Court addressed the execution of juveniles in Simmons the terms of the debate were largely repeated. Christopher Simmons, convicted of a murder for a crime committed when he was a seventeen year old high school junior, had his death sentence overturned by the Missouri Supreme Court. The state high court, applying the logic of Atkins, ruled that the same “national consensus” present in opposition to the execution of the mentally retarded existed in opposition to the execution of minors. The U.S. Supreme Court upheld the decision after concluding such a consensus did exist.

Again, Scalia, in a dissent joined by Rehnquist and Thomas, was flummoxed. In Scalia’s view, the majority’s depiction of a national consensus against juvenile execution rested “on the flimsiest of grounds” and resulted from the majority’s headcount of a “faux majority.” Or as he artfully put it, “The attempt by the Court to turn its remarkable minority consensus into a faux majority by counting Amishmen is an act of nomological desperation.”

Contrary to the depiction of the majority’s opinion as an improvisation built on a fiction, Kennedy’s opinion for the Court clearly stated that “the beginning point” for an evaluation of public standards of decency “is a review of objective indicia of consensus, as expressed in particular by the enactments of legislatures.

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86. Id.
88. Id.
89. Id. at 335.
90. Roper v. Simmons, 125 S. Ct. 1183, 1217, 1219 (Scalia, J., dissenting).
91. Id. at 1219.
that have addressed the question.”

Here, Kennedy found, “[t]he evidence of national consensus against the death penalty for juveniles is similar, and in some respects parallel, to the evidence Atkins held sufficient to demonstrate a national consensus against the death penalty for the mentally retarded.” Indeed, the same number of states then prohibited the execution of juveniles as had prohibited the execution of the mentally retarded when Atkins was heard. Moreover, Kennedy noted that even in states with a juvenile death sentences available, use was extremely rare since the Court had upheld the practice in 1989. “Since Stanford, six States have executed prisoners for crimes committed as juveniles. In the past 10 years, only three have done so: Oklahoma, Texas, and Virginia.”

Apparently heeding the overwrought objections of the dissenters in Atkins, the majority opinion in Simmons assessed the evolving standards of decency among the American people with references to public opinion polls, surveys, referenda, or other direct expressions of American public standards in not a single sentence or footnote. This, despite the fact that various national and state polls showed overwhelming majority opposition to the juvenile death penalty.

Given the absence of public opinion data, much of Scalia’s ire in Simmons is focused on the majority’s references to what he deemed “like-minded foreigners” and the “so-called international community.” In Scalia’s view, regardless of the substance of foreign standards “the basic premise of the Court’s argument—that American law should conform to the laws of the rest of the world—ought to be rejected out of hand.” Moreover, Scalia found “indefensible” the failure of the majority to acknowledge that other legal practices in foreign lands would be anathema to those same justices.

To be sure, the majority in Simmons did discuss the international context of the juvenile death penalty. Kennedy wrote that “the United States is the only country in the world that continues to give official sanction to the juvenile death penalty.” and that “only seven countries other than the United States have

92. Id. at 1192.
93. Id.
94. Id. Repulsion to juvenile execution ultimately spared Kevin Stanford from execution. Stanford, the petitioner in Stanford v. Kentucky (in which the Court had previously ruled in favor of juvenile execution), had his sentence commuted in 2003 to life in prison. Stanford v. Kentucky, 492 U.S. 361, 400 (1989). The governor of Kentucky explained the commutation: “we ought not be executing people who, legally, were children.” Simmons, 125 S. Ct. at 1192.
95. For example, a 2002 Gallup Poll found that while seventy-two percent of Americans favored the death penalty, sixty-nine percent opposed subjecting juvenile offenders to death sentences (Gallup News Service, May 20, 2002).
96. Simmons, 125 S. Ct. at 1217, 1225 (Scalia, J., dissenting).
97. Id. at 1226.
98. Id. at 1227. In criminal matters, Scalia cited: mandatory death sentences for some crimes, the use of illegally seized evidence, limits on the right to a jury, and absence of a double jeopardy standard. In civil matters he cited: the lack of church/state separation and limits on access to abortion. Id.
99. Id. at 1198.
executed juvenile offenders since 1990: Iran, Pakistan, Saudi Arabia, Yemen, Nigeria, the Democratic Republic of Congo, and China." 100 But the ancillary nature of this observation was repeatedly established. “The opinion of the world community,” Kennedy wrote, “does not become controlling, for the task of interpreting the Eighth Amendment remains our responsibility.”101

Ironically, given his position on the relevance of public opinion, Scalia faults the mention of international views in part because it suggests “the views of our own citizens are essentially irrelevant to the Court’s decision.”102 Scalia cites approvingly two state ballot measures which expanded the applicability of the death penalty to juveniles: “The people of Arizona and Florida” have “expressly established 16 as the minimum” age for death penalty imposition rather than eighteen.103 Leave aside for the moment that mentioning these citizen votes seems to contradict Scalia’s position that there are only two “objective indicia” of public consensus, state legislative and jury decisions. There remains the question of Scalia’s characterization of the Florida vote. In saying the voters “expressly” decided upon the age of sixteen for death penalty imposition, Scalia strongly implies the voters were asked directly about juveniles and the death penalty. They were not. Instead, in 2002 Florida voters were asked whether the Florida constitution’s ban on “cruel or unusual punishment” should be amended to replicate the U.S. Constitution’s ban on “cruel and unusual punishment.” Nowhere in the title (which was: “Amendment One: Amending Article 1, Section 17 of the state Constitution”) or in the more than five-hundred word description of the ballot question provided to voters was the execution of juveniles mentioned.104 Not surprisingly, from voters to experts the question was characterized as baffling: “I’ve read it many times, and I’m still not sure what it means. Voters are left feeling somehow that they are inadequate because they can’t understand it,” said one election official.105 Supporters initially sought the change in the state’s constitution to protect the state’s ability to use the electric chair, then later argued it was necessary to reduce death row appeals.106 To borrow some of Scalia’s imagery, concluding that Florida voters approved executing minors because they did not object to a ballot issue that never mentioned minors is rather like saying old-order Amishmen would obviously enjoy a vacation in Las Vegas given how few complaints the Las Vegas travel bureau has received from the Amish.

100. Id. at 1199.
101. Simmons, 125 S. Ct. at 1198.
102. Id. at 1225, (Scalia, J., dissenting).
103. Id. at 1221, (Scalia, J., dissenting).
104. PALM BEACH POST, November 3, 2002, at 15E.
105. Julie Hauserman, Bewildering Ballot Measures. ST. PETERSBURG TIMES, November 4, 2002, at 1B.
Based on Atkins and Simmons it is clear that public opinion results have failed to hold the Court’s confidence. Before we discuss the merits of public opinion surveys as a measure of what the public thinks, we consider the value of state legislative action and jury decisions, those measures the Supreme Court has deemed the “objective indicia” of public thought.

III. STATE LEGISLATIVE ACTION AS A MEASURE OF PUBLIC OPINION

A. Which States Count?

Following the premise of “objective indicia” as a measure of public sentiment, the Court attends to a count of the number of states on each side of death penalty controversies. In the Court’s view, the greater the number of states engaging in a particular death penalty practice (such as executing the mentally retarded, or executing minors), the more clearly the public must embrace the penalty. The more clearly the public embraces the penalty, the less, according to this logic, it can be cruel and unusual or constitutionally suspect. Whatever the flaws of this particular indicator of public thought, at least this is a straightforward measure on which everyone can clearly see which states permit a particular kind of execution and which do not.

In his Atkins dissent, Scalia determined that 47% of the states have banned the execution of the mentally retarded. After his count in Simmons produced the same conclusion, Scalia proclaimed, “[w]ords have no meaning if the views of less than 50% of death penalty States can constitute a national consensus.” Similarly, in Atkins he asked, “[h]ow is it possible that agreement among 47% of the death penalty jurisdictions amounts to ‘consensus’?” (A more pressing question might be, how is it possible, when there are fifty states, for 47% of them to do anything? After all, 47% of fifty is 23.5.) Scalia’s answer is that only some states count.

States that use the death penalty are the only states “for which the issue exists,” according to Scalia. Therefore, measures of the acceptability of the death penalty need only consider states that authorize its use. In other words, Scalia does not include states that do not have the death penalty when he calculates the percentage of states that do not execute the mentally retarded or juveniles. As he explained in Simmons,

[c]onsulting States that bar the death penalty concerning the necessity of making an exception to the penalty for offenders under eighteen is

108. Simmons, 125 S. Ct. at 1218 (Scalia, J., dissenting).
109. Atkins, 536 U.S. at 343 (Scalia, J, dissenting). Oddly, Scalia is nevertheless prepared in Simmons to call the 53% of states (which he identifies as favoring juvenile execution) “a large majority” of relevant states.” Simmons, 125 S. Ct. at 1229, [Scalia, J, dissenting]).
rather like including old-order Amishmen in a consumer-preference poll on the electric car. Of course they don’t like it, but that sheds no light whatever on the point at issue.”

Given his predilection to delete states from his counts of state policy, the gap between Scalia’s math and other Justices’ math can grow quite pronounced. As Scalia calculated in Stanford, the earlier case on the death penalty for juveniles, he claimed that 60% of the states allowed the execution of sixteen year olds. In that same case, Justice Brennan (counting all fifty states) determined that 42% of the states allowed the execution of sixteen year olds. In Atkins and Simmons, Scalia concluded that 53% of the states permitted the execution of the mentally retarded and juveniles respectively. Majority opinions in both cases (counting all fifty states) showed that 40% of the states permitted the practices.

With this technique of erasing inconvenient states from his state policy counts, Scalia has speciously stacked the deck by asserting that the question of whether it is cruel and unusual to execute the mentally retarded or juveniles is an issue to be decided only by the states most strongly favoring the death penalty in general. That the non-death penalty states (and the District of Columbia) should be excluded from this decision – i.e., that the issue does not “exist” for them – borders on ridiculous. Especially given the obvious conclusion, as the majority asserted in Simmons that a state’s decision barring the death penalty “of necessity demonstrates a judgment that the death penalty is inappropriate for all offenders, including juveniles.” Moreover, if, as Scalia repeatedly asserts, the question of what constitutes “cruel and unusual punishment” can only be answered by locating a national consensus, then why should twelve states and

111. Simmons, 125 S. Ct. at 1219 (Scalia, J., dissenting). Curiously, while unwilling to infer that states without the death penalty likely oppose the execution of minors, Scalia has no reservations discussing the views of states which provide for a juvenile death penalty but do not actually impose the sentence. Thus, he wrote, “even States that have not executed an under-18 offender in recent years unquestionably favor the possibility of capital punishment in some circumstances.” Id. at 1221.
113. Id. at 384 (Brennan, J., dissenting). Brennan went further in Stanford, by arguing that the true test of state policy is between states that have specifically considered whether to ban the execution of minors (and chosen not to) versus the states that have banned the execution of minors. Id. Using that calculation, Brennan determines that only nine percent of the states are left endorsing the execution of sixteen year olds. Id. Meanwhile, Chief Justice Burger in Coker made the argument that an assessment of state policy decisions should encompass a century-long backward look, a technique that serves to nullify the significance on any contemporary thought, or evolution of thinking, on punishment, and sets the Court’s understanding of public attitudes squarely on the legislative sensibilities of another, far more punitive, time. Coker v. Georgia, 433 U.S. 584, 605 (1977).
114. Atkins v. Virginia, 536 U.S. 304, 322-54 (2002). In Atkins, Scalia makes no mention in his assertion that non-death penalty states should be removed from consideration that several state legislatures without the death penalty (Iowa, Minnesota, Massachusetts) have recently considered legislation to impose death sentences – and all included an exclusion for mental retardation in the legislative proposals. Id. at 304-322.
the District of Columbia (representing over thirty-five million Americans) not factor into the equation whatsoever? On what precedent has Scalia decided that specific applications of the death penalty are questions only for states supporting the death penalty? Surely the members of those twelve state legislatures did not intend to waive their right to weigh in on a range of Eighth Amendment questions when they chose to set their states’ penalties at something other than death. Where in the Eighth Amendment, one wonders, does it suggest that some states are entitled to define the boundaries of “cruel and unusual” while other states should have absolutely no say in the matter? Absent any meaningful foundation for his position, it becomes apparent that Scalia wants to exclude the non-death penalty states simply because they do not agree with him. And despite his professed commitment to upholding the framers’ intentions, Scalia has never been able to cite any Constitutional language whatsoever in support of this argument.

Scalia’s alternate measures in Atkins, such as counting the population of the states living with and without a ban on executing the mentally retarded are even more skewed. Scalia asserted that only 44% of the population of death penalty states lived under a ban of executions for the mentally retarded. Again, this omitted the thirty-five million persons living in states that did not execute anyone. Further, it ignored the fact that 290 million Americans, or 100% of the population, lived under a ban of execution of the mentally retarded because federal law specifically prohibited the execution of the mentally retarded for federal crimes.

B. The Concept of State Legislative Action as Indicator of Community Sentiment

Putting aside the matter of Scalia’s refusal to count all fifty states when measuring the policy outcomes of the states, there remains the question of what is to be gained by this exercise in the first place. As we alluded to above, one of the fundamental problems in making state legislative action the central indicator of whether a punishment is cruel or not is that it essentially places in the hands of state legislatures the power to define the acceptability of its actions merely by engaging in them. As Radin states:

117. Atkins, 536 U.S. at 346 (Scalia, J., dissenting). Taken to its logical conclusion, Scalia’s approach would have absurd results. Scalia’s argument implies that if forty-nine states were to outlaw the death penalty, the remaining death penalty state would have sole say over which forms of executions are cruel and unusual. A single state would, apparently, yield a “national consensus” for the issue, because the issue “exists” only for that state. Id.
118. Id.
119. Id.
120. 18 U.S.C.A. § 3596(c) (1994).
Constitutional doctrine may not be formulated by the acts of those institutions which the Constitution is supposed to limit. To glean a list of permissible punishments from those enacted by legislatures either assumes that legislators never enact a punishment they think is, or may be, cruel or allows the legislature to define permissible punishments by its enactments. Such a view removes any role for a constitutional check.

And Finkel adds that “[i]n practical and jurisprudential terms, Scalia’s Court could never rule the death penalty unconstitutional, because the case at bar would demonstrate, a priori, that a categorical aversion did not exist.” In other words, “[t]he very fact that a defendant has a case means that he or she has no case.” It is a system analogous to asking a child to formulate a list of acceptable behaviors. The clever child may then respond, “Things I do.”

Finkel also notes that one significant influence on state legislative behavior is their interpretation of the current Court’s thinking. This scheme of Constitutional interpretation leaves us with a Court interpreting the behavior of legislators who are in turn interpreting and predicting the behavior of the Court. Chief Justice Burger offered a similar objection to using state legislative action as a measure of Constitutionality, asserting that states making “an accurate forecast” of Court holdings would create a thoughtless loop of Court decisions based on state legislative decisions based on projected Court decisions.

Aside from that cyclical absurdity, the purpose of looking to state legislative action, according to Scalia and Rehnquist, is to see what the people think. That is a truly ironic notion for a couple of textualists to advance. While both Rehnquist and Scalia have cited The Federalist Papers in death penalty cases as

123. Id. at 640.
124. Id. at 612-642.
125. Id.
126. Coker v. Georgia, 433 U.S. 584, 614 (1977) (Burger, C.J., dissenting). Interestingly, in Simmons Scalia objected to considering the decision of four state legislatures to ban the juvenile death penalty because he doubted they understood the Court would consider their actions as part of its efforts to determine a national consensus (“I also doubt whether many of the legislators who voted to change the laws in those four States would have done so if they had known their decision would (by the pronouncement of this Court) be rendered irreversible.” (Simmons, 125 S.Ct. at 1220, [Scalia, J., dissenting])). In other words, Scalia implies the Court should only attend to the actions of legislators who understand that their decisions in effect dictate Court thinking on the Eighth Amendment. Id. Thus after Scalia removes anti-death penalty states from policy counts, states with limitations not deemed sensible, he then may one day also remove states with death penalty limitations passed without explicit acknowledgment of the intended ramifications on the Court. See supra note 74.
127. See supra note 35.
evidence of the Constitutional framers’ intentions, they remain apparently
unmoved by the warnings that run rampant throughout the document about the
dangers of a legislature that pays close attention to the people. Indeed, a
legislative body strictly following the people’s wishes would be tantamount to a
subversion of its purpose.

More importantly, research into legislative decision making finds that there
are many and varied influences on legislators. To be sure, public opinion can
be – and often is – a factor, but it is not a dominant factor. Indeed, most
legislative decisions require legislators to cast votes in ignorance of popular
sentiment, even if they were otherwise inclined to follow it. Rather, factors
such as political party affiliation, ideological disposition, legislative committee
membership, personal experience, collegial interaction, interest groups, staff, and
previous decisions by the legislator have all been found to influence legislators
beyond public opinion. Moreover, while research on legislative behavior that
focuses on the Congressional level finds a modest role for public opinion, the
public is likely to have an even more restrained influence on state legislators
given the obscurity in which they work.

128. See, e.g., Furman, 408 U.S. at 466 (Rehnquist, J., dissenting); Simmons, 125 S.Ct. at 1217
(Scalia, J., dissenting).
129. See, e.g., THE FEDERALIST NO. 10 (James Madison).
130. Alexander Hamilton, in THE FEDERALIST NO. 71, discussed the need for the elected to rise
above the preferences of the people:
When occasions present themselves, in which the interests of the people are at
variance with their inclinations, it is the duty of the persons whom they have
appointed to be the guardians of those interests, to withstand the temporary
delusion, in order to give them time and opportunity for more cool and sedate
reflection. Instances might be cited in which a conduct of this kind has saved
the people from very fatal consequences of their own mistakes, and has
procured lasting monuments of their gratitude to the men who had courage and
magnanimity enough to serve them at the peril of their displeasure.

JAMES MADISON, ALEXANDER HAMILTON & JOHN JAY, THE FEDERALIST PAPERS 203-204 (University
of Virginia Electronic Text Center 1788).
131. See Herbert B. Asher & Herbert F. Weisberg, Voting Change in Congress: Some Dynamic
Perspectives on an Evolutionary Process, 22 AM. J. POL. SCI. 391 (1978); AAGE CLAUSEN, HOW
CONGRESSMEN DECIDE (St. Martin’s Press 1973); JOHN W. KINGDON, CONGRESSMEN’S VOTING
133. See JOHN W. KINGDON, CONGRESSMAN’S VOTING DECISIONS (University of Michigan Press
1989).
134. See Richard Niemi & Lynda Powell, Constituents’ Knowledge of and Contacts with State
Legislators: The Effects of Term Limits and Other Structural Characteristics, Paper Presented at the
Coping with Term Limits Conference in Columbus, Ohio (Apr. 12 & 13, 2000). Justice Marshall in
Furman makes the point that the lack of connection between the people and their legislators can
“result in preservation of the status quo, whether or not that is desirable, or desired.” Furman v.
Georgia, 408 U.S. 238, 361 n.145 (1972).
Beyond the immediate influences visible on a legislator’s radar screen, scholars also find that the past plays an important role. Policies decided in the past influence modern policy outcomes. Therefore, state policies will lag current public opinion, and in some cases, be more reflective of the political culture of another era than of today.

Research directly on the process of death penalty policy creation at the state level echoes this conclusion. Norrander finds that current state death penalty policy must be understood as a result of a historical chain of factors, including not just the influence of current public opinion, but of longstanding previous policies and their effects, direct and indirect, on policy elites and the public.

A number of studies that compare inclinations of elected officials and the public find a stronger punitive streak and less interest in reform among officeholders than the public at large. Moreover, studies that have directly tested state legislators’ knowledge of constituent opinion on the death penalty reveal a consistent tendency to overestimate public support for executions. McGarrell and Sandys’ survey of Indiana legislators found that a majority of legislators believed the public favored the death penalty over any alternative, such as life in prison without parole (LWOP). In reality, a majority of state residents favored LWOP over the death penalty. Meanwhile, the study also found that Indiana citizens mistakenly believed their legislators to be more open to LWOP than they actually were. As McGarrell and Sandys surmise, “The result is that both lawmakers and citizens act (pass laws and vote, respectively)

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139. Furman, 408 U.S. at 279 (Brennan, J., concurring). Similarly, in Furman, Justice Brennan warned against taking state policy decisions as direct evidence of contemporary public thought. “Legislative authorization, of course, does not establish acceptance. The acceptability of a severe punishment is measured, not by its availability, for it might become so offensive to society as never to be inflicted, but by its use.” Id.
142. See generally, McGarrell & Sandys, supra note 141.
143. Id.
144. Id.
based on their misperceptions of each other." Consequently, researchers find that there is only a slight relationship between citizen opinion and state death penalty laws.146

Whatever state legislators are reacting to, there is simply no scholarship to support the notion that state legislative action is a pure reflection of the people's preferences. Moreover, as Rehnquist pointed out in his Atkins dissent, the states are "laboratories" of democracy.147 That is, in this and countless other cases, Rehnquist and Scalia have supported the rights of the states because they are thought to be uniquely testing the processes of government in fifty different ways.148 If they believe the states are laboratories, it is hard to imagine they would expect each of the fifty states to have a system in which public opinion is translated into legislative action in precisely the same way.

Indeed, consider for a moment the diverse systems that we refer to when we mention "state legislatures." The fifty states, and their ninety-nine legislative bodies, could scarcely be more heterogeneous. For example, New Hampshire has a 400 member state house, with some members representing as few as 3,000 people, while California has a forty member state senate where each represents 878,000 people (more people than in a U.S. House district). The Florida House is a highly partisan body, while the Nebraska Senate is non-partisan. The Massachusetts legislature meets full time, while the Texas legislature meets only every other year. Members serve careers in the New York Assembly, while term limits evict members every six years in the Arkansas house. Members in Maine won seats with publicly financed campaigns, while New Mexico legislators won with campaign treasuries built with no limits on the size or sources of contributions. We would have to ignore the endless structural differences of the ninety-nine state legislative bodies were we to assume that they behave and react to state public opinion uniformly.

The logic of turning to state legislative action as a window into public thinking is simply indefensible.149 Scalia seems to acknowledge this point when he notes in Atkins that the importance of a state-by-state policy count is not to find out what the people think – because the Eighth Amendment requires "a consensus of the sovereign States that form the Union, not a nose count of Americans for and against."150 Leaving aside for the moment that this assertion contradicts Scalia's stated importance of the "current social attitudes" of the "common herd," one is left to grapple with the fact that Scalia has re-written the

145. Id. at 510.
148. Id.
149. Id. at 346 (Scalia, J., dissenting).
150. Id.
Eighth Amendment. 151 The Eighth Amendment reads: “Excessive bail shall not be required, nor excessive fines imposed, nor cruel and unusual punishment inflicted.”152 It does not require the approval of any state, much less a consensus of states to give the amendment meaning. Indeed, that would rather dampen the point of having a federal Constitution. As Chief Justice Warren wrote in Trop v. Dulles, a Court which allows the legislature to apply the Constitution allows the Bill of Rights to “become little more than good advice.”153 In sum, a deference to state legislative action in defining the meaning of the Eighth Amendment is not supported in fact, logic, law, or scholarship.

IV. JURIES AS INDICATORS OF PUBLIC OPINION

There is one other ‘objective’ indicator of public thought, albeit of lesser value according to Rehnquist and Scalia. It is juror decision making.154 As Scalia wrote in Simmons, the Court has “consulted the practices of sentencing juries” to aid in “our determination of society’s moral standards.”155

But juries are not representative samples of the larger American population and its collective moral standards.156 Indeed, jury pools under-represent minorities and low socio-economic-status citizens.157 Those demographic groups tend to offer less support to the death penalty.158

Moreover, jury decisions are limited to the facts and law presented at trial. Jurors are not asked to pass judgment on whether they support policies in favor of the death penalty. Indeed, the “death qualification” of capital juries ensures that no person who is categorically opposed to the death penalty may serve on a capital jury. Thus, a jury decision to sentence a person to death is not commensurate with an endorsement of the death penalty, nor even an endorsement of the death penalty in that situation. It is, instead, an application of laws to a specific situation outside the control of a jury.159 In fact, a study of former jurors in capital cases reveals that most who had once voted to impose a

151. Id. at 348.
152. U.S. CONST. amend. VIII.
155. Roper v. Simmons, 125 S.Ct. 1183, 1222 (Scalia, J., dissenting).
159. Similarly, watching second graders in a school cafeteria coerced by circumstance to choose between peas and carrots would amount to a poor measure of their favorite food.
death sentence would have favored a sentence of life without the possibility of parole if it had been available to them during the trial.\textsuperscript{160}

Finally, the circumstances of jury service make for such an usual decision making setting that it would be careless, at best, to generalize from capital jury decisions to a broad support of death penalty policies. Indeed, serving on a capital jury inspires great stress, far beyond what is typically experienced by jurors in non-capital trials.\textsuperscript{161}

A. Ability of Jurors

Researchers have discovered -- in both jury simulations and surveys of jurors -- that jurors fail to comprehend their obligations.\textsuperscript{162} Mock jury studies reveal disquieting tendencies in juries.\textsuperscript{163}

Jurors often think the judge’s instructions implied that death was the appropriate sentence.\textsuperscript{164} Juror inability to comprehend sentencing instructions increases the likelihood of death sentences.\textsuperscript{165} Mock jurors with clear instructions were more likely to choose life in prison.\textsuperscript{166} One study adds that

\begin{footnotesize}
\begin{enumerate}
\item \textsuperscript{160} William J. Bowers & Benjamin D. Steiner, The People Want an Alternative to the Death Penalty, in Glen Stassen, Capital Punishment: A Reader (Pilgrim Press 1998).
\item \textsuperscript{164} \textit{Id.}
\item \textsuperscript{166} See Patry supra note 165.
\end{enumerate}
\end{footnotesize}
victim impact statements encouraged mock jurors to favor a death sentence regardless of other facts of case.167

Several studies of former jurors support the view that juries generally fail to give full consideration to the defendant’s case.168 Another study found former jurors hostile to defense presentations of mitigating evidence.169 One former juror explained the value of mitigating evidence: “It was interesting, but it had no bearing on the case . . . his whole life boils down to this one incident.”170

Given their skew toward the prosecution, it is not surprising to find that juror thinking about the defendant is often without foundation. Those sentenced to death were not more likely to harm prison staff or other inmates, suggesting that jurors err toward false positives in assessing the likely future dangerousness of a capital crime defendant.171

1. Bias

Beyond a general skew favoring the prosecution is the even more disquieting tendency for juror thinking to be affected by irrelevant attributes of the defendant.172 A survey of former jurors who served in capital trials found that in African American defendant/white victim cases, white jurors were significantly more concerned about the future dangerousness of the defendant.173 This made them more likely to take an early pro-death stand in the deliberations and to cast a first ballot vote for the death sentence.174 Prejudice among whites stimulates support for the death penalty.175 Concomitantly, numerous studies of trial outcomes176 find race to be a significant factor in the likelihood of a death sentence.
sentence. Women convicted of murder of a spouse or a stranger are less likely to face a death sentence.

2. Death Qualification

While many of the previous concerns about juror decision making may reflect inherent flaws in human behavior, the Court has made one deliberate stand on the composition of juries that undeniably ensures death-penalty-friendly juries. In voir dire, jurors are asked whether they are willing to impose a death sentence. Those who say yes are “death qualified,” and permitted to remain on the panel. Those who say no are excused. The Court has upheld this process in Witherspoon v. Illinois and subsequent cases.

A survey research found that among those whose views would make them “death qualified” for capital case service there was a significantly higher rate of authoritarianism and dogmatism. Those who would be death qualified not only supported use of the death penalty, but were more punitive in general. Death qualified jurors have also been found to have a predisposition to believe the prosecution, distrust the defendant and defense attorney, and to value controlling crime over protecting rights. Dillehay and Sandys study of former jurors on felony cases found that more than one-fourth (28.2%) of those who would have been “death qualified” were inclined to favor the death penalty regardless of the facts of a case. A meta-analysis of studies on this question also concluded those who would be death qualified have a greater tendency to believe the prosecution’s case and to favor harsher sentences. Death

177. While these patterns are ultimately the product of jury decisions, prosecutorial discretion can encourage these imbalanced outcomes. Weiss, Berk, and Lee studied the sentences sought over a decade long period in San Francisco County, California. Id. They found, for example, white or Asian victims were more than three times as likely to garner death sentence prosecutions against the defendant, while gay victims were thirty-three times less likely to inspire death sentence prosecutions. See Robert E. Weiss, Richard A. Berk & Cathrine Y. Lee, Assessing the Capriciousness of Death Penalty Charging, 30 LAW & SOC’y REV. 607 (1996). Id.


180. Id.


185. See Lockhart v. McCree, 476 U.S. 162 (1986). Rehnquist argued that death qualification may skew the makeup of the jury, but random chance might do the same. Id. “It is hard for us to
qualification also reduces the diversity of jury panels, disproportionately removing women, African Americans and the poor from service.\footnote{186. See Robert Fitzgerald & Phoebe C. Ellsworth, Due Process vs. Crime Control: Death Qualification and Jury Attitudes, 8 LAW & HUM. BEHAV. 31 (1984).}

Not only is a death qualified jury a skewed sample of the citizenry, but the mere process of death qualification is a source of imbalance.\footnote{187. See Craig Haney, Examining Death Qualification: Further Analysis of the Process Effect, 8 LAW & HUM. BEHAV. 133 (1984).} The pre-trial voir dire process of focusing on the willingness of potential jurors to impose a death sentence encourages a belief among jurors that the defendant is guilty and increases the inclination to convict and to sentence to death.\footnote{188. Id.} This implies to potential jurors that opposition to the death penalty is disfavored by legal authorities.\footnote{189. Id.}

It is a little misleading to consult jury decisions for evidence of community standards. When Justice Rehnquist noted in his Atkins dissent that as many as ten percent of people on death row are mentally retarded, he concluded that juries are not “reluctant to impose the death penalty on defendants like Petitioner.”\footnote{190. Atkins v. Virginia, 536 U.S. 304, 324 n.* (2002) (Rehnquist, C.J., dissenting).} But if juries are given no legal avenue to exclude the mentally retarded from death row, then Rehnquist takes their willingness to uphold the laws they were sworn to obey as evidence of endorsement.\footnote{191. Id.} Further, if the state in question had no legal avenue to exclude the mentally retarded from death row, many juries would not be aware of the defendant’s status.\footnote{192. Penry v. Lynaugh, 492 U.S. 302, 324 (1989).} Further, if a juror had openly opposed the death penalty for mentally retarded persons before the case began, such a juror would not have been death qualified, and would therefore never have sat on a jury in the first place.

understand the logic of the argument that a given jury is unconstitutionally partial when it results from a state-ordained process, yet impartial when exactly the same jury results from mere chance.” Id. at 178. Of course, by that logic, if state law excluded African Americans and women from juries, that would be perfectly acceptable, since by chance alone a particular jury might lack African Americans and women. Indeed, Rehnquist in that same decision mocks the notion of pursuing a representative jury:

On a more practical level, if it were true that the Constitution required a certain mix of individual viewpoints on the jury, then trial judges would be required to undertake the Sisyphean task of “balancing” juries, making sure that each contains the proper number of Democrats and Republicans, young persons and old persons, white-collar executives and blue-collar laborers, and so on.

Id.
There is no evidence to support the notion that capital juries are representative of the population at large or that they make decisions in line with the population’s preferences.

V. PUBLIC OPINION AS INDICATOR OF PUBLIC OPINION

Coupled with Rehnquist and Scalia’s faith in state legislative action and jury decisions is a categorical refusal to accept public opinion surveys as objective or accurate means of locating public sentiment. In Atkins, when confronted with the results of twenty-seven independent surveys showing overwhelming public opposition to imposing the death penalty on mentally retarded individuals, Scalia flatly stated that “the results of opinion polls are irrelevant.” Rehnquist’s dissent attempts to undermine the validity of survey data in general by highlighting the potential for shoddy methodology:

Even if I were to accept the legitimacy of the Court’s decision to reach beyond the product of legislatures and practices of sentencing juries to discern a national standard of decency, I would take issue with the blind-faith credence it accords the opinion polls brought to our attention. An extensive body of social science literature describes how methodological and other errors can affect the reliability and validity of estimates about the opinions and attitude of a population derived from various sampling techniques. Everything from variations in the survey methodology, such as the choice of the target population, the sampling design used, the questions asked, and the statistical analyses used to interpret the data can skew the results.

Rehnquist has correctly identified the most common threats to the validity and reliability of survey data, but what he fails to appreciate is that, far from dismissing the results out of hand, social scientists routinely accept survey questions as accurate measures of public sentiment. Ironically, the two books cited by Rehnquist in support of his argument – Groves’ *Survey Errors and Survey Costs* and Turner and Martin’s *Surveying Subjective Phenomena* – were both written by scholars who regularly utilize survey data in their own research. To say that public opinion surveys should be avoided because “[a]n extensive body of social science literature describes how methodological and other errors can affect the reliability and validity of estimates” is rather like

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194. Id. at 326 (Rehnquist, C.J., dissenting). Scalia reminds the Court of the perils of consulting social science evidence by quoting large portions of this discussion in his *Simmons* dissent. Roper v. Simmons, 125 S.Ct. 1183, 1217-30 (2005).
195. ROBERT M. GROVES, *SURVEY ERRORS AND SURVEY COSTS* (Wiley 1989). In fact, Robert Groves is the director of the Survey Research Center at the University of Michigan’s Institute for Social Research. *Id.*
saying that people should avoid taking prescription medicine because an extensive body of research describes their potential side effects. 197

Social scientists routinely use public opinion surveys because, quite simply, they effectively measure public opinion. 198 When properly implemented, surveys “provide useful information” 199 and possess a “singular ability to provide an accurate reflection of the attitudes and preferences of the people.” 200 Indeed, surveys are frequently admitted as legal evidence in cases involving trademark infringements and misleading advertising, and are often used by judges to help determine the suitability of particular locations for conducting criminal trials or to assess appropriate fines and damages. 201

Moreover, in situations in which we can definitively test the accuracy of polls, the results suggest the “amazing precision” of survey data. 202 For example, pre-election polls use samples and professional surveying techniques -- methods that Rehnquist views skeptically -- to attempt to measure support for candidates. Election day voting results later provide definitive evidence concerning the actual preferences of the full population. Even as polling organizations seek to produce survey results within a small margin of error, typically three or four points from the full population’s preference, we know from election results that major polls consistently stay within that margin of error. 203 In presidential elections, the typical final pre-election poll of the Gallup organization has assessed the support of the leading candidate within 1.6 percentage points of the voting outcome. 204 Indeed, when Warren compiled all major polling organizations’ final pre-election poll results, he found that they cumulatively placed support for the leading presidential candidate within two points of the actual voting outcome. 205

Nevertheless, Rehnquist specifically complains that the Court has no way of knowing whether the twenty-seven surveys submitted as evidence in Atkins can be trusted, because

none . . . disclose the targeted survey population or the sampling techniques used by those who conducted the research. Thus . . . it is impossible to know whether the sample was representative enough or the methodology sufficiently sound to tell us anything about the

197. Atkins, 536 U.S. at 326 (Rehnquist, C.J., dissenting).
199. Weisberg, supra note 198.
201. Id.
204. Warren supra note 202, at 63.
205. Id.
opinions of the citizens of a particular State or the American public at large.206

Here the alleged skepticism must surely be at least partially disingenuous. While it may be true that the survey methodologies were not made available to the Court, even a cursory glance at the organizations conducting the surveys should instill confidence in the survey results. Four of the surveying organizations are well respected universities (University of Maryland, Quinnipiac University, Georgia State University, and Sam Houston State University), five are major news organizations (Scripps-Howard, Newsweek, Charlotte Observer, Austin American-Statesman, and Houston Chronicle), while others are nationally recognized polling firms (e.g., Harris Poll, Yankelovich Clancy Shulman, Peter Hart Research Associates, etc.). Aside from Amnesty International, few of the remaining twenty-seven surveys were conducted by organizations with any obvious political or ideological agenda; most were conducted by large independent survey research firms. (In fact, one of the only polling organizations with a clear political bias is the Tarrance Group, which conducts polls exclusively for Republican political candidates.)

