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CHALLENGES PRESENTED TO MILITARY LAWYERS REPRESENTING DETAINEES IN THE WAR ON TERRORISM

*MATTHEW IVEY**

INTRODUCTION

On September 11, 2001, four planes were hijacked and used in attacks on the Pentagon and World Trade Center.[1] In the days that followed, Congress authorized the use of military force against "those nations, organizations, or persons" determined to be responsible for these terrorist acts.[2] In early October 2001, the United States and its allies launched missile and air strikes against the Taliban and al Qaeda in Afghanistan.[3] In the ensuing fighting on the ground, many prisoners were captured and approximately 700 persons were sent to the facilities at Guantanamo Bay, some arriving as early as January 11, 2002.[4]

In a Military Order dated November 13, 2001, President George W. Bush announced that military commissions would administer trials of detainees captured in Iraq or Afghanistan who were believed to have "engaged in, aided or abetted, or conspired

* Matthew Ivey is a Lieutenant in the United States Navy. The views expressed in this paper are the Author's own. They do not necessarily represent the views of the Department of Defense, the United States Navy, or any of its components. The Author would like to thank Professor Frank R. Herrmann, S.J., for his guidance and mentorship on this project. The Author would also like to thank military prosecutors and defense lawyers for their assistance in researching this project, especially Lieutenant Colonel Colby C. Vokey, United States Marine Corps (retired). Finally, the Author would like to thank the staff of the *New York University Annual Survey of American Law* for their outstanding editorial assistance, especially Dominique Windberg and Daniel Passeser.

1. NAT'L COMM'N ON TERRORIST ATTACKS UPON THE U.S., THE 9/11 COMM'N REPORT: FINAL REPORT OF THE NATIONAL COMMISSION ON TERRORIST ATTACKS UPON THE UNITED STATES (2003).

2. Authorization for Use of Military Force, Pub. L. No. 107-40, 115 Stat. 224 (2001) (codified as amended in 50 U.S.C. §§ 1541–48 (2006)) [hereinafter AUMF].

3. Jason Straziuso, *U.S. Plans for Longer Stay in Afghanistan*, CHI. TRIB., Oct. 7, 2007, at 16.

4. *See* Carol D. Leonnig & Julie Tate, *Some at Guantanamo Mark Five Years in Limbo; Big Questions About Low-Profile Inmates*, WASH. POST, Jan. 16, 2007, at A1; Steve Vogel, *U.S. Takes Hooded, Shackled Detainees to Cuba*, WASH. POST, Jan. 11, 2002, at A10.

to commit, acts of international terrorism."[5] Pursuant to this order, Secretary of Defense Donald Rumsfeld established procedures for military commissions.[6] Thus, the United States has since faced a need to develop rules for military commissions that allow the nation to protect its security while adhering to international standards of human rights and respect for due process.

Since their inception, these military commissions have been subject to controversy and legal challenges.[7] President Barack Obama described the events of the past seven years at Guantanamo Bay as a "sad chapter in American history" and promised to close down the prison.[8] On January 21, 2009, President Obama ordered the suspension of all prosecutions of Guantanamo Bay detainees for 120 days to allow his administration to review all detainee cases.[9] Shortly thereafter, President Obama issued an executive order mandating the closure of Guantanamo Bay within a year.[10] Although President Obama has called for review of all detainee files and for the closure of the facility within the year,[11] his plans have seen some setbacks. Many of the detainees have incomplete or nonexistent files.[12] Further, although some detainees have been cleared for release, there has been difficulty in the repatriation process in parent countries.[13] Undoubtedly, the U.S. government will continue to have to make difficult decisions regarding the legal process afforded to detainees at Guantanamo. Of the 700 detain-

5. Military Order of Nov. 13, 2001, Detention, Treatment, and Trial of Certain Non-Citizens in the War Against Terrorism, 66 Fed. Reg. 57,833 (Nov. 16, 2001).

6. *See* Department of Defense Military Commission Order No. 1 (Mar. 21, 2002), *available at* http://www.defense.gov/news/Mar2002/d20020321ord.pdf.

7. *See, e.g.*, Mary Cheh, *Should Lawyers Participate in Rigged Systems? The Case of the Military Commissions*, 1 J. NAT'L SEC. L. & POL'Y 375, 379 (2005); Joshua L. Dratel, *Ethical Issues in Defending a Terrorism Case: How Secrecy and Security Impair the Defense of a Terrorism Case*, 2 CARDOZO PUB. L. POL'Y & ETHICS J. 81 (2003–2004); David Glazier, *Full and Fair by What Measure?: Identifying the International Law Regulating Military Commission Procedure*, 24 B.U. INT'L L.J. 55, 58 (2006).

8. Stephanie Hessler, *What to do about the Gitmo Detainees; The Ball is in Congress's Court*, WEEKLY STANDARD, Feb. 2, 2009; *see also* Peter Finn, *Guantanamo Closure Called Obama Priority*, WASH. POST, Nov. 12, 2008, at A1.

9. Peter Finn, *Obama Seeks Halt to Legal Proceedings at Guantanamo*, WASH. POST, Jan. 21, 2009, at A2; Carol J. Williams, *Guantanamo Judge Says He's Forging Ahead; He Defies Obama's Request to Suspend Tribunal Proceedings*, L.A. TIMES, Jan. 30, 2009, at A9.

10. *See* Exec. Order No. 13,492, 74 Fed. Reg. 4897 (Jan. 27, 2009).

11. *See id.*

12. Karen DeYoung & Peter Finn, *Guantanamo Case Files in Disarray—Situation Complicates Prison's Closure*, WASH. POST, Jan. 25, 2009, at A5.

13. *Uighurs Ask Supreme Court for Their Freedom*, MIAMI HERALD, Apr. 6, 2009.

ees who were charged under the original military commissions trial procedures, only a handful were re-charged following the United States Supreme Court's 2006 decision in *Hamdan v. Rumsfeld*[14] and even fewer were re-charged following the Military Commissions Act of 2006.[15] The attorneys, whether civilian or military commissioned, appointed to defend these individuals have faced innumerable challenges.

Many civilian attorneys have traveled to Guantanamo in order to defend detainees, and many attorneys continue to work on detainee issues from outside Guantanamo, both in the United States and elsewhere in the world.[16] This Article, however, will focus specifically on military defense attorneys in the Judge Advocate General's Corps (JAGs).[17] Military defense attorneys have a unique place in both the legal profession and the armed services. According to noted ethicist Professor David Luban:[18]

> The JAG Corps is a fascinating segment of the legal profession, and it cries out for a detailed ethnography. . . . In obvious ways, JAGs' identities are lawyers set apart from other military officers. Some, to be sure, began their career as warriors. . . . While many JAGs regard themselves proudly as warriors and lawyers, common-sense psychology suggests that their dual

14. Hamdan v. Rumsfeld, 548 U.S. 557 (2006).

15. Military Commissions Act of 2006, Pub. L. No. 109-366, 120 Stat. 2600 (2006).

16. *See generally* Neal Kumar Katyal, Hamdan v. Rumsfeld: *The Legal Academy Goes to Practice*, 120 HARV. L. REV. 65 (2006); Peter Margulies, *True Believers at Law: National Security Agendas, the Regulation of Lawyers, and the Separation of Powers*, 68 MD. L. REV. 1 (2008); Jenny S. Martinez, *Process and Substance in the "War on Terror,"* 108 COLUM. L. REV. 1013 (2008).

17. JAG officers are commissioned officers who serve as lawyers in each branch of the U.S. military. Since Congress adopted the Uniform Code of Military Justice (UCMJ) after World War II, JAGs are required to be trained lawyers and members in a state bar. 10 U.S.C. § 827(b)(1) (2000). JAG officers can serve in a variety of legal roles, including criminal litigation. Lawyers assigned as defense attorneys are known as "detailed defense attorneys." *See* Michael A. Newton, *Modern Military Necessity: The Role & Relevance of Military Lawyers*, 12 ROGER WILLIAMS U. L. REV. 877 (2007).

18. David Luban is the Frederick Haas Professor of Law and Philosophy at Georgetown University's Law Center and Department of Philosophy. He has published extensively on legal ethics, international criminal law and international human rights, just war theory, jurisprudence, and moral responsibility within complex organizations. Georgetown Philosophy Department (David Luban) (Mar. 8, 2004), http://philosophy.georgetown.edu/faculty/bios/luban.htm.

identity may make them more, rather than less, zealous than civilian lawyers in their defense of rule-of-law values.[19]

Professor Luban recognized that "JAGs have shared a dual professional identity as military officers and lawyers."[20] This Article will focus, in part, on the dual role of JAG officers as warriors and attorneys and the conflicts that may arise from this.

A variety of factors have posed difficulties for military defense attorneys in Guantanamo Bay. The legal process employed there has been in a constant state of flux.[21] Detainees have not always cooperated with their military attorneys.[22] The government and military officials have put pressure on the military attorneys.[23] Finally, military defense attorneys have struggled with numerous personal and professional ethical issues.[24]

Part I will discuss the systemic challenges that military defense attorneys face in their pursuit of defending detainees, focusing on the evolving legal process employed at Guantanamo and reviewing detainee petitions in the Supreme Court. Part II will examine challenges stemming from detainee attempts to subvert the legal process and other barriers to establishing attorney-client rapport. Part III will evaluate the tools and techniques a military defense attorney utilizes to provide effective representation to Guantanamo detainees in the face of these challenges. Part IV will conclude the Article with some best practices and policy recommendations for improving representation of Guantanamo detainees in light of these challenges.

I.
SYSTEMIC CHALLENGES

A. A Constantly Evolving Legal Process

The legal process in Guantanamo Bay has been anything but predictable, creating many challenges for military defense lawyers. The Bush Administration's approach to the continued detention of Guantanamo detainees was conceptually based on the idea of a "war on terror."[25] In 2001, Congress passed the Authorization for

19. David Luban, *Lawfare and Legal Ethics in Guantanamo*, 60 STAN. L. REV. 1981, 2000 (2008).

20. *Id.* at 1999.

21. *See infra* Part I.A.

22. *See infra* Part II.

23. *See infra* Part III.C.

24. *See infra* Part III.E.

25. *See generally* JACK L. GOLDSMITH, THE TERROR PRESIDENCY: LAW AND JUDGMENT INSIDE THE BUSH ADMINISTRATION (2007). The "war on terror" was founded

Use of Military Force (AUMF) that gave the President the power to use "all necessary and appropriate force against those nations, organizations, or persons determined planned, authorized, committed, or aided the terrorist attacks that occurred on September 11, 2001."[26]

Military defense attorneys initially faced complications concerning the classification of detainees.[27] The Bush Administration determined that the power to detain enemy combatants was incident to the executive's power to wage war, as authorized by Congress in the AUMF.[28] Whether a detainee is treated as a criminal defendant, a prisoner of war, a lawful enemy combatant, or something else entirely is of great consequence to the legal process afforded to the detainee and the detainee's defense strategy.[29] Scholars and military lawyers have asserted that it has been difficult to discern the government's process in designating a detainee as an enemy combatant or a criminal defendant.[30] The cases of John Walker Lindh and Yaser Esam Hamdi, both captured in Afghanistan, are instructive. The government deemed Lindh a criminal defendant and prosecuted him in federal court for providing material support to a designated foreign terrorist organization.[31] Hamdi was detained for more than three years as an enemy combatant.[32] Some have gone so far as to allege that government prosecutors

on the concept that the United States is at war with terrorist organizations and those who supported these terrorist organizations. *Id.* at 102–15.

26. AUMF, *supra* note 2.

27. *See* Tung Yin, *Coercion and Terrorism Prosecutions in the Shadow of Military Detention*, 2006 BYU L. REV. 1255, 1259 (2006).

28. *Id.* at 1258.

29. *See id.* at 1259. For example, both prisoners of war and criminal defendants are entitled to a variety of procedural rights, including indictment by a grand jury, appointed or hired counsel, presumption of innocence, trial by a jury of peers, and, perhaps most importantly, proof of guilt must be beyond a reasonable doubt. Protocol Additional to the Geneva Conventions of 12 August 1949, and Relating to the Protection of Victims of International Armed Conflicts, Jun. 8, 1977, U.N. Doc A/32/144. In contrast, in the first few years of the war on terrorism, an unlawful enemy combatant was denied all of these rights. *See* Hamdi v. Rumsfeld, 542 U.S. 507, 552 (2003); Tom Jackman & Dan Eggen, *"Combatants" Lack Rights, U.S. Argues; Brief Defends Detainees' Treatment*, WASH. POST, June 20, 2002, at A1.

30. *See* Yin, *supra* note 27, at 1259.

31. *"I Made a Mistake by Joining the Taliban"; Apologetic Lindh Gets 20 Years*, WASH. POST, Oct. 5, 2002, at A1; *A Plea for Forgiveness / Lawyers: Lindh Believes his Joining Taliban was a Mistake*, NEWSDAY, Sept. 1, 2002, at A7.

32. *See* Hamdi, 542 U.S. at 552; Jackman & Eggen, *supra* note 29; *Prosecutors Detail "Enemy Combatant" Case*, N.Y. TIMES, July 26, 2002, at A19.

have manipulated the status determinations in order to use them as leverage when negotiating pre-trial plea agreements.[33]

The designation of "enemy combatant" has proved difficult to define and apply, as members of terrorist organizations generally try to conceal their identities and blend into civilian populations.[34] Furthermore, the law of war contemplates that those designated as "enemy combatants" will be released when the war concludes.[35] It will be difficult to tell when this war concludes, if ever.[36]

This environment has created difficulty for military attorneys attempting to advise their clients of their procedural rights. Several military and civilian lawyers, frustrated with the uncertain legal process at Guantanamo Bay, have sought clarification of detainee rights in the Supreme Court.[37]

B. Detainee Petitions in the Supreme Court

The detainee cases that have been heard by the United States Supreme Court highlight some of challenges and frustrations faced by military attorneys. In 2004, in *Hamdi v. Rumsfeld*,[38] the Supreme Court determined that a citizen-detainee is entitled to legal representation, even when detained as an enemy combatant.[39] Further, pursuant to *Mathews v. Eldridge*,[40] the Court determined that citizen-detainees seeking to challenge classification as an enemy combatant were entitled to receive notice of the factual basis for their classification and a fair opportunity to rebut the government's factual assertions before a neutral decisionmaker.[41]

The scope of these rights, however, was somewhat unclear. In a plurality opinion by Justice O'Connor, the Court stated that the detainee was only entitled to counsel "in connection with the issues

33. *See, e.g.*, Yin, *supra* note 27, at 1259.

34. U.S. DEP'T OF ARMY, FIELD MANUAL 3–24: COUNTERINSURGENCY D-5 (2006).

35. Geneva Convention Relative to the Treatment of Prisoners of War art. 3, Aug. 12, 1949, 6 U.S.T. 3316, 75 U.N.T.S. 135 (referring to release of prisoners at end of hostilities).

36. Attorney General Michael B. Mukasey, Remarks Prepared for Delivery at the American Enterprise Institute for Public Policy Research (July 21, 2008), *available at* http://www.justice.gov/archive/ag/speeches/2008/ag-speech-0807213.html (stating that "although wars traditionally have come to an end that is easy to identify, no one can predict when this one will end or even how we'll know it's over").

37. *See infra* Part I.B.

38. Hamdi v. Rumsfeld, 542 U.S. 507 (2004).

39. *See id.* at 510–13.

40. Mathews v. Eldridge, 424 U.S. 319 (1976).

41. *Hamdi*, 542 U.S. at 534 (citing *Mathews*, 424 U.S. 319).

on remand."[42] Some scholars have concluded that Justice O'Connor's opinion should be read quite narrowly, recognizing the right to legal counsel only for the status hearing to challenge a citizen's classification as an enemy combatant.[43] In other words, the right to counsel would not extend to broader challenges, such as the President's authority to detain citizen combatants.[44]

In *Rasul v. Bush*,[45] the Court granted certiorari on the petition for a Writ of Habeas Corpus on behalf of two British citizens, Shafiq Rasul and Asif Iqbal, and an Australian citizen, David Hicks.[46] The three men were not notified of the charges against them and had not appeared before any type of military or civilian tribunal.[47] Further, the men had not been informed of their rights, nor had they been able to contact counsel.[48] The Supreme Court ruled that these detainees were entitled to invoke the statutory habeas jurisdiction of the federal courts to challenge their detention.[49]

Perhaps most notably, in 2006, the Court decided the case of *Hamdan v. Rumsfeld*, involving a Yemeni national alleged to have served as Osama bin Laden's personal driver.[50] Hamdan challenged his detention in federal court.[51] In reply, the government filed a motion to dismiss, maintaining that the Detainee Treatment Act of 2005 (DTA)[52] barred a detainee from seeking review in fed-

42. *Id.* at 539.

43. Yin, *supra* note 27, at 1293.

44. *Id.*

45. Rasul v. Bush, 542 U.S. 466 (2004).

46. David Hicks is an Australian citizen who converted to Islam and trained with al-Qaeda. Hicks was captured by the Afghan Northern alliance and sold to U.S. forces. As the first detainee charged under the MCA, Hicks pleaded guilty to "providing material support for terrorism." After his conviction, Hicks was repatriated to Australia, where he served the remainder of his sentence. *See* Michael Melia, *Australian Gitmo Detainee Gets 9 Months*, WASH. POST, Mar. 31, 2007, *available at* http://www.washingtonpost.com/wp-dyn/content/article/2007/03/31/AR2007033100279_3.html; Carol J. Williams, *Terror Suspect Pleads Guilty; Australian* DAVID HICKS' Admission Caps a Day of Legal Wrangling at the Guantanamo Tribunal, L.A. TIMES, Mar. 27, 2007, at A1; Elise Labott, *U.S., Australia Reach Detainee Agreement*, CNN.COM, Nov. 26, 2003, http://www.cnn.com/2003/LAW/11/26/guantanamo.hicks/index.html.

47. *Rasul*, 542 U.S. at 472.

48. *Id.*

49. *Id.* at 483.

50. Hamdan v. Rumsfeld, 548 U.S. 557, 570 (2006).

51. *Id.* at 567.

52. Detainee Treatment Act of 2005, Pub. L. No. 109-148, §§ 1001–06, 119 Stat. 2739, 2739–44, *available at* http://thomas.loc.gov/cgi-bin/cpquery/T?&report=hr359&dbname=109&.

eral court.[53] The Supreme Court held that the military commission's procedure violated numerous aspects of U.S. and international law, including the Uniform Code of Military Justice (UCMJ)[54] and Geneva Conventions Common Article 3.[55] The Court held that the DTA applied only prospectively and that Hamdan retained the right, recognized in *Rasul v. Bush*, to challenge his detention.[56]

In response to the Court's decision in *Hamdan*, Congress passed the Military Commissions Act (MCA) in 2006, authorizing "trial by military commission for violations of the law of war, and for other purposes."[57] Furthermore, the MCA attempted to definitively establish what constitutes a "lawful"[58] or "unlawful"[59] enemy combatant. Nevertheless, the MCA still faced challenges in the Supreme Court. In the consolidated cases of *Al Odah v. United States* and *Boumediene v. Bush*, the Court found the MCA to be unconstitu-

53. *Hamdan*, 548 U.S. at 572.

54. *Id.* at 620–21. The Court held that the commission's procedures failed to comply with UCMJ Article 36(b), 10 U.S.C. § 836(b), which required that the procedural rules that the President promulgated for military commissions and courts-martial be "uniform insofar as practicable."

55. *Id.* at 629–30 (holding that commission's procedures violated Geneva Conventions because commissions did not meet Common Article 3 requirement that detainee be tried by "regularly constituted court affording all the judicial guarantees which are recognized as indispensable by civilized peoples").

56. *Id.* at 650–51.

57. Military Commissions Act of 2006, Pub. L. No. 109-366, 120 Stat. 2600 (2006).

58. Military Commissions Act of 2006 § 948(a) ("The term 'lawful enemy combatant' means a person who is—

(A) a member of the regular forces of a State party engaged in hostilities against the United States;

(B) a member of a militia, volunteer corps, or organized resistance movement belonging to a State party engaged in such hostilities, which are under responsible command, wear a fixed distinctive sign recognizable at a distance, carry their arms openly, and abide by the law of war; or

(C) a member of a regular armed force who professes allegiance to a government engaged in such hostilities, but not recognized by the United States.").

59. *Id.* ("The term 'unlawful enemy combatant' means—

(i) a person who has engaged in hostilities or who has purposefully and materially supported hostilities against the United States or its co-belligerents who is not a lawful enemy combatant (including a person who is part of the Taliban, al-Qaida, or associated forces); or

(ii) a person who, before, on, or after the date of the enactment of the Military Commissions Act of 2006, has been determined to be an unlawful enemy combatant by a Combatant Status Review Tribunal or another competent tribunal established under the authority of the President or the Secretary of Defense.").

tional.[60] In doing so, the Court determined that constitutional habeas corpus rights applied to all Guantanamo detainees.[61] Despite the seeming finality of this decision, *Boudemiene*, like other Supreme Court cases involving the war on terror, left many questions open, including the scope of the executive's power to detain.[62]

Shortly after his inauguration on January 22, 2009, President Barack Obama issued an executive order ordering the Secretary of Defense to take steps immediately sufficient to ensure that no new charges be referred to a military commission under the MCA and the Rules for Military Commissions.[63] Further, President Obama ordered the immediate halt of any military commission in which no judgment had been rendered, and of all proceedings pending in the United States Court of Military Commission Review.[64]

The future of legal process for the Guantanamo detainees is unclear. Undoubtedly, it will undergo further modifications and changes.[65] Some have suggested eliminating the military tribunals and offering process to the detainees in Military Courts—martial or Article III courts.[66] Many have advocated for an entirely new legal system, including a National Security Court, which would consist of judges specifically trained in matters relating to terrorism and na-

60. *See* Boumediene v. Bush, 128 S. Ct. 2229, 2269 (2008).

61. *Id.*

62. *See id.* at 2276. *See also* Matthew C. Waxman, *Administrative Detention of Terrorists: Why Detain, and Detain Whom?*, 3 J. NAT'L SECURITY L. 1, 2 (2009); Benjamin Wittes, Editorial, *Congress's Guantanamo Burden*, WASH. POST, June 13, 2008, at A23.

63. *See* Exec. Order No. 13,492, 74 Fed. Reg. 4897 (Jan. 27, 2009).

64. *See id.* Even the President's order faced challenges. A military commission judge, Colonel James Pohl, ruled against the executive order in the case of Abd al-Rahim al-Nashiri, and continued with military proceedings. *Judge Won't Halt Hearing on USS Cole Suspect*, RICHMOND TIMES (Va.), Jan. 30, 2009, at A4. Abd ad-Rahim al-Nashiri faced the death penalty for his participation in the 2000 bombing of the USS Cole. On February 2, 2009, the government withdrew charges against al-Nashiri, forgoing further action from the President. Carl Rosenberg, *Standoff Averted: Defense Official Dismisses Charges*, MIAMI HERALD, Feb. 6, 2009.

65. *See, e.g.*, Waxman, *supra* note 62, at 8–10 (providing comprehensive description of options for legal process at Guantanamo Bay).

66. LIBERTY AND SECURITY COMM'N & COALITION TO DEFEND CHECKS AND BALANCES, THE CONSTITUTION PROJECT, A CRITIQUE OF "NATIONAL SECURITY COURTS" 4–5 (2008). *But see* Kenneth Anderson, *What to Do with Bin Laden and Al Qaeda Terrorists?: A Qualified Defense of Military Commissions and United States Policy on Detainees at Guantanamo Bay Naval Base*, 25 HARV. J.L. & PUB. POL'Y 591, 611 (2002) ("U.S. district courts are, by constitutional design, for criminals and not for those who are at once criminals and enemies. U.S. district courts are eminently unsuited by practicality but also by concept for the task of addressing those who planned and executed September 11.").

tional security.[67] Others have called for the expansion of the jurisdiction of the Foreign Intelligence Surveillance Court.[68]

Such a constantly evolving legal landscape presents great challenges to military attorneys. A defense lawyer has an ethical duty to provide his or her client with an assessment of the likelihood of different outcomes.[69] Some scholars and judges have maintained that defense counsel has a constitutional duty "to advise clients whether to plead guilty or proceed to trial, and, if necessary, to attempt to persuade clients to accept their advice."[70] From a client-centered perspective, this allows the client to make an informed decision about how to proceed.[71] Because of the unpredictable nature of the process, military defense attorneys have had difficulties presenting firm legal options to detainees. This has led to increased mistrust between Guantanamo military attorneys and their clients.[72]

According to Major Mori, the defense attorney for David Hicks:

> Stepping into it, I thought I was going to be involved in court-martials [sic]. I have plenty of experience dealing with court-martials and that's [sic] the laws we would be using. Unfortunately what I found out [sic] that we were in something different, something completely made up and resurrected from 1942.[73]

67. *E.g.*, Matthew Ivey, *A Framework for Closing Guantanamo Bay*, 32 B.C. INT'L & COMP. L. REV. 353, 367, 373 (2009); Jack L. Goldsmith & Neal Katyal, Op-Ed, *The Terrorists' Court*, N.Y. TIMES, July 11, 2007, at A19.

68. *See* PHILIP B. HEYMANN & JULIETTE N. KAYYEM, PROTECTING LIBERTY IN AN AGE OF TERROR 18, 51–52 (2005).

69. STANDARDS FOR CRIMINAL JUSTICE, PROSECUTION FUNCTION AND DEFENSE FUNCTION, §§ 4-5.1(a) to (b) (1993).

70. Steven Zeidman, *To Plead or Not To Plead: Effective Assistance and Client-Centered Counseling*, 39 B.C. L. REV. 841, 894 (1997) (discussing Boria v. Keene, 99 F.3d 492 (2d Cir. 1996)). *See also* United States v. Day, 969 F.2d 39, 43 (3d Cir. 1992); Dan K. Webb, *The Responsibility of a Criminal Defense Attorney*, 30 LOY. L.A. L. REV. 131, 133 (1996); Yin, *supra* note 27, at 1292.

71. *See* Zeidman, *supra* note 70, at 893–94.

72. *See infra* Part II. *But see* Charles J. Dunlap, Jr. & Linell A. Letendre, *Military Lawyering and Professional Independence in the War on Terror: A Response to David Luban*, 61 STAN. L. REV. 417, 420–25 (2008).

73. Transcript of interview with Major Mori on *Enough Rope,With Andrew Denton* (Australian Broadcasting Corporation television broadcast, Aug. 14, 2006), *available at* http://www.abc.net.au/tv/enoughrope/transcripts/s1709428.htm.

II.
CHALLENGES PRESENTED BY THE DETAINEES

A. Detainees Who Wish to Reject the Legal Process

U.S. law recognizes a defendant's autonomy and allows a defendant to take many procedural steps that may be contrary to a defendant's interest.[74] In the case of detainees captured in the war on terrorism, defendants may wish to take actions contrary to their own interests in order to reject the legal process. Some detainee legal requests, if allowed, would compromise the ability of the already maligned military commissions system to reach just outcomes. Nevertheless, in the context of client-counseling and the efforts of a military lawyer to represent a detainee effectively, the interests of the detainees cannot be ignored. By their efforts to subvert the legal process, the detainees at Guantanamo presented further challenges to their military attorneys.

1. Detainees Who Wish to Dismiss Their Attorneys

Several detainees have made requests to dismiss their attorneys and represent themselves. The reasons behind these dismissals may not always be readily apparent. Omar Khadr, one of the youngest detainees in the war on terrorism, fired his military lawyers a week before he was to appear before a military tribunal to face the charge of murder.[75] His lead military attorney, Lieutenant Colonel

74. *See* Johnson v. Zerbst, 304 U.S. 458 (1937) (recognizing defendant's right to waive counsel). *See generally* John F. Decker, *The Sixth Amendment Right to Shoot Oneself in the Foot: An Assessment of the Guarantee of Self-Representation Twenty Years After Faretta*, 6 SETON HALL CONST. L.J. 483, 490 (1996).

75. Omar Khadr, a Canadian citizen, was accused of murder for events involving a grenade killing a U.S. Army Special Forces medic, Sgt. First Class Christopher Speers, United States Army. *See* Colin Nickerson, *A Boy's Journey from Canada to Al Qaeda*, BOSTON GLOBE, Mar. 9, 2003, at A1. Separately, Khadr was also charged with planting roadside bombs in Afghanistan. *Id.* In 2002, U.S. military forces apprehended Khadr in Afghanistan when he was 15 years old. *Id.* Soon thereafter, Khadr was transferred to Guantanamo Bay. *Id.* The U.S. government first brought charges against Khadr on November 4, 2005. Charge Sheet, United States v. Omar Ahmed Khadr (Military Commission Feb. 2, 2007). On January 11, 2006, Omar appeared before a Military Commission, but the judge postponed the hearing pending decision on issues, including Khadr's right to choose his own attorney. Melissa A. Jamison, *The Sins of the Father: Punishing Children in the War on Terror*, 29 U. LA VERNE L. REV. 88, 128 n.216 (2008). Khadr boycotted an April 2006 hearing before the Military Commission. Tim Golden, *Boycott Threat Roils Guantanamo Hearing*, N.Y. TIMES, Apr. 6, 2006, at A14. Charges against Khadr have been dropped in the past. Order on Jurisdiction, United States v. Khadr, 1 Military Comm'n 152, 154 (2007). *See also Charges Dismissed Against Canadian at Guantanamo*, U.S. FED. NEWS, June 4, 2007.

Vokey,[76] stated that the firing stemmed from his distrust of American lawyers, as the United States is "responsible for his interrogation and his treatment under a process that is patently unfair."[77] Such a sentiment demonstrates that Khadr may have been unable to separate his appointed attorney from the legal process that sought to detain him.[78]

More recently, the self-described mastermind of the September 11, 2001 attacks, Khalid Sheikh Mohammed (KSM),[79] led a group of five detainees who unexpectedly told a military judge of their intentions to plead guilty, dismiss their military attorneys, and withdraw all pending motions filed on their behalf.[80] In making such a plea, KSM and his cohorts subjected themselves to a possible punishment of death.[81] KSM notified the military judge during the proceeding that he was "not trusting any Americans."[82]

Some military lawyers suspect that the conduct of Guantanamo guards and interrogators has fueled detainee decisions to dismiss attorneys.[83] One civilian lawyer who represents thirty-five detainees has maintained that interrogators have told detainees that certain defense lawyers are Jewish or homosexual.[84] Further, as previously discussed, attorneys have noted that attorney-client relationships

76. Lieutenant Colonel Vokey also defended Staff Sgt. Frank Wuterich, the Marine squad leader charged with unpremeditated murder in the deaths of Iraqi civilians in Hadiatha on Nov. 19, 2005. Diane Jennings, *Retired Marine is still fighting Attorney critical of U.S. military plans to keep defending servicemen*, DALLAS MORNING NEWS, Dec. 9, 2008, at 1A.

77. Carol Rosenberg, *Captive Commits Suicide in Cell*, MIAMI HERALD, May 31, 2007.

78. *See* Robert Burt, *Conflict and Trust Between Attorney and Client*, 69 GEO. L.J. 1015, 1035–36 (1981).

79. KSM claimed responsibility for the September 11, 2001 attacks as well as the beheading of Wall Street Journal reporter Daniel Pearl. KSM was captured in Pakistan in 2003 and transferred to Guantanamo in 2006. *Khalid Sheikh Mohammed Confesses to Daniel Pearl's Execution*, FOX NEWS (Mar. 15, 2007), *available at* http://www.foxnews.com/story/0,2933,258907,00.html.

80. Alan Gomez, *Five Accused in 9/11 Ask to Plead Guilty; Defendants Seek to End Tribunal at Guantanamo*, USA TODAY, Dec. 9, 2008, at 8A.

81. William Glaberson, *U.S. Said to Seek Execution for 6 in Sept. 11 Case*, N.Y. TIMES, Feb. 11, 2008, at A1; Josh White, Dan Eggen, & Joby Warrick, *U.S. to Try 6 on Capital Charges over 9/11 Attacks*, WASH. POST, Feb. 12, 2008, at A1.

82. Bryan Bender & Farah Stockman, *Five Try to Plead Guilty in 9/11 Attacks*, BOSTON GLOBE, Dec. 9, 2008, at A1.

83. William Glaberson, *Many Detainees at Guantanamo Rebuff Lawyers*, N.Y. TIMES, May 5, 2007.

84. JOSEPH MARGULIES, GUANTANAMO AND THE ABUSE OF PRESIDENTIAL POWER 204 (2006) (mentioning that interrogators have told detainees that their lawyers are Jewish); Luban, *supra* note 19, at 1994–95 (mentioning that interrogators have told detainees that their lawyers are homosexual).

have deteriorated as the detainee's legal cause suffered setbacks in Congress and the courts, and policies have been enacted to limit lawyer access to detainees.[85]

2. Detainees Who Wish to "Boycott" Trial

As of early 2009, five detainees have threatened to boycott, or fail to appear at, their trials for a variety of reasons.[86] The first boycott in Guantanamo Bay involved Ali al-Bahlul, an alleged bodyguard of bin Laden.[87] Al-Bahlul was denied the opportunity to represent himself after making such a request at his first pretrial proceeding in 2004.[88] In January 2006, he held up a piece of paper with the word "boycott" written in English and Arabic and then repeated the word "boycott" three times aloud in English.[89]

Similarly, Omar Khadr also initially threatened to boycott his trial, announcing his intentions in April 2006.[90] According to a variety of sources, Khadr threatened to boycott in order to challenge the legitimacy of the proceedings.[91] His attorney, Lieutenant Colonel Vokey, suggested that Khadr may have initiated the boycott for entirely different reasons.

According to Lieutenant Colonel Vokey, just before a pretrial hearing, Khadr was moved from the communal living at Guantanamo to the maximum security Camp Five, where his privileges were limited to spending two hours a day outside of his cell.[92] Immediately following the move, Khadr became uncooperative with his attorney.[93] Captain Wade Faulkner reported a similar occur-

85. *See* Luban, *supra* note 19, at 1997.

86. *See* Matthew Bloom, *"I Did Not Come Here To Defend Myself": Responding to War on Terror Detainees' Attempt To Dismiss Counsel and Boycott the Trial*, 117 YALE L.J. 70, 80–84 (2007) (describing various instances of detainee boycotts).

87. *See* David S. Cloud, *Terror Suspect Upsets Plan to Resume Trials in Cuba*, N.Y. TIMES, Jan. 12, 2006, at A24.

88. Scott Higham, *Detainee Tells Hearing He Was Member of Al Qaeda*, WASH. POST, Aug. 27, 2004, at A3.

89. Record of Trial at 60, United States v. al-Bahlul, No. 04-0003 (Military Comm'n Jan. 11, 2006).

90. Golden, *supra* note 75, at A14; Michelle Shephard, *Khadr Vows Boycott As Shouts Rock U.S. Court; Toronto Teen Moved to Solitary Confinement; Accused Terrorist Demands "Humane and Fair" Treatment*, TORONTO STAR, Apr. 6, 2006, at A10.

91. Human Rights First, *Khadr Boycotts Hearings, Challenges Conditions of Confinement*, Apr. 5, 2006, http://www.humanrightsfirst.org/us_law/detainees/gitmo_diary/post-040506-patel.aspx.

92. Michelle Shephard, *The View from* GUANTANAMO: "They Just Struggle to Maintain Hope," TORONTO STAR, Feb. 4, 2007, at A08.

93. Telephone Interview with Colby C. Vokey, Lieutenant Colonel, United States Marines Corps (Apr.–May 2009) [hereinafter LtCol Vokey Interview].

rence with his client, Sufyian Barhoumi, an Algerian charged with planning attacks against U.S. military units in Afghanistan.[94] Barhoumi told Captain Faulkner that he would become uncooperative if he was not moved back to communal living.[95]

3. Detainees Who Wish to Use the Court as a Political Forum

Several detainees have made clear their intentions to use the court as a political forum.[96] For example, Binyam Ahmed Muhammed noted that "what happens in America happens around the world," indicating his awareness of the political implications of his actions.[97] Like Khadr and others before him, Muhammed also attempted to boycott his trial and dismiss his attorneys.[98] Muhammed informed the Court that he "wish[ed] [for] no representation . . . . I didn't ask for a trial. You can kill me tomorrow. I really don't care."[99]

Although not a detainee at Guantanamo, Zacarias Moussaoui is another example of a defendant in a terrorism case who sought to use the legal process to make a political statement.[100] Moussaoui claimed to be the so-called twentieth hijacker in the September 11 attacks and was tried in federal district court in Virginia.[101] On the first day of jury selection, Moussaoui attempted to fire his attorneys, declaring "I am al Qaeda. They are American. They are my enemies."[102] Moussaoui continued outbursts and diatribes throughout his proceedings.[103] On April 3, 2006, Moussaoui was found to be eligible for the death penalty.[104] Before leaving the courtroom af-

94. Carol J. Williams, *A Dilemma for the Defenders*, L.A. TIMES, Apr. 30, 2006, at A11.

95. *Id.*

96. Toni Locy, *"Terrorism on Trial": The Trials of al Qaeda: Federal Court vs. Military Commission*, 36 CASE W. RES. J. INT'L L. 507, 507–12 (2004). *See generally* Eric Posner, *Political Trials in Domestic and International Law*, 55 DUKE L.J. 75 (2005) (discussing political trials, though not trials involving terrorists specifically).

97. Record of Trial at 84, United States v. Muhammad, No. 05-0009 (Military Comm'n Apr. 6, 2006).

98. *Id.* at 79.

99. *Id.* at 54, 82.

100. United States v. Moussaoui, 282 F. Supp. 2d 480 (E.D. Va. 2003), *aff'd in part, vacated in part*, 365 F.3d 292 (4th Cir. 2004).

101. *Id.*

102. *Moussaoui: "I am al Qaeda,"* CNN.COM, Feb. 6, 2006, http://www.cnn.com/2006/LAW/02/06/moussaoui.trial/index.html.

103. *See, e.g.*, Neil A. Lewis, *Moussaoui Tells Court He's Guilty of a Terror Plot*, N.Y. TIMES, Apr. 23, 2005, at A1.

104. James Gordon Meek, *Jurors find Moussaoui Eligible for the Death Penalty*, DAILY NEWS (N.Y.), April 3, 2006.

ter being found eligible for the death penalty, he shouted, "You will never get my blood" and "God curse you all!"[105] On May 4, 2006, he was sentenced to life in prison without parole.[106] At the conclusion of the proceedings, Moussaoui clapped his hands and said, "America, you lost . . . . I won."[107]

KSM likewise attempted to use the court as political forum.[108] KSM led a group of five detainees in drafting a letter to a military judge seeking to confess to the terrorist events of September 11, 2001.[109] Indicating their desire to use the court as a political forum, KSM and his cohorts submitted the letter on November 4, 2008, the day Barack Obama was elected President of the United States.[110] According to one observer, "What Khalid Sheikh Mohammed wants is martyrdom. And why should we hand him martyrdom on a platter in way that can be seen in the wider Muslim world as an unfair process?"[111]

A detainee's desire to use the court as a political forum presents many challenges to military defense attorney. On the one hand, allowing a detainee to make a mockery of the system may prevent the administration of justice. On the other hand, ignoring detainee desires may be contrary to ethical rules, as will be discussed in subsequent sections.

B. Barriers to Establishing Attorney-Client Rapport

In addition to detainee efforts to reject the legal process at Guantanamo, many other barriers exist to establishing attorney-client rapport. Numerous detainees suffer from mental health problems. Further, detainees have expressed inherent mistrust for "enemy officers" who serve as their attorneys. The al Qaeda training manual orders officers to lie to attorneys about the conditions

105. Mark Coultan, *Moussaoui Near to Death Row as Bereaved Prepare to Testify*, SYDNEY MORNING HERALD, Apr. 5, 2006, at 13 (quotations omitted).

106. Adam Liptak, *Moussaoui Verdict Highlights Where Juries Fear To Tread*, N.Y. TIMES, May 5, 2006, at A21.

107. Kevin Johnson, *Terrorist Moussaoui Gloats, "I won,"* USA TODAY, May 4, 2006. *See* Editorial, *Nobles and Knaves*, WASH. TIMES, May 6, 2006, at A12. Judge Brinkema responded by telling him that he would "die with a whimper" and "never again get a chance to speak." *Id.*

108. *See* Edward A. Adams, Moussaoui v. United States: *How Due Process Thwarted A Courtroom Jihad*, 93 A.B.A. J. 18 (2007).

109. Bryan Bender & Farah Stockman, *Five Try to Plead Guilty in 9/11 Attacks*, BOSTON GLOBE, Dec. 9, 2008, at A1.

110. *September 11 Defendants at Guantanamo Say They Want to Confess*, VOICE OF AMERICA NEWS, Dec. 8, 2008.

111. *Id.* (quoting Joanne Mariner of Human Rights Watch).

of confinement.[112] These issues present a variety of challenges to attorneys attempting to represent a detainee effectively.

1. Mental Health Problems

There have been increasing reports of mental illness in Guantanamo Bay. Long periods of detention, periods of solitary confinement, certain interrogation tactics, and long separations from family may have led to serious mental health consequences.[113] Further, many of the detainees may have had mental health problems prior to imprisonment at Guantanamo.[114] Mental health issues have presented further complications to attorney-client relationships.[115]

Model Rule 1.14 may apply when "a client's capacity to make adequately considered decisions in connection with a representation is diminished, whether because of minority, mental impairment, or some other reason."[116] When a lawyer determines that a client may suffer from some sort of diminished capacity, an attorney may take protective action on behalf of the client, provided no guardian exists.[117] The Model Rules of Professional Conduct (Model Rules) advise a lawyer to maintain an attorney-client relationship as normally as possible: "[I]f the client lacks a guardian or legal representative, the lawyer may be called upon to determine if her client is sufficiently incompetent or incapacitated to justify her

112. *See* Donna Miles, *Al Qaeda Manual Drives Detainee Behavior at Guantanamo Bay*, AMER. FORCES PRESS SERVICE, June 29, 2005 (noting that manual "directs detainees to insist on proving that torture was inflicted and to complain of mistreatment while in prison" as well as "how to lie") (internal punctuation omitted).

113. In 2003, there were 350 acts of self-harm, mass suicide attempts, and widespread hunger strikes resulting in force-feeding. PHYSICIANS FOR HUMAN RIGHTS, BREAK THEM DOWN: SYSTEMATIC USE OF PSYCHOLOGICAL TORTURE 52–53 (2005); *see also* Michelle Shephard, *MD Says Terror Suspect May Die; Stopped Eating 75 Days Ago in Detention Center; Wants Medical Treatment, Visits with Children*, TORONTO STAR, Sept. 20, 2005, at A08 (noting that Khadr, who had been hospitalized, was participating in a hunger strike "to protest the fact he's being held without charges, and the 'military's disrespect of Islam' "); Jeff Tietz, *The Unending Torture of Omar Khadr*, ROLLING STONE, Aug. 24, 2006, at 60 (stating that Khadr had contemplated suicide and that guards confiscated his possessions as a precautionary measure).

114. Susan Okie, *Glimpses of Guantanamo—Medical Ethics and the War on Terror*, 353 NEW ENG. J. MED. 2529, 2534 (noting that fifteen percent to eighteen percent of detainees arrived at Guantanamo with mental illness).

115. *See* Neil A. Lewis, *A Nation Challenged: The Terror Suspect; Defense Seeks Extensive Tests on Mental Health of Suspect*, N.Y. TIMES, Apr. 25, 2002, at A16.

116. MODEL RULES OF PROF'L CONDUCT R. 1.14(a) (1983).

117. *Id.* R. 1.14(b).

taking over as de facto guardian."[118] Indeed, many military defense attorneys have questioned the capacity of their clients to make informed decisions.[119]

Further, Sixth Amendment issues are presented if a defendant is found incompetent to stand trial.[120] Many military lawyers have sought to have mental health evaluations for precisely this purpose.[121] The doctors, however, who examine detainees for competency to stand trial also participate in detainee interrogation operations.[122] There are no reports of a Guantanamo doctor finding a detainee unfit to stand before the military commissions.[123]

2. Distrust of Military Attorneys

Detainees have expressed great distrust for detailed military attorneys. One detainee stated that he would proceed with trial rather than challenge the legitimacy of the system if only he were granted the right to be represented by a Yemeni attorney.[124] Additionally, the constant changes in legal process and regulations at Guantanamo have further exacerbated detainee distrust of military attorneys. Several military and civilian lawyers in Guantanamo have noted that changes in policy have caused attorneys to look powerless in their clients' eyes.[125]

Many attorneys have alleged that prison officials engaged in a misinformation campaign with detainees.[126] Reports have surfaced that interrogators have pretended to be lawyers in the hopes of obtaining information from detainees.[127] Obviously, breakdowns in attorney-client openness can occur in such an environment.

Finally, a detainee's distrust of his lawyer may stem simply from the lawyer's participation in the U.S. military. For example, during his boycott, al-Bahlul remarked that he could not trust an "enemy" officer or a volunteer civilian seeking personal fame as his defense

118. *Id.* R. 1.14; Jan Ellen Rein, *Ethics and the Questionably Competent Client: What the Model Rules Say and Don't Say*, 9 STAN. L. & POL'Y REV. 241, 244 (1998).

119. *See* Lewis, *supra* note 115.

120. *See generally* Richard J. Bonnie, *The Competence of Criminal Defendants: Beyond* Dusky *and* Drope, 47 U. MIAMI L. REV. 539 (1993).

121. Rein, *supra* note 118, at 244.

122. LtCol Vokey Interview, *supra* note 93.

123. Shephard, *supra* note 92, at A08.

124. Scott Higham, *Detainee Tells Hearing He Was Member of Al Qaeda*, WASH. POST, Aug. 27, 2004, at A3.

125. Luban, *supra* note 19, at 1997–99.

126. *Id.* at 1994–95.

127. *Id.* at 1994.

counsel.[128] Al-Bahlul concluded that he would only be satisfied with self-representation or the ability to select his own foreign attorney.[129] Such an embedded mindset in the detainees presents great difficulty in establishing attorney-client rapport.

3. The Manchester Document

In 2000, while searching computer files found in the home of a known al Qaeda operative, police in Manchester, England discovered a document that has come to be known as the "al Qaeda training manual" or "Manchester document."[130] The contents of the manual were translated into English and used as evidence in the 2001 trial of the terrorists who bombed the U.S. embassies in Tanzania and Kenya in 1998.[131]

Most significantly, the Manchester Document contains instructions regarding counter-interrogation techniques, including how to lie and how to minimize one's role in a terrorist plot.[132] Further, the handbook preaches that operatives should level charges of mental abuse, torture, and religious desecration at interrogators and custodians.[133] If a person is captured, the manual requires that "[a]t the beginning of the trial . . . the brothers must insist on proving that torture was inflicted on them by state security before the judge. Complain of mistreatment while in prison."[134]

The U.S. government believed that the practices suggested in the Manchester document have pervaded the prison population at Guantanamo and beyond.[135] For example, Ahmed Omar Abul Ali, accused of planning to assassinate President George W. Bush,[136] told a district court judge in Virginia that he had been brutally whipped by U.S. interrogators.[137] A subsequent physical examination of Ali revealed no physical mistreatment on the defendant's

128. Transcript of Record at 23–24, United States v. al Bahlul, No. 04-0003 (Military Commission Aug. 26, 2005 & Jan. 11, 2006).

129. *Id.*

130. Miles, *supra* note 112.

131. Sue Reid, *Manual for Murder*, DAILY MAIL (London), July 16, 2005, at 7.

132. Rowan Scarborough, *Captives Told to Claim Torture*, WASH. TIMES, May 31, 2005, at A1.

133. *Id.*

134. *Id.*

135. *Id.*

136. *See* Indictment, United States v. Abu Ali, Crim. No. 1:05CR53 (E.D. Va. filed Feb. 3, 2005) (alleging that Abu Ali and co-conspirator plotted to assassinate President Bush by getting close to him on the street or by detonating a car bomb). *See also* Jerry Markon, *N.Va. Man Indicted in Plot Against Bush*, WASH. POST, Sept. 9, 2005, at A04.

137. Scarborough, *supra* note 132.

back or any other part of his body.[138] Government officials also believed that stories of guards at Guantanamo flushing the Koran down the toilet to be part of an al Qaeda campaign to spread misinformation, however the Pentagon later admitted to desecration of the Koran.[139] The Manchester document presents problems to military attorneys assigned to defend Guantanamo detainees. How can a military attorney be certain that a detainee is telling the truth when such a document may govern his actions?

III.
CHALLENGES ARISING FROM TENSION IN THE MODEL RULES

The central duty of a defense lawyer is to "further the interests of . . . clients by all lawful means."[140] Beyond this, however, there are several sets of rules and models to govern a defense attorney's pursuit of carrying out this duty. By the "zealous representation" of a client, a lawyer serves the court and ensures the proper administration of justice.[141] Many advocate the client-centered model as the best way to achieve client goals.[142] Yet when considering the attorney-client relationship between military attorneys and detainees captured in the course of the war on terrorism, these rules no longer seem so straightforward. In fact, as discussed in subsequent sections, many factors may complicate a military lawyer's desire

138. *Id.*

139. Richard A. Serrano & John Daniszewski, *Dozens Have Alleged Koran's Mishandling*, L.A. TIMES, May 22, 2005, at A1. Detainees staged hunger strikes when reports of the desecration spread. *Id.* Detainees complained that soldiers tore the book into pieces, urinated on the book, scrawled obscenities inside it, had a guard dog carry it around, flushed it in the toilet, and threw it on the floor and used it as a carpet. *Id. See also* James Rainey & Mark Mazzetti, *Newsweek Retracts Its Article on Koran*, L.A. TIMES, May 17, 2005, at A1. The Pentagon called the Newsweek article "irresponsible" and "demonstrably false." The White House indicated that the article had "serious consequences" and that the "image of the United States abroad has been damaged." *Id.* Less than two weeks later the Pentagon confirmed the alleged desecration of the Koran. Eric Schmitt, *Military Details Koran Incidents at Base in Cuba*, N.Y. TIMES, June 4, 2005, at A1; Richard A. Serrano, *Pentagon: Koran Defiled*, L.A. TIMES, June 4, 2005, at A1.

140. *In re* Griffiths, 413 U.S. 717, 724 n.14 (1973).

141. The Preamble to the Model Rules states that "when an opposing party is well represented, a lawyer can be a zealous advocate on behalf of a client and at the same time assume that justice is being done." MODEL RULES OF PROF'L CONDUCT pmble (1983).

142. *See generally* DAVID A. BINDER, PAUL BERGMAN, SUSAN C. PRICE, & PAUL R. TREMBLAY, LAWYERS AS COUNSELORS: A CLIENT-CENTERED APPROACH (2d ed., West 2004).

(and duty) to represent a detainee effectively. Should the norms and rules that apply to attorney conduct elsewhere not apply in Guantanamo?

Military defense attorneys have identified conflicts between the Model Rules and military rules of conduct and other regulations.[143] The client-centered model may not apply to the particular circumstances of Guantanamo detainees and military defense lawyers. The military and government have placed career and institutional pressure on military defense attorneys. Finally, military attorneys have faced internal and personal conflicts.

A. Applying the Model Rules

Despite the seemingly straightforward principles of lawyering envisioned by the Model Rules, many military attorneys have experienced great difficulty in following these rules when representing a detainee.[144] Examining the spirit and purpose of the Model Rules from a high level of generality only begins to reveal some of conflicts experienced by military defense attorneys defending Guantanamo detainees. Further examination of specific rules of conduct exposes additional issues. The efforts of military defense attorney to resolve these conflicts have been met with varying degrees of success.

1. Broad Application of the Model Rules

Undoubtedly, many of the detainees in Guantanamo espouse different values and social concerns than their military attorneys. This may complicate a military lawyer's ability to zealously pursue a detainee's interest. Nevertheless, the Model Rules assume that both the client and the lawyer are autonomous individuals.[145] Thus, a lawyer's values and social concerns deserve respect. Indeed, the Model Rules provide that "[i]n representing a client, a lawyer shall exercise independent professional judgment and render candid advice."[146]

143. *See generally* C. Peter Dungan, *Avoiding "Catch-22s": Approaches to Resolve Conflicts Between Military and State Bar Rules of Professional Responsibility*, 30 J. LEGAL PROF. 31 (2006) (describing various conflicts between state ethical rules and military rules).

144. *Id.* at 35.

145. DAVID A. BINDER, PAUL BERGMAN, SUSAN C. PRICE, & PAUL R. TREMBLAY, LAWYERS AS COUNSELORS: A CLIENT- CENTERED APPROACH 282 (West 1991) ("you do not completely surrender your autonomy by becoming a lawyer"); BINDER ET AL., *supra* note 142, at 391 ("[Y]ou too are an autonomous individual whose values and broader social concerns deserve respect.").

146. MODEL RULES OF PROF'L CONDUCT R. 2.1 (1983).

The Model Rules emphasize that a lawyer "should not be deterred from giving candid advice by the prospect that the advice will be unpalatable to the client."[147] The Model Rules encourage a lawyer to "pursue a matter on behalf of a client despite opposition, obstruction or personal inconvenience to the lawyer, and take whatever lawful ethical measures are required to vindicate a client's cause or endeavor."[148] This is a difficult proposition given the many challenges at Guantanamo.

2. Specific Application of the Model Rules

Establishing attorney-client communication has been one of the primary challenges for military attorneys attempting to comply with the Model Rules. In 2004, the military issued a protective order greatly limiting attorney-client communications.[149] The Protective Order prohibited the sharing of any classified information with the client.[150] Further, detainees were not allowed to speak with their attorneys over the telephone and instead needed to communicate in person or via mail.[151] Given the logistically difficult and expensive nature of travel to Guantanamo Bay, face-to-face communication was not always a viable option.[152] Communication by mail, at first glance, seemed to be the most effective way of discussing matters regarding a case with a client.

Communication by mail also presented obstacles. On September 15, 2006, a federal district court judge in the District of Columbia issued a memorandum order to allow the review of attorney-detainee mail communications.[153] New regulations established what has been called a "privilege team."[154] The "privilege team" was authorized to read all mail from an attorney to a detainee.[155] If the "privilege team" determined that a letter contained "unneces-

147. *Id.* R. 2.1 cmt. 1.

148. *Id.*

149. *See In re* Guantanamo Detainee Cases, 344 F. Supp. 2d 174, 180 (D.D.C. 2004); Mark Denbeaux & Christa Boyd-Nafstad, *Attorney-Client Relationship in Guantanamo Bay*, 30 FORDHAM INT'L L.J. 491, 500–01 (2006); Brendan M. Driscoll, Note, *The Guantanamo Protective Order*, 30 FORDHAM INT'L L.J. 873, 874 (2006).

150. *See In re Guantanamo Detainee Cases*, 344 F. Supp. 2d at 180.

151. *See id.* at 190.

152. *See* Luban, *supra* note 19, at 1989–90.

153. *See* Hicks (Rasul) v. Bush, 452 F. Supp. 2d 88, 94 (D.D.C. 2006).

154. *See In re Guantanamo Detainee Cases*, 344 F. Supp. 2d at 186–87 (requiring that written correspondence from attorney to client be first sent to privilege review team, which in turn should pass authorized materials to clients).

155. *Id.*

sary outside information," the letter would not be forwarded to a detainee.[156]

Oftentimes during trials of military detainees, military attorneys will become privy to incriminating classified information that cannot be shared with a client.[157] A rule that prohibits one accused of a crime to see evidence that will be used against him has shocked many lawyers and commentators.[158] These restrictions aspire to provide a "reasonable balance" of government requirements and "the right of the accused to effective representation."[159]

Regardless of the needs of national security, many feel that such a system contradicts the Model Rules.[160] Model Rule 1.4 requires that an attorney keep a client updated on all matters.[161] Oftentimes, "outside information" greatly implicated a detainee's case.[162] Lieutenant Colonel Vokey noted that his client would often ask him direct questions about outside current events.[163] According to another military defense attorney:

> Oftentimes [my client] would ask me questions he knew the answers to. He was testing me, so I discussed the events in violation of the military order. I never discussed classified information. But I viewed the prohibition on discussing outside information as an illegal order that conflicted with a greater duty.[164]

While it is beyond the scope of this Article to discuss whether the military order was illegal, this statement underscores the senti-

156. *Id.*

157. Detailed Defense Counsel were prohibited from sharing incriminating classified information with the client or with any other counsel who do not have clearance and who were not present during the introduction of such evidence in closed session. *See* Military Comm'n Order No. 1, at 8–9 (Dep't of Defense Mar. 21, 2002), www.defense.gov/news/Mar2002/d20020321ord.pdf.

158. Emanuel Gross, *Trying Terrorists-Justifications for Differing Trial Rules: The Balance Between Security Considerations and Human Rights*, 13 IND. INT'L. & COMP. L. REV. 1, 96 (2002).

159. *See* Col. Frederick L. Borch III, *Why Military Commissions Are the Proper Forum and Why Terrorists Will Have "Full and Fair" Trials: A Rebuttal to Military Commissions: Trying American Justice*, ARMY LAW., Nov. 2003, at 10, 14.

160. *See* Dungan, *supra* note 143, at 40.

161. MODEL RULES OF PROF'L CONDUCT R 1.4 (1983).

162. *Cf. id.* (requiring that client be kept informed of all matters, including outside information, because such information may impact detainee's case).

163. LtCol Vokey Interview, *supra* note 93.

164. Interview with Anonymous, Military Defense Attorney (on file with Author). Some of the military defense attorneys whom I interviewed for this Article prefer to remain anonymous. The reader is free to assign whatever weight he or she deems appropriate to this anonymous quotation.

ments of many defense attorneys who have represented Guantanamo detainees: the current system employed in the military commissions, in some ways, may contradict the Model Rules.

3. Resolving Conflicts with Model Rules

Prior to the establishment of Guantanamo as a detention facility, ethics opinions from state bar associations seem to provide harbor for the conflicting nature of military practice and the Model Rules.[165] Further, each individual service has its own rules of professional conduct and the military takes the position that these rules supersede those of state bars.[166] In 2003, however, the National Association of Criminal Defense Lawyers (NACDL) concluded that defense attorneys could not ethically participate in the military commissions.[167] Some state bars have insisted that state ethical rules take precedence over military rules, often calling for withdrawal in cases of conflict.[168]

In an effort to resolve ethical conflicts, some military lawyers have sought advisory ethics opinions from state bar associations and ethics experts.[169] The ethical opinions have offered conflicting results regarding the representation of detainees.[170] While some states have allowed military defense attorneys to continue to represent detainees, other state bar associations have called for attorney withdrawal.[171] Even in the face of these opinions, military

165. *See* Dungan, *supra* note 143, at 32–33.