Any lingering doubts Rehnquist may have about the validity of the survey’s results should be easily overcome by the uniformity of the results. As every survey researcher knows, one of the best ways to validate the results of a specific survey question is to conduct a second survey in which the target question is slightly reworded.207 If the results of the two survey items are similar, the researcher’s confidence in the poll is strengthened. Similarly, replicating a survey with slightly different sampling techniques can allay fears of sampling bias. Individual survey researchers rarely have the resources to be quite so thorough, but the Court is presented with twenty-seven different surveys conducted by independent survey organizations employing slightly different question wordings and sampling techniques, and focusing on a variety of target populations. Seven surveys used national samples, the rest focused on individual states. That all twenty-seven surveys found a sizable majority, and in many cases an overwhelming majority, in opposition to the death penalty for mentally retarded individuals should be enough to convince even the most skeptical analyst. The findings are even more persuasive in light of the fact none of the state-specific surveys were conducted in states that do not use the death penalty, where, presumably, opposition to the death penalty for mentally retarded people could be even stronger.

Finally, Rehnquist questions the appropriateness of the specific questions presented in the survey evidence:

207. See FLOYD J. FOWLER, IMPROVING SURVEY QUESTIONS: DESIGN AND EVALUATION (Sage 1995); See also WEISBERG et al., supra note 198.
One cannot help but observe how unlikely it is that the data could support a valid inference about the question presented by this case. . . . The questions reported to have been asked in the various polls do not appear designed to gauge whether respondents might find the death penalty an acceptable punishment for mentally retarded offenders in rare cases. Most are categorical (e.g., “Do you think that persons convicted of murder who are mentally retarded should or should not receive the death penalty?”), and, as such, would not elicit whether the respondent might agree or disagree that all mentally retarded people by definition can never act with the level of culpability associated with the death penalty, regardless of the severity of their impairment or the individual circumstances of their crime.

A careful examination of the survey questions reported in Atkins, however, does not support the Chief Justice’s characterization. While it is true that only a few questions explicitly include a broad range of response options within the question itself (e.g., “would you strongly favor, somewhat favor, have mixed or neutral feelings, somewhat oppose, or strongly oppose…”), the vast majority of the questions do allow respondents to offer conditional responses (e.g., “depends,” “not sure,” etc.). When, Harris Poll reports that 71% of the American public opposes executions for mentally retarded individuals (with 21% in favor), it has already taken into consideration that 4% said “it depends” and 3% refused to answer. Although the question did not specifically ask whether the appropriateness of the death penalty would depend on the particular circumstances of the case or the degree of mental retardation, clearly respondents were free to say that it did. An objective observer should therefore conclude that the 71% who voiced opposition in this survey would probably voice opposition for all cases involving mentally retarded individuals. Given that the great majority of survey questions appear to include at least one non-categorical response, Rehnquist’s insistence that the questions unfairly force respondents into yes-or-no choices appears to be little more than wishful thinking.

In contrast to Rehnquist’s position, experts on public opinion recognize the unique capacity of surveys to gauge public sentiment: “Scholars understand the appeal and the value of polls. No measurement can read the feelings of people during a moment in history better than public opinion polls.”

VI. CONCLUSION

In the words of Chief Justice Rehnquist, the meaning of the Eighth Amendment’s prohibition of cruel and unusual punishment hinges on

208. Atkins, 536 U.S. at 327 (Rehnquist, C.J., dissenting).
209. Warren supra note 202, at 68.
“contemporary American conceptions of decency.” In the words of Justice Scalia, the meaning of the Eighth Amendment’s prohibition of cruel and unusual punishment hinges on “current social attitudes.” In other words, it hinges on the attitudes of the American people.

We have argued that in determining the attitudes of the American people, public opinion data is a superior indicator compared to the action of state legislatures or the decisions of juries. Successfully making this argument appears something of a modest accomplishment. Indeed, it sounds as if we advanced a preposterous straw man assertion – that state legislatures and juries better reflect public attitudes than does the public – then knocked it down. But in truth, this straw man is advocated in the writings of Justice Scalia and Chief Justice Rehnquist and has been embraced by all their colleagues on the Court.

When it comes to the Eighth Amendment, Scalia and Rehnquist have handed the Constitution to state legislatures and juries to define. Neither of these sources is a pure reflection of public attitudes. More to the point, both of these sources are considerably more supportive of the death penalty than is the public at large. Indeed, this is almost guaranteed since Scalia and Rehnquist have fashioned what amount to death qualified juries (where opposition to the death penalty is a disqualifier from service) and death qualified states (where the absence of the death penalty is a disqualifier from being counted in assessments of state policy).

Ironically, both Scalia and Rehnquist accuse their colleagues in Atkins and Simmons of ignoring the public’s will and advancing their own agenda. As Scalia put it, the Court utilized “embarrassingly feeble evidence of ‘consensus’” because it seems to believe “really good lawyers have moral sentiments superior to those of the common herd.” To the extent the majority’s opinion was embarrassingly feeble, that trait can only be credited to Scalia and Rehnquist because the majority in both cases built their argument on Scalia and Rehnquist’s terms heeding their call for “objective indicia.”

Scalia and Rehnquist both claim that what is cruel and unusual is based on current social attitudes and conceptions. Yet both have refused to consider the most accurate measure of current social attitudes available, and they instead turn to inferior methods of measuring Americans’ conceptions of cruel and unusual punishment. The absurdity of their position is crystallized in Scalia’s statement in Stanford: “our job is to identify the ‘evolving standards of decency’; to determine, not what they should be, but what they are.” We have no power under the Eighth Amendment to substitute our belief in scientific evidence for the society’s apparent skepticism. In other words, the Court must endeavor to

211. Id. at 337 (Scalia, J., dissenting).
212. Id. at 348 (Scalia, J., dissenting).
213. Id. at 324.
find out what the people think while maintaining a Luddite’s skepticism of modern scientific techniques ideally suited to reveal what people think. Scalia and Rehnquist have brought the rest of the court along with them on this stance as the majority’s tangential reference to public opinion in Atkins was followed by a complete banishment of public opinion evidence in Simmons.

In their refusal to consider public opinion, Scalia and Rehnquist fight on behalf of the death penalty not for the people, or for the Constitution, but for their own ideology. Indeed, it seems clear that Justice Scalia yearns for a yet harsher penalty to be developed. As he once wrote, “How enviable a quiet death by lethal injection.”215

Without question the case against making the Constitution dependent on popular preferences is compelling. Indeed, “The very purpose of a Bill of Rights was to withdraw certain subjects from the vicissitudes of political controversy, to place them beyond the reach of majorities.”216 However, that is an argument against the notion of basing the Eighth Amendment on “evolving standards of decency,” not an argument for the measurement of a “faux majority” position on those standards.

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THE TAXATION OF CONTINGENT ATTORNEY FEES: 
DID THE SUPREME COURT CORRECTLY DECIDE 
COMMISSIONER V. BANKS?

Jennifer J. Loomis*

I. INTRODUCTION

A group of dinner guests were blaming all of America’s troubles on lawyers when a woman said, “They aren’t all so bad. Why, last year a lawyer gave me $1000.”

“I don’t believe it,” the host responded.

“It’s true, I swear it,” said the woman. “I had a complicated personal injury case and what with the lawyer’s fee, the cost of expert witnesses, the expense of the appeal and so on, my bill was $41,000. When the judgment only amounted to $40,000, my lawyer simply forgave the difference.”

This lawyer joke is one of many that the public has used in order to vent their frustration with our legal system, which can leave a prevailing party with less than nothing after the payment of legal fees, expenses and taxes. For those who will soon enter the legal arena and those that have fought to make the legal profession well-respected in the eyes of the public, this “joke” may seem offensive or ridiculous. However, the sentiment expressed in this joke must have some basis in truth to account for its popularity, and, as this article will show, a client that succeeds in winning a favorable settlement or judgment can often be left with a very small portion of the award after costs, fees and taxes. In fact, in some cases, the client may be left owing substantial taxes to the government over and above the value of the client’s “award.”

By taxing the prevailing party on the entire judgment, including the contingent attorney fee portion of the award which the client never receives, the client may ultimately collect an award significantly smaller than the jury intended. While it has always been the position of the Commissioner of the

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2. Id.
4. See id.
Internal Revenue Service that contingent attorney fees must be included in the client’s gross income based on the anticipatory assignment of income doctrine, the United States circuit courts were split on this issue prior to the recent 8-0 decision of the United States Supreme Court resolving the circuit court split in favor of the position advocated by the Commissioner.

This article argues that the Supreme Court should have distinguished the payment of contingent attorney fees from the anticipatory assignment of income doctrine and should have found in favor of the taxpayers. In the alternative, the Supreme Court should have recognized that state law determines property rights, and, therefore, the Court should have deferred to the states’ attorney lien statutes in resolving the adequacy of the attorney’s property rights in the underlying claims in applying the anticipatory assignment of income doctrine to contingent fee arrangements.

Part II of this article discusses the general background of the taxation of gross income and the anticipatory assignment of income doctrine as well as the cases that formed the circuit court split. Part III reviews the facts and holdings of the circuit court decisions of Banks v. Commissioner and Banaitis v. Commissioner followed by the consolidated decision of the United States Supreme Court in Commissioner v. Banks. Part IV analyzes the anticipatory assignment of income doctrine and points out ways in which the Supreme Court should have distinguished contingent attorney fees from the anticipatory assignment of income doctrine. In addition, Part IV argues that contingent attorney fee agreements operate to form a joint venture between the client and lawyer, so contingent attorney fees should be taxed accordingly. Further, equitable considerations support taxing contingent attorney fees according to the tax treatment of joint ventures. Finally, Part IV argues that state law...
determines property rights while federal law determines how to tax property. Therefore, even though the Supreme Court decided that the anticipatory assignment of income doctrine does apply to contingent attorney fees, the Supreme Court should have concluded that the Internal Revenue Service must defer to state law and allow taxpayers to exclude contingent attorney fees from their gross income where the state’s attorney lien statute grants an ownership interest to their attorneys in their clients’ claims.15

II. BACKGROUND

In order to understand the Banks and Banaitis cases, it is important to briefly review the definition of gross income under Section 6116 of the Internal Revenue Code (I.R.C.) as it relates to the taxability of settlements and judgments. It is also helpful to understand the limited exception of income received as a result of injury or physical sickness under I.R.C. Section 104(a)(2).17 In addition, to fully appreciate the Banks decision, a review of key cases which made up the circuit court split is in order.

A. Gross Income and the Anticipatory Assignment of Income

Under I.R.C. Section 61, “gross income includes all income from whatever source derived.”18 The United States Supreme Court has given a broad interpretation to this statute in recognition of Congress’s intent to tax all gains unless specifically exempted.19 In other words, gains received as a result of a settlement, or a favorable judgment, are included in the client’s gross income unless Congress has specified an exemption.20

Congress created such an exemption under I.R.C. Section 104(a)(2).21 The exemption states that, while punitive damages are always included in gross income, damages on account of personal injury or sickness are not included in gross income.22 Due to the possibility of collusion, the Internal Revenue Service (IRS) is not bound by the allocations contained in settlement agreements to which it is not a party and where the settlement allocation is not being made at arm’s-length.23 The allocation must reflect the economic substance of the claim.24

17. Id. § 104.
18. Id. § 61.
20. See id.
22. Id.
24. Id.
Once the proper allocation has been reached, the question then becomes whether or not the entire taxable portion of the settlement or judgment should be included in the client’s gross income if a contingent fee agreement causes the client to receive only a portion of the award. \(^{25}\) The Commissioner of the IRS has repeatedly taken the position that the contingency fee portion of a settlement or judgment must be included in the prevailing party’s gross income \(^{26}\) based on the anticipatory assignment of income doctrine. \(^{27}\)

The anticipatory assignment of income doctrine was popularized by the Supreme Court decisions in *Lucas v. Earl* \(^{28}\) and *Helvering v. Horst*. \(^{29}\) The facts in *Lucas v. Earl* \(^{30}\) reveal that Earl and his wife entered into a contract in 1901 in which it was agreed that during their marriage, any property acquired by either of them would be treated as owned by them as joint tenants. \(^{31}\) Many years later, the Revenue Act of 1918 \(^{32}\) came into effect, which imposed a tax on the net income of individuals for the first time. \(^{33}\) This early version of the I.R.C. did not allow married couples to split their aggregate taxable income to benefit from lower tax rates. \(^{34}\) Earl filed his tax return reporting only one-half of his salary which he earned as an attorney. \(^{35}\) Earl assumed that his salary and fees had become joint property between him and his wife immediately upon receipt as a result of the contract. \(^{36}\) The Commissioner of Internal Revenue imposed a tax on his entire salary subjecting him to a higher tax rate than he and his wife would have received on his income if they had divided his income equally. \(^{37}\) The Supreme Court, utilizing the analogy that the fruit must be attributed to the tree on which it grew, held that the statute taxed income to those who earned it, and the tax could not be escaped by such anticipatory arrangements. \(^{38}\)

In *Helvering v. Horst* an owner of negotiable bonds gifted the attached interest coupons to his son shortly before maturity of the coupons. \(^{39}\) Again using the analogy that the “fruit is not to be attributed to a different tree from that on


\(^{26}\) But see generally id. at 253 (reasoning that where the settlement or judgment is mixed between taxable and non-taxable income, the attorney’s fee is included in the client’s gross income in the same proportion as the total award was includable in gross).

\(^{27}\) Banks v. Comm’r, 345 F.3d 373, 382 (6th Cir. 2003).


\(^{29}\) Helvering v. Horst, 311 U.S. 112 (1940).

\(^{30}\) *Earl*, 281 U.S. at 113-14.

\(^{31}\) *Id.*

\(^{32}\) Revenue Act of 1918, ch. 18, 40 Stat. 1065 (1919).

\(^{33}\) *Earl*, 281 U.S. at 114.


\(^{35}\) See *Earl*, 281 U.S. at 113.

\(^{36}\) See id.

\(^{37}\) *Id.*

\(^{38}\) *Id.* at 114-15.

which it grew,” the Supreme Court held that the interest coupons are taxable to the donor because the purpose of the statute is to tax the income to those who earn it or “create the right to receive it,” and the tax cannot be escaped by “anticipatory arrangements.”

Applying the assignment of income doctrine to contingent fee agreements, the Commissioner generally argues that the entire taxable portion of a settlement or judgment must be included in the gross income of the prevailing party because the underlying claim was owned by that party creating the right to receive income generated from the claim. Further, the Commissioner argues that, although the client may never have possession of the contingent fee portion of the claim paid to the lawyer, the plaintiff receives the benefit of a discharge of his/her indebtedness to the lawyer for amounts owed for services rendered. The majority of circuit courts agreed with the Commissioner, but several courts came to the opposite result utilizing several creative techniques to avoid this arguably unjust double taxation.

B. Circuit Court Split

1. Circuit Courts Finding that Attorney Contingency Fees Are Not Includable in the Client’s Gross Income

In 1959, prior to the split to form the Eleventh Circuit, the United States Court of Appeals for the Fifth Circuit heard Cotnam v. Commissioner. After successfully suing the Estate of T. Shannon Hunter for $120,000.00 in a breach of contract claim, the Commissioner of Internal Revenue assessed a deficiency against Ms. Cotnam by including the entire judgment in her gross income, including the contingent attorney fees. While finding that the judgment of $120,000.00 was taxable because the underlying claim did not fall within any exceptions to the I.R.C.’s definition of gross income, the court went on to find that the portion of the judgment that covered attorney fees was taxable to the attorney, not to Ms. Cotnam, as a result of the Alabama attorney lien statute. That statute provided attorneys with an equitable property interest in the lawsuit

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40. Id. at 120.
41. Id. at 119.
42. Id. at 119-20.
43. Banks v. Comm’r, 345 F.3d 373, 382-83 (6th Cir. 2003).
44. Estate of Clarks v. United States, 202 F.3d 854, 856-57 (6th Cir. 2000) (citing Baylin v. United States, 43 F.3d 1451, 1454 (Fed. Cir. 1995)).
45. See Reece, supra note 7.
47. Id. at 120-21.
48. Id. at 125.
giving the attorney the same rights and powers to enforce a judgment as their
clients would have.49

The court also found that, although Ms. Cotnam may have earned the entire
judgment in a remote sense, the judgment was uncertain and without value prior
to suit.50 The only benefit that she could derive from her claim was to assign
away a portion of the claim in order to collect the remainder.51 The court
distinguished the anticipatory assignment of income doctrine discussed in Lucas
v. Earl and Helvering v. Horst from this case, because those cases sought to tax
the taxpayer who earned the income rather than the person who was given a
beneficial interest in the taxpayer’s earnings.52 In this case, the attorney was
assigned an interest in an otherwise worthless claim which required the skills of
the attorney in order to convert the claim into a judgment.53 Utilizing the
analogy in Lucas v. Earl,54 the court reasoned that Ms. Cotnam’s tree would be
barren had she not had the assistance of an attorney to bring forth the fruit.55
The court insisted that the attorney earned his portion of the settlement and that
the only benefit that Ms. Cotnam realized was the $75,254.17 she received.56

The Fifth Circuit Court of Appeals also rejected the Commissioner’s claim
that the payment of attorney fees to Ms. Cotnam’s lawyer was the equivalent of
receipt of funds to her as a discharge of indebtedness to her lawyer.57 The court
found that Ms. Cotnam never obligated herself to pay the attorney fees, but
rather the payment was contingent on the outcome of the case.58

After the Eleventh Circuit was formed, the court adopted all of the Fifth
Circuit decisions handed down prior to September 30, 1981 as binding precedent
in Bonner v. City of Prichard.59 In 2000, the Eleventh Circuit Court of Appeals
had occasion to rehear the issue of whether or not attorney contingent fees
should be included in the gross income of a client in which the Alabama attorney
lien statute applied in Davis v. Commissioner.60 Recognizing Cotnam61 as
binding precedent, the court held that the attorney’s contingent fee was not
includable in the client’s gross income.62

49. Id.
50. Id.
51. Id. at 125-26.
52. Cotnam, 263 F.2d at 125-26.
53. Id.
55. Cotnam, 263 F.2d at 126.
56. Id.
57. Id.
58. Id.
59. Davis v. Comm’r, 210 F.3d 1346, 1347 n.2 (11th Cir. 2000) (citing Bonner v. City of
Prichard, 661 F.2d 1206, 1209 (11th Cir. 1981)).
60. Davis, 210 F.3d at 1347.
61. Cotnam, 263 F.2d at 119.
62. Davis, 210 F.3d at 1347.
The Commissioner then made the novel argument that under the Alabama lien statute, Ms. Davis sold a portion of her claim to her attorney when the contingent fee agreement was signed in 1989.63 Recognizing that the sale would be time-barred for tax purposes, the Commissioner argued that the taxable event should be deferred under the open transaction doctrine because the value of the claim and the attorney’s fee was unascertained in 1989.64 This doctrine permits the valuation of property to be delayed until the value is made certain.65 However, the Eleventh Circuit rejected this argument because the Commissioner did not present adequate proof that the value of the claim was unascertainable in 1989.66

In Foster v. United States, decided in 2001, the Eleventh Circuit Court of Appeals again had occasion to address the issue of whether or not contingent attorney fees are includable in the client’s gross income.67 In that case, the court again found that the contingent attorney fees were not includable in the client’s gross income even where the fee agreement was later changed after initial judgment allowing the attorney to collect 100 percent of interest due on the judgment in consideration of additional work necessary to fight an appeal.68 The court also awarded litigation costs to the prevailing party, admonishing the Commissioner for denying Foster’s claim for a tax refund because the law in the circuit was clear on the issue.69

In 2000, the United States Court of Appeals for the Sixth Circuit decided In re Estate of Clarks v. United States.70 After receiving a jury award of $5,600,000.00 for head injuries sustained in the course of employment, the Commissioner of the IRS issued a Notice of Deficiency to the Estate of Clarks in order to recover taxes on the interest portion of contingent fees paid to the Clarks’ attorney.71 The circuit court, finding Cotnam persuasive, held for the taxpayer indicating that the Michigan attorney lien statute applicable in this case was similar to the Alabama attorney lien statute discussed in Cotnam.72 However, the Sixth Circuit Court of Appeals further stated that the attorney lien statute operated to make the transaction more closely analogous to a division of property than an assignment of income.73

The Sixth Circuit Court of Appeals believed that the Cotnam court properly distinguished that case from Lucas v. Earl and Helvering v. Horst noting that,
unlikely the cases in Earl and Horst, the value of such legal claims and contingency fees are speculative and the attorneys do not receive their fees gratuitously, they earn it.74 In addition, the court noted that, since the amounts received in Earl and Horst were received gratuitously, the grantees were not subject to tax on the amounts received.75 In contrast, the attorney is subjected to taxes on contingent fees earned and so an additional taxation to the client would unfairly amount to a double taxation on the contingency fee portion of the judgment.76 In closing, the Sixth Circuit Court of Appeals noted that in a contingency fee arrangement, the client transfers “some of the trees in his orchard, not merely the fruit,”77 so if income is to be taxed to the one who earns it, then the attorney, not the client, should be taxed on the contingency fee portion of the award.78

In 2000, after separating from the Eleventh Circuit, the Fifth Circuit Court of Appeals heard the issue of whether or not to tax contingent fees to the client in Srivastava v. Commissioner.79 After receiving a favorable judgment for defamation, and finally receiving a settlement payment, the Srivastavas were issued a notice of deficiency for failure to pay income taxes on the judgment.80 The Fifth Circuit Court of Appeals grudgingly applied Cotnam to the case finding that case controlling and substantially indistinguishable from the case before it.81 The court specifically failed to distinguish this case from Cotnam82 even though the case before it involved a Texas judgment and Texas did not have an attorney lien statute equivalent to Alabama’s.83 The court reasoned that the presence of a state attorney lien statute granting an attorney ownership rights in the client’s claim was not a decisive factor in the Cotnam decision.84 The court felt this was true because a similar argument could have been made in Helvering v. Horst where the son’s right to collect on the detached coupons without further action on the part of the underlying holder of the negotiable bond failed to allow the father to escape the anticipatory assignment of income doctrine.85

The court’s opinion was not a complete endorsement of the underlying merits of the Cotnam86 case.87 Instead, the court began by discussing the

74. Id.
75. Id. at 857.
76. Id.
77. Id. at 858.
78. Id.
80. Id. at 356.
81. Id. at 357-58.
82. Cotnam v. Comm’r, 263 F.2d 119, 119 (5th Cir. 1959).
83. Srivastava, 220 F.3d at 363-64.
84. Id. at 364 n.33.
85. Id.
86. Cotnam, 263 F.2d at 119.
87. See Srivastava, 220 F.3d at 364-65.
meaning of realization and how income can be taxed.\textsuperscript{88} The court stated that the taxpayer equally enjoys a gain whether he collects and uses the income to satisfy his desires, or whether he assigns away his right to collect his income as a means of procuring his desires.\textsuperscript{89} Conversely, if a taxpayer relinquishes an asset or source of income, the doctrine of assignment of income does not apply because the taxpayer ceases to receive income from the asset.\textsuperscript{90} Therefore, in the court’s view, the question came down to one of characterization.\textsuperscript{91} However, the court was unable to come to a conclusion on this question because it found that the client neither completely divests himself of the tree nor does the client completely retain the tree in a contingency fee arrangement.\textsuperscript{92} Instead, as discussed in \textit{Estate of Clarks},\textsuperscript{93} a “virtual co-ownership” results as though the client transferred to the attorney some of the trees of the orchard and not merely the fruit.\textsuperscript{94}

The court also noted that the contingent fee agreement may be distinguished from the assignment of income doctrine discussed in \textit{Lucas v. Earl} and \textit{Helvering v. Horst} because the attorney must perform to earn his fee rather than receive income gratuitously.\textsuperscript{95} Further, a contingency fee agreement is arrived at through an arm’s-length transaction.\textsuperscript{96} Nevertheless, the court disagreed with this reasoning, indicating that the taxpayer who assigns a future stream of income in order to receive services obviously procures a benefit.\textsuperscript{97} The court further stated that the fact that the value of the contingency fee is uncertain makes no difference in terms of anticipatory assignment of income because the taxpayer can still achieve gain through anticipatory assignment.\textsuperscript{98} Finally, the court felt that it was not fair to give favorable tax treatment to clients who procure the services of an attorney on a contingent basis rather than a non-contingent basis in which the dollars used to pay the attorney have already been subjected to tax.\textsuperscript{99} The court argued that the fact that a contingency fee arrangement has an added benefit of risk-shifting does not change the economic reality that the client is assigning a portion of his claim in order to procure the benefit of counsel.\textsuperscript{100} As a result of this final argument, the court indicated that

\begin{itemize}
  \item \textsuperscript{88} Id. at 359.
  \item \textsuperscript{89} Id.
  \item \textsuperscript{90} Id.
  \item \textsuperscript{91} Id.
  \item \textsuperscript{92} Id. at 360.
  \item \textsuperscript{93} Estate of Clarks v. United States, 202 F.3d 854, 857-58 (6th Cir. 2000).
  \item \textsuperscript{94} Srivistava, 220 F.3d at 360.
  \item \textsuperscript{95} Id. at 360-61 (citing Estate of Clarks, 202 F.3d at 857).
  \item \textsuperscript{96} Srivistava, 220 F.3d at 361.
  \item \textsuperscript{97} Id.
  \item \textsuperscript{98} Id. at 361-62.
  \item \textsuperscript{99} See id. at 362-63.
  \item \textsuperscript{100} Id. at 362.
\end{itemize}
it would probably have decided the case differently had *Cotnam* not been controlling.\(^{101}\)

2. Circuit Courts Finding that Attorney Contingency Fees Are Includable in the Client’s Gross Income

On the other side of the circuit court split, in 1963 the United States Court of Appeals for the Third Circuit affirmed in whole the judgment in *O’Brien v. Commissioner*.\(^ {102}\) In that case, the court distinguished *Cotnam*\(^ {103}\) because the Pennsylvania attorney lien statute applicable to the case at bar did not create an equitable property interest.\(^ {104}\) The court then held that the irrevocable assignment of income in a contingency fee agreement is income to the client under the familiar doctrine of assignment of income discussed in *Lucas v. Earl* and *Helvering v. Horst*.\(^ {105}\)

The next circuit to rule against the taxpayer on this issue was the United States Court of Appeals for the Federal Circuit.\(^ {106}\) In *Baylin v. United States*,\(^ {107}\) the Federal Circuit Court of Appeals simply found that a partnership was discharging its debt to its lawyer when the partnership paid attorney fees out of the proceeds of the condemnation award recovered.\(^ {108}\) The court stated that under *Lucas v. Earl* and *Helvering v. Horst* the partnership could not avoid taxation by assigning away a portion of its judgment.\(^ {109}\) Further, the fact that the assignment was made before the amount of the judgment was certain made no difference.\(^ {110}\) Without ever citing to *Cotnam*, the court then stated that the Maryland attorney lien statute gives the attorney a security interest in the judgment, not an ownership interest.\(^ {111}\)

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\(^{101}\) *Id.* at 363.


\(^{103}\) *Cotnam v. Comm’r*, 263 F.2d 119, 119 (5th Cir. 1959).


\(^{105}\) *Id.*

\(^{106}\) *Baylin v. United States*, 43 F.3d 1451, 1455 (Fed. Cir. 1995).

\(^{107}\) *Id.*

\(^{108}\) *Id.* at 1454. *But see id.* at 1453 (stating that the IRS treated the attorney fees as a transaction cost in disposing of the property because the “IRS classified all of the legal fees as a capital expenditure and [the IRS] calculated a capital gain . . . by adding all the legal fees to the basis of the condemned property.” *Id.* As such, the taxpayer was arguing that a portion of the legal fees should be deducted against the interest portion of the condemnation award reducing the partnership’s tax on ordinary income rather than being added to the basis in the condemned property which merely reduced the partnership’s long-term capital gain tax. Therefore, this decision did not result in a double taxation.).

\(^{109}\) See *Baylin*, 43 F.3d at 1454.

\(^{110}\) *Id.*

\(^{111}\) *Id.* at 1455.
Prior to 2003, the Ninth Circuit Court of Appeals ruled against taxpayers three times by including attorney contingent fees in their gross income.\(^\text{112}\) In *Coady v. Commissioner*,\(^\text{113}\) a husband and wife were issued a deficiency when they excluded attorney fees on their wrongful termination award.\(^\text{114}\) The Ninth Circuit Court of Appeals, finding *Baylin v. United States*\(^\text{115}\) persuasive, held that the contingent attorney fees constituted an anticipatory assignment of income used to discharge a debt to their attorney and so the fees paid out of the judgment were includable in the client’s gross income.\(^\text{116}\) Like the Federal Circuit Court of Appeals, the Ninth Circuit Court of Appeals did not feel that the anticipatory assignment theory was affected by uncertainty in the claim’s value at the time the contingency fee agreement was entered.\(^\text{117}\) The court also found it important that the attorney lien statute in Alaska did not give the attorney a superior lien or ownership interest in the claim as may be interpreted under the Alabama and Michigan statutes.\(^\text{118}\)

Soon after hearing *Coady v. Commissioner*,\(^\text{119}\) the Ninth Circuit Court of Appeals was presented with *Benci-Woodward v. Commissioner*.\(^\text{120}\) On similar facts,\(^\text{121}\) the court decided against the taxpayers, finding the outcome foreclosed by its decision in *Coady*.\(^\text{122}\) The court also addressed a fairness argument.\(^\text{123}\) The taxpayers argued that the decision was unfair because inclusion of attorney fees in their gross income, and their attempt to deduct the fees under itemized deductions, caused them to pay the Alternative Minimum Tax in which they could not deduct attorney fees at all.\(^\text{124}\) The court, citing *Alexander v. Internal Revenue Service*,\(^\text{125}\) stated that equitable arguments cannot overcome the plain meaning of the tax statutes.\(^\text{126}\)

\(^\text{112. }\) See Sinyard v. Comm’r, 268 F.3d 756, 757 (9th Cir. 2001); Coady v. Comm’r, 213 F.3d 1187, 1191 (9th Cir. 2000); and Benci-Woodward v. Comm’r, 219 F.3d 941, 942-44 (9th Cir. 2000) (finding contingent attorney fees are included in taxpayers’ gross income).

\(^\text{113. }\) *Coady*, 213 F.3d at 1187.

\(^\text{114. }\) Id. at 1188.

\(^\text{115. }\) *Baylin*, 43 F.3d at 1455.

\(^\text{116. }\) *Coady*, 213 F.3d at 1190. Interestingly, it seems that the Coadys were paid the entire judgment first and then issued a check to their attorney – but this fact was never taken into account. Id. at 1187-88.

\(^\text{117. }\) Id. at 1191.

\(^\text{118. }\) Id. at 1190 (citing Cotnam v. Comm’r, 263 F.2d 119 (5th Cir. 1959), and Estate of Clarks v. United States, 202 F.3d 854 (6th Cir. 2000)).

\(^\text{119. }\) *Coady*, 213 F.3d at 1187.

\(^\text{120. }\) Benci-Woodward v. Comm’r, 219 F.3d 941 (9th Cir. 2000).

\(^\text{121. }\) Id. at 942-43. In the case, a California attorney lien statute was involved which also did not give attorneys an ownership interest in the claim. Id. at 943.

\(^\text{122. }\) Id. at 942.

\(^\text{123. }\) Id. at 944.

\(^\text{124. }\) Id.

\(^\text{125. }\) *Alexander v. Internal Revenue Serv.*, 72 F.3d 938, 946-47 (1st Cir. 1995).

\(^\text{126. }\) *Benci-Woodward*, 219 F.3d at 944.
The third case that the Ninth Circuit Court of Appeals addressed was *Sinyard v. Commissioner*. Again, the Ninth Circuit Court of Appeals ruled for the Commissioner, finding that the taxpayer constructively received the contingency fee portion of the age discrimination award when they anticipatorily assigned a portion of the claim to their lawyer through a contingency fee arrangement. Interestingly, the contingent fee agreement was signed when the Sinyards were residents of Alabama, but the Ninth Circuit Court of Appeals felt that a statute in favor of the taxpayer’s creditor did not change the fact that payment directly to the taxpayer’s attorney satisfied their obligation and so was income to them.

In 2001, the United States Court of Appeals for the Fourth Circuit decided *Young v. Commissioner*. The facts of the case disclosed that Mr. Young transferred land to Mrs. Young as satisfaction of attorney fees he owed to her attorneys as a result of divorce proceedings. Agreeing with *O’Brien, Baylin* and *Coady*, the Fourth Circuit Court of Appeals decided that Mr. Young’s payment of attorney fees constituted income to Mrs. Young as a discharge of her indebtedness, and the anticipatory assignment of income made by Mrs. Young through a contingency fee agreement could not preclude her tax liability on the income. In rejecting the contention in *Cotnam* that the client’s claim is worthless without the skills of an attorney, the Fourth Circuit Court of Appeals pointed out that an attorney on an hourly rate adds just as much “worth” to the claim as an attorney working on a contingent fee basis. In addition, the Fourth Circuit Court of Appeals noted that the North Carolina attorney lien statute applicable in the case did not provide attorneys with an ownership interest, and even if it had, the application of federal tax laws should not be controlled by state law. In addition, the attorney could not be characterized as having an ownership right in the claim because only the client determines the goals of litigation including whether to pursue a claim or whether to settle.

The United States Court of Appeals for the Seventh Circuit also found against the taxpayer on whether to include contingent attorney fees in the client’s

128. *Id.* at 758-59 (citing *Old Colony Trust Co. v. Comm’r*, 279 U.S. 716 (1929)).
129. *Sinyard*, 268 F.3d at 759-60.
131. *Id.* at 376. Note that the court did not discuss the fact that Mrs. Young’s receipt of land allowed her to have ownership and control over the property, therefore this case is not really analogous to an assignment of property in which the client never receives the portion of the judgment allocated to attorney fees. *Id.* at 372.
133. *Young*, 240 F.3d at 378.
134. *Id.* at 378-79.
135. *Id.* at 378.
gross income in *Kenseth v. Commissioner*.