166. U.S. DEP'T OF ARMY, ARMY REGULATION 27-26, RULES OF PROF'L CONDUCT FOR LAWYERS R. 8.5(f)(1) (1992) (stating that whenever a conflict between the Army Rules and a state rule cannot be resolved, "these Rules will govern the conduct of the lawyer in the performance of the lawyer's official responsibilities"); DEP'T OF NAVY, JAG INSTRUCTION 5803.1C, PROF'L CONDUCT OF ATTORNEYS PRACTICING UNDER THE COGNIZANCE AND SUPERVISION OF THE JUDGE ADVOC. GEN., R. 8.5 cmt. 2 (2004) (stating that "these Rules supersede any conflicting rules applicable in jurisdictions in which the covered attorney may be licensed"). DEP'T OF AIR FORCE, TJS-2, AIR FORCE RULES OF PROF'L CONDUCT R. 3 (2002) Air Force Rules are silent on the precedence of the rules over state rules. *Id.*

167. NACDL Ethics Advisory Committee, Op. 03-04, at 15 (2003).

168. *See, e.g.*, Mich. Op. RI-172, at 1 (1993) (arguing that Michigan rule of imputed disqualification, based on ABA Model Rule 1.10, applies to military legal assistance offices, even though military rules specifically disavow imputed disqualification; and failing to mention Model Rule 8.5).

169. *See* Luban, *supra* note 19, at 2008.

170. For example, Lieutenant Colonel Bradley obtained ethics opinions indicating that continued representation of her detainee-client would present a disqualifying conflict of interest because funding requests would have to be approved by an adversary attorney. *Id.* at 2007–08.

171. *See id.* at 2007–08. An opinion from the State Bar of California held that Lieutenant Commander William Keubler could no longer represent his detainee-

commission policy has limited opportunity for military lawyers to withdraw.[172]

Lieutenant Colonel Vokey described in-depth his ongoing personal battle concerning the conflict with the Model Rules and his zealous defense of Kahdr:

> All emails and phone calls were being monitored. The Navy-Marine Corps Computer Intranet (NMCI) requires that you sign a statement that computer can be monitored at any time for any purpose. This was a huge problem in Guantanamo. I guarantee that my phone was being listened to when I called overseas to Pakistan. I'm sure the Patriot Act kicked in. What are the ethical considerations when you suspect your phone calls are being monitored? I could have been disbarred.[173]

Rule 1.6 of the Model Rules implicates a duty of confidentiality between an attorney and a client.[174] What is a military defense attorney to do when he knows that confidentiality is constantly in jeopardy?

B. Attempting to Apply the Client-Centered Model

As a baseline for advising clients, many lawyers rely on the client-centered model.[175] The client-centered counseling model offers the lawyer techniques for developing open communication with clients. The underlying assumption is that the lawyer who follows the client-centered model should be able to counsel a client in

client, given his client's desire to dismiss him. *See* Bloom, *supra* note 86, at 84. In contrast, the Kentucky State Bar found no ethical dilemma in Lieutenant Colonel Bryan Broyle's representation of his detainee-client. *Id.*

172. 32 C.F.R. § 9.4(c)(4) (2006) (requiring that "the Accused must be represented at all relevant times by Detailed Defense Counsel"); 32 C.F.R. § 13.3(c)(2) (2006) (requiring that "Detailed Defense Counsel shall so serve notwithstanding any intention expressed by the Accused to represent himself").

173. LtCol Vokey Interview, *supra* note 93.

174. MODEL RULES OF PROF'L CONDUCT R. 1.6(a) (1983).

175. The creation of the client-centered model to counseling was initiated by concerns that traditional lawyering placed clients in an unequal or subordinate position with the lawyer. As a result, the client was thought to be overwhelmed by the power represented in the lawyer's position and, therefore, subject to manipulation by the lawyer. According to many, the American Bar Association's Model Rules have embraced the client-centered approach as, perhaps, a reaction to the cause lawyering of the 1960s and 1970s. Some scholars have recently compared the client-centered approach to the cause-lawyering approach in the context of representing Guantanamo detainees. *See generally* Scott L. Cummings, *The Internationalization of Public Interest Law*, 57 DUKE L.J. 891 (2008); Peter Margulies, *The Detainees' Dilemma: The Virtues and Vices of Advocacy Strategies in the War on Terror*, 57 BUFF. L. REV. 347 (2009); Luban, *supra* note 19.

a way which empowers the client to make informed decisions.[176] But, given the complexities and challenges facing military attorneys defending Guantanamo detainees, perhaps the client-centered model is not the most appropriate. The following paragraphs will attempt to apply elements of the client-centered model to the experience of military defense attorneys in Guantanamo Bay. The client-centered model provides a rough framework to address the so-called difficult client, differences in cultural norms between an attorney and a client, and differences in religious beliefs.

1. The Difficult Client

Proponents of the client-centered model recognize that the model may not work for a difficult client.[177] However, this may be the most applicable category to discuss in the context of detainees captured in the course of warfare with extremists, proponents of the client-centered model recognize that there is a class of clients known as the "atypical or difficult client."[178]

Advocates of the client-centered model define a difficult client as one who refuses to participate effectively in the discussion of the case, who will not make eye contact with the lawyer, and who displays an inappropriate lack of concern for the seriousness of the issues which he or she faces.[179] Furthermore, a difficult client may refuse or be reluctant to commence an interview or to discuss a particular topic.[180] Certainly, the detainees in Guantanamo have all displayed attributes of the so-called difficult clients. Some difficult clients, according to advocates of the client-centered model, may display signs of psychological impairment and need professional psychiatric assistance that a lawyer is unqualified to give.[181]

These appraisals of the client-centered model have endured scholarly criticism.[182] One scholar has noted that the client-centered model does not provide enough emphasis on the race of the client or the race of the lawyer.[183] Many of the traits of the so-called

176. BINDER ET AL., *supra* note 142, at 4–5.

177. *Id.* at 237–56.

178. *Id.* at 99–100, 247.

179. *Id.* at 237.

180. *Id.*

181. *See* Paul R. Tremblay, *On Persuasion and Paternalism: Lawyer Decisionmaking and the Questionably Competent Client*, 1987 UTAH L. REV. 515, 537 ("Much has been written on the topic of defining and recognizing competence, yet the concept remains elusive.").

182. *See* Michelle S. Jacobs, *People from the Footnotes: The Missing Element in Client-Centered Counseling*, 27 GOLDEN GATE U. L. REV. 345, 376–80 (1997).

183. *Id.*

difficult clients are in fact manifestations of cultural differences or misunderstandings. For these reasons, examination of the cultural issues inherent in the representation of Guantanamo detainees may be relevant.

2. Cultural Issues

For several cultural reasons, Guantanamo detainees and a military lawyer may have difficulty communicating effectively. Often, detainees do not speak very much English, if any at all.[184] Further, most of the U.S. military lawyers detailed to represent detainees do not speak the languages of the detainees.[185] Accordingly, often times, client counseling must occur through an interpreter, creating difficulties in establishing rapport and trust between an attorney and client.

Perhaps most notably, many of the detainees at Guantanamo Bay fundamentally disagree with U.S. policies. A leading authority on the client-centered model suggests that discussing personal moral concerns with a client may alleviate or resolve differences in world view.[186] Nevertheless, this scenario seems impractical in the case of detainees captured in the course of the war on terrorism.

One proponent of the client-centered model has opined that the model requires that a balance be struck between moral blindness and moral domination.[187] In the case of Guantanamo detainees, it is conceivable that moral disagreement with a detainee's attitude toward the United States could be so strong that most military officers would seek to withdraw. Nevertheless, perhaps a military lawyer's concern for providing the accused with an adequate defense will override philosophical differences.

3. Religious Differences

Many challenges may arise between detainees and military defense attorneys due to differences in religious beliefs. Virtually all

184. Erwin Chemerinsky, *The Myth of the Liberal Ninth Circuit*, 37 LOY. L.A. L. REV. 1, 8–9 (2003).

185. *See* Gail Gibson & Scott Shane, *Contractors Act as Interrogators; Control: The Pentagon's Hiring of Civilians to Question Prisoners Raises Accountability Issues*, BALTIMORE SUN, May 4, 2004, at 1A ("At an October Senate hearing, a Pentagon official said that staffing shortages, particularly of Arabic linguists, had forced the Department of Defense to hire contractors not only as interpreters but for interrogation work as well. 'We do use contractors as a means to hire linguists and interrogators,' said Charles Abell, principal deputy undersecretary of defense for personnel and readiness.").

186. BINDER ET AL., *supra* note 142, at 293–95.

187. *Id.* at 295.

of the detainees in Guantanamo Bay practice Islam. Fewer than one percent of U.S. uniformed military personnel identify with the Muslim faith.[188] Differences between a Western and the Muslim lifestyle may further inhibit an attorney-client relationship.[189]

For periods of time, religion had been used as a pressure point in Guantanamo Bay, assisting interrogators in discovering intelligence information from detainees.[190] In an October 11, 2002 memorandum drafted by the Guantanmo interrogation unit's lawyer, Lieutenant Colonel Diane Beaver opined: "Forced grooming and removal of clothing are not illegal, so long as it is not done to punish or cause harm, as there is a legitimate governmental objective to obtain information . . . ."[191] The memorandum further stated that removal of religious items or published material did not implicate the First Amendment because detainees are not U.S. citizens.[192] In January 2003, new interrogation guidelines were approved that seemed to extend some further religious protections to detainees:

> Other nations that believe that detainees are entitled to POW protections may consider that provision and retention of religious items (e.g. the Koran) are protected under international law . . . . Although the provisions of the Geneva convention are not applicable to interrogation of unlawful combatants, consideration should be given to these views prior to application of the technique.[193]

Various allegations of religious abuse at the hands of Guantanamo interrogators and guards exacerbated religious tensions between detainees and military attorneys. According to one detainee,

188. Lorraine Ali, *Muslim Warriors—For America*, NEWSWEEK, Oct. 15, 2001, at 40 (estimating 15,000 Muslims in the U.S. military and reserves); Faye Fiore & Eric Slater, *War with Iraq/ The Armed Forces; Muslim GIs Also Battle Prejudice*, L.A. TIMES, Mar. 30, 2003, at 15 (describing feelings of alienation by Muslim members of U.S. military).

189. *See* Susan Page, *Survey: Suspicion Separates Westerners, Muslims; Poll of Several Countries Finds "Complete Misperceptions,"* USA TODAY, June 23, 2006, at A7.

190. Carol Rosenberg, *Captives Allege Religious Abuse*, MIAMI HERALD, Mar. 6, 2005, at 1A.

191. Memorandum from Diane E. Beaver, Staff Judge Advocate, to Commander, Joint Task Force 170, Legal Brief on Proposed Counter-Resistance Strategies (Oct. 11, 2002) at 6, *available at* http://levin.senate.gov/newsroom/supporting/2008/Documents.SASC.061708.pdf.

192. *Id.*

193. Memorandum from Secretary of Defense Donald H. Rumsfeld to Commander of U.S. Southern Command on Counter-Resistance Techniques in the War on Terrorism (Apr. 16, 2003), *available at* http://www.washingtonpost.com/wp-srv/nation/documents/041603rumsfeld.pdf.

an interrogator stepped on his Koran and mocked him during prayers.[194] One detainee was transferred to a no-trousers cell section known as Romeo block.[195] After unsuccessfully trying to explain that he could not give up his pants for religious reasons, he was tackled, punched, and pepper-sprayed; and had a testicle squeezed and a finger broken by military guards.[196] Some detainees have complained that military police threw their Korans into the toilet.[197]

Lieutenant Commander Swift, Hamdan's lawyer, attempted to provide his client with some Muslim reading material.[198] The guards at Guantanamo informed him, however, that only military-approved Korans were allowed, greatly limiting the detainee's practice of their faith.[199] With conditions in place that continue to abrasively highlight differences in religious practice between attorneys and clients, building rapport and trust is all the more difficult for military defense attorneys.

C. Career Pressures

A military defense lawyer faces many conflicts. Military officers are largely trained not to question directives or authority.[200] Oftentimes, second-guessing an order can have tragic consequences in combat situations or training. Upon receiving an officer's commission in the military service, officers are required to take an oath "to support and defend the Constitution of the United States."[201] In many ways, defending a suspected terrorist who desires to destroy

194. Neil A. Lewis & Eric Schmitt, *Inquiry Finds Abuses at Guantanamo Bay*, N.Y. TIMES, Apr. 30, 2005, at 35.

195. *City on the Hill or Prison on the Bay? The Mistakes of Guantanamo and the Decline of America's Image: Hearing Before the Subcomm. on Int'l Orgs., Human Rights, & Oversight of the H. Subcomm. on Foreign Affairs*, 110th Cong. 74 (2008) (testimony of Stephen H. Oleskey, Partner, Wilmer, Cutler, Pickering, Hale & Dorr LLP).

196. *Id.*

197. *See* Rasul v. Myers, 512 F.3d 644, 650 (D.C. Cir. 2008).

198. Rosenberg, *supra* note 190.

199. *Id.*

200. *See, e.g.*, Joint Service Committee on Military Justice, Manual for Courts-Martial, United States pt. IV, para. 16.a–c (2008), *available at* http://www.jag.navy.mil/documents/mcm2008.pdf. Article 92 prohibits service members from disobeying lawful orders.

201. The Commissioning Oath for U.S. Military Officers states:

> I, _____ , having been appointed an officer in the (Service) of the United States, as indicated above in the grade of _____ do solemnly swear *(or affirm)* that I will support and defend the Constitution of the United States against all enemies, foreign or domestic, that I will bear true faith and allegiance to the same; that I take this obligation freely, without any mental reservations or pur-

the Constitution and the American way of life seems contrary to this oath. Nevertheless, according to Lieutentant Colonel Vokey, defending a suspected terrorist is directly in line with the officer oath:

> I don't have any conflict in my head where I have to switch gears and go from one side to the other, I don't think so at all . . . . When everyone gets commissioned in the [military service], you take your oath, and every time you're promoted you take the oath again. And the oath is to support and defend the constitution of the United States. So you're not swearing to the president or to a general; that's what your oath is, to support and defend the constitution.[202]

Many have vociferously questioned the independence of military defense lawyers due to perceptions that Hamdan's attorney, Lieutenant Commander Charles Swift, was passed over for promotion and forced to retire because of his success.[203] Numerous commentators have alleged that Lieutenant Commander Swift was forced into retirement because the Supreme Court ruled in his client's favor in *Hamdan v. Rumsfeld* and the advancement results were released shortly after the decision.[204] Despite these strong sentiments and allegations, Lieutenant Commander Swift's failure to be promoted is entirely unrelated to the *Hamdan* decision. Although the public release of the promotion board results did closely follow the Court's decision in *Hamdan*, the decision concerning Lieutenant Commander Swift's advancement was made months earlier.[205]

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pose of evasion; and that I will well and faithfully discharge the duties of the office upon which I am about to enter; So help me God.

See DEPARTMENT OF THE ARMY, Oath of Office - Military Personnel DA Form 71, (1999), *available at* http://www.army.mil/USAPA/eforms/pdf/A71.pdf.

202. LtCol Vokey Interview, *supra* note 93; *Murder Charges Against Canadian Omar Khadr, Now Imprisoned at Guantanamo Bay, Have Left the U.S. Military Deeply Divided*, TORONTO STAR, Apr. 29, 2007, at A1.

203. Erwin Chemerinsky, *Navy Is Wrong to Force Out Guantanamo Lawyer*, DAILY J. (Cal.), Oct. 23, 2006; Editorial, *The Cost of Doing Your Duty*, N.Y. TIMES, Oct. 11, 2006, at A26.

204. Stephen Ellmann, *The "Rule of Law" and the Military Commission*, 51 N.Y.L. SCH. L. REV. 760, 795 (2006) (alleging that provision of the Military Commissions Act designed to ensure independence of defense counsel "would be more reassuring if Lt. Cmdr. Charles Swift, the military lawyer who represented Hamdan, had not been passed over for promotion, thus ending his military career, shortly after the Supreme Court's decision in favor of his client.").

205. *See* David J. R. Frakt, *An Indelicate Imbalance: A Critical Comparison of the Rules and Procedures for Military Commissions and Courts-Martial*, 34 AM. J. CRIM. L. 315, 353 n.221 (2007). *See also id.* at 352–54 (contending that foreign attorneys should be allowed to represent suspected terrorists, thus alleviating some client-counseling challenges arising from cultural differences); David Frakt, *Winning De-*

Nevertheless, possibly in response to these perception issues, the MCA adopted further provisions designed to protect defense counsel.[206] Regardless of this provision and Lieutenant Commander Swift's personal experience, many high-profile military defense attorneys have failed to be promoted following tours in Guantanamo and have otherwise suffered in their careers.[207]

Military attorneys (or their paralegals) have been punished for "doing too good of a job." For instance, Lieutenant Colonel Vokey filed a complaint with the Inspector General's Office after his paralegal, a Marine sergeant, stated that prison guards bragged to her about beating detainees.[208] On February 7, 2007, officials announced that there was insufficient evidence to substantiate this charge.[209] An investigation was launched against the paralegal for allegedly making a false claim.[210] In late 2008, a copy of the investigation obtained by the Associated Press revealed that one of the guards had previously told military officials that he abused detainees.[211]

Major Mori was, at one point, threatened with prosecution under Article 88 of the UCMJ, which forbids military officers from speaking "contemptuous words" about the President, Vice President, or Secretary of Defense.[212] Although it is unlikely that such a

tainee Hamdan's Case Didn't Prevent Navy Lawyer's Promotion, DAILY J. (Cal.), Nov. 8, 2006.

206. *See* 10 U.S.C. § 949b(b) (2006) (stating that "[i]n the preparation of an effectiveness, fitness, or efficiency report or any other report or document used in whole or in part for the purpose of determining whether a commissioned officer of the armed forces is qualified to be advanced in grade, or in determining the assignment or transfer of any such officer or whether any such officer should be retained on active duty, no person may: (1) consider or evaluate the performance of duty of any member of a military commission under this chapter; or (2) give a less favorable rating or evaluation to any commissioned officer because of the zeal with which such officer, in acting as counsel, represented any accused before a military commission under this chapter").

207. In addition to Lieutenant Commander Swift, Lieutenant Colonel Vokey also failed to achieve the next rank after service in Guantanamo. *See* Rick Rogers, *Marine Lawyer has Sought Judicial Reform*, UNION TRIBUNE (San Diego), Aug. 18, 2008, at B1.

208. *Lawyers: Marines Want Silence on Gitmo Charges*, ORLANDO SENTINEL, Oct. 16, 2006, at A8; Miranda Leitsinger, *Two Ordered to Stop Speaking About Alleged Guantanamo Abuse*, INTELLIGENCER, Oct. 15, 2006, at A3.

209. Andrew O. Selsky, *Military Probe: Gitmo Guard Admitted to Abuse*, ORLANDO SENTINEL, Dec. 19, 2008, at A12.

210. LtCol Vokey Interview, *supra* note 93.

211. Selsky, *supra* note 209.

212. *See* Michael J. Davidson, *Contemptuous Speech Against the President*, ARMY LAW., July 1999, at 1.

charge would be litigated at a court martial, the threat was serious enough for Major Mori to question if he could effectively represent his client.[213] Although Major Mori was never ultimately prosecuted, many have contended that his lack of a promotion served as punishment in lieu of prosecution.[214]

Lieutenant Commander Swift has described the environment at Guantanamo Bay as "poisonous."[215] According to Lieutenant Commander Swift, "I've watched colleagues and people who are close friends, people I have the utmost respect for, just ground down by this."[216] While defending Hamdan, Lieutenant Commander Swift reported that he faced great hostility from his superiors and innuendos from his superiors that he would be prosecuted .[217] Lieutenant Commander Swift believes that he avoided prosecution only because the *Hamdan* decision was decided in his favor by the Supreme Court.[218]

D. Pressures to Seek Resolution Outside of the Courtroom

Some military attorneys representing detainees have received front-page attention in national newspapers.[219] At first, despite overwhelming press interest, most military lawyers avoided making public statements, especially in light of restrictions placed on defense attorney's ability to speak with the media.[220] Nevertheless, many military lawyers soon realized that acceptable resolution for their clients may not be found in the military commissions.[221]

Under the Model Rules, a lawyer is not permitted to speak about a pending case with the media if the statement "will have a substantial likelihood of materially prejudicing an adjudicative pro-

213. *See* Ellen Yaroshefsky, *Military Lawyering At the Edge of the Rule of Law in Guantanamo: Should Lawyers Be Permitted to Violate the Law?*, 36 HOFSTRA L. REV. 563, 573–74 (2008).

214. *See id.* at 574.

215. Brooks Egerton, *"Moral Decision" Jeopardizes Navy Lawyer's Career*, DALLAS MORNING NEWS, May 18, 2007, at 1A.

216. *Id.*

217. Joe Shaulis, *Hamdan Navy Lawyer Denied Promotion, Will Leave U.S. Military*, JURIST, Oct. 9, 2006, *available at* http://jurist.law.pitt.edu/paperchase/2006/10/hamdan-navy-lawyer-denied-promotion.php.

218. *Detainees: Hearing Before the S. Comm. on the Judiciary*, 109th Cong. 49 (2005) (statement of Lieutenant Commander Charles D. Swift).

219. *See, e.g.*, Neil A. Lewis, *Military's Lawyers for Detainees Put Tribunals on Trial*, N.Y. TIMES, May 4, 2004, at A1.

220. Ellen Yaroshefsy, *Zealous Lawyering Succeeds Against All Odds: Major Mori and the Legal Defense Team for David Hicks*, 13 ROGER WILLIAMS U. L. REV. 469, 478 (2008).

221. *Id.*

ceeding."[222] Nevertheless, the Rules allow a lawyer to communicate with the media if the "attorney would believe [it] is required to protect a client from the substantial undue prejudicial effect of recent publicity not initiated by the covered attorney or the attorney's client."[223] Given the high level of attention the Guantanamo detainees received in the press, this exception seems to apply.[224]

Major Mori determined that his client's situation would be improved through successful utilization of the media.[225] Major Mori delivered a number of public comments, criticizing the military commissions.[226] He also made statements to the media of several other countries, including Australia, the home of his client.[227] Over time, the Australian public became outraged by their fellow countryman's treatment and began to demand his release.[228]

Major Mori was careful to confine his comments to the lack of fairness in the commission process and did not discuss conditions of confinement or the specific facts of the case.[229] Nevertheless, as previously discussed, a presiding military judge of the commission suggested that Major Mori might be court-martialed for violating Article 88 of the UCMJ, which prohibits speaking disrespectfully of high ranking government officials.[230] Ultimately, no charges were filed.[231]

E. Effects on the Military Lawyer as an Individual

The implications of engaging in such high profile defense work may extend well beyond the individual career of a judge advocate. According to Lieutenant Colonel Vokey, "there were great personal costs and tolls on my family. The defense of my client required extensive travel and time away from home."[232] The facili-

222. MODEL RULES OF PROF'L CONDUCT R. 3.6(a) (1983).

223. *Id.* R. 3.6(c).

224. Luban, *supra* note 19, at 2015.

225. *See, e.g.*, Raymond Bonner, *Terror Case Prosecutor Assails Defense Lawyer*, N.Y. TIMES, Mar. 5, 2007, at A10; Lewis, *supra* note 219, at A1.

226. *See* Yaroshefsky, *supra* note 220, at 482–83.

227. *See* Raymond Bonner, *Australian Parents Have New Hope for U.S.-Detained Son*, N.Y. TIMES, Jan. 19, 2004, at A8.

228. Bonner, *supra* note 227, at A10.

229. *See* Yaroshefsky, *supra* note 220, at 483.

230. *Id.*; *see also* Davidson, *supra* note 212, at 2–3; Moris D. Davis, *AWOL Military Justice*, L.A. TIMES, Dec. 10, 2007, at A15.

231. *See* Yaroshefsky, *supra* note 213, at 574.

232. LtCol Vokey Interview, *supra* note 93.

ties at Guantanamo Bay are unlike any other place in the world, and travel to and from the facility is often quite complicated.[233]

Further, many JAGs who defended detainees described a diminished faith in the U.S. government and the military. Many JAGs believed that the military would always do the right thing. While most seem to still believe this to be true, many JAGs found it demoralizing to see the military so zealously carry out possibly illegal orders. According to Lieutenant Colonel Yvonne Bradley, "I never thought that it would be political, but it's all political, not legal. The military is better than this and our government is better than this."[234]

The official (and unofficial) security requirements for Guantanamo Bay also presented situations that challenged a military attorney's faith in military justice. Lieutenant Colonel Vokey recounted that he would be fully searched prior to speaking with his client.[235] This search extended to the guard reading his confidential notes.[236] Lieutenant Colonel Vokey confronted the guard and asked to speak to the guard's supervisor; the supervisor patently denied that anything happened.[237] "Things like this happened too many times than I care to count," stated Lieutenant Colonel Vokey.[238]

IV.
A PROPOSED FRAMEWORK FOR REPRESENTING DETAINEES IN THE WAR ON TERRORISM

Effective representation of a client detained in the course of the war on terrorism presents challenges unlike any other. Strict application of the client-centered model undoubtedly fails. Of course, principles from the client-centered model can be, and should be, applied. Nevertheless, military officers detailed to the representing detainees captured in the course of the war on terrorism must apply a framework that considers the myriad pressures,

233. For example, Lieutenant Colonel Vokey reported that to visit his client, he would often have to take a flight on Wednesday, he wouldn't be able to see his client until Friday, and he wouldn't be able to get a return flight home until the following Thursday. In essence, for only a few brief meetings with his client, Lieutenant Colonel Vokey would have to embark on eight days of travel. *See id.*; Luban, *supra* note 19, at 1989–90 (discussing difficulty of traveling to Guantanamo).

234. Luban, *supra* note 19, at 2005.

235. LtCol Vokey Interview, *supra* note 93.

236. *Id.*

237. *Id.*

238. *Id.*

challenges, and obstacles inherent in such work. These assignments do not appear to be for the faint of heart. Such defense work requires a nimbleness, tact, and skill that may not have been required in any prior experience.

Competence and zealousness, however, are not the only ingredients required to represent Guantanamo detainees effectively. Several policy changes may need to be implemented, many of which are beyond the scope of this Article. At a minimum, to facilitate the efforts of defense lawyers in their pursuits to provide detainees with an adequate defense, greater opportunities for withdrawal by military lawyers and greater opportunities for service as a defense lawyer should exist for qualified attorneys.

A. Staying Motivated

In light of all of the challenges faced by military attorneys defending detainees, it is undoubtedly a challenge to stay motivated. With an influx of pressures from the chain of command, an uncooperative client, and other internal ethical conflicts to face, many obstacles exist in providing effective client counseling. Further, military lawyers face many complex ethical dilemmas when continuing to represent Guantanamo detainees. Despite the challenges of representing a Guantanamo detainee and the seeming helplessness of the situation, there are many ways a military can "do good" or improve the military commissions before seeing ultimate success in the court room.

On July 11, 2003, the National Institute of Military Justice issued a statement stating that each attorney should decide on his or her own whether to participate in military commission trials. Nevertheless, the statement concluded that the non-participation by an otherwise qualified and interested lawyer would be "unfortunate." While these remarks were targeted to the civilian bar, the same also holds true for military lawyers:

> Public esteem for the bar would also suffer. . . . We recommend that attorneys . . . give serious consideration to submitting their names. The highest service a lawyer can render in a free society is to provide quality independent representation for those most disfavored by government.[239]

Likewise, military attorneys should consider representing a detainee one of the highest services a military lawyer can render. Even if one does not agree with the processes employed in Guanta-

239. NAT'L INST. OF MIL. JUST., STATEMENT ON CIVILIAN ATTORNEY PARTICIPATION AS DEFENSE COUNSEL IN MILITARY COMMISSIONS 1, 3 (2003).

namo, by participating, a military lawyer can challenge commission procedures and suggest changes. Increased and continued participation by highly qualified military attorneys increases the chances that there will be justice or improvements in the system.

B. Establishing and Maintaining Trust

It appears that it is a constant challenge to establish and maintain trust with the detainees in Guantanamo Bay. From the literature on the subject and interviews with military lawyers who defended Guantanamo detainees, there are a few key practices that may be useful to gain the confidence of a detainee. This list is by no means inclusive, but it discusses some of the key practices employed by Guantanamo Bay defense attorneys:

- Never promise anything you can't deliver

This advice, of course, is good practice for maintaining a relationship with a client in any area of the law. Avoiding making promises you can't keep, however, has a heightened importance when advising Guantanamo detainees. As it stands, Guantanamo military defense lawyers routinely look powerless in the eyes of their clients for many things beyond their control, including the evolving legal process and strict prison regulations. Therefore, it is even more important to ensure that a military lawyer can deliver on any promises, however great or small. Otherwise, a failure to deliver will add to the perception of powerlessness and further degrade attorney-client relations.

- Provide material from the outside world, whenever possible

Although protective orders and prison regulations may limit detainee exposure to outside material, whenever possible, military attorneys have reported great gains in establishing rapport when providing detainees with various items from the outside world. Lieutenant Colonel Vokey's client grew to enjoy Pepsi soft drinks.[240] Lieutenant Commander Swift provided his client with a variety of religious materials.[241] Other attorneys provided their clients with magazines, comic books, or newspapers.[242] These gestures may seem small, but they go a long way in establishing attorney-client rapport.

- Be forthright with your client

Obviously, there are many restrictions on communications between Guantanamo detainees and attorneys. Military defense attor-

240. LtCol Vokey Interview, *supra* note 93.
241. Rosenberg, *supra* note 190.
242. Interview with Anonymous, *supra* note 164.

neys need to find creative ways to adhere to regulations, orders, and the law, and also convey necessary information to clients.

- Engage your client's family

Many military attorneys make great headway in establishing and maintaining trust with their clients by engaging the client's family. Lieutenant Colonel Vokey made numerous trips to Canada to meet with Khadr's family.[243] Major Mori traveled to Australia, often meeting with David Hicks' family.[244] These encounters provided valuable insight into the minds of the detainees and allowed the attorneys to better serve their clients. Further, a military attorney could relay messages from family members who may have been unable to reach a detainee by mail or telephone due to prison regulations.

- Keep your client continually updated

Oftentimes, the breakdown in trust between a military attorney and a detainee seems to stem from a breakdown in the flow of information between the client and the attorney. As discussed, communication by phone, email, or regular mail is often impossible or impracticable. Accordingly, a military attorney must endure the challenges of traveling to Guantanamo to keep the detainee apprised of his situation. Undoubtedly, national security requirements and prison regulations prevent a military attorney from sharing all of the information that may apply to a detainee's case. Nevertheless, a military attorney should inform his client about the measures the attorney has taken in pursuit of the case.

D. Reconciling Conflicting Ethical Rules

If a military attorney senses that following a military regulation or rule conflicts with the Model Rules, a variety of options exist. First, the military attorney can discuss the issue with his or her chain of command. Many military defense attorneys, however, find this option to be impractical or unlikely to result in a positive manner. Further, military attorneys can seek ethical opinions from state bar associations or, more informally, from ethics experts.

The Model Rules require an attorney to withdraw when "the representation will result in a violation of the Rules of professional conduct or other law."[245] Despite these provisions, as previously discussed, many attorneys in Guantanamo have encountered great difficulties in attempting to withdraw from representation. Further-

243. LtCol Vokey Interview, *supra* note 93.
244. Major Mori, *supra* note 73.
245. MODEL RULES OF PROF'L CONDUCT R. 1.16(a)(1) (1983).

more, even if the opportunities to withdraw were present, many military defense attorneys have expressed a desire to continue representation, regardless of the many difficulties, because of their belief that all accused deserve good representation.[246] Nevertheless, more opportunities should exist to allow an attorney to withdraw without repercussion.

E. Civilian Counsel May Be More Suitable Than Military Counsel

Perhaps detainees should be able to retain civilian counsel independent of the military. Civilian counsel, from a detainee's standpoint, may be more trustworthy, enabling more open attorney-client communication. This may be accomplished if the civilian attorney is willing to abide by the commission's rules and is not a security threat to the United States.

While the right to counsel is sufficient to meet international minimums, the right, perhaps, is not as broad as it could be. Of course, many believe that further rights should not be extended to the detainees. Expanding allowable attorneys to foreign counsel would undoubtedly enhance the legitimacy of the military commissions in the eyes of the international community. Further, this may be particularly appropriate considering the war on terrorism is ideally waged as a joint endeavor among several nations. Thus, perhaps allowing detainees to be represented by United States legal aliens and attorneys from coalition partners in the war on terrorism is appropriate.

Further, civilian counsel may be more appropriate than military counsel for several other reasons. First, civilian counsel would not be subject to the same rules and regulations as a military officer. Simply put, military officers are required to follow orders and are subject to the UCMJ. Second, military officers' First Amendment rights are restricted, limiting what a military attorney can say to the press.[247] Finally, a civilian lawyer may be more appropriate because there would be no actual or perceived professional repercussions for doing "too good of a job."

CONCLUSION

Military attorneys are unique in their dual calling as officers of the U.S. military and as lawyers. Because of the potentially conflict-

246. *See generally* Abbe Smith, *Defending the Unpopular Down-Under*, 30 MELB. U. L. REV. 495 (2006).

247. *See generally* John A. Carr, *Free Speech in the Military Community: Striking a Balance Between Personal Rights and Military Necessity*, 45 A.F. L. REV. 303 (1998).

ing duties pertaining to each of these professions, military counsel detailed to represent Guantanamo detainees often find themselves in very difficult positions. Some critics may go so far as to assert that providing counsel to Guantanamo detainees is unpatriotic; however, such assertions ignore the foundations of our government and country.

The United States has a strong tradition of providing a defense attorney to even the most hated defendants. A defendant's right to a fair trial is embodied in the Constitution. Furthermore, in all of our nation's conflicts since the Revolutionary War, we have provided counsel to all of our adversaries. For example, John Adams demonstrated this country's commitment to a right to counsel by defending British soldiers involved in the Boston Massacre. Of course, the patriotism of John Adams is beyond question; he took the case because he believed in the right to counsel and not because he sympathized with the British cause.[248] Like the military attorneys involved in the defense of Guantanamo detainees, Adams defended the British, risking his personal and professional reputation. Adams reported that although he lost half of his practice after defending British officers charged in the Boston Massacre, he still considered that case "one of the best pieces of service that I ever rendered for my country."[249]

The plight of military defense attorneys detailed to defend Guantanamo detainees, in many ways, mirrors the experience of John Adams, over 200 years later. The zealous representation of a detainee does not indicate sympathy for terrorists. Indeed, one Guantanamo military lawyer noted that "there are guys down in Guantanamo who would, if you sat down next to them, try to kill you."[250] Nevertheless, military defense attorneys have been described as fiercely committed to the rule of law and preserving the values embodied in the Constitution. Lieutenant Colonel Vokey described his experiences as very rewarding, despite the challenges. His continued motivation stemmed from a "sense of duty" and a desire to do what is right, regardless of the personal costs.[251]

While the United States continues to wage the war on terrorism, our country is fortunate to be able to rely on the continued service of military defense lawyers tasked with defending detainees suspected of terrorism. Hopefully, our country's policymakers and

248. *See* DAVID MCCULLOUGH, JOHN ADAMS 66 (2001).

249. HILLER B. ZOBEL, THE BOSTON MASSACRE 3–4 (W.W. Norton & Company, 1970).

250. Interview with Anonymous, *supra* note 164.

251. LtCol Vokey Interview, *supra* note 93.

leaders will strive to put better laws, guidelines, and procedures in place to assist these attorneys and military officers in their pursuit of preserving the ideals upon which our country was founded.

THE VETERANS' JUDICIAL REVIEW ACT TWENTY YEARS LATER: CONFRONTING THE NEW COMPLEXITIES OF THE VETERANS BENEFITS SYSTEM

*BY JAMES D. RIDGWAY**

INTRODUCTION

Since Congress passed the Veterans' Judicial Review Act[1] (VJRA) twenty-two years ago, judges and scholars alike have characterized the Department of Veterans Affairs' (VA) claims adjudication system as a search for balance between a paternalistic charitable model and an adversarial entitlement model. In the paternalistic charitable model, there is "no legally enforceable . . . duty to provide benefits, which are given out of a sense of moral obligation" based upon discretionary judgment.[2] In contrast, in an adversarial entitlement model, "benefits provided [are] not mere gratuities to be distributed in an ad hoc and discretionary manner."[3] Unfortunately, this false dichotomy obscures the true conflict afflicting veterans claims adjudication. A closer inspection reveals that the VA system is a paternalistic entitlement system, a hybrid of both characterizations. It is paternalistic because claimants receive significant procedural assistance. It is also an entitlement system because claimants pursue non-discretionary benefits.

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1. Veterans' Judicial Review Act, Pub. L. No. 100-687, 102 Stat. 4105 (1988).

2. Richard E. Levy, *Of Two Minds: Charitable and Social Insurance Models in the Veterans Benefits System*, 13 KAN. J.L. & PUB. POL'Y 303, 304 (2004).

3. *Id.* at 306. For specific examples of this type of analysis, see Bailey v. West, 160 F.3d 1360, 1365 (Fed. Cir. 1998) ("Since the [VJRA], it appears the system has changed from a nonadversarial, ex parte, paternalistic system for adjudicating veterans' claims, to one in which veterans like Bailey must satisfy formal legal requirements, often without the benefit of legal counsel, before they are entitled to administrative and judicial review.") (internal quotation marks omitted); Steven Reiss & Matthew Tenner, *Effects of Representation by Attorneys in Cases Before VA: The "New Paternalism,"* 1 VETERANS L. REV. 2 (2009); Levy, *supra* note 2, at 306. *See also* Kenneth M. Carpenter, *Why Paternalism in Review of the Denial of Veterans Benefits Claims is Detrimental to Claimants*, 13 KAN. J.L. & PUB. POL'Y 285 (2004); Theda Skocpol, *America's First Social Security System: The Expansion of Benefits for Civil War Veterans*, 108 POL. SCI. Q. 85 (1993).

By incorporating both paternalism and entitlement, the VA system suffers from internal conflict: it seeks to comprehensively cover all deserving claimants through substantively and procedurally complex rules intended to address all possible fact patterns,[4] yet it also seeks to be informal so as to avoid denying claims on technicalities or requiring applicants to bear the expense of expert attorneys.[5]

Although the motivations behind these two aspects of the VA adjudication system are laudable, independent judicial review under the VJRA has illuminated the core tension between complexity and informality. After Congress authorized judicial review of veterans benefits claims decisions by federal courts, those courts imposed new requirements and standards on the VA system, increasing both transparency and accountability.[6] However, this increase in turn pushed the system toward both complexity and informality, two distinctly different directions, with little introspection regarding the larger effects on the system generally.[7] Compounding the complications brought about by judicial review, both Congress and VA have been altering the system in reaction to these judicial interpretations. As a result, the VA adjudication system today is very different from the one that existed prior to the VJRA, but the adjudication system has not necessarily improved.[8] The challenge for the future will be integrating complexity and informality to produce satisfactory results in an acceptable amount of time.

4. See, for example, 38 C.F.R. § 3.7 (2009), which lists over fifty classes and subclasses of military service, including "[t]hree scouts/guides, Miguel Tenorio, Penedicto Taisacan, and Cristino Dela Cruz, who assisted the United States Marines in the offensive operations against the Japanese on the Northern Mariana Islands from June 19, 1944, through September 2, 1945," 38 C.F.R. § 3.7(x)(32) (2008), and 38 C.F.R. Part 4, which contains thousands of diagnostic codes used to rate nearly all possible physical and mental disabilities. Schedule for Rating Disabilities, 38 C.F.R. pt. 4 (2008).

5. Walters v. Nat'l Ass'n of Radiation Survivors, 473 U.S. 305, 321 (1985) (observing that Congress intended for VA system to be "managed in a sufficiently informal way" so as to eliminate need for "an attorney to obtain benefits to which a claimant was entitled, so that the claimant would receive the entirety of the award without having to divide it with a lawyer").

6. *See infra* Parts III and IV.

7. *See infra* Part VI.

8. Prior retrospectives on the VJRA have focused on the federal courts' effect upon and relationship with VA. *See* Lawrence B. Hagel & Michael P. Horan, *Five Years under the Veterans' Judicial Review Act: The VA is Brought Kicking and Screaming into the World of Meaningful Due Process*, 46 ME. L. REV. 43 (1994); Bill Russo, *Ten Years After the Battle for Veterans Judicial Review: An Assessment*, FED. LAWYER, June 1999. As will be seen, the purpose of this retrospective is to examine the courts' direct and indirect effects upon veterans law itself.

Part I of this Article reviews the nature of the VA system prior to the Act's passage in 1988, and explains how the VJRA, although designed to have a limited impact, actually contained the seeds of a drastic overhaul. Part II examines how the efficiency and accuracy of the VA adjudication system has changed since the VJRA. Part III discusses the most significant changes in the decisionmaking process caused by judicial review. Part IV compares these changes in the decisionmaking process to the role courts have defined for claimant participation in the process. This comparison reveals that, although the process has grown more complex, the courts have shielded claimants from the need to understand the process. Part V examines the significant impact congressional and agency reactions to judicial review have had in shaping the development of the process since the VJRA. In conclusion, this Article assesses the current dynamic of the VA system and contemplates the challenges presented by the paternalistic entitlement model. Ultimately, both complexity and informality are characteristics intended to benefit veterans, but none of the stakeholders involved has developed a strategy for reconciling the inherent tension between the two.

I.
THE VJRA AND THE END OF THE VETERANS ADMINISTRATION'S NOT-SO-SPLENDID ISOLATION

A. The Veterans Administration Adjudication System Prior to the VJRA

There can be no doubt that the veterans benefits system has moved from a charitable model to an entitlement model.[9] The bulk of this transformation occurred during the period of "splendid isolation"[10] prior to the VJRA. During this 200-year period, various offices within the Departments of War, the Interior, and the Treasury made decisions on veterans benefits before VA was created in 1921;[11] and the decisions of these agencies were not subject to judicial review by federal courts.[12] This occurred because the first Congress refused to cede final authority over such claims to the judiciary.[13] Although the first Congress passed a law allowing veter-

9. *See* Levy, *supra* note 2, at 307–15 (discussing history of system).

10. Brown v. Gardner, 513 U.S. 115, 122 (1994) (quoting H.R. REP. NO. 100-963, pt. 1, at 10 (1988)).

11. DEP'T OF VETERANS AFFAIRS, VA HISTORY IN BRIEF 3–8, *available at* http://www1.va.gov/opa/feature/history/docs/histbrf.pdf (last updated June 10, 2010).

12. WILLIAM F. FOX, JR., THE LAW OF VETERANS BENEFITS: JUDICIAL INTERPRETATION 3–11 (3d ed. 2002).

13. *See* WILLIAM H. GLASSON, FEDERAL MILITARY PENSIONS IN THE UNITED STATES 56–57 (1918).

ans to file benefits claims in the federal courts, it granted the Secretary of War and itself the authority to reject decisions of the courts if either suspected "imposition or mistake."[14] The Supreme Court invalidated this review scheme on the grounds that the judiciary was a co-equal branch that could not issue opinions that the executive and legislature could treat as merely advisory.[15] Rather than accept decisions of the federal courts as binding, Congress replaced the invalid statute with a scheme that excluded judicial review altogether.[16] This immunity from judicial review continued even after the Economy Act of 1933[17] laid the foundation for the system we know today by abolishing the prior patchwork of benefits laws pertaining to veterans of different wars and conflicts, and giving the President the power to establish a new, unified system through executive orders.[18]

The two levels of the modern veterans claims adjudication system—the regional VA offices (ROs) throughout the country, at which veterans initially file claims, and the Board of Veterans Appeals (BVA) in Washington, D.C., which decides appeals from RO decisions—were established by the end of World War II.[19] Despite the lack of judicial review, pressure from veterans groups shaped

14. Act of March 23, 1792, 1 Stat. 243, 244 (1789).

15. Hayburn's Case, 2 U.S. 409, 410 (1792). Notably, although *Marbury v. Madison*, 5 U.S. 137 (1803), is commonly cited as the case that established the Supreme Court's authority to declare a statute unconstitutional, *Marbury* actually relies upon the Court's prior decision in *Hayburn's Case*:

> It must be well recollected that in 1792, an act passed, directing the secretary at war to place on the pension list such disabled officers and soldiers as should be reported to him, by the circuit courts, which act, so far as the duty was imposed on the courts, was deemed unconstitutional.

Marbury, 5 U.S. at 171.

16. *See* GLASSON, *supra* note 13, at 60–61; FOX, *supra* note 12, at 4–5.

17. Economy Act of 1933, Pub. L. No. 73-2, 48 Stat. 8, Title I.

18. *Id.* at §§ 1 (general authority), 3 (power to create disability rating system), 4 (power to define periods of war), 7 (power to define authority of VA), 9 (power to create adjudication system).

19. *See* Exec. Order No. 6230 (1933) (creating BVA); Charles L. Cragin, *A Time of Transition at the Board of Veterans' Appeals: The Changing Role of the Physician*, 38 FED. B. NEWS & J. 500, 500–01 (1991) (describing evolution of BVA from precursor bodies in 1920); Robert C. Mueller, *Two Down, One to Go: The Effort to Achieve Meaningful Due Process for Claimants of Veterans' Benefits*, 38 FED. B. NEWS & J. 505, 505–07 (1991) (discussing evolution of RO decision teams in decades prior to VJRA). *See generally* ROBERT T. KIMBROUGH & JUDSON B. GLEN, AMERICAN LAW OF VETERANS: AN ENCYCLOPEDIA OF THE RIGHTS AND BENEFITS OF VETERANS, AND THEIR DEPENDENTS, ARISING FROM SERVICE DURING WORLD WAR II, THE KOREAN CONFLICT AND LATER, WITH STATUTES, REGULATIONS, FORMS, AND PROCEDURE §§ 59, 78 (2d ed. 1954).

the system long before Congress considered the VJRA.[20] For example, although RO decisions originally required no explanation, Congress added the "Statement of the Case" procedure in 1962, which required an RO to explain its decision in detail if a veteran disputed it.[21] Pressure to provide veterans more procedural reforms continued to mount, and VA later adopted by regulation its first formal duty to assist claimants in 1972.[22] This duty to assist requires VA to "assist a claimant in developing the facts pertinent to his claim and to render a decision which grants him every benefit that can be supported in law."[23] Furthermore, by the time of the VJRA's enactment, VA had been battling significant calls for judicial review for well over two decades.[24]

Aside from procedure, prior to the VJRA, oversight offices discussed the quality of VA decisions from an entitlement perspective. In 1982, VA's Office of Inspector General concluded that the rate of errors in benefits decisions was at least fifty percent higher than that documented by the internal reporting system of the adjudication division.[25] Following this finding was a Government Accounta-

20. *See* Laurence R. Helfer, *The Politics of Judicial Structure: Creating the United States Court of Veterans Appeals*, 25 CONN. L. REV. 155, 160–61 (1992) (discussing "pervasive" power of veterans groups in shaping system from at least 1940 to passage of VJRA).

21. *See* Pub. L. No. 87-666, 76 Stat. 553 (1962); *see also* Pensions, Bonuses, and Veterans' Relief, 28 Fed. Reg. 28 (Jan. 1, 1963).

22. Due Process and Appellate Rights, 37 Fed. Reg. 14,780 (July 25, 1972) (amending 38 C.F.R. § 3.103(a)). This is not to say that VA was unhelpful prior to 1972. Rather, relevant policies were promulgated by directive and not organized or generally available to claimants. *See* Due Process and Appellate Rights: Disability, Death Benefits and Related Relief, 37 Fed. Reg. 10,745 (May 27, 1972) (notice of proposed rulemaking).

23. Due Process and Appellate Rights, 37 Fed. Reg. 147,80 (July 25, 1972) (amending 38 C.F.R. § 3.103(a)).

24. Donald Ivers, Judge (ret.), U.S. Court of Appeals for Veterans Claims, Remarks at the Tenth Judicial Conference of the Court of Appeals for Veterans Claims (Apr. 14–15, 2008), *in* 22 Vet. App. at XLV (2008) [hereinafter Judge Ivers Remarks]. Judge Ivers was General Counsel of VA from 1985 until he was appointed as one of the original judges of the CAVC. Bills concerning judicial review passed the Senate four times, but each died in the House. *See* S. 330, 96th Cong. (1979); S. 349, 97th Cong. (1982); S. 636, 98th Cong. (1983); S. 367, 99th Cong. (1985).

25. *See* U.S. GEN. ACCOUNTING OFFICE, IMPROVED PRODUCTIVITY CAN REDUCE THE COST OF ADMINISTERING VETERANS BENEFITS PROGRAMS, GAO-83-12, 6 (1982) [hereinafter PUBL'N NO. GAO-83-12] (*citing* VA OFFICE OF INSPECTOR GENERAL, DEP'T OF VETERANS BENEFITS STATISTICAL QUALITY CONTROL FOR BENEFITS AUTHORIZATIONS (1982)). The Author requested a copy of the Inspector General's report pursuant to the Freedom of Information Act, but was informed that it had been destroyed pursuant to VA's records retention policy. Letter from Shirley J. Landes,

bility Office (GAO) report questioning the productivity and staffing practices at the VA regional offices.[26] Several years later, the GAO found a number of "significant problems" in claims development, adjudication, and notice procedures in its efforts to calculate the extent of errors in VA claims processing.[27] Many of these reports assumed that each veteran's benefits claim has an objectively correct outcome, consistent with an entitlement perspective. Thus, by the time of the VJRA, veterans benefits were not considered discretionary or subjective.[28]

B. The Many Facets of the VJRA

In 1989, the unified front presented by VA, the congressional veterans affairs committees and the major veterans groups that had blocked past pushes for judicial review[29] finally broke down,[30] and Congress added judicial review to the system.[31] However, accountability, not transformation, was the goal. Congress had "little inter-

Chief, Information Release Office, VA Office of Inspector General, to the Author (Apr. 29, 2009) (on file with Author).

26. *See* PUBL'N NO. GAO-83-12, *supra* note 25.

27. U.S. GEN. ACCOUNTING OFFICE, PROCESSING VETERANS' DISABILITY CLAIMS, GAO-89-24, 2 (1989); *see also* U.S. GOV'T ACCOUNTABILITY OFFICE, IMPROVEMENTS NEEDED TO MEASURE THE EXTENT OF ERRORS IN VA CLAIMS PROCESSING, GAO-89-9 (1989) [hereinafter PUBL'N NO. GAO-89-9].

28. Arguably, the shift to an entitlement mentality began in 1919 when Congress deliberately used "compensation" in Public Law 66-104 (Dec. 24, 1919), rather than "pension." *See* DAVIS R.B. ROSS, PREPARING FOR ULYSSES: POLITICS AND VETERANS DURING WORLD WAR II 21 (1969). However, the purpose of this semantic change was to limit benefits by linking them to a veteran's proven loss rather than the nation's generosity. *Id.*

29. *See* Judge Ivers Remarks, *supra* note 24, at XLVI (noting that these three groups were collectively known as the "Iron Triangle"). *See generally* PAUL C. LIGHT, FORGING LEGISLATION (1992).

30. One commentator described this breakdown as a successful insurgency by the upstart Vietnam Veterans of America against the older, established veterans service organizations. Helfer, *supra* note 20, at 162–64. One Senate staff member has written a comprehensive account of the legislative process that led to the passage of the VJRA, which largely confirms this view. *See* LIGHT, *supra* note 29 (detailing interplay between judicial review movement and efforts to elevate VA to cabinet department).

31. Veterans' Judicial Review Act of 1988, Pub. L. No. 100-687, 102 Stat. 4105 (codified as amended in scattered sections of 38 U.S.C.). A few commentators would refer to this as a "republican moment," at which dramatic change was brought to an administrative system by a wave of public sentiment that was able to transcend the entrenched resistance of the established interests. *See* James Gray Pope, *Republican Moments: The Role of Direct Popular Power in the American Constitutional Order*, 139 U. PA. L. REV. 287, 291–93 (1990).

est . . . in a comprehensive overhaul of . . . VA itself."[32] Nonetheless, even though Congress intended the VJRA to be "a fine-tuning process with particular emphasis placed on the format for judicial review,"[33] the VJRA did much more.

1. Two Layers of Judicial Review

The VJRA created two layers of judicial review. The first layer and major innovation of the VJRA was the creation of the U.S. Court of Appeals for Veterans Claims (CAVC),[34] a traditional appellate court that reviews BVA decisions deferentially based on the record at the time of the decision.[35] The CAVC is an Article I court whose judges are appointed for fifteen-year terms.[36] It may decide cases either by non-precedential, single-judge decisions or precedential, panel opinions.[37] Whereas the VA system is non-adversarial and claimant-friendly, the CAVC is an adversarial forum that favors neither side in a case. However, because only claimants may appeal to the CAVC,[38] the court acts as a one-way ratchet that tends to add rules favoring claimants—it is usually confronted with either affirming the status quo (under which the claimant lost before the BVA) or ruling in favor of the petitioner claimants by expanding substance or procedure in their favor. Rarely would a case present the option of creating rules further restricting claimants' interests. For this reason, rulings can expand the procedural and substantive rights of claimants beyond the Secretary of Veterans Affairs' (Secretary) original understanding of a statute or regulation, but the rulings are not needed when the Secretary is already providing the

32. FOX, *supra* note 12, at 16.

33. *Id.* This description is somewhat of an understatement. There was a contentious debate over the form that review would take and how intrusive the resulting supervision would be. *See* LIGHT, *supra* note 29, at 224–27 (discussing major positions and compromises that resulted in judicial review in its current form).

34. Originally, it was called the United States Court of Veterans Appeals. *See* Veterans' Judicial Review Act of 1988, Pub. L. No. 100-687, 102 Stat. 4113 (codified as amended in scattered sections of 38 U.S.C.). It was not renamed until 1998. Veterans Programs Enhancement Act of 1998, Pub. L. No. 105-368 § 511(b), 112 Stat. 3315, 3341 (1998).

35. 38 U.S.C. § 7261 (2006). *See generally* Michael P. Allen, *Significant Developments in Veterans Law (2004–2006) and What They Reveal About the U.S. Court of Appeals for Veterans Claims and The U.S. Court of Appeals for the Federal Circuit*, 40 U. MICH. J.L. REFORM 483, 514–21 (2007) [hereinafter Allen, *Significant Developments*] (discussing differences between the two types of decisions in practice).

36. 38 U.S.C. §§ 7251, 7253 (2006).

37. *Id.* § 7254.

38. *Id.* § 7252(a).

assistance or benefits requested.[39] In the second layer of judicial review added by the VJRA, Congress gave the Federal Circuit limited jurisdiction to hear appeals as of right from the decisions of the CAVC.[40] Although either side may appeal from a decision of the CAVC, the Federal Circuit can only review questions of law.[41]

The dual levels of appellate review burden the system by adding uncertainty. This is because every interpretation of law by the CAVC is de facto tentative.[42] If the CAVC's decision is directly appealed, it ordinarily adds a year or more of waiting before the Secretary knows what the final rule will be so that he or she can adjust the agency process accordingly if the rule requires such an alteration.[43] If it is not directly appealed, it may still be challenged in the appeal of a later case, sometimes years later. Whether or not the appeal is direct, the Federal Circuit can prolong the uncertainty if it

39. Many schemes of administrative and judicial review tend to operate in this one-way manner. *See, e.g.*, EUGENE BARDACH & ROBERT A. KAGAN, GOING BY THE BOOK: THE PROBLEM OF REGULATORY UNREASONABLENESS 185–86 (1982); Frank B. Cross, *Shattering the Fragile Case for Judicial Review of Rulemaking*, 85 VA. L. REV. 1243, 1319 (1999) (arguing that judicial review of agency rulemaking acts as one-way ratchet because "[t]he functional result of an antiregulatory bias is to benefit special interests at the expense of the general public"); Lawrence M. Frankel, *The Flawed Institutional Design of U.S. Merger Review: Stacking the Deck Against Enforcement*, 1 UTAH L. REV. 159, 199–207 (2008) (arguing that review of corporate mergers by Federal Trade Commission and Department of Justice acts as one-way ratchet because "review is far less geared to reducing false positives at the expense of false negatives"); Peter DiCola, Note, *Choosing Between the Necessity and Public Interest Standards in FCC Review of Media Ownership Rules*, 106 MICH. L. REV. 101, 132 (2007) (arguing that Federal Communications Commission (FCC) review of media consolidation acts as one-way ratchet because "[t]he FCC can relax stricter media regulations more easily than it can tighten looser media regulations"). The one notable exception in the CAVC's jurisprudence is *Morton v. West*, 12 Vet. App. 477 (1999) (interpreting VJRA as unintentionally limiting VA's authority to provide medical examinations and opinions to claimants). See *infra* notes 227–35 and accompanying text for a discussion of *Morton* and the congressional response abrogating that decision.

40. 38 U.S.C. § 7292 (2006).

41. *Id.* § 7292(d).

42. The Chief Judge of the CAVC has told Congress that "because jurisdiction exists in another Federal appeals court, parties have less incentive to negotiate settlement in the USCAVC; a losing party can once again argue its case in the Federal Circuit." *Battling the Backlog Part II: Challenges Facing U.S. Court of Appeals for Veterans Claims: Hearing Before the S. Comm. on Veterans' Affairs*, 109th Cong. 17 (2006) (statement of William P. Greene).

43. *See* Ribaudo v. Nicholson, 21 Vet. App. 137 (2007) (ruling on Secretary's motion to stay cases within VA pending his appeal of *Haas v. Nicholson*, 20 Vet. App. 257 (2006)); Ramsey v. Nicholson, 20 Vet. App. 16 (2006) (ruling on Secretary's motion to stay cases within VA pending his appeal of *Smith v. Principi*, 18 Vet. App. 448 (2004)).

disapproves of the CAVC's ruling on a procedural issue and remands for further proceedings without explaining what the correct procedure should have been,[44] which can add many years before a final ruling is provided.

Given that the Federal Circuit decides "only a small number of its appeals on the merits,"[45] it often takes years before the court weighs in, and its opinions, as noted above, can result in traumatic change or great uncertainty that trickles down through the system.[46] For example, in *Vazquez-Flores v. Peake*,[47] the CAVC held that VA's notice duty under 38 U.S.C. § 5103(a) was substantially more demanding than VA had interpreted it to be.[48] In his annual report for fiscal year 2008, the Chairman of the BVA noted how significant the CAVC ruling was, and commented that "[t]he Board [had] worked with [the rest of the VA adjudication system] to develop procedures that would provide the necessary notice with the least possible disruption to the processing of current claims and appeals."[49] Subsequently, the Federal Circuit reversed the CAVC decision and nullified the need for the changes developed by the Board.[50] This kind of traumatic change and corresponding uncertainty have resulted in friction between the two courts' decisions.[51] This is not to say that the Federal Circuit has no regard for CAVC rulings or that it is oblivious to these potential effects,[52] but it is

44. *See* FOX, *supra* note 12, at 222–24 (discussing how Grantham v. Brown, 114 F.3d 1156 (Fed. Cir. 1997), *sub silentio* called into question CAVC's en banc decision in *West v. Brown*, 7 Vet. App. 329 (1995)).