While citing other circuits that have decided on the issue, the Fourth Circuit Court of Appeals determined that the Commissioner was clearly correct to include contingent attorney fees from an age-discrimination case in the client’s gross income. The Fourth Circuit Court of Appeals felt that there was no reason to treat hourly attorney fees in a different manner than contingent attorney fees. Next, while noting that the Wisconsin attorney lien statute actually prohibits attorneys from acquiring ownership rights in their client’s claims, the court also stated that the relationship between the attorney and client is more similar to the relationship between a corporation and its commissioned sales employees rather than a joint venture. In such a situation, the corporation would be taxed on profits generated by the salesman, and the salesman would also be taxed on his commissions as employment income. In addition, the Fourth Circuit Court of Appeals did not feel that subjecting the taxpayer to the Alternative Minimum Tax was any more inequitable a result than any other situation which causes a taxpayer to pay the Tax. In concluding its opinion, the Fourth Circuit Court of Appeals admonished the Fifth, Eleventh and Sixth Circuits for their lack of neutrality because their decisions seemed to have been most likely based on taxpayer sympathy.

The United States Court of Appeals for the Tenth Circuit was next to find against the taxpayer on the inclusion of attorney fees in their gross income. In *Hukkanen-Campbell v. Commissioner*, after receiving a favorable judgment in a Title VII discrimination suit, the taxpayer filed her return claiming the award under “other income” and deducting attorney fees as an itemized expense. She then amended her return to exclude attorney fees from her gross income and claimed a refund of over $20,075. The Commissioner rejected the taxpayer’s claim, and instead issued a Notice of Deficiency in the amount of $17,402 as a result of the Alternative Minimum Tax. The taxpayer claimed that she should not be required to include the contingent fee portion of the judgment in her gross income because she lacked sufficient control over the funds which were paid directly to her attorney. However, the court found that her recovery of attorney fees clearly benefited her no matter how she tried to label the receipt, so

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137. *Id.* at 883.
138. *Id.*
139. *Id.*
140. *Id.*
141. See *id.* at 884-85.
142. *Kenseth*, 259 F.3d at 885.
144. *Id.*
145. *Id.* at 1313.
146. *Id.*
147. *Id.*
148. *Id.* at 1313.
the attorney fee portion of the judgment was income to her.\textsuperscript{149} Additionally, the court noted that the Missouri attorney lien statute relevant to the case at bar did not give attorneys an ownership interest in their client’s claim.\textsuperscript{150} Finally, while noting the inequitable result that occurred in this case due to the applicability of the Alternative Minimum Tax, the Tenth Circuit Court of Appeals denied all responsibility in the outcome suggesting that such problems should be resolved by Congress.\textsuperscript{151}

The last circuit to address the issue of whether attorney fees should be included in taxpayers’ gross income was the United States Court of Appeals for the Second Circuit.\textsuperscript{152} In \textit{Raymond v. United States},\textsuperscript{153} the taxpayer, after successfully suing IBM for wrongful termination, filed his return including the attorney’s contingent fees in his gross income which subjected him to the Alternative Minimum Tax when he tried to deduct the fees under “itemized deductions.”\textsuperscript{154} Raymond then filed for a refund asserting that he should not have included the attorney fees in his gross income.\textsuperscript{155} After a careful review of the applicable Vermont attorney lien statute, the Second Circuit Court of Appeals found, contrary to the district court, that the statute only provided the attorney with a security interest in their client’s claim, not an ownership interest.\textsuperscript{156} In reviewing \textit{Horst}, the court found that Raymond controlled the contingency fee portion of his claim when he diverted that portion to his attorney in order to satisfy his wants.\textsuperscript{157} So the contingent attorney fees were income to him.\textsuperscript{158} The court next stated that, where a client fires his attorney prior to judgment, the client is still obligated to pay attorney fees incurred.\textsuperscript{159} Therefore, it is not true that the contingency fee nature of these agreements remove the obligation for clients to pay their attorneys.\textsuperscript{160} Additionally, in rejecting the argument that the anticipatory assignment of income doctrine does not apply to contingent attorney fees due to the uncertain value of the claim, the court argued that the same could have been said in \textit{Earl}; the value of the future marital property and salary was unknown.\textsuperscript{161} Finally, in an attempt to distinguish assignment of income under \textit{Earl} and \textit{Horst} from contingent fee agreements, Raymond highlighted the fact that those cases tried to determine who should be taxed with the income; the Supreme Court was not trying to tax income to both

\textsuperscript{149} Hukkanen-Campbell, 274 F.3d at 1313-14.
\textsuperscript{150} Id. at 1314.
\textsuperscript{151} Id. at 1314-15.
\textsuperscript{152} Raymond v. United States, 355 F.3d 107, 108 (2d Cir. 2004).
\textsuperscript{153} Id.
\textsuperscript{154} Id. at 109.
\textsuperscript{155} Id.
\textsuperscript{156} Id. at 113-15.
\textsuperscript{157} Id. at 115.
\textsuperscript{158} Raymond, 355 F.3d at 115.
\textsuperscript{159} Id. at 116.
\textsuperscript{160} Id.
\textsuperscript{161} Id. at 116-17.
the grantor and grantee. In response, the court felt that while this was true, there was no reason to treat hourly attorney fees differently than contingent attorney fees.

III. STATEMENT OF FACTS AND HOLDINGS

A. John W. Banks, II v. Commissioner of Internal Revenue

In March 2003, the Sixth Circuit Court of Appeals heard Banks v. Commissioner. A review of the facts in the case revealed that Mr. Banks was terminated from employment with the California Department of Education (CDOE) in 1986 after fourteen years of employment. Mr. Banks sued the CDOE and various employees under federal employment discrimination claims and a number of other state statutory and tort claims. Mr. Banks abandoned several claims during the pretrial conference and proceeded to trial requesting reinstatement, back pay and attorney fees under the federal statutory claims. Nine days into the trial, the parties settled the claim when Banks agreed to reduce his claim from $850,000 to $464,000 per his understanding that the claim would be characterized as personal injury damages, excludable from his gross income under I.R.C. Section 104(a)(2). Petitioner paid his attorney $150,000 pursuant to the contingency fee agreement, and he did not include the settlement proceeds in his gross income for the 1990 tax year.

The Commissioner issued a Notice of Deficiency in 1997 and included the entire settlement amount in Mr. Banks’ gross income for 1990, disallowing deductions for attorney fees. In 2001, the tax court filed its opinion agreeing with the Commissioner on the issues of taxability of the settlement and gross income inclusion of the contingency fee portion of the award. The Sixth Circuit Court of Appeals also agreed that the settlement was includable in Mr. Bank’s gross income because Mr. Banks did not give any evidence of the CDOE’s intent to compensate personal injuries other than the self-serving language in the settlement agreement. In addition, the “relief sought” at trial of “reinstatement, back pay and attorneys’ fees” suggested that

162. Id. at 117.
163. Id.
165. Id.
166. Id. at 375.
167. Id.
169. Id. at 376.
170. Banks, 345 F.3d at 376.
171. Id. at 377.
172. Id.
173. Id. at 381.
the claim did not encompass personal injuries at the time of trial.\footnote{174} Finally, in settlement agreements, Mr. Banks’ initial offer to settle the claim for $850,000 was based on his salary, so the parties’ final settlement was clearly based on economic damages.\footnote{175}

Next, in a 2-1 decision, the Sixth Circuit Court of Appeals reversed the tax court ruling on the issue of whether contingent attorney fees may be excluded from the taxpayer’s gross income.\footnote{176} After a careful review of the assignment of income doctrine in \textit{Earl} and \textit{Horst}, and discussing the “old” Fifth Circuit Court of Appeals decision in \textit{Cotnam}, as well as Sixth Circuit Court of Appeals precedent in \textit{Estate of Clarks}, the Sixth Circuit Court of Appeals found that the contingent attorney fees were not taxable to the client even where the applicable attorney lien statute did not give the attorney an ownership interest in their client’s claim.\footnote{177} Positively citing the Fifth Circuit Court of Appeals decision in \textit{Srivastava}, the Sixth Circuit Court of Appeals declined to distinguish the case at bar from \textit{Estate of Clarks} based on the intricacies of property rights under state attorney lien laws.\footnote{178} The court feared that such a decision would result in unreliable precedent and inadequate notice to taxpayers on the proper method of reporting judgment and settlement income.\footnote{179} Importantly, the Sixth Circuit Court of Appeals felt that the other grounds for the decision in \textit{Estate of Clarks} were adequate to uphold the judgment to exclude contingent attorney fees from the client’s gross income.\footnote{180} These grounds included:

\begin{quote}
(1) the fact that the claim, at the time the contingency fee agreement was signed, was ‘an intangible, contingent expectancy,’ (2) taxpayer’s claim was like a partnership or joint venture in which the taxpayer assigned away one-third in hope of recovering two-thirds; (3) no tax-avoidance purpose was at work with the contingency fee arrangement, as there ostensibly was in Lucas and Horst; and (4) double taxation would otherwise result by including the contingency fee in taxpayer’s income.\footnote{181}
\end{quote}

Judge Moore dissented as to the portion of the judgment that allowed the taxpayer to exclude attorney fees in his gross income.\footnote{182} Judge Moore felt that the effect of state attorney lien statutes on the attorney’s bundle of rights was
decisive. Therefore, the contingent attorney fees should not be excluded from the taxpayer’s gross income because California law merely gave attorneys a security interest in their client’s claim, not an ownership interest.

B. Sigitas J. Banaitis v. Commissioner of Internal Revenue

In February 2003, the Ninth Circuit Court of Appeals heard Banaitis v. Commissioner. The underlying facts of the case indicate that Mr. Banaitis began working for the Bank of California in 1980, which was acquired by Mitsubishi Bank in 1984. As a result of the merger, some of Mr. Banaitis’ clients became concerned about the confidentiality of their financial information and trade secrets because they competed directly with firms controlled and operated by the bank’s parent company, Mitsubishi Group, Ltd. Mr. Banaitis complied with his clients’ wishes and refused to breach confidentiality agreements with his customers. However, unhappy with Mr. Banaitis’ lack of cooperation, the Bank of California forced Mr. Banaitis to resign, and Mr. Banaitis suffered emotional and reputational damages in addition to lost compensation. After trial, the jury awarded damages to Mr. Banaitis for past and future compensation as well as punitive damages and damages for emotional distress and injuries to reputation. The Bank appealed and eventually settled the claim in 1995 for $8,728,599, of which Mr. Banaitis received $4,864,547 and his attorneys received $3,864,012. Mr. Banaitis also paid $150,000 to the state of Oregon under their law requiring recipients of punitive damages to “contribute a portion of such awards to the State.” Banaitis filed his return only reporting the portion of his settlement that constituted taxable interest on his portion of the award.

The Commissioner disagreed with Mr. Banaitis on the taxable portion of the settlement and only allowed $625,000 to be excluded for emotional and reputational injuries under the then current version of I.R.C. Section 104(a)(2). As a result, Mr. Banaitis was taxed on $8,103,599 and he owed an additional $1,708,216 under the Alternative Minimum Tax. Mr. Banaitis filed for a

183. Id.
184. Id.
185. Banaitis v. Comm’r, 340 F.3d 1074 (9th Cir. 2003).
186. Id.
187. Id. at 1076.
188. Id.
189. Id.
190. Id. at 1076-77.
191. Banaitis, 340 F.3d at 1077.
192. Id. at 1078.
193. Id. at 1078 n.1.
194. Id. at 1078.
195. See id.
196. Id.
redetermination; however, the Tax Court found for the Commissioner in all respects.197

On appeal, the Ninth Circuit Court of Appeals agreed with the Commissioner as to the taxability of economic injuries and punitive damages since these awards are not excludable under I.R.C. Section 104 (a)(2) because they are not paid “on account of” personal injuries or sickness.198 Nevertheless, the Ninth Circuit reversed the Tax Court’s ruling on the inclusion of the contingent attorney fee portion of the settlement in the taxpayer’s gross income.199 The Ninth Circuit Court of Appeals, citing to United States v. Mitchell,200 felt that state law determines property rights while federal law determines how those rights are taxed.201 As such, the attorney’s property rights defined under each state’s attorney lien statute determine whether or not the client has sufficient ownership and control over the contingency fee portion of the award in order to be taxed with income generated from that source.202 In reviewing the applicable Oregon attorney lien statute, the Ninth Circuit Court of Appeals stated that the Oregon statute was very similar to the Alabama lien statute discussed in Cotnam.203 In fact, the Oregon statute went even further than the Alabama attorney lien statute because it gave attorneys a right to sue third parties for fees left unsatisfied by their clients.204 As a result of these distinctive features of the Oregon attorney lien statute, the Ninth Circuit Court of Appeals unanimously found that the contingent attorney fees were not includable in Mr. Banaitis’ gross income.205

C. Commissioner of Internal Revenue v. John W. Banks III and Sigitas J. Banaitis206

On May 29, 2004, the United States Supreme Court granted certiorari to the Commissioner of the IRS to hear Commissioner v. Banks207 and Commissioner v. Banaitis.208 In addition, the Court consolidated the cases in order to determine the taxability of contingent attorney fees.209 Oral argument before the Supreme Court was heard on November 1, 2004.210

197. Banaitis, 340 F.3d at 1078-79.
198. Id. at 1080-81.
199. Id. at 1081.
201. Banaitis, 340 F.3d at 1081.
202. See id. at 1081-82.
203. Id. at 1082 (citing Cotnam v. Comm’r, 263 F.2d 119 (5th Cir. 1959)).
204. Id. at 1082.
205. Id. at 1083.
209. Banks, 124 S. Ct. at 1712; Banaitis, 124 S. Ct. at 1713. Note that shortly before oral argument of the Banks case, Congress passed the American Jobs Creation Act on October 11, 2004.
In a surprisingly short opinion authored by Justice Kennedy, and joined by
all Justices taking part, the United States Supreme Court reversed the Sixth
Circuit decision in Banks and the Ninth Circuit decision in Banaitis. While
expressing that the purpose of the anticipatory assignment of income doctrine
was to tax income to the person who earns it, Justice Kennedy indicated that the
person who earns the income is “ordinarily” determined according to which
“taxpayer exercises complete dominion over the income.” Since the taxpayer
makes critical decisions as to the underlying claim such as whether to settle or
proceed to trial, Justice Kennedy stated that it is the plaintiff that maintains
dominion over the property throughout the litigation process and he did not
understand the respondents to be arguing otherwise.

Instead, Justice Kennedy believed the respondents arguments to be focused
on the inapplicability of the assignment of income doctrine due to two key
reasons: the initial speculative nature of the claims and characterizing the
attorney-client relationship as a joint venture where a contingent fee agreement
is involved so that the attorney’s skill and the client’s claim are treated as capital
assets. Treating the arguments separately, Justice Kennedy found that the
uncertainty in the value of the income to be produced by the asset “at the
moment of assignment” made no difference to the applicability of the assignment
of income doctrine. In addition, he rejected the argument that the attorney-
client relationship could be characterized as a type of joint venture for tax
purposes because it “is a quintessential principal-agent relationship.” Justice
Kennedy felt this position was supported by the fact that the client retains
ultimate control over the claim throughout the litigation process, and the fact that
the attorney could no more be considered a joint owner of his client’s claim then

and it was signed into law on October 22, 2004. Petitioner’s Supplemental Brief at 2, Comm’t v.
Banks, 125 S. Ct. 826 (2005) (Nos. 03-892, 03-907). Section 703(a) of the Act,
[A]mends Section 62(a) of the Internal Revenue Code to provide a deduction
from gross income for, inter alia, “[a]ny deduction allowable under [chapter 1
of subtitle A of the Code] for attorney fees and court costs paid by, or on behalf
of, the taxpayer in connection with any action involving a claim of unlawful
discrimination.”

Id. This Act creates an “above-the-line” deduction for attorney fees in applicable discrimination
cases, meaning the deduction is taken before determining adjusted gross income and the deduction
is not added back in when determining a client’s alternative minimum tax. Id. at 5-7. While this
new law would have made a difference in the Banks case, the law is prospective in application:
“Section 62(a) ‘shall apply to fees and costs paid after the date of the enactment of this Act with
respect to any judgment or settlement occurring after such date.’” Id. at 3. As such, the Act did not
apply to the United States Supreme Court decision in Banks. See id.

211. Id. at 828.
212. Id. at 831.
213. Id. at 832-33.
214. Id. at 832.
215. Id.
216. Banks, 125 S. Ct. at 832, (citing MODEL RULES OF PROF’L CONDUCT R. 1.3, cmts. 1, 1.7 1
(2002)).
a commissioned sales person could be considered a “joint owner of his employer’s accounts receivable.” Justice Kennedy stated that this rule applied so long as the state attorney lien law did not change “the fundamental principal-agent character of the relationship.”

Although various amici presented novel arguments in support of the respondents, Justice Kennedy felt that the court need not address any of these because the arguments were not presented in the earlier stages of litigation.

Finally, Justice Kennedy rejected respondent Banks’ argument that the application of the anticipatory assignment of income doctrine to his case would be contrary to the statutory fee-shifting purposes of the federal anti-discrimination laws. Justice Kennedy felt that this argument did not need to be addressed because the Banks attorney was not paid his fee under a statutory fee-shifting provision nor did the contingency fee agreement or settlement agreement indicate that the fee was paid in lieu of statutory fees.

IV. ANALYSIS

A. Distinguishing Characteristics of Contingent Attorney Fees from Anticipatory Assignment of Income

To determine how the United States Supreme Court should have decided Banks and Banaitis, it is best to begin with the anticipatory assignment of income doctrine as defined in Earl and Horst. As discussed by the Fifth,

217. *Id.* at 832-33 (citing Kenseth v. Comm’r, 259 F.3d 881, 883 (7th Cir. 2001)).
218. *Id.* at 833.
219. *Id.* Among the legal theories favorably discussed by the United States Supreme Court in oral argument of the Banks decision was the transaction theory presented by Professor Davenport. See Transcript of Oral Argument at 12-15, 21-22, 27-28, 41-43, Comm’r v. Banks, 125 S. Ct. 826 (2005) (Nos. 03-892, 03-907).  According to Professor Davenport:

The legal fees in these cases were incurred to acquire and dispose of Respondents’ tort claims against their employers.  Tort claims are intangible property.  The costs of acquiring and disposing of property are transaction costs, and transaction costs are not deductible under either section 162 (dealing with business expenses) or 212 (dealing with investment expenses) of the Internal Revenue Code.  Rather, transaction costs are offset directly against the proceeds earned by the costs.

Brief for Amicus Curiae Professor Charles Davenport in Support of Respondents at 1-2, Comm’r v. Banks, 125 S. Ct. 826 (2005) (Nos. 03-892, 03-907); In addition, Justice O’Connor suggested that the 5th Amendment may be applicable to these cases: “[T]his is an appalling situation . . . . Does the Fifth Amendment Takings Clause apply to a Government tax scheme that taxes something beyond the income received?” Transcript of Oral Argument at 28, Comm’r v. Banks, 125 S. Ct. 826 (2005) (Nos. 03-892, 03-907).

220. *Id.* at 834.
221. *Id.*
224. Cotnam v. Comm’r, 263 F.2d 119 (5th Cir. 1959); Srivastava v. Comm’r, 220 F.3d 353 (5th Cir. 2000).
Sixth and Eleventh Circuit Courts of Appeal, there are many ways to distinguish the anticipatory assignment of income doctrine under *Earl* and *Horst* from the contingent attorney fee situation.

First, contingency fee agreements are not entered into for the purpose of shifting taxable income to a family member who is in a lower tax bracket so the family will pay less overall tax on the income. Contingency fee agreements are obviously entered into for the purpose of retaining competent counsel to pursue a legitimate claim where it would be difficult for the client to afford hourly rates prior to settlement or judgment, or the client prefers the contingent fee arrangement to hourly rates because the client will not be obligated to pay attorney fees if the lawyer does not prevail on the claim. In contrast, the facts of the case in *Horst* suggest that the father/holder of the negotiable bond gifted the interest coupons to his son so that the income would be taxed at his son’s lower tax rates resulting in lower tax liability for the entire family. If the father’s purpose was solely to transfer wealth to his son, he could have gifted the entire bond to his son in which case the interest coupons would rightly be taxed at the son’s tax rates. In *Earl*, the facts suggest that the taxpayer’s method of taxing only one-half of his salary to himself (and presumably one-half to his wife), would result in a lower overall tax for him and his wife because they would each benefit from lower tax rates on the income. In both cases, the taxpayers did not disagree that the income was taxable to their families; instead, the taxpayers argued that their income should be taxed to particular family members with lower tax rates.

A second distinguishing feature of the contingency fee agreement from the circumstances in *Earl* and *Horst* is that the underlying value of the client’s claim in a contingent fee arrangement is uncertain because the client may choose to never enforce his/her claim, and the client’s chances of prevailing on the claim are rarely ever guaranteed; if a client’s right to judgment was so clear, the client would have likely settled the problem with the opposing party before the

226. Foster v. United States, 249 F.3d 1275 (11th Cir. 2001); Davis v. Comm’r, 210 F.3d 1346 (11th Cir. 2000); Cotnam, 263 F.2d at 119.
227. See Foster, 249 F.3d at 1279-80; Srivastava, 220 F.3d at 359-63; Estate of Clarks, 202 F.3d at 856-58; Davis, 210 F.3d at 1347; Cotnam, 263 F.2d at 125-26.
230. See Estate of Clarks, 202 F.3d at 857.
232. See *Estate of Clarks*, 202 F.3d at 857.
233. See id.
234. Srivastava v. Comm’r, 220 F.3d 353, 362 n.26 (5th Cir. 2000) (citing *Jones v. Comm’r*, 306 F.2d 292, 301 (5th Cir. 1962)).
need for legal representation ever arose. While it has been argued that in *Earl* the taxpayer’s salary was similarly uncertain when he entered into the contract with his wife, it is obvious that if Earl did have a job, he would properly be paid the value of his services when he performed them. Earl’s situation can hardly be compared to a client’s legal claim which, however legitimate, must be diligently pursued with the assistance of legal counsel in order to convert the possibility of payment into a reality.

These first two reasons that distinguish contingent attorney fee arrangements from the situations in *Earl* and *Horst* also distinguish contingent attorney fee agreements from hourly attorney fee agreements. One of the purposes for which clients enter contingent fee agreements with their attorneys is to avoid an obligation to pay attorney fees if the lawyer does not prevail in the claim. The client thereby shifts to the lawyer a sizeable portion of the risks of pursuing the claim by assigning a percentage of the uncertain claim to the lawyer. In the hourly fee situation, the client must accept all of the burdens of pursuing a claim along with all of the benefits. The client must pay his/her attorney fees regardless of the outcome of his/her case. The attorney accepts no risk for pursuing the claim and receives his/her fee according to a set fee schedule. These differences are substantial enough to suggest that it may be appropriate to characterize these attorney fee arrangements in different ways which, according to such characterization, would rightly be taxed in a different manner. Unfortunately, by failing to analyze the uncertainty of the client’s claim in light of the risk-shifting feature that it entails, resulting in a clearly different financial relationship between the attorney and client, the Supreme Court seems to have missed the point of respondent’s argument.

235. Note that a defendant that litigates a claim in the face of clear liability will be subject to sanctions under Rule 11 of the Federal Rules of Civil Procedure. Fed. R. Civ. P. 11.
236. Raymond v. United States, 355 F.3d 107, 116-17 (2d Cir. 2004).
237. See *Estate of Clarks*, 202 F.3d at 857 (finding that in *Earl* and *Horst* “the income assigned to the assignee was already earned, vested and relatively certain to be paid to the assignor”) (citing Lucas v. Earl, 281 U.S. 111, 111 (1930) and Helvering v. Horst, 311 U.S. 112, 112 (1940)).
238. See *Cotnam v. Comm’tr*, 263 F.2d 119, 126 (5th Cir. 1959).
243. See id.
244. See Feldman, *supra* note 241, at 1334.
245. See id. (arguing that contingent fees should be excluded from gross income but hourly fees should not).
246. See *supra* text accompanying note 215.
A third feature that distinguishes attorney contingent fee agreements from the situations discussed in *Earl* and *Horst* is that contingent fee agreements are made at arm’s-length; they are not entered into gratuitously. As discussed in *Srivastava*, a contingent fee agreement is a commercial transaction; one would be “hard-pressed to imagine a client who would offer his attorney a pure gratuity.” This difference is important because, as a direct result of the fact that *Earl* and *Horst* involved gratuitous transfers, the Supreme Court’s decision to include the income in the donor’s gross income did not result in double taxation; the donee was not also taxed on gross income from the gift because, although the donee realized an increase in wealth, gifts are not subject to income taxation. This is not the case with contingent attorney fees; the attorney clearly earns his/her fee, and so is subjected to tax on the fee under I.R.C. Section 61 as “compensation for services.”

Double taxation can have unconscionable results, and is potentially as unfair as the double taxation of corporate earnings. But at least with corporate earnings, although Congress did not eliminate the taxation of dividends as encouraged by President Bush, Congress did use creative and aggressive tax reform to reduce “the maximum tax rate on dividends paid by most domestic and foreign corporations.” Indeed, one could argue that taxing dividends to taxpayers after the earnings have already been taxed at the corporate level would tend to affect those with high incomes because few individuals with low incomes can afford investments, therefore these higher income individuals could be expected to afford the added tax burden. In contrast, people that receive income as a result of settlements or judgments may come from any socioeconomic background, and one of the main reasons that people choose to enter contingent fee agreements is that they cannot afford hourly fees. As such, it is difficult to imagine why Congress would have intended double taxation to result from the receipt of settlements and judgments.
taxation in the contingent fee situation when they put so much effort into avoiding double taxation in the corporate earnings sector.261

A fourth and more technical distinguishing characteristic of contingent attorney fee arrangements from the anticipatory assignment of income doctrine is that contingent fee agreements are more accurately characterized as an assignment of an asset rather than the assignment of an income stream.262 As stated in *Estate of Clarks*,263 a contingent fee agreement transfers some of the trees in the orchard, not merely the fruit.264 In *Horst* the father was clearly assigning an income stream to his son when he gifted the coupons to him but retained the underlying bond.265 In *Earl*, the gratuitous transfer at issue consisted of the future earnings of an individual.266 Since the underlying income producing asset was an individual, it would not be possible to gift a portion of the individual in order to characterize the transfer as the assignment of an asset.267 By contrast, assuming that the contingent fee agreement is correctly written, when a client assigns away a portion of his settlement or judgment the client assigns away a portion of the underlying income producing asset – the claim.268 This is entirely consistent with the Model Rules of Professional Conduct which states that a lawyer may acquire a proprietary/ownership interest in the cause of action for the limited purposes of (1) acquiring a lien “authorized by law to secure the lawyer’s fee or expenses,”269 and (2) contracting “with a client for a reasonable contingent fee in a civil case.”270 This is also consistent with the previous United States Supreme Court decision in *Nutt v. Knut*271 which stated that in a contingent fee situation in which the agreement made the payment of attorney fees a lien upon the claim, “[i]n giving that lien from the outset, before the allowance of the claim and before any services had been rendered by the attorney, the contract, in effect, gave him an interest or share in

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261. See Reece, supra note 256, at 337-38. Also note that the recent enactment of the American Jobs Creation Act suggests that Congress does feel that the double taxation of attorney fees is inherently unfair. See Petitioner’s Supplemental Brief at 2, Comm’r v. Banks, 125 S. Ct. 826 (2005) (Nos. 03-892, 03-907). Indeed, they felt so strongly that they created an “above-the-line” deduction for attorney fees in discrimination cases. Id. Contra id. at 7 (arguing that Congress would not have created a law specifically excluding contingent fees in discrimination cases from gross income if it believed that contingent fees generally were excludable).


263. Id.

264. Id. at 858.


267. See id. (citing Lucas v. Earl, 281 U.S. 111, 115 (1930)) (stating that “[i]n this case, the owner of the ‘tree’ was Mr. Earl, the taxpayer earning income from services, and the ‘fruit’ was the salary he earned from his efforts”).

268. See *Estate of Clarks*, 202 F.3d at 857-58.


270. Id. at R. 1.8(i)(2).

the claim itself.” If the claim is initially the property of the client, there is little reason for courts to deny the client’s intent to assign a portion of the claim to the attorney by way of the fee agreement. The attorney’s fee is satisfied by an interest in the client’s claim which may or may not result in an eventual settlement or judgment. As such, assuming that the claim is divisible, the contingent attorney fee agreement operates as the assignment of an asset, not the assignment of income. As described in Srivastava, when a taxpayer relinquishes an income producing asset, the assignment of income doctrine does not apply because the taxpayer ceases to retain an interest in the asset. Likewise, the client no longer retains an interest in the contingent fee portion of the award, so the assignment of income doctrine should not apply.

These last two features seem to have been overlooked by the Supreme Court decision in Banks. Instead, while noting that income should be taxed to the one who earns it, and the one retaining dominion over the income producing asset is “ordinarily” the one who earns the income, Justice Kennedy failed to recognize that this is not an ordinary situation. It is due to the nature of the underlying asset as a legal claim that the client is required to retain “dominion” over the property as to whether to settle or proceed to judgment; the client does not purposefully retain this right to prevent a present transfer of the assigned interest. Regardless of the client’s retained “dominion,” commercial tort claims (not just the proceeds thereof) are recognized property interests to which clients may make assignments or grant other recognized security interests. As a result of Justice Kennedy’s failure to distinguish contingent attorney fee arrangements from the “ordinary” situation, he incorrectly concluded that the client’s retained dominion over the asset throughout the litigation process meant that the client “earns” the contingency portion of the award.

B. Should the Supreme Court Have Refused to Expand its Anticipatory Assignment of Income Rule to Cover Contingent Attorney Fees?

As shown above, there were many ways in which the United States Supreme Court

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272. Id. at 20.
274. Cotnam v. Comm’r, 263 F.2d 119, 126 (5th Cir. 1959).
279. Id.
280. See generally U.C.C. § 9-109 (a)(1) (2001) (stating “this article applies to . . . a transaction, regardless of its form, that creates a security interest in personal property . . . by contract”); see also, U.C.C. § 9-109 (a)(1), (d)(12) (2001) (stating “[t]his article does not apply to . . . [a]n assignment of a claim arising in tort, other than a commercial tort claim, but Sections 9-315 and 9-322 apply with respect to proceeds and priorities in proceeds”).
Court could have distinguished contingent attorney fee arrangements from the anticipatory assignment of income doctrine it created in *Earl* and *Horst*. The differences are so great, that the Supreme Court could even have found the doctrine entirely inapplicable to contingent attorney fee agreements. Therefore, the question becomes: should the Supreme Court have refused to expand the anticipatory assignment of income doctrine to include contingent attorney fee agreements?

This question is perhaps best answered by looking at the various examples raised by taxpayers and the Commissioner of the IRS to illustrate their positions. The question can also be answered by looking toward equitable considerations.

As discussed under the fourth distinguishing characteristic of contingent attorney fee agreements from the anticipatory assignment of income doctrine, these agreements are more like an assignment of a portion of the client’s claim (or asset), rather than an assignment of a portion of the client’s income stream. Frequently repeated examples that taxpayers have used in order to explain their views include that contingent attorney fee agreements result in a “joint venture,” “partnership” or “virtual co-ownership” with their attorneys.

According to *Black’s Law Dictionary*, a “joint venture” is:

A business undertaking by two or more persons engaged in a single defined project. The necessary elements are: (1) an express or implied agreement; (2) a common purpose that the group intends to carry out; (3) shared profits and losses; and (4) each member’s equal voice in controlling the project.

Clearly, the first three elements are met when the client signs a contingent fee agreement. First, the signed contingent fee agreement constitutes an express agreement. Second, the client and attorney agree to work toward the goal of receiving a favorable settlement or judgment on the client’s claim. Third, the attorney and client share profits and losses in that if a favorable judgment or settlement is received, both will receive payment; if the claim does not produce a favorable judgment or settlement, both client and attorney receive nothing for their efforts.

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283. See Srivastava v. Comm’r, 220 F. 3d 353, 360 (5th Cir. 2000).
286. Id.
288. See id.
289. See id.
The fourth element is more difficult to meet. Under the Model Rules of Professional Conduct, the client has the authority to determine the objectives of representation and whether and how to settle, while the lawyer generally has authority to determine the day-to-day means by which the client’s objectives are met. As such, the client and lawyer do not technically have an “equal voice” in every matter raised in litigation. However, both the client and the lawyer have a great deal of control over important aspects of the litigation, so it could be argued that their responsibilities are more or less equal, even if they are different. Of the district courts that have had occasion to decide directly on the point of whether the partners in a joint venture must share control over every aspect of the project, the decisions seem to indicate that a division of responsibilities will not make the project’s status as a joint venture fail. Therefore, a contingent attorney fee arrangement meets the requirements of a joint venture.

According to Black’s Law Dictionary, a partnership exists where there is “a voluntary association of two or more persons who jointly own and carry on a business for profit.” Further, a partnership is presumed where “the persons agree to share proportionally the business’s profits or losses.” Case law suggests that the elements of partnerships and joint ventures are nearly identical, with the chief difference being that joint ventures are formed for a single purpose, while partnerships involve extended business operations. With these definitions in mind, it seems that a contingent fee agreement is more closely analogous to a joint venture than a partnership because the arrangement is entered into with the intent of pursuing a particular claim.

Black’s Law Dictionary does not contain a technical definition of “virtual co-ownership.” However, if we assume that the term was meant to describe a situation where the client and lawyer “almost” co-own the claim, then the idea becomes clearer. According to Black’s Law Dictionary, a co-owner shares “ownership, possession, and enjoyment” of the property. Liberally
interpreting this definition, the contingent fee agreement gives the attorney an ownership interest in the claim when the client assigns a portion of the claim to him.\textsuperscript{302} The agreement also gives the attorney a possessory interest in the claim from the moment that the contract is signed.\textsuperscript{303} In addition, the attorney has the right to enjoy the proceeds of the claim when the litigation is concluded.\textsuperscript{304} However, the example becomes complicated when the attorney-client relationship is terminated prior to a resolution of the claim and a new attorney completes the litigation.\textsuperscript{305} In such a case, the first attorney is still entitled to his contingent fee under the agreement, but the attorney’s fee will likely be reduced so that the lawyer does not collect an “unreasonable fee” under the \textit{Model Code of Professional Conduct} Section 1.5.\textsuperscript{306} As such, it seems that the joint venture example provides a much clearer illustration of the contingent fee arrangement.

Instead of properly analyzing the attorney-client relationship in contingent fee arrangements to determine whether the various elements are met to create a joint venture or similar relationship requiring altered tax consequences, Justice Kennedy concluded that a joint venture could not exist simply because the attorney-client relationship represented a principal-agent relationship.\textsuperscript{307} However, the existence of a principal-agent relationship is not foreign to partnership law.\textsuperscript{308} Partners are agents of the partnership and have fiduciary duties toward each other.\textsuperscript{309} Justice Kennedy believed his position to be supported by the \textit{Model Code of Professional Conduct}.\textsuperscript{310} However, such an interpretation of the Code leads to perverse results because the Code’s rules specifically defining and fortifying the ethical duties of attorneys toward their clients, presumably designed to protect their clients, would actually be used to hurt their clients as a direct result of the added protections provided.\textsuperscript{311} In addition, clients are not without their own duties toward their attorneys; clients have the duty to deal fairly which their lawyers and this duty can be enforced by exceptions to the lawyer’s duty to keep their client’s confidences under the

\begin{itemize}
  \item \textsuperscript{302} See Estate of Clarks v. United States, 202 F.3d 854, 858 (6th Cir. 2000) (“The situation is no different from the transfer of a one-third interest in real estate that is thereafter leased to a tenant.”).
  \item \textsuperscript{303} See id.
  \item \textsuperscript{304} See id.
  \item \textsuperscript{306} See \textit{Model Rules of Prof’l Conduct} R. 1.5 (2002) (“A lawyer shall not make an agreement for, charge, or collect an unreasonable fee or an unreasonable amount for expenses.”); \textit{See also} Mujalovic, supra note 305, at 386-87.
  \item \textsuperscript{307} Comm’r v. Banks, 125 S. Ct. 826, 832 (2005).
  \item \textsuperscript{308} See R.U.P.A. § 301 (2004) (stating “[e]ach partner is an agent of the partnership for the purpose of its business.”). Presumably, since joint ventures differ from partnerships only to the extent to the limited purpose involved, joint ventures would similarly be agents of the venture. \textit{See id}.
  \item \textsuperscript{309} Id. \textit{See also} R.U.P.A. § 404 (2004).
  \item \textsuperscript{310} Banks, 125 S. Ct. at 832.
  \item \textsuperscript{311} See \textit{Model Rules of Prof’l Conduct} R. 1.1-7 (2002).
\end{itemize}
Model Code of Professional Conduct and various state attorney lien laws. Consequently, it is difficult to understand why Justice Kennedy felt that the attorney-client relationship as agent-principal foreclosed the possibility of characterizing the relationship as a joint venture.

The Commissioner has also attempted to use examples which he feels more closely describe the contingent attorney fee situation. In Kenseth, the Commissioner compared the contingent attorney fee arrangement to a commissioned salesperson for a corporation. The Commissioner argued that the corporation receives and pays taxes on profits generated by the salesman, and the salesman likewise pays taxes on the commission he receives. The Seventh Circuit Court of Appeals agreed that this was an appropriate comparison even though the court also noted that the corporation can fully deduct the commission paid to the salesperson and so a double taxation would not result. The court then went on to concede that the contingent attorney fee agreement operates like a joint venture, but unfortunately the court then confused the concept with joint ownership and suggested that the applicable state attorney lien statute does not give the attorney an ownership interest in his client’s claim. Even though it could be argued that the contingent fee agreement itself gives the lawyer an ownership interest in the client’s claim, the elements of a joint venture do not require co-ownership of the capital contributed to the joint venture. Case law suggests that it is enough that the client contributes his/her claim to the venture, and that the lawyer contributes his time, expertise and resources. Therefore, not only did the Commissioner fail to put forth an adequate example that took into account all of the factors at issue in the contingent fee agreement situation, the Commissioner and the Seventh Circuit Court of Appeals utterly failed to properly address the joint venture concept. As such, Justice Kennedy’s reliance on this example in the United States Supreme Court decision in Banks was also unwarranted.

In the Commissioner’s brief requesting certiorari on the Banks case, he put forth two more examples. In order to emphasize the idea that the taxpayer

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312. Id. § 1.6; See also Banks, 125 S. Ct. at 833.
314. Kenseth, 259 F.3d at 881.
315. Id. at 883. See also supra note 217 and accompanying text.
316. Kenseth, 259 F.3d at 883.
317. See id.
318. Id.
319. See BLACK’S LAW DICTIONARY 856 (8th ed. 2004).
320. See Albina Engine and Mach. Works, Inc. v. Abel, 305 F.2d 77, 81 (10th Cir. 1962) (finding that a joint venture “relationship may exist even though a single adventurer owns all of the property”).
321. See Banks, 125 S. Ct. at 833.
322. Id.
cannot avoid paying taxes on the contingent fee portion of the claim because the taxpayer earned the entire claim, the Commissioner compared the taxpayer’s claim to a situation in which a father pays child support. According to the Commissioner, this example is indistinguishable from the claim of the taxpayer because the father paying child support cannot deduct the support payments even though the payments are made directly to his ex-wife. This example seriously distorts the relationship that exists between a client and lawyer, because a lawyer is hardly the client’s ex-spouse, and the lawyer clearly earns his/her fee. Furthermore, in the child support example, the payments are made for the purpose of paying the child’s living expenses. Child support payments are not income to the custodial parent, so a double taxation does not result. Again the Commissioner used an example that failed to take into account all of the factors that are at issue in the contingent fee situation.

The other example that the Commissioner used in his brief is more on point. In this example, the Commissioner compared the taxpayer’s claim to one in which a professional athlete agrees to pay his agent ten percent of his salary as compensation to the agent and the athlete’s employer pays the commission directly to the agent. The professional athlete and the agent both pay taxes on the ten percent commission. Admittedly, this example does resemble the attorney-client relationship, but the two situations can still be distinguished in a meaningful way. First, the professional athlete’s salary is not nearly as uncertain as the success of a client’s claim. The professional athlete can be expected to receive some kind of salary; the exact amount is the only point at issue. As such, the agent of the professional athlete does not enter the relationship prepared to receive no compensation if a favorable salary is not negotiated. This risk factor is a crucial element to the joint venture concept that taxpayers are relying on in the taxability of contingent attorney fees. In addition, by agreeing to pay the agent a fixed percentage of the athlete’s salary,

324. Id.
325. Id.
326. See Estate of Clarks v. United States, 202 F.3d 854, 858 (6th Cir. 2000).
330. Id.
331. Id.
332. Note that this is similar to the situations in Earl and Horst. See Estate of Clarks v. United States, 202 F.3d 854, 857 (6th Cir. 2000) (finding that in Earl and Horst “the income assigned to the assignee was already earned, vested and relatively certain to be paid to the assignor”) (citing Lucas v. Earl, 281 U.S. 111 (1930) and Helvering v. Horst, 311 U.S. 112 (1940)).
the athlete is truly assigning away his future income, just as the husband assigned away his future income to his wife in *Earl*.\(^{334}\) As discussed above, the contingent attorney fee agreement acts to assign a portion of the client’s claim to the attorney, not just the proceeds of the claim.\(^{335}\) Therefore, the Commissioner’s example is distinguishable from the contingent attorney fee arrangement because the professional athlete’s relationship with his agent does not result in the agent taking a substantial risk of loss as required by a joint venture, and the professional athlete assigns an income stream to his agent, not an asset as occurs in the contingent attorney fee situation.

As shown, a careful review of the taxpayers’ and Commissioner’s positions and examples used to demonstrate their views suggests that the United States Supreme Court should have refused to expand its anticipatory assignment of income doctrine to include contingent attorney fee arrangements. A look at a few examples demonstrating the inequity of the application of the anticipatory assignment of income doctrine further supports the conclusion that the Supreme Court should have ruled in favor of taxpayers on contingent attorney fee awards.

Consider the following example:\(^{336}\) A client for the 2003 tax year has a complicated tort claim which resulted in economic (non-physical) injury. The client has a contingent fee agreement with his attorney whereby the attorney is given a forty percent interest in the client’s claim. Expert fees cost the client $155,000.00. After the conclusion of litigation, the jury awards the client $100,000.00 in compensatory damages for lost earnings and $400,000.00 in punitive damages. Before taxes, the client will receive $145,000.00, the experts will receive $155,000.00 and the attorney will receive $200,000.00. If the client is able to exclude attorney fees from his gross income, and the client is single and has no other taxable income or itemized deductions, the client’s adjusted gross income will be $300,000.00 and he will receive the standard deduction of $4,750.00 resulting in a tax of $85,003.50 according to 2003 tax tables.\(^{337}\) If we assume that the attorney and experts have an effective tax rate of thirty percent, the I.R.S. will receive an additional $46,500.00 from the experts and $60,000.00 from the client’s attorney. After-tax, the client is left with $59,996.50, the experts are left with $108,500.00, the attorney is left with $140,000.00 and the I.R.S receives $191,503.50.

On the other hand, if the client is taxed on the attorney’s portion of the award, the client will have an adjusted gross income of $500,000.00 and he will attempt to deduct attorney fees under itemized deductions. Legal fees related to

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trying to produce or collect taxable income are deductible as a miscellaneous
deduction under Schedule A.\footnote{338} There is no deduction available for legal
expenses incurred in the collection of punitive damages.\footnote{339} As such, the portion
of the award attributable to legal expenses incurred to collect the compensatory
damages will be excluded. Since twenty percent of the overall reward was for
compensatory damages, twenty percent of the legal fee (or $40,000.00) can be
deducted under itemized expenses\footnote{340} less the two-percent floor ($800.00).
However, since the taxpayer’s adjusted gross income is over $139,500.00, the
taxpayer’s itemized deductions will be reduced.\footnote{341} Due to this limitation, the
taxpayer will only be able to deduct $28,385.00 under itemized deductions.\footnote{342}
The client will pay taxes on $471,615.00 resulting in a tax of $146,397.25.\footnote{343}
The taxes paid by the experts and attorney would be the same. After-tax, the
client would be left with a tax debt of $1,397.25, the experts would receive
$108,500.00, the attorney would receive $140,000.00 and the IRS would receive
a whopping $252,897.25. In this case the alternative minimum tax does not
apply.

Also consider the real life sexual harassment case of Chicago police officer
Cynthia C. Spina.\footnote{344} After enduring over eight years of sexual harassment from
multiple fellow officers, Officer Spina sued and the jury awarded her
$3,000,000.00.\footnote{345} The magistrate reduced the award to $300,000.00 stating that
the jury award was excessive.\footnote{346} The plaintiff was also ultimately awarded
$850,000.00 in attorney fees and almost $100,000.00 in costs.\footnote{347} Since the
United States Supreme Court agreed with the Illinois Seventh Circuit, which
decided that contingent attorney fees are income to the taxpayer in \textit{Kenseth},\footnote{348}
this award would result in Officer Spina being taxed with $1,250,000.00.\footnote{349}
According to her attorney, the tax would wipe out her $300,000.00 award and

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\textit{\textsuperscript{338}}\textsuperscript{338.} \textit{INTERNAL REVENUE SERVICE, U.S. DEP’T OF TREASURY, PUBLICATION 529, MISCELLANEOUS
DEDUCTIONS} 9 (2003).
\footnotesize
\textit{\textsuperscript{339.}} \textit{See id. at 1-23.}
\footnotesize\textit{\textsuperscript{340.}} \textit{See id. at 9.}
\footnotesize\textit{\textsuperscript{341.}} \textit{See \textit{INTERNAL REVENUE SERVICE, U.S. DEP’T OF TREASURY, 2003 INSTRUCTIONS FOR
SCHEDULES A & B (FORM 1040) A-6 (2003).}
\footnotesize\textit{\textsuperscript{342.}} \textit{See id.}
\footnotesize\textit{\textsuperscript{343.}} \textit{INTERNAL REVENUE SERVICE, U.S. DEP’T OF TREASURY, PUBLICATION 17, 2003 TAX RATE
SCHEDULES} 283 (2003).
\footnotesize\textit{\textsuperscript{344.}} \textit{Sharone Reece, Eighth Circuit Survey: Lemonade from Lemons: The Solution to Taxation
Adam Liptak, \textit{Tax Bill Exceeds Award to Officer in Sex Bias Suit}, N.Y. TIMES, Aug. 11, 2002, Section One, at 18).}
\footnotesize\textit{\textsuperscript{345.}} \textit{Adam Liptak, \textit{Tax Bill Exceeds Award to Officer in Sex Bias Suit}, N.Y. TIMES, Aug. 11, 2002, Section One, at 18.}
\footnotesize\textit{\textsuperscript{346.}} \textit{Id.}
\footnotesize\textit{\textsuperscript{347.}} \textit{Id.}
\footnotesize\textit{\textsuperscript{348.}} \textit{Kenseth v. Comm’r, 259 F.3d 881, 885 (7th Cir. 2001).}
\footnotesize\textit{\textsuperscript{349.}} \textit{Liptak, \textit{supra} note 345, Section One, at 18.}
leave her owing approximately $99,000.00 to the IRS. Commenting on this case, Stephen Cohen, a professor at Georgetown University, suggested that Congress “amend the law to allow a deduction in full of attorneys’ fees.” He further stated that “[i]t doesn’t make any sense not to be allowed to deduct the cost of producing an award. It’s an income tax, and costs should be deductible.”

In deciding Banks, the United States Supreme Court should have made its decision according to the factors discussed thus far. First, the Court should have distinguished Banks from the anticipatory assignment of income doctrine discussed in Earl and Horst based on the fact that contingent attorney fee agreements are (1) not entered into for tax avoidance purposes, (2) uncertain in value at the time the agreement is entered into, (3) commercial transactions made at arm’s-length, not gratuitous transfers that will not cause a double taxation, and (4) more closely analogous to the assignment of an asset rather than the assignment of an income stream. Next, the Supreme Court should have reviewed the various examples used by taxpayers and the Commissioner to illustrate their positions and the Court should have ruled that the attorney-client contingent fee agreement operates as a joint venture and should have been taxed accordingly. Finally, the Court could have concluded with an overview of the equities involved in these cases, while not conclusive, do suggest that Congress did not intend to tax contingent fees to the taxpayer under current tax laws.

Had the United States Supreme Court decided Banks in this way, then it could have simply decided Banaitis on similar grounds without having to look at the additional issue brought up in that case – the effect of state attorney lien statutes. However, regardless of the fact that the Supreme Court disagreed with this analysis and chose to expand the anticipatory assignment of income doctrine to include contingent attorney fee awards, the Court should still have

350. Id.
351. Id.
352. Id. But see Petitioner’s Supplemental Brief at 2, Comm’r v. Banks, 125 S. Ct. 826 (2005) (Nos. 03-892, 03-907). Based on the language of the American Jobs Creations Act, Officer Spina would have been able to deduct attorney fees for her discrimination claim from gross income. Id.
356. See Estate of Clarks, 202 F.3d at 857-58.
359. See Banaitis v. Comm’r, 340 F.3d 1074, 1082 (9th Cir. 2003).
found in favor of the taxpayer in *Banaitis* by interpreting the state attorney lien statute as creating a property interest in the claim for the attorney.360

C. State Attorney Lien Statutes

Prior to the Supreme Court decision in *Banks*, several United States circuit courts in their discussions of whether or not to include contingent attorney fees in the taxpayer’s gross income had included in their opinions the effect of state attorney lien statutes.361 As described in *Estate of Clarks*,362 the common law attorney’s lien is unlike “any other lien known to the law”363 because it creates a property right in the judgment without the attorney having possession of the judgment awarded.364 “It is a peculiar lien, to be enforced by peculiar methods.”365 In fact, the United States Circuit Court of Appeals for the Second Circuit in *Raymond*366 even went so far as to say that “to the extent that most courts to consider the issue have indicated that the analysis of state law is determinative, this is perhaps not a true ‘circuit split.'”367

According to the Circuit Court decisions, the Alabama, Michigan and Oregon state attorney lien statutes have been interpreted to transform the attorney’s lien over the client’s claim into an ownership interest.368 A closer look at the unique features of these state laws may help explain the role they have played in the taxation of contingent attorney fees.

In *Contam*,369 the United States Court of Appeals for the Fifth Circuit explained that under the Alabama attorney lien statute, “the attorneys at law shall have the same right and power over said suits, judgments and decrees, to enforce their liens, as their clients had or may have for the amount due thereon to them.”370 As such, the attorney has all the same rights as his/her client to enforce the client’s rights under the claim.371

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360. See id. at 1082-83.
361. Raymond v. United States, 355 F.3d 107, 113-14 (2d Cir. 2004); Hukkanen-Campbell v. Comm’r, 274 F.3d 1312, 1314 (10th Cir. 2001); Kenseth, 259 F.3d at 883; Foster v. United States, 249 F.3d 1275, 1279 (11th Cir. 2001); Young v. Comm’r, 240 F.3d 369, 378-79 (4th Cir. 2001); Srivastava, 220 F.3d at 364; Benci-Woodward v. Comm’r, 219 F.3d 941, 943 (9th Cir. 2000); Coady v. Comm’r, 213 F.3d 1187, 1190 (9th Cir. 2000); Davis v. Comm’r, 210 F.3d 1346, 1347 n.2 (11th Cir. 2000); Estate of Clarks, 202 F.3d at 856; Baylin v. United States, 43 F.3d 1451, 1455 (Fed. Cir. 1995); Cotnam v. Comm’r, 263 F.2d 119, 125 (5th Cir. 1959); O’Brien v. Comm’r, 38 T.C. 707, 712 (1962).
362. Estate of Clarks, 202 F.3d at 854.
363. Id. at 856 (citing Goodrich v. McDonald, 19 N.E. 649, 651 (N.Y. 1889)).
364. See Estate of Clarks, 202 F.3d at 856.
365. Id. (citing Goodrich, 19 N.E. at 651).
367. Id. at 110 n.4.
368. Banaitis v. Comm’r, 340 F.3d 1074, 1082 (9th Cir. 2003); Estate of Clarks, 202 F.3d at 856; Cotnam v. Comm’r, 263 F.2d 119, 125 (5th Cir. 1959).
369. Cotnam, 263 F.2d at 119.
370. Id. at 125.
371. Id.
In *Estate of Clarks*, the United States Court of Appeals for the Sixth Circuit found that the Michigan attorney lien statute operated in a way which was very similar to the Alabama attorney lien statute. In particular, the court suggested that the Michigan attorney lien statute operates to make the attorney a “tenant in common” of the client’s claim.

In *Banaitis*, the United States Court of Appeals for the Ninth Circuit found that the Oregon attorney lien statute treats an attorney’s interest in legal actions in a manner which is almost identical to the Alabama lien statute. In particular, the Oregon attorney lien law makes the attorney’s lien “superior to all other liens” except “tax liens.” Attorneys are also given the same rights and powers over the action as their clients to enforce judgments, and going further than Alabama lien law, no party can “extinguish or affect the attorney’s lien by any means (such as settlement) other than by satisfying the underlying claim of the attorney for the fees incurred in connection with the action.”

Putting these ideas together, it seems that the key feature of state attorney lien laws creating a property interest in the claim for an attorney is that the attorney has the same rights as his/her clients to enforce payment of awards. If such a statute is interpreted under the laws of the state to make the attorney a tenant in common in the client’s claim, then any contingent attorney fee generated is treated as being earned by the attorney and should not be taxed to the client as well.

In *Banaitis*, the Ninth Circuit Court of Appeals decided the case in favor of the taxpayer almost entirely based on the Oregon state attorney lien statute. The taxpayer felt that this conclusion necessarily followed from the prior United States Supreme Court decision in *Morgan v. Commissioner*, which stated that “[s]tate law creates legal interests and rights,” and “[t]he federal revenue acts designate what interests or rights, so created, shall be taxed.” As such, if the unique attributes of the state attorney lien statute create a recognized property interest under state law, federal tax rules must be applied accordingly.

While it may be true that basing the tax treatment of contingent attorney fees on a state-by-state analysis of attorney lien laws will cause confusion and will

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373. *Id.* at 856.
374. *See id.* at 858.
376. *Id.* (citing *OR. REV. STAT.* § 87.490 (2003)).
377. *Id.* at 1082 (citing *OR. REV. STAT.* § 87.480 (2003)).
378. *Id.* at 1082 (citing Potter v. Schlesser Co., 63 P.3d 1172, 1174 (Or. 2003)).
379. *Id.* at 1074.
380. *See id.* at 1083.
383. *See Banaitis*, 340 F.3d at 1082-83.
result in differing tax treatment to taxpayers living in different states.\textsuperscript{385} Precedent demands that federal law respect the various state interpretations of property.\textsuperscript{386} Therefore, regardless of the United States Supreme Court decision that contingent attorney fee agreements are to be included under the anticipatory assignment of income doctrine, the Supreme Court should still have decided \textit{Banaitis} in favor of the taxpayer because property interests are determined under state law, not federal law.\textsuperscript{387}

Unfortunately, Justice Kennedy, writing for the United States Supreme Court, felt that the role of the attorney as agent for his/her client also foreclosed the ability of the attorney to gain an ownership interest in the client’s claim.\textsuperscript{388} Again, it is difficult to understand why Justice Kennedy felt that the duties that an attorney owes to his client would have the perverse result of damaging the client, especially when the Model Rules of Professional Conduct specifically speaks favorably on the ability of the attorney to have a proprietary interest in his client’s claim in order to secure payment of his contingent attorney fee.\textsuperscript{389}

\textbf{V. CONCLUSION}

Chief Justice Marshall once wrote “"the power to tax involves the power to destroy.'''\textsuperscript{390} This statement is just as true today as it was in 1819 when Justice Marshall wrote it. The United States Supreme Court decision in \textit{Banks} now forces taxpayers of every state who prevail on their legal claims to include contingent attorney fees in their gross income.\textsuperscript{391} This tax bite often leaves the taxpayer with a much smaller portion of the judgment than juries intended as compensation.\textsuperscript{392} In some cases, the prevailing client will actually be left with a substantial tax bill exceeding the award that the taxpayer receives.\textsuperscript{393} The United States Supreme Court had the opportunity to resolve the circuit court split favorably for taxpayers on whether or not to include contingent attorney fees in the client’s gross income.\textsuperscript{394} Since the Commissioner of the IRS suggested that contingent attorney fees are includable in taxpayers’ gross income under the Supreme Court’s anticipatory assignment of income doctrine, the Supreme Court had the authority to limit the doctrine by distinguishing contingent attorney fee

\textsuperscript{385} See id.
\textsuperscript{386} See Respondent’s Brief at 12-13, \textit{Banaitis} (No. 03-907).
\textsuperscript{387} See Morgan, 309 U.S. at 80.
\textsuperscript{388} Comm’r v. Banks, 125 S. Ct. 826, 833 (2005).
\textsuperscript{389} See supra note 264-62 and accompanying text.
\textsuperscript{390} McCulloch v. Maryland, 17 U.S. 316, 431 (1819).
\textsuperscript{391} Comm’r v. Banks, 125 S. Ct. 826, 834 (2005).
arrangements from the intended scope of the doctrine. Unfortunately, the Supreme Court decision to expand the anticipatory assignment of income doctrine to include contingent attorney fee arrangements has eliminated the ability of taxpayer’s to seek relief from the double tax burden of contingent attorney fees under this theory. 395 Taxpayer’s seeking relief must either attempt to seek relief in the courts under legal theories which were not addressed by the *Banks* decision, or must rely on Congress to amend the tax laws in order to specifically designate contingent attorney fees as income to attorneys, not their clients. 396 Taxpayers such as Mr. Banks and Mr. Banaitis bring their cases to our courts seeking justice, but regrettably, under the Supreme Court decision in *Banks*, our legal system failed them. 397

396. *See supra* note 219, 351-48 and accompanying text.
397. *Banks*, 124 S. Ct. at 1712; *Banaitis*, 124 S. Ct. at 1713.
DURA PHARMACEUTICALS, INC. V. BROUDO: EXTRACTING TEETH FROM SECURITIES REGULATION

Christopher J. Dutton*

I. INTRODUCTION

"Sometimes it takes a crisis to convince the world that the status quo has to change."

In 1985, Enron started as a simple natural gas-pipeline company. By 2002, it had evolved into “the seventh largest company in the country with $108 billion in revenues.” Enron “borrowed heavily to finance [its] aggressive expansion.” It did not, however, want “a mountain of debt to reduce its credit rating” or decrease its share price. Accordingly, rather than listing these debts on its balance sheets, “Enron formed hundreds of off-the-books partnerships called ‘special purpose entities’” (SPEs). The SPEs allowed Enron to borrow capital from investors, and then “manipulate accounts by inflating earnings and hiding losses.” This practice improved credit ratings and share values, while keeping investors in the dark with regard to total debt levels.

Enron backed the loans needed to fund the SPEs with Enron stock. Consequently, when an SPE’s assets fell, or when an SPE was unable to make its loan payment, Enron had to tender shares to cover the difference. Because accounting rules in place at that time did not require reporting these SPE-related transactions, Enron shareholders were unaware of the risk the company had

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1. ARTHUR LEVITT, TAKE ON THE STREET, 152 (First Vintage Books ed., Vintage Books 2003) (emphasis added) (commenting on the Enron scandal). First appointed in 1993, Arthur Levitt was the longest-serving SEC chairman. Id. at 8. He was also chairman of the New York City Economic Development Corporation and the American Stock Exchange. Id. at 7.

2. Id. at 148.

3. Id.

4. Id.

5. Id.

6. Id. at 149.


8. Id.

9. Id.

10. Id.

11. Id.
assumed. Specifically, shareholders were not privy to the fact that Enron was liable for damages caused to lenders by failure of the SPEs, and that shares of Enron stock would be diluted if Enron had to cover any SPE losses.

The market decline of 2000 and 2001 brought down the proverbial “house of cards.” For the third quarter of 2001, Enron reported $618 million in losses directly attributable to SPE losses. “Three weeks later, Enron restated net income back to 1997,” reducing it by $586 million. Two weeks subsequent, Enron “announced that it had to repay $690 million in partnership debt.” These and other disclosures “undermined investor confidence and caused Enron’s stock to plummet from a high of $90 in the fall of 2000 to under $1 in December 2001.” On December 2, 2001, Enron filed bankruptcy. Ultimately, investors lost more than $60 billion, and some 5,000 Enron employees lost their jobs and retirement savings.

Motivated by Enron and other highly publicized corporate scandals that undermined the nation’s economy during the early part of this decade, Congress adopted the Sarbanes-Oxley corporate reform law of 2002. This Act provides stricter scrutiny for corporate accounting procedures. Also, the Public Company Accounting Oversight Board was created to monitor the practices of accounting firms that keep and audit corporate books. Arthur Levitt, former Chairman of the Securities and Exchange Commission, found that the “silver lining” of the “Enron disaster” was that important public policy issues relating to the accountability of corporations for insider misrepresentations had “finally caught the public’s imagination.”

While the Enron crisis and similar corporate scandals may have captured the attention of Congress and the American public at large, it appears that they were quickly and unanimously forgotten by the Supreme Court. This note examines the Court’s misreading of the Public Securities Litigation Reform Act of 1995 as set forth in the case of Dura Pharmaceuticals, Inc. v. Broudo. Part II traces the history of causes of action based on corporate insider misrepresentation from their common law roots through the creation of the Securities and Exchange

12. Id.
14. Id.
15. Id.
16. Id.
17. Id. at 149-50.
18. Id. at 150.
20. Id. at 152.
21. See id.
22. Id.
23. Id.
24. Id.
Commission to the current statutory standards set by the Public Securities Litigation Reform Act of 1995. Part III sets forth the factual and procedural background of Dura. Part IV analyzes the Supreme Court’s holding and identifies potential negative effects the holding may have on future securities-fraud based lawsuits.

II. BACKGROUND LAW

A. Insider Misrepresentation: The Evolution of the 10b-5 Cause of Action

1. State Common Law and Causes of Action for Fraudulent Misrepresentation

Prior to the stock market crash of 1929, the federal government had little to do with regulating the buying and selling of securities. Accordingly, individuals defrauded in securities transactions prior to the Great Depression had to rely on tort theories grounded in English and state common law to provide remedies for damages caused by the misrepresentations of corporate insiders. The essence of the common law cause of action for fraud is captured in section 525 of the Restatement (Second) of Torts which states:

One who fraudulently makes a misrepresentation of fact, opinion, intention or law for the purpose of inducing another to act or to refrain from action in reliance upon it, is subject to the other in deceit for pecuniary loss caused to him by his justifiable reliance upon the misrepresentation.

Sections 546, 548A, and 549 of the Restatement further discuss causation with respect to claims under section 525.

While the common law standards set forth by the states provided plaintiffs with a colorable cause of action, their strict pleading requirement often rendered them useless to plaintiffs who had been defrauded by corporate insiders. For example, under the common law, a cause of action for misrepresentation

29. RESTATEMENT (SECOND) OF TORTS § 546 (1977). (“The maker of a fraudulent misrepresentation is subject to liability for pecuniary loss suffered by one who justifiably relies upon the truth of the matter misrepresented, if his reliance is a substantial factor in determining the course of conduct that results in his loss.”).
30. RESTATEMENT (SECOND) OF TORTS § 548A (1977). (“A fraudulent misrepresentation is a legal cause of a pecuniary loss resulting from action or inaction in reliance upon it if, but only if, the loss might reasonably be expected to result from the reliance.”).
necessitated a showing of privity.\textsuperscript{33} This requirement foreclosed a fraud action against any securities transaction that occurred in an impersonal market (i.e., trading stocks in a resale market).\textsuperscript{34} Further, in cases where the fraud was perpetrated by an omission of a material fact rather than a misstatement, there could be no cause of action, even in a face to face transaction, unless the court found that the insider had a fiduciary duty to speak regarding the withheld information.\textsuperscript{35} In many instances, the courts rejected fraud claims under the common law, finding that the insider owed a duty to the corporation but not to the purchasers of shares.\textsuperscript{36}


Federal regulation of transactions in securities emerged as part of the aftermath of the market crash of 1929 and was enacted as a “New Deal” measure under the Roosevelt administration in an effort to cope with the depression.\textsuperscript{37} The Securities Act of 1933 and the Securities Exchange Act of 1934 were the first steps toward regulatory reform.\textsuperscript{38}

The Securities Act of 1933 was implemented to provide investors with full disclosure of material information concerning public offerings of securities in commerce, to protect investors against fraud and, through the imposition of specified civil liabilities, to promote ethical standards of honesty and fair dealing.\textsuperscript{39} By contrast, the Securities Exchange Act of 1934 was enacted principally to protect investors against the manipulation of stock prices through the regulation of transactions upon securities exchanges and the imposition of regular reporting requirements on companies whose stocks are listed on national securities exchanges.\textsuperscript{40}

3. Section 10(b), Rule 10b-5 and the Private Securities Litigation Reform Act of 1995

\textsuperscript{33} \textit{Id.} at § 6.1.1. “The defendant must intend to induce the plaintiff’s reliance on the statement.” \textit{Id.} Therefore, “a defendant [was not] liable to a person whom the defendant neither intended to hear the misstatement, nor realized would here the misstatement.” \textit{Id.} For instance, “the English House of Lords held that directors, who prepared a prospectus containing false statements for the purpose of inducing individuals to buy stock from the corporation, could not be liable to a person who thereafter bought stock sold by an existing shareholder.” \textit{Id.} (citing Peek v. Gurney, 6 H.L. 377 (1893)).

\textsuperscript{34} \textit{Gevurtz, supra} note 32 at § 6.1.1.

\textsuperscript{35} \textit{Id.} at § 6.1.2(a).

\textsuperscript{36} \textit{Id.}

\textsuperscript{37} \textit{Id.} at § 6.2.2.

\textsuperscript{38} \textit{See id.} §§ 6.2.2-6.2.3.

\textsuperscript{39} \textit{See H.R. Rep. No. 73-85 (1934).}

\textsuperscript{40} \textit{See S. Rep. No. 73-792 (1934).}
The sponsors of the Securities Exchange Act of 1934 believed that “[t]here cannot be honest markets without honest publicity,” and that “[m]anipulation and dishonest practices of the marketplace thrive upon mystery and secrecy.” Accordingly, the Act included many proscriptive clauses that raised the accountability of corporations and their officers and directors. For example, Section 10(b) of the Act makes it unlawful for any person to use “any manipulative or deceptive device or contrivance” that violates any rules set forth by the Securities and Exchange Commission (SEC), in connection with any “purchase or sale” of a security that is “registered on a national securities exchange . . .” Section 10(b) does not provide for a statutory remedy for a violation, but bestows authority upon the SEC to establish such remedies as needed.

In 1942, acting under authority granted by section 10(b) of the 1934 Act, the SEC promulgated Rule 10b-5, which forbids, among other things, the making of any “untrue statement of material fact” or the omission of any material fact “necessary in order to make the statements made . . . not misleading” in connection with the sale of securities. While it covers a wide range of fraudulent activities, insider trading falls within the scope of section 10(b).

“[T]here is no indication that the Commission . . . considered the question of private civil remedies under” the rubric of Rule 10b-5. However, notwithstanding the lack of explicit causes of action in either Section 10(b) or Rule 10b-5, the United States District Court for the Eastern District of Pennsylvania, in 1946, found that there was an implied right of action under the rule analogous to common law tort actions for misrepresentation and deceit.

On several subsequent occasions, the Supreme Court ruled on issues in Rule

43. Id. at § 78j(a)(2)(b).
44. See id.
   It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange, (a) To employ any device, scheme, or artifice to defraud, (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security. Id.
46. See id. See also In re Cady, Roberts & Co., 40 S.E.C. 907, 912 (1961). Roughly speaking, insider trading involves use of nonpublic information by any person having “a relationship [director, officer, attorney] giving access, directly or indirectly, to information intended only to be available for a corporate purpose and not for the personal benefit of anyone . . .” Id.
cases without comment on the existence of a right by investors to sue for damages or injunctive relief.49 Finally, in 1979, the Supreme Court confirmed the validity of the common law cause of action arising out of Rule 10b-5, stating that such a ruling was consistent with its own precedent, which held that private enforcement of Commission rules was "a necessary supplement to SEC enforcement activity."50 In 1988, the Supreme Court noted that "legislative acquiescence, and the passage of time have removed any doubt that a private cause of action exists for a violation . . . of Rule 10b-5 . . ."51

In an effort to control problematic abuse of securities law, Congress passed the Private Securities Litigation Reform Act of 1995 (PSLRA) as an "add on" code of civil procedure for securities class actions, effectively codifying the common law 10b-5 cause of action as it pertained to class action cases.52

B. Modern 10b-5 as a Working Cause of Action:

1. Elements of 10b-5 in General

Based on the aforementioned common law and statutory evolution of the claim, the elements required to successfully litigate a claim for damages under Rule 10b-5, as set forth by the Supreme Court in the Dura Pharmaceuticals opinion, are: “(1) a material misrepresentation . . .”; “(2) scienter . . .”; “(3) a connection with the purchase or sale of a security . . .”; “(4) reliance . . .”; “(5) “economic loss . . .”; and “(6) loss causation . . .”53 In the Supreme Court’s ruling 49. See, e.g., Affiliated Ute Citizens v. United States, 406 U.S. 128 (1972); Superintendent of Ins. of the State of New York v. Bankers Life & Cas., 404 U.S. 6 (1971).
52. See 15 U.S.C. §78u-4(b) (2000). In pertinent part, the PSLRA specifies the required pleading standard for securities fraud actions are as follows:

(1) . . . In any private action arising under this [title] in which the plaintiff alleges that the defendant (A) made an untrue statement of a material fact; or (B) omitted to state a material fact necessary in order to make the statements made, in light of the circumstances in which they were made, not misleading; the complaint shall specify each statement alleged to have been misleading, the reason or reasons why the statement is misleading, and, if an allegation regarding the statement or omission is made on information and belief, the complaint shall state with particularity all facts on which that belief is formed.