45. *Id.* at 220.

46. *See id.* at 222–24; *see also* James D. Ridgway, *Why So Many Remands?: A Comparative Analysis of Appellate Review by the United States Court of Appeals for Veterans Claims*, 1 VETERANS L. REV. 113, 144–45 [hereinafter Ridgway, *Why So Many Remands*] (discussing numerous Federal Circuit decisions over six years disapproving CAVC's attempts to formulate rule of prejudicial error notice violations under 38 U.S.C. § 5103(a) (2002)).

47. 22 Vet. App. 37 (2008).

48. *See id.* at 42–44, 47–48.

49. JAMES P. TERRY, FISCAL YEAR 2008 REPORT OF THE CHAIRMAN, BD. OF VETERANS APPEALS 12–13 (2009) [hereinafter BVA CHAIRMAN'S REPORT FOR FISCAL YEAR 2008].

50. *See* Vazquez-Flores v. Shinseki, 580 F.3d 1270, 1280–81 (Fed. Cir. 2009).

51. *See* Allen, *Significant Developments*, *supra* note 35, at 523–24 (observing that opinions of CAVC and Federal Circuit convey "a certain sense of distrust between them" and "tension" that contributes to "the sometimes odd interaction between them").

52. *See* Emenaker v. Peake, 551 F.3d 1332, 1339 (2008) ("[B]ecause it would be imprudent for us to address the issue without the benefit of its having been properly presented to, and decided by, the Veterans Court, we decline to address the issue in the first instance."). Recently, the Supreme Court reversed the Federal

inevitable from the dual layers of appellate review chosen by Congress that the VA adjudication system is often charting a course through a suddenly shifting landscape of precedential case law.[53]

2. Attorney Involvement

One change that flowed naturally from the advent of judicial review was the revision of a Civil War-era statute that severely limited compensation of attorneys assisting in veterans benefits claims.[54] Although a small number of powerful claims agents had dominated the landscape of veterans benefits claims in the post-Civil War era,[55] by the time of the VJRA, a vast network of pro bono non-attorney representatives sponsored by veterans service organizations had replaced them.[56] The VJRA changed this setup by permitting appellants at the CAVC and Federal Circuit to hire attorneys and, if the matter were remanded, to keep them before all levels of VA.[57]

Although Congress opened the door to attorneys, it could not force them through it. The statute's design may have contributed to the slow increase in attorney participation. The VJRA restricted attorney compensation[58] and allowed non-attorney practitioners such as veterans service officers (VSOs) employed by the major veterans organizations, who practiced before the BVA, to appear

Circuit's decision in *Sanders v. Nicholson*, 487 F.3d 881 (2007). The Court noted that the Federal Circuit's jurisdiction was limited, and that "the Veterans Court, which has exclusive jurisdiction over these cases, is likely better able than is the Federal Circuit to exercise an informed judgment" about the correct outcome of fact-specific problems. Shinseki v. Sanders, 129 S. Ct. 1696, 1707 (2009).

53. *See also* John Fussell & Jonathan Hager, *The Evolution of the Pending Claim Doctrine*, 2 VETERANS L. REV. 145 (2010) (describing years of uncertainty in this area as the CAVC and the Federal Circuit exchanged opinions addressing specific factual scenarios).

54. Charles L. Cragin, *The Impact of Judicial Review on the Department of Veterans Affairs' Claims Adjudication Process: The Changing Role of the Board of Veterans' Appeals*, 46 ME. L. REV. 23, 26–27 (1994) [hereinafter Cragin, *The Impact of Judicial Review*] (discussing history of the pre-VJRA $10 fee limit).

55. RICHARD SEVERO & LEWIS MILFORD, THE WAGES OF WAR: WHEN AMERICA'S SOLDIERS CAME HOME—FROM VALLEY FORGE TO VIETNAM 171 (1989) (stating that one observer in 1880 estimated that over 85% of all pending pension claims filed were controlled by fewer than 100 lawyers).

56. In 1992, Veterans Service Officers represented eighty-five percent of the appellants before the BVA. CHARLES L. CRAGIN, ANNUAL REPORT OF THE CHAIRMAN, BD. OF VETERANS' APPEALS, FOR FISCAL YEAR 1992 20 (1992) [hereinafter BVA CHAIRMAN'S REPORT FOR FISCAL YEAR 1992]. *See also* Helfer, *supra* note 20, at 159.

57. Veterans' Judicial Review Act of 1988, Pub. L. No. 100-687, 102 Stat. 4108 (codified as amended in scattered sections of 38 U.S.C.).

58. *Id.*

before the CAVC.[59] One scholar, recounting the history of the VJRA, asserted that Congress intentionally designed the Act to be hostile to attorney involvement in the system, which had been dominated by non-attorney service officers from the major veteran service organizations for most of the twentieth century.[60] Additionally, it is not clear that any veterans organizations actively encouraged attorneys to practice veterans law after the VJRA.[61] Furthermore, many attorneys may have doubted whether developing a veterans law practice would be lucrative enough to justify having to learn an unfamiliar area of the law.[62]

Unsurprisingly, in the first decade of the CAVC, appellants were overwhelmingly pro se.[63] Initially, attorneys appeared in fewer than a quarter of the first 5117 cases decided by the CAVC.[64] In fiscal year 1992 (the first year for which the BVA published statistics), attorneys appeared in only sixty-three of the 33,483 cases decided by the BVA.[65] Even today, there are "fewer than 500 attorneys nationwide whose practices are primarily in veterans law,"[66] despite the fact that the number of veterans benefits claims is more than twice the total of all cases filed in the federal district

59. *Id.*; Pub. L. No. 100-687, 102 Stat. 4116 (1988).

60. *See* Helfer, *supra* note 20, at 169–70. *See generally* DAVIS R.B. ROSS, PREPARING FOR ULYSSES: POLITICS AND VETERANS DURING WORLD WAR II 10–11 (1969) (describing how American Legion built influence prior to World War II by developing network of "service officers" to assist both members and non-members in pursing claims).

61. *See infra* note 199.

62. *See e.g.*, Richard L. Revesz, *Specialized Courts and the Administrative Lawmaking System*, 138 U. PA. L. REV. 1111, 1164 (1990) ("When a court's procedures are not common to those of other courts, the high cost of becoming familiar with such procedures provides serious disincentives for lawyers to practice before the specialized court only occasionally.").

63. FOX, *supra* note 12, at 229–30. *See* U.S. COURT OF APPEALS FOR VETERANS CLAIMS, ANNUAL REPORTS, 1999–2008, http://uscourts.cavc.gov/documents/Annual_Report_-_20081.pdf. However, in fiscal year 2008, attorneys appeared in 76% of the cases by the time of resolution by the CAVC. *Id.* That same year, the number of cases handled by attorneys at the BVA had risen to 3467. BVA CHAIRMAN'S REPORT FOR FISCAL YEAR 2008, *supra* note 49, at 23. That is still only 7.9% of the cases before the BVA. *Id.*

64. Remarks of Chief Judge Frank Q. Nebeker, First Judicial Conference of the Court of Appeals for Veterans Claims, 4 Vet. App. XXX (1992).

65. BVA CHAIRMAN'S REPORT FOR FISCAL YEAR 1992, *supra* note 56, at 20.

66. PARALYZED VETERANS OF AM. ET AL., THE INDEPENDENT BUDGET FOR THE DEPARTMENT OF VETERANS AFFAIRS FISCAL YEAR 2010, at 39 (2009) [hereinafter INDEPENDENT BUDGET FOR FISCAL YEAR 2010], *available at* http://www.independentbudget.org/pdf/IB_2010.pdf.

courts.[67] As a result, even after twenty-two years of judicial review, cases involving claimants without attorney representation dominate the landscape of veterans law.[68]

Despite the prevalence of pro se litigants, the reintroduction of attorneys is a primary cause of more complex procedures for two reasons. First, by allowing attorneys to become involved only after the record on appeal is closed, the VJRA facilitates the complication of claim adjudication procedure.[69] On appeal, although attorneys can argue for reversal, in most situations it makes tactical sense to focus on arguing that procedural errors require a remand, so the case returns to the BVA where the record is reopened and issues can be fully developed.[70] For example, a lawyer who becomes involved at the CAVC level may realize that the veteran did not previously understand that his medical evidence was legally inadequate for some reason, such as his or her doctor's failure to state any rationale for the conclusion in the opinion. In this situation, ultimately prevailing on the merits depends on obtaining a remand from the CAVC on procedural grounds so that the attorney can introduce a new opinion to remedy the problem, regardless of the basis of the remand. Thus, the VJRA implicitly encourages attorneys to use the one-way ratchet of judicial review to expand the

67. *Compare* INST. OF MEDICINE OF THE NAT'L ACADEMIES, A 21ST CENTURY SYSTEM FOR EVALUATING VETERANS FOR DISABILITY BENEFITS 169 (2007) [hereinafter INSTITUTE OF MEDICINE], *available at* http://www.iom.edu/CMS/26761/34247/43423.aspx (reporting that VA received 806,000 claims for benefits in fiscal year 2006), *with* JAMES C. DUFF, STATISTICS DIV., ADMIN. OFFICE OF THE U.S. CTS., JUDICIAL BUSINESS OF THE UNITED STATES COURTS: 2007 ANNUAL REPORT OF THE DIRECTOR 14, *available at* http://www.uscourts.gov/judbus2007/JudicialBusinespdf version.pdf (reporting that 325,920 cases were filed in federal district courts in fiscal year 2007).

68. In fiscal year 2008, fewer than 8% of appellants at the BVA had an attorney, BVA CHAIRMAN'S REPORT FOR FISCAL YEAR 2008, *supra* note 49, at 23, and 24% of appellants at the CAVC were still pro se at the time their case was decided. U.S. COURT OF APPEALS FOR VETERANS CLAIMS, ANNUAL REPORTS, *supra* note 63. The Federal Circuit has recently clarified that "the assistance provided by [a non-attorney VSO] is not the equivalent of legal representation" and is "insufficient to disqualify [a veteran] as a pro se claimant." Comer v. Peake, 552 F.3d 1362, 1369 (Fed. Cir. 2009).

69. *See* Veterans' Judicial Review Act of 1988, Pub. L. No. 100-687, 102 Stat. 4108 (codified as amended in scattered sections of 38 U.S.C.); *see also* Bonhomme v. Nicholson, 21 Vet. App. 40, 43–44 (2007) (discussing general process for appealing veterans' claims, and role courts play in process).

70. *See* Ridgway, *Why So Many Remands*, *supra* note 46, at 153 n.231 (arguing that lack of attorney involvement at BVA level leads most attorneys at CAVC to focus on obtaining remand based on procedural error so that case can be further developed with open record).

procedural complexity of the system in the interest of generating remands.

Second, attorneys have taken a legislative advocacy role. For example, the National Organization for Veterans Advocates (NOVA), founded in 1993 and composed primarily of attorneys,[71] has become a significant force in Congress on issues relating to the VA adjudication system.[72] In this role, NOVA often promotes additional procedures in the name of protecting veterans.[73] For example, NOVA Executive Director Richard Cohen recently advocated legislation to create a class-action procedure for veterans claims, in order to manage what issues the CAVC decides and to make the notice requirements of 38 U.S.C. § 5103(a) in a more detailed manner.[74] Although its motives are laudable, such policies also have an inherent tendency to promote complexity.

3. Statutory Duty to Assist

Another watershed aspect of the VJRA was a codified general duty for the Secretary to assist claimants.[75] Prior to the VJRA, Congress required the Secretary to furnish applications to claimants[76] and to inform them when an application was incomplete.[77] The Secretary's duty to provide more general assistance—such as gathering service medical records and other supporting documents—existed only in regulations.[78] In contrast, the VJRA requires the

71. *See* NOVA Membership Directory, http://www.vetadvocates.com/membershipdirectory2.html (last visited Feb. 25, 2010).

72. *See, e.g.*, *Pending Benefits Legislation: Hearing Before the S. Comm. on Veterans' Affairs*, 110th Cong. III (2008) (including on witness list Richard Paul Cohen, Executive Director of NOVA); *Examining the Backlog and the U.S. Department of Veterans Affairs' Claims Processing System: Hearing Before the H. Comm. on Veterans' Affairs*, 110th Cong. iii (2008) (including on witness list Richard Paul Cohen, Executive Director of NOVA); *Oversight Hearing on Performance and Structure of the United States Court of Appeals for Veterans Claims: Hearing Before the S. Comm. on Veterans' Affairs*, 110th Cong. III (2007) (including on witness list Richard Paul Cohen, Executive Director of NOVA).

73. *See, e.g.*, *Legislative Hearing on H.R. 952, the "Compensation Owed for Mental Health Based on Activities in Theater Post-Traumatic Stress Disorder Act": Hearing Before the H. Comm. on Veterans' Affairs*, 111th Cong. 11 (2009) (testimony of Richard Paul Cohen, Executive Director of NOVA) (equating incorrect denial of veterans benefit claim with conviction of innocent criminal defendant).

74. *Examining Appellate Processes and Their Impact on Veterans: Hearing Before the S. Comm. on Veterans' Affairs*, 111th Cong. (2009).

75. Veterans' Judicial Review Act, Pub. L. No. 100-687, 102 Stat. 4106 (1988).

76. 38 U.S.C. § 3002 (1982).

77. 38 U.S.C. § 3003 (1982).

78. 38 C.F.R. §§ 3.102 (stating Secretary's duty to decide claims based upon all "procurable" evidence), 3.103 ("It is the obligation of the [VA] to assist a claim-

Secretary to assist a claimant "in developing the facts pertinent to the claim."[79]

The Senate Committee report on the Act indicates that Congress intended the section to "[c]odify . . . VA's present practices of providing claimants all reasonable assistance in the development of claims and construing the evidence liberally in favor of the claimant [so that they] are not lost in reaction to the provision . . . authorizing judicial review of final decisions denying claims."[80] At the very least, elevating the duty to assist from a regulatory requirement to a statutory requirement lowered the level of deference owed by the courts to the Secretary's interpretation.[81] In practice, the Secretary's duty to assist, particularly by providing medical examinations of claimants, became a central—if not *the* central—battleground in the CAVC's jurisprudence.[82] Nonetheless, as will be shown, the central cause of this duty-to-assist litigation—the expulsion of staff physicians from VA's adjudication process—did not occur until later.[83]

4. Other Important Changes

The VJRA added other elements to the system as well. First, the VJRA imposed a statutory requirement on the BVA to provide hearings at ROs by a "traveling section" of the BVA.[84] Previously, the BVA provided such hearings on an *ad hoc* and discretionary basis, so the new law dramatically increased the workload on the BVA. In fact, the BVA held 880 hearings in fiscal year 1991 as compared

ant in developing the facts pertinent to his claim . . . .") (1988). *See also supra* note 22 and accompanying text.

79. Veterans' Judicial Review Act, Pub. L. No. 100-687, 102 Stat. 4106 (1988). The provision explicitly included requesting records in the custody of an agent of the federal government. *Id.*

80. S. Rep. No. 100-418, at 22 (1988).

81. *Compare* Chevron, U.S.A., Inc. v. Natural Res. Def. Council, Inc., 467 U.S. 837, 844 (1984) (requiring deference to "reasonable" agency interpretations of statute administered by agency), *with* Auer v. Robbins, 519 U.S. 452, 461 (1997) (reaffirming that agency's interpretation of its own regulation is "controlling unless plainly erroneous or inconsistent with the regulation") (internal quotation marks omitted).

82. For a comprehensive review of the court's case law relating to the duty to assist, see VETERANS BENEFITS MANUAL 933–41 (Barton F. Stichman & Ronald B. Abrams eds., 2009); *see also* FOX, *supra* note 12, at 92–102.

83. *See infra* Part III.B.

84. Veterans' Judicial Review Act of 1988, Pub. L. No. 100-687, 102 Stat. 4110–12 (codified as amended in scattered sections of 38 U.S.C.).

to the 10,652 hearings it held in fiscal year 2008.[85] Second, the VJRA abolishes the presumption that an appellant before the BVA agreed with any determination by the RO that was not explicitly contested,[86] which broadens the scope of issues the BVA is required to address. Third, the VJRA subjects VA's rulemaking to the notice and comment procedures of the Administrative Procedure Act (APA).[87] Fourth, the VJRA introduced a new level of legislative oversight of VA's adjudication system by mandating that the BVA Chairman prepare a detailed report for Congress each year.[88] Finally, the VJRA required more detailed decisions by the BVA.[89]

With these profound changes, the VJRA ended the isolation of VA in myriad ways. After its passage, there has been a substantial increase in the interaction between different levels of VA, as well as more interaction with outside actors such as Congress, the federal courts, and attorneys. At its core, it provided a set of tools to review and expand almost every aspect of the adjudication process, including individual decisions, regulations and statutory interpretations, and VA's internal management issues. Rather than changing the established paternalistic entitlement model of the system, the VJRA brought numerous forms of transparency and accountability to bear upon it, which pushed towards increased complexity.

II.
OUTPUT OF THE VETERANS BENEFITS ADJUDICATION SYSTEM BEFORE AND AFTER THE VJRA

The changes brought by the VJRA have had a radical impact on the efficiency and accuracy of VA's ability to adjudicate claims. A consortium of the leading veterans organizations recently concluded that "[j]udicial review of VA decisions has, in large part, lived up to the positive expectations of its proponents,"[90] and a leading academic authority on veterans law opined that "[b]y most

85. Cragin, *The Impact of Judicial Review*, *supra* note 54, at 39; BVA CHAIRMAN'S REPORT FOR FISCAL YEAR 2008, *supra* note 49, at 3.

86. Veterans' Judicial Review Act of 1988, Pub. L. No. 100-687, 102 Stat. 4111 (codified as amended in scattered sections of 38 U.S.C.).

87. *Id.* at 102 Stat. 4106. Prior to the VJRA, litigants had only limited success in challenging VA regulations in federal courts on constitutional grounds. *See generally* Kenneth B. Kramer, *Judicial Review of the Theoretically Non-Reviewable: An Overview of Pre-COVA Court Action on Claims for Veterans Benefits*, 17 OHIO N.U. L. REV. 99–100 (1990).

88. Veterans' Judicial Review Act of 1988, Pub. L. No. 100-687, 102 Stat. 4112 (codified as amended in scattered sections of 38 U.S.C.).

89. *See infra* Part III.C.

90. INDEPENDENT BUDGET FOR FISCAL YEAR 2010, *supra* note 66, at 33.

measurements, the CAVC is doing a good job."[91] This praise is based on favorable results for veterans.

First, after the passage of the VJRA, VA grants a higher percentage of veterans claims. In the decade prior to the VJRA, VA denied approximately half of the 800,000 benefits claims received each year.[92] Of those 400,000 annual denials, veterans contested an average of 60,000 such denials.[93] The BVA heard 36,000 appeals of these denials,[94] granting 12% and remanding 13% for further proceedings.[95] Twenty-two years after the passage of the VJRA, the numbers—to the extent they are comparable[96]—are substantially different. The number of annual "claims" is now near 840,000.[97] Moreover, VA grants roughly 88% of claims for disability compensation[98] as to at least one disabling condition.[99] During fiscal year

91. FOX, *supra* note 12, at 251. Even more recently, another law professor who has studied the CAVC commented that judicial review has been successful, particularly in increasing the uniformity and predictability of VA decision making, enhancing the actual and perceived fairness of the system, and improving the overall quality of VA decisions. *Veterans' Disability Compensation: Forging a Path Forward: Hearing Before the S. Comm. on Veterans' Affairs*, 111th Cong. (2009) [hereinafter *Forging a Path Forward Hearing*] (testimony of Professor Michael P. Allen, Stetson University College of Law).

92. FOX, *supra* note 12, at 13.

93. *Id.*

94. An appeal may not result in a BVA decision for several reasons. In particular, benefits may be granted by the RO on review before the appeal is certified, or the appellant may fail to complete the appeal by filing a Substantive Appeal alleging specific allegations of error. *See* Ridgway, *Why So Many Remands*, *supra* note 46, at 148–49.

95. FOX, *supra* note 12, at 14.

96. Although VA reports statistics on "claims," it uses the term to refer to applications received instead of individual claims for benefits. Ridgway, *Why So Many Remands*, *supra* note 46, at 145–47. Recent trends show that the number of individual benefits claimed per application has been rising in recent years. *See* Veterans for Common Sense v. Peake, 563 F. Supp. 2d 1049, 1070 (N.D. Cal. 2008); INSTITUTE OF MEDICINE, *supra* note 67, at 169. Moreover, between ten and twenty percent of all applications have new claims raised during the processing of the initial claims. *Veterans for Common Sense*, 563 F. Supp. 2d at 1072. Hence, the available numbers tend to obscure a more substantial increase in the number of individual benefits decisions that VA makes each year.

97. *Veterans for Common Sense*, 563 F. Supp. 2d at 1070. *Cf.* DEPT. OF VETERAN'S AFFAIRS, FISCAL YEAR 2008 PERFORMANCE AND ACCOUNTABILITY REPORT 2 (2008) (stating that "VA processed more than 899,800 claims for disability benefits" in fiscal year 2008).

98. In fiscal year 2006, 654,000 of the 806,000 claims received by VA were claims for compensation. INSTITUTE OF MEDICINE, *supra* note 67, at 169.

99. *Veterans for Common Sense*, 563 F. Supp. 2d at 1070.

2007, the BVA granted 21% of the claims appealed to it and remanded over 35%.[100]

Second, in addition to the increased approval rates, the amount of compensation awarded has also risen. VA can rate a veteran's disabilities anywhere between non-compensable to 100% compensable, in 10% increments.[101] "In fiscal year 1987, [VA] paid about $14.3 billion [$26.8 billion in 2008 dollars[102]] in disability benefits to 3.8 million veterans."[103] That is an average of $7,060 per recipient in 2008 dollars. In fiscal year 2008, VA paid approximately $38 billion to 3.4 million veterans.[104] That is an average of $11,200 per recipient: an increase of 59%.[105] Accordingly, twenty-two years after the passage of the VJRA, a veteran applying for benefits has a substantially higher chance of at least partial success and is also likely to receive substantially more compensation.[106] In this

100. JAMES P. TERRY, FISCAL YEAR 2007 REPORT OF THE CHAIRMAN, BD. OF VETERANS' APPEALS 19 (2008) [hereinafter BVA CHAIRMAN'S REPORT FOR FISCAL YEAR 2007]. These numbers have been relatively stable. In the 2006 fiscal year, 19% were granted and 32% were remanded. JAMES P. TERRY, FISCAL YEAR 2006 REPORT OF THE CHAIRMAN. BD. OF VETERANS' APPEALS 19 (2007) [hereinafter BVA CHAIRMAN'S REPORT FOR FISCAL YEAR 2006]. In fiscal year 2005, 21% were granted and 39% were remanded. JAMES P. TERRY, FISCAL YEAR 2005 REPORT OF THE CHAIRMAN, BD. OF VETERANS' APPEALS 17 (2006).

101. 38 U.S.C. § 1114 (2006).

102. *See* ROBERT C. SAHR, CONSUMER PRICE INDEX (CPI) CONVERSION FACTORS 1774 TO ESTIMATED 2019 TO CONVERT TO DOLLARS OF 2008, http://oregonstate.edu/cla/polisci/faculty-research/sahr/cv2008.pdf (presenting CPI conversion table) (last visited Jul. 3, 2010).

103. PUBL'N NO. GAO-89-9, *supra* note 27, at 8.

104. *Veterans for Common Sense*, 563 F. Supp. 2d at 1069.

105. This actually understates the increase because the real value of compensation rates has declined. For example, in 1987 the compensation for a total disability rating was $1411 per month ($2647 per month in 2008 dollars). 38 U.S.C. § 314 (1987). By 2008, that rate had declined 6.6% in real value to $2471. 38 U.S.C.A. § 1114 (West 2008). Thus, the increase has occurred despite a decline in the real value of compensation rates. Although it is not entirely clear why the number of recipients has declined by 400,000, it seems likely due to the declining population of World War II veterans. Between 1994 and 2007, the number of living WWII veterans declined from 7.8 million to 2.9 million. *Compare* U.S. CENSUS BUREAU, 2009 STATISTICAL ABSTRACT OF THE U.S. Table 577, http://www.census.gov/prod/1/gen/95statab/defense.pdf, *with* U.S. CENSUS BUREAU, 1995 STATISTICAL ABSTRACT OF THE U.S., Table 576, http://www.census.gov/prod/1/gen/95 statab/defense.pdf.

106. This is not to say that these are attributable entirely to the VJRA. Furthermore, it can be debated whether this is a positive development. *See generally* Michael Waterstone, *Returning Veterans and Disability Law*, 85 NOTRE DAME L. REV. 1081 (2010). Some have argued that the system is fundamentally flawed because "[t]he entire system seems designed to encourage chronic disability." David Dobbs, *The Post-Traumatic Stress Trap*, SCI. AM., Apr. 2009, at 68 (noting that "most

sense, judicial review has had the effect desired by veterans advocates: it has preserved and enhanced the entitlement system.

However, the overall value of judicial review has also been questioned, primarily because the adjudication process takes dramatically longer to complete without a corresponding increase in accuracy.[107] Prior to the VJRA, VA took an average of 106 days to adjudicate a claim for benefits.[108] As of the fiscal year 2008, that time had risen to 183 days.[109] Although that change is substantial, it is dwarfed by the increase in appellate processing time within the agency. Between the fiscal years 1991 and 2008, the average time to process an appeal has more than doubled from 462 days[110] to almost three years.[111] As noted above, it is increasingly likely that an agency appeal will lead to a remand and even more delay before a final decision is reached.[112] This problem is not a recent development. For example, in 2000 the GAO reported that VA's backlog of

veterans getting PTSD treatment from the VA report worsening symptoms until they are designated 100 disabled—at which point their use of VA mental health services drops by 82 percent"). In this view, the system encourages veterans to focus—consciously or unconsciously—on their disabilities, rather than on trying to reintegrate with normal life.

107. *See, e.g.*, William F. Fox, Jr., *Deconstructing and Reconstructing the Veterans Benefits System*, 13 KAN. J.L. & PUB. POL'Y 339, 342 (2004); James T. O'Reilly, *Burying Caesar: Replacement of the Veterans Appeals Process is Needed to Provide Fairness to Claimants*, 53 ADMIN. L. REV. 223 (2001).

108. OFFICE OF INSPECTOR GEN., DEP'T OF VETERANS AFFAIRS, REP. NO. 5D2-B01-013, AUDIT OF APPEALS PROCESSING IMPACT ON CLAIMS FOR VETERANS' BENEFITS (1995), *available at* http://www.va.gov/oig/52/reports/1995/5D2-B01-013—appeals.htm.

109. *Veterans for Common Sense*, 563 F. Supp. 2d at 1070. By way of comparison, the average time for an initial decision in a social security disability claim currently hovers around 120 days. *See* SOC. SEC. ADVISORY BD., DISABILITY DECISION MAKING: DATA AND MATERIALS 84 (2006) [hereinafter DISABILITY DECISION MAKING], *available at* http://www.ssab.gov/sumrDisabilityChartbook.shtml.

110. *See* CHARLES L. CRAGIN, ANNUAL REPORT OF THE CHAIRMAN, BOARD OF VETERANS' APPEALS, FISCAL YEAR 1991 8 (1992). The requirement that the BVA chairman produce an annual report was instituted in the VJRA, *see supra* note 88, and the fiscal year 1991 report was the first one prepared under the statute. *See* DEP'T OF VETERANS AFFAIRS, BOARD OF VETERANS APPEALS ANNUAL REPORTS TO CONGRESS: 1991–2008, http://www.bva.va.gov/Chairman_Annual_Rpts.asp.

111. BVA CHAIRMAN'S REPORT FOR FISCAL YEAR 2008, *supra* note 49, at 19. The VA adjudication system is not the only one so afflicted. In the twenty years between 1985 and 2005, the processing time for an administrative appeal of a social security disability claim nearly tripled from approximately 160 days to 422 days. DISABILITY DECISION MAKING, *supra* note 109, at 85. This has prompted similar criticisms of that system. *See* Paul R. Verkuil & Jeffrey S. Lubbers, *Alternative Approaches to Judicial Review of Social Security Disability Cases*, 55 ADMIN. L. REV. 731, 768 (2003).

112. *See supra* notes 96 and 100 and accompanying text.

claims had been growing since 1996, and that "problems with large backlogs and long waits for decisions have not yet improved, despite years of studying these problems."[113]

In fairness to VA, the number of compensation claims—the most difficult to adjudicate[114]—received each year has increased about 53% over the last decade, from 468,000 to 719,000,[115] and VA's output has actually increased at a slightly faster pace over that time.[116] Furthermore, although the adjudication times for appeals are extreme, they affect only a minority of claims. Claimants dispute only a little over 10% of RO decisions, and the BVA reviews only about 5% of claims.[117] Beyond that, only about 0.5% of cases are appealed to the CAVC,[118] often resulting in remands and further delay,[119] and the number of veterans appeals that the Federal

113. U.S. GEN. ACCOUNTING OFFICE, VETERANS BENEFITS ADMINISTRATION: PROBLEMS AND CHALLENGES FACING DISABILITY CLAIMS PROCESSING, GAO/T-HEHS/AIMD-00-146 1–2 (2000) [hereinafter GAO REP. NO. GAO/T-HEHS/AIMD-00-146]. *See also* Cragin, *The Impact of Judicial Review*, *supra* note 54, at 41 (observing, five years after commencement of judicial review, that decisionmaking times "now has increased to more than threefold from what historically had been considered 'timely'"). *See generally* U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-10-213, FURTHER EVALUATION OF ONGOING INITIATIVES COULD HELP IDENTIFY EFFECTIVE APPROACHES FOR IMPROVING CLAIMS PROCESSING (2010); U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-07-512T, LONG-STANDING CLAIMS PROCESSING CHALLENGES PERSIST (2007); U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-05-749T, CLAIMS PROCESSING PROBLEMS PERSIST AND MAJOR PERFORMANCE IMPROVEMENTS MAY BE DIFFICULT (2005) (testimony of Cynthia A. Bascetta before Committee on Veterans' Affairs, U.S. Senate).

114. Compensation claims are difficult because they often raise complicated issues of medical diagnosis and causation, while most other benefits, such as educational benefits and home loan benefits, are based upon objective criteria that are usually easy to document. As a result, 94.4% of the appeals decided by the BVA each year involve compensation claims. *See* BVA CHAIRMAN'S REPORT FOR FISCAL YEAR 2008, *supra* note 49, at 22; BVA CHAIRMAN'S REPORT FOR FISCAL YEAR 2007, *supra* note 100, at 19; BVA CHAIRMAN'S REPORT FOR FISCAL YEAR 2006, *supra* note 100, at 19.

115. U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-09-910T, PRELIMINARY FINDINGS ON CLAIMS PROCESSING TRENDS AND IMPROVEMENT EFFORTS 7 (2009) [hereinafter PUBL'N NO. GAO-09-910T].

116. *Id.* at 4.

117. *See* BVA CHAIRMAN'S REPORT FOR FISCAL YEAR 2008, *supra* note 49, at 18, 21 (analyzing statistics for VA in 2006, in which there were 806,000 applications for benefits filed, 101,000 administrative appeals filed, and 39,000 administrative appeals prosecuted to the issuance of a BVA decision). There are several reasons why an appeal might be terminated before reaching the BVA, including the possibility that further development and review at the RO level will lead to a grant of benefits without reaching the BVA. *See* Ridgway, *Why So Many Remands*, *supra* note 47, at 148–49.

118. Ridgway, *Why So Many Remands*, *supra* note 46, at 151.

119. *See id.* at 152–57.

Circuit hears on the merits is negligible compared to the overall volume of claims.[120] Accordingly, although troubling delays plague the appeals process, the overwhelming majority of veterans do not experience them.

Ultimately, the best measure of how well the system is performing is the accuracy of the decisionmaking. One commentator cautioned that "in any large scale benefit program that must make complex factual and legal determinations for a large number of cases, [i]t is easy to focus on the relatively small percentage of cases that are problematic and overlook the majority of cases in which the system works relatively well."[121] However, the small sample of cases appealed to the CAVC suggests agency errors are frequent, as the CAVC fully affirms fewer than 35% of the BVA decisions that it addresses on the merits.[122] On a wider scale, VA's Office of Inspector General released a report in March 2009 concluding that VA's internal quality control system was under-reporting errors, and estimated that 203,000 of the 882,000 (24%) compensation claims decided over a one-year period contained non-technical errors that affected the amount of benefits paid.[123] This report followed a previous one that found disturbing variances in the treatment of claims between different ROs,[124] and a 2000 GAO report stating that stricter quality review measures implemented in 1999 showed that initial RO decisions were correct only 68% of the time.[125] Thus, there is ample reason to be concerned about how well the current VA adjudication process works.

120. *See* U.S. COURT OF APPEALS FOR THE FEDERAL CIRCUIT, APPEALS FILED IN MAJOR ORIGINS, *available at* http://www.cafc.uscourts.gov/pdf/10yrHistCaseldBy-Origin99-08.pdf (showing that Federal Circuit has been receiving about 200 appeals from CAVC each year); Allen, *Significant Developments*, *supra* note 35, at 492 (noting that Federal Circuit issued only 63 written opinions on the merits in two years covered by study).

121. Levy, *supra* note 2, at 323.

122. *See* Ridgway, *Why So Many Remands*, *supra* note 46, at 154. It is difficult to extrapolate the results from CAVC appeals because there is no basis for determining whether these self-selected, largely pro se appeals are a representative sample of claims decided at the RO or BVA level.

123. VA OFFICE OF INSPECTOR GEN., DEP'T OF VETERANS AFFAIRS, REP. NO. 08-02073-96, AUDIT OF VETERANS BENEFITS ADMINISTRATION COMPENSATION RATING ACCURACY AND CONSISTENCY REVIEW ii (2009) (analyzing claims in the twelve months ending in February 2008). The report does not suggest that the errors systematically over- or under-paid claimants. *See also* U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-08-473T, CLAIMS PROCESSING CHALLENGES PERSIST, WHILE VA CONTINUES TO TAKE STEPS TO ADDRESS THEM (2008).

124. VA OFFICE OF INSPECTOR GEN., REP. NO. 05-00765-137, REVIEW OF STATE VARIANCES IN VA DISABILITY COMPENSATION PAYMENTS (2005).

125. *See* GAO REP. NO. GAO/T-HEHS/AIMD-00-146, *supra* note 113, at 5–6.

In summary, after twenty-two years of judicial review, claims are taking longer for VA to adjudicate, but are producing more favorable results for claimants. Unfortunately, empirical data suggests that a substantial portion of the decisions are unreliable. This raises the question of how the VJRA directly or indirectly caused this situation.

III.
JUDICIAL REVIEW AND THE DECISIONMAKING PROCESS

A. Prelude: The Appellate Judges

One of the first steps in implementing the VJRA was for the President to nominate the judges for the newly formed CAVC. Article III appellate judges are frequently drawn from the ranks of the trial judges who, in turn, are often former trial attorneys.[126] It has been argued that this osmosis of experience between levels is a major contributing factor to the rate of affirmances by the appellate courts, due to the tendency of those judges to identify with their brethren "in the judicial trenches."[127] In contrast, none of the original members of the CAVC, an Article I court, had any direct experience with adjudicating individual claims.[128] Currently, only two of the seven judges have any direct experience litigating veterans claims.[129] Consistent with this trend, none of the judges appointed to the Federal Circuit since Congress passed the VJRA have had any veterans law experience.[130] Thus, the judges conducting judicial review of the VA adjudication system have added new perspectives to the process rather than merely conducting deferential reviews of claims. This characteristic is neither completely positive nor negative, but it does increase the likelihood that such review will alter the status quo and lead to changes in the system, which ultimately leads to less predictability and a longer process for claimants.

126. UNITED STATES DEP'T OF STATE, OUTLINE OF THE U.S. LEGAL SYSTEM 142–43 (2004), *available at* http://www.america.gov/publications/books//outline-of-u.s.-legal-system.

127. *See* Harlon Leigh Dalton, *Taking the Right to Appeal (More or Less) Seriously*, 95 YALE L.J. 62, 79 (1985).

128. *See* FOX, *supra* note 12, at 260–63 ("Appendix C: Biographies of the Judges of the [CAVC]").

129. United States Court of Appeals for Veterans Claims, Judges, http://www.uscourts.cavc.gov/about/judges/ (last visited Jul. 3, 2010).

130. United States Court of Appeals for the Federal Circuit, Judicial Biographies, http://www.cafc.uscourts.gov/judgbios.html (last visited Jul. 3, 2010). *See also* Pamela Banner Krupka, *An Interview with Chief Circuit Judge Paul R. Michel*, 2 LANDSLIDE 18, 23 (2009).

B. Colvin v. Derwinski *and the Separation of Medical and Legal Issues*

One major effect not explicit in the VJRA was a makeover of the BVA by removing its staff physicians from the claims adjudication process. Prior to the VJRA, the BVA contained both lawyers and doctors, who reviewed cases in panels of three.[131] Although this setup facilitated detailed discussions of medical and legal principles, the BVA did not record those discussions, and its decisions often rejected favorable medical evidence in the claims file while citing only "sound medical principles."[132] The CAVC quickly recognized that continuing this procedure would make judicial review a practical impossibility. Accordingly, in one of its earliest decisions, *Colvin v. Derwinski*,[133] the CAVC declared that the BVA must base its decisions upon "independent medical evidence."[134]

The practical effect of this decision was that VA decided to eliminate the physicians on the BVA and the RO rating teams.[135] As a result, the BVA and the RO now lack the medical expertise necessary to resolve claims (either favorably or unfavorably) if the medical evidence in the file was inadequate to resolve every medical issue,[136] and inadequate medical evidence accounts for about a third of all cases remanded by the BVA.[137] The importance of this

131. Cragin, *The Impact of Judicial Review*, *supra* note 54, at 24.

132. *Id.* at 25.

133. 1 Vet. App. 171 (1991).

134. *Id.* at 175.

135. Cragin, *The Impact of Judicial Review*, *supra* note 54, at 26. Shortly after *Colvin* was decided, the Chairman of the BVA publicly discussed how the BVA was having difficulty in deciding how to utilize the physician members of the BVA in light of the CAVC's decision. *See* Cragin, *supra* note 19, at 501–04.

136. Medical opinions may be considered inadequate for a number of reasons. *See, e.g.*, Miller v. West, 11 Vet. App. 345, 348 (1988) (failure to explain factual basis); Reonal v. Brown, 5 Vet. App. 458, 461 (1993) (reliance on factual basis that BVA rejects in whole or in part); Stefl v. Nicholson, 21 Vet. App. 120, 124 (2007) (failure to provide reasons for conclusion reached); Robinson v. Mansfield, 21 Vet. App. 545, 553 (2008) (failure to address theory of causation suggested by record). *See generally* James D. Ridgway, *Lessons the Veterans Benefits System Must Learn on Gathering Expert Witness Evidence*, 18 FED. CIR. B.J. 405, 408–11 (2009) [hereinafter Ridgway, *Lessons the Veterans Benefits System Must Learn*].

137. *See* U.S. GOV'T ACCOUNTABILITY OFFICE, VA CAN IMPROVE ITS PROCEDURES FOR OBTAINING MILITARY SERVICES RECORDS, GAO-07-98, at 7 (1996) (reporting that between November 2004 and January 2006, leading basis for remand from the BVA to the RO was to obtain adequate medical opinion (36.3% of remanded cases)); *Hearing to Receive the Report of the VA Claims Processing Task Force (Cooper Report) Before the H. Comm. on Veterans' Affairs*, 107th Cong. 79 (2001) [hereinafter *VA Claims Processing Task Force*] (reporting that inadequate medical evidence caused one third of remands from BVA).

change is difficult to overstate. Prior to the VJRA, the adjudication process was streamlined to gather medical records and put them before a panel of legal and medical specialists for a collaborative decision. After *Colvin*, VA splintered the process into separate procedures for analyzing medical evidence and then applying legal standards to it. Although the duty to assist was relatively straightforward when it focused on gathering records, *Colvin* completely changed its focus to generating independent medical opinions.[138] In other words, the VJRA indirectly caused the separation of legal and medical expertise within the system, and required the development of a more robust duty to assist to reconnect these halves.[139] Thus, it is not surprising that the duty to assist has been subjected to so much litigation, thereby increasing the cost and time of claim adjudication.[140]

C. The Reasons or Bases Requirement

In addition to forcing a remake of the BVA, the CAVC also quickly developed one of the most demanding rubrics of appellate review known in the American legal system. Prior to the VJRA, the BVA's jurisdictional statute required only that "[t]he decisions of the [BVA] shall be in writing and shall contain findings of fact and conclusions of law separately stated."[141] The VJRA added a further requirement that the BVA state "the reasons or bases for those findings and conclusions, on all material issues of fact and law

138. This change took a little time to develop. It was not until three years after *Colvin* that the CAVC explicitly held that the duty to assist "may, under appropriate circumstances, include a duty to conduct a thorough and contemporaneous medical examination." Caffrey v. Brown, 6 Vet. App. 377, 381 (1994). *See generally* Fox, *supra* note 12, at 92–102 (discussing development of CAVC's duty-to-assist case law). Although VA's duty to assist has been a statutory and regulatory issue for the last twenty-two years, the Federal Circuit may be on the verge of elevating many of the disputes to the constitutional due process level. *See* Gambill v. Shinseki, No. 2008-7120, slip op. at 1 (Fed. Cir. Aug. 13, 2009) (Moore, J., concurring) (arguing that claimants may have due process right to "confront" VA doctors who provide medical opinions on their claims, including right to serve them with interrogatories). *But see id.* (Bryson, J., concurring) (rejecting existence of such right under due process).

139. For a comprehensive review of the role of medical evidence in VA adjudications before and after *Colvin*, see Ridgway, *Lessons the Veterans Benefits System Must Learn*, *supra* note 136.

140. The "selective re-litigation" model would suggest that persistent litigation is a sign that the current rules are inefficient and that litigation will continue until the underlying rules are refined. *See* E. Donald Elliott, *Law and Biology: The New Synthesis?*, 41 St. Louis U. L.J. 595, 600–01 (1997).

141. 38 U.S.C. § 4004(d) (West 1979).

presented on the record."[142] The early case law of the CAVC quickly turned this standard into an extremely probing form of review. The CAVC did not adopt the traditional appellate rule that a decision below be affirmed if there was any view of the evidence that supported the conclusion,[143] Instead the CAVC held that a reasons or bases error "frustrates judicial review," and will ordinarily not reach the merits of an issue in such cases unless the BVA explicitly has made all the relevant findings of fact and explained why any unfavorable findings were resolved against the veteran; in such cases the CAVC remands without addressing the merits.[144] As a result of this requirement, the CAVC functionally required the BVA to earn deference before it would substantively review the matter.[145] Therefore, "[i]n practice, [the reasons or bases] requirement means that it is not enough that there be sufficient evidence of record to support a BVA decision. Instead, the decision must affirmatively discuss all the relevant evidence and law, and articulate a valid and comprehensive basis for denying benefits."[146] This stern standard has been applied by the court "continuously and unremittingly since the Court began deciding cases in 1989."[147] Both the BVA and veterans groups have asserted that this standard substantially increased the amount of work and length of time it takes to produce BVA decisions.[148] Thus, this standard has added a substantial layer of formality to a once highly informal system.

In retrospect, the development of this standard is not surprising. The original judges of the court had no direct experience with the adjudication of individual claims, they reviewed decisions by BVA members accustomed to announcing conclusions with little explanation, and they handled appeals that were overwhelmingly pro se.[149] These circumstances often put the CAVC in the "some-

142. Veterans' Judicial Review Act of 1988, Pub. L. No. 100-687, 102 Stat. 4111 (codified as amended in scattered sections of 38 U.S.C.).

143. *See* Gilbert v. Derwinski, 1 Vet. App. 49, 57 (1990) ("[T]he Board must identify those findings it deems crucial to its decision and account for the evidence which it finds to be persuasive or unpersuasive. These decisions must contain clear analysis and succinct but complete explanations. A bare conclusory statement, without both supporting analysis and explanation, is neither helpful to the veteran, nor clear enough to permit effective judicial review, nor in compliance with statutory requirements.") (internal quotation marks omitted).

144. *See*, *e.g.*, McNeely v. Principi, 3 Vet. App. 357, 364 (1992) (relying on *Gilbert* to remand matter for Board to rule on issues raised by Court).

145. *See* Ridgway, *Why So Many Remands*, *supra* note 46, at 137.

146. *Id.* at 136.

147. Fox, *supra* note 12, at 108.

148. *Id.* at 109.

149. *See supra* note 56 and accompanying text.

what awkward position [of] handling review of a pro se appeal where the appellant [was] totally incapable of articulating, in terms [the court could] understand, what he or she [didn't] like about the decision of the [BVA]."[150] Faced with trained VA attorneys dismantling the arguments made in unsophisticated, informal briefs,[151] the court developed this aggressive standard to ensure that the issues were presented in a meaningful way despite the disparity in the skills of the advocates, thereby providing meaningful review for the mostly pro se appellants.[152] This is not to say that the CAVC has not been impartial. Rather, to provide meaningful judicial review, the court needed a tool to make sure that issues were presented to it in a meaningful way despite the disparity in skill of the advocates before it.[153] The heightened standard for the conclusions of the BVA made its reasoning more transparent, thereby sharply reducing the BVA's ability to avoid complex issues with vague statements and conclusory findings.

150. Nebeker, *supra* note 64, at XXXIII.

151. In the first "State of the Court" speech for the CAVC, then-Chief Judge Nebeker compared reviewing such cases to watching "a good tennis player who's pitted against a novice. Can't play worth a damn." *Id.* at XXX.

152. The Court also took an active interest in growing the veterans bar. Shortly after the court opened, Chief Judge Nebeker recommended to Congress that the unspent portion of the CAVC's budget be used "[t]o develop a pro bono representation program." *Departments of Veterans Affairs and Housing and Urban Development and Independent Agencies Appropriations for Fiscal Year 1993: Hearing Before the H. Comm. on Veterans' Affairs*, 102nd Cong. (1992) (testimony of Chief Judge Frank Q. Nebeker) (describing recommendation and results). The Veterans Pro Bono Consortium was created in 1992. *See Dire Emergency Supplemental Appropriations and Transfers for Relief from the Effects of Natural Disasters, for Other Urgent Needs, and for the Incremental Costs of "Operation Desert Shield/Desert Storm" Act of 1992*, Pub. L. No. 102-229, 105 Stat. 1701, 1710 (1991); VETERANS CONSORTIUM PRO BONO PROGRAM, 2006 ANNUAL REPORT 2 (2007), *available at* http://www.vetsprobono.org/pdf/ProBono_AR06.pdf.

153. This raises the interesting issue of whether the uniform application of the reasons or bases requirement continues to be appropriate as more claims are presented with the full assistance of counsel below. The courts have struggled with this issue. *Compare* Comer v. Peake, 552 F.3d 1362, 1368–69 (Fed. Cir. 2009) ("A liberal and sympathetic reading of appeal submissions is necessary because a pro se veteran may lack a complete understanding of the subtle differences in various forms of VA disability benefits and of the sometimes arcane terminology used to describe those benefits."), *with* Acciola v. Peake, 22 Vet. App. 320, 323 (2008) ("[T]he Secretary concede[s] that all pleadings are read sympathetically regardless of any type of representation."). *See generally* Reiss & Tenner, *supra* note 3.

D. The Right to "One Review on Appeal"

The reasons or bases standard was not the most dramatic constraint on the BVA's decisionmaking authority. Prior to the VJRA, the BVA consisted of a group of legal and medical professionals who reviewed the decisions of lay RO adjudicators de novo.[154] The advent of the VJRA's judicial review limited the ability of the BVA to re-analyze claims when the CAVC held that "fair process" required the BVA to notify a claimant of any authorities that it intended to rely upon that had not been previously raised.[155]

Nonetheless, VA continued to look for ways for the BVA to minimize remands and bring finality to claims. In 2002, it proposed to allow the BVA to develop new evidence and consider that evidence in the first instance.[156] However, the BVA's jurisdictional statute provides that "[a]ll questions in a matter . . . subject to decision by the Secretary shall be subject to one review on appeal" by the BVA.[157] In *Disabled American Veterans v. Secretary of Veterans Affairs* (*DAV*), the Federal Circuit concluded that this provision generally prohibits the BVA from considering new evidence.[158] The *DAV* decision forced VA to disband the BVA's Evidence Development Unit and cede direct control to the ROs over correcting development problems, such as gathering relevant records and obtaining a comprehensive medical opinion based upon an accurate factual history.[159] Subsequently, VA promulgated regulations in response to *DAV* requiring remand of cases not only for consideration of new evidence developed by VA, but also of new evidence submitted by claimants during the appellate process.[160] As a result, the BVA's role shifted from that of a superior trial court toward that of an inferior appellate court. In turn, procedural issues frequently arise when BVA decisions vary from the rationale stated by the RO so as to suggest it considered some piece of evidence or legal authority in the first instance.[161]

154. *See* Cragin, *The Impact of Judicial Review*, *supra* note 54, at 24.

155. Thurber v. Brown, 5 Vet. App. 119, 126 (1993).

156. 38 C.F.R. §§ 19.9(b)(2), 20.901(a) (2002).

157. 38 U.S.C. § 7104(a) (2006).

158. *Disabled American Veterans v. Secretary of Veterans Affairs*, 327 F.3d 1339, 1346–68 (Fed. Cir. 2003).

159. VETERANS BENEFITS MANUAL, *supra* note 82, § 13.5.4, at 1040–41.

160. 38 C.F.R. § 20.1304(c) (2009)*; see also* 69 Fed. Reg. 53807 (Sept. 3, 2004) (noting that regulation had been modified from version issued in 67 Fed. Reg. 3105 (Jan. 21, 2002) "to conform to a recent decision from the United States Court of Appeals for the Federal Circuit").

161. *See, e.g.*, Gardner v. Shinseki, 22 Vet. App. 415, 418 n.2 (2009) (questioning whether *DAV* permits BVA to address merits of claim after reversing RO deci-

In conclusion, a survey of a few of the key changes demonstrates that judicial review has been about much more than micromanaging specific aspects of the process that existed in 1989. Judicial review has fundamentally reinvented the process in a way that requires many more steps to complete and that demands VA show each step was completed properly. For example, the CAVC helped formalize detailed requirements based upon existing VA authorities in many areas of benefits adjudication with special procedures, including post-traumatic stress disorder claims,[162] the rating of mental disabilities,[163] lost service records,[164] undiagnosed illnesses related to the first Gulf War,[165] exposure to chemical

sion declining to reopen claim); Urban v. Principi, 18 Vet. App. 143, 145–46 (2004) (per curiam) (observing that *DAV* might preclude BVA from addressing in the first instance new issues raised by favorable ruling on issue appealed by appellant); Pelegrini v. Principi, 18 Vet. App. 112, 123 (2004) (noting other regulatory provisions called into question by *DAV* to the extent that they appear to permit BVA to consider evidence in the first instance). The leading consortium of major veterans groups has concluded that these practical effects of *DAV* have not been healthy for the system and recently recommended that "Congress should allow the [BVA] to directly hear new evidence in cases certified to it, rather than require VA's [ROs] to hear the evidence . . . ." AMVETS ET AL., THE INDEPENDENT BUDGET FOR THE DEPARTMENT OF VETERANS AFFAIRS FISCAL YEAR 2011, 27 (2010) [hereinafter INDEPENDENT BUDGET FOR FISCAL YEAR 2011], *available at* http://www.independentbudget.org/2011/3_GOE.pdf.

162. *See*, *e.g.*, Bradford v. Nicholson, 20 Vet. App. 200, 204–05 (2006) (detailing VA's duty to seek corroboration of in-service sexual assault); Sizemore v. Principi, 18 Vet. App. 264, 270–75 (2004) (detailing VA's duty to seek corroboration of claimant's combat experience). *See generally* Shera Finn et al., *VA's Duty to Assist in the Context of PTSD Stressor Verification: What Must VA Do to Fulfill the Veterans Claims Assistance Act of 2000?*, 1 VETERANS L. REV. 50 (2009) (discussing procedural aspects of VA's verification duties under Veterans Claims Assistance Act).

163. *See*, *e.g.*, Mauerhan v. Principi, 16 Vet. App. 436, 443 (2002) (holding VA's rating criteria for mental disabilities allows adjudicators to consider symptom descriptions contained in DIAGNOSTIC AND STATISTICAL MANUAL OF MENTAL DISORDERS (4th ed. 1994)); Hood v. Brown, 4 Vet. App. 301, 303–04 (1993) (addressing meaning of adjective "definite" as used to rate mental disabilities).

164. *See*, *e.g.*, Russo v. Brown, 9 Vet. App. 46, 51 (1996) (holding that court's case law establishes "heightened duty" to assist when appellant's medical records have been lost or destroyed); Cuevas v. Principi, 3 Vet. App. 542, 548 (1992) (holding that BVA's duty to assist claimant in cases in which his service medical records are lost or destroyed "includes the obligation to search for alternate medical records").

165. *See*, *e.g.*, Stankevich v. Nicholson, 19 Vet. App. 470, 472–73 (2006) (discussing the proper method for rating an undiagnosed condition); Gutierrez v. Principi, 19 Vet. App. 1, 9–10 (2004) (discussing acceptable lay evidence of undiagnosed condition).

agents[166] and exposure to radiation.[167] Increased complexity, such as these new requirements, has become a major issue for the adjudication system, as acknowledged by VA management,[168] VA adjudicators,[169] the major veterans service organizations,[170] and the GAO.[171]

IV.
JUDICIAL REVIEW AND CLAIMANT RESPONSIBILITY

The increased complexity of the adjudication process stands in contrast to the relaxation of the procedural burdens on claimants. As in other areas of law that are receptive to simplified procedural requirements, such as relaxed pleading requirements for pro se liti-

166. *See*, *e.g.*, Stefl v. Nicholson, 21 Vet. App. 120, 124 (2007) (holding that VA doctor cannot summarily conclude that condition is not related to Agent Orange merely because National Institute of Health has not recognized significant statistical correlation).

167. *See*, *e.g.*, Earle v. Brown, 6 Vet. App. 558, 561–62 (1994) (discussing VA's duty to obtain dosage estimates for radiation exposed veterans).

168. *See*, *e.g.*, *Battling the Backlog Part II: Challenges Facing U.S. Court of Appeals for Veterans Claims: Hearing Before the S. Comm. on Veterans' Affairs*, 109th Cong. 36 (2006) (statement of James P. Terry, Chairman of the BVA) ("[A]ll of us involved in the adjudication system agree that cases have grown more complex, with more numerous issues and much larger records to review and consider. Even a case with just a few simple issues takes more time to process, when, as is increasingly common, the record on appeal may constitute thousands and thousands of pages.").

169. *Addressing the Backlog: Can the U.S. Department of Veterans Affairs Manage One Million Claims?: Hearing Before the Subcomm. on Disability Assistance & Memorial Affairs of the H. Comm. on Veterans' Affairs*, 111th Cong. 67 (2009) [hereinafter *Addressing the Backlog Hearing*] (statement of Michael Ratajczak, Decision Review Officer, VA Cleveland Regional Office on Behalf of the American Federation of Government Employees, AFL-CIO) (acknowledging increased complexity of claims and recommending additional training).

170. *See*, *e.g.*, INDEPENDENT BUDGET FOR FISCAL YEAR 2010, *supra* note 66, at 30 ("It is vital . . . that Congress recognize that the backlog will not go away overnight: it developed through years of increasing complexity of the claims development process with an overlay of judicial review."); *Examining the Backlog and the U.S. Department of Veterans Affairs' Claims Processing System: Hearing Before the H. Comm. on Veterans' Affairs*, 110th Cong. 101 (2008) (statement of Gerald T. Manar, Deputy Director, National Veterans Service, Veterans of Foreign Wars of the United States) (testifying that "as we have seen, increased complexity extends the time it takes to resolve claims and increases the opportunity for error").

171. *See* PUBL'N NO. GAO-09-910T, *supra* note 115, at 8 ("Another factor impacting VA's claims workloads—particularly the average time to complete a claim—is the complexity of claims received.").

gants,[172] the VA system was intended to be informal and claimant-friendly.[173] For example, in another early ruling, the CAVC established that it would interpret pro se arguments liberally.[174] However, the relaxed procedure in the veterans benefits adjudication system extends beyond reading pleadings liberally.

A. Informal Claims and Appeals

One set of procedural rules involves determining when a claim has been raised. Although VA has a formal application for benefits,[175] any "informal communication in writing requesting a determination of entitlement or evidencing a belief in entitlement, to a benefit" constitutes a claim.[176] A veteran is not required to "specify with precision the statutory provisions or the corresponding regulations under which he is seeking benefits."[177] As the CAVC explained:

> It is the pro se claimant who knows what symptoms he is experiencing that are causing him disability . . . . [and] it is the Secretary who knows the provisions of title 38 and can evaluate whether there is potential under the law to compensate an averred disability based on a sympathetic reading of the material in a pro se submission.[178]

Moreover, the Federal Circuit has ruled that it is the responsibility of VA to determine when an informal claim has been filed.[179] Thus, any correspondence to VA that mentions a condition or a

172. *See*, *e.g.*, Hughes v. Rowe, 449 U.S. 5, 15 (1980) ("An unrepresented litigant should not be punished for his failure to recognize subtle factual or legal deficiencies in his claims.").

173. *See* Hodge v. West, 155 F.3d 1356, 1362 (Fed. Cir. 1998) (stating that courts have "long recognized that the character of the veterans' benefits statutes is strongly and uniquely pro-claimant").

174. Myers v. Derwinski, 1 Vet. App. 127, 130 (1991). In fact, the very first published opinion of the CAVC noted that the court accepted jurisdiction of the case based upon a liberal construction of the petitioner's pro se pleadings because the veteran had not articulated a basis for the relief requested. *In re* Quigley, 1 Vet. App. 1, 1 (1990).

175. DEP'T OF VETERANS AFFAIRS, VETERAN'S APPLICATION FOR COMPENSATION AND/OR PENSION, VA FORM 21-526 (2004), *available at* http://www.vba.va.gov/pubs/forms/VBA-21-526-ARE.pdf.