(2) . . . In any private action arising under this [title] in which the plaintiff may recover money damages only on proof that the defendant acted with a particular state of mind . . . (3) . . . (A) . . . In any private action arising under this [title], the court shall, on the motion of the defendant, dismiss the complaint if the requirements of paragraphs (1) and (2) are not met . . . (4) . . . In any private action arising under this [title], the plaintiff shall have the burden of proving that the act or omission of the defendant alleged to violate this [title] caused the loss for which the plaintiff seeks to recover damages. Id.
on Dura, the critical elements in review were reliance, commonly referred to as transaction causation, and loss causation. Accordingly, these elements and their treatment leading up to Dura merit a closer look.


In a common law securities fraud case, a plaintiff must plead and prove that the misrepresentation was a significant factor leading to the decision to invest in the security. This requirement is typically referred to as reliance or transaction cost. In Affiliated Ute Citizens Bank of Utah v. United States, the court defined the standard for proving transaction costs, stating, “[a]ll that is necessary is that the facts withheld be material in the sense that a reasonable investor might have considered them important in the making of this decision.”

In recent cases, courts have begun to recognize an exception to a strict showing of the reliance or transaction cost element in cases involving publicly traded securities. “[T]he fraud on the market” theory recognizes that the public securities market almost instantly reflects all publicly known information about the companies. If, however, the companies have disclosed misleading information or failed to disclose information that they should have, then market prices will not accurately reflect the true market value of the securities. Accordingly, the investor’s reliance on the market will have necessarily led to paying an inflated price for the security in question.

In Basic Inc. v. Levinson, the Supreme Court officially recognized the fraud on the market theory stating that reliance on the market is “supported by common sense and probability,” and that “it is hard to imagine that there ever is a buyer or seller who does not rely on market integrity.” Further, the Court stated, “where materially misleading statements have been disseminated into an

54. See id. at 1631-35.
55. Note that the United States District Court for the Southern District of California and the Ninth Circuit Court of Appeals each discussed the scienter element at length. However, the Supreme Court limited its review of the case to only the causation elements. Accordingly, this note limits its discussion to the same.
60. See id.
61. See, e.g., Peil v. Speiser, 806 F.2d 1154, 1160-61 (3d Cir. 1986) (“The misstatements may affect the price of the stock, and thus defraud purchasers who rely on the price as an indication of the stock’s value. By artificially inflating the price of the stock, the misrepresentations defraud purchasers who rely on the price as an indication of the stock’s value.”).
63. Id. at 246-47 (quoting Schlanger v. Four-Phase Sys. Inc., 555 F.Supp. 535, 538 (S.D.N.Y. 1982)).
impersonal, well-developed market for securities, the reliance of individual plaintiffs on the integrity of the market price may be presumed.\textsuperscript{64}

In addition to establishing a causal link demonstrating that insider misrepresentations were a factor in choosing to enter into the transaction, plaintiffs also have the burden of proving that the defendant’s conduct resulted in the plaintiff’s damages.\textsuperscript{65} The plaintiff must accordingly prove that its injuries “(generally the diminution in value of its investment) [are] directly attributable” to the defendant’s “wrongful conduct.”\textsuperscript{66} In the alternative, plaintiffs may prove that the misstatements were a “substantial cause” in producing the loss that the plaintiff suffered.\textsuperscript{67} As previously noted, the Public Securities Litigation Reform Act of 1995 (as incorporated in section 78u-(4)(b) of article fifteen of the United States Code) codified this requirement.\textsuperscript{68}

C. Circuit Court Treatment of Loss Causation

Leading up to \textit{Dura}, the Circuit Courts split regarding what is necessary to satisfy the loss causation element. The Second, Third, Seventh, and Eleventh Circuits each held that the plaintiff must plead that the disclosure of defendant’s fraud led to the decline in share price resulting in the damages sought.\textsuperscript{69} However, the Eighth and Ninth Circuits held that pleading that the price of the security was inflated at the time of purchase because of defendant’s misrepresentations is sufficient.\textsuperscript{70}

III. THE BACKGROUND AND HOLDING OF \textit{DURA PHARMACEUTICALS}

A. Factual Background

\textit{Dura Pharmaceuticals}, Inc. was a San Diego based developer and marketer of prescription pharmaceutical products for the treatment of allergies, asthma, and related respiratory conditions.\textsuperscript{71} After becoming a publicly traded corporation in 1992, Dura’s initial business plan involved the purchasing of rights from large pharmaceutical companies to market drugs that were nearing

\textsuperscript{64}. \textit{Id.} at 247.
\textsuperscript{65}. \textit{See} Franklin A. Gevurtz, Corporation Law § 6.1.1 (1st ed. 2000).
\textsuperscript{67}. \textit{Sec. e.g.}, Semerenko v. Cendant Corp., 223 F.3d 165, 187 (3d Cir. 2000).
\textsuperscript{70}. \textit{In re} Control Data Corp. Sec. Litig., 933 F.2d 616, 619-20 (8th Cir. 1991); Knapp v. Ernst & Whinney, 90 F.3d 1431, 1438 (9th Cir. 1996).
\textsuperscript{71}. Broudo v. Dura Pharms., Inc., 339. F.3d 933, 936 n.1 (9th Cir. 2003).
the end of their profitable lives with their parent companies. In late 1994, Dura made the strategic decision to begin “develop[ing] its own proprietary drug products,” beginning with a product called Albuterol Spiros, an asthma medication designed to employ a mechanical device to aerosolize and deliver proper drugs dosages. The Spiros device was to be superior to competing products which required users to precisely time breathing with inhalation of the product.

To keep the costs associated with developing this new product from having a negative impact on earnings, Dura created an Enron-like special purpose entity aptly named “Spiros Development Corporation (Spiros I)” to incur development expenses. Like the SPEs in the Enron litigation, Dura backed Spiros I with its own shares, allowing it to borrow money without reporting the liabilities created by the loans. Under this arrangement, Dura developed the product and billed associated work to Spiros with a 15% to 35% markup. Ultimately, Dura planned to exchange shares of Dura stock to buy out Spiros I once product development was complete and the drug went to market.

On December 31, 1996, Dura stock reached an all time high (as of that date) of $47-7/8 per share. However, shortly thereafter, serious flaws with Albuterol Spiros began to develop. Clinical trial data for tests conducted between December 1996 and March 1997 showed that the device “suffered from electro-mechanical defects which would prevent” Federal Drug Administration (FDA) approval. In fact, Dura was forced “to replace between 7-10% of the inhalers used in the clinical trials due to mechanical problems.” Ultimately, problems with the product were so severe that Dura had to modify the aerosolizing device, subsequently discarding all clinical trials conducted in late 1996 and early 1997.

Recognizing that correcting these flaws and retesting the product would exhaust all of Dura’s financial resources by the end of 1997, Dura devised a complex, threefold strategy to generate the funding necessary to complete product development. First, in order to quickly generate capital, Dura planned...
to accomplish a massive debt offering. 85 Next, Dura would exercise its option to purchase Spiros I using as few of Dura’s shares as possible. 86 Finally Dura planned to create a new corporate entity, Spiros II, to finance ongoing development in much the same fashion as Spiros I and then complete a successful public offering of Spiros II to raise additional capital. 87 Each step of Dura’s strategy was contingent upon maintaining high share prices. 88

Realizing that a decline in share prices could potentially result in the catastrophic failure of the organization, in April of 1997, Dura commenced a “concerted campaign” to bolster the company’s marketability by persuading investors that Dura’s sales were increasing and that development of Albuterol Spiros was progressing as planned. 89 Throughout the remainder of 1997 and during the beginning of 1998, Dura strategically disseminated information into the market announcing, among other things, financial results that exceeded expectations for all four quarters of 1997, and rapidly increasing market share for Ceclor CD, Dura’s key product. 90 In addition, Dura continued to report promising progress regarding the development of Albuterol Spiros. 91

On July 15, 1997 Dura announced that “it had completed clinical trials necessary for filing [a] New Drug Application (‘NDA’) for [Albuterol] Spiros and that it was on track to file the . . . NDA in the second half of 1997.” 92 After releasing this news, Dura began implementation of its financial strategy by selling “$287 million in convertible notes, the largest securities offering in the Company’s history . . .” 93 Subsequently, on October 15, 1997 Dura stock reached “an all time high of $53” per share. 94 In November, 1997, Dura announced that it filed the NDA, citing it as a “significant advancement in the execution of our strategy to establish Dura as a leader in the respiratory marketplace.” 95 In January 1998, Dura raised “$88 million to fund Spiros II to continue development of the Spiros inhaler.” 96

86. Id.
87. Id.
88. Id. at *4-5.
89. Id. at *5. An April 15, 1997 press release stated that Dura: (1) Experienced better than expected results for the first quarter of 1997; (2) “Continue[d] to execute its strategy of developing its proprietary Spiros dry powder drug delivery technology;” 3) “[C]ompleted the design of its Albuterol Spiros drug system and the patient dosing studies necessary for filing a New Drug Application with the FDA;” and (4) “[D]oubled its market share for Ceclor CD over Q4 1996.” In re Dura Pharms., Inc. Sec. Litig., 2000 U.S.Dist. Lexis 15258, at *5-6.
90. Id. at *5-8.
91. Id.
92. Id. at *6.
93. Id. at *8 n.3.
95. Id. at *7.
96. Id. at *8.
While Dura’s marketing effort was successful in the respect that it maintained share prices and afforded the opportunity to continue the development of Albuterol Spiros, actual events during the affected period were significantly different than those reported. In addition to the mechanical problems experienced with Albuterol Spiros in early 1997, sales of Ceclor CD began to drop that same year for reasons that included serious side effects, development of more powerful antibiotics, and exclusion from most managed care insurance policies. To counter poor sales performance, Dura artificially inflated sales numbers by shipping excess amounts of product to customers resulting in overstocked inventory.

On February 24, 1998, Dura shocked the market and its investors by announcing that it expected lower than forecasted revenues and earnings per share due to, inter alia, slower than expected sales of Ceclor CD. Further, Dura reported it would need to boost its sales force from 270 to over 450 to move the product. The report mentioned nothing about Albuterol Spiros. On February 25, 1998, the day after this announcement, Dura’s stock dropped from $39-1/8 to $20-3/4 – a 47% one-day decline.

Disclosures that followed the February 24th announcement were equally shocking. During a conference call with a securities analyst on April 16, 1998, Dura announced that “wholesale channels had been clogged with many months of excess inventory” of product by as early as December of 1997. In November 1998, Dura “revealed that the FDA had found the Albuterol Spiros device not approvable due to electro-mechanical reliability issues and chemistry, manufacturing, and control concerns.”

B. Procedural Background

After the February 1998 drop in stock value, several class action suits were filed against Dura and various corporate officers and directors. These separate matters were consolidated by the District Court for the Southern District of

97. See id. at *8-*11.
98. Id. at *8-*9.
100. Id. at *10.
101. Id.
102. See id. at *32. Note that this finding was outcome determinative in the Supreme Court opinion. See Dura Pharm., Inc. v. Broudo, 125 S. Ct. 1627, 1631-1634 (2005).
104. See id.
105. Id.
106. Id.
California.\textsuperscript{108} Thereafter, plaintiffs filed a Consolidated Amended Complaint on behalf of all plaintiffs who purchased shares of Dura stock between April 15, 1997, the date of the first press release containing material misrepresentations, and February 24, 1998, the day of the disclosure that led to the drastic drop in share price the following day.\textsuperscript{109} The complaint alleged that the defendants violated sections 10(b) and 20(b) of the Securities and Exchange Act and Rule 10b-5, as set forth by the SEC.\textsuperscript{110} Specifically, the plaintiffs contended that Dura “made false and misleading statements about Dura’s positive future during an earnings conference call, in press releases, at investor conferences, and in SEC filings.”\textsuperscript{111}

Defendants filed a motion to dismiss on grounds that the plaintiffs “failed to meet the requisite pleading standards as set forth by the PSLRA . . .”\textsuperscript{112} The Consolidated Amended Complaint was dismissed without prejudice by the district court on July 12, 2000 for failure to concisely set forth each allegedly false or misleading statement, and failure to follow each statement with the specific reason why it was false and “why the [d]efendants had a duty to disclose.”\textsuperscript{113} Further, the plaintiffs were admonished that failure to comply with the pleading requirements of the PLSRA could subject their complaint to “dismissal with prejudice.”\textsuperscript{114}

Subsequently, plaintiffs filed a Second Amended Complaint that was also dismissed, this time with prejudice, on November 2, 2001 for failure to comply with pleading standards set forth by PLSRA.\textsuperscript{115} The Second Amended Complaint contended that the Defendants misrepresented the company’s sales and business performance throughout the class period and thereby inflated Dura’s stock price.\textsuperscript{116} Specifically, plaintiffs challenge that “[d]efendants misrepresented: (1) the effectiveness of its sales force; (2) the development of its Spiros Albuterol [sic] product; (3) the sales and success of Rondec” (another drug marketed by Dura); and (4) the sales of Ceclor CD and other major drugs.\textsuperscript{117} The Second Amended Complaint painstakingly recounted the factual basis for each of these claims and the admissions of their falsity that followed.\textsuperscript{118} However, the

\begin{footnotes}
108. \textit{Id.}
109. \textit{Id.} at *2-*3.
110. \textit{Id.} at *7.
112. \textit{Id.} at *18.
113. \textit{Id.} at *35-*36.
114. \textit{Id.} at *36.
116. \textit{Id.} at *5.
117. \textit{Id.} at *14.
118. \textit{See Id.} at *24-*32; \textit{See also} Dura Pharm., Inc. v. Broudo, 125 S.Ct. 1627, 1630 (2005) (“In respect to the question before us, their detailed amended (181 paragraphs) complaint makes substantially the following allegations . . .) (parenthetical in original).
\end{footnotes}
complaint was rejected by the Court as “conclusory and insufficient.” The Court found that the “post-Class Period statements are not sufficient to indicate that the Defendants’ statements . . . during the Class Period were false and made with knowledge of their falsity.” Further, the Court found that the complaint did “not contain any allegations that the FDA’s non-approval [of the Albuterol Spiros product] had any relationship to the February price drop” and does not explain how the misrepresentation “touched upon” the reasons for the decline in stock price.

The holding of the District Court was reversed and remanded by the United States Court of Appeals for the Ninth Circuit. Citing its own precedent, the court of appeals found that “[i]n a fraud-on-the-market case, plaintiffs establish loss causation if they have shown that the price on the date of purchase was inflated because of the misrepresentation.” Accordingly, the court of appeals found that the district court erred in basing its holding on the “presum[ption] that the loss causation element requires a demonstration of a corrective disclosure followed by a stock price drop during the class period and that those facts must be alleged in the complaint.” Further, the court of appeals explained that a proper pleading of loss causation need only “allege 1) that the stock’s price at the time of purchase was overstated and 2) sufficient identification of the cause for this overvaluation.”

Thereafter, to resolve the aforementioned split among the Circuits, the Supreme Court granted certiorari to determine the proper pleading standard for loss causation.

C. The Supreme Court’s Opinion

In a very brief opinion, the United States Supreme Court unanimously reversed the Circuit Court’s holding, thereby rejecting the finding that loss causation may be adequately proved by demonstrating that share prices were inflated because of insider misrepresentations. The Court promulgated three

120. Id. at *39-*40.
121. Id. at *32; “In [the Ninth Circuit], loss causation is satisfied where ‘the plaintiff shows that the misrepresentation touches upon the reasons for the investment’s decline in value.’” Broudo v. Dura Pharm., Inc., 339 F.3d 933, 937-38 (9th Cir. 2003) (quoting Binder v. Gillespie, 184 F.3d 1059, 1066 (9th Cir. 1999)). Accord Provenz v. Miller, 102 F.3d 1478, 1492 (9th Cir. 1996).
122. Broudo, 339 F.3d at 941.
123. Id. at 938 (quoting Knapp v. Ernst & Whinney, 90 F.3d 1431, 1438 (9th Cir. 1996) (parenthetical and emphasis in original).
124. Id. at 938-939.
125. Id. at 939.
reasons for its finding. First, it argued that at the moment the transaction took place, “the plaintiff had suffered no loss [because] the inflated purchase payment [was] offset by ownership of a share that at that instant possessed equivalent value.” Second, the Court found that the common law roots for misrepresentation causes of action required plaintiffs to prove “not only that had [they] known the truth [they] would not have acted but also that [they] suffered actual economic loss” caused by the misrepresentation. Third, the Court reasoned that rather than protecting investors from economic losses caused by misrepresentations, the Ninth Circuit’s holding provided investors with broad insurance against market losses and was otherwise inconsistent with the PSLRA’s requirement that plaintiffs “prove the traditional elements of causation of loss.”

With regard to requisite pleading standards, the Court found that the PSLRA implicitly requires a pleading of loss causation. It “concede[d] that the Federal Rules of Civil Procedure require only ‘a short and plain statement of the claim showing that the pleader is entitled to relief,’” but further noted that plaintiffs were required to provide the defendant’s with “‘fair notice of what the . . . claim is and the grounds upon which it rests.’” By only averring that it paid inflated prices caused by misrepresentation about the “spray device,” which resulted in damages, the Court concluded that the plaintiffs failed to meet their burden to establish causation. The Court further stated that “provid[ing] a defendant with some indication of the loss and the causal connection that the plaintiff has in mind” should not prove burdensome. “[A]llowing a plaintiff to forgo giving any indication of the economic loss and proximate cause” would result in “the routine filing of lawsuits . . . with only the faint hope that the discovery process might lead eventually to some plausible cause of action.” It would also “transform a private securities action into a partial downside insurance policy.”

128. Id. at 1631–33.
129. Id. at 1631 (emphasis in original).
130. Id. at 1632.
131. Id. at 1633.
132. Dura Pharms., Inc., 125 S. Ct. at 1633.
133. Id. at 1634 (quoting Fed. R. Civ. P. 8(a)(2)).
134. Id. (quoting Conley v. Gibson, 355 U.S. 41, 57 (1957)).
135. Id.
136. Id.
138. Id.
IV. ANALYSIS

A. Rejection of the Ninth Circuit’s Standard for Proving Loss Causation

The Ninth Circuit’s holding in Dura was based on decades of proven precedent recognizing that the plaintiff’s injury in a fraud on the market case occurs at the time of the transaction and that loss causation is established if plaintiffs can prove that the price of securities on the date of purchase was inflated because of insider misrepresentation. However, the Supreme Court unanimously rejected the Ninth Circuit’s position in favor of a more stringent burden of proof. As previously noted, the Supreme Court set forth three reasons for rejecting the notion that proof of loss causation could be sufficiently demonstrated by a showing that the insider misrepresentations induced the plaintiff to purchase stock at an artificially inflated price.

1. Timing and Value of Plaintiff’s Alleged Damages.

The Court begins the explanation of its holding in Dura with the general conclusion that “at the moment the transaction took place, the plaintiff [had] suffered no loss [because] the inflated purchase payment [was] offset by ownership of a share that at that instant posess[ed] equivalent value.” This assertion, which the Court qualifies as “pure logic,” is markedly inconsistent with common law definitions of price and value.

139. Knapp v. Ernst & Whinney, 90 F.3d 1431, 1438 (9th Cir. 1996) (“In a fraud-on-the-market case, plaintiffs establish loss causation if they have shown that the price on the date of purchase was inflated because of the misrepresentation.”); Blackie v. Barrack, 524 F.2d 891, 909 (9th Cir. 1975) (“Out of pocket loss is the ordinary standard in a 10b-5 suit”); Green v. Occidental Petroleum Corp., 541 F.2d 767, 773, 775 (9th Cir. 1976) (Sneed, J., concurring) (“The out-of-pocket measure furthers the purpose of rule 10b-5 without subjecting the wrongdoer to damages the incidence of which resembles that of natural disasters.”); Hatrock v. Edward D. Jones & Co., 750 F.2d 767, 773, 775 (9th Cir. 1984).

140. Dura Pharm., Inc. v. Broudo, 125 S. Ct. 1627, 1629 (2005). Note that the Court does not comment on what would meet the requisite burden of proof. Id. at 1629-35.

141. Id. at 1631-1634.

142. Id. at 1631 (emphasis in original).

143. Id.

144. RESTATEMENT (SECOND) OF TORTS §549 cmt. c (1977).

The value of the article is normally determined by the price at which it could be resold in an open market or by private sale if its quality or other characteristics that affect its value were known. However, the price that determines the value of the article is not necessarily the price that it would bring at the time the sale is made. In many cases this price is due to the widespread belief of other buyers in misrepresentations similar to that made to the person seeking recovery... Id.
In market based misrepresentations cases, courts have recognized three separate means of calculating damages “on market or capital values.”145 The first type, typically referred to as “loss of bargain gives plaintiffs the difference between what [was] received in value and the value [that] would have been received had matters been as represented.”146 The second type, known as “out of pocket” damages is the difference between the transaction price and the true value of the security “at the time of the transaction.”147 The final type “calculates the out of pocket measure at a later date, giving the plaintiffs a recovery that resembles the financial effect of a rescission.”148

The Supreme Court and lower courts have recognized for over a century that the primary measure of injury when a plaintiff is fraudulently induced to purchase or sell securities is the value of the “out of pocket” loss. 149 In fact, several jurisdictions that reject the Ninth Circuit’s position regarding proof of loss causation concur that out of pocket damages are the appropriate remedy.150 Moreover, the Court has recognized in precedent that the proper measure of damages in such situations is the difference between the value of the security and the inflated price that plaintiffs pay.151 Thus, the Court’s contention that the value of Dura’s stock at the moment of the transaction was equivalent to the inflated purchase price is inaccurate.152 If this were true, the concept of out of

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146. Id.
147. Id.
148. Id. (noting that recovery for this type of damages is rare).
149. See Randall v. Loftsgarden, 478 U.S. 647, 661-62 (1986) (“[O]rdinarily ‘the correct measure of damages . . . is the difference between the fair value of all that the [plaintiff] received and the fair value of what he would have received had there been no fraudulent conduct.’” (quoting Affiliated Ute Citizens v. United States, 406 U.S. 128, 155 (1972)); See also Sigafus v. Porter, 179 U.S. 116, 123 (1900) (“The true measure of the damages suffered by one who is fraudulently induced to make a contract of sale, purchase, or exchange of property is the difference between the actual value of that which he parts with and the actual value of that which he receives under the contract.”) (quoting Rockefeller v. Merritt, 40 U.S. App. 666, 674) (1896); See also Smith v. Bolles, 132 U.S. 125, 129-31 (1889) (applying same rule to stock fraud case); See also Sowell v. Butcher & Singer, Inc., 926 F.2d 289, 297 (3d Cir. 1991) (In 10b-5 cases "a plaintiff's damages are most commonly calculated as the difference between the price paid for a security and the security's 'true value.'); See also Alley v. Miramon, 614 F.2d 1372, 1387 (5th Cir. 1980).
pocket damages could not exist.\textsuperscript{153} Simply put, the Court has confused value with cost.\textsuperscript{154}

In buttressing its value equals cost argument, the Court noted that “the logical link between the inflated share purchase price and any later economic loss is not invariably strong.”\textsuperscript{155} Consequently, the Court expressed its concern that, in fraud on the market cases, plaintiffs who sell shares at a loss sometime after disclosure of the fraud cannot guarantee that the loss was caused by the disclosure and not some other market condition.\textsuperscript{156} Based on this assertion, the Court concluded that simply because disclosure of a fraud that resulted in an inflated purchase prices “sometimes plays a role in bringing about a future loss,” standing alone, it is not sufficient to show that the fraud caused the loss.\textsuperscript{157}

On this matter, the Court is correct.\textsuperscript{158} In some circumstances, the normal functioning of the securities market causes the inflationary effect of insider misrepresentations to dissipate over time.\textsuperscript{159} All “things being equal, the longer the time between purchase and sale, the more likely . . . that other factors caused the loss.”\textsuperscript{160} However, because out of pocket damages are determined at the moment the sale is executed, and not at some later time, these types of concerns by definition cannot manifest themselves in determining the value of damages.\textsuperscript{161}

\textsuperscript{153} See DAN B. DOBBS, THE LAW OF TORTS § 483 (1st ed. 2000).
\textsuperscript{154} See Dura Pharms., Inc., 125 S. Ct. at 1631.
\textsuperscript{155} Id.
\textsuperscript{156} Id. at 1632.
\textsuperscript{157} Id.
\textsuperscript{159} While the inflationary effect ‘should be’ constant, there may be circumstances where this will not be the case. In the usual case, a misstatement will retain its importance so long as contrary information is not made public. For example, when a company misstates its earnings, the importance of that misstatement should have a continuing effect on the price of the stock. In some cases, however, the importance of misstatements may diminish over time, and the inflationary effect may diminish (or disappear entirely) with it. Id.
\textsuperscript{160} Dura Pharms., Inc. v. Broudo, 125 S. Ct. 1627, 1632 (2005). The Ninth Circuit provides a classic example of this scenario in Green v. Occidental Petroleum Corp., 541 F.2d 1335, 1345 n. 6-7 (9th Cir. 1976) (Sneed, J., concurring): Assume Corporation C discloses the discovery of X barrels of oil when, in fact, no oil was discovered at all. Further assume that the per share value of X barrels of oil is $10. Following the false disclosure the stock sells on the open market at $150 per share. At this point, P purchases a share. Its true value is $140 ($150-$10) . . . [I] a massive discovery of oil in the United States [occurred thereafter], the effect would . . . reduce the value of misrepresentation to, say, $5 per share. Ceteris paribus, the price of each share would decline to $145 while true value would remain at $140. This decline in the value of misrepresentation should not diminish the recovery available to P who held his stock throughout. Id.
\textsuperscript{161} See DAN B. DOBBS, THE LAW OF TORTS § 483 (1st ed. 2000).
Thus, under the out of pocket theory, the plaintiff need not demonstrate that the disclosure of insider misrepresentations caused any loss at all.162 Because the proper measure for damages, according to common law, Supreme Court precedent, and the Restatement (Second) of Torts, is “out of pocket” losses, the Court’s assertion that a subsequent price decrease, not caused by disclosure of fraud, will distort plaintiff’s claim is baseless and otherwise irrelevant.163

2. Common Law Precedent Regarding Loss Causation

The Court recognized that the root of the judicially-implied 10b-5 cause of action extends back into the common law and that its essence is set forth in the Restatement (Second) of Torts.164 This is relevant because the second reason promulgated by the Court for its decision in *Dura* is that the Ninth Circuit’s holding lacked support in common law precedent.165 Specifically, the Court found that the Ninth Circuit’s standard failed to meet the common law requirement that proof of damages be demonstrated in addition to a showing that the plaintiff suffered an injury “occasioned” by a fraud.166 Consequently, the Ninth Circuit’s position was found too unique to reconcile with the common law and precedent of other circuit courts.167

The common-law rule was well established preceding the passage of the Securities Exchange Act of 1934.168 At least twice in the nineteenth century,
English common law found that a false statement made to raise the price of public funds and securities

strikes at the price of a vendible commodity in the market, and if it gives it a fictitious price by means of false rumors [and] . . . is a fraud levelled [sic] against all the public, for it is against all such as may possibly have anything to do with the funds on that particular day. 169

In 1962 the Tenth Circuit held that:

the measure of damages recoverable by one who through fraud or misrepresentation has been induced to purchase bonds or corporate stock, is the difference between the contract price, or the price paid, and the real or actual value at the date of the sale, together with such outlays as are attributable to the defendant’s conduct. 170

In 1966, the Third Circuit articulated the common law fraud rule, stating that “[i]n an action based upon fraud the purchaser is entitled to recover his actual loss measured by the difference between the price he paid and the value of that which he received, determined as of the time of the transaction.” 171 Circuit court opinions concurring with the theory are legion. 172

In 1900, the Supreme Court held in Sigafus v. Porter, that when one induced by misstatements to make an investment overpays, the core loss proximately caused by the fraud is suffered at the time of the initial purpose - by paying more than the investment was worth. 173 Further, Sigafus notes that the proper measure of damages under such circumstances “is the difference between the real value of the stock at the time of the sale and the fictitious value at which the buyer was induced to purchase . . .” 174

169. Id.
172. Accord, e.g., Associated Randall Bank v. Griffin, Kubik, Stephens & Thompson, Inc., 3 F.3d 208, 214 (7th Cir. 1993); Astor Chauffeured Limousine Co. v. Runnfeldt Inv. Corp., 910 F.2d 1540, 1552 (7th Cir. 1990) (rejecting benefit-of-the-bargain for out-of-pocket loss (citing Sigafus v. Porter, 179 U.S. 116, 123 (1900))); Mayer v. Mylod, 988 F.2d 635, 640 (6th Cir. 1993) (“Under Section 10(b), the level of damages is usually the difference in price that the investor paid based on the false or misleading statements and the price that the stock would have sold at had the market been aware of the truth.”); Hoxworth v. Blinder, Robinson & Co., Inc., 903 F.2d 186, 203 n.25 (3d Cir. 1990) (“Ordinarily, a defrauded buyer is entitled to out-of-pocket damages under rule 10b-5.”); Abell v. Potomac Ins. Co., 858 F.2d 1104, 1136-37 (5th Cir. 1988), vacated on other grounds, 492 U.S. 914 (1989); Flamm v. Eberstadt, 814 F.2d 1169, 1179-80 (7th Cir. 1987); Harris v. Union Elec. Co., 787 F.2d 355, 367-68 (8th Cir. 1986); Garnatz v. Stifel, Nicolaus & Co., Inc., 559 F.2d 1357, 1360 (8th Cir. 1977) (“[Out-of-pocket rule] provides for the recovery of the difference between the actual value of the securities and their purchase price.”).
174. Id. at 124 (quoting High v. Berret, 148 Penn.St. 261 (1892)).
The Supreme Court has reaffirmed its decision in *Sigafus* several times in modern jurisprudence. In *Affiliated Ute Citizens v. United States*, which involved violations of section 10(b) and Rule 10b-5 by a buyer of securities, the Supreme Court held that in a section 10(b) action “the correct measure of damages under §28 . . . is the difference between the fair value of all that the [plaintiff] received and the fair value of what he would have received had there been no fraudulent conduct.”

In *Basic v. Levinson*, the Supreme Court noted that in cases of fraud on the market, the relevant causal link is between defendant’s misrepresentation and resulting transaction prices.

Despite the Court’s assertion that the Ninth Circuit’s holding conflicts with common law precedent, caselaw shows that the Ninth Circuit has strictly followed the *out of pocket* standard set forth in the common law to establish proof of loss causation. In *Hatrock v. Edward D. Jones & Co.*, the Ninth Circuit held that “in an action brought under Rule 10b-5 for material omissions or misstatements, the plaintiff must prove both transaction causation, that the violation in question caused the plaintiff to engage in the transaction, and loss causation, that the misrepresentations or omissions caused the harm.”

Further, in *Blackie v. Barrack*, the Ninth Circuit held that a “10b-5 action remains compensatory[,] it is not predicated solely on a showing of economic damage (loss causation)” suffered upon purchase; and “transactional causation” can be inferred secondarily from the fact that reasonable investors would not choose to incur the loss. Thus, *Blackie* stands for the proposition that the necessary “causal nexus can be adequately established indirectly, by proof of materiality coupled with the common sense that a stock purchaser does not ordinarily seek to purchase a loss in the form of artificially inflated stock.”

This is consistent with the holdings set forth in *Sigafus*, *Affiliated Ute Citizens*, and *Basic*.

Based on the theory of *out of pocket* damages, the plaintiffs in *Dura* did, in fact, allege *proof of damages* in the complaint. Specifically, the complaint demonstrated that plaintiffs paid a price for Dura Pharmaceuticals stock that was

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176. *See Basic Inc. v. Levinson*, 485 U.S. 224, 248 (1988). (“The Court of Appeals found that petitioners made public, material misrepresentations and [respondents] sold Basic stock in an impersonal, efficient market. Thus the class, as defined by the district court, has established the threshold facts for proving their loss.”) *Id*. (parenthetical in original).

177. *See Knapp v. Ernst & Whinney*, 90 F.3d 1431, 1438 (9th Cir. 1996).