176. 38 C.F.R. § 3.1(p) (2009). *See also* 38 C.F.R. § 3.155(a) (2009) (defining "informal claim" as "[a]ny communication or action, indicating an intent to apply for . . . benefits under the laws administered by the [VA]").

177. Akles v. Derwinski, 1 Vet. App. 118, 121 (1991).

178. Ingram v. Nicholson, 21 Vet. App. 232, 256–57 (2007).

179. *See* Moody v. Principi, 360 F.3d 1306, 1310 (Fed. Cir. 2004).

symptom can potentially raise an informal claim, even if the claimant is unaware of it.

Similarly, the CAVC has held that any expression of disagreement with an RO decision will put a claim into appellate status. In *Anderson v. Principi*,[180] the CAVC held appellant's correspondence stating that he "wonder[ed] why [his claim] wasn't allowed back in 1985" was sufficient to put his claim into appellate status because it should have been "[l]iberally interpreted" by VA as a Notice of Disagreement with the effective date assigned to his award of benefits.[181] Hence, VA must construe any correspondence expressing dissatisfaction with a decision as initiating an appeal. Notably, these rules have the effect of aiding claimants by expanding the scope and tenure of their claims, while simultaneously increasing the length and cost of adjudication for claimants.

B. Weak Abandonment

These generous rules of interpretation are particularly important because the veterans benefits adjudication system has a very weak concept of abandonment. The applicable provision of the Code of Federal Regulations declares claims abandoned when the claimant fails to respond to a VA request for evidence or an order to cooperate with a VA medical technician.[182] However, the CAVC has limited this regulation by holding that a claimant who refuses to cooperate with a VA medical examination ordered in relation to an original claim for benefits is still entitled to a decision on the merits of the claim based upon the evidence in the record.[183] In addition, the CAVC has held that if a claim is put into appellate status by a statement of disagreement with a decision, the appeal remains pending indefinitely.[184] Even subsequent denials of the same claim by an RO will not resolve the appeal if the claim does not reach the BVA.[185] The CAVC later held in *Norris v. West* that if a claim were raised, but not adjudicated, then it would also remain pending indefinitely.[186] Ultimately, the CAVC explained,

> [W]hen an appellant submits a claim or takes an action on a claim that puts the ball into the Secretary's court, it remains

180. 18 Vet. App. 371 (2004).

181. *Id.* at 375 (quotations omitted).

182. 38 C.F.R. § 3.158 (2009).

183. *See* Kowalski v. Nicholson, 19 Vet. App. 171, 176–77 (2005) (holding that 38 C.F.R. § 3.655(b) trumps 38 C.F.R. § 3.158(b)).

184. Tablazon v. Brown, 8 Vet. App. 359, 361 (1995).

185. Myers v. Principi, 16 Vet. App. 228, 235–36 (2002).

186. Norris v. West, 12 Vet. App. 413, 422 (1999).

> there—possibly for years—until the Secretary takes appropriate action to return the onus to the claimant to act within the time periods specified by statute and regulation.[187]

Moreover, even if a claimant were to receive a final decision from VA, the Federal Circuit has recently indicated that the claimant may still challenge it decades later on due process grounds, regardless of any intervening rulings on the claim.[188] Thus, issues and appeals are easy to raise and very hard to abandon, which lengthens the time and cost of the claims process.

C. Sua Sponte Development

The CAVC and the Federal Circuit have set forth very generous standards as to the Secretary's obligations after a claim has been raised. In *EF v. Derwinski*,[189] decided just three years after the passage of the VJRA, the CAVC built upon the liberal pleading standard established in *Myers* by holding that the Secretary's statutory duty to assist required VA to develop all issues raised in "all documents or oral testimony submitted prior to [a] BVA decision."[190] The CAVC has emphasized this point by frequently reiterating the duty in its published opinions.[191] Thus, although *Myers* required the Secretary to address all theories raised by the appellant regardless of how inarticulately they were expressed, *EF* extended this duty to all theories of entitlement raised by the record, even if the claimant was never aware of them. The Federal Circuit endorsed this position in *Schroeder v. West*,[192] when it held that the Secretary's duty to assist claimants "attaches to the investigation of *all* possible in-service causes of [a] current disability, including those unknown to

187. Ingram v. Nicholson, 21 Vet. App. 232, 242 (2007).

188. *See* Cushman v. Shinseki, 576 F.3d 1290, 1300 (Fed. Cir. 2009) (ruling that VA's original 1980 decision violated due process, and remanding matter for BVA to make de novo ruling on claimant's 1977 claim). However, the decision in *Cushman* was quickly criticized by another judge of the Federal Circuit. *See* Edwards v. Shinseki, 582 F.3d 1351, 1356–58 (Fed. Cir. 2009) (Rader, J., concurring) ("invit[ing] further inquiry" about *Cushman* and arguing that it was wrongly decided).

189. 1 Vet. App. 324 (1991).

190. *Id.* at 326.

191. *See*, *e.g.*, Urban v. Principi, 18 Vet. App. 143, 145 (2004) ("When reviewing [the appellant's] claim, the Board was obligated to consider all reasonably raised matters regarding the issue on appeal."); Brannon v. West, 12 Vet. App. 32, 34 (1998) (concluding that Board must "adjudicate all issues reasonably raised by a liberal reading of the appellant's substantive appeal, including all documents and oral testimony in the record prior to the Board's decision").

192. 212 F.3d 1265 (Fed. Cir. 2000).

the veteran."[193] Re-emphasizing this principle, the court later defined the broad breadth of VA's duties in *Roberson v. Principi* by holding that VA must "fully and sympathetically develop the veteran's claim to its optimum before deciding it on the merits."[194] Hence, in practice, the courts have interpreted the VA system as one in which claimants are absolved of any responsibility other than to report their complaints and may often raise procedural errors by the Secretary years, if not decades, after the fact.

Recently, the courts have retreated slightly from this standard. In *Robinson v. Mansfield*[195] (*Robinson I*), the CAVC again acknowledged that "[a]s a nonadversarial adjudicator, the Board's obligation to analyze claims goes beyond the arguments explicitly made," but concluded, "it does not require the Board to assume the impossible task of inventing and rejecting every conceivable argument in order to produce a valid decision."[196] This seemingly reasonable boundary provoked a dissent arguing that the Secretary's duty was not limited to those theories raised by the claimant or the evidence, but rather extended to all "possible" theories.[197] Nonetheless, the Federal Circuit affirmed the majority decision in *Robinson I*, and agreed that "[w]here a fully developed record is presented to the Board with no evidentiary support for a particular theory of recovery, there is no reason for the Board to address or consider such a theory."[198]

The *Robinson* decisions are particularly noteworthy because the appellant was not pro se before VA.[199] In fact, he had been assisted by an attorney for six years during the agency proceedings.[200] Both courts acknowledged the participation of the attorney, but concluded that it did not alter the Secretary's duty to scour the evidence for theories of entitlement that the attorney failed to present.[201] That conclusion in the *Robinson* decisions was not without precedent. VA had previously conceded that its policy is to

193. *Id.* at 1271.

194. Roberson v. Principi, 251 F.3d 1378, 1384 (Fed. Cir. 2001). Notably, *Roberson* traced its holding to *Hodge*, which relied upon the legislative history of the VJRA, rather than any statute or regulation defining the scope of VA's duty to claimants. *Id.* at 1384 (citing Hodge, 155 F.3d at 1362–63). *See also* Ingram v. Nicholson, 21 Vet. App. 232, 255 (2007) (discussing *Hodge*).

195. Robinson v. Mansfield (*Robinson I*), 21 Vet. App. 545 (2008).

196. *Id.* at 553.

197. *Id.* at 559 (Schoelen, J., dissenting).

198. Robinson v. Shinseki (*Robinson II*), 557 F.3d 1355, 1361 (Fed. Cir. 2009).

199. *Robinson I*, 21 Vet. App. at 554.

200. *Id.*

201. *Robinson II*, 557 F.3d at 1359–61; *Robinson I*, 21 Vet. App. at 552–53.

read *all* pleadings sympathetically, including those submitted by attorneys.[202] The CAVC has also concluded that if VA fails in its duty to notify a claimant of what general types of evidence are necessary to prove a claim, the fact that the claimant was represented by an attorney is not alone sufficient to rebut the presumption that such a notice error is prejudicial.[203] Thus, the limited increase in attorney involvement in the system has done nothing to ease the procedural burdens on VA.

D. Informality in Context

Although these rules of informality are important, it is more important to understand the context in which they operate. The CAVC has noted that "VA ROs do not operate under any form of a claim docket number system" and that "[v]eterans benefits litigation is frequently piecemeal."[204] Often, the process is characterized by "a continuous stream of evidence and correspondence" from the veteran.[205] Rather than a neatly organized docket that clearly defines the state of any given claim, all the paperwork pertaining to every claim filed by a single veteran ends up in a single pile.[206] As a result, a veteran's claim file will frequently be a disorganized "puzzle box."[207] Thus, it can be extraordinarily challenging to interpret any given document either when it arrives or when it is reviewed in retrospect.

More importantly, the non-attorney staff at VA's ROs bear the initial responsibility for noticing every informal claim raised, every theory of entitlement suggested by any of the evidence received, and every less-than-articulate appeal that arose during the unstructured correspondence.[208] This, however, is not to say that the sys-

202. Acciola v. Peake, 22 Vet. App. 320, 323 (2008).

203. *See* Overton v. Nicholson, 20 Vet. App. 427, 443–44 (2006) (determining that notice error was prejudicial even though claimant was represented by counsel). This holding provoked a dissent arguing that decision "create[d] a presumption that an attorney does not know how to prove a claim for VA benefits unless and until told how to do so by the Secretary[, which] is fundamentally inconsistent with an attorney's ethical obligation to know the relevant law in any area in which he or she practices." *Id.* at 445 (Lance, J., dissenting).

204. Ingram v. Nicholson, 21 Vet. App. 232, 253 (2007).

205. *Id.* at 254.

206. Carpenter, *supra* note 3, at 294–95 (describing in detail many problems with VA's claims file system).

207. *See* VETERANS BENEFITS MANUAL, *supra* note 82, § 16.1.2, at 1324.

208. Although a plurality of RO adjudicators have college degrees, a quarter do not. DANIEL HARRIS, FINDINGS FROM RATERS AND VSOS SURVEYS 14 (2007), *available at* https://www.1888932-2946.ws/vetscommission/edocumentmanager/gallery/Documents/2007_July/CNA_Raters&NVSO-Survey_FinalReport.pdf. Law-

tem has reached a point at which only attorneys have the sophistication to handle all of the duties imposed upon the Secretary. Nonetheless, as one union leader representing VA adjudicators has said, RO employees who are "expected to decide and evaluate [complex claims], in less than two hours, are generally not brain surgeons with law degrees."[209] Furthermore, as one VA attorney has written, the non-attorney staff at the ROs often brings a perspective to the job that is different from that ingrained in lawyers.[210] Even if they were to have both law and medical degrees, the RO staff is notoriously overworked and pressured to handle cases quickly.[211]

It is no mystery that VA's regional offices are simply not set up to handle the procedural burdens placed upon them. It can be debated what combination of management, personnel, information technology, procedural, and other changes should be made to allow VA's front lines to perform as intended.[212] However, until changes are made, the appellate litigation will continue to follow a predictable pattern of focusing on issues overlooked below.

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yers were originally part of the decisionmaking teams at the ROs, but VA phased them out prior to the VJRA rather than raise adjudicator salaries to remain competitive with inflation in the legal salary market. *See* Mueller, *supra* note 19, at 505.

209. American Federation of Government Employees, *Comment on Proposed Rule AM75: "Schedule for Rating Disabilities; Evaluation of Residuals of Traumatic Brain Injury"* 3–4 (2008), *available at* http://www.regulations.gov/fdmspublic/component/main?main=DocumentDetail&o=09000064803a7f6b.

210. Jeffery Parker, *Two Perspectives on Legal Authority Within the Department of Veterans Affairs Adjudication*, 1 VETERANS L. REV. 208, 211–212 (2009) (arguing that non-attorney staff at ROs focus on decisionmaking rules articulated in sub-regulatory authorities because they are not trained in legal analysis of general rules and do not find higher authorities useful in communicating with lay veterans).

211. *See, e.g.*, INDEPENDENT BUDGET FOR FISCAL YEAR 2010, *supra* note 66, at 21 (describing VA adjudicators as "[i]nadequately trained and overworked"). In 2008, a leader of the union representing VA adjudicators commented that the proposed regulation to rate traumatic brain injuries as "a difficult, burdensome regulation will be subverted by VA managers which will further pressure employees to take shortcuts on the case based on the threat of their livelihood." American Federation of Government Employees, *supra* note 209, at 1.

212. *See, e.g.*, INDEPENDENT BUDGET FOR FISCAL YEAR 2011, *supra* note 161, at 23–36 (containing reform recommendations from consortium of veterans groups); *Forging a Path Forward Hearing*, *supra* note 91 (Senate hearing on reform proposals); *Addressing the Backlog Hearing*, *supra* note 169 (House hearing on reform proposals).

E. Informality Rules and Litigation Incentives

Although the CAVC has held that VA has the responsibility to "review all the communications in the file"[213] to discover any "that could be interpreted as a formal or informal claim,"[214] in practice it is the attorneys who first become involved at the CAVC level who have the time and the training to mine a veteran's file for issues that were not properly developed. Unfortunately, by the time an attorney raises a potential claim or an appeal that was missed below, it is likely that many years have passed.[215] At that point, it is possible that the relevant substantive or procedural law has changed, maybe multiple times, and that the procedural posture will be muddled by years of intervening developments, re-openings, or collateral attacks based upon a different view of the claim's status.[216] Thus, the focus often becomes how to reassemble a procedural Humpty Dumpty. Moreover, there is often little evidence concerning the veterans' conditions in the distant past and there may be other factual uncertainties complicating the claim.[217]

Not only are the resulting procedural and factual issues difficult, but they are also attractive to attorneys. Because the broad duties to recognize claims and appeals have been applied retroactively,[218] they are among the most lucrative that an attorney can raise. Most paid attorneys in veterans cases work on a contingency fee basis based upon the amount of past due benefits awarded when a claim is granted.[219] The longer the gap between when a veteran

213. Lalonde v. West, 12 Vet. App. 377, 381 (1999).

214. *Id.*

215. *See supra* notes 107–113 (discussing length of time it takes to process claim at agency level).

216. *See*, *e.g.*, Savitz v. Peake, 519 F.3d 1312, 1313–16 (Fed. Cir. 2008) (remanding for determination as to whether appellant's 1946 claim remained pending due to court's determination that common law mailbox rule should be applied); Young v. Shinseki, 22 Vet. App. 461, 468–70 (2009) (accepting appellant's argument that BVA had misconstrued status of his claims after decade of adjudications, and remanding for potential application of pre-1996 law).

217. *See*, *e.g.*, Chotta v. Peake, 22 Vet. App. 80, 85–86 (2008) (remanding claim for consideration of obtaining retrospective medical opinion on veteran's condition from 1947 to 1999).

218. *See*, *e.g.*, Ingram v. Nicholson, 21 Vet. App. 232, 257 (2007) (applying the duty to recognize claims to a 1986 application for benefits); Criswell v. Nicholson, 20 Vet. App. 501, 503 (2006) (considering on merits whether appellant had originally raised claim in 1947).

219. *Benefits Legislative Initiatives Currently Pending Before the U.S. Senate Committee on Veterans' Affairs: Hearing Before the S. Comm. on Veterans' Affairs*, 109th Cong. 43–44 (2006) (statement of Richard Weidman, Director, Government Relations, Vietnam Veterans of America). *C.f.* 38 C.F.R. § 20.609(h) (2007) (allowing VA to

first files a claim and when VA finally grants it, the larger the amount of past due benefits awarded.[220] If a claim remains pending for decades before a court grants it, the potential award—and fee—can be quite large.[221] Therefore, when an attorney becomes involved in a case, there is a strong incentive to comb the appellant's file for old claims or appeals that VA should have recognized based upon a sympathetic reading of the file but failed to do so. Accordingly, the VJRA has inadvertently brought a new focus to the operation of the adjudication system. Rather than turning a new page on the adjudication system, it has invited close reexamination and reinterpretation of many VA decisions made in the era prior to the VJRA.

V.
REACTIONS TO JUDICIAL REVIEW

As much as judicial review and the interpretation of established statutes and regulations have shaped the VA adjudication process, case law tells only the beginning of the story of the VJRA. Both Congress and VA have actively responded to the courts' decisions and the effects thereof.

A. Congressional Involvement

Since the VJRA, Congress has become more active in managing the claims adjudication system. First, there has been a marked increase in congressionally commissioned examinations of the process. Although the GAO had regularly reviewed VA prior to the

pay contingent fee directly to attorney from award of benefits so long as it did not exceed twenty percent). The major veterans groups deliberately advocated for the significant restrictions on fee agreements in veterans cases in order to provide opportunities for non-attorneys from those organizations to practice before the CAVC. *See* Helfer, *supra* note 20, at 169–70.

220. *See* Wright v. Gober, 10 Vet. App. 343, 346–47 (1997) (citing 38 U.S.C. § 5110(a)).

221. For example, in 2009, a veteran rated as totally disabled was entitled to benefits of $2527 per month. 38 U.S.C.A. § 1114 (West 2009). Although the rate has been increased slightly every year, an award of a decade of back benefits can be worth a quarter million dollars, which translates to a $50,000 fee if the veteran had agreed to the 20% contingency fee that VA had defined as presumptively reasonable under its authority to invalidate unreasonable fee agreements. 38 C.F.R. § 20.609(f) (2007). However, the period of time in question can amount to much more than a decade. *See*, *e.g.*, *Ingram*, 21 Vet. App. at 257 (remanding in 2007 for determination of whether appellant's claim was first raised in 1986); *Criswell*, 20 Vet. App. at 503 (involving appellant in 2006 who argued claim had been pending since 1947).

VJRA,[222] the last two decades have witnessed numerous special, independent reviews requested by Congress.[223]

Second, Congress passed laws in response to appellate court rulings on the VA system, made possible by judicial review. Although the first decade of judicial review included some congressional alterations of the adjudication process, such as allowing the BVA to issue single-member decisions,[224] requiring the ROs to include more detail in their decisions,[225] and eliminating the requirement that private medical evidence be corroborated by a VA medical examination,[226] Congress's most dramatic intervention occurred in 2000 with the passage of the Veterans Claims Assistance Act (VCAA).[227] The immediate catalyst for the VCAA was the CAVC's ruling in *Morton v. West*[228] that the Secretary did not have statutory authority to provide a medical opinion for a claim that did not meet the threshold of being well grounded.[229] Thus, a claimant had to submit "a well grounded claim" before the Secretary was obligated under the duty to assist to obtain further medical evi-

222. *See*, *e.g.*, PUBL'N NO. GAO-89-9, *supra* note 27; PUBL'N NO. GAO-83-12, *supra* note 25.

223. *See generally* VETERANS' DISABILITY BENEFITS COMM'N, HONORING THE CALL TO DUTY: VETERANS' DISABILITY BENEFITS IN THE 21ST CENTURY (2007) (produced pursuant to Pub. L. No. 108-136); INSTITUTE OF MEDICINE, *supra* note 67; CENTER FOR NAVAL ANALYSIS, FINAL REPORT FOR THE VETERANS' DISABILITY BENEFITS COMMISSION: COMPENSATION, SURVEY RESULTS, AND SELECTED TOPICS (2007), *available at* https://www.1888932-2946.ws/vetscommission/e-documentmanager/gallery/Documents/Reference_Materials/CNA_FinalReport_August2007.pdf; NAT'L ACADEMY OF PUB. ADMIN., MANAGEMENT OF COMPENSATION AND PENSION BENEFITS CLAIM PROCESSES FOR VETERANS vii (1997) (commissioned by Senate Committee on Appropriations); VETERANS' CLAIMS ADJUDICATION COMMISSION REPORT (1996) (produced pursuant to Pub. L. No. 103-446). *Cf.* SERVE, SUPPORT, SIMPLIFY: PRESIDENT'S COMM'N ON CARE FOR AMERICA'S RETURNING WOUNDED WARRIORS (2007) [hereinafter DOLE-SHALALA REPORT], *available at* http://www.veteransforamerica.org/wp-content/uploads/2008/12/presidents-commission-on-care-for-americas-returning-wounded-warriors-report-july-2007.pdf.

224. Board of Veterans' Appeals Administrative Procedures Act of 1994, Pub. L. No 103–271, 108 Stat. 740, 742–43 (adjusting provisions relating to BVA's operation).

225. Veterans' Benefits Amendments of 1989, Pub. L. No. 101-237, 103 Stat. 2062, § 115.

226. Veterans' Benefits Improvement Act of 1994, Pub. L. No. 103-446, 108 Stat. 4645, § 301(b) (effectively modifying 38 C.F.R. § 3.157(b)(2) (1994)).

227. Veterans Claims Assistance Act of 2000, Pub. L. No. 106-475, 114 Stat. 2096 (2000).

228. 12 Vet. App. 477 (1999).

229. *Id.* at 481.

dence.[230] In effect, claimants could not obtain a medical opinion from VA unless they first submitted a private medical opinion.[231] The CAVC opinion recognized that Congress had probably not intended to add this threshold condition that claimants must satisfy when it created a statutory duty to assist in the VJRA and invited Congress to revise the statute.[232]

Congress responded, but did not limit its response to the issue decided in *Morton*. In addition to giving the Secretary broad authority to provide assistance to claimants, the VCAA required VA to seek government or private records in enumerated specific situations. The VCAA created the first explicit statutory duty to provide claimants with a medical opinion, and lowered the threshold from requiring a "well grounded claim" to requiring only evidence that "indicates" the claim might have merit.[233] More importantly, Congress added an entirely new duty. Pursuant to the VCAA, the Secretary must provide claimants notice "of any information and any medical or lay evidence . . . necessary to substantiate" the claims made.[234] Although this notice duty sounds straightforward in principle, in practice it has been subject to tremendous litigation and friction between the Secretary, who sought to satisfy this duty with generic notice letters, and veterans groups that wanted every notice letter tailored to the specific evidence already in the claims file.[235]

Congress followed the VCAA with mostly minor interventions[236] and waded back into the thick of the adjudication system

230. Grivois v. Brown, 6 Vet. App. 136, 140 (1994) ("[N]o duty to assist arises absent a well-grounded claim.").

231. This is not to say that *Morton* reached an absurd result. The well-grounded-claim threshold was still lower than that required to grant the claim. In many cases, claimants still needed a VA opinion because the private opinion that they submitted lacked sufficient detail to allow VA to grant the claim.

232. *Morton*, 12 Vet. App. at 485–86.

233. 38 U.S.C. § 5103A(d) (2006); *see also* McLendon v. Nicholson, 20 Vet. App. 79, 83–84 (2006).

234. 38 U.S.C. § 5103(a) (2006).

235. The Federal Circuit ultimately agreed with the CAVC that the notice requirement did not require the Secretary to pre-adjudicate the claim in order to provide notice. Wilson v. Mansfield, 506 F.3d 1055, 1062 (Fed. Cir. 2007) (reaching same conclusion as CAVC's decision in *Locklear v. Nicholson*, 20 Vet. App. 410, 415 (2006)). However, the Federal Circuit has held that notice must be tailored to the specific type of claim, *Wilson*, 506 F.3d at 1062, and the CAVC has held that notice must also be tailored to any factual findings made in a prior adjudication. Kent v. Nicholson, 20 Vet. App. 1, 9–10 (2006). *See generally* VETERANS BENEFITS MANUAL, *supra* note 82, at § 12.5.3 (detailing years of litigation involving notice requirement).

236. *See, e.g.*, Veterans Benefits Act of 2003, Pub. L. No. 108-183, § 701(b), 117 Stat. 2651, 2670 (abrogating Federal Circuit's interpretation of VCAA in *Para-*

with the Veterans Benefits Improvement Act of 2008 (VBIA).[237] The VBIA addressed the increasing length of the adjudication process by creating a mechanism for assigning a temporary disability rating during the pendency of certain types of claims and permitting substitution of a surviving spouse or dependant in cases where the veteran died before a claim was final.[238] However, perhaps wary of the litigation over the VCAA,[239] its chief provisions required the establishment of pilot programs to experiment with specified changes to the process.[240] The VBIA appears to represent a more cautious approach to intervention. Congress thus seems no less determined to tinker with the system, but has gained a new appreciation of how difficult it can be to translate abstract ideals into practice in such a complex yet informal system.

B. The Department of Veterans Affairs' Reaction

1. Management Strategy

Although VA has recognized the need to make changes to handle the developments brought about by judicial review, it has struggled to do so effectively. Like Congress, VA has repeatedly examined its processes.[241] For example, in June 1993, VA formed a "blue ribbon panel" to develop recommendations for revising the

lyzed Veterans v. Sec. of Veterans Affairs, 345 F.3d 1334, 1344–47 (Fed. Cir. 2003)); Veterans Benefits Act of 2002, Pub. L. No. 107-330, § 402, 116 Stat. 2820 (broadening jurisdiction of Federal Circuit over veterans claims).

237. Veterans' Benefits Improvement Act of 2008, Pub. L. No. 110-389, 122 Stat. 4145.

238. Veterans' Benefits Improvement Act of 2008, Pub. L. No. 110-389, §§ 211–212, 122 Stat. 4149–51 (authorizing temporary disability ratings for claimants asserting total unemployability and substitution upon death of claimant).

239. *See supra* note 235 and accompanying text (discussing litigation over substance of VCAA notice requirement) and note 46 (discussing years of litigation over how CAVC should consider whether VCAA notice error was prejudicial).

240. Veterans' Benefits Improvement Act of 2008, Pub. L. No. 110-389, § 221, 122 Stat. 4154 (creating pilot programs for expedited claim treatment and revised notice to claimants). VA and the major veterans groups continue to debate the relative success of these programs. *See Implementation and Status Update on the Veterans' Benefits Improvement Act, P.L. 110-389*: *Hearing Before the H. Subcomm. on Disability Assistance and Memorial Affairs of the H. Comm. on Veterans' Affairs*, 111th Cong. (2010).

241. *See VA Claims Processing Task Force*, *supra* note 137; OFFICE OF INSPECTOR GEN., REP. NO. 5D2-B01-013, *supra* note 108; BLUE RIBBON PANEL ON CLAIMS PROCESSING, PROPOSALS TO IMPROVE DISABILITY CLAIMS PROCESSING IN THE VETERANS BENEFITS ADMINISTRATION (Nov. 1993) [hereinafter VA BLUE RIBBON PANEL]. Furthermore, "[i]n September 2008, VA contracted with Booz Allen Hamilton to conduct a review of the rating-related claim development process to provide recommendations to improve the process," although it does not appear that a for-

adjudication process.[242] The panel made numerous recommendations, but focused on replacing "the current assembly-line process[ ]" with one that would bring "ownership and accountability" to the RO system.[243] Despite this recommendation, VA overhauled its procedures in 2001 at the RO level by adopting the more assembly-line driven "claims process improvement" (CPI) model.[244] The essence of the model is that VA breaks up the initial adjudication of claims into steps and a specialized team handles each step.[245] Not surprisingly, veterans groups have criticized the current system as suffering from a lack of accountability.[246] The fundamental problem is that it is difficult, if not impossible, to assign blame when different teams performed their task correctly based upon their subjective interpretation of which evidence in the file was credible and persuasive, but the final outcome was defective because of differences between the teams in how the evidence was evaluated.[247] As a result, there is a strong perception both outside and within VA that there is too much emphasis on productivity and too little emphasis on quality.[248]

The creation of the appeals management center (AMC) in 2003 was another change to the process made by VA that has since been criticized by veterans groups. The original concept of the AMC was to manage as many remands as possible in a single location that concentrated resources and expertise.[249] It was designed

mal report was made available publicly. *See Forging a Path Forward Hearing*, *supra* note 91 (testimony of Patrick W. Dunne, Under Secretary for Benefits).

242. *VA Claims Processing Task Force*, *supra* note 137, at 2–3.

243. VA BLUE RIBBON PANEL, *supra* note 241, at 5.

244. INSTITUTE OF MEDICINE, *supra* note 67, at 140. *See generally VA Claims Processing Task Force*, *supra* note 137.

245. INSTITUTE OF MEDICINE, *supra* note 67, at 141–44.

246. *See* Ridgway, *Lessons the Veterans Benefits System Must Learn*, *supra* note 136, at 422–23 (pointing out problem that arises when different teams within RO evaluate same evidence differently). *Compare* VA BLUE RIBBON PANEL, *supra* note 241, at 9–13 (recommending unified decisionmaking process), *with Examining the Effectiveness of the Veterans Benefits Administration's Training, Performance Management and Accountability: Hearing Before the H. Comm. on Veterans' Affairs*, 110th Cong. (2008) (criticizing current fragmented process).

247. *See* Ridgway, *Lessons the Veterans Benefits System Must Learn*, *supra* note 136, at 422–23.

248. *See, e.g.*, INDEPENDENT BUDGET FOR FISCAL YEAR 2010, *supra* note 66, at 26 (urging VA to "change a mind-set focused mostly on quantity-for-quantity's sake"), and note 211 and accompanying text.

249. *Board of Veterans' Appeals Adjudication Process and the Appeals Management Center*: *Hearing Before the H. Subcomm. on Disability Assistance and Memorial Affairs of the H. Comm. on Veterans' Affairs*, 110th Cong. 57 (2007) (statement of Arnold Russo, Director, AMC).

to operate as a specialized RO, whose staff would have expertise in interpreting BVA remand orders and developing the medical evidence needed to properly adjudicate remanded claims.[250]

Unfortunately, the AMC had difficulty in quickly meeting its goals due in large part to the steep learning curve for the new employees it hired.[251] Furthermore, a past president of the National Organization for Veterans Advocates (NOVA) noted in 2005 that more cases were being referred to the AMC than it was intended to handle and called it a "parking lot."[252] At a recent hearing, the Disabled American Veterans organization argued for the elimination of the AMC because of its unacceptably high twenty-five percent rate of errors requiring a remand for further notice or evidentiary development.[253] At the same hearing, NOVA added that the AMC operates as a "black hole" from which veterans can obtain no information about the status of their claims.[254] Furthermore, Disabled American Veterans has argued that even if the AMC worked as intended, it would still have the undesirable effect of relieving the ROs from the responsibility of correcting their past mistakes.[255] Accordingly, the current verdict on the AMC from veterans groups seems entirely negative.

The CPI model and the AMC may be the two most significant management changes in recent years, but they are far from the only practices of note. VA has also experimented with distributing hundreds of thousands of claims between regional offices in the last three years.[256] However, the GAO has criticized VA's implementa-

250. *Id.* at 28 (response of Arnold Russo, Director, AMC to question from Subcommitee Chairman John Hall).

251. *Id.* at 28–29.

252. *Battling the Backlog: Challenges Facing the VA Claims Adjudication and Appeal Process: Hearing Before the S. Comm. on Veterans' Affairs*, 109th Cong. 39 (2005) (statement of Robert Chisholm, Former President of the Nat'l Org. of Veterans Advocates).

253. *Review of Veterans' Disability Compensation: What Changes are Needed to Improve the Appeals Process?: Hearing Before the S. Comm. on Veterans' Affairs*, 111th Cong. (2009) (testimony of Kerry Baker, Legislative Director of Disabled American Veterans) [hereinafter Baker Testimony].

254. *Review of Veterans' Disability Compensation: What Changes are Needed to Improve the Appeals Process?: Hearing Before the S. Comm. on Veterans' Affairs*, 111th Cong. 75 (2009) (statement of Richard Paul Cohen, Executive Director of National Organization of Veterans' Advocates).

255. Baker Testimony, *supra* note 253. In theoretical terms, this is a leverage problem. If only a small portion of an agency's decisions are being reviewed, then each error found must result in strong negative reinforcement if review is to affect behavior. *See* James Salzman et al., *Regulatory Traffic Jams*, 2 WYO. L. REV. 253, 258 (2002). If review does not result in any feedback, it cannot affect behavior.

256. PUBL'N NO. GAO-09-910T, *supra* note 115, at 13.

tion of this program for its inability to measure the timeliness and consistency of decisions in such claims.[257] VA has also established "Tiger Teams" to deal with claims that are over one year old[258] and a Benefits Delivery at Discharge program for veterans that have recently concluded their active duty service.[259] Unfortunately, none of these initiatives have achieved breakthrough success.[260]

Most of VA's management choices are manifestations of its desire to deal with the increased burdens on the adjudication system through increases in productivity rather than staffing.[261] From 2000 to 2007, the staffing of VA's adjudicative branch "remained essentially flat" despite the backlog of claims rising seventy-five percent.[262] However, in 2007, VA abandoned the strategy of focusing exclusively on productivity and hired 3000 new full-time employees to handle the backlog.[263] In April 2009, VA announced its intent to

257. *Forging a Path Forward Hearing*, *supra* note 91 (testimony of Daniel Bertoni, Director Education, Workforce, and Income Security for GAO). The lack of good metrics is not unique to brokered claims. As a consortium of veterans groups has recognized, "claims are so complex, with so many potential variables, that meaningful trend analysis is difficult. As a consequence, [VA] rarely obtains data of sufficient quality to allow it to reform processes, procedures, or policies." INDEPENDENT BUDGET FOR FISCAL YEAR 2010, *supra* note 66, at 26.

258. *Forging a Path Forward Hearing*, *supra* note 91 (testimony of Patrick W. Dunne, Under Secretary for Benefits).

259. PUBL'N NO. GAO-09-910T, *supra* note 115, at 13.

260. *See supra* Part II (detailing problems that continue to plague system). Nonetheless, VA continues to look ways to improve the process. Very recently, VA Secretary Shinseki announced that an effort to seek innovation ideas from VA employees had produced ten suggestions for improving the claims adjudication process. *See* Press Release, VA Office of Public and Intergovernmental Affairs, Shinseki Announces Winners of Innovation Competition for Improving Claims Processing (Feb. 19, 2010), *available at* http://www1.va.gov/opa/pressrel/pressrelease.cfm?id=1852.

261. *Battling the Backlog: Challenges Facing the VA Claims Adjudication and Appeal Process: Hearing Before the S. Comm. on Veterans' Affairs*, 109th Cong. 37 (2005) (statement of Cynthia Bascetta, Director, Education, Workforce, and Income Security, Government Accountability Office) (discussing VA's management strategy "in the face of increasing workloads and decreased staffing levels").

262. THE INDEPENDENT BUDGET, CRITICAL ISSUES REPORT FOR FISCAL YEAR 2009, at 27 (2008), *available at* http://www.independentbudget.org/pdf/CI_FY09.pdf. These staffing problems were not unanticipated. In 1997, the National Academy of Public Administration reported that "[t]he bipartisan drive to reduce the deficit has put great pressure on administrative budgets government wide, and this pressure has resulted in planned reductions by FY 2002 of over 31 percent from levels of VBA staff allocated to adjudication in FY 1996." NAT'L ACADEMY OF PUB. ADMIN., MANAGEMENT OF COMPENSATION AND PENSION BENEFITS CLAIM PROCESSES FOR VETERANS x (1997).

263. *The Fiscal Year 2010 Budget for Veterans' Programs: Hearing Before the S. Comm. on Veterans' Affairs*, 111th Cong. (2009) (statement of Eric K. Shinseki, Sec-

hire an additional 1500 "temporary claims processors."[264] This hiring spree has been slow to dent the backlog due to the years of training and experience it takes for a new employee to become familiar with the complex procedures and substance of veterans law.[265] Shortly after his confirmation, VA Secretary Shinseki referred to this as a "brute force" approach to the backlog, but promised to supplement this strategy by completing long-overdue initiatives in modernizing VA's recordkeeping system and other procedures.[266] It remains to be seen whether this shift in strategy will have appreciable results in terms of claims backlog or veterans satisfaction. However, it demonstrates that the state of the VA adjudication system cannot be understood by looking at the law alone.

2. Procedural Initiatives

VA is also working on several other initiatives in response to judicial review. The VJRA gave the CAVC the power to review the validity of VA rules and regulations.[267] The CAVC soon concluded that in many situations, the authorities regulating the Secretary's duties presented "a confusing tapestry."[268] Shortly thereafter, the VA Blue Ribbon Panel observed:

> Potential problems with the applicable regulations and implementing manuals and directive may be pervasive. It appears

retary of Veterans Affairs) [hereinafter *Shinseki Testimony*]. In 2004, VA had 12,000 adjudicators. Levy, *supra* note 2, at 319. *See also Hearing on Review of Veterans' Disability Compensation: Undue Delay in Claims Processing: Hearing Before the S. Comm. on Veterans' Affairs*, 110th Cong. 7 (2008) (statement of Patrick W. Dunne, Acting Under Secretary for Benefits) [hereinafter *Dunne Statement*].

264. Associated Press Report, *Washington Digest: Veterans Affairs*, WASH. POST, Apr. 3, 2009, at A4.

265. *See* PUBL'N NO. GAO-09-910T, *supra* note 115, at 12 ("[I]t takes about 3 to 5 years for newly hired rating specialists to become proficient given the complexity of the job."); *Dunne Statement*, *supra* note 263. *See generally* OFFICE OF AUDIT, VA OFFICE OF INSPECTOR GEN., VETERANS BENEFITS ADMINISTRATION: REVIEW OF NEW HIRE PRODUCTIVITY AND THE AMERICAN RECOVERY AND REINVESTMENT ACT HIRING INITIATIVE (2010).

266. *See Shinseki Testimony*, *supra* note 263. VA's Under Secretary for Benefits has recently testified that information technology is the chief roadblock to productivity improvements. *Forging a Path Forward Hearing*, *supra* note 91 (testimony of Patrick W. Dunne, Under Secretary for Benefits).

267. Veterans' Judicial Review Act of 1988, Pub. L. No. 100-687, 102 Stat. 4113 (codified as amended in scattered sections of 38 U.S.C.).

268. Hatlestad v. Derwinski, 1 Vet. App. 164, 167 (1991) (describing provisions relating to unemployability and total disability ratings); *see also* Golliday v. Brown, 7 Vet. App. 249, 255 (1994) (describing provisions defining a helpless child); Stillwell v. Brown, 6 Vet. App. 291, 303 (1994) (describing provisions defining "surviving spouse").

> that VA regulations never have been subject to broad-based review to determine whether they are legally valid, consistent with each other, and provide the most effective means to afford claimants all the benefits to which they are entitled.[269]

The Panel cautioned that if VA did not comprehensively revise its rules and regulations, "it will be accomplished in a piecemeal fashion by the Courts through the litigation process."[270] Despite this warning, VA has been slow to conduct such a revision.[271] It was not until 2001 that VA began an organized effort to comprehensively rewrite its regulations.[272] Eight years later, the revised regulations still have not been issued.[273]

A more controversial initiative has been the Expedited Claims Adjudication Initiative (ECA).[274] Under ECA, the Secretary has sought to speed up processing time by seeking waivers of certain procedural rights by claimants, such as the right to submit additional evidence for up to a year after receiving a request for information, the right to a hearing prior to each decision, and the right

269. VA BLUE RIBBON PANEL, *supra* note 241, at 22.

270. *Id.*

271. This delay is not a complete surprise. *See* Thomas O. McGarity, *Some Thoughts on "Deossifying" the Rulemaking Process*, 41 DUKE L.J. 1385, 1419–20 (1992) (discussing how close judicial review can discourage agencies from revising even clearly outdated and inefficient rules); Peter H. Schuck & E. Donald Elliott, *Studying Administrative Law: A Methodology for, and Report on, New Empirical Research*, 42 ADMIN. L. REV. 519, 532 (1990) (suggesting that data indicates that judicial review of rulemaking "may have had the perverse effect of discouraging its use"). *See generally* Sidney A. Shapiro & Richard W. Murphy, *Eight Things Americans Can't Figure Out About Controlling Administrative Power*, 61 ADMIN. L. REV. 5 (2009) (discussing several sources of tension that arise when courts conduct judicial review of agency rulemaking).

272. William A. Moorman & William F. Russo, *Serving our Veterans Through Clearer Rules*, 56 ADMIN. L. REV. 207, 208 (2004).

273. *See* William L. Pine & William F. Russo, *Making Veterans Benefits Clear: VA's Regulation Rewrite Project*, 61 ADMIN. L. REV. 407, 410 (2009). This is not to say that no rulemaking has occurred. The Secretary has repeatedly rewritten or eliminated regulations after receiving an adverse interpretation. *See, e.g.*, Definition of Service in the Republic of Vietnam, 73 Fed. Reg. 20,566, 20,566–67 (proposed Apr. 16, 2008) (to be codified at 38 C.F.R. pt. 3) (abrogating Haas v. Nicholson, 20 Vet. App. 257 (2006)); Notice and Assistance Requirements and Technical Correction, 73 Fed. Reg. 23,353 (April 30, 2008) (to be codified at 38 C.F.R. pt. 3) (abrogating Pelegrini v. Principi, 18 Vet. App. 112 (2004)); DIC Benefits for Survivors of Certain Veterans Rated Totally Disabled at Time of Death, 65 Fed. Reg. 3388 (Jan. 21, 2000) (to be codified at 38 C.F.R. pt. 3) (abrogating Green v. Brown, 10 Vet. App. 111 (1997)).

274. Board of Veterans' Appeals: Expedited Claims Adjudication Initiative—Pilot Program, 73 Fed. Reg. 20,571 (proposed Apr. 16, 2008) (to be codified at 38 C.F.R. pts 3, 20) (proposal of pilot program).

to have all evidence considered first by an RO.[275] The reaction of veterans groups has been mixed. The comments on the rulemaking proposal were overwhelmingly negative.[276] However, Disabled American Veterans has recently supported a presumed waiver of certain rights so as to avoid having claims trapped at the RO, where a veteran submits a constant stream of correspondence that requires repetitive remands from the BVA to the RO for consideration of new material.[277]

Overall, VA's reactions to judicial review demonstrate that the VJRA has pressured it to rethink every aspect of the adjudication system. However, many of these initiatives have added more complexity and have not been implemented smoothly due to pushback from veterans groups and advocates who view them as inconsistent with the broad rights of veterans.

VI.
THE FUTURE OF THE PATERNALISTIC ENTITLEMENT MODEL

The VJRA reinvented the adjudication process with the purpose of increasing transparency and making its promise of informality enforceable. After twenty-two years, the idea of a paternalistic entitlement model remains, but adding judicial review has highlighted the fundamental conflict between complexity and informality. On one hand, the system continues to add rules and procedures to achieve the "right" outcome in each claimant's case. On the other hand, both the courts and Congress have stressed that there is no requirement that claimants know these rules. Ironically, the mechanisms created to enforce informality have added more layers of procedural complexity, which make it very difficult for VA to produce decisions that withstand review. The net result is a process that can seem interminable for those who diligently pursue

275. Board of Veterans' Appeals: Expedited Clams Adjudication Initiative—Pilot Program, 73 Fed. Reg. 65,726, 65,729 (Nov. 5, 2008) (final rule creating pilot program) ("The purpose of the ECA is to evaluate whether claims processing can be expedited by claimants' voluntary waiver of certain existing statutory and regulatory response periods and pre-screening of cases by the [BVA]."). *See generally* Marcy W. Kreindler & Sarah B. Richmond, *Expedited Claims Adjudication Initiative (ECA): A Balancing Act Between Efficiency and Protecting Due Process Rights of Claimants*, 2 VETERANS L. REV. 55 (2010).

276. Board of Veterans' Appeals: Expedited Clams Adjudication Initiative—Pilot Program, 73 Fed. Reg. at 65,727 (summarizing comments as expressing seven criticisms).

277. Baker Testimony, *supra* note 253. *See supra* Part III.D (discussing evolution of right to "one review on appeal").

their appellate rights. Twenty-two years of increasing the number of claimant-friendly rules appears to be producing a system that in some respects is more claimant-friendly—as more claims are adjudicated and more are approved—but in other respects is paradoxically less claimant-friendly—at least as measured by the length of the process and the expressions of dissatisfaction.[278]

The intent of this Article is to highlight the tension between complexity and informality[279] so that the stakeholders can thoughtfully examine the issue to discuss potential improvements or tradeoffs. There are no easy solutions to the conflict between complexity and informality. Both have been built into the system in the name of providing just outcomes across the near-limitless spectrum of service, medical, and legal fact patterns.

Scaling back can be characterized as unfriendly to claimants. Yet, emerging theories of administrative law suggest that, even if every component rule were perfectly clear and efficient, there is a limit to the number of rules that any regulatory system can apply efficiently.[280] Eventually, the rules of an administrative system can reach a point at which even skilled and conscientious practitioners cannot keep track of all the rules or grasp their interactions.[281] Given that the National Veterans Legal Services Program's guide and reference materials for adjudication of veterans claims run

278. *See*, *e.g.*, DOLE-SHALALA REPORT, *supra* note 223, at 6 (stating that only "38 percent of retired/separated service members are 'very' or 'somewhat' satisfied with [VA's] disability evaluation system," and only 42 percent "report that they 'completely' or 'mostly understand the VA claims process"); Fox, *supra* note 107, at 339 ("There are few persons who believe that the current system for administering these benefits is working properly.").

279. At this point, it could be argued that the informality rules that have developed are merely another form of complexity facing the system. Even though that may be semantically true, it would obscure the fundamental point that the system needs to consciously address the tension between the increasing number of rules focused on achieving correct outcomes and those focused on reducing claimant responsibility. Although each set of rules has grown, there has been little effort to understand or address the interaction between the two.

280. *See generally* J.B. Ruhl & James Salzman, *Mozart and the Red Queen: The Problem of Regulatory Accretion in the Administrative State*, 91 GEO. L.J. 757 (2003). In 2000, the GAO reported that the RO process for making an initial decision on a compensation claim "contains as many as 66 decision points and 39 queues (or waiting points)." GAO REP. NO. GAO/T-HEHS/AIMD-00-146, *supra* note 113, at 6. The report included a flow chart diagramming the initial claim decision process. It covers eight full pages. *Id.* at 12–20.

281. *See* Salzman et al., *supra* note 255, at 261–62, 282–89.

4000 pages,[282] is it possible for lay adjudicators on the front line to decide claims quickly and accurately even if they were adequately staffed and supported?[283] "Unlimited good intentions and money to back them up" are not enough if the system reaches a critical mass of complexity.[284] How much truer must this be in a system that wants to remain informal and absolve claimants of the responsibility of understanding the complexities that govern their claims? Even a representative of the Veterans of Foreign Wars has dared to suggest to Congress that "the world in which the VA operates has changed and it may no longer be realistic to expect accurate benefit decisions in a short period of time."[285]

Developing management systems for an agency that wants to be both complex and informal is a huge challenge. On top of that, the VA adjudication process continues to evolve. Twenty-two years after the VJRA, it is now clear that Congress, VA management, VA adjudicators, the courts, veterans groups, and veterans attorneys will each have a role in the debate and use different tools in different places to effect change.

With so many players pulling so many levers in so many places, the VA adjudication system is now "complex" in a formal, academic sense as well. In other words, the interactions have reached the point at which the effects of each change are difficult to predict, especially with so many changes happening concurrently.[286] In such a system, an ex ante analysis of proposed changes is unlikely to

282. *See* VETERANS BENEFITS MANUAL, *supra* note 82 (2058 pages); NAT'L VETERANS LEGAL SERV. PROGRAM, FEDERAL VETERANS LAWS, RULES AND REGULATIONS (2009 ed.) (2100 pages).

283. The Chief Executive Officer of a company that was consulted about computerizing the decisionmaking process testified before Congress that VA's regulations are "so complicated that no human being can be expected to accurately negotiate its byzantine, sometimes conflicted, and ever changing rules in a timely and consistent manner." *Hearing on Review of Veterans' Disability Compensation: Undue Delay in Claims Processing: Hearing Before the S. Comm. on Veterans' Affairs*, 110th Cong. 47 (2008) (statement of Howard Pierce, Chief Executive Officer, PKC Corporation). *Cf.* THE FEDERALIST No. 62 (James Madison) ("It will be of little avail to the people that the laws are made by men of their own choice, if the laws be so voluminous that they cannot be read, or so incoherent that they cannot be understood . . . .").

284. Salzman et al., *supra* note 255, at 273.

285. *Addressing the Backlog Hearing*, *supra* note 169, at 57 (statement of Robert Jackson, Assistant Director, National Legislative Service, Veterans of Foreign Wars of the United States).

286. *See generally* Donald T. Hornstein, *Complexity Theory, Adaptation, and Administrative Law*, 54 DUKE L.J. 913 (2005); Thomas Earl Geu, *Chaos, Complexity, and Coevolution: The Web of Law, Management Theory, and Law Related Services at the Millennium*, 66 TENN. L. REV. 137 (1998); J.B. Ruhl, *The Fitness of Law: Using Complexity*

accurately predict system costs, benefits, or unintended consequences.[287] This means that improvement will often be difficult and not every wrong turn will necessarily be anyone's fault. Nonetheless, there is a deep and abiding belief that the system should remain informal and claimant-friendly.

Two decades of transparency brought about by judicial review has illuminated the problem. Only time will tell if informality and complexity can be harmonized to create a system capable of finally producing timely, consistent, and accurate decisions.

Theory to Describe the Evolution of Law and Society and its Practical Meaning for Democracy, 49 VAND. L. REV. 1407 (1996).

287. Salzman et al., *supra* note 255, at 273. Despite these concerns, both an academic and a service organization have put radical change on the table. *See* Michael P. Allen, *The United States Court of Appeals for Veterans Claims at Twenty: A Proposal for a Legislative Commission to Consider Its Future*, 58 CATH. U. L. REV. 361 (2009); *Addressing the Backlog Hearing*, *supra* note 169 (statement of Kerry Baker, Assistant National Legislative Director of the DAV) (outlining DAV's "21st Century Claims Process" proposal).

100% CAPITALIST, 90% OF THE TIME: THE 20 DAY SHORT-SALE BAN†

*JEANA BISNAR**

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INTRODUCTION

"You have to save them now or they'll be gone while you're still thinking about it."

—Henry Paulson, September 18, 2008[1]

† Inspiration for the title comes from characterizations of Alexander Bickel's approach to political question doctrine. *See, e.g.*, Gerald Gunther, *The Subtle Vices of the "Passive Virtues"—A Comment on Principle and Expediency in Judicial Review*, 64 COLUM. L. REV. 1, 3 (1964) (characterizing the Bickel thesis as "100% insistence principle, 20% of the time").

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1. James B. Stewart, *Eight Days: The Battle to Save the American Financial System*, THE NEW YORKER, Sept. 21, 2009, at 78.

During the week beginning September 12, 2008, regulators scrambled to avoid financial calamity. On September 18, the Securities and Exchange Commission (SEC) put short selling into a twenty-day coma as part of the effort to "save" the failing banking institutions. The short-selling ban, ultimately affecting the stocks of nearly 1,000 financial companies,[2] stemmed from the supposed belief that traders were engaging in manipulation.[3] The move was ostensibly intended to "restore equilibrium to markets,"[4] though the move may be better described as an ill-informed attempt to support stock prices. Whatever the metric, several recent studies conclude that the ban not only failed to achieve its goals, but also produced unintended and detrimental consequences.[5] Ultimately, Christopher Cox, then-chairman of the SEC, conceded as much: "The costs [of the short sale ban] appear to outweigh the benefits," he said.[6] Cox may admit that the ban did not meet its equilibrium-enhancing goals, but because the public debate continues to focus on the presence or absence of market manipulation there is the possibility of public pressure and support for a future ban even where it is sure to fail in bringing about equilibrium. It may be that one need only find manipulation to generate support for such a ban. Cox later said, "Knowing what we know now . . . the commission would not do it again."[7] However, review of the episode and an analysis of the relevant interests suggest otherwise; the SEC may very well do it again.

This Note explores the influences on the SEC that resulted in its exercise of emergency powers to institute the ban on short selling. It analyzes the successful strategy undertaken by opponents of short selling, namely public company CEOs, to reframe the debate in terms of the wrong factor—manipulation—as opposed to "equilibrium." It further analyzes interagency and international pressure that contributed to the ultimate decision to ban short sales.

If, "knowing what [they] know now," the SEC would not decide to institute a short-selling ban, the place to start an analysis of this ban is with what they knew *then*, i.e., what we knew before the ban.

2. The ban ultimately included many companies that would not ordinarily be characterized as "financial" firms. *See infra* notes 112–116.

3. *See* Press Release, SEC, SEC Halts Short Selling of Financial Stocks to Protect Investors and Markets (Sept. 19, 2008), http://www.sec.gov/news/press/2008/2008-211.htm.

4. *Id.*

5. *See infra* Part III.A.

6. Rachelle Younglai, *SEC Chief Has Regrets Over Short-Selling Ban*, REUTERS, Dec. 31, 2008, http://www.reuters.com/article/idUSTRE4BU3GG20081231.

7. *Id.*

Part I of this Note briefly presents the historical debate on short selling, including lessons learned from the Great Depression, a summary of the law facing short sellers, and a breakdown of some of the relevant interests inherent in short selling. Part II analyzes the particular interests that influenced the 2008 ban on short selling by drawing on three narratives: the raging conflict between company executives and hedge fund managers, the lead roles played by the Treasury and the Federal Reserve in bringing about the ban, and the influence of international rhetoric and efforts to curb short selling. The resulting picture is one in which public opinion fixated on the wrong factor, Cox was more notable for his absence than his leadership, and hurried decisions were made at the discretion of very few individuals based on limited input. Part III considers the outcomes of the ban, which was a failure on its own terms as well as from a regulatory behavior perspective. The ban did not decidedly support prices; it choked important liquidity from the financial system, and it slowed price recovery.[8] Furthermore, the political result of having based the decision ostensibly on manipulation is that no beneficial lesson can be learned about the poor efficacy of the ban. Part IV considers the SEC's decision to make its antifraud rule permanent and its more recent decision to impose a "circuit breaker" price test on short selling, which is designed to pacify investor sentiment should stock prices of a given stock experience a sudden drop. A brief conclusion follows.

Because the factor at the heart of public opinion on this issue—manipulation—is one which can be triggered simply by allegations, speculation, or rumors, the SEC has been left in a very flexible position. If it were to decide that a ban was desirable in the future, or if it were to be the subject of intense public pressure again, the SEC could easily justify another ban by framing it as an effort to resist manipulation. Furthermore, the likelihood of its doing so may depend on the outcome of ongoing investigations into the behaviors of short sellers during the 2008 crisis. If illegal market manipulation were taking place, the public would likely respond to future crises with calls for similar action, despite the failure of the 2008 ban to restore equilibrium to markets.[9] The re-

8. *See infra* note 194 and accompanying text.

9. This Note does not quibble about the meaning of "equilibrium" nor its legitimacy as an end in itself. One might argue that price support is not a legitimate goal for the SEC, or that its legitimacy is limited to the context of panic with respect to financial institutions only, for some of the reasons discussed below. *See infra* notes 91–94 and accompanying text. Instead this Note explores how the ban did not achieve its stated goal of equilibrium, which I take generally to at least

cent regulations contribute to the political forces that make this kind of regulatory behavior possible.

I.
CLASSIC AND MODERN DEBATES

A. Short Sellers as Villains or as Information-Bearers?

An ordinary stock purchase leaves an investor in the position of holding a stock and carrying the risks associated with its change in value—otherwise known as a "long position."[10] A short sale, on the other hand, involves selling a stock that the investor does not already hold, resulting in a "short position."[11] A short seller "borrows" stock and sells it with the intention of buying stock at a later date, i.e., covering the position, in order to return it to the lending party.[12] The short seller turns a profit on the transaction if the price of the stock declines between the sale and the later purchase.[13] However, where the price increases, a short seller who wishes to close her position by purchasing the stock must do so at a loss, since the purchase price will have exceeded the sale price.[14] The transaction is structured such that the investor profits with the decline of a company's stock price.

History is riddled with financial disasters for which short sellers have been blamed.[15] One of the first and most widely cited examples of this phenomenon is the regulatory response that followed the price collapse accompanying the Dutch tulip craze of the

include liquidity and the absence of rapid price decline. Discussion regarding whether the appropriate equilibrium should be market driven, or some other interpretation of "accurate," is left for another day.

10. B. O'NEILL WYSS, FUNDAMENTALS OF THE STOCK MARKET 64 (2001).

11. *Id.* at 64, 72.

12. *Id.* at 72.

13. *Id.* at 72–73.

14. *Id.* at 73.

15. The Dutch tulip bulb craze of the 1600s led to attempts to regulate short selling; it was banned by British Parliament after the South Sea bubble burst in the 1700s; Germany banned a set of agricultural securities when commodity prices collapsed in 1896; the New York state legislature banned short selling from 1812 until 1858; NYSE required brokers to identify short sellers, who would be revealed upon unusual price behavior, and then banned shorting for two days in 1931. *See* Charles M. Jones, *Shorting Restrictions: Revisiting the 1930's* 5–6 (unpublished working paper, 2008), *available at* http://www4.gsb.columbia.edu/finance/faculty/workingpapers; Kara Scannell & Jenny Strasburg, *SEC Moves to Curb Short-Selling; Controversial Step Comes Amid Claims That Financial Stocks Were Manipulated*, WALL ST. J., July 16, 2008, at A1; Daniel Trotta, *Short Sellers Have Been the Villain for 400 Years*, REUTERS, Sept. 23, 2008, http://www.reuters.com/article/idUSTRE48P7CS20080926.

1600s.[16] Indeed, "[s]hort sellers, or 'shorts,' have been blamed for almost every financial crisis in the 400 years since the Dutch episode."[17]

One force underlying the hostility toward short sellers is the common moral objection to profiting from another's loss.[18] However, in neither a long-sale nor a short-sale scenario can both parties capture the profits from a change in price.[19] Unsurprisingly, however illogically, few identify this problem in the context of long positions, in which a buyer captures profits from stock price increases—increases that the seller would have captured had she held the stock. To the extent that short sellers are immoral for exacting a profit, an analogous criticism can be levied against those taking long positions. When a long investor buys low, she profits from the failure of the seller to anticipate the future price increase. Both buy stock at a low price and sell for a high price. The short seller simply does so in the reverse order. Many supporters of short selling have discussed this imbalance at length and recommend financial-sector policy that treats long sales and short sales similarly.[20]

The two main concerns relevant to short selling are manipulation by short selling, and the role of short selling in stock price panics. Short selling as a method of manipulation is illegal.[21] For example, "bear raids" are strategies by which a short seller intentionally depresses the value of stock, perhaps by spreading false rumors or timing large volumes of short sales in conjunction with other short sellers.[22] If a short seller sells the stock, then spreads a false rumor that initiates sales, this could result in a decrease in

16. Jones, *supra* note 15, at 5.

17. Trotta, *supra* note 15.

18. *See, e.g.*, *Japan Sells Itself Short*, ASIAMONEY, May, 2002, at 1 ("Short sellers—are mean-spirited sorts bent on making money by getting a jump on ordinary investors.") (quoting finance minister Masajuro Shiokawa).

19. However, society can benefit from the diffuse positive externalities of these trades, which contribute to an efficient pricing market that allows for efficient allocation of resources. *See infra* text accompanying note 46.

20. *See, e.g.*, Michael R. Powers et al., *Market Bubbles and Wasteful Avoidance: Tax and Regulatory Constraints on Short Sales*, 57 TAX L. REV. 233, 248–49 (2004); Kevin A. Crisp, *Giving Investors Short Shrift: How Short Sale Constraints Decrease Market Efficiency and a Modest Proposal for Letting More Shorts Go Naked*, 8 J. BUS. & SEC. L. 135, 142–43, 147 (2008).

21. Securities Act of 1933 § 17(a), 15 U.S.C. § 77q(a) (2006) (fraud); Securities Exchange Act of 1934 §§ 9(a)(4), 10(b) (2006), 15 U.S.C. §§ 78i(a)(4), 78j(b) (2006) (fraud); Rule l0b-5, 17 C.F.R. § 240.10b-5 (2009) (market manipulation).

22. *See* Powers, *supra* note 20, at 246–49. These are particularly "successful" strategies with thinly traded stocks which decline faster. *Id.*; *see* Crisp, *supra* note 20, at 142.

price. The short seller can then buy back the shares at a profit. Similarly, large timed transactions can create perceived supply in the market that reduces the price relative to demand, thus allowing the short seller to cover her position at the lower price. Large timed transactions can also trigger more sales by garnering negative media attention with respect to a particular stock or industry.

To combat such practices, the SEC brings enforcement actions for fraud and manipulation under Section 17(a) of the Securities Act of 1933, Sections 9(a)(4) and 10(b) of the Securities Exchange Act of 1934, and Rule 10b-5 thereunder.[23] For example, in April of 2008, the SEC filed a settled civil action against Paul S. Berliner, formerly of Schottenfeld Group, LLC, for "intentionally disseminating a false rumor" concerning the acquisition of Alliance Data Systems Corp by The Blackstone Group.[24] The complaint alleged that Berliner sent instant messages to traders at brokerage firms and hedge funds about an alleged Alliance meeting featuring the discussion of a new Blackstone proposal at a significantly lower price.[25] When the news media disseminated the story, Alliance stock fell 17% in thirty minutes.[26] The trading impact was significant enough to provoke the New York Stock Exchange (NYSE) to halt trading on the stock.[27]

Short selling in the context of panic—in which the short seller rides a wave of public behavior—is a more complicated issue for two reasons: myriad factors can contribute to a panic, making it difficult to dissect and dampen; and blanket responses, such as a ban, are not tailored to illegal behavior. First, short selling is just one factor contributing to price collapse; a panic can be triggered and maintained by legitimate, non-manipulative sales, which can be based on true, false, or simply malicious information.[28] Thus, it is

23. 15 U.S.C. § 77q(a) (2006); 15 U.S.C. §§ 78i(a)(4), 78j(b) (2006); 17 C.F.R. § 240.10b-5 (2009).

24. SEC Litigation Release No. 20,537, SEC v. Berliner, Civil Action No. 08-CV-3859 (S.D.N.Y.) (Apr. 24, 2008), *available at* http://www.sec.gov/litigation/litreleases/2008/lr20537.htm.

25. *Id.*

26. *Id.*

27. *Id.*

28. For example, American International Group (AIG) and Lehman Brothers, organizations whose stocks fell rapidly in the week preceding the ban, were both facing serious financial strain that threatened their viability. *See* Michael J. de la Merced & Andrew Ross Sorkin, *Report Details How Lehman Hid Its Woes*, N.Y. TIMES, Mar. 12, 2010, at A1; Stewart, *supra* note 1 (discussing AIG). Even beyond the actual financial risk posed by these conditions, the fact that the banks' officers were meeting with government officials, see Stewart, *supra* note 1, communicated concerns to the market and likely contributed to sales.

difficult to identify root causes of price decline, which can then be eliminated. Furthermore, it is unclear whether eliminating those root causes will have any effect on price, considering that the public is already reacting to the information by that time. In other words, banning short selling may have no impact on stock prices if members of the public are convinced that others will sell shares anyway, and indeed, they must sell as well to mitigate their own personal losses.

Second, the speed and anonymity with which rumors spread make it difficult to know what is true and good-intentioned, what is false and good-intentioned, and what is false and maliciously intended. There may be reason to worry about all of these scenarios since each can dramatically impact price, but only short selling accompanied by manipulation or the spread of knowingly false rumors is illegal.[29] Thus, immediate interference with short sales would require restraint on potentially innocent market actors who may suffer losses or forgo potentially lucrative opportunities as a result of government action.

Short selling has many benefits, both for individuals and society as a whole.[30] The most common rationale for resisting the regulation of short sales is that short positions operate against long positions in producing an efficient asset price market.[31] Ordinary purchases of stock—"long" purchases—communicate optimistic information to the market, the presumption being that one who buys stock at a given price believes that the stock is undervalued at that price and anticipates either appreciation in the stock price or higher than expected dividends.[32] The market incorporates this positive information; the additional demand for the stock will increase its price. Short selling, on the other hand, communicates

29. *See supra* note 21. This is, of course, an over-simplification. Short selling can also be illegal for more technical reasons. *See infra* Part I.C.

30. *See, e.g.*, Powers, *supra* note 20, at 235–41; Crisp, *supra* note 20, at 141–42 ("Empirical evidence supports that short-selling increases informational efficiency by increasing the speed of price adjustments to new information.").

31. *See* Powers, *supra* note 20, at 240; Crisp, *supra* note 20, at 139–42. R

32. See Judge Posner's articulation:

> For every short seller—a pessimist about the value of the stock that he's selling short—there is, on the other side of the transaction, an optimist, who thinks the stock worth more than the short-sale price. Unless the shorts are trading on insider information, all that a large volume of short selling proves is a diversity of opinions about the company's future . . . . Of course, if there were more pessimists, all wanting to sell short, than there were optimists, the price of a stock would plunge . . .

Law v. Medco Research, Inc., 113 F.3d 781, 784 (7th Cir. 1997).

negative information about a company's health and earnings potential, which is incorporated into the market.[33] To the extent that such negative information is constrained, it will not be incorporated; and market price will reflect an overvaluation of the stock.[34] In this respect, short sales mitigate over-pricing and contribute to the prevention of bubbles.[35]

Empirical studies suggest that short selling provides a social benefit by detecting and exposing corporate fraud.[36] By pouring over filings and financial statements, short sellers have been able to identify companies that appear to be overvalued, sometimes by purposeful deceit of management.[37] The data shows that short sellers' sales have brought values down, such that when the fraud is finally revealed the market does not have to swing as wildly to reach the lower, more appropriate price that reflects the new negative information.[38] One famous example of detection was that of David Einhorn, who suspected accounting misrepresentation by Allied Capital and therefore recommended shorting its stock at a 2002 charity event.[39] Allied shares opened the next day at 20% below the previous day's price, and the company was later investigated by

33. *See id.*

34. *See* Powers, *supra* note 20, at 237–40; Crisp, *supra* note 20, at 139–42. Options markets can potentially provide an alternative avenue for bearish bets, to the extent that a given stock has tradable options. Where it does, movement away from short sales and into put options is influenced by a number of factors, but primarily the equity borrowing cost, which is driven by the supply and demand of borrowable securities. Benjamin M. Blau and Chip Wade have seen a pattern characterized by short sales in the wake of positive returns and a shift to put options following negative returns. Benjamin M. Blau & Chip Wade, *A Comparison of Short Selling and Put Option Activity* 25 (unpublished working paper, Feb. 23, 2009), *available at* http://ssrn.com/abstract=1348133. *But see* Paul Asquith et al., *Short Interest and Stock Returns* 30 (Nat'l Bureau of Econ. Research, Working Paper No. 10434, 2004) ("Hedge fund managers and other practitioners involved in short selling maintain that they cannot effectively use the options market. In interviews, they repeatedly claimed that the options market provides less liquidity and is more expensive than the short sales market when trying to establish a large position."). R

35. *See* Powers, *supra* note 20, at 235–41; Crisp, *supra* note 20, at 142.

36. *See* Powers, *supra* note 20, at 241; Crisp, *supra* note 20, at 142; Jonathan M. Karpoff & Xiaoxia Lou, *Short Sellers and Financial Misconduct* (unpublished working paper, 2009), *available at* http://ssrn.com/abstract=1443361 (empirically finding that short selling "conveys external benefits to uninformed investors, by helping to uncover financial misconduct and by keeping prices closer to fundamental values when firms provide incorrect financial information").

37. Karpoff & Lou, *supra* note 36, at 38–39.

38. *Id.*

39. Fooling Some of the People All of the Time: A Long Short Story—The Speech (May 2002) (audio recording), *available at* http://www.foolingsomepeople.com/main/speeches.html. Einhorn is back in the news currently because

both the SEC and the United States Attorney's Office.[40] Allied ultimately settled with the SEC, which found that the company had violated securities laws regarding recordkeeping and internal controls.[41]

Short positions also provide tools for more nuanced investment strategies. Most notably, they provide a mechanism for mitigating the risks associated with a particular long position and thus can facilitate more net-long positions.[42] Short sellers also provide liquidity and capital-raising opportunities. Liquidity is the ease with which an asset can be converted to cash, ideally without suffering a discount in value in order to do so.[43] Shares that are traded more frequently are more liquid.[44] Furthermore, short sales can be critical to certain investment strategies. For example, many investors will not purchase convertible bonds, a key capital-raising avenue, without hedging their position with a short sale.[45] Lastly, because secondary-market investments impact the primary market and the cost of capital, overvaluing particular stocks subsidizes the cost of capital for less healthy companies.[46] In other words, artificially high stock prices can lead to capital flow to less healthy companies. Thus, by reducing over-valuation, short selling contributes to efficient resource allocation.

B. Lessons from the Great Depression

For the Great Depression-era public, the dangers of short selling were perceived to outweigh the benefits. Similar to other historical patterns involving short selling, the stock market crash of 1929 was followed by public outcry blaming short sellers for the collapse, despite the fact that short interests represented only 0.15% of

some indication has surfaced that his statements regarding questionable accounting practices at Lehman Brothers had merit. *See* Merced & Sorkin, *supra* note 28.

40. Gretchen Morgenson, *Following Clues the S.E.C. Didn't*, N.Y. TIMES, Feb. 1, 2009, at BU1.

41. *Id.*

42. A net-long position occurs where the investor owns more than she has sold and thus still benefits when prices rise, not fall. Some other practices or strategies involving short sales include market-making, hedging, and volatility bets among others. Powers, *supra* note 20, at 235–41.

43. DAVID LOGAN SCOTT, WALL STREET WORDS 213 (2003).

44. WYSS, *supra* note 10, at 8.

45. *See infra* note 124 and accompanying text. However, any practice used with manipulation is illegal. *See supra* note 21; *see, e.g.*, Deepa Nayini, Comment, *The Toxic Convertible: Establishing Manipulation in the Wake of Short Sales*, 54 EMORY L.J. 721 (2005). R

46. Crisp, *supra* note 20, at 142–43.

shares at the time.[47] Responding to public sentiment, J. Edgar Hoover launched an investigation into potentially illegal behavior by short sellers,[48] but nothing ever came of it. However, the exchanges themselves, and then later the regulatory agencies, implemented several restrictive initiatives that shed some light on the potential effects and desirability of short-sale restraints in the context of panic.

First, there was a ban on short sales in September of 1931, coinciding with England's transition off the gold standard.[49] The ban did not respond to price declines; rather, it was planned in advance, based on the anticipation of sharp declines in the wake of England's transition.[50] Nonetheless, the ban was labeled an "emergency measure."[51] Richard Whitney, president of the NYSE, noted a visible decrease in liquidity as a result of the ban, commenting that "[w]ithin two hours after short selling was forbidden, the governing committee found there was a real danger of technical corners and of crazy and dangerous price advances."[52] In other words, there was an impact on price volatility and stock concentration such that parties might be able to "corner"—or, control the price of—a given security over which they had obtained sufficient control.[53]

Despite negative conclusions regarding the ban among NYSE officials, there existed intense political pressure for reform.[54] This led the NYSE to prohibit short-sale orders on a "downtick," i.e., a price lower than the last sale.[55] The purpose of the rule was to prohibit manipulative raids and aggressive coordinated selling, without impeding liquidity aids, such as market-makers.[56] The SEC

47. Jones, *supra* note 15, at 6. R

48. *Id.* at 6, 26–27.

49. *Financial Markets: Stocks Unexpectedly Steady, Despite England's Action—Heavy Sterling Discount*, N.Y. TIMES, Sept. 22, 1931, at 22; *Stocks Here Rally After Violent Drop: With Short Sales Barred, Most Issues Recover with Some Gains at the Close*, N.Y. TIMES, Sept. 22, 1931, at 1.

50. This turned out to be either premature or brilliant from a price support perspective. The market saw only a modest decline of .93% on the first day and .75% on the second day. Jones, *supra* note 15, at 6. R

51. Jones, *supra* note 15, at 7. R

52. *Stock Exchange Practices: Hearing on S. Res. 84 Before the S. Comm. on Banking and Currency*, 72nd Cong. 186 (1932) (speech of Richard Whitney, President, New York Stock Exchange), *available at* http://fraser.stlouisfed.org/publications/sensep/issue/3912/download/64809/19320411_sensep_pt01.pdf.

53. SCOTT, *supra* note 43, at 83 (definition of "corner"). R

54. Jones, *supra* note 15, at 7. R

55. *Id.*

56. *Id.* Market makers are persons or firms who buy and sell a particular security on their own account on a continuing basis. SCOTT, *supra* note 43, at 225. R

eventually passed a regulation restricting short-sale orders to "upticks"—prices higher than the previous sale.[57] This meant that a group of short sellers could not drive down the price of a security on their own, since each short seller would have to sell at a price higher than the last sale price.[58]

The introduction of the rule generated a sharp rise in stock prices with little effect on volume or price volatility, similar to other short-sale restrictions imposed during the period.[59] However, imposition of the uptick rule also resulted in a slight increase in liquidity, as measured by bid-ask spreads.[60] Interestingly, the market response did not distinguish between stocks with heavy short interests and all other stocks; that is, the market responded favorably to the uptick rule in general, without regard for whether the rule was likely to have an impact on a particular stock.[61]

The experience of the Great Depression is useful in considering the desirability of short sale restraints, particularly in the context of a panic. First, the experience highlights the potential threat to liquidity engendered by a ban on short selling—dangerous price advances and corners came on quickly. Imposing a similar restriction would necessitate balancing a likely sacrifice in liquidity against the objectives of the ban. Second, the experience also suggests that there may be alternatives to an outright ban, like a tick rule, which could be preferable in a panic context, where liquidity is especially important.[62] Third, the market response to the imposition of the

57. Jones, *supra* note 15, at 20–24; Rule 10-a for the Regulation of Short Selling, 3 Fed. Reg. 247 (Jan. 26, 1938) (formerly 17 C.F.R. § 240.10a-1) (adopting Rule 10-a-1, prohibiting short sales on a downtick), *amended by* Amendments to Short Selling Rules, 4 Fed. Reg. 1,209 (Mar. 14, 1939) (allowing zero-tick or uptick short sales), *removed by* Regulation SHO and Rule 10a-1, 72 Fed. Reg. 36,348 (July 3, 2007). R

58. Later developments cut back on the effectiveness of the rule. *See infra* notes 74–80 and accompanying text. R

59. Jones, *supra* note 15, at 21–23. Other events functionally restricting short selling included a requirement for written authorization for lending shares, SEC investigations, and release of a "list of shame" (top fifty short sellers). *Id.* R

60. *Id.* The bid-ask spread is the difference between the bid (the price the buyer is willing to pay) and the ask (the price that the seller is willing to accept). SCOTT, *supra* note 43, at 18, 30, 355 (definitions of "ask," "bid," and "spread"). One explanation for the rise in liquidity hypothesizes that it is due to the fact that the tick restrictions force shorts to use less aggressive limit orders as opposed to market orders, thereby providing more liquidity than otherwise. Jones, *supra* note 15, at 26. R R

61. Jones, *supra* note 15, at 10, 24.

62. Of course, the imposition of the uptick rule was (supposed to be) a one-time occurrence; the rule is a prophylactic, not an emergency measure. This suggests that the two options (bans and tick tests) are not true alternatives for dealing

uptick rule demonstrates that the fear of short selling can be very strong—so strong that its prohibition might raise the price of stocks without regard to whether they will be affected by a ban. The implication of this phenomenon may be that the public generally overestimates the downward impact of short selling. Thus if a regulatory objective is the prevention of price collapse of an entire market, the sheer price support engendered by a short selling ban could be perceived as a convenient side effect. Unfortunately, as discussed below, some of these lessons were borne out for the worse in the 2008 crisis. Some had to be learned again.

C. The State of the Law

Despite the fruitlessness of Hoover's investigation, the experience of the market crashes of the Great Depression seemed only to reinforce the stereotypes of short sellers. This was demonstrated by the anti-shorting social pressure that drove the NYSE to introduce the tick test, which persisted until only recently.[63] In recent years, there existed two major regulatory restraints on short selling: "naked short" rules that impose borrowing requirements on short sellers prior to sale; and "price tests" or "tick tests," which regulate the price at which shorts may sell.[64] Recent developments in these restraints played a crucial role in the lead up to the 2008 ban.

"Naked shorts" are short sales undertaken without having borrowed the stock first.[65] There are several fears associated with naked short selling. First, if short sellers are not required to borrow a particular stock, short sales can flood the market more quickly because the added step of formally borrowing from a broker would be eliminated.[66] This would be of particular concern in the event of a

with panics and need not be traded off. However, as will be mentioned below, the uptick rule had been repealed, *see infra* note 75 and surrounding text, thus it (or a version of it) was one possible emergency option during the 2008 crisis. R

63. *See infra* note 75 and accompanying text. R

64. A third is unfavorable taxation relative to long sales. *See* Powers, *supra* note 20, at 249–63.

65. The colloquial definition includes all sales where no stock was borrowed beforehand. However, the SEC defines a "naked" short sale as one in which "the seller does not borrow or arrange to borrow the securities in time to make delivery to the buyer within the standard three-day settlement period." SEC, Naked Short Sales, http://www.sec.gov/answers/nakedshortsale.htm (last visited June 12, 2010).

66. Borrowing a stock is a formal transaction requiring collateral, *see* KATHRYN F. STALEY, THE ART OF SHORT SELLING 13–14 (1997), which could otherwise be sourced from the proceeds of the short sale. Thus, to require borrowing prior to sale would prohibit or delay short sales where collateral was not available.

panic, where dramatic price drops are exacerbated by the speed with which sales can take place.

Second, "naked shorts" could result in a "failure to deliver" the stock, wherein the seller does not actually provide a stock to the purchaser within the allotted time, which is currently three days.[67] If the seller cannot find a stock to borrow within three days, the seller will be unable to deliver the stock to the buyer.[68] Failures to deliver may be unintentional. For example, if the price of the stock goes up, short sellers may race to borrow stock in order to make delivery. Demand for stocks to borrow may exceed supply, leading to a failure to secure a stock to borrow, and thus a failure to deliver the stock.[69]

Failures to deliver can also be intentional. They might create the illusion that there is high demand for borrowed stocks due to heavy short interest, thereby indicating negative market sentiment about the quality of the stock, leading to price decline.[70] In this way, short sellers can manipulate the price to their profit. The SEC responded to this problem in 2004 with Regulation SHO, which requires that sellers "locate securities to borrow before selling"[71]

67. *See* SEC, Naked Short Sales, *supra* note 65.

68. *Id.*

69. *See* Powers, *supra* note 20, at 266–69.

70. There is much debate about how serious this concern is, and whether, aside from manipulation, short selling exerts excessive downward pressure on price. Some think the Depository Trust & Clearing Corp. and its subsidiary the National Securities Clearing Corp. execute borrows in a way such that shares may be loaned multiple times, creating "counterfeit shares." *See* John R. Emschwiller & Kara Scannell, *Blame the 'Stock Vault'?*, WALL ST. J., July 5, 2007, at C1. The SEC denies this, and the DTC has addressed the Emschwiller article almost line by line. *See, e.g.*, SEC, Division of Market Regulation: Responses to Frequently Asked Questions Concerning Regulation SHO, http://www.sec.gov/divisions/marketreg/mrfaqregsho1204.htm (last visited Apr. 6, 2010) (explaining that DTC and NSCC systems do not allow lender to relend shares, and explaining that confusion arises from broker-dealers' practices of crediting buyer's account with a share and crediting lender's account with a right to a share, but the obligation of seller to deliver persists). Thus, while a failure to deliver does not create additional shares, it does allow for the possibility that the number of tradable shares could exceed float during the period that the failure to deliver is open. The DTC notes that one tenth of 1% of the daily number of trades fail, and 80% of total failed positions are resolved within two business weeks. DTCC, DTCC Responds to The Wall Street Journal Article, "Blame the 'Stock Vault?'" (July 6, 2007), http://www.dtcc.com/news/press/releases/2007/wsj_response.php (last visited Apr. 6, 2010).

71. The requirement to "locate" does not require it to be borrowed. The rule allows short sellers to use the proceeds from a sale to finance a borrow, but increases the likelihood the stock will be available to borrow and thus deliver.

and imposes delivery requirements "for securities in which a substantial number of failures to deliver have occurred."[72]

The "tick test," prohibiting short sales that are not at or above the sale price of the last sale, was in effect with minimal change from the Great Depression.[73] However, significant changes in the logistics of trading, including the use of complex trade-executing systems and the switch to decimal pricing increments, prompted the SEC to study the effectiveness of the test by conducting a "pilot" temporarily suspending the rule for a set of securities.[74] The results of the pilot, as well as analysis performed both inside and outside the agency, convinced the SEC to remove all price tests and prohibit their imposition by self-regulatory organizations, such as the NYSE.[75]

The SEC release accompanying the repeal of the price tests responded to comments submitted after the publication of the proposed amendments.[76] In response to a comment regarding manipulation, the release stated that improvements in transparency and regulatory surveillance of modern markets have greatly reduced the risk of undetected manipulation.[77] In response to a comment regarding panic, or "unusually rapid and large market declines," the release only stated that to adopt special rules to deal with panic circumstances would undermine the uniformity objective of abolishing the tick test.[78]

The concern for manipulation, evident in the regulation of naked short sales, is curious compared to the approach to the tick tests, which explicitly declined to accommodate manipulation and

72. Regulation SHO, 69 Fed. Reg. 48008, 48008 (Aug. 6, 2004) (codified at 17 C.F.R. 240–42). The locate requirement is met where the broker-dealer has "reasonable grounds to believe that the security can be borrowed so that it can be delivered on the date delivery is due." *Id.* at 48014. Therefore, collateral need not necessarily be paid before the short sale. There are also even more benign reasons for failures to deliver (e.g., mechanical error, legitimate market making).

73. Amendments to Regulation SHO and Rule 10a-1, 72 Fed. Reg. 36,348, 36,348 (July 3, 2007).

74. *See* Order Suspending the Operation of Short Sale Price Provisions (July 28, 2004), 69 Fed. Reg. 48,032 (Aug. 6, 2004); Order Delaying Pilot Period for Suspension of the Operation of Short Sale Price Provisions (Nov. 29, 2004), 69 Fed. Reg. 70,480 (Dec. 6, 2004); Order Extending Term of Short Sale Pilot (April 20, 2006), 71 Fed. Reg. 24,765 (April 26, 2006).

75. Amendments to Regulation SHO and Rule 10a-1, 72 Fed. Reg. 36348 (July 3, 2007).

76. *Id.* at 36,348.

77. *Id.* at 36,351–52.

78. *Id.* at 36,352.

panics.[79] This may be explained by the absence of serious backlash to deregulatory activity where there is empirical data demonstrating that the regulation was ineffective in its then-current form.[80] Additionally, the fact that the pilot was conducted during a period of general stock price incline likely contributed to its lack of public salience. Unsurprisingly, this issue resurfaced after the events of Fall 2008.

D. Identifying Relevant Interests

The interests affected by restraints on short selling can be divided into three categories: 1) those who use short selling as part of their portfolio and benefit from less restriction, 2) those holding net-long positions or equivalent interests who benefit from restriction, and 3) society in general, which benefits from market efficiency and its superior allocation of societal resources. Each category of interests puts pressure on regulatory behavior and affects regulatory action or inaction.

Setting aside concerns regarding manipulation, short sellers' interests are the most straightforward. Prior to undertaking any given investment strategy, an investor benefits from the freedom to devise any tools she can imagine to enable more nuanced investment strategies. A paramount interest for such an investor is flexibility. This means that the investor would likely favor a regulatory landscape of minimal restrictions and open markets, without prejudice to either long or short sales.[81]

Those who restrict themselves to long positions, on the other hand, only profit when prices go up. Thus they prefer heavy restriction of short sales, which exert downward pressure on market prices.[82] This category includes many unsophisticated investors. After all, any individual who simply buys shares on her own account becomes a shareholder with a long position, which improves when prices rise. Complicating this calculus, companies themselves have an equivalent position: because their cost of capital depends in part

79. *See supra* notes 76–78 and accompanying text. R

80. *See* Amendments to Regulation SHO and Rule 10a-1, 72 Fed. Reg. 36,348, 36,349 & n.20 (July 3, 2007).

81. Of course, based on any given chosen strategy, there may be reasons why a short seller may resist regulation of one type of investment strategy more than another, due to the market dynamics and logistical elements of the various strategies. Furthermore, various Pareto-optimal regulations may be desirable to all investors, for example rules forbidding fraud.

82. *See supra* note 32 and accompanying text. R

on their stock price, companies benefit from higher stock prices.[83] Additionally, executive compensation often consists of stock or stock options, or is aligned with, stock prices.[84] Companies, their executives, and their shareholders thus have interests directly contrary to those of short sellers in this regard—restrictions on short selling mean relief from some amount of downward pressure on stock price.

Society generally has an interest in an efficiently priced stock market.[85] Because stock prices play a role in determining how capital will be allocated, stock prices that accurately reflect business health will ensure that capital resources flow to operations that will most productively use them. Therefore, society in general should welcome the role played by short sales in incorporating negative information into stock prices to more accurately reflect business health.[86] The mission of the SEC—to ensure efficient markets for investors—reflects this societal interest.[87] Assuming that mission is respected by the governing administration, SEC regulators also have a personal interest in promoting efficiency: such action will preserve their places in the agency, and continue their capacity to exercise power.[88]

However, the societal interest is obscured by political complexities. The reality is that the capitalization of the stock market is regarded as an important indicator of the country's economic health.[89] The political implication of this fact is that the government is continually faced with the temptation of an over-valuation bias. Furthermore, the ratio of parties whose interests are aligned

83. *See* Powers *supra* note 20, at 249. R

84. *See* Crisp, *supra* note 20, at 150. R

85. *See also supra* notes 30–38, 46 and accompanying text. R

86. This extends to potential shareholders in the ex ante position, who will likely prefer that a stock price accurately reflect its value. Of course, once the shareholder owns a stock, she will prefer that its value go up regardless of its worth.

87. SEC, The Investor's Advocate: How the SEC Protects Investors, Maintains Market Integrity, and Facilitates Capital Formation, http://sec.gov/about/whatwedo.shtml (last visited Apr. 6, 2010) ("The mission of the U.S. Securities and Exchange Commission is to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation.").

88. *See* Michael E. Levine & Jennifer L. Forrence, *Regulatory Capture, Public Interest, and the Public Agenda: Toward a Synthesis*, 6 J.L. ECON. & ORG. 167, 169 (1990). They'll also have an interest in later employment. *Id.*

89. *See, e.g.*, Javier C. Hernandez, *Dow Industrials Close Below 10,000*, N.Y. TIMES, Feb. 9, 2010, at B9 ("The Dow Jones industrial average, a closely watched barometer of the economy's health, dipped below the 10,000 threshold on Monday, delivering a psychological setback as investors braced for more market volatility.").

with stock market increases—shareholders, companies, and employees—may outnumber those who utilize short sales to benefit from stock price decline.[90] Thus, in addition to the general political interest in projecting a healthy economy, the government may face a more concrete over-valuation bias if it hopes to respond to the dominant voices of those constituents who benefit from high prices. There is little political gain from the diffuse social interest in efficiency.

Setting aside the political aspects of determining the public interest, complexities persist in assessing substantive metrics of the public interest. In particular, market efficiency is still a work in progress in the banking sector, which was at the heart of the 2008 crisis and resulting ban. Capital markets are essential to the economy. And public confidence is crucial to the continuing viability of the banking system, and is thus a focus of regulatory efforts to protect that system.[91] When a bank's stock price falls, this may indicate to investors that their money is not safe in that bank. If investors race to withdraw their investments from a bank—a "run"—the bank may be unable to meet all its withdrawal demands, leading to its failure.[92] The possible resulting loss of confidence in the market, coupled with the financial interdependence of banks, may lead to the failure of other banks as well.[93] Unlike companies with hard assets, which cannot necessarily be recalled by investors during a panic, a bank has no time for its stock price to bounce back and instill public confidence before a run can destroy it.[94] As a result, the public interest with respect to short selling policy may be different in the financial sector, where the risks associated with stock price decline are greater.

In sum, there are powerful private interests exerting pressure on regulatory action. The public interest that the regulator may be seeking to vindicate is nebulous and, particularly in the area of

90. Brokers charge for lending shares, and would therefore seem to be a potential force on the other side of the debate, aligned with short sellers. However, brokers have not played a large role in public debate about short selling.

91. HENNIE VAN GREUNING & SONJA BRAJOVIC BATANOVIC, ANALYZING AND MANAGING BANKING RISK 34 (2003).

92. Steven L. Schwarcz, *Systemic Risk*, 97 GEO. L.J. 193, 199 (2008).

93. *Id.*

94. This is why there is a special resolution process for banks through the FDIC, which does not disclose which banks are in trouble, as such disclosure would only make matters worse for the bank and have fallout throughout the economy. *See* Tami Luhby, *Problem banks: What you need to know*, CNNMONEY.COM, July 26, 2008, http://money.cnn.com/2008/07/26/news/economy/fdic_list_what_it_means/index.htm.

banking, of great consequence. In addition, the matters themselves—high-level trading strategies and their impact on trading markets in the financial sector—are objectively complex.[95] Furthermore, agency regulation is opaque relative to publicly broadcasted congressional sessions. Thus, monitoring and information costs of public supervision of regulatory action related to short selling are very high[96]—another factor which contributed to the ultimate regulatory action in 2008.

In general, restrictions are bad for short sellers. They are good for companies, their executives, and their shareholders. And while they are good for the public's interest in market efficiency, they are potentially bad for the interests of many members of the public as individual investors. Finally, the impacts of short-sale restrictions may be somewhat unclear in the context of a struggling financial industry.

II.
THE 20 DAY SHORT-SELLING BAN DURING THE 2008 CRISIS

This Part examines the twenty day short-selling ban during the 2008 crisis in light of the history, the law and the relevant interests discussed in Part I. After establishing the timeline of the relevant events, this Part examines three narratives: the role of the rhetoric of short sellers and companies, the experience and behavior of the regulators, and the international influences on regulatory behavior.

A. Timeline

On July 13, 2008, four months after the government orchestrated the merger of Bear Stearns into JPMorgan Chase and two days after IndyMac collapsed, the SEC announced that it would be conducting examinations aimed to prevent "intentional spreading of false information intended to manipulate securities prices."[97] Two days later, the SEC announced that it was exercising its authority under the "Emergency Provision" of the Securities Exchange Act to temporarily ban naked short sales on the securities of nineteen

95. *See infra* Part II.C.

96. For discussion of the importance of monitoring and information costs for regulatory decision-making, see Levine & Forrence, *supra* note 88, at 170. R

97. Press Release, SEC, Securities Regulators to Examine Industry Controls Against Manipulation of Securities Prices Through Intentionally Spreading False Information (July 13, 2008), http://www.sec.gov/news/press/2008/2008-140.htm (to be conducted together with Financial Industry Regulatory Authority, Inc. and New York Stock Exchange Regulation, Inc.).

"substantial financial firms," including Fannie Mae, Freddie Mac, and Lehman Brothers.[98] On September 17, 2008, two days after the collapse of Lehman Brothers and the day following the AIG bailout, the SEC announced another emergency order to 1) impose new penalties on clearing agencies and broker dealers with a "fail to deliver" position, and 2) effect a "naked" short-selling antifraud rule making it illegal to deceive as to "intention or ability to deliver a security."[99] The next day, September 18, the SEC used its emergency power to temporarily ban short sales of securities of 799 financial firms.[100]

B. Public Companies vs. Short Sellers

Because public companies and their executives have an interest in high stock prices—for cost of capital, executive compensation, and, in the case of a bank, investor confidence reasons[101]—short sellers are convenient targets to blame for poor stock performance.[102]

98. Emergency Order Pursuant to Section 12(k)(2), Exchange Act Release No. 58,166 (July 15, 2008), *available at* http://www.sec.gov/rules/other/2008/34-58166.pdf (citing Bear Stearns failure as example of effects of false rumors and naked short selling, and saying that "[t]his emergency requirement will eliminate any possibility that naked short selling may contribute to the disruption of markets in these securities"). The order was to be effective on July 21 and to terminate on July 29, 2008 but was later amended to extend for the full period authorized by the SEC emergency power (30 days), to August 12, 2008. Order Extending Emergency Order Pursuant to Section 12(k)(2), Exchange Act Release No. 58,248 (July 29, 2008), *available at* http://www.sec.gov/rules/other/2008/34-58248.pdf.

99. Emergency Order Pursuant to Section 12(k)(2), Exchange Act Release No. 58,572 (Sept. 17, 2008), *available at* http://www.sec.gov/rules/other/2008/34-58572. The order also revoked the market-maker exception to the close out requirements for "naked" short selling. *Id.*

100. Emergency Order Pursuant to Section 12(k)(2), Exchange Act Release No. 58,592 (Sept. 18, 2008) (effective immediately and terminating Oct. 2, 2008), *available at* http://www.sec.gov/rules/other/2008/34-58592. The order was later extended to terminate earlier than the thirty-day maximum (Oct. 17, 2008) or 3 days after the President's signing of the Emergency Economic Stabilization Act. Order Extending Emergency Order Pursuant to Section 12(k)(2), Exchange Act Release No. 58,723 (Oct. 2, 2008), *available at* http://www.sec.gov/rules/other/2008/34-58723. Also on September 18, the SEC temporarily required certain institutional investment managers to report information concerning daily short sales of securities. Emergency Order Pursuant to Section 12(k)(2), Exchange Act Release No. 58,591 (Sept. 18, 2008) (to be in effect Sept. 29 to Oct. 2, 2008), *available at* http://www.sec.gov/rules/other/2008/34-58591.

101. *See infra* text accompanying notes 82–84, 91–93. R

102. Shorts can also contribute to stock price increase in the event of a short squeeze whereby short sellers are forced to cover their open positions due to increases in a stock price, and the rush to cover actually accelerates the increasing

Firms use many strategies to hinder short sellers or to make their transactions more costly: trading over the counter or on NASDAQ, where short-sale constraints are heavier than on AMEX or NYSE; using stock splits to force short sellers to close their positions; conditioning dividend distributions on remitting physical stock certificates; publicly encouraging shareholders to remove their stock from street name and margin accounts; and moving stock into "friendly ownership" that will not lend, thereby decreasing shares available for borrowing and potentially causing a squeeze.[103] Firms also use litigation, calls for regulatory investigation, and public accusations of market manipulation to chill short selling and gain public support for government action.[104]

In the 2008 story, the companies' perspective won over the media long before they convinced the government of the imminent danger posed by short sellers. Lehman Brothers publicly fought the short sellers, accusing them of spreading false rumors, and taking deliberate acts to beat them. For example, a large preferred-shares issue was intended to combat speculation regarding its capital position.[105] The SEC had opened investigations in July as to whether investors spread misinformation to profit from stock declines, particularly those of Bear Stearns and Lehman Brothers, and sent subpoenas to over fifty hedge funds.[106] In April, Representative Barney Frank asked Cox and the SEC to broaden the inquiry to include trading in all major banks.[107]

The days leading up to the twenty-day ban were characterized by intense lobbying by companies whose stocks had fallen. The companies lobbied the public, stock lenders, and government officials, who in turn lobbied the SEC. John Mack, the chief executive officer of Morgan Stanley, and Lloyd Blankfein, the chief executive officer of Goldman Sachs, spoke with many government officials and made several public statements about "the abuses of short sell-

stock price. However, this is unlikely to cause net benefit since the initial short sale depressed the price, and the later increase must be stimulated by some force. The magnitude of a net increase in price is likely very small relative to other upward forces at work.

103. Firms have also tried to impose explicit trading restrictions and even withdraw shares from DTC, but the SEC stepped in to prohibit such actions. For discussion of these issues, see Crisp, *supra* note 20, at 150–54.

104. *Id.*

105. Susanne Craig, *Lehman Wants To Short-Circuit Short Sellers*, WALL ST. J., Apr. 1, 2008, at C1.

106. Scannell & Strasburg, *supra* note 15. R

107. *SEC Rumour Probe Should Examine Banks, U.S. House Committee Says*, NAT'L POST, Apr. 5, 2008, at F6.

ers" in the days leading up to the ban.[108] As justification for its decision to stop lending shares of Goldman Sachs, Morgan Stanley and Wachovia, Eric Baggesen of CalPERS (the California Public Employees' Retirement System), the largest American public pension fund, noted its "degree of concern about volatility in financials."[109] Amid this campaign against short selling came the first regulator: Andrew Cuomo, New York's attorney general, opened investigations into the stock price slides "aggravated by illegal short selling."[110] New York Senators Charles Schumer and Hillary Clinton, worried about their Wall Street constituents, called Cox directly and urged a ban on short sales.[111]

Efforts to demonize short sellers did not stop with the implementation of the ban. On the Monday following the Friday ban, the exchanges added seventy-one companies to the list of firms whose stock could not be shorted, including IBM, GE, and GM.[112] Some saw this as part of "an attempt to remediate a failure to consider carefully what was going to happen"[113] and questioned the necessity of adding such firms to the list, which had reached over 900 companies, about one seventh of the total listed on American exchanges.[114] Of course, many of these firms lobbied NYSE to be added.[115] As Keith Bliss, director of sales at Cuttone & Co., said, "What company would not want to get on the list if they could?"[116]

As a matter of fact, some companies did ask to be removed from the list.[117] "Short-selling is an important activity in terms of providing information to market participants," said Rob Dillon, the chief executive of Diamond Hill Investment Group, Inc., a company which utilizes short selling as part of its investment strategy.[118]

108. Kara Scannell et al., *SEC Is Set To Issue Temporary Ban Against Short Selling*, WALL ST. J., Sept. 19, 2008, at A1.

109. *Id.*

110. *Id.*

111. *Id.*

112. Kara Scannell, *The Financial Crisis: SEC Quickly Revises Short-Selling Rules; Shift on Financials, Hedge Funds Sends Traders Scrambling*, WALL ST. J., Sept. 23, 2008, at A3.

113. *Id.* (quoting Lawrence Harris, former chief economist at the SEC from 2002 to 2004).

114. *No-Short List Keeps Getting Longer*, N.Y. TIMES DEALBOOK, Sept. 25, 2008, http://dealbook.blogs.nytimes.com/2008/09/25/short-selling-shield-now-covers-drug-stores/ (last visited June 14, 2010); Kara Scannell & Serena Ng, *SEC's Ban on Short Selling Is Casting a Very Wide Net*, WALL ST. J., Sept. 26, 2008, at C1.

115. Scannell & Ng, *supra* note 114. R

116. *Id.*

117. *Id.*

118. *No-Short List Keeps Getting Longer*, *supra* note 114. R

Some firms that asked to be removed cited concerns about liquidity in the marketplace.[119] Others focused on information effects with respect to their own stock and the market generally. "For the economy and markets to efficiently allocate capital, you need to have information," Mr. Dillon noted.[120] When a medical malpractice insurer opted out, its CEO declared, "We also believe in free and fair markets."[121] Greenlight Capital, the Cayman Islands-based reinsurer headed by David Einhorn, famous for his early short positions against Allied Capital and Lehman Brothers, said, "We believe it is in the long-term interest of our company to have the market set an appropriate price for our shares. We also do not want investors to feel our stock is the beneficiary of any artificial price support."[122]

A firm might also opt out to maintain a convertible bond market for its stock. In the early part of 2008, these half-stock, half-bond hybrids were an extremely important source of liquidity for financial firms—indeed, many investors would not buy convertible bonds without a short sale to hedge their position.[123] Without an exception for hedging, the SEC was "literally shutting the market down."[124]

Both short sellers and public company representatives framed their message in public-interest language to garner the public support that would turn out to be crucial. The endangered companies focused on morally charged language to excite the public's already heightened distrust of the secretive side of banking, using words like "abuse," variations on "illegal" behaviors, and "false" rumor spreading.[125] Even the word "naked" came to be accusatory, despite the fact that "naked" short selling is not illegal provided that certain conditions are met, and the practice was not heavily regulated prior to these events.[126] In the media, "naked" came to be equivalent to deceptive, manipulative, and "illegal."

Short sellers, on the other hand, framed their arguments in terms of truth-finding, focusing on informational aspects of efficient markets and the preservation of "free and fair markets."[127] By

119. Scannell & Ng, *supra* note 114. R

120. *Id.*

121. *Id.*

122. *Id.*

123. Tom Lauricella, *The Crisis On Wall Street: Short-Sale Ban Wallops Convertible-Bond Market*, WALL ST. J., Sept. 26, 2008, at C2.

124. *Id.* (quoting Adam Stern, chief executive at hedge-fund manager AM Investment Partners).

125. *See supra* notes 108 (abuse), 110 (illegal), 105 (false). R

126. *See supra* notes 71–72. R

127. *See* Scannell & Ng, *supra* note 114.

claiming to reject the appearance of "artificial price support," they implicitly accused the public companies of deception and framed themselves as protectors of truth.[128] Bloggers had picked up the arguments on their own, with references to the role of short sellers in revealing fraud in public companies.[129] In addition, both sides appealed to the "un-American" or unpatriotic nature of the other's behavior, though this seemed to be used against short sellers.[130]

Others who participated in the SEC calls on the day of the ban expressed concerns for liquidity and for the potentiality that net-long investors would sell their stock if they could not use short sales to hedge their positions.[131] Some also noted a likely increase in the use of options to make bearish bets.[132] In hindsight, the statements of James Chanos, the short seller famous for revealing the Enron corporate scandal and chairman of a hedge fund lobbyist group, were very telling: "While this is all politically pleasing to the regulatory powers that be, the fact of the matter is that there has been no evidence presented of short sellers circulating false market rumors to drive down the price of stocks."[133] He made a second point that trading in credit default swaps—unregulated insurance contracts for off-exchange debt instruments—"dwarf[ ] the trading in equities in financial firms[, and u]ntil the SEC . . . gets their hands around that, the banning of the short selling is meaningless."[134] He also expressed concern that requiring short sellers to publish their

128. *See id.*

129. *See*, *e.g.*, Gray Galles, Don't Sell Short Selling Short, Ludwig Von Mises Institute (Apr. 6, 2007), http://www.mises.org/story/2527 (last visited June 18, 2010).

130. A clip of Jim Cramer discussing the issue demonstrates just how purposeful the use of rhetoric is. The goal of both Cramer and the anchor seems to be using the language of patriotism and terrorism, rather than expressing any particular point. *See Stop Trading with Jim Cramer* (CNBC television broadcast Sept. 18, 2008), *available at* http://www.youtube.com/watch?v=zj0Vwnt1CLs. This language was around long before the events of this episode. *See The Long and Short of Hedge Funds: Effects of Strategies for Managing Market Risk, H. Subcomm. on Capital Markets, Insurance, and Government Sponsored Enterprises, H. Comm. on Financial Services*, 108th Cong. 6 (2003) (testimony by Professor Owen A. Lamont) ("There is a natural tendency to feel that short selling is somehow inherently malevolent or un-American. To the contrary, it is quite positive for our economy to correct overpricing and detect fraud. And nothing could be more American than free speech, free markets, and a healthy competition among ideas and firms.").

131. Scannell et al., *supra* note 108. **R**

132. *Id.*

133. *Id.*

134. *Id.*

positions could allow chief executives to bring frivolous lawsuits against those who short their stock.[135]

As it turned out, these results-oriented arguments by short sellers did not carry the day. One of the United Kingdom's largest hedge fund managers thought that "the hedge funds would have lost the debate anyway[,] but given that no one turned up[,] there was no chance."[136] The CEOs won the public relations battle due to months of rumors about the impact of short selling, converting what would have been a *special* interest into a *general* interest by convincing the public that its interests were more accurately aligned with those of companies rather than with short sellers. The mudslinging was interesting enough to spark intense media attention: from January 1, 2006 to the day of the ban, over 7144 newspaper articles were published mentioning short selling.[137] Three quarters of those were published since January 1, 2007 and almost half were published in the eight months of 2008 preceding the ban—almost 3300 articles, not including blog postings, television news and interviews, nor public statements from government or private players.[138]

The issue was squarely on the public agenda and thus limited the policy discretion on the part of regulators. Michael Levine and Jennifer Forrence describe this discretion as "slack" that gives agencies room to maneuver in the grey areas that the public does not understand.[139] Because the issues are complex, there is a high cost to gathering and sorting the information relevant to determining what the best action is, and monitoring the actions of regulators is very difficult. A gap in the principal-agent relationship is thus created. However, where "slack" is reduced due to high levels of media attention, as with short selling, the regulator's decision whether to act will not be shielded from the public's view.[140] At the same time, with respect to short selling, the public may not have fully internalized the complexity of the issues necessary to determine an objectively "best" course of action. As a result, the likelihood of an

135. *Regulators Move to Stop Some Short Selling*, N.Y. TIMES (Online), Sept. 19, 2008, http://www.nytimes.com/2008/09/19/business/worldbusiness/19ihtsell.4.16317673.html.

136. James Mackintosh, *Short Shrift*, FIN. TIMES, Oct. 6, 2008, at 8.

137. Figures were generated using "Proquest Newspapers" database with confined date parameters (search: "short-selling or short-sale or 'short selling' or 'short sale' or 'short seller'").

138. *Id.*

139. *See* Levine & Forrence, *supra* note 88, at 176 & n.15. R

140. *Id.* at 179.

outcome in the "general interest"—supported by the polity[141]—was high, as was the risk of unintended consequences.

C. Agency Dynamics: the SEC, the Treasury, and the Federal Reserve

As the chairman of the SEC, Cox was faced with balancing public demand for action with concern for unintended consequences. As for unintended consequences: "You can sort it out later!" Henry Paulson exclaimed to Cox over the phone. "You have to save [the banks] now or they'll be gone while you're still thinking about it."[142]

The "supremely self-confident" Paulson, former chairman of Goldman Sachs and then-current Treasury Secretary, had spent the week in meetings with Ben Bernanke, the quiet Great Depression scholar and then-chairman of the Federal Reserve System; Timothy Geithner, the young gun and then-president of the Federal Reserve Bank of New York; and the CEOs of the major banks, scrambling as they spiraled downward.[143] The bailouts and government-sponsored deals of the preceding six months had brought a heap of public criticism upon Paulson and Bernanke.[144] As known pragmatists, both were willing to do what was necessary to save the system; they had been acting with the interests of the system front and center, and they had little left to lose in terms of their political reputations, especially amongst Republicans. If successful, weathering the financial crisis was sure to be their legacies; no doubt ends would be more important than means. Judging by Paulson's response to Cox's concerns regarding unintended consequences, Cox was likely feeling pressured to adopt a similar outlook.

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141. *Id.* at 176. I use "general interest" in the Levine-Forrence sense, based on its likelihood of being ratified by an informed polity. However, as will be evident below, I believe this particular "general interest" to be flawed from an efficiency standpoint and objectively inferior. This does not conflict with the "informed" nature of the polity; its constituents are simply irrational in the aggregate. Explanations I would suggest for this are behavioral irrationalities (including endowment and prospect theory applications) and/or a prisoner's dilemma. Unfortunately, exploration of such theories is outside the scope of this Note.

142. Stewart, *supra* note 1, at 79. **R**

143. *Id.* at 60.

144. Steven R. Weisman & Jenny Anderson, *Can Hank Paulson Defuse this Crisis?,* N.Y. TIMES, July 27, 2008, at B1; Steven R. Weisman, *U.S. Lawmakers Set to Question Bernanke on Bear Stearns Bailout*, N.Y. TIMES (Online), Apr. 2, 2008, http://www.nytimes.com/2008/04/02/business/worldbusiness/02iht-fed.1.11616448.html?pagewanted=1&sq=bernanke%20bailout&st=cse&scp=77; Michael M. Grynbaum, *Plan to Aid Borrowers Is Greeted by Criticism*, N.Y. TIMES, Feb. 13, 2008, at C4.

Those days were replete with the influence of company leadership, pleading for their solvency.[145] Paulson had close ties to many of the bank heads,[146] and had likely been influenced by the one-sided nature of the discussions held in the board room at the Federal Reserve during that week. John Mack of Morgan Stanley, in particular, publicly lambasted short sellers for allegedly spreading false rumors to drive the company's stock price down and secure profits for themselves.[147] In light of sharp stock declines and the urgency in the air, Paulson was sufficiently persuaded to push Cox to act against short sellers.[148] Moreover, this approach was supported by Bernanke's general stance, which, informed by experiences from the Great Depression, advocated for over-intervention rather than insufficient action.[149]

The SEC, Treasury, and the Federal Reserve do not necessarily have the same goals, nor should they necessarily err in the same direction. The Treasury mission includes "promoting economic growth and stability, and ensuring the safety, soundness, and security of the U.S. and international financial systems."[150] The Federal Reserve Board mission is "to ensure the safety and soundness of the nation's banking and financial system."[151] The mission of the SEC, on the other hand, is "to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation."[152] Based on these roles, it is not clear that the SEC should place the same weight as the Treasury and the Federal Reserve on the survival of the banks.

However, looking closely at its mission statement does not provide a clear picture of how the SEC should approach the problem of short sales in the context of panic. There exist investors with conflicting interests: those who want to invest in the stock and those, like short sellers, who invest by moving stock from those who

145. *See generally* Stewart, *supra* note 1. R

146. *Id.* at 62, 63, 65, 75.

147. Susan Pulliam et al., *Anatomy of the Morgan Stanley Panic—Trading Records Tell Tale of How Rivals' Bearish Bets Pounded Stock in September*, WALL ST. J., Nov. 24, 2008, at A1. An interesting twist is that records show that while those CEOs were sitting in the Federal Reserve board room, their companies were placing bets against each other in the credit default swap market. *Id.*

148. Stewart, *supra* note 1, at 79. R

149. *Id.* at 61.

150. Dep't of the Treasury, Duties & Functions, http://www.ustreas.gov/education/duties/ (last visited Apr. 7, 2010).

151. Bd. of Governors of the Fed. Reserve Sys., Mission, http://www.federalreserve.gov/aboutthefed/mission.htm (last visited Apr. 7, 2010).

152. SEC, The Investor's Advocate, *supra* note 87.

value it less to those who value it more (in reverse chronological order). It is hard to say whether the SEC's mission statement contemplates protecting one group of investors from the other. The statement focuses on macro-type mechanisms to protect investors, such as efficiency and order in the markets, which could suggest that the first goal, protection of investors, is to be achieved by pursuing the latter goals.[153] Ex ante short selling constraints designed to enhance price continuity could be desirable,[154] but, the SEC had to make this tradeoff in the context of a crisis, when there is no time for ex ante constraints. Considering that a significant cost of short selling constraints is decreased liquidity, the choice may appear to tip away from a ban. However, the conflicts do not end there—the SEC must still tradeoff the need for capital formation with the hit to the convertible bond market that will result from restraints on short sales.

Even if these tradeoffs are properly balanced, conflicts between the SEC and the Treasury or the Federal Reserve will surely arise. For example, if banks are insolvent, it could potentially be the SEC's obligation to let the market achieve efficiency by accurately reflecting the dismal reality of a failing bank's balance sheet. Though it is unlikely that the SEC's obligations require the collapse of the banking system, it is unclear how aligned its duties are with the primary concerns of the agencies whose subjects of regulation are threatened.

The SEC sidesteps these problems by focusing on the fairness aspect of its mission: it must protect investors from unfairness in the market.[155] The agency could justify its action to intervene by blaming the undesirable stock declines on *unfair* and *illegal* behavior. In that way, if the intervention does not work, the failure can be explained by new and unpredictable unfair activities to circumvent the prohibited mechanisms for achieving the same undesirable outcome. In other words, if the activity that led to the negative outcome was prohibited, it is easy to shift blame to human error; thus, one can achieve political cover by prohibiting any behavior that cannot be controlled.

153. But, even a focus on "efficiency" does not provide a clear solution; general investors may prefer *continuous* market efficiency while traders may prefer *immediate* market efficiency. *See* Douglas M. Branson, *Nibbling at the Edges—Regulation of Short Selling: Policing Failures to Deliver and Restoration of an Uptick Rule* 38–39 (U. of Pitt. Sch. of L. Legal Studies Research Paper Series, Working Paper No. 2009-10, 2009), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1364475.

154. *Id.* at 8–10.

155. *See supra* note 152 and accompanying text.

The shift in blame was achievable in 2008 because slack was reduced sufficiently to generate action; but the complexity of the matters, the dominance of the CEOs' voices, and the plethora of issues on the table were such that slack was not enough to ensure that action truly in the public interest was taken. If there had been slack, Cox could have ignored the public demand for a ban based on the belief that it was not in the best interest of the public. Levine and Forrence refer to this type of regulatory behavior as that of a "Burkean Independent," one who acts in an "other-regarding" as opposed to self-interested manner to bring about an outcome that he believes to be best for society, but that would not be ratified by the polity if provided with all the relevant information.[156] However, here there was no slack, and thus if Cox ignored public demand and declined to implement the ban, he would have made himself into what Levine and Forrence termed a "failed ideologue"—one who exercises Burkean-style independent judgment as to what is in the public interest, but who does so in the absence of slack and thus has no chance of hiding her action or avoiding public criticism.[157] Instead, Cox accommodated the public demand for action, though it is unclear whether he did so simply to avoid public criticism, or because he too had been convinced of the urgent threat posed by short sellers.

Paulson certainly served as an additional source of pressure, but he was facing his own complex set of influences. He may have been acting with "Burkean" motives—those consistent with his own, personal notion of society's best interests[158]—with respect to the bank bailouts, a topic about which public opinion was mixed.[159] However, he was captured on the short selling issue. Because he was not the primary regulator—the decision to ban short selling was technically not his to make—Paulson had some slack; his actions to influence the decision were not as easily accountable to the public. However, he did need the banks to cooperate with his efforts to save the banks through forced mergers. Therefore Paulson was able to invest the slack he did have to support the short-selling ban and appease the bank heads, in order to serve his primary interest in preserving the banking system by other means. Furthermore, as between Paulson and Cox, there appeared to be zero

156. Levine & Forrence, *supra* note 88, at 179. **R**

157. *Id.*

158. *Id.* at 174.

159. *See, e.g.*, Floyd Norris, *How Voters See the Bailout*, N. Y. TIMES, Oct. 18, 2008, at B3.

slack—Cox had virtually no discretion, and no space, to act independently outside the scrutiny of Paulson.

In going ahead with the ban, the SEC used public interest language, borrowed from the CEOs, to assure the public that it was acting in their general interest. Beginning with its investigations into hedge fund activity and the imposition of less dramatic restraints on short selling following Bear Stearns and IndyMac, the SEC emphasized in releases the impact of unfair behavior on the orderliness of the market, thus providing the justification for its activities. For example, the release regarding the ban on naked short selling of nineteen stocks in July of 2008 starts off strong, stating that "false rumors can lead to a loss of confidence in our markets," citing recent charges against a trader for market manipulation.[160] It goes on to promise that "this emergency requirement will eliminate any possibility that naked short selling may contribute to the disruption of markets in these securities."[161] Of course, that was neither the first nor the last attempt to restrict the naked short selling that the agency and much of the public blame for the drastic declines.[162] The press release regarding the outright ban on short selling of 799 stocks quotes Cox: "The Commission is committed to using every weapon in its arsenal to combat market manipulation that threatens investors and capital markets."[163] He claims the order "will restore equilibrium to markets."[164]

However, by the time the SEC extended the ban on October 2, 2008, the S&P Banking Index had dropped 11% and the S&P Insurance Index dropped 12%.[165] Washington Mutual's stock fell so dramatically that it had to be seized by the FDIC and sold at an incredible price to JPMorgan Chase.[166] And Wachovia stock plunged almost 50% to be eventually seized by the FDIC and sold to Citigroup.[167] With these numbers, many wondered why the SEC

160. Emergency Order Pursuant to Section 12(k)(2), Exchange Act Release No. 58,166, at 1–2 (July 15, 2008), *available at* http://www.sec.gov/rules/other/2008/34-58166.pdf.

161. *Id.* at 3.

162. *See infra* Part II.A.

163. *See* Press Release, SEC, SEC Halts Short Selling of Financial Stocks, *supra* note 3.

164. *Id.*

165. Paul R. La Monica, Commentary, *The SEC's Crusade Against Shorts is a Joke*, CNNMONEY.COM, Oct. 2, 2008, http://money.cnn.com/2008/10/02/markets/thebuzz/index.htm.

166. *Id.*

167. *Id.*

extended the ban at all.[168] But a clue emerged from a comparison of the extension order to previous orders. All previous orders referenced the dangers to the orderly functioning of markets posed by false rumors.[169] However, the order extending the ban did not mention rumors, and instead stated only that it "intend[ed] the prohibition to restore investor and market confidence by preventing short selling from being used to drive down the prices of securities in financial institutions even where there is no fundamental basis for a price decline other than general market conditions."[170] The language shifted from abusive conduct to information problems—the actions that the emergency orders restrain are not justified from the perspective of an accurate representation of the market.

By 2008, the SEC seemed to have abandoned its attempt to exclusively frame its actions as a response to illegal behavior, and did little to ward off the potential inference that it was simply trying to prevent an exceedingly unpleasant outcome. The agency ultimately ended up helping the Treasury and the Federal Reserve achieve their objectives and neglected its own mission—in particular, concerns for efficiency and liquidity.