180. *Id*. at 908.


artificially inflated above true market value because of corporate fraud. 183

Contrary to the Supreme Court’s holding, the Ninth’s Circuit’s position evolved from the common law and is easily reconciled with it. 184 In actuality, it is the Supreme Court’s implicit rejection of the out of pocket standard that does not accord with common law precedent. 185

The Court also references Comment b of section 548A of the Restatement (Second) of Torts to support its position that the judicial consensus of the common law is contra the Ninth Circuit’s position. 186 Comment b reads in pertinent part:

[O]ne who misrepresents the financial condition of a corporation in order to sell its stock will become liable to a purchaser who relies upon the misinformation for the loss that he sustains when the facts as to the finances of the corporation become generally known and as a result the value of the shares is depreciated on the market . . . 187

What the Court fails to convey, however, is that this comment serves only to demonstrate the Restatement’s foreseeability requirement and is no way concerned with loss causation. 188 To find the true “consensus” set forth by the Restatement, the Court should have continued to section 549 which provides,

[t]he recipient of a fraudulent misrepresentation is entitled to recover as damages in an action of deceit against the maker the pecuniary loss to him of which the misrepresentation is a legal cause, including . . . the difference between the value of what he has received in the transaction and its purchase price or other value given for it . . . 189


Failure to comply with the loss causation requirement set forth by the PLSRA in 15 U.S.C. § 78u-4(b)(4) is the final reason alleged for rejecting the Ninth Circuit’s standard. 190 “[M]aintain[ing] public confidence in the marketplace,” according to the Court, is accomplished “by deterring fraud through the availability of private securities fraud actions.” 191 The Court noted,

183. See id.
184. See Knapp v. Ernst & Whinney, 90 F.3d 1431, 1438 (9th Cir. 1996); Blackie v. Barrack, 524 F.2d 891, 905-08 (9th Cir. 1975); Green v. Occidental Petroleum Corp., 541 F.2d 1335, 1341-46 (9th Cir. 1976) (Sneed, J., concurring); Hatrock v. Edward D. Jones & Co., 750 F.2d 767, 773 (9th Cir. 1984).
188. See id.
190. Dura Pharmcs., Inc., 125 S. Ct at 1633.
191. Id.
however, that statutes like the PSLRA are not intended “to provide investors with broad insurance against market losses, but to protect them against [the] economic losses” caused by insider misrepresentation.192 Subsequently, the Court found that the Ninth Circuit “overlook[ed] an important securities law objective” of protecting investors from “economic losses that misrepresentations actually cause”193. Further, the Court reiterated its position that the plaintiff did not satisfy its burden regarding loss causation and that providing relief to plaintiffs for simply paying an artificially inflated price “would allow recovery where a misrepresentation leads to an inflated purchase price but nonetheless does not proximately cause an economic loss.”194

Functionally, the Court’s argument in support of its third reason is identical to its argument in support of its first and second.195 Indeed, the Court framed its position three different ways, but the argument itself did not change.196 In the first reason, the Court found that there can be no showing of loss causation because “the logical link between the inflated share purchase price and any later economic loss is not invariably strong.”197 In the second reason, the Court found that the plaintiffs’ pleading was insufficient because the common law requires proof of damages be demonstrated in addition to a showing that the plaintiff suffered an injury occasioned by a fraud.198 Finally, in its third reason, the Court reads the language of 15 U.S.C. § 78u-4(b)(4), which prescribes that plaintiffs have “‘the burden of proving’ that the defendant’s misrepresentations ‘caused the loss for which the plaintiff seeks to recover,’” to justify its rejection of the Ninth Circuit’s definition of loss causation.199 However, as previously noted, the Ninth Circuit recognizes the out of pocket losses which were caused by the fraud perpetrated by the defendant.200 Thus, the Ninth Circuit is fully compliant with the PSLRA’s loss causation standard which, on its face, says nothing about what is or is not required to prove causation; only that it be must be proved.201

192. Id.
193. Id.
194. Id. at 1634, 1633.
196. Id.
197. Id. at 1631.
198. Id. at 1632 (citing Pasely v. Freeman, 100 Eng. Rep. 450, 457 (1789) (“[I]f no injury is occasioned by the lie, it is not actionable: but if it be attended with a damage, it then becomes the subject of an action”) Id.; and Freeman v. Venner, 120 Mass. 424, 426 (1876) (“[A] mortgagee cannot bring a tort action for damages stemming from a fraudulent note that a misrepresentation led him to execute unless and until the note has been paid”) Id.).
200. See Knapp v. Ernst & Whinney, 90 F.3d 1431, 1438 (9th Cir. 1996); Blackie v. Barrack, 524 F.2d 891, 909 (9th Cir. 1975); Green v. Occidental Petroleum Corp., 541 F.2d 1335, 1346 (9th Cir. 1976) (Sneed, J., concurring); Hatrock v. Edward D. Jones & Co., 750 F.2d 767, 773 (9th Cir. 1984).
While the PSLRA fails to provide a statutory definition for loss causation, the Court needed only to look to the House Reports for confirmation of Congressional intent.\textsuperscript{202} Both the Legislative Conference Report and Senate Report explained that in codifying the requirement that plaintiffs prove the loss in the value of their stock was caused by the Section 10(b) violation and not other factors, the PLSRA

requires the plaintiff to show that the misstatement or loss alleged in the complaint caused the loss incurred by the plaintiff. For example, the plaintiff would have to prove that the price at which the plaintiff bought the stock was artificially inflated as the result of the misstatement or omission. The defendant would then have the opportunity to prove any mitigating circumstances, or that factors unrelated to the fraud contributed to the loss.\textsuperscript{203}

The standard set forth in the House Reports was exactly the standard employed by the Ninth Circuit in \textit{Knapp v. Ernst \& Whinney}, where the court held that “plaintiffs establish loss causation if they have shown that the price on the date of purchase was inflated because of the misrepresentation.”\textsuperscript{204} Further, the Ninth Circuit applied the \textit{Knapp} decision as the basis for its decision in \textit{Dura}\textsuperscript{205} Accordingly, the Ninth Circuit’s standard in general, and the \textit{Dura} decision in particular, are completely in accord with the intent behind 15 U.S.C. § 78u-4(b)(4).\textsuperscript{206}

\begin{footnotesize}
\begin{enumerate}
\item[202.] \textit{Id.}
\item[204.] \textit{Knapp v. Ernst \& Whinney}, 90 F.3d 1431, 1438 (9th Cir. 1996).
\item[205.] \textit{Broudo v. Dura Pharms., Inc.}, 339 F.3d 933, 938 (9th Cir. 2003).
\item[206.] \textit{Id.}
\end{enumerate}
\end{footnotesize}
B. Pleading Loss Causation

After rejecting the Ninth Circuit’s standard regarding proof of loss causation, the Supreme Court held that there existed a burden to plead loss causation implied in the PLSRA and, because the plaintiffs pled according to the rejected standard, their burden of adequately pleading loss causation was not met. Specifically, the Court found that plaintiffs’ said “nothing significantly more” about economic losses attributable to the Albuterol Spiros device than, “[i]n reliance on the integrity of the market, [the plaintiffs] . . . paid artificially inflated prices for Dura securities” and consequently “suffered damage[s].” In short, because the complaint failed to allege that stock prices fell significantly because of the disclosure of the fraud, the Court found that the complaint failed to plead loss causation.

In reference to the pleading standards set forth by the Federal Rules of Civil Procedure, the Court conceded that the “pleading rules are not meant to impose a great burden” on the plaintiff and that this burden may be satisfied with “only ‘a short and plain statement of the claim showing that the pleader is entitled to relief.’” However, the Court opined that “it should not prove burdensome for a plaintiff who has suffered an economic loss to provide a defendant with some indication of the loss and the causal connection that the plaintiff has in mind.” Note, however, that this is contradictory to the Court’s statement earlier in the opinion that “the logical link between the inflated share purchase price and any later economic loss is not invariably strong,” and “the longer the time between purchase and sale, . . . the more likely that other factors caused the loss.”

The Court further argued that “allowing a plaintiff to forgo giving any indication of the economic loss and proximate cause that the plaintiff has in mind would bring about harm of the very sort the [PLSRA] seek[s] to avoid.” These include “the routine filing of lawsuits . . . with only a faint hope that the discovery process might lead eventually to some plausible cause of action” and “permits a plaintiff ‘with a largely groundless claim to simply take up the time of a number of other people, with the right to do so representing an in terrorem increment of the settlement value, rather than a reasonably founded hope that the [discovery] process will reveal relevant evidence.” Such a role, the Court

208. Id. at 1630, 1634 (parenthetical and ellipses in original).
209. Id. at 1634.
210. Id. (quoting FED. R. CIV. P. 8(a)(2)).
211. Id.
212. Dura Pharm., Inc., 125 S. Ct. at 1631, 1632.
213. Id. at 1634.
alleges, would “transform a private securities action into a partial downside insurance policy.”

The PLSRA, as discussed in the previous section, does, in fact, expressly impose on plaintiffs the substantial burden of proving that the defendant’s misrepresentations “caused the loss for which the plaintiff seeks to recover damages.” However, the language of the statute very pointedly excludes a pleading standard for loss causation.

Analysis of the Congressional intentions behind a statute begins with the language of the statute itself. The plain language of 15 U.S.C. § 78u-4(b) on its face provides persuasive evidence that Congress did not intend to impose the burden of pleading loss causation on plaintiffs. In section 78u-4(b)(1), the statute states that “the complaint shall specify each statement alleged to have been misleading, the reason or reasons why the statement is misleading, and, if an allegation regarding the statement or omission is made on information and belief, the complaint shall state with particularity all facts on which that belief is formed.”

Section 78u-4(b)(2) continues:

[P]laintiff may recover money damages only on proof that the defendant acted with a particular state of mind, the complaint shall, with respect to each act or omission alleged to violate this [Act], state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind.

Section 78u-4(b)(3)(A) further states, “[i]n any private action arising under this [Act], the court shall, on the motion of any defendant, dismiss the complaint if the requirements of paragraphs (1) and (2) are not met.”

Finally, section 78u-4(b)(4), which speaks to the heart of this case, sets forth that “[i]n any private action arising under this [Act], the plaintiff shall have the burden of proving that the act or omission of the defendant alleged to violate this [Act] caused the loss for which the plaintiff seeks to recover damages.”

In summary, the plain language of sections 1 and 2 explicitly require plaintiffs to plead, with particularity, that defendants made misleading statements, why these statements were misleading, and that the statements were made with the required state of mind. Section 3 then unambiguously states that

217. See id.
220. Id. at § 78u-4(b)(1).
221. Id. at § 78u-4(b)(2).
222. Id. at § 78u-4(b)(3)(A) (emphasis added).
223. Id. at § 78u-4(b)(4) (emphasis added).
224. Id. at § 78u-4(b)(1)-(2).
a Court may dismiss a claim that does not meet the \textit{pleading} requirements of paragraphs 1 and 2.\textsuperscript{225} Only after the statute concludes with what is required with regards to \textit{pleading} does it continue, in section 4, to discuss \textit{proving} loss causation.\textsuperscript{226} In fact, any mention of a \textit{pleading} standard is markedly missing from section 4.\textsuperscript{227} If the legislators had intended a pleading requirement for loss causation, they could have included the language in section 4 that was used in sections 1 and 2, namely, to require pleading “with particularity.”\textsuperscript{228} Further, the legislators could have inverted sections 3 and 4 and noted that failure to meet pleading standards in section 1, 2, and 3 could serve as grounds for dismissal.\textsuperscript{229}

In addition to being consistent with the intent embodied in the PSLRA, the Ninth Circuit’s position furthers Congress’ current trend of cracking down on corporate offenders.\textsuperscript{230} In order to enable investors more time to uncover and pursue securities fraud, Congress recently extended the statute of repose for section 10(b) actions from three to five years with the passage of the Sarbanes-Oxley Act in 2002.\textsuperscript{231} Senator McCain, co-sponsor of the Act, explained “the worst offenders may avoid accountability and be rewarded if they can successfully cover up their misconduct for merely three years.”\textsuperscript{232} Senator McCain continued by stating that “[t]he more complex the case, the easier it will be for these wrongdoers to get away with fraud.”\textsuperscript{233} The ability to conceal and the passage of time should not relieve those who commit securities fraud because the inflationary effects of their fraud have dissipated during the five years that Congress has now given investors to uncover and pursue.\textsuperscript{234} Similarly, the \textit{out of pocket} remedy forecloses corporate insiders from using time as a means of covering their transgressions.\textsuperscript{235}

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\textsuperscript{225} \textit{Id.} at § 78u-4(b)(3).
\textsuperscript{226} \textit{Id.} at § 78u-4(b)(3)-(4).
\textsuperscript{227} \textit{See id.} at § 78u-4(b)(4).
\textsuperscript{228} \textit{See id.} at § 78u-4(b)(1)-(2), (4).
\textsuperscript{229} \textit{See id.} at § 78u-4(b)(1)-(4).
\textsuperscript{230} \textit{See 28 U.S.C.A. § 1658 (West 2005):}
(a) Except as otherwise provided by law, a civil action arising under an Act of Congress enacted after the date of the enactment of this section [enacted Dec. 1, 1990] may not be commenced later than 4 years after the cause of action accrues. (b) Notwithstanding subsection (a), a private right of action that involves a claim of fraud, deceit, manipulation, or contrivance in contravention of a regulatory requirement concerning the securities laws, as defined in section 3(a)(47) of the Securities Exchange Act of 1934 . . . may be brought not later than the earlier of - (1) 2 years after the discovery of the facts constituting the violation; or (2) 5 years after such violation. \textit{Id.}
\textsuperscript{231} \textit{See id.}
\textsuperscript{233} \textit{Id.}
\textsuperscript{234} \textit{See 28 U.S.C.A. § 1658(b)(2) (West 2005).}
\textsuperscript{235} \textit{See Basic Inc. v. Levinson, 485 U.S. 224, 248-49 (1988).}
\end{flushright}
Because the plain language of the statute clearly dispels any ambiguity with regards to the appropriate standard of pleading regarding loss causation, and because Congress is aggressively attempting to legislate a means of bringing corporate tortfeasors to justice, the Supreme Court’s implicit reading of a pleading standard in 15 U.S.C. § 78u-4(b)(4) is erroneous.\textsuperscript{236}

C. Potential Impact of the Dura Decision on Future 10b-5 Cases.

During the months that preceded the \textit{Dura} decision, many potential litigants and corporate defendants postponed related procedures in anticipation of the Supreme Court’s verdict.\textsuperscript{237} Accordingly, perhaps the biggest and most immediately recognizable shortcoming of the \textit{Dura} decision is that the Supreme Court gives no indication of what would constitute a sufficient pleading of loss causation.\textsuperscript{238} This leaves lower courts and potential plaintiffs with no more guidance regarding this issue than was previously available.\textsuperscript{239} The few cases that have wrestled with this issue since the \textit{Dura} decision have fundamentally dealt with the analysis in the same fashion as courts did before \textit{Dura}.\textsuperscript{240}

In \textit{Sekuk Global Enterprise v. KVH Industries, Inc.}, the plaintiffs claimed that the defendant company engaged in improper accounting practices related to the sales of a key product.\textsuperscript{241} In allegations nearly identical to those in \textit{Dura}, the plaintiffs alleged losses occurred after the company issued a press release announcing quarterly revenue based on lower than expected sales.\textsuperscript{242} In their motion to dismiss, the defendants argued that the press release and the resulting drop in the price of KVH common stock failed to establish loss causation because the press release did not attribute the declining revenue to the sales of

\textsuperscript{236} Dura Pharms., Inc. v. Broudo, 125 S. Ct. 1627, 1634 (2005).
\textsuperscript{238} See \textit{Dura Pharms., Inc.}, 125 S. Ct. at 1631-34.
\textsuperscript{239} \textit{Id.} at 1634-35.
\textsuperscript{242} \textit{Id.} at *49.
the key product. This argument is parallel to the precedent set by *Dura* that found that the press release’s failure to mention the Albuterol Spiros product meant that misrepresentations concerning the product could not be a cause of the loss. However, the court in *KVH* found that the key product was a possible contributor to the lower than expected sales, even if it was not expressly discussed in the press release. Accordingly, the court found that the plaintiffs adequately pled causation.

In stark contrast with the *KVH* opinion is *D.E. & J. Limited Partnership v. Conaway*, the first Court of Appeals case to apply the *Dura* holding. In this case, plaintiffs brought suit against Kmart executives and PricewaterhouseCoopers alleging that defendants misled Kmart investors in 2000 and 2001 prior to the company’s bankruptcy. Plaintiffs relied entirely on allegations that they had paid artificially inflated prices for Kmart stock and that Kmart’s stock price declined after the company announced bankruptcy. The Sixth Circuit held that the Supreme Court had expressly rejected price inflation as an adequate basis of proving loss causation. Further, the court of appeals found that the plaintiffs “never alleged that Kmart’s bankruptcy announcement disclosed any prior misrepresentations to the market.”

As illustrated in the introduction to this note, corporate fraud is not always as simple as misrepresent-buy-disclose-sell. Manipulative schemes like the Enron debacle involve numerous misrepresentations and disclosures. However, the Court in *Dura* found the fact that disclosure of a fraud that results in an inflated purchase price “sometimes play[s] a role in bringing about a future loss,” but that fact standing alone, is not sufficient to show that the fraud caused the loss.

Based on the precedent set by *Dura*, a corporation faced with the inevitable disclosure of insider fraud may be able to avoid liability for the damages caused by its own misrepresentations by simply releasing other negative statements into the market in advance of the disclosure of the fraud. Accordingly, by the time

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243. *Id.*
244. *See Dura Pharms., Inc. v. Broudo, 125 S. Ct. 1627, 1634 (2005).*
246. *Id.* at *51.
248. *Id.* at *8-*9.
249. *Id.* at *18-*19.
250. *Id.* at *19-*20.
251. *Id.* at *18-*19.
252. *See supra text accompanying notes 1-25.*
255. *See id.* at 1631-35.
corporate misgivings become public knowledge, the price per share will have already fallen. 256 Thus, when plaintiffs attempt to prove loss causation, the defendant can rebut the charge by pleading that the share price depreciation did not result from the disclosure since the fraud had not been disclosed at the time of the depreciation. 257 In fact, as noted by the Supreme Court, sufficient passage of time between the misrepresentations and the price drop will alone be enough to leave plaintiffs without a remedy. 258

Accordingly, the holding of the Supreme Court is inconsistent with the fraud on the market doctrine and consequently undermines the confidence that market participants have in the open market system. 259 The Court rationalized its decision by observing that there is inherent risk involved in the buying and selling of publicly traded securities. 260 This assertion is correct and plaintiffs should not have the ability to shift risks associated with the instability of the market to defendant corporations, even in cases of fraud. 261 However, plaintiffs should not have to bear the risk of purchasing securities at inflated prices because individuals inside the corporation may have perpetrated a fraud. 262 Such individuals should be entitled to recover the amount overpaid once the fraud is discovered, regardless of whether or not share prices drop because of the misrepresentation. 263

The Dura opinion is completely void of guidance regarding what the proper measure of damages in a securities fraud action should be. 264 The Court effectively overruled centuries of precedent grounded in the out of pocket doctrine without once mentioning the concept. 265 In contrast, the standard of proving loss causation proffered by the Ninth Circuit, which required proof that the defendant’s fraud caused plaintiffs to pay an inflated purchase price for the

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256. See id.
257. See id.
258. Id. at 1632.
   The fraud on the market theory is based on the hypothesis that, in an open and
developed securities market, the price of a company's stock is determined by
the available material information regarding the company and its business . . .
Misleading statements will therefore defraud purchasers of stock even if the
purchasers do not directly rely on the misstatements . . . The causal connection
between the defendants' fraud and the plaintiffs' purchase of stock in such a
case is no less significant than in a case of direct reliance on
misrepresentations. Id. at 241-42 (citing Peil v. Speiser, 806 F.2d 1154, 1160-61
(3d Cir. 1986)).
260. Id. at 1631-32.
261. Green v. Occidental Petroleum Corp., 541 F.2d 1335, 1345 (9th Cir. 1976) (Sneed, J.,
concurring).
262. Id. at 1345-46.
263. Id.
265. Id.
securities at issue, was completely in accord with the *out of pocket* doctrine and proved a much more efficient proxy. Application of this standard to the three reasons set forth by the Supreme Court in rejection of the Ninth’s Circuit’s holding, as discussed in this note, demonstrate the wisdom of the test. Further, it provided lower courts and plaintiffs with clear precedent by which to gauge their pleadings and procedures.

V. CONCLUSION

The Enron litigation was part of an outbreak of securities fraud disclosures and subsequent litigations that shocked investors and the government out of complacency regarding regulation of publicly traded securities. Aggressive steps have since been taken to ensure that sufficient accountability is in place to deter corporations from making similar financial misrepresentations. Further, common law and federal statutes provide an abundance of precedent rationale for compensating investors who have purchased stock for artificially inflated prices, thereby suffering damages. While the Supreme Court’s aversion to “transform[ing] a private securities action into a partial downside insurance policy” is inarguably virtuous, it does not justify abandoning centuries of proven precedent or denying Congress the deference it is due. Rather than setting precedent to protect investors and deter other Enron-like crises, the *Dura* decision makes it more difficult for plaintiffs to have their cases heard by an impartial fact finder. This undermines the regulatory standards put in place by the Sarbanes-Oxley Act and insulates corporate defendants from accountability.

While the Enron crisis may have convinced Congress and the former chairman of the Securities and Exchange Commission that the *status quo* had to change, the *Dura* holding demonstrates the Supreme Court remains incredulous concerning this issue.

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266. *Id.* at 1629 (citing Broudo v. Dura Pharms., Inc., 339 F.3d 933, 938 (9th Cir. 2003)).
267. *Id.*
269. *Id.*
272. *See id.* at 1631-34.
273. *Id.*
274. *Id.*
NOT SO FAST, EMPLOYERS: THE KENTUCKY SUPREME COURT ALLOWS A PRIVATE RIGHT OF ACTION FOR INDEPENDENT CONTRACTORS UNDER THE KENTUCKY OCCUPATIONAL SAFETY AND HEALTH ACT IN HARGIS V. BAIZE

Seth Musulin*

I. INTRODUCTION

Gary lives in a small town in eastern Kentucky. He ekes out a small income for his family and himself by hauling various items with his truck. In the hopes of more steady employment, he joins a logging company who rents him a trailer to transport their logs to and from different sites. Before the company will use his services, however, the owner makes him sign an exculpatory agreement, stating that he is an independent contractor and cannot sue if injured.

Gary makes his money solely on the amount of lumber he hauls, so naturally, he tries to pile on as many logs as he can each trip. Although Gary piles the logs high on the trailer, he secures them with straps to ensure they do not roll off. The owner enjoys having a worker like Gary since the owner does not have to pay any Worker’s Compensation insurance, unemployment insurance, social security or Medicaid taxes, or provide Gary with any benefits.1 The company does not even have to pay Gary minimum wage.2

While working at the company’s jobsite one day, a log rolls off one of the trailers after a driver releases the straps. The log hits the ground and rolls for a bit, but no one is injured. Gary is a little concerned, and wonders why there are no safety procedures. He does not realize that there are safety procedures – however, the logging company chooses to ignore them.3 Two months later, another log rolls off, once again due to the company’s refusal to institute the safety procedures. This time Gary happens to be under it, and is killed instantly. The logging company hates to lose a productive worker, but is not worried about any liability. After all, Gary was not an employee – he was an independent contractor. His family has no financial recourse. What happens?

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2. Id.
3. See KY. REV. STAT. ANN. §§ 338.031(a)-(b) (West 2004) (setting forth the obligations of an employer regarding its worksite).
The above situation is not an odd one. Many employers choose to hire independent contractors for different reasons, mostly because it saves them money.4 Many Kentucky employers who hire independent contractors are not aware that they might have a duty to provide a safe workplace, and in many instances to install policies and procedures mandated by the Kentucky Occupational Safety and Health Act.5

This note discusses and analyzes *Hargis v. Baize*, a Kentucky Supreme Court case that essentially remedies the problem in the above scenario by allowing an independent contractor to sue an employer for injuries sustained due to the employer’s failure to provide a safe workplace.6 Section II of this note lays out the background law needed to understand *Hargis*. Section III provides an overview of the facts and holding of the case, along with the dissenting opinion. Section IV analyzes the case’s holding by exploring the courts reasoning and discussing other cases that have held similarly. Section V concludes the article.

**II. BACKGROUND LAW**

A. Kentucky Occupational Safety and Health Act

In 1972, the Kentucky General Assembly added Chapter 338 to the Kentucky Revised Statutes, which became the enabling legislation for the Kentucky Occupational Safety and Health Act (“KOSHA”).7 KOSHA was promulgated to insure the health and safety of Kentucky workers in both public and private workplaces.8

KOSHA, like its federal parent, the Occupational Safety and Health Act (“OSHA”), prescribes that employers have two main duties: first, that they give

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The General Assembly finds that occupational accidents and diseases produce personal injuries and illness including loss of life as well as economic loss. Therefore, the General Assembly declares that it is the purpose and policy of the Commonwealth of Kentucky to promote the safety, health and general welfare of its people by preventing any detriment to the safety and health of all employees, both public and private, covered by this chapter, arising out of exposure to harmful conditions and practices at places of work and otherwise to preserve our human resources by providing for education and training, inspection of workplaces, consultation, services, research, reports and statistics, and other means of furthering progress in the field of occupational safety and health. *Id.*
each employee a place of employment that is free from recognized harms, and second, that the employer comply with the occupational safety and health standards under the statute.\textsuperscript{9} The first provision creates a “general duty.”\textsuperscript{10} The “general duty” provision was intended to cover unanticipated hazards not covered by the “specific duties” referred to in the second provision.\textsuperscript{11} KOSHA also requires employees to comply with the standards and regulations contained within the statute.\textsuperscript{12} Because KOSHA borrows much of its language and meaning from OSHA, Kentucky courts have shown a willingness to adopt federal court interpretations of OSHA provisions.\textsuperscript{13}

KOSHA sets forth that the Kentucky Occupational Safety and Health Board (“KOSHA Board”) “shall adopt and promulgate occupational safety and health rules, regulations, standards, and secure all expertise, testimony, and evidence necessary to accomplish the purposes of this chapter.”\textsuperscript{14} Along with any standards the KOSHA Board deems necessary to adopt or abolish, it is also allowed to adopt any “[e]stablished federal standards and national consensus standards….”\textsuperscript{15} The regulations at issue in Hargis v. Baize were federal regulations incorporated into Kentucky’s administrative regulations that provide specific procedures for log handling, sorting, and storing.\textsuperscript{16}

\textsuperscript{9} KY. REV. STAT. ANN. §§ 338.031(1)-(2) (West 2004)

(1) Each employer: (a) Shall furnish to each of his employees employment and a place of employment which are free from recognized hazards that are causing or are likely to cause death or serious physical harm to his employees; (b) Shall comply with occupational safety and health standards promulgated under this chapter. (2) Each employee shall comply with occupational safety and health standards and all rules, regulations, and orders issued pursuant to this chapter which are applicable to his own actions and conduct. \textit{Id.}

\textsuperscript{10} See also 29 U.S.C. §§ 654(a)-(b) (2005) (using nearly identical language).

\textsuperscript{11} Teal v. E.I. DuPont De Nemours and Co., 728 F.2d 799, 803 (6th Cir. 1983).

\textsuperscript{12} KY. REV. STAT. ANN. § 338.031(2) (West 2004).

\textsuperscript{13} See also 29 U.S.C. § 654(b) (2004).

\textsuperscript{14} See Hargis v. Baize, 168 S.W.3d 36, 43 (Ky. 2005) (adopting verbatim the holding in Teal v. E.I. DuPont De Nemours and Co., 728 F.2d 799 (6th Cir. 1983)). Kentucky courts have shown a strong inclination to follow the opinions of other courts on issues involving OSHA. See Ky. Labor Cabinet v. Graham, 43 S.W.3d 247, 253 (Ky. 2001) (“As KOSHA is patterned after the federal act and must remain as effective as its federal counterpart, KOSHA should be interpreted consistently with federal law.”).

\textsuperscript{15} KY. REV. STAT. ANN. § 338.051(3) (West 2004).

\textsuperscript{16} Hargis, 168 S.W.3d at 43 (citing 803 Ky. ADMIN. REGS. 2:317 (2004), which adopts by reference 29 C.F.R. §§ 1910.265 (d)(1)(b)(c) (2004), which are the federal standards for releasing binding and unloading logs).
Violations of KOSHA standards may lead to the issuance of citations by the Kentucky Occupational Safety and Health Review Commission. Additional penalties may apply if a standard or regulation is willfully or repeatedly violated. However, the statute does not set forth a private right of action for an employee injured by a violation of a standard or regulation:

Nothing in this chapter shall be construed to supersede or in any manner affect any workers' compensation law or to enlarge or diminish or affect in any manner the common law or statutory rights, duties, or liabilities of employers or employees, under any law with respect to injuries, diseases, or death of employees arising out of, or in the course of employment.

It is a well established proposition that an employee may not have a private right of action under KOSHA because an employee is precluded by the “exclusive remedy” provision in the Workers’ Compensation Act. The “exclusive remedy” provision of the Workers’ Compensation Act prescribes that, after an employer secures compensation according to the provisions of the Workers’ Compensation Act to an injured employee, the employer is relieved of all liability to the employee. The “exclusive remedy” provision combined with the KOSHA provision limiting an employer’s liability effectively works to bar an employee’s civil suit under KOSHA. Hargis addressed KOSHA as it applied to independent contractors working at another employer’s workplace, and held that the federal standards adopted by Kentucky’s administrative regulations extend to those independent contractors.

17. KY. REV. STAT. ANN. § 338.141(1) (West 2004).
20. Hargis, 168 S.W.3d at 45. See also Stinnett v. Buchele, 598 S.W.2d 469, 471 (Ky. Ct. App. 1980) (stating that courts have uniformly held that there is not right of action for an employee against his or her employer for a violation of OSHA). See KY. REV. STAT. ANN. § 342.690(1) (West 2004) (setting forth the exclusive remedy provision of the Workers’ Compensation Act).
21. KY. REV. STAT. ANN. § 342.690(1) (West 2004). Because the distinction between an employee and independent contractor is of such importance, it bears explaining the difference under Kentucky law. An analysis requires consideration of at least four predominant factors: (1) the nature of the work as related to the business generally carried on by the alleged employer; (2) the extent of control exercised by the alleged employer; (3) the professional skill of the alleged employee; and (4) the true intent of the parties. See generally Ratliff v. Redmon, 396 S.W.2d 320, 324-25 (Ky. Ct. App. 1965).
22. Hargis, 168 S.W.3d at 45.
23. Id. at 43. In Hargis, Baize claimed that the only duty he owed to Hargis was to warn him of any hidden dangers at the workplace, which was a rule previously upheld in Kentucky. Id. at 40. See also Ralston Purina Co. v. Farley, 759 S.W.2d 588, 589 (Ky. 1988) (holding that it is the duty of the landowner only to warn an independent contractor or contractor of hidden dangers on his property).
To summarize, KOSHA acts to protect Kentucky workers by setting forth both general and specific duties with which employers must comply. Although employees are the intended beneficiaries of the statute’s protection, they are precluded from a private right of action under it. The interpretation of KOSHA as set forth in Hargis, however, effectively creates a private right of action under the specific duties of KOSHA for injured independent contractors working at another employer’s workplace.

B. Section 446.070 of the Kentucky Revised Statutes

Because of the provision in KOSHA that prohibits expansion of an employer’s liability, the Kentucky Supreme Court had to find a source for a right of action that was both separate and independent from KOSHA. The court found this separate and independent source in section 446.070 of the Kentucky Revised Statutes, which states: “A person injured by the violation of any statute may recover from the offender such damages as he sustained by reason of the violation, although a penalty or forfeiture is imposed for such violation.” In other words, if there is a statute that does not set forth a civil remedy for a person who is injured by another person’s violation of that statute, then section 446.070 creates a private right of action in favor of the injured person. However, if the statute in question precludes a private right of action, then section 446.070 does not provide one.

Section 446.070 does not automatically create liability. Proximate cause must also be shown for liability to attach. Further, the violated statute must have purposely intended to protect the individual from the type of injury that occurred and the violation must have been a substantial factor in the injury. Finally, if the statute is used for negligence purposes, the contributory fault of

24. KY. REV. STAT. ANN. § 338.031 (West 2004).
25. KY. REV. STAT. ANN. § 338.021(2) (West 2004).
27. KY. REV. STAT. ANN. § 338.021(2) (West 2004).
28. Hargis, 168 S.W.3d at 45. See also Ellis v. Chase Commc’ns, Inc., 63 F.3d 473, 478 (6th Cir. 1995) (holding that the plaintiff must present a theory of liability independent of OSHA to recover for a violation).
29. KY. REV. STAT. ANN. § 446.070 (West 2004).
30. Hargis, 168 S.W.3d at 40-41.
31. Grzyb v. Evans, 700 S.W.2d 399, 401 (Ky. 1985) (holding that under section 446.070, “[w]here [a] statute both declares the unlawful act and specifies the civil remedy available to the aggrieved party, the aggrieved party is limited to the remedy provided by the statute.”).
32. Isaacs v. Smith, 5 S.W.3d 500, 502 (Ky. 1999) (stating that the violation of a statute will create liability only when the statute was intended to prevent the type of injury that occurred).
33. Id.
34. Id.
the injured person comes into play to prove causation and possible reduction of damages.  

The court in *Hargis* used section 446.070 to imply a right of action for independent contractors by stating that KOSHA was intended to protect independent contractors working at the workplace of another employer.  

**C. Teal v. E.I. DuPont De Nemours and Company.**  

Because the court in *Hargis* adopted the reasoning set forth in *Teal v. E.I. DuPont De Nemours and Co.*, an understanding of *Teal* is essential to an understanding of *Hargis*. The major issue in *Teal* was whether an employee of an independent contractor working at another employer’s workplace was a member of the class to be protected under the specific provisions of OSHA. The regulation before the *Teal* court was similar to that before the court in *Hargis*; namely, it was a specific OSHA regulation requiring the employer to comply with a recognized federal standard.  

Richard Teal was an employee of Daniel Construction, an independent contractor of DuPont. In March 1979, Teal fell from a permanently affixed ladder on DuPont’s property. The affixed ladder varied in the clearance specifications proffered by the OSHA provision. The court had to decide whether the lower court’s refusal to instruct the jury on negligence per se was correct in relation to a violation of an OSHA regulation. The court looked to Tennessee law and found that the case law allowed a negligence per se claim arising out of violation of a statute or regulation if the injury was the type to be prevented by the violated statute. Because the duty required by the federal regulations was a specific duty, the court held that “once an employer is

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35. Durham v. Maratta, 195 S.W.2d 277, 279 (Ky. 1946) (holding that a plaintiff’s contributory fault needed to be considered by the jury in a case where the defendant was negligent under a statute).  
37. Id. at 43–44.  
38. Teal v. E.I. DuPont De Nemours and Co., 728 F.2d 799, 803 (6th Cir. 1983). The court did not rule on the scope of the general duty provision of OSHA. Id. at 804 n.8.  
40. Teal, 728 F.2d at 803 (stating that Teal was the employee of an independent contractor whom DuPont had hired).  
41. Id.  
42. Id. See also 29 C.F.R. § 1910.27(c)(4) (2004).  
43. Teal, 728 F.2d at 802.  
44. Id. See also Alex v. Armstrong, 385 S.W.2d 110, 114 (Tenn. 1964) (holding that it is a settled matter of Tennessee law that a violation of a statute is negligence per se if the injury is a proximate result of the violation). This common law action is the equivalent of KY. REV. STAT. ANN. § 446.070 (West 2004).  
45. 29 C.F.R. § 1910.27(c)(1) (2005) (“On fixed ladders, the perpendicular distance from the centerline of the rungs . . . shall be 36 inches for a pitch of 76°, and 30 inches for a pitch of 90° . . . ”).
deemed responsible for complying with OSHA regulations, it is obligated to protect every employee who works at its workplace.” The court justified the extension of OSHA to all employees by stating that Congress had a broad purpose in promulgating OSHA:

Congress enacted [the specific duty provision] for the special benefit of all employees, including the employees of an independent contractor, who perform work at another employer’s workplace. The specific duty clause represents the primary means for furthering Congress’ purpose of assuring ‘so far as possible every working man and woman in the Nation safe and healthful working conditions.”

Essentially, the *Teal* court created the grounds and justification needed to extend the protection of OSHA beyond the employees of an employer to the employees of an independent contractor working at another employer’s workplace.

III. THE FACTS AND HOLDINGS OF HARGIS V. BAIZE

A. The Facts

Allen R. Baize owned a lumber yard and sawmill in Muhlenberg County, Kentucky, known as the Greenville Log and Lumber Company. Darrell Ruben Hargis worked as an independent contractor for Baize. Hargis was a driver paid in correlation to the amount of lumber he hauled. He owned his own tractor, but rented a trailer from Baize to haul the lumber. It was undisputed by both parties that Hargis was an independent contractor.

On November 24, 1998, Hargis was sent to Campbellsville, Kentucky to pick up a load of logs that Baize had ordered from Whitney & Whitney Lumber Co. Hargis had overloaded the trailer on the day of the accident and the logs were loaded above the “pole racks” on the sides of the trailer. Independent contract drivers, like Hargis, had motivation to carry as much lumber as possible since they were paid by the amount of lumber they hauled. After returning to

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46. *Teal*, 728 F.2d at 805.
47. *Id.* at 804 (quoting 29 U.S.C. § 651(b) (2004)) (emphasis in original).
48. *Id.* at 805.
50. *Id.*
51. *Id.* The phrase used in the logging business to refer to the amount of lumber carried is “board-feet hauled.” See *id.*
52. *Id.*
53. Hargis, 168 S.W.3d at 42.
54. *Id.* at 39.
55. Appellee’s Brief at 2-3, Hargis v. Baize, 168 S.W.3d 36 (Ky. 2005) (No. 2002-SC-000969-D) (stating that pole racks are devices intended to keep the logs from rolling off the trailer).
56. *Id.* at 3.
Greenville Log and Lumber, Hargis released the binders on his load so that the truck could be unloaded. However, one of the logs rolled off, and killed him.