D. International Context

Another factor contributing to the ultimate decision to institute the ban was the international response to the crisis. The United States did not act alone that week in 2008; the United Kingdom was on a similar schedule reacting to the Lehman disaster, and, in implementing its ban one day before the United States, was the first nation to institute emergency short-selling restrictions.[171] However, the international instinct to blame and heavily restrict short sellers put the issue on the global public agenda in the weeks and months prior, and as a result, inaction became even less of a politically feasible option for United States regulators.

While this did contribute to the push to regulate, it also created some slack for American regulators in their choice of what regulation to use, because United States regulators could count on other developed countries to impose market regulations in even

168. *See, e.g.*, *id.*

169. *See, e.g.*, *supra* notes 160–63 and accompanying text.

170. Order Extending Emergency Order Pursuant to Section 12(k)(2), Exchange Act Release 58,723 (Oct. 2 2008), *available at* http://www.sec.gov/rules/other/2008/34-54723.

171. Peter Thal Larsen, *UK Ban on Short Selling of Financials*, FIN. TIMES, Sept. 19, 2008, at 2.

more controversial ways. To the extent that the international responses appeared harsh, rash, and unprincipled, American regulators were given slack to continue or adjust their strategy without public outcry.

Indeed, generally, during the period following the Lehman collapse, short sellers were met with more and harsher restrictions abroad than in the United States.[172] There was sharper rhetoric and even more accusatory language. Italian Prime Minister Silvio Berlusconi banned what he called "speculative attacks" on Italian banks, and Peer Steinbrück, Germany's then-finance minister, was pushing for a global ban on "purely speculative short selling."[173] John Sentamu, archbishop of York, referred to short sellers as "bank robbers and asset strippers."[174]

The entire crisis was acknowledged to be a global affair, and future systemic risk and crisis management had been determined to be dependent on coordinated strategies.[175] Thus international pressure to act against short sellers was significant, and countries reacted in substantive ways.[176] Some countries implemented bans similar to that in the United States but lasting longer. The United Kingdom, for example, maintained its ban on short selling of financial firms until January of 2009.[177] In Canada and Switzerland, there were short selling bans on financial stocks beginning on the same day as the United States, lasting until early October of 2008 in Canada and until December of 2008 in Switzerland.[178] The Netherlands imposed a similar ban lasting eight months.[179] Denmark and Ireland have bans still outstanding.[180]

Other countries instituted broader bans that lasted longer than that in the United States. In contrast to the United States and United Kingdom, many Asian countries and Australia have applied

172. However, the initial implementation of the UK ban was more nuanced than that of the US, including both a convertible-bond hedge exemption and market-maker exemption. *See* Mackintosh, *supra* note 136. **R**

173. *Id.*

174. *Id.*

175. Gerald F. Seib, *The Financial Crisis; Capital Journal: Global Crisis Coordination Takes Shape—Slowly*, WALL ST. J., Oct. 11, 2008, at A2.

176. *See, e.g.*, Sheryl Gay Stolberg & Mark Landler, *Bush Calls 20 Nations To Meeting On Markets*, N.Y. TIMES, Oct. 23, 2008, at B1.

177. Seraina Gruenewald et al., *Emergency Short Selling Restrictions in the Course of the Financial Crisis* 14 (unpublished working paper, Jan. 21, 2010), *available at* http://ssrn.com/abstract=1441236. The status of such bans reflects information available as of January, 2010, except where otherwise noted.

178. *Id.* at 8 (Canada), 14 (Switzerland).

179. *Id.* at 12.

180. *Id.* at 8 (Denmark), 10 (Ireland).

emergency measures to all listed firms.[181] Iceland also instituted a ban on short selling of financials for four months that included "any instrument with the same purpose and the same economic exposure."[182] Greece and Russia had outright short-selling bans for around eight months in late 2008 and early 2009.[183] India banned short selling of non-financial companies, and South Korea banned short selling for all listed firms, measures which are both still outstanding.[184] Italy had a ban on short selling all listed firms, but later limited it to financial firms, and it now restricts only short selling of firms increasing their capital.[185] France and Germany instituted bans only on naked short selling, but the former included spot and options contracts.[186] France's measure is still in force.[187] On January 29, 2010, Germany declined to extend its original ban,[188] but has since instituted a new ban on some naked short selling and is considering a market-wide ban.[189]

Even if a prediction as to the likelihood of other countries' following the lead of the United States was never explicitly made, the general characterization of the United States as a more lenient and predictable forum for trading generates a kind of feedback loop. To their constituents, European countries cannot be seen to

181. *Id.* at 4.

182. *Id.* at 10.

183. *Id.* at 9 (Greece), 13 (Russia). Greece recently instituted a new ban, scheduled to expire June 28, 2010. *Greek SEC Watchdog Bans Short Selling in Stocks*, REUTERS, Apr. 28, 2010, http://www.reuters.com/article/idUSATH00541520100428.

184. *Id.* at 10 (India), 13 (South Korea).

185. *Id.* at 11.

186. *Id.* at 9.

187. *See* Press Release, Autorité des Marchés Financiers [AMF, Financial Markets Authority], AMF Prolongs Exceptional Measures on Short Selling of Financial Stocks Pending a Permanent Europe-Wide Regime (Jan. 27, 2010), http://www.amf-france.org/documents/general/9297_1.pdf.

188. *See* Press Release, Bundesanstalt für Finanzdienstleistungsaufsicht [BaFin, Federal Financial Supervisory Authority], General Decrees on the Ban of Short Sales Expire (Jan. 29, 2010), http://www.bafin.de/cln_161/nn_720494/SharedDocs/Artikel/EN/Service/Meldungen/meldung__100129__leerv__aufhebung__en.html?__nnn=true. BaFin recently adopted a requirement that investors holding a net-short position above a certain threshold in specified stocks notify BaFin by the end of the following day. Press Release, Bundesanstalt für Finanzdienstleistungsaufsicht [BaFin, Federal Financial Supervisory Authority], BaFin Introduces Transparency System for Net Short-Selling Positions (Mar. 4, 2010), http://www.bafin.de/cln_161/nn_720494/SharedDocs/Mitteilungen/EN/2010/pm__100304__leerverk__transparenz__en.html?__nnn=true.

189. Patrick McGroarty & Andreas Kissler, *Germany Proposes Wider Ban on Naked Short Selling*, WALL ST. J. (Online), May 25, 2010, http://online.wsj.com/article/SB10001424052748704026204575266212488296850.html.

respond only as much as the notoriously under-regulated United States, and the United States can count on more populist reactions abroad. While it may not help to quell the immediate backlash following implementation of restrictions, the relatively harsh international responses certainly help to downplay, in hindsight, the seriousness of the restrictions imposed by the United States if media attention turns negative. It also provided some room to maneuver when the SEC was considering whether to extend the ban in early October 2008. The international scramble to push through their own restrictions kept the issue on the global public agenda and urged an extension. Yet, the international response had so much momentum that it prevented the factual realities of the market response (or lack thereof) to the ban in the United States to generate more skepticism about the nuances of the ban and its propriety. This is especially important to the extent regulators were concerned about the move of investors to more lenient regimes, a concern which continues to be salient as regulators debate long-term rules on short selling.[190]

III.
WHAT WE LEARNED

> People will endeavor to forecast the future and to make agreements according to their prophecy. Speculation of this kind by competent men is the self-adjustment of society to the probable. Its value is well known as a means of avoiding or mitigating catastrophes, equalizing prices and providing for periods of want. It is true that the success of the strong induces imitation by the weak, and that incompetent persons bring themselves to ruin by undertaking to speculate in their turn. But legislatures and courts generally have recognized that the natural evolutions of a complex society are to be touched only with a very cautious hand, and that such coarse attempts at a remedy for the waste incident to every social function as a simple prohibition and laws to stop its being are harmful and vain.[191]

Speculative behaviors can be damaging, but are not always worth the trouble of trying to control. Of course, Holmes may not have envisioned in 1905 the kind of impact such behaviors could

190. *See, e.g.*, Jill Lawless & Aoife White, *Hedge Funds Mull Ditching UK for Switzerland, Asia*, ASSOC. PRESS, Nov. 27, 2009, http://abcnews.go.com/Business/wireStory?id=9188318 (last visited June 16, 2010).

191. Board of Trade v. Christie Grain & Stock Co., 198 U.S. 236, 247–48 (1905) (Holmes, J.) ("This court has upheld sales of stock for future delivery . . . .").

exert given the speed and breadth of the modern market. In other words, maybe this time was different. Looking to how great the waste incident to this social function truly was or could have been, was it right to attempt to control it in this way, and will it be right next time?

A. In Hindsight

In hindsight, the 2008 decision to ban short sales appears to have been a bad one on its own terms. Immediately following its implementation, volumes of trades on American exchanges fell 41%, at least in part due to reluctance to take long positions that could not be hedged with shorts.[192] As a result, the cost of trading on such stocks rose as bid-offer spreads "widened substantially."[193]

Frank Hatheway, Nasdaq's chief economist, echoed Richard Whitney, president of NYSE during the two-day ban in 1931.[194] The SEC had not met its goals: "The ban did not restore stability to the market. It did not support prices," and "I would not advocate a return to a short-selling ban."[195] Emerging empirical research concludes that the ban was detrimental for liquidity, slowed price discovery, and failed to support prices.[196] There was more volatility in the "protected" stocks, and liquidity in those stocks had decreased by half.[197] The results paralleled those of the naked short-sale ban on nineteen stocks over the summer of 2008, identified by Arturo Bris and neglected by the SEC at the imposition of the September ban and its extension.[198]

192. Mackintosh, *supra* note 136.

193. *Id.*

194. For Whitney's statement, see *supra* note 52 and accompanying text. **R**

195. David Greising, *Short-Selling Ban Leaves SEC with Little to Show*, CHI. TRIB., Oct. 10, 2008, at 37.

196. Alessandro Beber & Marco Pagano, *Short-Selling Bans Around the World: Evidence from the 2007–09 Crisis* 3–4 (Centre for Studies in Econ. and Fin., Working Paper No. 241, updated Jan. 2010), *available at* http://www.csef.it/WP/wp241.pdf. The data showed a positive stock price correlation in the United States. However, based on the declines in other countries, the authors believe it is probably due to other policy measures announced at the time, *id.* at 26, namely the bailout. "[T]he overall evidence indicates that short-selling bans have at best left stock prices unaffected, and at worst may have contributed to their decline." *Id.* at 4.

197. Greising, *supra* note 195. **R**

198. *Id.*; Arturo Bris, Op-Ed, *Shorting Financial Stocks Should Resume*, WALL ST. J., Sept. 29, 2008, at A25.

B. Means and Ends

Cox has acknowledged the undesirable results of the ban, but it is unclear whether he perceives the failure to have been one of degree or one of kind.[199] It is not possible to determine what would have happened if the ban were not pushed on Cox after Lehman fell, but it is clear that five commissioners who would not have supported a ban on Wednesday voted unanimously to implement one on Thursday after calls from Treasury, the Federal Reserve, Blankfein, and Mack, and after the United Kingdom had already announced its ban.[200] Perhaps after a few weeks Cox would have made a reasoned determination that the threat of unfair activity to the orderliness of the market was real enough to warrant a tradeoff for disorderliness resulting from decreased liquidity that would certainly accompany a ban. Indeed, a few weeks after the ban was lifted, markets were dropping, and, again, banks were begging for bans and market shut down, citing examples of rule of law violations such as Lincoln's suspension of habeas corpus and Roosevelt's forcible internment of Japanese Americans.[201] The SEC rejected that advice and exchanges stayed open.[202]

The fact that even the banks conjured such extreme analogies suggests private actors recognized the situation for what it was: a major deviation from established process. The emergency powers possessed by the SEC are meant to be used sometimes, and it is possible they were warranted in 2008. However, the SEC had no evidence of illegal behavior, at least none they touted then, or since. The SEC spent all of one day debating the merits of the ban, and essentially rested their decision on pressure from another agency with different objectives and obligations under the cover of public misunderstandings and international media chaos.[203] At the end of the day, Cox had no solid explanation for these acts beyond sheer price support, which is evidenced by the evolving language of the public and of the SEC's own releases from "manipulative," "abusive," and "illegal" behavior, to simply detrimental short sales.[204]

199. Younglai, *supra* note 6 ("[K]nowing what we know now, I believe on balance the commission would not do it again. . . . The costs appear to outweigh the benefits,") (quoting Cox).

200. Stewart, *supra* note 1, at 78.

201. Younglai, *supra* note 6.

202. *Id.*

203. *See generally* Stewart, *supra* note 1, at 79.

204. *See infra* notes 160–70 and accompanying text.

C. Political Correctness

Some still blame abusive short sellers for the demise of the major banks with colorful language and outright conspiracy theories.[205] Much of the media attention characterizes the past two years' events as a secret slaughter of banks by short sellers, despite that while only eighty-nine banks had failed by September 2009, nearly 1900 hedge funds had gone out of business by March 2009.[206] On the other hand, emerging empirical research found no evidence of price decline resulting from naked short selling of the hardest hit financial institutions, and has concluded that naked short sellers have responded to public news, with their activity intensifying after the price has already declined rather than triggering such price declines.[207] A majority of the scholars and economists at the SEC's recent short selling roundtable noted the benefits of the practice and indicated that the events of the financial crisis were more global in nature, thus justifying a regulatory approach that did not focus solely on short selling.[208]

The enduring factual debate is important because of its political implications. From the perspective of history, the public's perception of the appropriateness of the SEC's acts will turn not on their efficacy, but on the perceived factual truth of the role played by short sellers in the collapse of the banks, which is more easily distorted. Though the SEC investigations are apparently ongoing, no results have been publicized. If culprits are found, and especially if they are convicted of crimes, history will say that the SEC action was proper and that drastic restrictions will be warranted in the future.

This raises two issues. The fact remains that the ban did not achieve its objective to restore equilibrium, presumably not demonstrated by the falling stock prices, the deep hit to liquidity, and the increased volatility that occurred despite the ban. To the extent that the companies continue to dominate in the media war, this

205. For colorful language, see Matt Taibbi, *Wall Street's Naked Swindle*, ROLLING STONE, Oct. 15, 2009, at 50, and for conspiracy theories, see MARK MITCHELL, THE STORY OF DEEP CAPTURE (2009), http://www.deepcapture.com/wp-content/uploads/2009/08/deepcapture-the-story-v1.pdf.

206. Stewart, *supra* note 1, at 79. R

207. *See generally* Veljko Fotak et al., *Naked Short Selling: The Emperor's New Clothes?* (May 22, 2009) (unpublished working paper), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1408493&rec=1&srcabs=1264939.

208. *See* SEC, Roundtable to Discuss Short Sale Price Tests and Short Sale Circuit Breakers (May 5, 2009), at 111–33, http://www.sec.gov/spotlight/shortsales/roundtable050509/shortsalesroundtable050509-transcript.pdf.

aspect of our experience will not be preserved, just as it was not preserved following the Great Depression. For the public, the crucial question in their minds going forward will be whether there exists manipulative activity in the marketplace, and whether the likelihood of such activity is great enough to warrant intervention. On this flawed theory past failures become irrelevant, and we continue to allow our fear of manipulative practices to determine the tools we use to regulate markets, as opposed to the efficacy of those tools.

Another issue is the possibility that no manipulative behavior will ever be "found," at least not in any conclusive way. This Note has suggested that the SEC should consider and focus on the remote likelihood of successful implementation of such a ban in the future. However, if the SEC continues to frame the legitimacy of its actions in terms of unfair behavior, the lack of evidence could constrain behavior in the future. This could allow for more appreciation of the observation that a short sale ban does not achieve objectives that rely on liquidity and reduced volatility. The possibility of unfair behavior does not change that fact.

The remaining question is whether the SEC, or even the Treasury or the Federal Reserve, is willing to go as far as pursuing price support without a justificatory hook, such as manipulative behavior. This Note has suggested that the lack of findings of illegal behavior would undercut that justification for the future. Yet, it is still undesirable for the regulatory agencies to acknowledge a plan to support prices temporarily. To prevent migration, the regulatory regime still has an interest in appearing to be the most capitalist and predictably efficiency-based, and thus its regulators will strive to reduce the appearance of deviation from those principles as much as possible. If the SEC wants to continue to use strategies based on public perception, its hope should be that some illegal behavior is discovered, in order to preserve the strategy for future use. The narrative will certainly take an even more aggressive turn against short selling if they do, despite lack of any evidence that they contributed to the harms suffered by those who oppose them. Regardless of whether one agrees that a price support goal is desirable or justified, intentionally obscuring the true causes of the harms we hope to prevent can only be counter-productive.

IV.
EPILOGUE: THE NEW UPTICK RULE

In response to continuing public and political pressure, on October 17, 2008, the SEC permanently adopted the antifraud rule it

implemented with its emergency powers on September 17, focusing on shorts effected by sellers "who deceive specified persons, such as a broker or dealer, about their intention or ability to deliver securities in time for settlement and that fail to deliver securities by settlement date."[209] Even in the release, the SEC acknowledged that such behavior was already illegal under the general antifraud provisions of federal securities laws.[210] More recently, the SEC voted 3–2 to adopt a new rule that restricts short sales on stocks that have fallen 10% in a day.[211] The rule requires that short sales in such circumstances be executed only at a price above the current national best bid.[212] The restriction applies until the close of the following day.[213] Chairman Mary L. Schapiro said that while short selling can be beneficial, "[w]e also are concerned that excessive downward price pressure on individual securities, accompanied by the fear of unconstrained short selling, can destabilize our markets and undermine investor confidence in our markets."[214] The rule

209. "Abusive" shorts are defined as those for which the seller intends to fail to deliver within the settlement cycle. "Naked" Short Selling Antifraud Rule, 73 Fed. Reg. 61,666, 61,667 (Oct. 17, 2008). On May 4, 2010, Goldman Sachs Execution & Clearing settled an SEC administrative action for violations of this rule in December 2008 and January 2009. *See* Goldman Sachs Execution & Clearing, L.P., Exchange Act Release No. 62,025 (May 4, 2010), *available at* http://www.sec.gov/litigation/admin/2010/34-62025.pdf; Marcy Gordon, *Goldman Sachs Settles Short-Sales Allegations*, ASSOC. PRESS, May 4, 2010, http://abcnews.go.com/Business/wireStory?id=10553721 (last visited June 19, 2010). However, this is unrelated to the SEC's fraud allegations against Goldman Sachs & Co. and Fabrice Tourre relating to synthetic collateralized debt obligations tied to subprime residential mortgage-backed securities, which they marketed in early 2007. *See* SEC Litigation Release No. 21,489, SEC v. Goldman Sachs & Co., No. 10-CV-3229 (S.D.N.Y.) (Apr. 15, 2010), *available at* http://www.sec.gov/litigation/complaints/2010/comp21489.pdf; *see also* Gordon, *supra* note 208.

210. SEC Litigation Release No. 21,489, SEC v Goldman Sachs & Co., No. 10-CV-3229 (S.D.N.Y.) (Apr. 15, 2010), *available at* http://www.sec.gov/litigation/complaints/2010/comp21489.pdf; *see* Rule 10b-5, 17 C.F.R. § 242.203(b)(1) (2009).

211. Fawn Johnson, *In 3-2 Vote, SEC Limits Short Sales*, WALL ST. J., Feb. 25, 2010, at C1. For the rule, see Amendments to Regulation SHO, Exchange Act Release No. 61,595 (Feb. 26, 2010) (effective May 10, 2010), *available at* www.sec.gov/rules/final/2010/34-61595.pdf.

212. Press Release, SEC, SEC Approves Short Selling Restrictions (Feb. 24, 2010), http://sec.gov/news/press/2010/2010-26.htm.

213. *Id.*

214. Mary L. Schapiro, Chairman, SEC, Statement at SEC Open Meeting—Short Sale Restrictions (Feb. 24, 2010), http://sec.gov/news/speech/2010/spch022410mls-shortsales.htm.

will "enable long sellers to stand in the front of the line and sell their shares before any short sellers."[215]

The two dissenting commissioners felt that the rule lacked empirical support, noting that the release itself states, with respect to the 2008 crisis: "[W]e are not aware . . . of any empirical evidence that the elimination of short sale price tests contributed to the increased volatility in the U.S. markets."[216] At the time of the rule's initial proposal, Commissioner Casey expressed that the relationship of the repeal of the uptick rule in 2007 to the increased market volatility was essential to the justification for the proposed rule.[217] The lack of such relationship, admitted by all commissioners, resulted in her harsh dissent:

> The focus of the Commission should be on rulemaking that furthers the mission of the agency: to protect investors, maintain fair, orderly and efficient markets, and promote capital formation.
>
> In the 330 pages of the rule release, there is no evidence that this proposed rule advances any of these goals, even the inchoate promise of the "promotion of investor confidence."
>
> . . . .
>
> . . . [T]his is regulation by placebo; we are hopeful that the pill we've just had the patient take, although lacking potency, will convince him that everything is all right.[218]

Commissioner Paredes agreed that there was insubstantial evidence supporting the rule and felt that the claim that it would bolster investor confidence was "conjecture and too speculative."[219] His long dissent also touched on another issue, which he refers to as "ratcheting."[220] Commissioner Paredes worried that when the new rule inevitably does not work—i.e., the price of a stock declines even after the 10% threshold is met and shorts are restrained—there will be calls for more restrictive rules, which "would harm

215. *Id.*

216. Amendments to Regulation SHO, Exchange Act Release No. 61,595, (Feb. 26, 2010), at 21–22, *available at* www.sec.gov/rules/final/2010/34-61595.pdf; Troy A. Paredes, Comm'r, SEC, Statement at Open Meeting and Dissent Regarding the Adoption of Amendments to Regulation SHO (the "Alternative Uptick Rule") (Feb. 24, 2010), http://www.sec.gov/news/speech/2010/spch022410tapshortsales.htm; Kathleen L. Casey, Commissioner, Securities Exchange Commission, Statement at Open Meeting Short Sale Restrictions (Feb. 24, 2010), http://www.sec.gov/news/speech/2010/spch022410klc-shortsales.htm.

217. Casey, *supra* note 216.

218. *Id.*

219. Paredes, *supra* note 216.

220. *Id.*

market quality even more."[221] "[B]y claiming more than the alternative uptick rule can deliver, [the SEC] will have fostered expectations among investors that the price test cannot meet," and demand will follow for "ratcheting" up the restrictiveness of the short-sale rules.[222]

A foundation for this scenario has already been laid by proponents of short-sale rules. Senator Ted Kaufman, Democrat of Delaware, expressed his disappointment with the rule.[223] "I am frankly surprised that the S.E.C. didn't go further on the uptick rule, so now I got to go around and talk to my colleagues and see what is available."[224] A joint statement with Senator Johnny Isakson, Republican of Georgia, criticized the rule as of "limited use, helping only in the worst-case scenarios that could occur during a terrorist attack or financial crisis."[225]

Thus, when the rule does not prevent rapid price decline, two groups will be validated: those ready to claim that weak regulation was the cause and those who see the rule as simply another "costly political directive that has nothing to do with preventing the next financial crisis."[226] Note one shift in regulatory behavior—instead of responding to emergency pressures as played out in the media, this rule-making episode brought the debate in-house. It occurred within the government agency itself, providing opportunity for a higher level of both dialogue and analysis. Also, the discussion took place in advance of the next emergency, and thus had the benefit of more thoughtful deliberation and might prevent later accusations of inaction. However, parallels in the regulatory method abound: both SEC actions proceeded based on a misdiagnosed threat, both neglected empirical history, and both sets of relevant actors ultimately declined to take up the complex questions surrounding efforts to prevent price decline. Furthermore, the operation of the recent rule mimics the most negative framing of short sellers themselves—while short sellers can benefit from fear-driven sales, so too can the SEC buoy the market by acknowledging and

221. *Id.*

222. *Id.*

223. *See* Cyrus Sanati, *Lawmakers Find S.E.C.'s Short-Sale Rule Lacking*, N.Y. TIMES DEALBOOK, Feb. 24, 2010, http://dealbook.blogs.nytimes.com/2010/02/24/lawmakers-find-s-e-c-s-short-sale-rule-lacking/ (last visited June 16, 2010).

224. *Id.*

225. Johnson, *supra* note 211. R

226. *Selling Investors Short; The SEC Refutes Its Own Short-Sale Ban*, WALL ST. J., Feb. 26, 2010, at A14. The SEC has estimated that costs will be approximately $1 billion to implement the rule and $1 billion annually to maintain it. *See* Johnson, *supra* note 211. R

thereby legitimizing fears. The SEC is not merely responding to the reality of irrational fears; it is incorporating the irrational fear into its policy.[227]

CONCLUSION

Implementing a new and effective price test and dedicating significant resources to investigation and prosecution of manipulation would hopefully go far to prevent manipulative behavior. However, where volatility is sufficient to allow circumvention of a price test, or where herding behavior simply drives prices down sharply in the absence of manipulative naked short selling, the SEC will find itself in the same situation as it was before the 2008 ban.[228] Executives will likely continue to dominate the public debate on short selling. Furthermore, the failure of investigations to provide specific scapegoats may not be sufficient to mitigate the historically vibrant perception of short sellers as generally immoral and untrustworthy. The legitimacy granted by the newest SEC rule to the cycle of elevation of public pressure over empirical experience ensures the cycle will continue.

The history has demonstrated this pattern over and over—regulators responding to some public notion of the general interest that requires short sale restraints, particularly in the context of panic—either during the panic or in anticipation of it. Yet, the empirical experience of history has been lost. Efforts to determine the public interest appear to have been set aside in favor of public pressure, resulting in an approach that threatens to neglect root causes.

In the case of the twenty day short-sale ban, regulators were presented with significant pressure, both inside and outside the government, to respond to a perceived threat of manipulation.

227. Another implication of the non-empirical approach to the operation of this rule is that its efficacy will be difficult to assess. If the rule is aimed to curb destabilization based on "fear of unconstrained short selling," it's work is mostly done the moment it goes into effect. If comfort taken from the rule is incorporated into all sales, perhaps we should be looking for less volatility overall.

228. An incident occurring just prior to this Note's going to press forced SEC Chairman Schapiro to acknowledge a limitation of the rule. On May 6, 2010, the Dow Jones Industrial Average dropped nearly 1,000 points in one half hour. *Fawn Johnson, SEC: 'Uptick Rule' Wouldn't Have Made Difference When Market Fell*, DOW JONES NEWSWIRES, May 11, 2010, http://www.nasdaq.com/aspx/stockmarketnews storyprint.aspx?storyid=201005111702dowjonesdjonline000579 (last visited Apr. 6, 2010). The rule was not yet in effect, but the event prompted questions regarding its anticipated efficacy in such a scenario. *Id.* Chairman Schapiro replied that "[t]o the extent the sales we saw were long sales, the uptick rule would not have made a difference." *Id.*

Even if one agrees that these efforts were "silly but harmless,"[229] there is reason to resist this style of regulatory behavior. By indulging public pressures for what will predictably be ineffective efforts, regulators fail to foster the appropriate appreciation of marketplace forces. This is not a deregulatory thesis. An appropriate appreciation of marketplace forces would acknowledge the fragile and interconnected nature of financial markets in particular[230]—a sphere which has been historically shaped and facilitated by regulatory entities and activities. However, in deciding whether to restrain investor behavior, the degree to which action will be effective in bringing about efficiency and stability is critical, as is the degree to which these values are traded off or sacrificed.

By folding these fears into regulatory policy, the SEC further complicates investors' calculus, thereby adding additional uncertainty. As a matter of regulatory behavior, we can expect this approach to continue, since public dialogue continues to place short selling in the context of manipulation and destruction, and regulators continue to face incentives that favor action over inaction. The recent uptick rule may temper some fears, but it cannot prevent rapid price decline in all but a few narrow circumstances. If another crisis occurred, there may indeed be pressure to institute another short selling ban, despite the rule; and such a ban will likely not achieve its goals.

229. Scannell & Strasburg, *supra* note 15 (quoting short-selling expert Owen A. Lamont).

230. *See supra* Part I.D.

SUBSTANTIVE CONSOLIDATION AND PARTIES' INCENTIVES IN CHAPTER 11 PROCEEDINGS

*SCOTT R. BOWLING**

Chapter 11 proceedings often involve large debtor companies consisting of multiple related corporate entities.[1] In a simple model, the debtor might consist of a corporate parent and a number of subsidiaries. Each of those entities typically has its own set of creditors who, in bankruptcy, seek distribution of that entity's assets. Each creditor attempts to maximize its return on its loan to the entity; creditors need not have any regard for the assets or creditors of related debtor entities. Additionally, any of those debtor entities may be solvent or insolvent. Accordingly, in the simple model, the creditors of a solvent subsidiary will recover fully, and the creditors of an insolvent subsidiary may not recover fully.

This model sets forth a straightforward distribution of assets in a reorganization. Underlying the model is the assumption that the debtor entities and creditors are neatly separated bundles of assets having distinct corporate forms. In other words, no two debtor entities have overlapping assets or corporate forms. This assumption simplifies the problem of reorganizing the entities: one must only match up a particular creditor's claim to a particular debtor's assets in order to determine how solvent an entity is. Yet the neat separation of assets and creditors by entity is not always the case. Sometimes there may be a reason for a bankruptcy court to disregard the corporate forms of debtor entities, particularly where strict adherence to corporate form would produce inequitable results. Substantive consolidation is one method of setting aside a debtor's corporate form in order to achieve equitable results in a reorganization.

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1. *See* William H. Widen, *Report to the American Bankruptcy Institute: Prevalence of Substantive Consolidation in Large Public Company Bankruptcies from 2000 to 2005*, 16 AM. BANKR. INST. L. REV. 1, 3–5 (2008) (finding hundreds of bankruptcies that involve multiple entities); Lynn LoPucki, The Myth of the Residual Owner: An Empirical Study 16 (UCLA Sch. of Law, Law & Econ Research Paper No. 3-11), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=401160.

Substantive consolidation is a common law remedy in bankruptcy proceedings[2] that "treats separate legal entities [of the debtor company] as if they were merged into a single survivor left with all the cumulative assets and liabilities (save for inter-entity liabilities, which are erased). The result is that claims of creditors against separate debtors morph into claims against the consolidated survivor."[3] Because the merged entities may be more or less solvent, as in the simple model above, substantive consolidation harms creditors of the more-solvent entities and benefits creditors of the less-solvent entities. By disregarding the debtor entities' corporate forms, this technique stands in tension with at least some creditors' ex ante expectations regarding the risk and value of their loans to those entities. It has the potential to change, and often does change, parties' state-law property rights in bankruptcy,[4] despite the absence of any Bankruptcy Code provision specifically authorizing such a remedy. The drastic effect this technique has on creditors' rights raises the following normative question: when, if ever, is substantive consolidation appropriate?

Three circuit courts of appeals have answered this question, each one differently.[5] In *In re Owens Corning*,[6] the Third Circuit proposed the latest test, attempting to settle the matter. Problematically, none of these tests adequately satisfies two uncontroversial bankruptcy policies. A proper substantive consolidation test ought to reflect parties' ex ante incentives and be practically administrable. By failing to meet these criteria, the two tests for substantive consolidation make large corporate reorganizations needlessly uncertain and inequitable.

This Note attempts to clarify the theoretical problems with the current models and proposes a test that satisfies the above three criteria. Part I explains the interests and incentives debtors and different kinds of creditors typically have in a Chapter 11 proceeding. Part II articulates the three leading substantive consolidation tests,

2. *See* Joy Flowers Conti, *An Analytical Model for Substantive Consolidation of Bankruptcy Cases*, 38 BUS. LAW. 855, 856 (1983) ("Substantive consolidation is a judicial doctrine which, with one exception [inapplicable to corporate bankruptcy], has not been codified by statute or embodied in any rule.").

3. *In re* Owens Corning, 419 F.3d 195, 205 (3d Cir. 2005) (quoting Genesis Health Ventures, Inc. v. Stapleton (*In re* Genesis Health Ventures, Inc.), 402 F.3d 416, 423 (3d Cir. 2005)).

4. *See* Widen, *supra* note 1, at 3–5.

5. *See* Owens Corning, 419 F.3d 195; Union Savings Bank v. Augie/Restivo Baking Co. (*In re* Augie/Restivo Baking Co.), 860 F.2d 515 (2d Cir. 1988); Drabkin v. Midland-Ross Corp. (*In re* Auto-Train Corp.), 810 F.2d 270 (D.C. Cir. 1987).

6. 419 F.3d at 216.

examines the effects of those tests on the different kinds of creditors, and shows that the tests raise a number of important, problematic questions for the administration of a bankruptcy proceeding. Part III argues that none of the three tests is sufficiently grounded in parties' incentives and proposes a new test to solve this problem. Part IV applies this new test to three hypothetical scenarios and explains why the test represents better bankruptcy policy than any of the existing substantive consolidation frameworks. Part V concludes with a brief summary of the concepts discussed herein.

I.
DEBTOR AND CREDITOR INCENTIVES IN CHAPTER 11 PROCEEDINGS

A. Debtors

Companies use debt to finance their businesses and limit their own equity's exposure to risk.[7] In a simple loan model, the creditor gives cash to the debtor, and the debtor repays both principal and interest to the creditor over a period of time agreed upon by the parties.[8] The interest on the loan compensates the creditor for performing two services: renting out its cash for use by the debtor and assuming the risk that the debtor will fail to repay that cash.[9] The greater the cost of renting cash or the greater the risk that the debtor will default on the loan, the higher the rate of interest the debtor will pay for the loan.[10] Further, the profit-maximizing debtor will always seek to obtain credit as cheaply as possible.

In a Chapter 11 proceeding, however, the debtor's duty to reorganize[11] carries with it some conflicting incentives. First, the debtor seeks to settle its debts in accordance with a plan of reorganization either by obtaining the unanimous consent of all classes of creditors or by "cramming down"[12] the classes that dissent.[13] The

7. *See* Richard A. Posner, *The Rights of Creditors of Affiliated Corporations*, 43 U. CHI. L. REV. 499, 501, 502 (1976).

8. *See id.* at 501.

9. *See id.*

10. *See* ANDREW J.G. CAIRNS, INTEREST–RATE MODELS: AN INTRODUCTION 1 (2004) (discussing both components of interest rates).

11. *See* Michelle J. White, *The Corporate Bankruptcy Decision*, *in* CORPORATE BANKRUPTCY: ECONOMIC AND LEGAL PERSPECTIVES 207, 217 (Jagdeep S. Bhandari & Lawrence A. Weiss eds., 1996).

12. *In re* Mattson, 210 B.R. 157 (Bankr. D. Minn. 1997), offers a definition of "Cramdown":

> Cramdown is the centerpiece of the reorganization chapters. Cramdown starts with § 506(a) [,] which basically provides that a creditor holding a security interest in property has a secured claim only to the extent that there is

profit-maximizing debtor will prefer whatever distribution of assets allows it to emerge from bankruptcy most quickly and cheaply. That is, the debtor will be relatively indifferent to who gets repaid and how much those parties receive, provided that such a distribution meets the statutory requirements of plan confirmation[14] and is acceptable to the bankruptcy court. Second, the debtor, like any other company, seeks to maximize the going-concern value of its business. The debtor wants to emerge from Chapter 11 in as strong an economic position as possible; therefore, it has an incentive to avoid either ruining its business relationships or driving up its future perceived default risk during the Chapter 11 process. These two reorganization incentives conflict to the extent that a debtor is unable to confirm a plan that does not impair at least some creditors.

This conflict underlies the decisions a large corporate debtor makes regarding whether to propose a plan involving substantive consolidation in a Chapter 11 reorganization. From the debtor's standpoint, "[s]ubstantive consolidation offers an inexpensive alternative to generating balance sheets for each individual company in a consolidated group of companies,"[15] thereby speeding the reorganization process and reducing transaction costs. Thus, the incentive to reorganize tends to favor substantive consolidation, whereas the incentive to maximize going-concern value (and minimize future perceived default risk), as described above, may tend to disfavor such a technique. The Chapter 11 debtor considering substantive consolidation must balance these two conflicting incentives in order to decide whether consolidation is appropriate.

B. Sophisticated Creditors

Sophisticated creditors[16] include banks, pension funds, institutional loan funds, and other financial institutions that typically ex-

> value in that property to provide actual security for its claim. . . . The basic rule of cramdown is that, under a plan, a debtor must make payments to a secured creditor [that] have a value equal to the debtor's allowed secured claim, which is not necessarily its entire claim.

Id. at 159.

13. *See* 11 U.S.C. § 1129(a)–(b) (2006); White, *supra* note 11, at 217–19.

14. *See* 11 U.S.C. § 1129 (setting forth statutory requirements for plan confirmation).

15. William H. Widen, *Corporate Form and Substantive Consolidation*, 75 GEO. WASH. L. REV. 237, 280 (2007) [hereinafter Widen, *Corporate Form*].

16. These classifications generally follow those set forth in Andrew Brasher, Substantive Consolidation: A Critical Examination 16–17 (2006) (unpublished manuscript), *available at* http://law.harvard.edu/programs/olin_center/corpo-

tend "term loans, revolving credit loans, and letters of credit" to debtor companies.[17] These loans are "in many cases secured" by the debtor company's assets[18] or guaranteed by the parent debtor's subsidiaries—i.e., direct claims against related corporate entities in the event that the borrowing entity defaults. Ex ante, sophisticated creditors negotiate the terms, covenants, security interests, and interest rates of their credit agreements with the borrowing companies and structure their affairs with debtors so as to fix a predetermined level of risk and return.[19] These creditors profit from receiving interest payments on the loans they extend; they maximize profit by making as many loans as possible, setting interest rates as high as possible, and assuming as little risk as possible.[20]

When a debtor company is undergoing a Chapter 11 reorganization, creditors are motivated by their desire to maximize their own repayment from the debtor's limited pool of assets. Because their loans are typically secured, sophisticated creditors tend to recover ahead of other kinds of creditors.[21] Substantive consolidation affects these creditors' recoveries depending on the relative solvencies of the consolidated entities. Creditors of a more-solvent entity that is consolidated with a less-solvent one will, other things being equal, recover less than they would absent consolidation by virtue of the consolidated entities' asset-to-debt ratio being decreased. In another scenario, sophisticated creditors of a parent company whose loans are guaranteed by the parent's subsidiaries may find their loans undersecured after consolidation, leaving them to share part of the distribution equally with the subordinated, unsophisticated creditors of the parent. The possibility of substantive consolidation in bankruptcy therefore motivates sophisticated creditors to (1) assess the possibility that a borrowing entity will be substantively consolidated, (2) increase the default-risk component of that entity's interest rate to compensate for the risk of consolidation, and (3) monitor the borrowing entity as much as

rate_governance/papers/Brudney2006_Brasher.pdf. They differ in that there is no need to distinguish between Brasher's "unsophisticated" and "involuntary" creditors because, on the theory proposed herein, those two groups have identical incentive structures.

17. *See* Douglas R. Urquhart & Roshelle Nagar, *Dealing With Senior Lenders*, *in* WEIL, GOTSHAL & MANGES LLP, REORGANIZING FAILING BUSINESSES: A COMPREHENSIVE REVIEW AND ANALYSIS OF FINANCIAL RESTRUCTURING AND BUSINESS REORGANIZATION 2-1, 2-1 (2006).

18. *Id.*

19. *See* Posner, *supra* note 7, at 503–05.

20. *See* Brasher, *supra* note 16, at 17.

21. *See* 11 U.S.C. § 1129(b) (2006).

possible prepetition to ensure that it does not undertake activities during the course of the loan that would increase the risk of its consolidation.

C. Unsophisticated Creditors

Unsophisticated creditors include tort claimants, employees,[22] and trade creditors, all of whom extend credit to companies only as an incidental part of their business.[23] These groups typically do not have the benefit of ex ante negotiations with debtors such that they are fully compensated for their borrowed cash and assumed risk by restrictive covenants and interest rates.[24] "This means . . . that the provisions of corporation law," and, by extension, the test for substantive consolidation, "will have a greater impact on credit transactions with" these creditors than with sophisticated creditors.[25]

Both prepetition and postpetition, these creditors have the same two incentives: to recover as much of the money owed them as possible and to see the debtor become a viable company.[26] These incentives are somewhat aligned because unsophisticated creditors' rights in the debtor's assets are of a lower priority than sophisticated creditors' rights. If a debtor's asset value exceeds its going-concern value, secured creditors will seek to have the firm liquidated; conversely, if the debtor's going-concern value exceeds its asset value, secured creditors will want the firm to reorganize.[27] Because unsophisticated creditors hold unsecured claims and therefore do not recover at all until secured creditors recover in full, they maximize their chances of recovery by seeking to have the debtor reorganize rather than liquidate.[28] Unsophisticated creditors, like sophisticated creditors, will benefit from or be harmed by substantive consolidation depending on the solvency of their respective debtor entity relative to that of the entities with which it is consolidated.

22. This definition excludes issues relating to collective bargaining agreements, which are beyond the scope of this Note.

23. *See* Brasher, *supra* note 16, at 17 ("Typical unsophisticated creditors are trade creditors who provide services on credit but do not profit from financing; they have neither the skill nor resources to investigate the debtor's status as a legal entity.").

24. *See* Posner, *supra* note 7, at 505.

25. *See id.*

26. *See* Brasher, *supra* note 16, at 17.

27. *See* Todd J. Zywicki, *Bankruptcy*, *in* THE CONCISE ENCYCLOPEDIA OF ECONOMICS (2008), *available at* http://www.econlib.org/library/Enc/Bankruptcy.html.

28. *See id.* ("[U]nsecured creditors, who have no hope of recovering their investment if the company is killed, have an incentive to favor reorganization.").

Courts articulate the legal requirements for substantive consolidation against the backdrop of this economic incentive structure.[29] Three circuit courts of appeals have done so, with varying effects on the different kinds of actors in a Chapter 11 proceeding. Part II of this paper describes the three major tests for substantive consolidation these courts have set forth and examines how the applicable legal rules interact with the economic incentives described above.

II.
THREE PROBLEMATIC TESTS FOR SUBSTANTIVE CONSOLIDATION

A. The Auto-Train *Analysis*

In 1987, the Court of Appeals for the District of Columbia Circuit proposed the first widely recognized test for substantive consolidation in *Drabkin v. Midland-Ross Corp.* (*In re Auto-Train Corp.*).[30] Under *Auto-Train*, a party moving for substantive consolidation establishes a prima facie case by showing both "a substantial identity between the entities to be consolidated"[31] and "that consolidation is necessary to avoid some harm or realize some benefit."[32] The prima facie case amounts to a showing that the debtor abused the corporate form to some unsecured creditors' detriment.[33] Like a veil-piercing analysis under state corporation law,[34] the *Auto-Train* test "recognize[es] that a parent company functions as a shareholder for its subsidiary, just as an individual may function as a shareholder for a single corporation."[35]

The burden then shifts to an objecting creditor to prove "that it relied on the separate credit of one of the entities and that it w[ould] be prejudiced" if the court ordered substantive consolida-

29. *Cf.* Posner, *supra* note 7, at 506 ("A corporation law that is out of step with [business] realities, and so induces contracting parties to draft waivers of the contract terms supplied by the law, is inefficient because it imposes unnecessary transaction costs.").

30. 810 F.2d 270 (D.C. Cir. 1987).

31. *Id.* at 276.

32. *Id.*

33. Seth D. Amera & Alan Kolod, *Substantive Consolidation: Getting Back to Basics*, 14 AM. BANKR. INST. L. REV. 1, 23 (2006).

34. *See* Widen, *Corporate Form*, *supra* note 15, at 270 ("Significantly, classic veil piercing doctrine requires a showing of some connection between the failure to respect corporate form and harm suffered by the veil piercing proponent."); Mary Elisabeth Kors, *Altered Egos: Deciphering Substantive Consolidation*, 59 U. PITT. L. REV. 381, 424–27 (1998).

35. Widen, *Corporate Form*, *supra* note 15, at 270.

tion of the debtor.[36] Finally, if an objecting creditor carries its burden, the court balances the harm and benefits to the parties. It may order substantive consolidation if the benefits "heavily outweigh the harm."[37]

The balancing aspect of this test lacks clarity. For example, what metric should the court use to ascertain the benefits and harm that substantive consolidation might cause? A court might measure the financial effects of consolidation in terms of either absolute dollar values of harm and benefits or the ratio of harm or benefits to the size of the respective creditor. The choice of metric may be outcome determinative of the consolidation motion. Secured creditors, of course, are larger, more sophisticated, and better able to bear default risk than unsecured creditors; if an *Auto-Train* analysis were to pit unsecured consolidation proponents against secured consolidation opponents, the same dollar value of loss would cause proportionally more harm to the unsecureds than it would to the secureds. Should the unsecureds therefore receive a handicap under a proportional analysis? Alternatively, if the court balances the benefits and harms of consolidation simply according to their absolute dollar values, what should be the threshold for the benefits "heavily" to outweigh the harm? No court construing the *Auto-Train* test has addressed these questions.[38]

Regardless of the metric, though, the *Auto-Train* test fails to conform to the ex ante incentives of the parties involved in a Chapter 11 proceeding, thereby systematically disadvantaging both sophisticated and unsophisticated creditors as well as debtors. First, the "avoid some harm or realize some benefit" language combined with the balancing prong frustrates sophisticated creditors insofar as it is not specific enough to allow them accurately to assess the risk that a debtor who enters Chapter 11 will be subject to a substantive consolidation. Risk-averse creditors thus will overestimate the prospect of consolidation, increase interest rates, and demand that more subsidiaries guarantee the loan than might otherwise be adequate to compensate them for the use of their money and allay the default risk they assume. This means more expensive credit and

36. *Auto-Train*, 810 F.2d at 276.

37. *Id.* (internal quotation marks omitted).

38. Often, courts state the *Auto-Train* test but do not perform the whole analysis. For example, in *In re Drexel Burnham Lambert Group, Inc.*, 138 B.R. 723 (Bankr. S.D.N.Y. 1992), the bankruptcy court concluded that the consolidation proponents had established a prima facie case, *id.* at 766, and then ordered consolidation without explicitly mentioning whether any party had opposed consolidation and without explicitly balancing the benefits against any harm. *Id.* at 773.

less lending—in other words, the creation of deadweight loss—than would be the case if the *Auto-Train* analysis had a more predictable application.

Second, the requirement that the harm or benefit to proponents "heavily" outweigh the harm or benefits to opponents[39] disadvantages unsophisticated creditors because it places the heaviest burden on the creditors who are least able to control how much default risk they assume. Unsecured creditors are typically the proponents of consolidation.[40] They are also less able to negotiate and structure their loans to the debtor ex ante than secured creditors are.[41] By demanding a significantly stronger showing of the weaker creditors than of the stronger, the *Auto-Train* test further diminishes the economic position of the already weakest creditors, producing what is arguably an inequitable result.

Finally, the *Auto-Train* test fails to provide the possibility of partial substantive consolidation.[42] Partial consolidation may be a useful restructuring tool in some cases: "If the benefits of consolidation truly outweighed its harm"[43] for most but not all creditors, then consolidation might be optimal "if the objecting creditor were compensated for, or protected against, injury."[44] For all of these reasons, the *Auto-Train* test is an undesirable substantive consolidation analysis as a matter of bankruptcy policy.

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39. *Auto-Train*, 810 F.2d at 276.

40. *See* Amera & Kolod, *supra* note 33, at 23 (noting that substantive consolidation is appropriate where movant shows that unsecured creditors would be harmed by abuse of corporate form).

41. *See supra* Part I.C.

42. As Andrew Brasher notes:

> Partial consolidations are substantive consolidation with a twist. Some courts have held that, even if the conditions are right for substantive consolidation, a creditor that can show that it actually and reasonably relied on an entity's separateness from the overall corporate group can have its claims settled solely from the assets of that entity. Thus, upon the distribution of assets in a liquidation or pursuant to a plan, the court sets aside the assets of the subsidiary to which the objecting creditor loaned and satisfies [its] claims from this pool within a pool. Partial consolidation usually requires the court to estimate what the objecting creditor's recovery would have been had there not been consolidation.

Brasher, *supra* note 16, at 5–6; *see also In re* Lionel L.L.C., No. 04–17324, 2008 WL 905928, at *11 (Bankr. S.D.N.Y. Mar. 31, 2008) (ordering partial consolidation as part of plan confirmation).

43. *See* Amera & Kolod, *supra* note 33, at 24.

44. *Id.*

B. The Augie/Restivo *and* Owens Corning *Analyses*

The Courts of Appeals for the Second and Third Circuits rejected the *Auto-Train* test and articulated their own tests in *Union Savings Bank v. Augie/Restivo Baking Co.* (*In re Augie/Restivo Baking Co.*)[45] and *In re Owens Corning*,[46] respectively. These courts' analyses have much in common with each other. Under *Augie/Restivo*, a consolidation proponent must prove either that prepetition "creditors dealt with the entities as a single economic unit and did not rely on their separate identity in extending credit"[47] or that postpetition the debtor entities' affairs "are so entangled that consolidation will benefit all creditors."[48] Likewise, under *Owens Corning*, a consolidation proponent must prove either that "prepetition [the debtor companies] disregarded separateness so significantly their creditors relied on the breakdown of entity borders and treated them as one legal entity"[49] or that "postpetition [the debtors'] assets and liabilities are so scrambled that separating them is prohibitive and hurts all creditors."[50] These tests both contain a "reliance" prong and an "entanglement" or "efficiency" prong;[51] they are both disjunctive; and they both reject the balancing framework used in *Auto-Train*. Despite the substantial agreement between the Second and Third Circuits as to the appropriate substantive consolidation analysis,[52] the *Augie/Restivo* and *Owens Corning* tests contain a number of problems that can lead to inconsistent or theoretically problematic results.

i. The "Reliance" Prong

A reliance-based test systematically disadvantages unsophisticated creditors to the benefit of sophisticated creditors. As discussed *supra* in Part I.B, unsophisticated creditors either lack the means to understand the legal implications of the debtor's corporate form or, in some cases, lend money to the debtor involuntarily and against their own interests. Only sophisticated creditors have the

45. 860 F.2d 515 (2d Cir. 1988).

46. 419 F.3d 195 at 210.

47. *In re Augie/Restivo*, 860 F.2d at 518 (internal quotation marks omitted).

48. *Id.*

49. *In re* Owens Corning, 419 F.3d 195, 211 (3d Cir. 2005).

50. *Id.*

51. *See* Widen, *Corporate Form*, *supra* note 15, at 268–69; J. Maxwell Tucker, *Substantive Consolidation: The Cacophony Continues*, 18 AM. BANKR. INST. L. REV. 89, 167–68 (2010).

52. *See* Tucker, *supra* note 51, at 168–69. As Tucker also points out, the Owens Corning test places a somewhat higher burden on proponents of consolidation. *Id.*

opportunity to rely on the corporate form of the debtor at all, regardless of whether that form appears to them to be unified or separate.[53] Since unsophisticated creditors do not have a meaningful "opportunity to transact around the provisions of corporation law, the provisions governing limited liability [and substantive consolidation] may alter the relative position of debtor and creditor,"[54] as well as the position of unsophisticated creditors relative to sophisticated creditors.[55]

As discussed above, unsophisticated creditors consist mainly of three groups, none of which are reasonably able to consider the debtor's corporate form before extending credit. Tort claimants cannot rely on the debtor's corporate form because they are involuntary creditors, discovering their status as such only after the debtor injures them and they obtain a right to compensation through settlement or a court-ordered award of damages.[56] Trade creditors do not rely on the debtor's corporate form because they "provide services on credit but do not profit from financing; they have neither the skill nor the resources to investigate the debtor's status as a legal entity."[57] And employees do not have a realistic option to rely because they typically cannot assess the corporation-law implications of working at one related corporate entity as opposed to another. Rather, employees either work at the entity that offers them employment or they do not; the corporate form of their employer simply is not part of their rational decisionmaking. And, in any event, the contingency of substantive consolidation generally does not enter into one's decision whether to accept employment at a particular firm.

Sophisticated creditors, by contrast, make it their business to take all potentially relevant factors into consideration before making loans to debtors.[58] Sophisticated creditors negotiate ex ante for an interest rate that compensates them for all the default risk they assume. They have an opportunity to assess the debtor's risk of defaulting on their loans, and debtors compensate them for bearing that risk by paying an appropriate interest rate. Unsophisticated creditors do not have these opportunities to conduct ex ante nego-

53. *Cf.* Kors, *supra* note 34, at 418 ("[A reliance] requirement eliminates tort and statutory claimants, who, as involuntary creditors, by definition did not rely on anything in becoming creditors.").

54. Posner, *supra* note 7, at 506.

55. *See supra* Part I.C.

56. *See id.*

57. Brasher, *supra* note 16, at 17.

58. *See id.* at 17.

tiations around default corporation-law principles.[59] They are thereby at a disadvantage in an *Augie/Restivo* or *Owens Corning* framework: reliance applies to sophisticated creditors but not to unsophisticated creditors, limiting unsophisticated creditors' ability to obtain the remedy of substantive consolidation.

The risk of inconsistent or theoretically problematic results is particularly high when courts must assess whether an unsophisticated creditor has satisfied the reliance prong of the *Augie/Restivo* test. To say, for example, that tort claimants "dealt with the entities as a single economic unit and did not rely on their separate identity in extending credit"[60] is problematic for two reasons. First, the debtor's corporate form is irrelevant to the debtor's injury of tort claimants: accident victims neither deal with the debtor entities as a single economic unit nor deal with them as separate economic units.[61] Second, any attempt to determine what entity the tort claimant dealt with must involve after-the-fact assessments that the parties could not have made prior to the injury. Tort claimants seeking substantive consolidation will argue that they dealt with the debtor as a single entity, whereas opposing creditors will argue that the tort claimants dealt with the debtor's individual subsidiaries. But since the tort claimants likely made no such ex ante assessment because they extended credit only involuntarily,[62] neither side's argument should be successful. For these reasons, analyzing an unsophisticated creditor's ex ante understanding of the debtor's corporate form is likely to produce problematic or inconsistent results.

Despite the inequitable and inconsistent results reliance-based tests can produce, some arguments in support of reliance-based

59. Put differently, "[r]eliance concerns cut both ways . . . . Creditors may have entered into credit arrangements with an expectation that the borrower would not be liable for the debts of affiliated entities." Christopher W. Frost, *Organizational Form, Misappropriation Risk, and the Substantive Consolidation of Corporate Groups*, 44 HASTINGS L.J. 449, 457 (1993). This may often be the case with unsophisticated creditors who are unaware of the legal implications of the borrower's corporate form.

60. Union Savings Bank v. Augie/Restivo Baking Co. (*In re* Augie/Restivo Baking Co.), 860 F.2d 515, 518 (2d Cir. 1988) (internal quotation marks omitted).

61. *See* Brasher, *supra* note 16, at 34–35 (explaining that the "contractarian definition of equitable harm—reliance and expectation[—]makes little sense" when applied to unsophisticated and involuntary creditors). *Cf.* Tucker, *supra* note 51, at 163–64 (setting forth another scenario in which *Augie/Restivo* reliance analysis would produce problematic result).

62. *See* Brasher, *supra* note 16, at 34–35.

tests nevertheless conclude that it is unfair to deprive bank creditors of the "benefit of their bargain":[63]

> It is inherently unfair to stand on corporate formality, where the debtors failed to do so themselves, when to do so would deny some creditors claims to greater funds and give other creditors a windfall simply as a result of happenstance concerning which entity was holding which assets at the time of the bankruptcy filing. . . . The harm comes from treating a creditor that did rely on the financial health of a particular debtor as if that creditor had assumed the risk of doing business with related entities in much poorer financial health.[64]

These arguments ignore a fundamental principle of corporate finance: "[T]he interest rate on a loan is payment not only for renting capital *but also for the risk that the borrower will fail to return it*."[65] Sophisticated creditors know that the increased availability of a substantive consolidation remedy in bankruptcy increases the risk that the debtor will fail to repay the loan.[66] Therefore, sophisticated creditors will consider this increased risk—just as they would consider the possibility of the debtor's entering bankruptcy—when determining an appropriate interest rate for the debtor's loan.

Yet the impact of the availability of substantive consolidation on a debtor's default risk may be impossible to measure ex ante. "At the time of lending, creditors [might] have difficulty assessing whether the difficulties of disentanglement or other bankruptcy concerns might lead a bankruptcy court a few years hence to consolidate 'their' debtor with related entities."[67] Even in this case, however, a creditor's ex ante knowledge that additional default risk exists allows it to structure its affairs with the debtor to a greater extent than can unsophisticated or involuntary creditors. Sophisticated creditors can at least estimate the additional default risk and demand appropriate compensation; unsophisticated and involuntary creditors must accept the default risk whatever its cost.

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63. Brief of Amici Curiae in Support of Appellant, et al. at 25–28, *In re* Owens Corning, 419 F.3d 195 (3d Cir. 2005) (No. 04-4080); Kors, *supra* note 34, at 446; *see, e.g.*, Sabin Willett, *The Doctrine of Robin Hood: A Note on "Substantive Consolidation,"* 4 DEPAUL BUS. & COM. L.J. 87, 89 (2005) ("The zero-sum principle always holds true: when estates are substantively consolidated, the rich are taxed to benefit the poor.").

64. Amera & Kolod, *supra* note 33, at 36–37.

65. Posner, *supra* note 7, at 501 (emphasis added).

66. *See* Brasher, *supra* note 21, at 34 ("If the creditor was a sophisticated creditor, then it almost certainly accounted for the potential for substantive consolidation and corporate disregard in its loan agreement.").

67. Kors, *supra* note 34, at 446.

In sum, reliance-based tests ignore a fundamental disparity between the two classes of creditors: sophisticated creditors evaluate risk and extend credit as their business, whereas unsophisticated creditors do not.[68] Trade creditors are often parts or services suppliers to the debtor, and extending credit is merely incidental to their lines of work. Employees can be characterized as voluntary creditors only with difficulty, and tort claimants extend credit only involuntarily. Compared to these kinds of creditors, banks are specialists in extending credit and even have a meaningful opportunity to control the risks they assume. Thus, any test that accommodates bank creditors' reliance interests fails to hold sophisticated creditors to a standard commensurate with their specialized ability to mitigate their losses—especially vis-à-vis unsophisticated creditors.[69] Accordingly, the reliance-based tests in *Augie/Restivo* and *Owens Corning* systematically disadvantage unsophisticated creditors insofar as those creditors are simply unable to rely on a debtor's corporate form before extending credit.

ii. The "Entanglement" Prong

The entanglement prong is distinct from the reliance prong in that it "relates primarily to the [debtor's] failure to maintain business records that properly identify assets with particular corporate names . . . and not to the destruction of artificial personality . . . ."[70] The problem with the entanglement prong of the *Augie/Restivo* and *Owens Corning* tests is that it fails to identify just how much entanglement is necessary to warrant substantive consolidation of the debtor entities.[71] For example, where assets are commingled, substantive consolidation would be a desirable remedy if it benefited every creditor and harmed no one; it would be undesirable if it merely effected an arbitrary transfer of wealth.[72] But a considerable gray area exists between these two ends of the spectrum. What if, for example, consolidation would harm one creditor but benefit every

68. *Compare* Frost, *supra* note 59, at 465 ("Creditors develop their expectations of risk, and concomitantly their desired return, by reference to the liabilities as well as the assets of the borrowing entity."), *with* Brasher, *supra* note 16, at 17 (explaining that trade creditors "do not profit from financing").

69. *But see* Tucker, *supra* note 51, at 178–80 (explaining why use of special-purpose entities might justify consideration of sophisticated creditors' reliance interests).

70. Widen, *Corporate Form*, *supra* note 15, at 269.

71. *See* Tucker, *supra* note 51, at 164 (examining difficulty of interpreting *Augie/Restivo* entanglement analysis), 168 (same, regarding *Owens Corning* entanglement analysis).

72. *Id.* at 280–91.

other creditor? Whereas *Auto-Train* might balance these interests,[73] *Augie/Restivo* and *Owens Corning* appear to grant veto power over the whole consolidation to the one creditor who is harmed.[74] This is the case even if the aggregate benefits of consolidation "heavily outweigh"[75] the harms. Alternatively, how much money would have to be spent unscrambling the debtor's financial records before "separating them is prohibitive and hurts all creditors"?[76]

Professor William H. Widen has identified four different factual scenarios that are susceptible to entanglement analysis,[77] and courts have not been entirely correct on which of those ought to merit a substantive consolidation order. First, substantive consolidation might be necessary if the debtor's financial records are literally "incapable of reconstruction by forensic accountants."[78] Substantive consolidation makes obvious sense here: if the business recordkeeping is so poor[79] that unscrambling the records would consume 100% of the bankrupt estate, then substantive consolidation at least pays creditors something in return for their loans, however crudely distributed those payments might be. This is indeed what *Owens Corning* seems to imply: that "[w]ithout substantive consolidation all creditors will be worse off (as Humpty Dumpty cannot be reassembled or, even if so, [only the professionals will profit])."[80] *Augie/Restivo* is similarly restrictive, requiring "'hopeless[ ] obscur[ity]' of interrelationships."[81] A number of courts have subsequently interpreted the standard narrowly. In one case, the District of New Jersey affirmed the bankruptcy court's denial of substantive consolidation on entanglement grounds where "postpe-

73. *See* Drabkin v. Midland-Ross Corp. (*In re* Auto-Train Corp.), 810 F.2d 270, 276 (D.C. Cir. 1987).

74. *See* Union Savings Bank v. Augie/Restivo Baking Co. (*In re* Augie/Restivo Baking Co.), 860 F.2d 515, 519 (2d Cir. 1988) ("[S]ubstantive consolidation should be used only after it has been determined that *all* creditors will benefit . . . .") (emphasis added); *In re* Owens Corning, 419 F.3d 195, 211 (3d Cir. 2005) (stating that substantive consolidation is appropriate where "assets and liabilities are so scrambled that separating them is prohibitive and hurts *all* creditors") (emphasis added). The Third Circuit has not decided whether such veto power is appropriate or whether partial consolidation except as to the harmed creditor would suffice. *See Owens Corning*, 419 F.3d at 212 n.22.

75. *Auto-Train*, 810 F.2d at 276.

76. *Owens Corning*, 419 F.3d at 211.

77. *See* Widen, *Corporate Form*, *supra* note 15, at 280–91.

78. *Id.* at 281.

79. *See id.* at 282–83.

80. *Owens Corning*, 419 F.3d at 211–12 n.20.

81. Union Savings Bank v. Augie/Restivo Baking Co. (*In re* Augie/Restivo Baking Co.), 860 F.2d 515, 519 (2d Cir. 1988).

tition the assets of the entities were not so scrambled as to prohibit accountants from separating them."[82] Shortly thereafter, the Bankruptcy Court for the Northern District of New York denied substantive consolidation where "untangling the affairs of the [d]ebtor[ ], while it may [have] require[d] extensive legal and forensic accounting work, [wa]s not impossible."[83] But courts often "will be able to estimate ranges" of assets held by entities and assets in dispute, and may have the ability to order partial consolidation only with respect to the estimated assets in dispute.[84] So although consolidation on the basis of actual necessity would be justified, the stringent entanglement requirements and the availability of partial consolidation make an "actual necessity" scenario unlikely to arise.

Second, substantive consolidation would be Pareto efficient[85] if it benefitted at least one creditor and harmed no one.[86] This scenario would arise where "the transaction costs incurred to create separate balance sheets are factored into the analysis, [and] a substantive consolidation yields a preferred result for [some] creditors and a neutral result for [others]."[87] This standard is similar to actual necessity in that it requires that no creditor be harmed by consolidation; it is different in that it allows consolidation where unscrambling is possible but not practical. Pareto-efficient substantive consolidation is justified because, as it was with actual necessity, its benefits outweigh its costs. Yet Pareto-efficient consolidation presents its own difficulties. One problem is that the transaction-cost savings substantive consolidation would provide can only be measured if the assets are actually unscrambled, which they must not be if the court orders them to be consolidated.[88] But assuming the savings could be estimated, different parties may not agree on

82. *In re* Macrophage, Inc., Nos. Civ. 06 3793 JBS, Civ. 06 3794 JBS, 2007 WL 708926, at *6 (D.N.J. Mar. 2, 2007).

83. *In re* Reserve Capital Corp., Nos. 03-60071 to - 78, 2007 WL 880600, at *5 (Bankr. N.D.N.Y. Mar. 21, 2007) (interpreting both *Augie/Restivo* and *Owens Corning*).

84. *See* Widen, *Corporate Form*, *supra* note 15, at 283–84 (analogizing partial consolidation of disputed assets to Enron settlement, which involved consolidation of 30% of each relevant creditor's claim based on 30% likelihood that substantive consolidation, if sought, would be granted).

85. Pareto superiority is defined as follows: "S_1 is Pareto superior to S if and only if no one prefers S to S_1 and at least one person prefers S_1 to S." JEFFRIE G. MURPHY & JULES L. COLEMAN, PHILOSOPHY OF LAW: AN INTRODUCTION TO JURISPRUDENCE 182 (rev. ed. 1990).

86. *See* Widen, *Corporate Form*, *supra* note 15, at 285–86.

87. *Id.* at 286.

88. *See id.*

that estimate and whether it would in fact justify consolidation.[89] Despite these difficulties, courts have often granted substantive consolidation on grounds of Pareto efficiency,[90] even though the language of the *Augie/Restivo* and *Owens Corning* entanglement tests literally excludes Pareto efficiency as a ground for ordering substantive consolidation.[91] Further, there may be little difference to creditors between the actual necessity scenario and the Pareto efficiency scenario because, in both cases, consolidation harms no creditors and benefits at least some. For these reasons, the Pareto-efficient consolidation scenario demonstrates that the *Augie/Restivo* and *Owens Corning* tests are underinclusive.

Third, substantive consolidation would be Kaldor-Hicks efficient if consolidation harmed some creditors but those creditors were compensated and ultimately made better off through subsequent negotiations with the creditors who benefitted from consolidation.[92] In this case, "consolidation yields enough [transaction-]cost savings such that [creditors that benefit] could pay [creditors that are harmed] to accept the consolidation and, following the payment, all parties would benefit financially."[93] This scenario essentially collapses into one of Pareto efficiency: "[C]ourts do not expressly mention Kaldor-Hicks improvement as a rationale because they wait until the parties themselves have converted a

89. *See id.* at 286–87.

90. *See, e.g.*, ASARCO LLC v. Americas Mining Corp., 382 B.R. 49, 68 (S.D. Tex. 2007) (finding that *In re Owens Corning*, 419 F.3d 195 (3d. Cir. 2005), did not apply where lawsuit challenged as being tantamount to substantive consolidation did not harm any creditors); Widen, *Corporate Form*, *supra* note 15, at 287 & n.156; *cf.* Windels Marx Lane & Mittendorf, LLP v. Source Enters., Inc. (*In re* Source Enters., Inc.), 392 B.R. 541, 554 (S.D.N.Y. 2008) (affirming bankruptcy court's grant of substantive consolidation under *Union Savings Bank v. Augie/Restivo Baking Co.* (*In re Augie/Restivo Baking Co.*), 860 F.2d 515 (2d Cir. 1988), where "the substantive consolidation does not benefit one creditor at the expense of another").

91. *See In re Augie/Restivo Baking Co.*, 860 F.2d at 518 (2d Cir. 1988) (permitting substantive consolidation on entanglement grounds only where debtors' records are "so entangled that consolidation will benefit all creditors"); *Owens Corning*, 419 F.3d at 211 (permitting substantive consolidation on entanglement grounds only where "postpetition [the debtors'] assets and liabilities are so scrambled that separating them is prohibitive and hurts all creditors"). By contrast, Pareto-efficient substantive consolidation would permit consolidation where it benefits at least one creditor but does not harm any.

92. *See* Widen, *Corporate Form*, *supra* note 15, at 288. Kaldor-Hicks efficiency is defined as follows: "S_1 is Kaldor-Hicks efficient to S if and only if in going from S to S_1 the winners *could compensate* the losers so that no one would be worse off than he or she was in S and at least one person would be better off than he or she was in S." MURPHY & COLEMAN, *supra* note 85, at 186.

93. *See* Widen, *Corporate Form*, *supra* note 15, at 288 (emphasis omitted).

Kaldor-Hicks Scenario through negotiations"[94] into one that is Pareto efficient. Further, the "large number of consensual substantive consolidation reorganization plans suggests . . . that, in some cases, courts approve substantive consolidation in Kaldor-Hicks Scenarios that are not also Pareto improvements."[95] But since courts cannot order consolidation under *Augie/Restivo* or *Owens Corning* based on a Kaldor-Hicks improvement, this scenario shows that creditors that stand to be harmed may be able to withhold their consent to consolidation in order to extract rents from creditors who stand to benefit. The Kaldor-Hicks scenario demonstrates that the entanglement prongs are underinclusive to the extent they prohibit courts from ordering some consolidations that would ultimately lead to benefits for all creditors.

Fourth, substantive consolidation might effect a "pure wealth transfer," and in this case it may or may not be efficient.[96] Here, "the aggregate amount of losses suffered as a result of substantive consolidation by creditors harmed in the consolidation exceeds the aggregate amount of transaction cost savings realized by imposing substantive consolidation. The losses suffered by the disadvantaged creditors show up as gains for the creditors who benefit . . . ."[97] Wealth transfers fail the *Augie/Restivo* and *Owens Corning* entanglement analyses because some creditors are harmed by consolidation. Generally speaking, this is correct: courts should not allow arbitrary wealth transfers. But it may be the case that not all such consolidations are unprincipled. For example, when a substantive-consolidation fight pits sophisticated creditors against unsophisticated creditors, as in *Owens Corning*,[98] the entanglement and reliance analyses may become intertwined insofar as consolidation will frustrate one of the two groups' reliance interests.[99] Put differently, situations may arise in which the entanglement analysis weighs in favor of unsophisticated creditors seeking consolidation; but the reliance analysis weighs in favor of sophisticated creditors seeking to avoid consolidation. Such a case might, for instance, involve a group of related debtor entities having entangled books, one or more of those debtor entities having liabilities to unsecured credi-

94. *Id.* at 289.

95. *Id.*

96. *Id.* at 290–91.

97. *Id.*

98. *See In re* Owens Corning, 419 F.3d 195 (3d Cir. 2005).

99. *See* Widen, *Corporate Form*, *supra* note 15, at 291 ("The Third Circuit decision might be seen to foreclose a substantive consolidation that results in a pure wealth transfer . . . . The better view is instead that the Third Circuit decision simply rejects the district judge's finding of necessity.").

tors in excess of assets, and entities having secured obligations to sophisticated creditors. In this case, entanglement analysis ought to give way to reliance analysis in order to reflect the parties' incentive structures, i.e., that sophisticated creditors have the ability to structure their loans ex ante, whereas unsophisticated creditors do not.[100] This further demonstrates the underinclusiveness of the existing entanglement tests, which may be understood to block all wealth transfers.

As demonstrated above, the *Auto-Train*, *Augie/Restivo*, and *Owens Corning* tests for substantive consolidation raise a host of difficult and unanswered questions. No court has yet articulated a test that is at once practical to apply and grounded in the parties' preexisting incentives. It may be that the Courts of Appeals for the District of Columbia, Second, and Third Circuits have designed their substantive consolidation tests based on unsound policies of bankruptcy or corporation law. The next part of this Note examines what might be wrong with these courts' policy choices and proposes a new test for substantive consolidation that avoids the problems raised by the existing tests.

III.
PROTECTING CREDITORS THAT CANNOT PROTECT THEMSELVES

A. Existing Substantive Consolidation Frameworks Are Not Grounded in Sound Policies

Each of the three courts of appeals stated policy considerations to guide application of its substantive consolidation test. Problematically, some of these policy choices are unsound, leaving the tests open to producing problematic results. In *Auto-Train*, the Court of Appeals for the District of Columbia Circuit attempted to balance two competing policies.[101] First, substantive consolidation is supposed to facilitate the debtor's reorganization and reduce transaction costs by "avoid[ing] the expense or difficulty of sorting out the debtor's records to determine the separate assets and liabilities of each affiliated entity."[102] Second, courts should not order substantive consolidation if it would cause unjustified windfalls or exaggerated losses to parties, bearing in mind that the remedy "almost invariably redistributes wealth among the creditors of the various

100. *See supra* Part I.

101. *See* Drabkin v. Midland-Ross Corp. (*In re* Auto-Train Corp.), 810 F.2d 270, 276 (D.C. Cir. 1987).

102. *Id.*

entities."[103] The court correctly determined that reducing transaction costs is good for all parties because it means that an additional portion of the debtor's assets will go to creditors rather than to professionals.[104] But the court also determined that because redistributing wealth harms some creditors, redistributing wealth is generally bad. By failing to explain when a windfall would be unjustified and when a loss would be exaggerated, the court needlessly foreclosed the possibility that consolidations with such ramifications may sometimes be justifiable.

As discussed previously,[105] substantive consolidations that defeats sophisticated creditors' purported reliance interests for the benefit of unsophisticated creditors is not inherently unfair, particularly where the opposite result would obtain absent consolidation.[106] In situations like these, courts cannot ignore the parties' different incentive structures: sophisticated creditors are always able to structure their loans to the debtor ex ante, but most unsophisticated creditors are not.[107] Courts must, in these situations, hold sophisticated creditors fully responsible for the default risk they chose to assume. Those creditors have already recovered for losses attributable to substantive consolidation by having charged the debtor an appropriate interest rate.[108] What the *Auto-Train* court should have said is that *arbitrary* wealth transfers are bad. Rather than requiring creditors opposed to consolidation to show "reli[ance] on . . . separate credit" to defeat consolidation, the *Auto-Train* test ought to require those creditors to show that substantive consolidation would effect an arbitrary transfer of wealth. Protecting the creditors that were unable ex ante to protect themselves would not be arbitrary; it would be justified by the difference in creditors' abilities to structure their loans to the debtor before extending credit. Thus, by using the broader term "unjustifiable" instead of the narrower term "arbitrary" to describe the kinds of wealth transfers that ought to be prohibited, the *Auto-Train* court grounded its substantive consolidation test on a bankruptcy policy that is unsound insofar as it is overinclusive.

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103. *Id.*

104. *See In re* Owens Corning, 419 F.3d 195, 211–12 n.20 (3d Cir. 2005) ("With substantive consolidation the lot of all creditors will be improved, as consolidation advance[s] one of the primary goals of bankruptcy-enhancing the value of the assets available to creditors[—]often in a very material respect." (internal quotation marks omitted)).

105. *See supra* Part II.B.ii.

106. *See, e.g.*, *Owens Corning*, 419 F.3d at 202–03.

107. *See supra* Part I.C.

108. *See* Posner, *supra* note 7, at 501.

In *Augie/Restivo*, the Court of Appeals for the Second Circuit stated that "[t]he sole purpose of substantive consolidation is to ensure the equitable treatment of all creditors."[109] With respect to the entanglement prong, the court expressed no specific policy statement other than that substantive consolidation should maximize all creditors' recoveries.[110] The problems resulting from this formulation are described above.[111] With respect to the reliance prong, however, the court explained that "lenders structure their loans according to their expectations regarding [the form and finances of a particular] borrower . . . . Such expectations create significant equities. Moreover . . . fulfilling those expectations is . . . important to the efficiency of the credit markets."[112] But again, this incorrectly appraises the relative ex ante positions of sophisticated versus unsophisticated creditors. Courts ought not protect sophisticated creditors at the expense of unsophisticated creditors because unsophisticated creditors typically do not have a meaningful chance to structure their loans ex ante the way sophisticated creditors do. Further, as mentioned above, sophisticated creditors protect themselves against default risk ex ante by charging the debtor an interest rate on their loans, whereas unsophisticated creditors do not.[113] Allowing those same creditors to assert their reliance interests in bankruptcy, particularly at the expense of unsophisticated creditors, amounts not to an efficient credit market but to a windfall for the banks: they recover prospectively through an appropriate interest rate, and they also recover retrospectively by defeating substantive consolidation. To prevent such a windfall, sophisticated creditors' reliance interests must be subordinated to unsophisticated creditors' competing reliance interests or lack thereof.

Two hypothetical situations, however, seem to suggest that sophisticated creditors' reliance interests should be given more weight. In one case, a debtor might decide to obtain loans by affirmatively misleading sophisticated creditors about its finances and corporate form. In another case, a debtor might decide to obtain loans through honest representations to sophisticated creditors and then shuffle around its assets among subsidiaries so as to undersecure the loan to the original borrowing entity. These two situa-

109. Union Savings Bank v. Augie/Restivo Baking Co. (*In re* Augie/Restivo Baking Co.), 860 F.2d 515, 518 (2d Cir. 1988).

110. *See id.* at 519 ("In such circumstances, all creditors are better off with substantive consolidation.").

111. *See supra* Part II.B.ii.

112. *In re* Augie/Restivo Baking Co., 860 F.2d at 518–19.

113. *See* Posner, *supra* note 7, at 501, 505.

tions involve the apparent intersection between fraudulent conveyance law and substantive consolidation law.

In the second, easier case, "[f]raudulent transfer law serves as a more appropriate remedy for misappropriation because it allows this simple recovery of the misappropriated assets or elimination of unfairly incurred liabilities."[114] It even "provides a clear and precise statutory formula to redress misappropriation," thereby making the remedy administratively easier to accomplish than a substantive consolidation remedy.[115]

The first case, although admittedly more difficult, calls not for the application of substantive consolidation doctrine but rather for the modification of turnover or fraudulent conveyance law.[116] Substantive consolidation in cases of ex ante fraud by the debtor is appropriate, under the principles discussed above, only when its resulting wealth transfer would be non-arbitrary. Consolidation should be limited here because it "is the most dramatic and far-reaching exception to corporate separateness."[117] In other words, substantive consolidation would be justified only when the debtor has fraudulently obtained so many loans that there would be no principled basis for maintaining the corporate form during bankruptcy. Another, more tailored alternative is partial consolidation of the assets in dispute.[118] In sum, the policy choice underlying the *Augie/Restivo* test's reliance prong is unsound because, in accounting for the reliance interests of sophisticated creditors but not of unsophisticated creditors, it allows banks to gain windfall recoveries at the expense of unsophisticated creditors.

In *Owens Corning*, the Third Circuit articulated five policy considerations underlying its substantive consolidation test: (1) "[l]imiting the cross-creep of liability by respecting entity separateness . . . absent compelling circumstances calling equity . . . into play";[119] (2) "[t]he harms substantive consolidation addresses are nearly always those caused by *debtors* . . . who disregard separateness";[120] (3) case-administration benefits do not justify substantive

114. Kors, *supra* note 34, at 421–22.

115. *Id.* at 422.

116. *See generally* Timothy E. Graulich, *Substantive Consolidation–A Post-modern Trend*, 14 AM. BANKR. INST. L. REV. 527, 537 (2006) (describing mechanisms of turnover and fraudulent conveyance law).

117. *Id.* at 538.

118. *Cf.* Widen, *Corporate Form*, *supra* note 15, at 283–84 (proposing method of partial consolidation in entanglement context).

119. *In re* Owens Corning, 419 F.3d 195, 211 (3d Cir. 2005).

120. *Id.*

consolidation;[121] (4) substantive consolidation is "extreme . . . and imprecise," and ought to be a remedy of last resort;[122] and (5) substantive consolidation may not be used "to disadvantage tactically a group of creditors in the plan process or to alter creditor rights."[123] Most of these are uncontroversial, but the first policy consideration—which also seems to have the most substance of the five—gives short shrift to unsophisticated creditors' reliance interests in precisely the same way the policy underlying the *Augie/Restivo* test does. Significantly, the *Owens Corning* court held that sophisticated creditors' reliance interests defeated substantive consolidation, without ever considering the ex ante position of the unsophisticated creditors who supported the motion.[124] To the extent a bankruptcy court's application of the *Owens Corning* test is guided by the first stated policy consideration, it also rests on unsound footing for the same reasons as *Augie/Restivo*.

Of the three existing tests, *Auto-Train* comes closest to sound bankruptcy policy because its balancing aspect allows a court to order consolidation in some cases where unsophisticated creditors would otherwise be harmed for the benefit of sophisticated creditors; *Augie/Restivo* and *Owens Corning* appear to foreclose this possibility.[125] Nevertheless, all three substantive consolidation tests are grounded in unsound policy choices that have the effect of system-

121. *Id.*

122. *Id.* Indeed, the United States District Court for the District of Delaware reversed, with express reference to this policy consideration, the Bankruptcy Court's confirmation of plan that involved a technique similar to classic substantive consolidation. The Court set forth the following analysis:

> The question raised on appeal is whether the plan, by aggregating multiple debtors into debtor groups to resolve claims, effects a substantive consolidation. As the bankruptcy court points out, the plan here does not call for the typical case of substantive consolidation where multiple separate entities are merged into a single entity and inter-entity liabilities are erased; instead of many-into-one, the plan calls for many-into-three, and the inter-entity liabilities are not erased. [Yet this] framework still presents the same potential inequities for creditors[:] namely that creditors face increased competition for a consolidated pool of assets and a re-valued claim that is less precise than if the creditors were dealing with debtors individually. This is the "rough justice" against which *Owens Corning* warns and, because it is effected by aggregating multiple debtors into one or more debtor groups, it falls within the definition of substantive consolidation.

In re New Century TRS Holdings, Inc., 407 B.R. 576, 591 (D. Del. 2009).

123. *In re Owens Corning*, 419 F.3d at 211.

124. *See id.* at 212–14.

125. *Cf.* Douglas G. Baird, *Substantive Consolidation Today*, 47 B.C. L. REV. 5, 8 (2005) ("Someone wanting to argue in favor of substantive consolidation for [a hypothetical debtor] might begin by invoking [*Auto-Train*].").

atically disadvantaging unsophisticated creditors. This is particularly true where sophisticated creditors' loans are guaranteed by one or more of the debtor entities. As Professor Widen wrote, however, "[S]ubstantive consolidation doctrine can be used to balance the equities when we find that intercompany guarantees divide creditors into various camps of single-source creditors competing with a multiple-source creditor that benefits from the web of intercompany guarantees. Substantive consolidation in this context removes the unfairness" to the unsophisticated creditors by eliminating the intercompany guarantees.[126] Bearing in mind this suggestion, Part III.B describes what a correct test might look like based on a correct understanding of creditors' reliance interests.

B. A Better Test for Substantive Consolidation

A proper substantive consolidation test ought to reflect what the parties' incentives actually are, so as not to "alter the relative position" of any party.[127] The three existing tests fail to accomplish these goals because they allow sophisticated creditors' reliance interests to trump the ex ante interests of unsophisticated creditors, thereby systematically disadvantaging the creditors who are least able to protect themselves. In this regard, the legal framework of substantive consolidation is itself a windfall of sorts for sophisticated creditors. Under all three major tests for substantive consolidation, the court-devised reliance analyses allow sophisticated creditors to benefit both ex ante by raising loan interest rates to compensate them for the risk that a default—necessarily including a substantive consolidation—will take place and ex post by asserting their reliance interests in bankruptcy court to defeat substantive consolidation.[128] A legal regime that allows this to happen does not take default risk seriously: it allows banks to obtain compensation for a certain measure of risk that they do not actually assume.

A proper test should also allow entanglement-based consolidation when it would benefit every creditor through either a Pareto improvement or a Kaldor-Hicks improvement combined with negotiation among creditors, regardless of whether substantive consoli-

126. Widen, *Corporate Form*, *supra* note 15, at 307–10. *But see* Tucker, *supra* note 51, at 171–72 (setting forth counterarguments to Widen's proposed "fairness" rationale for employing substantive consolidation).

127. *See* Posner, *supra* note 7, at 506.

128. This is the case even if sophisticated creditors actually determine that the probability of substantive consolidation is zero and, therefore, do not increase the cost of their loans accordingly. Sophisticated creditors benefit ex ante merely by having the opportunity to increase the cost of borrowing.

dation would be "rare and . . . of last resort."[129] If substantive consolidation can bring about an increased recovery for every creditor, it makes no difference whether such a remedy is rare or commonplace.[130] Yet by granting veto power over substantive consolidation to any creditors who are harmed, without regard to how much benefit all other creditors may gain, the Courts of Appeals for the Second and Third Circuits have foreclosed the use of substantive consolidation to achieve Kaldor-Hicks efficiency.[131] Notably, *Auto-Train* may avoid this result by allowing a court to balance benefits against harms. But its "heavy-outweighing" requirement might preclude Kaldor-Hicks-improving consolidations where the benefits outweigh the harm only narrowly but enough such that negotiations could make all creditors ultimately better off.

Finally, a proper test should allow consolidation where the borrowing entities received credit on the basis of fraudulent representations *and* there would be no principled way to sort out which entities should hold which assets for reorganization purposes. In these situations, when neither fraudulent conveyance law nor turnover law can achieve an equitable solution, substantive consolidation is indeed a last resort. In other words, a court's insistence on separate accountings in these situations would amount to arbitrary distributions of wealth.

On the basis of the critiques and policy discussions set forth above, a bankruptcy court ought to be able to order substantive consolidation if any one of the following conditions is met:

(1) separate accountings of entangled entities would result in lower recoveries for unsophisticated creditors than substantive consolidation would;

(2) substantive consolidation would achieve a Pareto improvement or facilitate a Kaldor-Hicks improvement with respect to the creditors of the consolidated entities;[132] or

(3) insisting on separate accountings of the relevant entities would produce an arbitrary transfer of wealth.

This test avoids the unsound policies that underlie the reliance prongs of the three existing tests. It clarifies when consolidation

129. *Owens Corning*, 419 F.3d at 211.

130. *See* William C. Blasses, Comment, *Redefining Into Reality: Substantive Consolidation of Parent Corporations and Subsidiaries*, 24 EMORY BANKR. DEV. J. 469, 505 (2008) (describing *Auto-Train*, *Augie/Restivo*, and *Owens Corning* tests as "overly restrictive" because they "prevented substantive consolidation, many times at the cost of equity").

131. *See* Amera & Kolod, *supra* note 33, at 38.

132. *See* Tucker, *supra* note 51, at 177–78.

should be ordered under an entanglement analysis. And its third prong avoids arbitrary transfers of wealth, including those that would otherwise result from fraudulent representations made to obtain credit. It is primarily useful when considering substantive consolidation of debtor entities whose sophisticated creditors' loans are guaranteed by one or more debtor entities. Ultimately, this test provides for a more desirable application of bankruptcy policy than the three existing tests because it avoids the problematic questions the other tests raise. Moreover, because of its simpler language, this test may also be easier to apply in practice than the existing tests. The next part addresses how the proposed test could be put into practice.

IV.
COULD COURTS EVER ADOPT THE PROPOSED TEST?

The *Owens Corning* case itself would undoubtedly have turned out differently under this proposed substantive consolidation test because *Owens Corning* pitted unsophisticated creditors seeking consolidation against sophisticated creditors opposing it.[133] The Court of Appeals for the Third Circuit could have affirmed the district court's order granting substantive consolidation under the first prong above. Practically speaking, the Courts of Appeals for the District of Columbia, Second, and Third Circuits would not be able to adopt this proposed test without overruling their own tests to some extent.[134] But the following three hypothetical scenarios present appropriate situations for adopting at least parts of this test.

In all three scenarios, Debtor D is a large public company with a complex corporate structure involving hundreds of subsidiaries. Debtor D has raised cash primarily by obtaining secured loans from Bank A and Bank B. These loans are guaranteed by Debtor D's subsidiaries, which hold significant assets but against which there are no unsecured claims. The loans took weeks to negotiate and involved numerous lawyers, bankers and accountants. To obtain these loans, Debtor D had to provide the Banks and professionals with corporate diagrams and the respective financial statements of all of its corporate entities. Banks A and B have been extending credit to Debtor D for years and are very familiar with D's complex

133. *See Owens Corning*, 419 F.3d at 202; *see also* Widen, *Corporate Form*, *supra* note 15, at 291.

134. *See* Tucker, *supra* note 51, at 181–88 (contending that proper test for substantive consolidation might be more appropriately defined by Congress than by courts).

corporate structure. Debtor D has also received unsecured credit in a number of ways: by withholding payment for forty-five days to small companies that supply parts to it; by paying its employees at the end of every second week rather than at the end of every day; and by structuring its settlements over a period of twenty years with a number of tort plaintiffs. D records its trade credit in the financial statements of whatever subsidiary a supplier dealt with, but D has always represented itself as one unified company to its suppliers. D and all of its subsidiaries enter into a jointly administered Chapter 11 proceeding.

In the first scenario, a substantive consolidation of D with some of D's subsidiaries would benefit the unsecured creditors at the expense of the secured creditors, while separate accountings of the subsidiaries would give the banks a full recovery but leave the unsecured creditors much worse off than they had expected to be. (This is essentially the wealth-transfer scenario described above.) Here, a bankruptcy court could appropriately grant unsophisticated creditors a substantive consolidation remedy because the banks have already been compensated for assuming default risk on their loans but the unsecured creditors have not been. Banks A and B are not deprived of the benefits of their bargains; rather, they are held to their bargains by suffering the event of default. Denying consolidation would instead deprive the unsecured creditors of the benefits of their bargains because those creditors never voluntarily assumed the debtor's default risk in any meaningful sense. In contrast, neither *Owens Corning* nor *Augie/Restivo* would allow this consolidation, and *Auto-Train* would allow it only if the unsecureds' benefits "heavily outweigh"[135] the secureds' harm.

In the second scenario, Banks A and B have not monitored Debtor D's assets carefully. D and its subsidiaries have in the past few months performed a flurry of inter-entity transactions, all of which are undocumented. The assets of D's corporate family have become entangled, but not hopelessly so. Unscrambling the assets would cost more for highly active subsidiaries—i.e., those that have made the most accounting transactions—and less for relatively inactive subsidiaries.[136] For some subsidiaries, unscrambling would consume all the assets; for others, it would consume only a very small proportion. Substantive consolidation of the entire corporate family, it turns out, would benefit all creditors except Bank A, but Bank A would suffer only a negligible loss. Separate accountings

135. Drabkin v. Midland-Ross Corp. (*In re* Auto-Train Corp.), 810 F.2d 270, 276 (D.C. Cir. 1987).

136. *See, e.g.*, Widen, *Corporate Form*, *supra* note 15, at 288.

would harm all other creditors, but Bank A would recover fully. Here, substantive consolidation would again be appropriate. Bank A should not be able to exercise de facto veto power over substantive consolidation when such a remedy would benefit every other creditor. Bank A would have the incentive to "'sell' its consent to the substantive consolidation—and thereby extract rents from the other creditors—by initially objecting to a proposed consolidation. For [a rent-extracting] recovery[,] Bank [A] might later drop its objection to a plan that included substantive consolidation."[137] Ex ante incentives cannot be forgotten even under an entanglement analysis, and Bank A, having previously charged Debtor D an interest rate that compensated it for assuming the risk of D's default, would not be treated unjustly if it suffers a loss in this situation. Again, *Owens Corning* and *Augie/Restivo* would block this consolidation, granting veto power to Bank A; *Auto-Train* would require balancing of the equities at issue.

In the third scenario, Banks A and B find that Debtor D has affirmatively misled them into extending credit. D, in fact, has just a few assets, all of which are scattered throughout its various subsidiaries. If separate accountings were performed, which they could easily be, some creditors would recover significantly more than others; however, there was so much fraud on D's part that those creditors would gain their enhanced recoveries by sheer luck. No creditor had a more reasonable basis for relying on D's misrepresentations than any other; all are equally surprised upon discovering the fraud. Substantive consolidation is appropriate here because there is no principled basis for performing separate accountings. A reorganization based on separate accountings would be tantamount to an arbitrary distribution of wealth. *Owens Corning* and *Augie/Restivo* would almost certainly block this consolidation because those tests grant veto power to a single creditor's reliance interest. How a bankruptcy court would apply *Auto-Train*, on the other hand, is inconclusive: it would require balancing the harms against the benefits of consolidation.

These hypothetical examples demonstrate that the prevailing frameworks for substantive consolidation are at best underinclusive. At worst, those frameworks systematically disadvantage unsophisticated creditors and work to the benefit of sophisticated creditors. The test proposed herein attempts to solve these problems by realigning the legal framework for substantive consolidation law with the parties' ex ante incentive structures.

137. *Id.* at 287 (discussing incentive in Pareto-improvement context).

V.
CONCLUSION

When grounded in sound principles of bankruptcy law and creditors' ex ante incentive structures, substantive consolidation can be a valuable tool to facilitate debtors' reorganizations in Chapter 11.[138] Yet the Courts of Appeals for the District of Columbia Circuit, Second Circuit, and Third Circuit have derived their substantive consolidation tests from principles that neither account for creditors' ex ante incentives nor provide practical guidance around which creditors may structure their future affairs. With these principles in mind, this Note analyzes the shortcomings of the substantive consolidation tests in *Auto-Train*, *Augie/Restivo*, and *Owens Corning*, and fashions a test that is better aligned with all parties' incentives. The proposed test attempts to achieve greater equity in consolidation proceedings, not by focusing on the debtor's end of its bargains with sophisticated creditors, but by holding sophisticated creditors fully to the risks they assume when they loan money to debtors. Treating banks as specialists in the field of risk assessment is equitable because, when compared to the unsophisticated creditors with whom they often compete for recovery in bankruptcy, they are indeed specialists. Through adoption of this proposed test and the principles on which it rests, future courts may at once correct and clarify the standards for substantive consolidation and make it a more practical reorganization remedy.

138. *See, e.g.*, *id.* at 280.

CAN THE COURTS TAME THE COMMUNICATIONS DECENCY ACT?: THE REVERBERATIONS OF *ZERAN V. AMERICA ONLINE*

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Congress passed the Communications Decency Act of 1996 (CDA)[1] amid concern over minors' access to Internet pornography.[2] Congress enacted the CDA, which included various provisions regulating objectionable Internet content,[3] as part of the Telecommunications Act of 1996,[4] which broadly overhauled United States telecommunications policy.[5] Passage of the CDA led to vigorous commentary and scholarship concerning freedom of speech on the Internet,[6] and the CDA was front-page news when the Supreme Court, in *Reno v. ACLU*, struck down as unconstitutional the portions of the Act making it a crime to transmit indecent material in a way accessible to minors.[7] After *Reno*, public

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1. Communications Decency Act of 1996 (CDA), Pub. L. No. 104-104, 110 Stat. 133 (codified as amended in scattered sections of 47 U.S.C.). This Act is Title V of the Telecommunications Act of 1996, *infra* note 4. Section 501 of the Telecommunications Act states that the Title may be referred to as the Communications Decency Act.

2. *See* 141 CONG. REC. 3203 (1995) (statement of Sen. Exon).

3. *See* Reno v. ACLU, 521 U.S. 844, 858–61 (1997) (discussing some of CDA's provisions).

4. Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 133 (codified as amended in scattered sections of 47 U.S.C.).

5. The House Conference Report stated that the Telecommunication Act's broad aims were "to provide for a pro-competitive, de-regulatory national policy framework designed to accelerate rapidly private sector deployment of advanced telecommunications and information technologies and services to all Americans by opening all telecommunications markets to competition." H.R. REP. NO. 104–458, at 1 (1996) (Conf. Rep.).

6. *See, e.g.*, Eric M. Freedman, *A Lot More Comes Into Focus When You Remove the Lens Cap: Why Proliferating New Communications Technologies Make it Particularly Urgent for the Supreme Court to Abandon its Inside-Out Approach to Freedom of Speech and Bring Obscenity, Fighting Words, and Group Libel Within the First Amendment*, 81 IOWA L. REV. 883, 962 (1996).

7. The Court invalidated provisions of section 223(a) and (d), except as applied to child pornography. *Reno*, 521 U.S. at 885.

awareness of the CDA subsided, with some commentators erroneously suggesting that the Court had struck down the CDA in its entirety.[8] Section 230 of the CDA[9] not only escaped Supreme Court scrutiny, but has developed in relative obscurity into "one of the most important and successful laws of cyberspace."[10] Described simply, section 230 provides protection from liability for websites and Internet Service Providers (ISPs)[11] who disseminate information provided by third parties.[12] Over the years, state and federal courts have interpreted section 230 expansively, conferring a broad immunity upon website operators that host third-party content.[13] The statute has grown into a "judicial oak,"[14] with impacts far beyond its language sounding in defamation law and its original intent to prevent the nascent Internet from becoming a "red light district."[15] This Note analyzes the degree to which judicial interpretations have departed from the statutory language, exploring how section 230 has evolved into an all-purpose liability shield for online entities. Moreover, this Note explains how the root causes of the prevailing judicial view of the statute inform possible new approaches judges might take in re-evaluating this grant of protection to websites and ISPs.

8. *See, e.g.*, Linda Greenhouse, *No Help for Dying: But Justices Leave Door Open to Future Claim of a Right to Aid*, N.Y. TIMES, June 27, 1997, at A1.

9. 47 U.S.C. § 230 (2006). Although this citation is to the United States Code, it is referred to in most legal scholarship as "section 230 of the CDA." Therefore, this Note will refer to it as such.

10. Recent Case, *Federal District Court Denies § 230 Immunity to Website that Solicits Illicit Content:* FTC v. AccuSearch, Inc., 121 HARV. L. REV. 2246, 2253 (2008) [hereinafter *Federal District Court Denies § 230 Immunity*].

11. ISPs provide consumers with internet access. Examples include online services such as America Online (AOL) and companies such as Earthlink who simply provide an Internet connection. *See* DOUG LOWE, NETWORKING: ALL-IN-ONE DESK REFERENCE FOR DUMMIES 392–93 (2005).

12. 47 U.S.C. § 230(c)(1) (2006) ("No provider or user of an interactive computer service shall be treated as the publisher or speaker of any information provided by another information content provider.").

13. *See, e.g.*, Green v. AOL, 318 F.3d 465, 471 (3d Cir. 2003); Carafano v. Metrosplash.com, Inc., 339 F.3d 1119, 1123–24 (9th Cir. 2003); Batzel v. Smith, 333 F.3d 1018, 1030–31 (9th Cir. 2003); Ben Ezra, Weinstein, & Co. v. AOL, 206 F.3d 980, 984–86 (10th Cir. 2000); Zeran v. AOL, 129 F.3d 327, 330–31 (4th Cir. 1997).

14. "A judicial oak which has grown from little more than a legislative acorn." Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 737 (1975) (discussing federal courts' interpretation of Rule 10b-5 of securities laws to include private cause of action when none is explicitly stated in rule or enabling statute). Stated generally, the "judicial oak" metaphor refers to a large and complex body of judge-made doctrine overlaying a statute, from which it has seemingly departed.

15. *See infra* note 31 and accompanying text.

Part I explores the historical context and legislative history of section 230. Part II discusses the impact of the Fourth Circuit's seminal decision in *Zeran v. America Online, Inc.*[16] on most federal and state courts applying section 230. *Zeran* made two key interpretive moves that invited expansive interpretation of the statute, both of which developed major practical problems for prospective plaintiffs. First, *Zeran* incorporated distributor liability into section 230's immunity provision, thus foreclosing future defamation plaintiffs from relying on that theory. Second, *Zeran* suggested that section 230 provides immunity for almost any claim against a third party. Part III gives an overview of more recent jurisprudence and commentary, and suggests new judicial approaches to solve the two problems *Zeran* created.

PART I

A. Senator Exon's Communications Decency Act

To better understand section 230, it is worth exploring the origins of the CDA as a whole. Television ratings, the V-chip, and especially online pornography were high on the agenda for Congress in the mid-1990s[17] and were generating significant public interest.[18] The CDA was a product of a particular historical and political moment: explosive growth occurred in the telecommunications industry, including the growth of cable television, cellular phone technology, and the Internet,[19] just as the Republican Revolution of 1994 pursued an ambitious agenda in Congress.[20]

The CDA's legislative history illustrates this collision of technological advances and resurgent social conservatism. Senator John Exon introduced the CDA as an amendment to the already-pend-

16. 129 F.3d 327 (4th Cir. 1997).

17. Many provisions in the CDA reflected this concern. *See, e.g.*, Communications Decency Act of 1996, Pub. L. No. 104-104, § 505, 110 Stat. 133, 136 (codified as amended in scattered sections of 47 U.S.C.) (providing for scrambling of sexually explicit video programming); Communications Decency Act § 551 (providing for "parental choice" in television programming).

18. *See, e.g.*, Mark Lander, *TV Turns to an Era of Self-Control*, N.Y. TIMES, Mar. 17, 1996, at H1 (discussing government pressure to implement television ratings system and V-chip); Ramon G. McLeod, *New System to Rate Web Sites*, S.F. CHRON., Feb. 29, 1996, at C1 (discussing development of online ratings system amid concerns over childrens' access to Internet pornography).

19. WALTER SAPRONOV & WILLIAM H. READ, TELECOMMUNICATIONS: LAW, REGULATION, AND POLICY, at xi (1998).

20. In the 1994 midterm elections, Republicans gained majorities in both the House of Representatives and the Senate. DONALD T. CRITCHLOW, THE CONSERVATIVE ASCENDANCY: HOW THE GOP RIGHT MADE POLITICAL HISTORY 247 (2007).

ing Telecommunications Reform Act.[21] The unveiling of his infamous "blue book," which was available for inspection to lawmakers who were "not familiar with what is going on the Internet today," solidified support for the amendment.[22] The blue book was a blue folder located on the Senator's desk containing pornographic downloads from the Internet.[23] Senators cited the "blue book" frequently in debate in support of the CDA, and some contend it was a principal factor in winning passage of the amendment.[24] Senator Exon also delivered a prayer on the Senate floor seeking help in controlling obscene and indecent material, leaving little doubt that morality inspired the legislation. Senator Exon's proposal most notably criminalized knowing transmission of "obscene or indecent" material to minors.[25] Notwithstanding strong opposition from Senator Patrick Leahy and House Speaker Newt Gingrich, who presciently objected to these provisions on free-speech grounds,[26] Senator Exon's proposal passed into law.[27]

The genesis of the CDA as a piece of social-minded legislation with goals having little to do with defamation law reveals a chasm between the original, focused intent of section 230 and the "judicial oak" it has become.

B. Background: Stratton Oakmont v. Prodigy *and Intermediary "Distributor" Liability*

Congress enacted section 230, titled "Protection for Private Blocking and Screening of Offensive Material," for the same concern which was underlying sections of the Act struck down in *Reno*: regulating access to indecent or obscene Internet content.[28] Instead of employing the blunt instrument of criminal sanctions like the invalidated portions of the CDA, section 230 took the subtler

21. Arthur D. Hellman, *Sex, Drugs, and Democracy: Who's Afraid of Free Speech?*, 41 BRANDEIS L.J. 417, 418–19 (2003); Robert Cannon, *The Legislative History of Senator Exon's Communications Decency Act*, 49 FED. COMM. L.J. 51, 71 (1996).

22. Cannon, *supra* note 21, at 64.

23. *Id.*

24. *See id.*; 141 CONG. REC. S8089 (daily ed. June 9, 1995) (statement of Sen. Exon); 141 CONG. REC. S8330, S8339 (daily ed. June 14, 1995) (statement of Sen. Exon); 141 CONG. REC. S8332 (daily ed. June 14, 1995) (statement of Sen. Coats).

25. 47 U.S.C. § 223(a)(1)(B) (Supp. II 1997), *invalidated by* Reno v. ACLU, 521 U.S. 844, 858–61 (1997).

26. Cannon, *supra* note 21, at 66–68.

27. *Id.* at 92.

28. *See id.* at 53–57.

(and constitutional) approach of offering websites limited civil immunity if they self-policed objectionable content.[29]

Section 230(c)(1), the key operative provision and the focus of this Note, provides for liability protection for websites and ISPs for torts emanating from content created by others. Section 230(c)(1) states that "[n]o provider or user of an interactive computer service shall be treated as the publisher or speaker provided by another information content provider."[30] An "information content provider" is "any person or entity that is responsible, in whole or in part, for the creating or development of information provided through the Internet or any other interactive computer service."[31] In plain terms, section 230(c)(1) provides a safe harbor for websites and ISPs so long as they do not "creat[e] or develop[ ]" the content at issue. Section 230(c)(2) provides another safe harbor for websites and ISPs, eliminating civil liability for actions that websites and ISPs might take to restrict access to content they deem objectionable.[32]

Because Congress enacted the invalidated sections of the CDA amid doubts as to the propriety of government regulation of Internet content,[33] section 230 was a complementary backstop to these coercive provisions of the CDA, pursuing the same ends through different means. At the time of its passage, section 230 conferred immunity for a limited goal: corralling the Internet's rapidly growing "red light district" and protecting children from perceived dangers on the web.[34]

29. *See* 47 U.S.C. § 230(b)(4) (2006) (declaring that the "policy of the United States" is to "remove disincentives for the development and utilization of blocking and filtering technologies that empower parents to restrict their children's access to objectionable or inappropriate online material").

30. *Id.* § 230(c)(1).

31. *Id.* § 230(f)(3).

32. *Id.* § 230(c)(2).

33. *See* 141 CONG. REC. S8331 (daily ed. June 14, 1995) (statement of Sen. Leahy).

34. *See* 141 CONG. REC. 3203 (1995) (statement of Sen. Exon). A recent report sheds doubt on popular perceptions that sexual predators are a significant threat to children online, but did stress that "cyberbullying" remains a serious problem. *See* Brad Stone, *Report Calls Online Threats to Children Overblown*, N.Y. TIMES, Jan. 13, 2009. *See generally* INTERNET SAFETY TECHNICAL TASK FORCE, ENHANCING CHILD SAFETY & ONLINE TECHNOLOGIES: FINAL REPORT TO THE INTERNET SAFETY TECHNICAL TASK FORCE TO THE MULTI-STATE WORKING GROUP ON SOCIAL NETWORKING GROUP ON SOCIAL NETWORKING OF STATE ATTORNEYS GENERAL OF THE UNITED STATES (2008), http://cyber.law.harvard.edu/sites/cyber.law.harvard.edu/files/ISTTF_Final_Report.pdf.

Ironically, future courts' broad interpretations of section 230 ultimately stem from the section's genesis as an effort to overrule a single, trial-level, state-court case that had nothing to do with indecency. *Stratton Oakmont v. Prodigy Services Co.*,[35] decided in New York in 1995, announced that an ISP could be held liable as a "publisher" for defamatory content posted by third parties on its online bulletin boards if it exercised some editorial control over that content.[36] In the now famous case, Stratton Oakmont, an investment banking firm, brought a defamation lawsuit against Prodigy, then a prominent ISP, over anonymous third-party postings on a Prodigy online bulletin board that implicated Stratton Oakmont and its management in wrongdoing.[37] Prodigy had employed various devices to moderate bulletin board content, including the use of software to automatically screen for offensive language, the promulgation of "content guidelines," and the use of "Board Leaders" to enforce the guidelines.[38] Prodigy argued it was merely a "deliverer" or "passive conduit" of the allegedly defamatory comments, and thus should not be vicariously liable.[39] The court disagreed and held that Prodigy, by using its content moderation devices, exercised sufficient "editorial control" to make it a "publisher" for purposes of defamation law.[40]

"Publication" is a term of art in defamation law, referring to the intentional or negligent transmission of defamatory material to someone other than the person defamed.[41] At common law, repetition of a defamatory statement ordinarily constitutes a new publication,[42] thereby making the repeater independently liable.[43] Thus, "talebearers are as bad as talemakers," and so, for example, a newspaper's repetition of defamatory statements in a letter to the editor

35. No. 3:04-CV-312, 1995 WL 323710 (N.Y. Sup. Ct. May 24, 1995), *superseded by statute*, Communications Decency Act of 1996, Pub. L. No. 104-104, 110 Stat. 133 (codified as amended in scattered sections of 47 U.S.C.).

36. *Id.* at *4.

37. The postings stated that Stratton's president was a "soon to be proven criminal" and that Stratton was a "cult of brokers who either lie for a living or get fired." *Id.* at *1.

38. *Id.* at *1–2.

39. *Id.* at *3.

40. *Id.* at *4.

41. RESTATEMENT (SECOND) OF TORTS § 577 (1977).

42. *Id.* at cmt. a.

43. *See, e.g.*, RAYMOND E. BROWN, THE LAW OF DEFAMATION IN CANADA 261 n.91 (1987) ("[I]f one reads a libel, that is no publication of it . . . but if . . . after that he knows it to be a libel, he reads it to others, that is an unlawful publication of it.") (citing *John Lamb's Case*, (1610) 9 Co. Rep. 59b, 59b, 77 Eng. Rep. 822, 822).

gives rise to independent liability for the paper.[44] However, because "publication" implicates some level of culpability,[45] the mere fact of repetition is insufficient for liability to arise. For newspapers, this extension of liability is due to the fact that "[t]he choice of material . . . and the decisions made as to the content of the paper constitute an exercise of editorial control and judgment, and with this editorial control comes increased liability."[46] Thus, in *Stratton Oakmont*, the court held that Prodigy incurred strict "publisher" liability for a defamatory statement because it had exercised control over its bulletin board content.[47]

In contrast to "publishers,"[48] who are liable for repeating defamatory content as if they had originally authored it, "distributors," such as bookstores, news dealers, and libraries, are generally not liable for disseminating defamatory content.[49] Whereas the law presumes that publishers know the content of the material they release due to the exercise of editorial supervision,[50] distributors are not liable for repetition unless they knew or had reason to know of the defamatory content—a negligence standard contrasting with the presumptive liability incurred by publishers.[51] A third category, "common carriers," or "conduits," also refers to entities, such as telephone companies, that have no editorial control over the content they carry and accordingly are not liable for information they carry.[52]

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44. LAURENCE H. ELDREDGE, THE LAW OF DEFAMATION 233 (1978).

45. Although defamation remains essentially a strict liability tort in Commonwealth jurisdictions such as the United Kingdom, defamation requires some level of fault in the United States. Gertz v. Robert Welch, Inc., 418 U.S. 323, 324 (1974).

46. Stratton Oakmont, Inc. v. Prodigy Servs. Co., 1995 WL 323710, at *3 (N.Y. Sup. Ct. May 24, 1995), *superseded by statute*, Communications Decency Act of 1996, Pub. L. No. 104-104, 110 Stat. 133 (codified as amended in scattered sections of 47 U.S.C.).

47. *Id.* at *4.

48. A "publisher" is sometimes referred to as a "primary publisher" as distinct from a distributor or "secondary publisher." *See* 1 RODNEY A. SMOLLA, THE LAW OF DEFAMATION § 4:92 (2d ed. 2008). For purposes of this Note, "publisher" and "distributor" are used.

49. *Id.*

50. While the Supreme Court has held that that some element of fault—at least negligence—is necessary to any defamation claim, the standard of care applicable to a primary publisher is extremely high, given that the requisite fault element is typically implied. *Gertz*, 418 U.S. at 324. *See also* 2 GEORGE B. DELTA & JEFFREY H. MATSUURA, THE LAW OF THE INTERNET §11.02(c) (3d ed. Supp. 2010-1).

51. *See id.*; Cubby Inc. v. CompuServe Inc., 776 F. Supp. 135, 139–41 (S.D.N.Y. 1991).

52. Jay M. Zitter, Annotation, *Liability of Internet Service Provider for Internet or E-mail Defamation*, 84 A.L.R. 5TH 169, § 2[a] (2000). Courts have held that common

In *Stratton Oakmont*, the court, citing Prodigy's "control" over its content, rejected Prodigy's contention that because it was merely a transmitter for allegedly defamatory online bulletin board postings it therefore should be subjected to the more favorable "distributor" liability standard.[53] In a move perhaps more significant to Congress than was the outcome of the case, the court based its conclusion that Prodigy was a "publisher" partly upon Prodigy's self-proclaimed status as a "family oriented computer network."[54] The court reasoned that because Prodigy "held itself out as a service exercising editorial control, thereby expressly differentiating itself from its competition," it should bear heightened responsibility for third-party content.[55] The court cited a passage in an article published by a Prodigy public relations executive: "We make no apology for pursuing a value system that reflects the culture of the millions of American families we aspire to serve."[56]

C. An Alternative Congressional Response: The Cox-Wyden Amendment

Section 230 emerged as an alternative to other CDA provisions that addressed the same problem of protecting children from sexually explicit content. As Congress grafted the CDA onto the expanding Telecommunications Act in the summer of 1995, Representatives Christopher Cox and Ron Wyden drafted the Cox-Wyden Amendment (Cox-Wyden), which would eventually become section 230.[57]

Section 230's supporters sought to remedy perceived disincentives for websites to monitor and remove "offensive" content posted by third parties, and to encourage the development of "blocking and filtering technologies" that would allow parents to regulate their children's online activities.[58] Under the guise of the

carriers may not be held liable for defamatory statements because they are required by law to serve all customers. *See, e.g.*, Anderson v. N.Y. Tel. Co., 320 N.E.2d 647, 649 (N.Y. 1974) (Gabrielli, J., concurring). The Internet-age "conduit" equivalent to a telephone company is an ISP that causes emails to be transmitted. *See* Lunney v. Prodigy Servs. Co., 723 N.E. 2d 539, 542 (N.Y. 1999) ("[A]n ISP, like a telephone company, is merely a conduit.").

53. Stratton Oakmont, Inc. v. Prodigy Servs. Co., 1995 WL 323710, at *4 (N.Y. Sup. Ct. May 24, 1995), *superseded by statute*, Communications Decency Act of 1996, Pub. L. No. 104-104, 110 Stat. 133 (codified as amended in scattered sections of 47 U.S.C.).

54. *Id.* at *2.

55. *Id.*

56. *Id.*

57. Stephen Collins, Note, *Saving Fair Housing on the Internet: The Case for Amending the Communications Decency Act*, 102 Nw. U. L. Rev. 1471, 1479 (2008).

58. 47 U.S.C. § 230(b)(4) (2006).

"[p]rotection for 'good Samaritan' blocking and screening of offensive material," section 230(c)(1) sets forth what has proved to be transformative language: "No provider or user of an interactive computer service shall be treated as the publisher or speaker of any information provided by another information content provider."[59] This language has been widely interpreted as conferring very broad immunity on websites, providing a "safe harbor" for a wide range of third-party-generated content.[60]

In creating section 230, Cox and Wyden had the same goal in mind as Senator Exon, "relief . . . from the smut on the Internet," but sought to achieve that end by "empower[ing] parents without Federal regulation" by the Federal Communications Commission (FCC).[61] Similarly, Representative Cox observed that with the amendment, "[w]e can keep away from our children things not only prohibited by law, but prohibited by parents."[62] Drawing a contrast to the rest of the CDA, in advocating for the amendment, Representative Wyden offered a sharp assessment of Senator Exon's content-based proposal, stating that the Exon amendment to the CDA "seek[s] there to try to put in place the Government rather than the private sector about this task of trying to define indecent communications and protecting our kids."[63] Moreover, as Representative Robert Goodlate noted, Cox-Wyden "doesn't violate free speech or the right of adults to communicate with one another,"[64] a swipe at the eventually invalidated provisions of the CDA. In sum, Cox-Wyden was envisioned as a more effective alternative to the original provisions because it (1) was likely constitutional and (2) would provide a more direct means—self-regulation—of preventing children from accessing inappropriate material. The goal of protecting children, of course, remained broadly similar to that reflected in Senator Exon's proposal.

To effectively achieve this goal, Representatives Cox and Wyden had to reckon with *Stratton Oakmont*. The portions of section 230's legislative history concerning *Stratton Oakmont* showed that, although Congress intended to encourage the growth of the young Internet, that purpose was subsidiary to and separate from the goal of protecting children. Although *Stratton Oakmont* was met

59. *Id.* § 230(c)(1).

60. *See infra* Part II.

61. 141 CONG. REC. H8470 (daily ed. Aug. 4, 1995) (statement of Rep. Wyden).

62. *Id.* at H8470.

63. *Id.*

64. *Id.*

with immediate concern in the business press that the scope of liability would stifle the growth of the Internet,[65] Congress did not express this concern, despite subsequent cases' contentions that protecting "freedom of speech in the new and burgeoning internet medium" was the main purpose of section 230.[66] The House Conference Report on the Telecommunications Act reveals that Congress inserted section 230 primarily to encourage content regulation, consistent with other provisions of the CDA:

> One of the specific purposes of this section is to overrule Stratton-Oakmont v. Prodigy and any other similar decisions which have treated such providers and users as publishers or speakers of content that is not their own *because they have restricted access to objectionable material.* The conferees believe that such decisions create serious obstacles to the important federal policy of *empowering parents to determine the content of communications their children receive* through interactive computer services.[67]

In a similar vein, Representative Cox stated that "we want to encourage people like Prodigy . . . to do everything possible for us, the customer, to help us control, at the portals of our computer, at the front door of our house, what comes in and what our children see."[68]

Representative Cox also stated that the Internet had "grown up to be what it is without . . . help from the government."[69] Instead of concerns about robust public debate and the First Amendment, Representatives Cox and Wyden had concerns that a new "Federal Computer Commission" or the current FCC would examine and regulate Internet content.[70] Representatives Cox and Wyden envi-

65. *See, e.g.*, Ethan de Seife, *Prodigy Libel Lawsuit Raises Concerns of On-line Industry*, WESTCHESTER CITY. BUS. J., Aug 14, 1995, §1, at 9.

66. Zeran v. AOL, 129 F.3d 327, 329 (4th Cir. 1997); *see also infra* Parts II and III.

67. H.R. REP. NO. 104-458, at 194 (1996) (Conf. Rep.) (emphasis added).

68. 141 CONG. REC. H8470.