It was the policy of Greenville Log and Lumber Co. that all drivers, both employees and independent contractors, “release the binders on their loads, and then move to a position at least two truck lengths in front of the truck so as to be in full view of the forklift operator while the logs were being unloaded.” This policy was contrary to the KOSHA regulation that binders not be released prior to the securing of the logs. Baize was aware that his policies were not in compliance with KOSHA and that he was willfully not following the regulations. Additionally, Hargis had signed an exculpatory agreement, allowing Baize to be held harmless should any injury occur.

Hargis’ widow brought an action against Baize alleging that his failure to comply with KOSHA had caused the death of her husband. After discovery, Baize moved for summary judgment, claiming that KOSHA did not create a private right of action and that he only owed Hargis the duty to warn him of hidden dangers on the property. The trial court granted Baize’s motion, holding that there was no private right of action under KOSHA and that the exculpatory agreement was valid. The court of appeals affirmed and the Kentucky Supreme Court granted discretionary review.

B. The Majority Opinion of Justice Cooper

Justice Cooper, writing for the majority, divided the opinion into three major sections: the violation of a KOSHA regulation, whether the violation was a substantial factor of the injury, and an analysis of the exculpatory agreement.

57. Hargis, 168 S.W.3d at 39.
58. Id.
59. Id.
61. Hargis, 168 S.W.3d at 40 (stating that Baize’s former safety officer testified that an insurance representative visited the site a few weeks before the accident and recommended implementation of the procedures required by KOSHA).
62. Id. at 40.
63. Id. at 39.
64. Id. at 40.
65. Id.
67. Hargis, 168 S.W.3d at 39. The majority opinion was also joined by Chief Justice Lambert and Justices Graves, Scott, and Wintersheimer. Id. at 48.
68. Id. at 40.
69. Id. at 46.
70. Id.
1. The Violation of a KOSHA Regulation.

The court began its analysis by reviewing the aforementioned section 446.070.71 Justice Cooper analyzed whether an administrative provision could be used under this statute, but held that the issue did not need to be decided since the KOSHA standards were promulgated under a Kentucky statute.72 The violation of a KOSHA regulation would mean a violation of a statute, and would trigger the right of action created by section 446.070.73

Justice Cooper also refuted Baize’s proposition that a previous decision by the Kentucky Supreme Court denied a private right of action under KOSHA.74 Baize cited as controlling authority *Carman v. Dunaway*, which contained facts almost identical to the ones in *Hargis*.75 The injured individual in *Carman* was also hurt by a log that had rolled off a trailer.76 In *Carman*, however, the injured person was not found to be within the class of persons protected by KOSHA.77 Rather, the court held that the *Carman* plaintiff was a private business man selling his own logs on the premises, and was not an independent contractor or employee.78

a. The Court Adopted Teal v. E.I. DuPont De Nemours and Co.

The court next reviewed the holding in *Teal*, and adopted verbatim the reasoning of the Sixth Circuit’s opinion, changing only the statutory provisions so that they referenced Kentucky law.79 With the adoption, the *Hargis* court announced that the “specific duty” provision of KOSHA extended to independent contractors working at the workplace of another employer.80 The court stated that “once an employer is deemed responsible for complying with OSHA regulations, it is obligated to protect every employee who works at its

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71. *Hargis*, 168 S.W.3d at 40 (quoting from KY. REV. STAT. ANN. § 446.070 (West 2004)).
72. *Id.* at 41-42. The analysis begun by the majority regarding violations of administrative regulations seems odd considering it decided the issue to be moot. See *id.*
73. *Id.* at 42-43. See KY. REV. STAT. ANN. § 338.061(2) (West 2004).
74. *Hargis*, 168 S.W.3d at 42-43.
75. *Id.* See also *Carman v. Dunaway*, 949 S.W.2d 569, 569-70 (Ky. 1997).
76. *Id.* at 570.
77. *Id.* at 571.
78. *Id.* Baize’s use of *Carman* is actually ironic (as well as misplaced) for two reasons: first, the explanation of the court’s interpretation of *Teal* in *Carman* foreshadows the courts interpretation in *Hargis*; and, second, the dissenting opinion actually urges a more expansive interpretation of *Teal*, including not only independent contractors, but also businessmen selling their own logs on the premises of a buyer. *Id.* 570-72. The court actually states, “*Teal* would extend the coverage of the federal Occupational Health and Safety Act to employees of independent contractors who work at another employer’s workplace.” *Carman*, 949 S.W.2d at 571. But for the court’s determination that *Carman* was outside the scope of KOSHA, this case note would be on *Carman* instead of *Hargis*.
79. *Hargis*, 168 S.W.3d at 43-44.
80. *Id.* at 43. The court did not rule on the scope of the “general duty” provision of KOSHA. See *id.*
workplace. 81 The court also declared, as did the court in Teal, that the specific duties set forth in KOSHA are the “primary means” of making sure that all workers have a healthy and safe work environment.82 The court then addressed the argument put forth by Baize that if Teal did apply to the case, it would not allow recovery since Hargis was himself an independent contractor and not an employee of one.83 Justice Cooper refuted this argument, calling it “ludicrous,” and reasoning that “Hargis was performing the same work duties and was exposed to the same hazards as Baize’s own truck-driver employees.”84

b. The Court Addressed Section 338.021(2) of the Kentucky Revised Statutes

In this section the court addressed the provision in KOSHA that states:

Nothing is this chapter shall be construed . . . to enlarge or diminish or affect in any manner the common law or statutory rights, duties, or liabilities of employers or employees, under any law with respect to injuries, diseases, or death of employees arising out of, or in the course of employment.85

The court first reviewed the established rule that a violation of KOSHA did not affect the exclusive remedy provision of the Worker’s Compensation Act, and therefore an injured employee would not have a right of action under KOSHA.86 The court, however, declared that “a violation of KOSHA is actionable by a person for whose benefit it was enacted if the right of action arises from a source created separately from and independently of KOSHA.”87 This separate and independent source, Justice Cooper pointed out, was section 446.070 of the Kentucky Revised Statutes, “which was enacted eighty years prior to KOSHA . . .”88 Section 446.070 “converts the standard of care required by the violated statute into a statutory standard of care for the negligence claim,

81. Id. at 44. See also Teal v. E.I. DuPont De Nemours and Co., 728 F.2d 799, 805 (6th Cir. 1983).
82. Hargis, 168 S.W.3d at 44 (emphasis omitted). See also Teal, 728 F.2d at 804.
83. Hargis, 168 S.W.3d at 44.
84. Id. The Kentucky Court of Appeals had actually upheld this distinction, which meant that Hargis was held to be only an independent contractor and not an employee of an independent contractor. See Appellee’s Brief at 8, Hargis v. Baize, 168 S.W.3d 36 (Ky. 2005) (No. 2002-SC-000969-D) (arguing against the interpretation set forth by the Kentucky Court of Appeals).
85. Hargis, 168 S.W.3d at 45 (quoting KY. REV. STAT. ANN. § 338.021(2) (West 2004)) (emphasis omitted).
86. Id. See KY. REV. STAT. ANN. § 342.690(1) (West 2004) (setting forth the exclusive remedy provision of Workers’ Compensation Act).
87. Hargis, 168 S.W.3d at 45. See also Ellis v. Chase Commc’ns, Inc., 63 F.3d 473, 478 (6th Cir. 1995) (construing 29 U.S.C. § 653(b)(4), which is replicated by KY. REV. STAT. ANN. § 338.021(2) (West 2004), to mean that an independent theory of liability must exist separate from OSHA).
88. Hargis, 168 S.W.3d at 45.
the violation of which is negligence per se.” The use of section 446.070 becomes the major contention raised by the dissent. However, the majority does not explain exactly how section 446.070 is a “separate and independent” right of action. The majority only cites one case, Ellis v. Chase Communications, for its proposition and then simply moves on to the next part of its analysis.

2. Was the Violation a Substantial Factor of the Injury?

The court noted that violation of a statute does not mean absolute liability. The statute must have intended to prevent the type of injury that occurred. Baize claimed that the injury occurred because of Hargis’ own negligence, but the court explained that many statutes and ordinances are intended to protect individuals from their own careless actions. Although Hargis might have been comparatively negligent in overloading his truck, Baize’s refusal to comply with OSHA regulations could also have been a substantial factor in the injury.

3. Exculpatory Agreement

Next the court analyzed the exculpatory agreement signed by Hargis. The agreement stated:

It is hereby agreed and acknowledged that I am a self-employed independent contractor. Therefore, I am not required to carry Worker’s compensation according to Kentucky Law. I accept responsibility for my own property and person and release ALLEN BAIZE, d/b/a GREENVILLE LOG & LUMBER CO., . . . and forever hold him harmless for any property damage/bodily injury sustained by me or any other person I authorize to be on the working premises while performing services for said contractor. I agree that my relationship with him will be strictly as a subcontractor and not an employee, which

89. Id.
90. Id. at 48-51.
91. Id. at 45.
92. Id. See also Ellis v. Chase Commc’ns, Inc., 63 F.3d 473, 478 (6th Cir. 1995) (stating that a violation of OSHA is actionable if the right arises from a separate and independent source).
93. Hargis, 168 S.W.3d at 46.
94. Id. See Isaacs v. Smith, 5 S.W.3d 500, 502 (Ky. 1999) (stating that the violation of a statute does not create liability unless the statute was intended to prevent the type of injury that occurred).
95. Hargis, 168 S.W.3d at 46. See also William S. Cooper, Negligence Per Se as Proximate Cause of Injury in Fall-Down Cases, 57 Ky. L.J. 277, 280 (1969) (“[I]n many negligence per se cases, the statute or ordinance violated was intended to protect individuals from their own carelessness in certain dangerous situations”).
96. Hargis, 168 S.W.3d at 46.
97. Id. at 46.
makes me ineligible for any employee benefits under said contractor's insurance programs or state requirements.98

The court explained that contracts for exemption from liability for negligence were not favored by the courts.99 In addition, the agreement must set forth the negligence it is meant to exculpate from in a clear and specific manner as well as release the party from injuries caused by the signing party’s own negligence.100 Because the agreement signed by Hargis failed to meet any of the factors, the agreement was unenforceable.101 The court also declared that a party could not “contract away liability for damages caused by that party’s failure to comply with a duty imposed by a safety statute.”102

C. The Dissenting Opinion of Justice Keller

Justice Keller’s dissent attacked the logic of the majority and argued against a private right of action under KOSHA.103 He felt that the court should have answered the question in the easiest way possible; by stating that KOSHA precluded a private right of action through section 338.021(2).104 Justice Keller wrote, “if a civil action for an employee’s injury or death did not exist before the adoption of KOSHA, then KOSHA could not be the basis thereafter for such an action. But the majority has ignored this clear mandate . . .”105 The dissent claimed that it was clear that the enactment of KOSHA did not, directly or indirectly, bring into existence a new cause of action.106

Justice Keller argued that the majority opinion had misconstrued the theory that section 446.070 was a separate and independent right of action on which to base liability.107 Justice Keller claimed that KOSHA explicitly stated that it was not to affect the civil standard of liability.108 Furthermore, section 446.070 did

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98. Id. at 46-47 (emphasis in original).
99. Hargis, 168 S.W.3d at 47. See also City of Hazard Mun. Hous. Comm’n v. Hinch, 411 S.W.2d 686, 689 (Ky. 1967) (“A contract for exemption from liability for negligence is generally void and unenforceable if it is violative of the law or contrary to some rule of public policy. Such contracts are not favored by the law and are strictly construed against the party relying thereon. Clear and explicit language in the contract is required to absolve one from such liability.”).
100. Hargis, 168 S.W.3d at 47.
101. Id.
102. Id. See also D.H. Davis Coal Co. v. Polland, 62 N.E. 492, 495-96 (Ind. 1902) (holding that a provision in a contract of employment by which employee relieved employer of duty to provide safeguards required by statute was unenforceable). The court does not spend much time regarding this proposition despite its importance. See Hargis, 168 S.W.3d at 47. This might be because Baize did not know he was under a duty and the court had nullified that agreement on other grounds. See id.
103. Id. 48-51 (Keller, J., dissenting).
104. Id. at 50.
105. Id. at 48-49; KY. REV. STAT. ANN. § 338.021(2) (West 2004).
106. Hargis, 168 S.W.3d at 50 (Keller, J., dissenting).
107. Id. at 50-51 (claiming that the majority’s citation of Ellis v. Chase Commc’ns, Inc., 63 F.3d 473, 478 (6th Cir. 1995) was misplaced).
108. Id. at 50.
not create a duty that was independent of the statute—the duty that it would create would be part of the statute, not independent from it.\textsuperscript{109} Although section 446.070 does allow a right of action under Kentucky statutes that do not set forth a civil remedy, he explained, it does not have the power to go beyond the limitations that a statute imposes on itself.\textsuperscript{110}

IV. ANALYSIS

A. Independent Contractors vs. Employees

In \textit{Hargis}, Greeneville Log and Lumber hired Hargis as an independent contractor.\textsuperscript{111} As noted, there are many benefits to an employer of hiring independent contractors.\textsuperscript{112} For example, an employer does not have to pay for social security or Medicare taxes, state unemployment insurance, worker’s compensation insurance, employer provided benefits, office space, or equipment.\textsuperscript{113} An independent contractor also has no right to minimum wage or overtime, or the right to sue for discrimination or the right to form a union.\textsuperscript{114}

As argued by Baize, employers in Kentucky were under the impression that independent contractors were to be regarded as licensees and were accordingly only owed a duty to be warned of hidden dangers on the property.\textsuperscript{115} The “licensee” standard does not require a landowner to provide a reasonably safe workplace and is only one legal step above a trespasser.\textsuperscript{116} This standard seems

\begin{itemize}
\item \textsuperscript{109} Id. at 51.
\item \textsuperscript{110} Id. at 50. \textit{See also} Grzyb v. Evans, 700 S.W.2d 399, 401 (Ky. 1985).
\item Under KRS 446.070, a person injured by the violation of any statute may recover from the offender such damages as he sustained by reason of the violation. But this is limited to where the statute is penal in nature, or where by its terms the statute does not prescribe the remedy for its violation. . . . Where the statute both declares the unlawful act and specifies the civil remedy available to the aggrieved party, the aggrieved party is limited to the remedy provided by the statute. \textit{Id.} (citations omitted).
\item Perhaps in a calculated move, the majority does not address this case although the argument made by the dissent seems to be very strong. \textit{See} Hargis v. Baize, 168 S.W.3d 36, 50 (Ky. 2005). Although explanation of this oversight would be pure conjecture, it might be claimed that the court had already made up its mind the way it was going to rule and it found the legal basis it needed in the 6th Circuit instead of its own state’s case law.
\item \textsuperscript{111} Appellant’s Brief at 15, Hargis v. Baize, 168 S.W.3d 36 (Ky. 2005) (No. 2002-SC-000969-D) (stating that Hargis was made to sign a document agreeing that he was an independent contractor).
\item \textsuperscript{113} \textit{Id.}
\item \textsuperscript{114} \textit{Id.}
\item \textsuperscript{115} Hargis v. Baize, 168 S.W.3d 36, 40 (Ky. 2005).
\item \textsuperscript{116} Dan B. Dobbs, \textit{The Law of Torts} § 233 (2000).
\end{itemize}
employer-oriented.\textsuperscript{117} The traditional notion behind the licensee status was that although the licensee was on the land with the owner’s permission, the licensee was on the land for his or her own purposes and he or she was not usually providing any economic benefit to the landowner.\textsuperscript{118} Since hiring independent contractors presents a great financial benefit for the employer, the traditional justification for the licensee status (at least regarding independent contractors working at the workplace of another employer) seems to be undercut. Under the old Kentucky law, the employers were “having [their] cake and eating it too.”\textsuperscript{119} They were reaping the benefits of hiring independent contractors, while at the same time avoiding almost all liability for circumstances that were often within their control.\textsuperscript{120}

Although the court in \textit{Hargis} does not mention these factors as part of its decision, there can be little doubt that the arguments made by \textit{Hargis} fell upon attentive ears.\textsuperscript{121}

\textsuperscript{117} In some contexts this standard makes sense. \textit{See generally id.} For example, it is logical that a person who hires an independent contractor to paint his or her house would only owe the independent contractor a duty to warn of dangers that were not open and obvious. \textit{See generally id.} There has been a movement, however, in recent years to abolish the distinction of licensee and simply require a “reasonable standard of care” for all entrants besides trespassers. \textit{Id.} at § 237. \textit{See generally Rowland v. Christian,} 443 P.2d 561 (Cal. 1968).

\textsuperscript{118} \textit{DOBBS,} supra note 116, at 596.


\textsuperscript{120} \textit{Id.}

\textsuperscript{121} \textit{Id.} The court does not really couch its decision in terms of public policy, but there is little doubt that it was a major factor in the decision, considering the repercussions of allowing a private right of action under KOSHA. \textit{See generally id.} \textit{Hargis v. Baize,} 168 S.W.3d 36, 39 (Ky. 2005). A glimpse of the court’s reasoning might be found in Chief Justice Lambert’s dissenting opinion in \textit{Carman}, which contained facts almost exactly the same as \textit{Hargis}. \textit{See Carman v. Dunaway Timber Co.,} 949 S.W.2d 569, 571-72 (Ky. 1997). The majority, however, had ruled that the plaintiff was outside the scope of KOSHA because he was an independent businessman on an employer’s property to sell his own logs and not an independent contractor or employee thereof. \textit{Id.} at 571. Chief Justice Lambert argued for an even more expansive interpretation of KOSHA than the court later found in \textit{Hargis}:

\begin{quote}
The reality of what transpired here and what transpires thousands of times each year across Kentucky is that a logger working alone or with only a helper brings a load of logs to a mill. The load is transported on a truck but the logger has no unloading equipment. Under the practice observed by Dunaway and apparently observed widely in the industry, the logger must himself loosen the chains and binders, taking all the risk associated therewith, before the mill will participate. It would be vastly more reasonable to comply with the regulation by bracing the load with a front-end loader before the chains are unfastened. Those who engage in the business of buying logs from independent loggers should be required to observe applicable safety regulations and not be absolved from that duty solely because no traditional employer-employee relationship exists. \textit{Id.} at 572.
\end{quote}

The blatant normative language and allusions to “reasonableness” show that the Kentucky Supreme Court is not as far away from the realities of the lumber yards as one might think. A strict reading of the limitations placed on KOSHA by its own provisions would hinder such an expansive interpretation as the one proffered by Chief Justice Lambert. \textit{See generally id.}
B. Multi-Employer Workplace Doctrine

In *Hargis*, the Supreme Court of Kentucky made the correct choice in interpreting KOSHA to protect independent contractors working at the worksite of another employer. While the Kentucky Supreme Court does not mention the phrase exactly, the court adopted what is called the “multi-employer doctrine,” which was outlined in *Teal* and has been adopted by a majority of jurisdictions.\(^{122}\) This doctrine “provides that an employer who controls or creates a worksite safety hazard may be liable under the Occupational Safety and Health Act even if the employees threatened by the hazard are solely employees of another employer.”\(^{123}\) The doctrine originally arose in the context of the construction industry where there were often numerous employees of different employers working in the same area.\(^{124}\)

The Fifth Circuit has rejected the multi-employer doctrine and refuses to accept the proposition that OSHA protects anyone other than an employer’s employees.\(^{125}\) This confusion of intent is probably due to the lack of meaningful legislative history.\(^{126}\) The Fifth Circuit claims that because there is no real legislative intent to answer the question, there is no support for the argument that Congress (or any state legislature adopting OSHA as the basis of its health and safety laws) intended to place a duty on employers to safeguard non-employees.\(^{127}\) The courts that do adopt the doctrine, however, consistently point to the broad language and purpose of OSHA to infer intent.\(^{128}\)

The courts that do not accept the multi-employer workplace doctrine have failed to give a sound reason for their interpretation. However, in *Melerine v. Avondale Shipyards, Inc.*, the Fifth Circuit claimed that it had found support for its position regarding the purpose of OSHA by citing a subsection dealing with variances.\(^{129}\) The court argued that the provision in OSHA that allowed an employer to apply for a variance used the phrase “his employees,” thereby

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\(^{122}\) Universal Constr. Co., Inc. v. Occupational Safety and Health Review Comm’n, 182 F.3d 726, 728 (10th Cir. 1999) (stating that the court joined the majority of circuits in adopting the multi-employer doctrine). See also *Teal v. E.I. DuPont De Nemours and Co.*, 728 F.2d 799 (6th Cir. 1983).

\(^{123}\) Universal Constr. Co., Inc., 182 F.3d at 728.

\(^{124}\) Id.

\(^{125}\) Melerine v. Avondale Shipyards, Inc., 659 F.2d 706, 710-711 (5th Cir. 1981) (stating that the court, along with others, only applies OSHA to an employer’s own employees); See also Southeast Contractors, Inc. v. Dunlop, 512 F.2d 675, 675 (5th Cir. 1975) (stating the general rule that a subcontractor is not responsible for the acts of subcontractors or their employees); See also Horn v. C. L. Osborn Contracting Co., 591 F.2d 318, 321 (5th Cir. 1979) (following *Southeast Contractors, Inc.*, 512 F.2d at 675).

\(^{126}\) See Universal Constr. Co., Inc., 182 F.3d at 729.

\(^{127}\) Melerine, 659 F.2d at 711.

\(^{128}\) See *Teal v. E.I. DuPont De Nemours and Co.*, 728 F.2d 799, 804-05 (6th Cir. 1983); See also *Hargis v. Baize*, 168 S.W.3d 36, 44 (Ky. 2005); See also *Beatty Equip. Leasing, Inc. v. Sec’y of Labor*, 577 F.2d 534, 536-37 (9th Cir. 1978).

\(^{129}\) Melerine, 659 F.2d at 711 n.17.
supporting an argument that OSHA does not protect anyone but an employer’s employees.\footnote{130} The court also pointed to some legislative history in which the same phrase was used.\footnote{131} These arguments are too weak to be taken seriously. First, the language used in the provision dealing with an application for a variance does not appear in other sections of OSHA, most notably, not in the declaration of purpose and policy.\footnote{132} Additionally, the language cited from the legislative history does not indicate Congress’ intent to remove independent contractors from the scope of OSHA in the face of such a broad purpose and policy statement.\footnote{133} If an employer is in control of a workplace where he knows that there are independent contractors, it seems reasonable that the employer should owe a duty to those independent contractors to follow recognized safety regulations.\footnote{134}

C. A Private Right of Action under KOSHA

One of the most striking aspects of the Hargis opinion, and to which the dissent mainly objects, is that the court ultimately recognized a right of action through KOSHA despite the statutory provision that, on its face, seemed to take KOSHA out of the civil litigation context.\footnote{135} Section 338.021(2) of the Kentucky Revised Statutes states that KOSHA was not meant “to enlarge or diminish or affect in any manner the common law or statutory rights, duties, or liabilities of employers or employees under any law with respect to injuries, diseases, or death of employees arising out of, or in the course of employment.”\footnote{136} As the dissent points out, if there was no cause of action for an independent contractor’s injuries before KOSHA, how could KOSHA be the basis of an action thereafter?\footnote{137}

\begin{itemize}
\item \footnote{130} Id. See 29 U.S.C. § 655(d) (2004).
\item \footnote{131} The Secretary shall issue such rule or order if he determines on the record, after opportunity for an inspection where appropriate and a hearing, that the proponent of the variance has demonstrated by a preponderance of the evidence that the conditions, practices, means, methods, operations, or processes used or proposed to be used by an employer will provide employment and places of employment to his employees which are as safe and healthful as those which would prevail if he complied with the standard. Id.
\item \footnote{133} See 29 U.S.C. § 651 (2004).
\item \footnote{134} See id.
\item \footnote{135} See Hargis v. Baize, 168 S.W.3d 36, 49 (Ky. 2005).
\item \footnote{136} See id. at 45.
\item \footnote{137} Ky. Rev. Stat. Ann. § 338.021(2) (West 2004).}

137. \textit{Hargis}, 168 S.W.3d at 48.
1. An Independent Theory of Liability

Although the majority relies on section 446.070 of the Kentucky Revised Statutes (which allows a right of action under a statute that does not specify a civil remedy) as an independent theory of liability, the dissent was right to point out that the duty that section 446.070 gives effect to is not independent of KOSHA, but an integral part of it. A truly independent theory of liability could not be based on the duty that OSHA supposedly created. Thus, the interpretation of the phrase independent theory of liability became a major aspect of the decision. The majority held that section 446.070 met the requirement of independent theory, while the dissent disagreed.

Both the majority and the dissent cited Ellis v. Chase Communications, in which the Sixth Circuit stated that a duty must be owed “under a theory of liability independent of OSHA, as OSHA [itself] does not create a private right of action.” The dissent obviously interpreted this statement to be a bright line rule, in which an employer could never owe a duty to an independent contractor unless that duty came from a statute or common law duty other than KOSHA. What the dissent failed to recognize was that the statement must be interpreted within the surrounding context of the case. In Ellis, the defendant, Chase Communications, was not the “employer” of the site where the injury occurred, and thus was not responsible for the accident. The proposition that the plaintiff had to put forth a theory of liability independent of OSHA was based on the fact that the defendant was not required to follow the OSHA provisions in regards to the site of the accident, not because OSHA could never be a part of civil litigation between employers and independent contractors. In fact, an in-depth reading of the opinion leads to the conclusion that the majority would have decided differently if the employer would have been in charge of the workplace, and would therefore have applied the holding of Teal v. E.I. DuPont De Nemours and Co.
2. Expansion of Rights, Duties, and Liabilities

Setting aside the dissent’s misreading of Ellis, there is still an aspect of the Hargis opinion that will bother many students of the law. Even if section 446.070 works as an independent theory of liability to allow a right of action under KOSHA, the fact still remains that allowing a right of action involving KOSHA seems to expand the “rights, duties and liabilities, of employers . . .”149 The majority does little to assuage this.150 It simply cites Ellis for the proposition that “a violation of [OSHA] is actionable by a person for whose benefit it was enacted if the right of action arises from a source created separately from and independent of [OSHA].”151 Both the Hargis and Ellis courts fail to give a satisfactory answer to the question posed by the dissenting opinion: If there was no right of action before KOSHA, how can there be one after KOSHA that does not expand the duties and liabilities of an employer?152

The answer to this question, if there is a satisfactory explanation, might be found in similar holdings. The cases that best explain the reasoning behind the majority’s opinion are Bellamy v. Federal Express Corp.153 and Practico v. Portland Terminal Co.154 In Bellamy, an injured employee brought an action that alleged violations of the Tennessee Occupational Safety and Health Act against a property owner and a general contractor.155 The court explained that the body of law holding violations of OSHA regulations as negligence per se conflicted with opinions that held such violations were no more than evidence of negligence because of the declared intention of the statute not to affect civil liability.156 Recognizing this difference of interpretation, the court expressly adopted a negligence per se approach because it gave “maximum effect to [the] statutes and one that indeed is on the outer periphery of the force and effect intended by the legislative bodies that the statutes be given.”157 This explanation, although broad and vague, does give an actual justification for a negligence per se approach.158 The court in Bellamy did something that the court in Hargis did not do: admitted that a negligence per se interpretation of the statute was on the “outer periphery” of the intended reaches of the statute but

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149. See KY. REV. STAT. ANN. § 338.021(2) (West 2004).
150. See Hargis, 168 S.W.3d at 45.
151. Id. See Ellis, 63 F.3d at 478.
152. Hargis, 168 S.W.3d at 48.
155. Bellamy, 749 S.W.2d at 32. The court mentioned that the exclusive remedy provision of the worker’s compensation statute would probably become a pertinent issue in the case, but because the case was brought to them on appeal of a grant for summary judgment, the issue had not yet been decided. Id. at 33.
156. Id. at 34.
157. Id.
158. See id.
assumed that the legislative bodies intended the statutes be given their full force and effect.\textsuperscript{159}

In \textit{Practico}, the court analyzed whether OSHA regulations could be used as evidence of negligence or negligence per se.\textsuperscript{160} The court pointed out that section 653(b)(4) (which is the OSHA equivalent of section 338.021(2) of KOSHA) “was designed to ensure that OSHA did not permit injured employees to bypass applicable state worker’s compensation schemes through a private action in federal court…”\textsuperscript{161} The court also argued that allowing OSHA regulations as evidence of negligence should not be viewed as expanding liability of employers because “[t]he doctrine of negligence per se does not have the effect of turning reasonable, nontortious behavior into unreasonable, tortious behavior. Rather it simply allows the presence of a statutory regulation to serve as irrefutable evidence that particular conduct is unreasonable.”\textsuperscript{162} Although the section could be read to take OSHA out of the realm of civil liability, the court argued, what would be the point of the safety regulation if it was to be withheld from the triers of fact?\textsuperscript{163}

Ultimately, the answer comes down to an interpretation of whether these type of actions would \textit{expand} or \textit{affect} liability.\textsuperscript{164} A strict reading of the statute would clearly seem to answer the question in the positive, and some courts

\textsuperscript{159.} \textit{Bellamy}, 749 S.W.2d at 34. Kentucky has a statute regarding statutory interpretation in section 446.080 of the Kentucky Revised Statutes, which states: “All statutes of this state shall be liberally construed with a view to promote their objects and carry out the intent of the legislature . . .” KY. REV. STAT. ANN. § 446.080(1) (West 2004). Of course, more than a few cases have cited this statute, but it is missing from the \textit{Hargis} opinion. \textit{See} Hargis \textit{v. Baize}, 168 S.W.3d 36 (Ky. 2005). One can imagine arguments for both sides, but ultimately comes back to the dichotomy of the interpretations made by the majority and the dissent: the majority reads the broad language of the purposes of statute to reach its conclusion, while the minority simply takes the plain meaning of the words, denying that an expansive interpretation is possible. \textit{Id.} at 43-51. A theoretical analysis of judicial interpretation is beyond the scope of this comment, but for an interesting majority statement on recent statutory interpretations see \textit{Revenue Cabinet v. O’Daniel}, 153 S.W.3d 815, 819 (Ky. 2005), where the Kentucky Supreme Court stated:

It is this Court's duty when interpreting statutes to give effect to the General Assembly's intent, but “no rule of interpretation . . . require[s] us to utterly ignore the plain . . . meaning of words in a statute.” In fact, “[t]he plain meaning of the statutory language is presumed to be what the legislature intended, and if the meaning is plain, then the court cannot base its interpretation on any other method or source.” We “ascertain the intention of the legislature from words used in enacting statutes rather than surmising what may have been intended but was not expressed.” In other words, we assume that the “[Legislature] meant exactly what it said, and said exactly what it meant.” Only “when [it] would produce an injustice or ridiculous result” should we ignore the plain meaning of a statute. \textit{Id.} (alterations in original).

\textsuperscript{160.} \textit{Practico v. Portland Terminal Co.}, 783 F.2d 255, 265 (1st Cir. 1985).

\textsuperscript{161.} \textit{Id}

\textsuperscript{162.} \textit{Id}

\textsuperscript{163.} \textit{Id} at 266.

\textsuperscript{164.} \textit{See} \textit{id.} at 265-66.
cannot get past this hurdle.\textsuperscript{165} When taken with the language of the statute, however, and the willingness of other courts to adopt a more liberal interpretation, the Kentucky Supreme Court made the right decision. Perhaps there is no strong legal explanation of how allowing a negligence per se action under KOSHA does not expand the rights, duties, and liabilities of employers, but the Kentucky Supreme Court does not simply pull the theory out of thin air.\textsuperscript{166} Although the logic might be a flawed, the \textit{Hargis} holding is followed in a number of jurisdictions and does have the affect of protecting more workers under the statute, which is in line with the statute’s stated purpose.\textsuperscript{167}

D. The Effects of \textit{Hargis} v. \textit{Baize}

The effects of \textit{Hargis} are yet to be seen. The Kentucky Supreme Court might limit its outcome to cases with similar facts, meaning only independent contractors working at the jobsite of another employer of which the employer has control,\textsuperscript{168} or it could expand the holding to encompass more employer-independent contractor relationships. It should be noted that the context in which the accident happened was one where the independent contractor (Hargis) came on to the premises of an employer (Baize) with a load of logs, but was unable to unload the logs without the equipment and employees of the employer.\textsuperscript{169} Therefore, Hargis really had no choice but to follow the employer’s practices.\textsuperscript{170} This might be a potential distinguishable fact to separate \textit{Hargis} from future cases. No matter how the court rules in the future, it has sent a stern message to employers using independent contractors in the same manner as Baize: employers would be wise to make sure that they are in compliance with specific KOSHA regulations.\textsuperscript{171}

In addition to expanding KOSHA’s protection to independent contractors, the court has also limited an employer’s use of exculpatory agreements.\textsuperscript{172} By

\textsuperscript{165} Ries v. Nat’l R.R. Passenger Corp., 960 F.2d 1156, 1161 (3d Cir. 1992) (holding that when interpreting a statute, “[o]nly the most extraordinary showing of contrary intentions from [legislative history] would justify a limitation on the ‘plain meaning’ of the statutory language.”) (alterations in original).

\textsuperscript{166} Hargis v. Baize, 168 S.W.3d 36, 43-44 (Ky. 2005) (adopting the reasoning in \textit{Teal} verbatim).

\textsuperscript{167} See \textit{Teal} v. E.I. DuPont De Nemours and Co., 728 F.2d 799, 804-805 (6th Cir. 1983) (adopting a negligence per se approach to violations of OSHA); Beatty Equip. Leasing, Inc. v. Sec’y of Labor, 577 F.2d 534, 536-537 (9th Cir. 1978) (adopting a negligence per se approach to violations of OSHA ); Angel v. United States, 775 F.2d 132, 144 (6th Cir. 1985) (adopting a negligence per se approach to violations of OSHA); Bellamy v. Federal Express Corp., 749 S.W.2d 31, 34 (Tenn. 1988) (adopting a negligence per se approach to violations of OSHA or state counterparts).

\textsuperscript{168} See \textit{Hargis}, 168 S.W.3d at 43-44.

\textsuperscript{169} Id. at 39.

\textsuperscript{170} Id.

\textsuperscript{171} See id. at 43-44.

\textsuperscript{172} Id. at 47-48.
expanding KOSHA’s duties to cover independent contractors, employers may no longer try to contract away injuries caused by a violation of those duties. If the employers are going to try to use exculpatory agreements for other injuries, those agreements will be acknowledged only if:

(1) [the agreement] explicitly expresses an intention to exonerate by using the word “negligence;” or (2) it clearly and specifically indicates an intent to release a party from liability for a personal injury caused by that party’s own conduct; or (3) protection against negligence is the only reasonable construction of the contract language; or (4) the hazard experienced was clearly within the contemplation of the provision.

The holding in Hargis will no doubt prompt more plaintiffs’ lawyers to test the new waters opened to them. It should be remembered that “[a] critical question in determining whether an OSHA violation is negligence per se . . . is whether the defendant is an employer subject to the OSHA regulation in question.” A context that could potentially be greatly affected by Hargis, and where control might be difficult to assess, is the construction industry. When there are both prime contractors and subcontractors on a worksite, there are some cases requiring both parties to be responsible for OSHA violations.

IV. CONCLUSION

In Hargis v. Baize, the Kentucky Supreme Court recognized a private right of action for independent contractors injured by violations of KOSHA regulations while working at the jobsite of another employer. Despite the provision in KOSHA that prohibits the use of KOSHA in expanding the rights, duties, or liabilities of an employer with respect to injuries incurred during employment, the court used Kentucky’s statutory codification of common law

173. Hargis, 168 S.W.3d at 47-48. See generally D.H. Davis Coal Co. v. Polland, 62 N.E. 492, 495-96 (Ind. 1902) (holding that an agreement to relieve employer of duty to provide statutory safeguards was unenforceable).
174. Hargis, 168 S.W.3d at 47 (citing 57A AM. JUR. 2D Negligence § 53 (2004)).
175. Ellis v. Chase Commc’ns, Inc., 63 F.3d 473, 477 (6th Cir. 1995). In Ellis, the injury had occurred on a television tower, which the court stated was not a “regular job site on which Chase had a duty to protect its own employees.” Id. at 478.
176. See generally, Brennan v. Occupational Safety and Health Review Comm’n, 513 F.2d 1032 (2d Cir. 1975) (concluding that an employer may be cited for a violation if he is in control of a hazard area that was accessible to his employees or those of other employers engaged in a common undertaking); D. Harris Masonry Contracting Inc. v. Dole, 876 F.2d 343 (3d Cir. 1989) (holding a masonry subcontractor liable for a violation which he did not create or control because he failed to warn his employees of the hazard, or to provide any alternative protection and failed to request that the general contractor fix the condition).
177. Hargis, 168 S.W.3d at 43-46.
178. See KY. REV. STAT. ANN. § 338.021(2) (West 2004) (stating that KOSHA shall not enlarge or diminish any common law rights, liabilities or duties of employers with respect to injuries incurred during employment).
negligence per se to allow a right of action for the independent contractors. 179 The court gave little justification for its interpretation of KOSHA and its self-inhibiting provision. 180 Because the effect of allowing the right of action will further the policy behind KOSHA and because other courts have taken the same approach, the court made the right decision. 181

Overall, Hargis presents a new form of protection for independent contractors, but also a new liability to employers. It has yet to be seen what effect this case will have on any industry; or whether the benefit of protecting the independent contractors will be outweighed by the damage to employers. The extent of liability to be found under Hargis, however, should be something that remains abstract. Employers should be providing safe workplaces for both their employees and the independent contractors they hire; and, this case simply gives them incentive to do so, albeit with a stick and not a carrot.

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180. Hargis, 168 S.W.3d at 45.

181. See Teal v. E.I. DuPont De Nemours and Co., 728 F.2d 799, 804-05 (6th Cir. 1983) (adopting a negligence per se approach to violations of OSHA); Beatty Equip. Leasing, Inc. v. Sec’y of Labor, 577 F.2d 534, 536-37 (9th Cir. 1978) (adopting a negligence per se approach to violations of OSHA); Angel v. United States, 775 F.2d 132, 144 (6th Cir. 1985); (adopting a negligence per se approach to violations of OSHA); Bellamy v. Federal Express Corp., 749 S.W.2d 31, 34 (Tenn. 1988) (adopting a negligence per se approach to violations of OSHA or state counterparts).
THE FEDERAL CIRCUIT’S DE NOVO CLAIM CONSTRUCTION REVIEW STANDARD: A “TITANIC” MISJUDGMENT LEADS TO UNCERTAINTY

Anil Arora*

I. INTRODUCTION

With the increased globalization of and information technology’s pervasiveness in the United States economy,1 this country finds itself in the midst of “an important transition from a mature industrial and manufacturing economy, to an emerging entrepreneurial/innovation-driven knowledge based economy.”2 This knowledge-based economy has put a premium on “creating and commercializing ideas” with a resultant increased need to protect these ideas in the form of intellectual property rights.3 This is borne out with a 117 % increase in the number of patent applications filed with the United States Patent and Trademark Office (“PTO”) between 1990 and 2004.4

Congress had the knowledge based economy in mind when it charged “the Court of Appeals for the Federal Circuit as an exclusive appellate court for patent cases.”5 Congress did so to increase uniformity in the application of...
patent rights in order to “strengthen the United States patent system in such a way as to foster technological growth and industrial innovation.” 6 This uniformity, and consequently the knowledge-based economy, is threatened by the non-deferential review the Federal Circuit affords trial court claim constructions.

This note argues that the Federal Circuit’s purely de novo review of claim construction is improper. Section II provides an introduction to patent law and the role of claim construction. Section III discusses the critical cases that form the jurisprudential basis for the Federal Circuit’s claim construction standard of review. Section IV provides an analysis of the Federal Circuit’s claim construction standard of review, finding it to be inconsistent with precedent, inconsistent with the fact/law duality of claim construction, and confusing to the patent marketplace. Section V concludes the note.

II. BACKGROUND

Prior to presenting the seminal cases on claim construction standard of review, a brief primer on patent law, and specifically claim construction, is in order. Congress is empowered “[t]o promote the Progress of Science and useful Arts, by securing for limited Times to Authors and Inventors the exclusive Right to their respective Writings and Discoveries.” 7 In 1790, Congress first exercised this authority when it extended to inventors the right to exclude others from practicing their inventions in exchange for disclosing the invention in detail to the public. 8

Specifically, a patent document needs to have a specification and claims. 9

The specification shall contain a written description of the invention, and of the manner and process of making and using it, in such full, clear, concise, and exact terms as to enable any person skilled in the art to which it pertains, or with which it is most nearly connected, to make and use the same, and shall set forth the best mode contemplated by the inventor of carrying out his invention. The specification shall conclude with one or more claims particularly pointing out and distinctly claiming the subject matter which the applicant regards as his invention. 10

In other words, the specification describes the invention in detail, while the claims define the outer bounds of the patent. 11

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6. Id. (citing H.R. REP. No. 97-312, at 20 (1981)).
7. U.S. CONST. art. I, § 8, cl. 8.
8. Markman, 517 U.S. at 373.
9. Id.
Once an inventor submits her application to the PTO, a patent examiner reviews the application to ensure that the invention is useful, novel, and non-obvious.\textsuperscript{12} Furthermore, the information disclosed in the application must enable others to make and use the invention.\textsuperscript{13} During the examination period prior to a patent grant, a negotiation is undertaken between the inventor and the PTO to ensure that the requirements for utility, novelty, non-obviousness, and enablement are sufficiently satisfied.\textsuperscript{14}

Patent litigation arises from a defendant’s use, production, or sale of a patented invention.\textsuperscript{15} This is otherwise known as infringement.\textsuperscript{16} Infringement analysis is a two-step process.\textsuperscript{17} The first step in the process is done by the court and involves a determination of “the scope and meaning of the patent claims asserted.”\textsuperscript{18} This step is commonly known as “claim construction.”\textsuperscript{19} The second step in the analysis is done by a jury and involves a determination of whether an accused product or process infringes upon the patent claim.\textsuperscript{20}

In construing the claims, the court is attempting to define the claim terms as it would have been understood by a “person of ordinary skill in the art” (“POSITA”) at the time the patent application was filed with the PTO.\textsuperscript{21} In conducting this analysis, the court first turns to intrinsic evidence such as the patent claims themselves, the patent specification, and the prosecution history.\textsuperscript{22} If the court cannot reach clarity by evaluating the intrinsic evidence, it may turn to extrinsic evidence to aid in proper claim construction.\textsuperscript{23} This extrinsic evidence takes “the form of prior art documentary evidence or expert testimony . . .”\textsuperscript{24} The presentation of this extrinsic evidence by the opposing parties is conducted without the presence of the jury and is referred to as a Markman hearing.\textsuperscript{25}

\begin{itemize}
  \item[12.] \textit{Id.} at 1045.
  \item[13.] \textit{Id.}
  \item[14.] \textit{Id.}
  \item[16.] \textit{Id.}
  \item[17.] Cybor Corp. v. FAS Tech., Inc., 138 F.3d 1448, 1454 (Fed. Cir. 1998).
  \item[18.] \textit{Id.} (citation omitted). \textit{See also} Rai, supra note 11, at 1046 (offering that this determination requires an inquiry into what the patent claim language would have meant to a “person having ordinary skill in the art” (“PHOSITA”) at the time of the invention). The “PHOSITA” that Rai refers to is also known as a “POSITA,” or “person of ordinary skill in the art.” \textit{See} Phillips v. AWH Corp., 415 F.3d 1303, 1313 (Fed. Cir. 2005).
  \item[19.] Markman v. Westview Instruments, Inc., 52 F.3d 967, 976 (Fed. Cir. 1995).
  \item[20.] \textit{Id.}
  \item[21.] Phillips, 415 F.3d at 1313.
  \item[22.] \textit{See id.} at 1314. “Prosecution history” is the negotiation record between the PTO and the inventor prior to patent issuance. \textit{Id.} at 1317.
  \item[23.] Markman, 52 F.3d at 980. \textit{See also} Rai, supra note 11, at 1048 (stating that district courts used extrinsic evidence in 83 % of claim construction cases).
  \item[24.] Markman, 52 F.3d at 991 (Mayer, J., concurring).
\end{itemize}
parties battle over experts offering conflicting evidence regarding who qualifies as one of ordinary skill in the art; the meaning of patent terms to that person; the state of the art at the time of the invention; contradictory dictionary definitions and which would be consulted by the skilled artisan; the scope of specialized terms; the problem a patent was solving; what is related or pertinent art; whether a construction was disallowed during prosecution; how one of skill in the art would understand statements during prosecution; and on and on.\textsuperscript{26}

At the conclusion of a \textit{Markman} hearing, the trial judge sifts through the conflicting evidence to “arrive at a sound interpretation” of the disputed claim.\textsuperscript{27} With the brief primer of patent law now complete, an exposition of the leading cases that established the current de novo claim construction standard of review follows.

\section*{III. Jurisprudence}

\subsection*{A. Early Federal Circuit Cases}

The Federal Circuit was created by Congress in 1982 to serve as the sole venue to hear patent appeals.\textsuperscript{28} In so doing, Congress was attempting to bring order to what many believed was a jurisprudence in chaos.\textsuperscript{29} Thus, the mandate of the Federal Circuit was clear; it would “act as the manager and developer of the patent law” and put in place an infrastructure “yield[ing] a clearer, more coherent, and more predictable patent doctrine . . ..”\textsuperscript{30}

In the early years of its jurisprudence, the Federal Circuit acknowledged the importance of facts in claim construction.\textsuperscript{31} For instance, in \textit{McGill, Inc. v. John Zink Co.}, the court held that the claim construction, which requires the use of extrinsic evidence, was a question of fact within the purview of the jury.\textsuperscript{32}

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\textsuperscript{26} Id.
\textsuperscript{27} Id.
\textsuperscript{29} Wagner & Petherbridge, supra note 28, at 1115 (referring to similar patent cases receiving disparate treatment in different circuit courts yielding confusion in patent enforcement and encouraging rampant forum shopping).
\textsuperscript{30} Id. at 1116.
\textsuperscript{31} Rai, supra note 11, at 1057.
\textsuperscript{32} McGill, Inc. v. John Zink Co., 736 F.2d 666, 672 (Fed. Cir. 1984). \textit{See also} Palumbo v. Don-Joy Co., 762 F.2d 969, 974 (Fed. Cir. 1985) (concluding that claim construction requiring the utilization of extrinsic evidence to resolve an underlying factual inquiry should be done by the jury). \textit{See also} Data Line Corp. v. Micro Technologies, Inc., 813 F.2d 1196, 1202 (Fed. Cir. 1987) (giving deferential review to jury’s verdict on claim construction). \textit{See also} Delta-X Corp. v. Baker Hughes Production Tools, Inc., 984 F.2d 410, 415 (Fed. Cir. 1993) (approving the trial judge’s decision to allow jury to resolve claim terms dispute).
\end{flushleft}
Further, in *Bio-Rad Labs., Inc. v. Nicolet Instrument Corp.*, the court refused to review the lower courts claim interpretation de novo.\(^{33}\) Finally, in *Perini America, Inc. v. Paper Converting Mach. Co.*, the court recognized that legal conclusions are subject to resolution of underlying facts and such factual inquiries are by nature questions of fact, not matters of law.\(^{34}\) As such, the early Federal Circuit viewed claim construction as a matter of law resolved through underlying factual inquiries.\(^{35}\) These inquiries could be made by a judge or jury and would be reviewed only for clear error.\(^{36}\)

B. *Markman v. Westview Instruments, Inc.* (*Markman I*)

The first Federal Circuit case to overturn this deferential standard was *Markman v. Westview Instruments, Inc.* (*Markman I*) wherein the majority held that claim construction was a matter of law to be reviewed de novo on appeal.\(^{37}\) The majority bolstered its holding by offering that the United States Supreme Court has consistently recognized claim construction to be the sole province of the judge.\(^{38}\) Although *Markman I* recognized that the court may use extrinsic evidence when construing claims, it deemed the use of extrinsic evidence in this context as merely assisting in the construction and “not crediting certain evidence over other evidence or making factual evidentiary findings.”\(^{39}\) Finally, the majority justified its holding by insisting that treating claim construction as a matter of law will bring stability to the area of patent litigation, as litigants will be assured that a trained judge, not a novice jury, is analyzing the claims and applying the canons of construction.\(^{40}\)

In his concurring opinion in *Markman I*, Justice Mayer disagreed with the majority and argued that the court should validate its precedent that claim construction “is a matter of law depending on underlying factual inquiries.”\(^{41}\) Further, he countered the majority’s invocation of the United States Supreme Court’s view that claim construction is the province of the court.\(^{42}\) He further stated that the Court has also been unequivocal in its position that claim


\(^{34}\) *Perini America, Inc. v. Paper Converting Mach. Co.*, 832 F.2d 581, 584 (Fed. Cir. 1987).

\(^{35}\) See * supra* notes 32-34 and accompanying text.

\(^{36}\) Id.

\(^{37}\) *Markman v. Westview Instruments, Inc.*, 52 F.3d 967, 979 (Fed. Cir. 1995).

\(^{38}\) Id. at 977.

\(^{39}\) Id. at 981.

\(^{40}\) Id. at 979.

\(^{41}\) Id. at 989 (Mayer, J., concurring).

\(^{42}\) *Markman*, 52 F.3d at 989.
construction depends on a factual resolution and is therefore the province of the jury. 43 Finally, Judge Mayer argued that the majority’s holding eviscerates the Seventh Amendment right to a trial by jury because it forces the hand of the jury in an infringement action since the claim construction selected by the judge (from conflicting constructions), for all intents and purposes, decides the issue of infringement. 44 In his brief concurring opinion, Judge Rader stated that the majority should have declined to answer the question of whether claim construction could involve resolution of underlying factual inquiries because it did not need to decide the question to rule on the case. 45

In her dissenting opinion in Markman I, Judge Newman disagreed with the majority’s characterization of the trial court’s evaluation of extrinsic evidence as not engaging in factual findings by arguing that “the meaning and scope of disputed technologic and other terms of art in particular usage are classical questions of fact.” 46 Next, Judge Newman stated that the resolution of disputes involving complex technological issues is better suited for a trial court than an appellate court, where litigants are only allowed written briefs and fifteen minutes for oral advocacy, because the trier of fact is present amidst “the witnesses, the advocates, the exhibits, and the demonstrations.” 47 Finally, Judge Newman agreed with Judge Mayer’s opinion that the majority has for the most part circumvented the Seventh Amendment by “calling a question of fact a question of law.” 48 It is this last point that the United States Supreme Court addressed when it reviewed Markman I. 49

C. Markman v. Westview Instruments, Inc. (Markman II)

In Markman II, the United States Supreme Court was called on to address whether the Seventh Amendment right to a jury trial meant that claim construction was a question for the jury or the judge. 50 In writing for a unanimous Court, Justice Souter wrote that neither history nor precedent provided “clear answers” to the question. 51 Rather, relying on a functional argument that judges, not juries are better equipped to resolve disputed claim terms, Justice Souter concluded that claim construction should remain the province of the court. 52 In further supporting the Court’s holding, Justice Souter noted that because the Federal Circuit was created to bring uniformity to patent

43. Id. at 995 (Mayer, J., concurring).
44. Id. at 993.
45. Id. at 998 (Rader, J., concurring).
46. Id. at 999 (Newman, J., dissenting).
47. Markman, 52 F.3d at 999.
48. Id. at 1000 (Newman, J., dissenting).
50. Id.
51. Id. at 388.
52. Id.
jurisprudence, this purpose would be ill-served if the claim construction were submitted to juries.53

D. Cybor Corp. v. FAS Tech., Inc.

Next, we address another significant case to take up this issue, namely, Cybor Corp. v. FAS Tech., Inc. The majority in Cybor sought to reaffirm its position in Markman I that claim construction was a matter of law subject to de novo review.54 It did so to clear up a misapprehension that the Markman II Court recognized that claim construction may involve the resolution of underlying facts when the Court stated that claim construction lies somewhere between “a pristine legal standard and a simple historical fact . . . .”55 The majority labeled these words by the Markman II Court as “prefatory,” pointing only to the Court’s recognition that determining whether claim construction is a matter of law or a question of fact is not easily made.56 In conclusion, the majority noted that because Markman II only addressed the issue of where the responsibility for claim construction lies, the Court implicitly let stand the Markman I holding with respect to the standard of review for claim construction.57

In his concurring opinion in Cybor, Judge Plager agreed with the majority’s holding that claim construction is a matter of law subject to de novo review.58 He reasoned that the consideration of intrinsic and extrinsic evidence by the trial judge during claim construction is not fact-finding in the traditional sense of the term, but rather just “part of the process of understanding.”59 Judge Plager departed slightly from the majority, however, by stating that even though claim construction is reviewed de novo, some regard will be given to the trial court’s claim construction.60 Judge Bryson’s concurring opinion, adopted Judge Plager’s slightly deferential view, noting that “the district court may be better situated than we are, and that as to those aspects we should be cautious about substituting our judgment for that of the district court.”61

Judge Mayer, on the other hand, concurred, but indicated that the United States Supreme Court could have adopted the Markman I holding, but did not; and in so abstaining, the Court only determined who should interpret claims, not how they should be reviewed on appeal.62 Judge Mayer also stated that a de

53. Id. at 390.
55. Id. at 1455 (quoting Markman v. Westview Instruments, Inc., 517 U.S. 370, 388 (1996)).
56. Id.
57. Id. at 1456.
58. Id. at 1462 (Plager, J., concurring).
59. Cybor, 138 F.3d at 1462 (Plager, J., concurring).
60. Id.
61. Id. at 1463 (Bryson, J., concurring).
62. Id. at 1464.
novo review standard usurps the authority of the trial court, transforming the Federal Circuit into a court of first and last resort.63

In his dissenting opinion, Judge Rader agreed with Judge Mayer that Markman II did not address the issue of claim construction appellate review, but limited itself to the characterization of claim construction as a legal matter.64 Judge Rader continued noting that the majority’s insistence that the use of evidence in claim construction is not a factual inquiry is illogical and contrary to the practice of the trial courts.65 Harkening to the promise of Markman I that early certainty in claim construction would bring consistency and efficiency to patent infringement actions, Judge Rader argued that the de novo standard has delayed claim construction certainty well into the appellate process thereby dimming hopes of early resolution of infringement actions.66

E. Phillips v. AWH Corp.

Next, we consider the Federal Circuit’s latest case relative to the issue of claim construction standard of review. In an order granting an en banc rehearing of Phillips v. AWH Corp., the court took the rare step of requesting amicus briefs from interested parties to address seven questions.67 One of these questions, in view of Markman II and Cybor, addressed what aspects, under what circumstances, and to what extent the Federal Circuit should accord deference to trial court claim constructions.68 After receiving more than thirty amici curiae briefs,69 with a vast majority favoring greater deference for trial court claim constructions, the majority let their prior Cybor decision on the matter stand without any accompanying reasoning.70 In his concurring opinion in Phillips, Judge Lourie supported the majority’s insistence of a de novo review, but offered “that we ought to lean toward affirmance of a claim construction in the absence of a strong conviction of error.”71

In his dissenting opinion in Phillips, Judge Mayer insisted that the inquiries invoked during claim construction were inherently factual since they go to answering how a claim would be interpreted by a “person of ordinary skill in the art,” or “POSITA,” at the time of the invention.72 To further support the factual nature of claim construction inquiries, Judge Mayer stated that the answer to these inquiries cannot be generalized, but rather are useful only to the case in

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63. Id. at 1466.
65. Id. at 1474.
66. Id. at 1475-76.
68. Id. at 1328.
69. Id. at 1330 (Mayer, J., dissenting).
70. Id. at 1328.
71. Id. at 1330 (Lourie, J., concurring).
72. Phillips, 415 F.3d at 1332 (Mayer, J., dissenting).
question.73 As such, they are not as helpful in guiding future cases as the resolution of a legal question would be.74 Judge Mayer concluded that the de novo standard of review for claim construction resulted in serious problems such as “increased litigation costs, needless consumption of judicial resources, and uncertainty, as well as diminished respect for the court and less ‘decisional accuracy.’”75

IV. ANALYSIS

The Federal Circuit’s purely de novo review of claim construction is improper. This thesis will be supported in three aspects. First, the Federal Circuit’s rejection of its early claim construction review standard is inconsistent with its own jurisprudence and Markman II’s holding that claim interpretation is an issue for the judge, not jury.76 Second, claim construction is not purely a question of law, but rather a mixed issue of law and fact where the underlying factual considerations should be reviewed for clear error. Finally, the Federal Circuit’s de novo claim construction review standard has yielded confusion in the patent marketplace.77

A. A De Novo Standard of Review and Prior Precedent

Turning to the first prong of the analysis, recall that the first few years of the Federal Circuit’s claim construction jurisprudence recognized the importance of facts in claim construction.78 In fact, the Federal Circuit went so far as to adopt the deferential review standards of “substantial evidence” for claim constructions by juries and “clear error” for claim constructions by judges.79 However, in Markman and Cybor, the Federal Circuit has “declared claim construction to be entirely a question of law that is reviewed de novo.”80

In reaching its conclusion in Cybor, the majority extended the Markman II holding that claim construction was the province of the court to an improper conclusion.81 Specifically, the Cybor majority felt that claim construction is a purely legal issue involving no underlying questions of fact, thereby requiring no deference on appeal.82

73. Id.
74. Id.
75. Id. at 1334.
77. Rai, supra note 11, at 1087-88.
78. Id. at 1057. See supra notes 32-34 and accompanying text.
79. Rai, supra note 11, at 1058.
80. Id.
82. Cybor Corp. v. FAS Tech., Inc., 138 F.3d 1448, 1456 (Fed. Cir. 1998).
This presumption is inconsistent with the Federal Circuit’s own jurisprudence. For instance, in *Gardco Mfg., Inc. v. Herst Lighting Co.*, the Federal Circuit held that when inequitable conduct is raised as a defense, the court may make the determination, including the factual issue of intent.\(^{83}\) Also, the determination of whether a case meets the standard of an “exceptional case” under 35 U.S.C. § 285\(^{84}\) is a question that the court alone decides before deciding whether to award attorney’s fees.\(^{85}\) Furthermore, when considering an appeal on the grounds of obviousness, the Federal Circuit reviews “for clear error the district court’s determination of the factual inquiries underlying obviousness, whereas we review *de novo* the legal conclusion of whether a claim is invalid as obvious.”\(^{86}\) Finally, on the question of enablement, the Federal Circuit has held that “[w]hile enablement is ultimately a question of law subject to de novo review, it is based on underlying factual findings that are reviewed for clear error.”\(^{87}\) As these examples point out, there are instances in the Federal Circuit’s own jurisprudence where factual findings are vested in the judge and not the jury; and these factual findings are reviewed for clear error.\(^{88}\)

The presumption is also inconsistent with *Markman II*. In *Markman II*, the United States Supreme Court stopped short of adopting the Federal Circuit’s holding in *Markman I* that claim construction was a pure question of law to be reviewed de novo on appeal.\(^{89}\) Instead, the United States Supreme Court limited its *Markman II* decision to where the responsibility for claim construction should reside and left open the question of the scope of appellate review to be afforded claim construction.\(^{90}\) In reaching its conclusion, the United States Supreme Court admitted that neither history nor precedent provided the answer, but rather functional considerations formed the basis of its decision as claim construction fell “somewhere between a pristine legal standard and a simple historical fact . . . .”\(^{91}\)

Specifically, the United States Supreme Court argued that claim construction should be the province of the judge, not the jury, given the training

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84. 35 U.S.C. § 285 (2004) (providing that as a remedy for patent infringement the court may award reasonable attorney fees to the prevailing party in exceptional cases).
85. *See Park-Ohio Indus. v. Letical Corp.*, 617 F.2d 450, 454 (6th Cir. 1980).
86. *Golight, Inc. v. Wal-Mart Stores, Inc.*, 355 F.3d 1327, 1336 (Fed. Cir. 2004). *See generally McNeil-PPC, Inc. v. L. Perrigo Co.*, 337 F.3d 1362, 1368 (stating that obviousness is evaluated by assessing the following factors: “(1) the scope and content of the prior art; (2) the differences between the claims and the prior art; (3) the level of ordinary skill in the pertinent art; and (4) secondary considerations, if any, of nonobviousness”).
87. *Bruning v. Hirose*, 161 F.3d 681, 686 (Fed. Cir. 1998). *See generally Genentech, Inc. v. Novo Nordisk, A/S*, 108 F.3d 1361, 1363 (Fed. Cir. 1997) (stating that the enablement requirement is satisfied if, given what they already know, the specification teaches those in the art enough that they can make and use the invention without “undue experimentation”).
88. *See supra* notes 83-87 and accompanying text.
90. *Id*.
and discipline of judges in light of the complexities of modern patent claims. Because the United States Supreme Court relegated claim construction to judges on the basis of the relative capacities of judges over juries and not on the inherent legal nature of claim construction, it is unlikely the Court would view claim construction as a purely legal matter always subject to a de novo review standard.

B. Claim Construction as a Mixed Issue of Law and Fact

In support of the second prong of the analysis, recall that Markman hearings conducted by judges, in advance of infringement trials, attempt to construe claims from the perspective of the POSITA and “in view of the state of art at the time of the invention.” However, as judges are not experts in all areas of technology, it might become necessary for them to hear testimony from experts in the technology. Experts may offer conflicting evidence with respect to who qualifies as a POSITA, what the state of the art was at the time of the invention, the meaning of particular terms to a POSITA, the bounds of the relevant art, the problem sought to be resolved, etc. Accordingly, the judge must carefully consider and weigh the conflicting evidence to arrive at a reasonable construction of the claim in dispute. The process, as described above, stands in stark contrast from the Markman I majority’s characterization where the judge is “not crediting certain evidence over other evidence or making factual findings.” As such, “when the Federal Circuit Court of Appeals states that the trial court does not do something that the trial court does and must do to perform the judicial function, the court knowingly enters a land of sophistry and fiction.”

Even if the process that trial courts utilize during claim construction were to be ignored, the “nature of the questions underlying claim construction illustrate that they are factual” and require a deferential review standard. In claim construction, the underlying determinations made by trial courts are almost always specific to a particular case and not subject to generalization. For example, the determination of who qualifies as a POSITA in one case will almost never have any bearing on any subsequent case because the underlying

92. Id. at 389-90.
93. See generally id.
95. Markman, 517 U.S. at 387.
96. Phillips, 415 F.3d at 1332 (Mayer, J., dissenting).
97. Id.
100. Phillips, 415 F.3d at 1332 (Mayer, J., dissenting).
101. Id.
inquiry is very fact intensive and case specific. Because one of the major functions of an appellate court is to formulate rules of general applicability, nothing can be gained from subjecting underlying factual determinations that “are either so variable or so specific that they are unlikely to recur” to de novo review.

With an understanding of why the underlying determinations of a claim construction are factual, we can now proceed to an exposition of the appropriate review standard for said determinations. Federal Rule of Civil Procedure section 52(a) provides that “[f]indings of fact, whether based on oral or documentary evidence, shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the trial court to judge of the credibility of the witnesses.” The United States Supreme Court has emphasized the authority of this rule by stating that the review of factual findings under the deferential clear error standard is the rule, not the exception. Certain categories of factual findings, including “those described as ‘ultimate facts’ because they determine the outcome of the litigation,” are not excluded from compliance with the rule. That being said, there is an obligation on the Federal Circuit to review a trial court’s underlying claim construction factual determinations, which ultimately decides patent infringement actions, under a clearly erroneous standard. It should also be noted that of those amici curiae that supported the preservation of the current de novo review standard for underlying claim construction factual inquiries, all conceded that there were some instances when clear error standard would be more appropriate.

102. Id. at 1333.
106. Id.
108. See Brief of Amicus Curiae Association of Corporate Counsel at 20-21, Phillips v. AWH Corp., 415 F.3d 1303 (Fed. Cir. 2005) (Nos. 03-1269, -1286), available at http://patentlaw.typepad.com/patent/files/acc.pdf (“As with any question of law, however, determinations of fact may be embedded in the lower court’s legal conclusion. If so, such factual findings should be reviewed under the usual ‘clearly erroneous’ standard.”); Brief of Amicus Curiae The Intellectual Property Law Association of Chicago at 19-20, Phillips v. AWH Corp., 415 F.3d 1303 (Fed. Cir. 2005) (Nos. 03-1269, -1286, available at http://iplac.org/Briefs/Amicus_Curiae-Phillips_Brief.pdf (stating that the Federal Circuit “should give deference only to purely factual findings which inform the claim construction process, but it should review the ultimate conclusion as a matter of law, de novo, without any deference.”).
C. Uncertainty in the Patent Marketplace

In addressing the third prong of the analysis, recall the importance of claim construction in the eventual resolution of a patent infringement action. Markman I promised, through the institution of Markman hearings, to bring early certainty to the meaning of patent claims. This, in turn, would bring early resolution to many patent suits. The theory was that claim construction by trial courts prior to the commencement of a trial would inform parties as to the probable outcome of a trial, thereby facilitating a settlement of the patent dispute prior to trial.

In practice, the Federal Circuit’s de novo review of claim construction has resulted in a reversal of 37.3% of lower court claim constructions. The import of this statistic is that in order to get certainty with respect to a patent claim, the parties must endure a Markman hearing, discovery, trial, post trial motions, and argument to the Federal Circuit. This reality changes the strategy at the trial level “from litigating for the correct claim construction to preserving ways to compel reversal on appeal . . . .” This relatively high reversal rate reduces the predictability and stability of the Federal Circuit’s claim construction jurisprudence.

109. Wagner & Petherbridge, supra note 28, at 1119. See also supra notes 17-20 and accompanying text.
111. Id.
112. Id. at 1475-76. See also id. at 1475, n. 3 (noting that the “likelihood of settlement” diminishes when there is uncertainty as to the outcome because it causes “each party to overestimate its chance of prevailing.”) See generally Richard A. Posner, The Federal Courts: Challenge and Reform, 89-94 (1996) (arguing that if the probability of plaintiff obtaining damages, p, multiplied by the expected value of a judgment for plaintiff, J, multiplied by the result of p(J) is greater than the cost of litigation, c, then plaintiff will sue (i.e. plaintiff sues if p(J)p(J)) > c).
113. Cybor, 138 F.3d at 1476, n.4 (Rader, J., dissenting) (stating that of the 141 district courts and Court of Federal Claims cases that the Federal Circuit reviewed, between April 5, 1995 and November 24, 1997, expressly for claim construction, the court reversed 54 of these cases in whole or in part). See generally Wagner & Petherbridge, supra note 28, at 1133-1134, 1176 (arguing that empirical data supports the contention that the district court claim construction reversals are significantly related to two distinct methodological claim construction approaches taken by the Federal Circuit judges: procedural, where there is a strong presumption in favor of the ordinary meaning of a claim term and any alteration from this ordinary meaning would have to be compelling under the circumstances; and holistic, where the correct meaning of a claim is sought in light of the circumstances presented). Thus, the claim construction that results from appeal depends on the methodological approaches of the majority of judges empanelled to hear said appeal. See id.
114. Cybor, 138 F.3d at 1476 (Rader, J., dissenting).
115. Id.
116. Id. See also Wagner & Petherbridge, supra note 28, at 1155 (arguing that although there is a trend toward proceduralism among the current Federal Circuit judges, there still remain a fervent few holistic judges).
The de novo standard for claim construction has had a “domino effect” on other aspects of patent jurisprudence and the patent marketplace.117 With respect to jurisprudence, the Federal Circuit has, after overturning a trial court’s claim construction, determined the question of infringement on its own by declaring “that there can be no factual dispute with respect to infringement.”118 In so doing, the Federal Circuit has extended the de novo standard to cover infringement, which under its own jurisprudence turns on factual inquiries.119 With respect to the marketplace, the relatively high reversal rate has emboldened more people and firms to file more patents very closely related to existing patents, thus creating “patent thickets,”120 and uncertainty has caused owners of dubious patents to file cases to enforce them.121 Finally, the domino effect has resulted in the doubling of patent lawsuits filed in the federal district courts over the past few years.122

V. CONCLUSION

By adopting a de novo standard of review for claim construction, the Federal Circuit contradicts its own precedent and the United States Supreme Court’s holding in Markman II.123 By viewing claim construction as strictly a matter of law subject to de novo review on appeal, the Federal Circuit ignores the realities of the underlying factual inquiries undertaken by trial courts in construing claims.124 By clinging to an untenable de novo standard of review for claim construction, the Federal Circuit has, contrary to its intended function, wrought confusion to the patent marketplace.125 In future reconsideration of the de novo standard of review, the Federal Circuit would be well-served in heeding Judge Mayer’s observations of the majority’s opinion in Phillips when he stated that “[t]he court’s opinion is akin to rearranging the deck chairs on the Titanic--the

117. Rai, supra note 11, at 1059-60. See also National Academy of Public Administration, U.S. Patent and Trademark Office: Transforming to Meet the Challenge of the 21st Century 16-17 (August 2005), available at http://www.napawash.org/Pubs/PTO8-25-05.pdf (stating that there are a disproportionate number of patents upheld in different circuits.).
118. Rai, supra note 11, at 1060.
119. Id.
120. NATIONAL ACADEMY OF PUBLIC ADMINISTRATION, supra note 117, at 17 (offering, as an example, that a patent for a smooth handle screwdriver will elicit applications for textured handle screwdrivers and shorter screw drivers).
121. ADAM B. JAFFE & JOSHUA LERNER, INNOVATION AND ITS DISCONTENTS: HOW OUR BROKEN PATENT SYSTEM IS ENDANGERING INNOVATION AND PROGRESS, AND WHAT TO DO ABOUT IT 105-06 (2004).
122. Id. at 17 (offering that the number of patent lawsuits settled in or disposed of in federal district courts increased from 1,200 in 1998 to nearly 2,400 in 2001).
123. See supra notes 78-93 and accompanying text.
124. See supra notes 94-108 and accompanying text.
125. See supra notes 109-122 and accompanying text.
orchestra is playing as if nothing is amiss, but the ship is still heading for Davey Jones’ locker.”