69. *Id.*

70. This concern was especially pressing given that Cox-Wyden was to be part of a sweeping bill that would define the jurisdiction of the FCC in the years to come. At the time, there was considerable debate as to how much regulatory control the FCC should exercise over the burgeoning Internet. And most significantly, Senator Exon's proposal originally charged the FCC with promulgating regulations necessary for carrying out the CDA's anti-obscenity and anti-indecency provisions. The CDA originally provided that the FCC "may describe measures which are reasonable, effective, and appropriate to restrict access to prohibited communications under subsection (d)." Communications Decency Act of 1996, Pub. L. No. 104-104, § 502, 110 Stat. 133, 134, *invalidated by* Reno v. ACLU, 521 U.S. 844, 858–61 (1997).

sioned that their amendment would discourage bureaucratic oversight and thereby encourage the robust growth of the Internet, largely by avoiding the unappetizing regulatory implications of Senator Exon's proposal. Their prevailing aim was not to create a liability shield, which was only inserted for the limited end of encouraging ISPs to monitor and, when appropriate, block "offensive" content.

D. The Text of Section 230: Shaky Ground

Although subsequent cases[71] and commentators[72] have suggested otherwise, the text of section 230 reflects the drafters' delineated objective of shielding children from objectionable content by encouraging websites to self-regulate through the means of explicitly overruling *Stratton Oakmont*. How, then, did section 230 evolve into an all-purpose liability shield for websites over the decade following its enactment? The partial answer is that section 230 is the product of both legislative accident and narrow-minded draftsmanship. Although courts are also responsible for much of section 230's transformation into a broad liability shield, the text of the statute itself sets the stage for future expansive interpretations.

One commonly cited provision is section 230(c)(1)'s safe harbor provision, which was clearly meant to overrule *Stratton Oakmont*. It states that "no provider or user of an interactive computer service shall be treated as the publisher or speaker."[73] The scope of this safe harbor rests upon two bases. The first is the meaning of "information content provider," which is defined as "any person or entity that is responsible, in whole or in part, for the creation or development of information provided through the Internet or any other interactive computer service."[74] The second is that the safe harbor only confers immunity for content provided by "*another* information content provider."[75] Therefore, if an Internet entity (an ISP or a website) *itself* is responsible for the "creation or development" of content, it is not entitled to immunity under the statute.

Although section 230(c)(1)'s safe harbor provision has received the most attention in the courts, subsection (c)(2) most directly addresses the "evil to be remedied" that Representatives Cox

71. *See Zeran*, 129 F.3d at 331.

72. *See, e.g.*, Cecilia Ziniti, *The Optimal Liability System for Online Service Providers: How Zeran v. America Online Got it Right and Web 2.0 Proves It*, 23 BERKELEY TECH. L.J. 583, 597 (2008).

73. 47 U.S.C. § 230(c)(1) (2006).

74. *Id.* § 230(f)(3).

75. *Id.* § 230(c)(1) (emphasis added).

and Wyden had in mind. Subsection (c)(2)(A)'s "Good Samaritan" protection specifies that "no provider or user of an interactive computer service" will incur liability for taking proactive steps to restrict access to material that the provider considers objectionable,[76] while subsection (c)(2)(B) provides for liability protection for Internet providers who make technological means available to restrict access to objectionable content, such as filtering software.

In developing an expansive interpretation of section 230, courts have heavily relied upon language contained in its findings and policy subsections. Subsection (a) begins with the finding that "the rapidly developing array of Internet and other interactive computer services available to individual Americans represents an extraordinary advance in the availability of educational and informational resources to our citizens," and proceeds with additional similar statements that generally state the importance of the Internet.[77] Of these, subsection (a)(4) has proved the most significant: "The Internet and other interactive computer services have flourished, to the benefit of all Americans, with a minimum of government regulation."[78]

Next, subsection (b) enumerates policies that underlie section 230 in language that more precisely suggests the purposes of the statute. The policies are as follows: subsection (b)(1), "to promote the continued development of the Internet; (b)(2), "to preserve the vibrant and competitive free market that presently exists for the Internet . . . unfettered by Federal and State regulation"; (b)(3), "to encourage the development of technologies which maximize user control over what information is received," (b)(4), "to remove disincentives for the deployment . . . of blocking and filtering technologies that empower parents to restrict their children's access to objectionable . . . material; and (b)(5), "to ensure vigorous enforcement of Federal criminal laws to deter and punish trafficking in obscenity, stalking, and harassment by means of computer."[79]

76. Subsection (c)(2)(A)'s "no provider or user" language has been interpreted to confer immunity on a wide range of Internet entities, from small, limited-audience websites to large ISPs with millions of subscribers. *See, e.g.*, Donato v. Moldow, 865 A.2d 711 (N.J. Super. Ct. App. Div. 2005) (involving community bulletin-board website); Doe v. Am. Online, Inc. (AOL), 783 So. 2d 1010 (Fla. 2001) (involving large ISP); Grace v. eBay, Inc., No. B168765, 2004 WL 214449 (Cal. Ct. App.), *vacated by* Grace v. eBay Inc., 16 Cal. Rptr. 3d 192 (Cal. App. Dep't Super. Ct.), *opinion superseded by* 99 P.3d 2 (Cal. 2004) (involving auction website).

77. 47 U.S.C. § 230(a)(1).

78. § 230(a)(4).

79. 47 U.S.C. § 230(b).

As explained above, and as explored further in Parts II and III, courts have often cited these anti-regulatory, pro-market findings and policies in subsections (a)(4), (b)(1), (b)(2), and (b)(3) in support of contentions that section 230's immunity provisions were enacted "[t]o ensure that web site operators . . . would not be crippled by lawsuits arising out of third-party communications."[80] However, deterring vexatious litigation was scarcely on Congress's radar screen during the period when section 230 was considered and enacted. Rather, these preambles directly reflect section 230's origins as rival to Senator Exon's bill. The legislative history of section 230 demonstrates that the findings and purposes subsections were likely inserted for persuasive effect, serving to differentiate section 230 from the Exon bill. In turn, courts have given these provisions outsize significance, distorting rather than furthering section 230's original purposes.

Additionally, given that what became section 230 was crafted as a rival bill to Senator Exon's, it is possible that its findings and policies sections were designed more for persuasive effect than as statements having the force of law. Jurists and commentators have often observed that legislators deliberately manipulate legislative history to influence judicial interpretations,[81] and an analogous proposition holds with respect to the statutory text itself. This proposition may be equally applicable to congressional findings or statements of policy, as opposed to operative statutory language.

Although statutory findings and purposes can be useful guides to the meaning of statutory language,[82] there is often reason to look upon findings and statements of purpose with some suspicion, or at least view such statements as less persuasive to courts than operative provisions of statutory text. Professor Joseph Gerken, for example, has suggested that courts consider "findings" and "policies" akin to legislative history, using the example of courts' interpretation of the Americans with Disabilities Act (ADA):

> The text of the ADA begins with an extended series of Congressional findings describing the ways that disabled people

80. *See, e.g.*, Doe v. Myspace, Inc., 474 F. Supp. 2d 843, 847 (W.D. Tex. 2007), *aff'd*, 528 F.3d 413 (5th Cir. 2008).

81. *See, e.g.*, Blanchard v. Bergeron, 489 U.S. 87, 98–99 (1989) (Scalia, J., concurring) (suggesting that references to district court decisions were inserted in committee report by staffers "to influence judicial construction").

82. ABNER J. MIKVA & ERIC LANE, AN INTRODUCTION TO STATUTORY INTERPRETATION AND THE LEGISLATIVE PROCESS 165 (1997) (findings and policy statement can "provide the public with the broad reasoning behind the enactment of legislation and statutory interpreters with a context in which the more detailed language of the statute, particularly if it is ambiguous").

> have historically been treated. Congress's findings in this introductory section are not technically "legislative history" since they are part of the legislation; however, they are used in a number of cases in the same way that findings in committee reports might be used.[83]

If findings and policies are akin to legislative history in terms of their interpretive usefulness, it follows that they share some of the practical limitations of relying on legislative history. For instance, legislative history "is sometimes written to influence an agency or to posture for a constituent, not to establish positions about the meaning of law."[84] Similarly, there is an ongoing debate as to whether findings and policies, even though enacted as part of statutory text, should carry the persuasive force of operative statutory provisions because "such clauses are often drafted in vacuous language which makes it unhelpful in determining statutory meaning."[85] Also, "the drafters of a statutory purpose clause might emphasize one purpose to the exclusion of others, in much the same way that they might try to write legislative history favorable to their point of view."[86] Under the most skeptical view of "findings" and policies, "[s]tatutory findings and statements of purpose are often best understood as little more than rhetorical devices to support the ways in which issues have been framed."[87]

Section 230's findings and policies, especially the negative statements about government regulation of the Internet, remained in the bill after they had outworn their original purpose: explaining how section 230 differed from Senator Exon's proposal. While courts were correct to still consider these provisions, they should have viewed them in light of the CDA's broader purposes, which were confined to the more limited goal of protecting minors online. Nevertheless, beginning with *Zeran*, by far the most influential case on section 230, courts have particularly seized upon the enumerated "policy" in favor of non-regulation in order to promote the unenumerated and court-implied purpose of protecting Internet entities with expansive immunity.[88] Even from a policy perspective,

83. JOSEPH L. GERKEN, WHAT GOOD IS LEGISLATIVE HISTORY?: JUSTICE SCALIA IN THE FEDERAL COURTS OF APPEALS 264–65 (2007).

84. WILLIAM D. POPKIN, A DICTIONARY OF STATUTORY INTERPRETATION 172 (2007).

85. *Id.* at 221.

86. *Id.*

87. Muriel Morisey, Liberating Legal Education from the Judicial Model, 27 SETON HALL LEGIS. J. 231, 262 (2003).

88. *See infra* Part II.

some commentators have noted that while websites and ISPs may have needed protection from potentially ruinous liability in 1997 when *Zeran* was decided, it makes little sense for the courts to "leave the training wheels intact" given the obviously robust nature of the current Internet.[89]

PART II

A. The Formation of Expansive Interpretation: Zeran v. America Online

The first major case interpreting section 230(c)(1) construed the provision in broad strokes, going further than was necessary to effectuate the congressional goals of overruling *Stratton Oakmont* and of removing obstacles to the empowering of parents to determine the content of communications their children receive.[90] Decided by the Fourth Circuit in 1997, barely a year after the statute went into effect, no case has had more influence on section 230 jurisprudence than *Zeran*.[91] Cited over 1,400 times,[92] virtually every subsequent opinion regarding section 230 references *Zeran*. Its importance stems from both its timing and its broad construction of the statute's grant of immunity. *Zeran* laid the groundwork for future expansive readings of section 230 in two principal ways. First, *Zeran* held that section 230(c)(1)'s provision that "no provider or user of an interactive computer service shall be treated as a publisher or speaker of any information provided by another information content provider," also conferred immunity on websites otherwise considered "distributors" under defamation law.[93] Second, with virtually no support in the text or history of the statute, the court suggested that section 230(c)(2) conferred immunity on websites and ISPs for non-defamation-based claims.[94] The *Zeran* court took substantial liberties with section 230's enumerated and implied purposes, erroneously reasoning that free speech concerns motivated the safe harbor provision of section 230(c)(2).

89. *See, e.g.*, Olivera Medenica & Kaiser Wahab, *Does Liability Enhance Credibility?: Lessons from the DMCA Applied to Online Defamation*, 25 CARDOZO ARTS & ENT. L.J. 237, 238–39 (2007).

90. H.R. REP. NO. 104-458, at 194 (1996) (Conf. Rep.).

91. Zeran v. AOL, 129 F.3d 327 (4th Cir. 1997).

92. Search of Westlaw database, March 10, 2010.

93. *Zeran*, 129 F.3d at 328–32 (4th Cir. 2007).

94. *Id.* at 330. The court stated that § 230 created an immunity for "*any* cause of action that would make service providers liable for information originating with a third-party user of the service." *Id.* (emphasis added).

In *Zeran*, an unidentified person posted a message on an America Online (AOL) bulletin board, advertising t-shirts with offensive slogans related to the then-recent Oklahoma City bombing.[95] The initial message urged interested parties to call Kenneth M. Zeran, the plaintiff in this case.[96] Predictably, Zeran received a large number of threatening and angry calls.[97] On the day the message was posted, Zeran called AOL, informing it that he was the victim of a hoax, and was unable to change his telephone number because he needed it for his business.[98] The next day, after AOL assured Zeran it would remove the posting but denied his request for a retraction, an unknown person again posted more "advertisements" for similar products with slogans "at least as vulgar and offensive as those listed in the prior day's notice."[99] Five days after the first posting, Zeran received abusive calls every two minutes, including death threats.[100]

Zeran sued for negligence based on a state common law theory of distributor liability, claiming that AOL, once notified, had a duty to remove the defamatory postings promptly, to notify subscribers of the hoax, and to screen defamatory material in the future, much as a bookstore would be obligated to do as a distributor or transmitter of defamatory content.[101] According to Zeran, failure to remove the offending postings after notice subjected AOL to "distributor" liability as distinct from the "publisher" liability safe harbor conferred by the statute.[102] Zeran also argued that the interpretive canon calling for statutes in derogation of common law principles to be strictly construed called for the court to read section 230's immunity provision restrictively because "publisher" and "distributor" are separate categories at common law, and section 230 speaks to "publishers" only, thus excluding "distributors."[103] The Fourth Circuit upheld the dismissal of the case on the basis that section 230 provided AOL with immunity from all state-law def-

95. Zeran v. AOL, 958 F.Supp. 1124, 1127 n.3 (E.D. Va 1997), *aff'd*, 129 F.3d 327 (4th Cir. 1997).

96. *Zeran*, 129 F.3d at 329.

97. *Id.*

98. *Id.*

99. The new slogans included "Forget the rescue, let the maggots take over—Oklahoma 1995," and "Finally a day care center that keeps the kids quiet—Oklahoma 1995." *Zeran*, 958 F.Supp. at 1127 n.5.

100. *Id.* at 1128.

101. *Zeran*, 129 F.3d at 330.

102. *Id.* at 331.

103. *Id.* at 343–44.

amation claims, even if, as Zeran asserted, AOL was a "distributor."[104]

The court reasoned that under the common law of defamation, distributor liability is a subset of publisher liability.[105] Therefore, even if AOL would otherwise be liable for defamatory postings as a distributor of third-party content, AOL was immune from suit under section 230 as a "publisher" because that term encompasses "distributor."[106] The court conceded that distributors are ordinarily subjected to a different liability standard in defamation law, but determined that because each party involved in a defamation action necessarily is charged with "publication," the term "publisher" in section 230(c)(1) must include both publishers and distributors.[107] The court also rejected Zeran's contention that *Stratton Oakmont* recognized distributor liability as existing wholly distinct from publisher liability.[108] Thus, the court's conclusion was that online providers acting as "distributors" of defamatory content are also "publishers" and thus within the ambit of section 230 immunity.[109]

The Fourth Circuit's conclusion was by no means inevitable. When *Zeran* was decided, it was unclear whether websites could be held liable for third-party content as "distributors" even though they could not be "treated as publishers" under section 230(c)(1). First, *Stratton Oakmont* had a detailed exposition of the common law distinction between publisher and distributor liability standards.[110] Also, well-known online defamation cases decided before *Stratton Oakmont* had endorsed the possibility of treating website operators

104. *Id.* at 334.

105. *Id.* at 332.

106. *Id.*

107. *Id.* ("AOL falls squarely within [the] traditional definition of a publisher and . . . is clearly protected by §230's immunity.").

108. *Id.* (noting that those cases "do not . . . suggest that distributors are not also a type of publisher for purposes of defamation law").

109. The court did indicate that its conclusion that AOL enjoyed immunity was not entirely based on this tidy logic, however. The court stated that Zeran's complaint treated AOL as a *publisher*, because, according to Zeran, "AOL is legally at fault because it communicated to the parties an allegedly defamatory statement," which is "precisely the theory under which the original poster of the offensive messages would be found liable." *Id.* at 333. This is incorrect, however, because Zeran principally attempted to hold AOL liable for failure to remove defamatory content, not for allowing it to be posted it in the first place. *Id.* at 332.

110. *See* Stratton Oakmont, Inc. v. Prodigy Servs. Co., 1995 WL 323710, at *3 (N.Y. Sup. Ct. May 24, 1995), *superseded by statute*, Communications Decency Act of 1996, Pub. L. No. 104-104, 110 Stat. 133 (codified as amended in scattered sections of 47 U.S.C.).

as distributors, as distinct from publishers.[111] In light of the common law norm of treating "publishers" separately from "distributors," along with relevant precedents reaffirming this distinction, Congress's silence on this question was surprising. Since the word "distributor" was conspicuously absent from section 230(c)(1), the court could have concluded that Congress deliberately *excluded* distributors from section 230's safe harbor.[112]

The court held that section 230 precluded distributor liability for online providers because it would be inconsistent with the statute's purposes. The court viewed Congress's purpose of fomenting a robust Internet as paramount, stating:

> Congress recognized the threat that tort-based lawsuits pose to freedom of speech in the new and burgeoning Internet medium. The imposition of tort liability on service providers for the communications of others represented, for Congress, simply another form of intrusive government regulation of speech. Section 230 was enacted, in part, to maintain the robust nature of Internet communication and, accordingly, to keep government interference in the medium to a minimum.[113]

Setting forth policy rationales from its interpretation of congressional purpose, the court went on to note that "the specter of tort liability in an area of . . . prolific speech"[114] might lead ISPs to restrict third-party postings, thus having a "chilling effect" on valuable online speech.[115] Moreover, of all of Congress's findings, the Fourth Circuit primarily emphasized the finding that it is "the policy of the United States . . . to preserve the vibrant and competitive free market that presently exists for the Internet . . . *unfettered by Federal or State Regulation*."[116]

111. *See, e.g.*, Cubby, Inc. v. Compuserve, Inc., 776 F. Supp. 135, 139–41 (S.D.N.Y. 1991).

112. See David R. Sheridan, Zeran v. AOL *and the Effect of Section 230 of the Communications Decency Act Upon Liability for Defamation on the Internet*, 61 ALB. L. REV. 147, 162 (1997) ("[O]ne could argue from the enumeration of publisher and speaker in § 230(c)(1) that distributor was deliberately omitted.").

113. *Zeran*, 129 F. 3d at 330.

114. *Id.* at 331. The court noted that ISPs had about 12 million members, a figure the court called "staggering." *Id.* at 331. As of June 2008, Nielson reported that the United States has over 160 million active Internet users. NIELSON ONLINE REPORTS TOPLINE U.S. DATA FOR MAY 2008 2 (2008), http://www.nielsen-online.com/pr/pr_080610.pdf.

115. *Zeran*, 129 F.3d at 331.

116. 47 U.S.C. § 230(a)(4) (2006) (emphasis added), *quoted in Zeran*, 129 F.3d. at 330.

While this was a valid summation of *part* of Congress's rationale for enacting section 230, the court failed to consider that the end of promoting speech on the Internet was arguably *subsidiary to*, or should at least be considered *in addition to*, section 230's overall purpose of providing "[p]rotection for private blocking and screening of offensive material."[117] Additionally, the legislative history of section 230 emphasizes repeatedly Congress's goal of protecting children from offensive online material.[118] Unlike section 230's findings and policies sections and its legislative history, the Fourth Circuit announced that protecting the then-nascent Internet was the most important purpose of the statute.[119]

The court also considered section 230's goal of encouraging ISPs to "self-regulate the dissemination of offensive material," but tellingly referred to that end as "*another* important purpose" (as opposed to "the purpose"), implying that this purpose was less important.[120] By contrast, the court referred to section 230's goal of protecting "freedom of speech in the new and burgeoning Internet medium" as "*the* purpose" of the statute.[121] This elevation of one of the two announced purposes of section 230, combined with the court's repeated statements that section 230 might immunize websites from other non-defamation-based torts, shaped judicial constructions of the statute for years to come.

Although the vast majority of section 230 decisions have followed *Zeran* in declining to recognize a separate species of "distributor" liability outside of the ambit of the statute,[122] some

117. The House Conference Report explained that "[o]ne of the specific purposes of [section 230] is to overrule *Stratton-Oakmont v. Prodigy* and any other similar decisions which . . . create serious obstacles to the important federal policy of empowering parents to determine the content of communications their children receive through interactive computer services." H.R. REP. NO. 104-458, at 194 (1996) (Conf. Rep.).

118. *See supra* Part I.

119. *Zeran*, 129 F.3d. at 330.

120. *Id.* at 331 (emphasis added).

121. *Id.* at 330 (emphasis added).

122. Courts have overwhelmingly interpreted section 230 as a broad grant of immunity for websites and ISPs for third-party content, even if they have notice of the objectionable content. *See, e.g.*, Blumenthal v. Drudge, 992 F. Supp. 44, 52 (D.D.C. 1998). *See also* Steven D. Zansberg & Adam M. Platt, *The Murky Wake of* Roommates.Com*: When does the Exercise of "Traditional Editorial Functions" Render a Website Operator Responsible for Third-Party Postings?*, MEDIA L. RES. CTR. BULL. 2 (May 2008), available at http://www.lskslaw.com/publications/Murky_Wake_of_Roommates_com.pdf (noting that after Congress passed section 230, "numerous courts have held that 230 . . . immuniz[es] website operators for a wide range of claims").

commentators have argued forcefully that section 230 left distributor liability intact.[123] In 2004, a California appellate court rejected *Zeran*'s analysis and held that section 230 immunity does not apply to distributors.[124] In *Barratt v. Rosenthal*, a case concerning an alternative health advocate who had posted messages to online bulletin boards calling mainstream doctors "quacks," the court held that section 230 "cannot be deemed to abrogate the common law principle that one who republishes defamatory matter originated by a third person is subject to liability if he or she knows or has reason to know of its defamatory character."[125] The court wrote that *Zeran*'s "analysis of section 230 is flawed, in that the court ascribed to Congress an intent to create a far broader immunity than that body actually had in mind or is necessary to achieve its purposes."[126] Among its many criticisms of *Zeran*, the court reasoned that the word "publisher" in section 230(c)(1) is capable of being read as either denoting "primary publisher"—the plaintiff's contention in *Zeran*—or referring to any party who engages in the necessary act of "publication," which was AOL's position.[127] Since the meaning of "publisher" is ambiguous, the court reasoned, that is "enough to justify application of the interpretive canon favoring retention of common law principles."[128]

This judicial stand against *Zeran*'s reading of section 230 was short-lived: the California Supreme Court reversed.[129] Influenced by amicus briefs by the ACLU and numerous commercial websites and ISPs, including Amazon.com, eBay, Google, and AOL,[130] the court concluded that Zeran's original analysis of the question of distributor liability in section 230 was correct.[131] The court relied

123. *See, e.g.*, Sheridan, *supra* note 112, at 151–52 (reading statute as ambiguous as to whether it preserved distributor liability for ISPs, Sheridan writes that "unless and until Congress acts more clearly, courts should continue to resolve cases involving alleged distributor liability according to traditional tort principles").

124. Barrett v. Rosenthal, 9 Cal. Rptr. 3d 142, 168 (Cal. Ct. App. 2004) (holding that "section 230 does not restrict distributor liability under the common law"), *rev'd*, 146 P.3d 510 (Cal. 2006).

125. *Id.* at 152.

126. *Id.* at 154.

127. *Id.* at 158.

128. *Id.* at 157.

129. Barrett v. Rosenthal, 146 P.3d 510, 511 (Cal. 2006), *rev'g* 9 Cal. Rptr. 3d 142 (Cal. Ct. App. 2004).

130. *Id.* at 512.

131. *Id.* at 519.

both on *Zeran*'s doctrinal soundness, and on stare decicis.[132] The court considered the practical implications of bucking prevailing trends: "Adopting a rule of liability under section 230 that diverges from the rule announced in *Zeran* and followed in all other jurisdictions would be an open invitation to forum shopping by defamation plaintiffs."[133]

The limited disagreement with *Zeran* poses two related questions. First, given the facts of the case, why did the Fourth Circuit decide the distributor liability question the way it did? Although it is difficult to discern courts' ulterior motives, the opinion suggests that the court relied on unstated reasoning. Second, what were the implications of *Zeran*'s holding on distributor liability? As explained in more detail below, *Zeran*'s collapse of the "distributor" category had implications beyond altering the common law of defamation in the Internet context.

First, it should be noted again that the Fourth Circuit could have held that AOL was impervious to suit as a *primary* publisher. Indeed, the court took a step in this direction, stating that "once a computer service receives notice of a potentially defamatory posting, it is thrust into the role of a *traditional* publisher. The computer service provider must decide whether to publish, edit, or withdraw the posting."[134] In other words, the court implied that once AOL had notice of the allegedly defamatory content on the bulletin board and failed to remove it, it had exercised sufficient editorial control to be considered a primary publisher. Accordingly, if the court had based its holding on a finding that AOL was a primary publisher, it could have left the question of distributor liability for another day.

The court's decision to address the distributor liability issue was driven partly by the prudential concern of judicial administration. If *Zeran* had held that the section 230 safe harbor did not apply to distributors, this would have enabled state courts, and federal courts sitting in diversity, to apply state law to distributors of defamatory content online. Section 230(e)(3)'s preemption provision states:

> Nothing in this section shall be construed to prevent any State from enforcing any State law that is consistent with this section. No cause of action may be brought and no liability may be im-

132. *See id.* at 518 (noting that "[t]he *Zeran* court's views have been broadly accepted, in both federal and state courts").

133. *Id.* at 525–26.

134. Zeran v. AOL, 129 F.3d 327, 332 (4th Cir. 1997) (emphasis added).

> posed under any State or local law that is inconsistent with this section.[135]

Therefore, if distributors of defamatory content do not fall within the safe harbor provided by the statute, state law would generally govern actions against distributors since defamation is traditionally an area of state law[136] and section 230(e)(3) permits application of non-conflicting state laws.[137] In *Zeran*, the Fourth Circuit was concerned that allowing state courts to administer claims of distributor liability would contravene congressional intent to address "a problem of national and international dimension."[138]

Most obviously, *Zeran*'s potential to engender inconsistent state applications of Internet defamation law was evident from the facts. Zeran almost certainly had an otherwise viable case against AOL based on a failure-to-remove-after-notice distributor liability theory. After being alerted to the initial offending posting, AOL did not immediately remove the post,[139] refused to publish a retraction as a "matter of policy,"[140] and claimed that the post would "soon" be removed.[141] In Zeran's case, "soon" was clearly inadequate, as evidenced by the involvement of the FBI and local police to ensure his own safety.[142] And AOL's alleged foot-dragging and refusal to publish a retraction certainly fit the black-letter definition of a party liable as a distributor: "[O]ne who . . . delivers or transmits defamatory matter published by a third person is subject to liability if . . . he *knows* . . . of its defamatory character."[143]

135. 47 U.S.C. § 230(e)(3) (2006).

136. *See* Joseph H. King, Jr., *Deus Ex Machina and the Unfulfilled Promise of* New York Times v. Sullivan*: Applying the Times for All Seasons*, 95 Ky. L.J. 649, 654 (2006).

137. This analysis formed the basis of the California Court of Appeals' argument in *Barrett*. Barrett v. Rosenthal, 9 Cal. Rptr. 3d 142, 168 (Cal. Ct. App. 2004), *rev'd*, 146 P.3d 510 (Cal. 2006).

138. *Zeran*, 129 F.3d at 334. Put another way, the Fourth Circuit was concerned with effectuating the Congressional aim of *preventing* regulation of the Internet. *Id.*

139. AOL and Zeran disputed the date that AOL eventually removed the original posting. *Id.* at 329.

140. *Id.*

141. *Id.*

142. *Id.*

143. RESTATEMENT (SECOND) TORTS § 581(1) (2009) (emphasis added).

PART III

A. A Recent Case Study on the Distributor Liability Problem: Global Royalties Ltd. v. XCentric Ventures, LLC

The Fourth Circuit's refusal to recognize distributor liability in a seemingly fitting case spoke volumes to later courts. *Global Royalties, Ltd. v. Xcentric Ventures, LLC*,[144] decided in the District of Arizona in 2008, is a representative case demonstrating how closely courts have adhered to the interpretation developed in *Zeran* that section 230 precludes distributor liability, even when the competing equities seem to weigh strongly in favor of the plaintiff. In *Global Royalties*, the defendant operated a website called Ripoff Report,[145] where users could post consumer complaints about companies and individuals.[146] The plaintiff, a Canadian[147] investment broker in

144. Global Royalties, Ltd. v. Xcentric Ventures, LLC, 544 F. Supp. 2d 929 (D. Ariz. 2008).

145. The home page contains the following disclaimer:

> Ripoff Report is a worldwide consumer reporting website and publication, by consumers, for consumers, to file and document complaints about companies or individuals. While we encourage and even require authors to only file truthful reports, Ripoff Report does not guarantee that all reports are authentic or accurate. Be an educated consumer. Read what you can and make your decision based upon an examination of all available information.

Ripoff Report, http://www.ripoffreport.com (last visited May 11, 2010).

146. *Global Royalties*, 544 F. Supp. 2d at 930.

147. This case contained an interesting jurisdictional twist: By the time Global Royalties filed its complaint, it had already obtained a default judgment for defamation against XCentric Ventures in Canada, which included an injunction directing XCentric to remove the offending postings. The complaint filed in district court requested that the court enforce this Canadian judgment. XCentric's motion to dismiss, which the district court granted on section 230 grounds without considering this issue, averred that enforcing the Canadian injunction would amount to an unconstitutional prior restraint on speech. XCentric argued that the Canadian injunction was "repugnant to the public policy of the United States or of the State where recognition is sought," and thus should not be enforced. This case raised the issue of whether a judgment obtained in a jurisdiction without an analogous immunity-conferring statute would be enforced in the United States if the defendant would have been immune under section 230 if sued domestically. Complaint at 7, Global Royalties, Ltd. v. Xcentric Ventures, LLC, 544 F. Supp. 2d 929 (D. Ariz. 2008) (No. CV-07-0956-PHX-FJM), 2007 WL 4448527; Motion to Dismiss at 15, Global Royalties, Ltd. v. Xcentric Ventures, LLC, 544 F. Supp. 2d 929 (D. Ariz. 2008) (No. CV-07-0956-PHX-FJM), 2007 WL 4452683. The Ripoff Report website contains a notice stating that it is intended "solely for use inside the United States," and that "this site should not be used to post information regarding foreign (non-U.S.-based) companies unless the report involves a transaction which took place inside the United States" and that "different countries have very different laws regarding, among other things . . . free speech rights and what may or may not constitute defamation." Ripoff Report, http://www.ripoffreport.com/

gemstones, alleged that a site visitor, Sullivan, posted messages stating it was engaged in unlawful activities.[148] After the plaintiff threatened legal action, Sullivan requested that Ripoff Report remove the offending postings and, according to the complaint, disavow their contents,[149] but the site refused.[150] The plaintiff claimed that the defendant website operators not only encouraged the posting of defamatory material, but also profited from it, alleging that they "use Ripoff Report messages as leverage to coerce targeted businesses to pay for defendants' Corporate Advocacy Program, which purports to help investigate and resolve posted consumer complaints."[151] The court noted that even though it was "obvious that a website entitled Ripoff Report encourages the publication of defamatory content,"[152] section 230 conferred absolute immunity so long as Ripoff Report did not itself "create or develop" the offending content.[153]

Here, *Global Royalties* highlighted a related trend in section 230 jurisprudence that often renders fatal plaintiffs' inability to rely on the distributor liability theory. While section 230 does not immunize those who create content, courts have endorsed a constricted notion of "creation or development."[154] Global Royalties' complaint observed that posters to Ripoff Report were *required* to select from a list of categories, like "Scam Artists," created by the website owners, which seemed to invite the posting of defamatory content.[155] Therefore, the argument went, Ripoff Report was a "creator or developer" of content submitted by "another information

ConsumersSayThankYou/NoticeForUsersOutsideTheUS.aspx (last visited May 11, 2010).

148. *Global Royalties*, 544 F. Supp. 2d at 930.

149. Complaint at 6, *Global Royalties*, 544 F. Supp. 2d 929 (No. CV-07-0956-PHX-FJM), 2007 WL 4448527. Sullivan was not named as a defendant, presumably because he had few assets.

150. *Id.*

151. *Global Royalties*, 544 F. Supp. 2d. at 932.

152. *Id.* at 933. The court references Ripoff Report's drop-down menus that included such categories as "Con Artists." The court declined to follow *Fair Housing Council of San Fernando Valley v. Roommates.Com*, which suggested that a website might be held liable as an "information content provider," the equivalent of the category of "author" at common law, if it encouraged unlawful content with its drop-down menus. Fair Hous. Council of San Fernando Valley v. Roommates.Com, LLC, 521 F.3d 1157, 1169 (9th Cir. 2008).

153. *Global Royalties*, 544 F. Supp. 2d. at 934.

154. *See, e.g.*, Blumenthal v. Drudge, 992 F. Supp. 44, 50 (D.D.C. 1998) (holding that AOL was not "creator or developer" of content despite retaining right to exercise control over editorialist Matt Drudge's news and gossip website).

155. *Global Royalties*, 544 F. Supp. 2d. at 932.

content provider," and was ineligible for immunity.[156] Despite Ripoff Report's obvious encouragement, the court held the website was not responsible for "creation or development" because it had not solicited Sullivan's posting in particular, nor had it solicited postings specifically targeting the plaintiff.[157] While it is reasonable to conclude that "development" might implicate more activity than simply uttering a defamatory statement (i.e., that websites might lose their immunity if they encourage objectionable content to the extent that they are themselves responsible for it), courts, engaging in similarly cramped analyses, have, with a few notable but limited exceptions,[158] virtually erased the word "development" from the statute. Therefore, unless a prospective plaintiff alleges that a website or ISP authored a defamatory statement, itself a high threshold, recovery is virtually impossible.

B. Section 230 Unhinged: Zeran*'s Expansion of the Subject Matter of Section 230 Immunity*

Zeran's most unsettling move was broadening the reach of section 230(c)(1) beyond the boundaries of defamation law to cover a broad range of claims. Instead of interpreting section 230 as precluding only claims against primary publishers of third-party content (which Zeran advocated) or, even more broadly, as a bar against all defamation or defamation-type lawsuits related to disseminating third-party content (which the court's collapse of distributor liability into the "publisher" category might suggest), the court employed the more general terms "tort-based lawsuits" and "tort liability" to describe the scope of the safe harbor.[159] This suggested that section 230 immunity might extend to other tort-based causes of action despite section 230(c)(1)'s language referring to "publisher[s] or speaker[s]"[160]—terms of art specific to defamation law. Later in the opinion, the *Zeran* court made an even bolder statement: "By its plain language, § 230 creates a federal immunity to *any cause of action* that would make service providers liable for information originating with a third-party user of that service."[161]

Properly read, *Zeran*, at its most expansive, ought to have stood for the proposition that section 230 conferred immunity on In-

156. *Id.*

157. *Id. at* 933.

158. *See, e.g.*, Fair Hous. Council of San Fernando Valley v. Roommates.Com, LLC, 521 F.3d 1157 (9th Cir. 2008).

159. Zeran v. AOL, 129 F.3d. 327, 330 (4th Cir. 1997).

160. 47 U.S.C. §230(c)(1) (2006).

161. *Zeran*, 129 F.3d. at 330 (emphasis added).

ternet entities only insofar as third-party content caused "defamation-type" harms. The court's reliance on doctrine exclusive to defamation law to establish that "distributor liability is a subset of publisher liability"[162] contradicts the notion that section 230's safe harbor extends to *any* legal malfeasance perpetrated by a third party.[163] Although it does not make the *Zeran* court's logic any more credible, the nature of Zeran's claims sheds some light on the court's possible motivations. Zeran did not allege harms to his reputation, which defamation law traditionally protects against.[164] Instead, he alleged that the negligence of AOL resulted in other detriments to him that were perhaps more properly cast as negligent infliction of emotional distress or false light invasion of privacy.[165] If the court had used the phrase "defamation-based torts" to describe section 230's immunity provision, this language would have been inadequate to sustain the court's holding that AOL was immune from suit. The court, interpreting section 230 in light of free-speech and Internet-development concerns, likely construed the statute to include a grant of immunity against those publication-based torts—false light invasion of privacy and infliction of emotional distress—that are sometimes treated as "cousins" of defamation law because the harms suffered are analogous and because they also implicate speech interests.[166]

While one of *Zeran*'s pronouncements on section 230—rejection of intermediate "distributor" liability—has persisted in largely the same formulations as in *Zeran*, courts have aggressively built upon its suggestion that section 230 immunity encompasses a broad range of claims. Courts have extended it to theories of liability as

162. *Id.* at 332.

163. On the other hand, the court's rejection of the publisher-distributor distinction, while using analytical tools indigenous to defamation law, enabled future courts considering section 230 to use the term "publisher" in the layman's sense to refer to the dissemination of any sort of content that results in any sort of harm to a prospective plaintiff.

164. RESTATEMENT (SECOND) OF TORTS § 621 cmt. a (1977) ("In defamation actions general damages are imposed for the purpose of compensating the plaintiff for the harm that the publication has caused to his reputation."); *see, e.g.*, Allen v. Pioneer Press Co., 41 N.W. 936, 938 (Minn. 1889) (purpose of defamation action is to "vindicate the plaintiff's character").

165. *See* Anthony Ciolli, *Chilling Effects: The Communications Decency Act and the Online Marketplace of Ideas*, 63 U. MIAMI L. REV. 137, 149, 155 (2008).

166. *See, e.g.*, Hustler v. Falwell, 485 U.S. 46, 56 (1988) (treating torts of defamation and intentional infliction of emotional distress, at least pertaining to public figures, as similar for purposes of First Amendment analysis).

diverse as breach of contract,[167] ordinary negligence,[168] interference with prospective economic advantage,[169] false advertising,[170] and distribution of child pornography.[171] While there has been some criticism concerning overbroad immunity for Internet entities,[172] there has been silence concerning section 230's dubious applicability to non-speech-based claims.[173] This trend, however, is more dangerous than concerns about overbroad immunity because it threatens to promote near-lawlessness on the Internet.

After *Zeran*, courts expanded the reach of section 230 immunity beyond defamation law not by construing the term "publisher" in subsection (c)(1) as a term of art, but instead using it as it appears in ordinary parlance.[174] *Doe v. MySpace, Inc.*,[175] decided in the Western District of Texas in 2007, is a typical example of how this notion of "publisher" operates. In *MySpace*, a mother sued the popular social networking website for negligence, fraud, and negligent misrepresentation after her daughter was sexually assaulted by a man she had met on the website.[176] The mother argued that section 230 immunity was inapplicable because she had "not sued MySpace for the publication of third-party content but rather for failing to implement basic safety measures to prevent sexual predators from communicating with minors."[177] She further argued that section 230 immunity was limited to "defamation or related actions."[178] The court disagreed, holding that section 230 "precludes courts from entertaining claims that would place a [website] in a

167. *See, e.g.*, Jane Doe One v. Oliver, 755 A. 2d 1000, 1002, 1004 (Conn. Super. Ct. 2000).

168. *See, e.g.*, Doe v. Myspace, Inc., 528 F.3d 413, 418, 422 (5th Cir. 2008).

169. *See, e.g.*, Optinrealbig.com, LLC v. Ironport Systems, Inc., 323 F.Supp. 2d 1037, 1049 (N.D. Cal. 2004).

170. *See* Perfect 10, Inc. v. CCBill, LLC, 340 F. Supp. 2d. 1077, 1110–11 (C.D. Cal. 2004), *aff'd in part*, *rev'd in part*, 481 F.3d 751 (9th Cir. 2007).

171. Doe v. Bates, No. 5:05-CV-91DF-CMC, 2006 WL 3813758, at *2, *5 (E.D. Tex. Dec. 27, 2006).

172. *See, e.g.*, Matthew G. Jeweler, *The Communications Decency Act of 1996: Why § 230 Is Outdated and Publisher Liability for Defamation Should be Reinstated Against Internet Service Providers*, 8 U. PITT. J. TECH. L. & POL'Y. 3, 3 (2007).

173. While some commentators have mentioned this phenomenon, there has been little analysis of its import. *See, e.g.*, *Federal District Court Denies § 230 Immunity*, *supra* note 10, at 2253 n.3 (2008).

174. *See, e.g.*, Gentry v. eBay, Inc., 99 Cal. App. 4th 816, 831 (Cal. App. 2002) (equating "publish" with "dissemination").

175. Doe v. MySpace, Inc., 474 F. Supp. 2d 843 (W.D. Tex. 2007), *aff'd*, 528 F.3d 413 (5th Cir. 2008).

176. *Id.* at 846.

177. *Id.* at 848.

178. *Id.* at 849.

publisher's role."[179] Without conducting any independent analysis of the statutory language, the court cited a line of cases, dating back to *Zeran*, supporting the proposition that section 230 immunity applied to non-defamation-based claims.[180] Ironically, despite itself stretching the statute to its breaking point, the court accused the plaintiff of disingenuous "artful pleading" for accusing MySpace of negligence.[181] The court construed "publish" to encompass any sort of behavior related to hosting third-party content, and even extended the immunity provision to cover MySpace's *own* failure to act.[182] Under this approach, websites enjoy immunity from virtually any claim[183] so long as a third party played some role in harming the plaintiff.

A hypothetical helps to illustrate the consequences of overbroad immunity. Assume that there is a federal law making it a crime for a social networking website to negligently allow a convicted sex offender to create a "profile." Assume that there is also a state law that creates a private right of action against social networking websites for negligently permitting sex offenders to register, and makes them strictly liable in tort for violations of the federal law. If parents sued the website in state court after their child was victimized by a convicted sex offender who had been negligently allowed to register on the site, section 230 immunity would operate to preempt the civil state law claim under the current judicial approach. This outcome does not comport with section 230's original aim of encouraging responsible Internet citizenship, nor does it serve to protect the important free speech interests that are often invoked in the section 230 context.[184] It also undermines traditional state prerogatives that are the basis for imposing tort liability.

Despite this worrisome trend, a few courts have moved to limit the subject matter of section 230 immunity. In *Avery v. Idleaire Tech-*

179. *Id.* at 847 (quoting Dimeo v. Max, 433 F. Supp. 2d 523, 528 (E.D. Pa. 2006)) (emphasis added).

180. *Id.* at 847–49.

181. *See id.* at 849.

182. *See id.* at 848–51.

183. Section 230 does not provide immunity for criminal or intellectual property claims. 47 U.S.C. § 230(e) (2006). While criminal claims are easy to categorize, courts have struggled with defining whether a law "pertain[s] to intellectual property." *Id.* In *Perfect 10*, for example, the Ninth Circuit determined that "intellectual property" referred to only "*federal* intellectual property" laws. Perfect 10, Inc. v. CCBill, LLC, 481 F.3d 751, 768 (9th Cir. 2007) (emphasis added).

184. *See, e.g.*, Batzel v. Smith, 333 F.3d 1018, 1027 (9th Cir. 2003); Ben Ezra, Weinstein, & Co. v. AOL, 206 F.3d 980, 985 n.3 (10th Cir. 2000).

nologies Corp.,[185] a 2007 case from the Eastern District of Tennessee, the court held that section 230 did not bar a sexual harassment claim under Title VII of the Civil Rights Act of 1964 when the plaintiff was subjected to viewing pornographic "pop-ups" that would intermittently appear on company computers.[186] In *Fair Housing Council of San Fernando Valley v. Roommates.Com, LLC*,[187] although the majority expressly disclaimed any reliance on the fact that the plaintiff made claims under the Fair Housing Act, the dissent forcefully argued that "the majority's conclusion [that section 230 does not confer immunity] rests on the premise that Roommate's questions and matching function violate the FHA."[188] In *FTC v. AccuSearch, Inc.*,[189] a 2005 District of Wyoming case, the court granted summary judgment to the Federal Trade Commission (FTC) against a website that helped users obtain private phone records.[190] While basing its conclusion that AccuSearch did not enjoy immunity on a determination that AccuSearch was not a "publisher,"[191] the court did not endorse the extension of section 230 immunity to the FTC's unfair trade practices theory of liability.[192] The court held that the object of the unfair trade practices claim was not the behavior of a third party, but rather stemmed directly from AccuSearch's facilitating the release of confidential phone records.[193]

These examples illustrate that courts might be more willing to limit the reach of section 230 immunity if the plaintiff seeks to advance a federal interest or assert a federally-created right. Stated more broadly, some types of claims, such as those involving civil rights, may simply be important enough from a policy perspective to defeat section 230 immunity. Yet the problem of over-expansive immunity unfortunately persists; these cases represent rare exceptions, indicating that courts may be unwilling to go against the precedential grain even in cases where it may be warranted.

185. No. 3:04-CV-312, 2007 WL 1574269 (E.D. Tenn. May 29, 2007).

186. *See id.* at *4, *20.

187. Fair Hous. Council of San Fernando Valley v. Roommates.Com, LLC, 521 F.3d 1157, 1178 (9th Cir. 2008).

188. *Id.* at 1178 (McKeown, J., dissenting). For example, the majority wrote that "Roommate's website is designed to force subscribers to divulge protected characteristics and discriminatory preferences." *Id.* at 1172.

189. No. 06-CV-105-D, 2007 WL 4356786 (D. Wyo. Sept. 28, 2007).

190. *Id.* at *10.

191. *Id.* at *5. As explained *infra*, *AccuSearch* also indicates that an online entity might not be entitled to section 230 immunity if it acts culpably in disseminating third-party content.

192. *Id.* at *6.

193. *Id.* Federal law makes phone records confidential and prohibits their unauthorized release. *Id.* at *2.

C. Barnes v. Yahoo!, Inc.

The recent Ninth Circuit case of *Barnes v. Yahoo!, Inc.*[194] gave the expansive view of section 230 another judicial thumbs-up, unfortunately solidifying the defendant-friendly position that the statute is an all-purposes liability shield. But in a puzzling and seemingly inconsistent move, the court did not close the door to liability altogether.

The facts of *Barnes* are not novel for a section 230 case. After Cecilia Barnes ended a relationship with her boyfriend, he allegedly posted "profiles" of Barnes on a Yahoo! website, including nude photographs and open invitations for romantic activity.[195] The profiles also included her real telephone numbers and place of employment.[196] To further his cruel hoax, the ex-boyfriend allegedly visited Yahoo! chat rooms, impersonated Barnes and directed suitors to the fake profile.[197] After many unwanted communications and visits to her office by strange men, Barnes sent a letter to Yahoo! asking them to remove the profiles.[198] After over a month of unsuccessful efforts to contact Yahoo!, the profiles had not been taken down and Yahoo! had not responded.[199] On the eve of a local news story exposing the hoax, a Yahoo! officer contacted Barnes and personally assured her that it would remove the postings.[200] After two more months, the postings remained until Barnes filed a lawsuit.[201]

As the court construed her complaint, Barnes made two Oregon state-law claims: first, for negligent provision of services, or "negligent undertaking," and second, for promissory estoppel.[202] The court observed that Oregon law on negligent undertaking covered:

> [O]ne who undertakes . . . to render services to another which he should recognize as necessary for the protection of the other[ ] . . . is subject to liability to the other for physical harm resulting from his failure to exercise reasonable care to perform his undertaking, if a) his failure to exercise such care in-

194. *Barnes v. Yahoo!, Inc.*, 570 F.3d. 1096 (9th Cir. 2009).
195. *Id.* at 1098.
196. *Id.*
197. *Id.*
198. *Id.*
199. *Id.*
200. *Id.* at 1098–99.
201. *Id.* at 1099.
202. *Id.*

> creases the risk of such harm, or b) the harm is suffered because of the other's reliance on the undertaking.[203]

Essentially, Ms. Barnes claimed that once Yahoo! undertook to remove the offending postings, it incurred a duty to protect Ms. Barnes.[204] As for the promissory estoppel claim, Barnes alleged that she detrimentally relied on Yahoo!'s promise to remove the postings.[205]

The court held that section 230(c)(1) barred Barnes' negligent undertaking claim because it "treated [Yahoo!] as a publisher or speaker of information provided by another information content provider [the ex-boyfriend]."[206] The court, like others before it, embraced an expansive interpretation of section 230, but was especially explicit about it, stating that "section 230(c)(1) precludes courts not just from treating internet service providers as publishers not just for the purposes of defamation law, but *in general*."[207] With ostensible faithfulness to the statutory text, the court relied on a dictionary definition of "publisher" to give the law broad scope: "[T]he reproducer of a work intended for public consumption" or "one whose business is publication."[208] Like other courts, the Ninth Circuit paid no mind to the fact that "publisher" and "speaker" are terms of art in defamation law.[209]

The court's "in general" language, while supposedly based on a textual reading of the statute, may be more indicative of acquiescence to the direction where section 230 jurisprudence has been headed ever since *Zeran*. The court could have construed Barnes' negligent undertaking claim as an artfully pled defamation claim, and even implied that it might.[210] The court could have just as easily held that Yahoo! was a "publisher" for "exercising [the] traditional editorial functions"[211] of deciding whether or not to remove or alter content on its website. Instead, the court went out of its way and beyond the facts of the case to pronounce that section 230 was a defense of general applicability.

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203. *Id.* at 1102 (citing RESTATEMENT (SECOND) OF TORTS § 323 (1965)).

204. *Id.* at 1103.

205. *Id.* at 1099.

206. 47 U.S.C. § 230(c)(1) (2006).

207. *Barnes*, 570 F.3d at 1104 (emphasis added).

208. *Id.* at 1102 (citing WEBSTER'S THIRD NEW INTERNATIONAL DICTIONARY 1837 (1986)).

209. *See supra* Part I.

210. *Barnes*, 570 F.3d at 1102 ("[A] plaintiff cannot sue someone for publishing third-party content simply by changing the name of the theory from defamation to negligence.").

211. Zeran v. AOL, 129 F.3d 327, 330 (4th Cir. 1997).

While the Ninth Circuit followed prevailing trends in discussing Barnes' negligent undertaking claim, it left many unanswered questions with respect to the future of the statute by holding that section 230 did not bar Barnes' promissory estoppel claim.[212] In a convoluted analysis that lacked the firm hand that parsed the negligent undertaking claim, the court held that the promissory estoppel claim did not treat Yahoo! as a "publisher or speaker":

> Section 230 creates a baseline rule: no liability for publishing or speaking the content of other information service providers. Insofar as Yahoo made a promise [to remove the offending material] with the constructive intent that it be enforceable, it has implicitly agreed to an alteration in such baseline.[213]

This holding was facially inconsistent with the portion of the opinion on negligent undertaking; for just as "negligent undertaking" might be a dressed-up, ordinary claim against a "publisher," the court could have held that Ms. Barnes' reliance on the alleged promise to remove the material was similarly based on Yahoo!'s actions as a "publisher."

Although promissory estoppel might only emerge as a claim in situations where an Internet entity promised to remove something and failed to do so, *Barnes* might open up the door to plaintiffs who come up with viable promissory estoppel claims.

D. The Practical Consequences of Zeran*'s Distributor Liability Problem*

Zeran's interpretation that section 230(c)(1) forecloses "distributor" liability eliminated any chance of recovery for plaintiffs in many Internet defamation cases. This consequence stems from the difficulty of identifying the original source of defamatory content on the Internet. Although the *Zeran* opinion claimed that plaintiffs could obtain redress,[214] the ability to communicate anonymously on the Internet makes this reassurance illusory without distributor liability for several reasons.

First, even where a website or ISP may have the means to identify a poster of defamatory content, defamation plaintiffs may have to subpoena the Internet company multiple times,[215] and may face

212. *Barnes*, 570 F.3d. at 1109.

213. *Id.* at 1108–09.

214. *Zeran*, 129 F.3d. at 330 (stating that its holding that AOL is immune from suit does not mean "that the original culpable party who posts defamatory messages would escape accountability").

215. *See* Jason C. Miller, *Who's Exposing John Doe? Distinguishing Between Public and Private Figure Plaintiffs in Subpoenas to ISPs in Anonymous Online Defamation Suits*, 13 J. TECH. L. & POL'Y 229, 245 (2008) (explaining that a first round of subpoenas

motions to quash if the website or ISP is reluctant to offer information about its users.[216] Second, plaintiffs may have trouble obtaining personal jurisdiction over a "John Doe" defamer of unknown origin.[217] Third, in deference to the First Amendment, many courts have imposed a three-part test that plaintiffs must meet to overcome the qualified privilege against disclosure of anonymous sources.[218] Fourth, even if a defamation plaintiff obtains the identity of an anonymous poster, libel suits are difficult to win,[219] and "the typical John Doe has neither deep pockets nor libel insurance from which to satisfy a defamation judgment."[220] Fifth, even if a defamed party can rebut false statements by posting rebuttals, as some sites allow, search engines like Google can exacerbate the problem by giving indexing preference to the initial false statement, which might display most prominently when searching for a business or a person's name online.[221] Given these obstacles, plaintiffs are often advised not to pursue online defamation litigation.[222]

The lack of distributor liability for websites and ISPs also has the effect of discouraging self-policing of content, an ironic consequence given the original aims of the statute.[223] Websites and ISPs know that no matter how inflammatory third-party postings are, complaints from aggrieved parties will be to no avail, even after notice to the website or ISP. The Ripoff Report website, for example, contains a page entitled, "About Us: Want to Sue Ripoff Report?,"

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might only reveal e-mail addresses and/or IP addresses, making a second round of subpoenas necessary to reveal actual identities of posters).

216. *See, e.g.*, Donato v. Moldow, 865 A.2d 711, 714 (N.J. Super. Ct. App. Div. 2005).

217. Miller, *supra* note 215, at 246.

218. Under this test, plaintiffs must show:

> (1) the issue as to which disclosure of the source is sought goes to the heart of the case, (2) disclosure is necessary to prove the issue because the party seeking the information is likely to prevail on all other issues, and (3) all other means of proving the issue have been exhausted.

Sinclair v. TubeSockTedD, 596 F. Supp. 2d 128, 132 (D.D.C. 2009) (citing Lee v. Dept of Justice, 413 F.3d 53, 59–60 (D.C. Cir. 2005)); *see also* Miller, *supra* note 215, at 246–50 (discussing First Amendment in context of defamation case).

219. *See* Randall P. Bezanson, *Libel Law and the Press: Setting the Record Straight*, 71 IOWA L. REV. 215, 228 (1985) (explaining that very few libel plaintiffs are successful).

220. Lyrissa Barnett Lidsky, *Silencing John Doe: Defamation & Discourse in Cyberspace*, 49 DUKE L.J. 855, 859 (2000).

221. Miller, *supra* note 215, at 236.

222. *Id.* at 246.

223. *See, e.g.*, David V. Richards, *Posting Personal Information on the Internet: A Case for Changing the Legal Regime Created by § 230 of the Communications Decency Act*, 85 TEX. L. REV. 1321, 1334–35 (2007).

which includes a lengthy exposition of section 230 immunity and responds to many frequently asked questions concerning the practicalities of suing them for defamation and other torts.[224] One heading, "I Know the CDA Protects Ripoff Report, But I am Going to Sue Anyway," contains an "answer" positing that attorneys and parties filing defamation lawsuits would be subject to Rule 11 sanctions,[225] and states that Ripoff Report will not stipulate to a dismissal once a case is filed absent agreement to pay Ripoff Report's attorneys fees.[226] Also, as indicated above,[227] it is unlikely that a court would find a website or ISP that edits content responsible for creating that content as "information content providers."[228]

E. Possible Solutions to the Distributor Liability Problem

Because courts should balance the government's interest in protecting reputation (in the case of individuals) and economic interests (in the case of businesses in the "trade libel" context) against other considerations, including free speech,[229] the current section 230 judicial approach must be changed in order to regain a proper equilibrium. Core American defamation jurisprudence has arguably reached such a balance after *New York Times v. Sullivan*[230] and other landmark cases[231] that restrained the harsh effects of common law defamation to coincide with First Amendment doctrine.[232] The principles announced in these cases did not arrive quickly or easily, indicating that swinging the pendulum back in favor of on-

224. Ripoff Report, About Us: Want to Sue Ripoff Report?, http://www.ripoffreport.com/ConsumersSayThankYou/WantToSueRipoffReport.aspx (last visited May 11, 2010).

225. Federal Rule of Civil Procedure 11 provides for sanctions of an attorney or party who advances frivolous claims. FED. R. CIV. P. 11(b)(2), (c)(1).

226. Want to Sue Ripoff Report?, *supra* note 224.

227. *See supra* Part II.

228. *See* Richards, *supra* note 223, at 1335–36.

229. *See* Milkovich v. Lorain Journal Co., 497 US 1, 22–23 (1990).

230. *N.Y. Times v. Sullivan*, 376 U.S. 254, 279–80 (1964) (prohibiting newspaper from being sued for defamation for statements about official conduct of public official if statements were not made with knowing or reckless disregard for the truth).

231. *See, e.g.*, Gertz v. Robert Welsh, Inc., 418 U.S. 323, 324 (1974) (prohibiting states from imposing defamation liability without fault); Philadelphia Newspapers, Inc. v. Hepps, 475 U.S. 767, 777 (1986) (placing burden on private-figure plaintiffs to prove falsity of allegedly defamatory statements).

232. *See* Lyrissa Barnett Lidsky & Thomas F. Cotter, *Authorship, Audiences, and Anonymous Speech*, 82 NOTRE DAME L. REV. 1537, 1599–1600 (2007) (discussing history of landmark distributor liability cases in First Amendment context).

line defamation plaintiffs will not be easy, especially given the reliance on *Zeran*'s status quo by entrenched interests.[233]

Although some courts have leaned towards simply re-establishing the common law distributor liability scheme for the Internet,[234] this is not a viable solution. As *Stratton Oakmont* suggested,[235] even if courts based such a scheme on "liability upon notice" of defamatory material—the typical formulation of distributor liability—it would be hard to administer: policing thousands of third-party postings would be difficult and expensive, threatening to put some useful websites out of operation entirely.[236] Some have also reasoned that because it may be hard to determine whether those claiming to be defamed are credible, websites may be overcautious in removing material rather than independently verifying each claim of defamation. For example, in the United Kingdom, which essentially retains the common law defamation regime, evidence suggests that ISPs "typically engage in self-censorship on receipt of a notice alerting to the (alleged) defamatory content of information . . . the present law results in [ISPs] removing material that may be in the public interest and well-researched."[237]

233. Both commercial interests and public interest groups have defended the distributor liability holding of *Zeran*. *See, e.g.*, Brief of Amici Curiae Electronic Frontier Foundation & ACLU of Northern California as Amici Curiae in Support of Defendant-Respondent Ilena Rosenthal, Barrett v. Rosenthal, 146 P.3d 510 (Cal. 2006) (No. S122953), 2004 WL 3256405; Brief of Amici Curiae Amazon.Com, Inc. et. al. in Support of Roommate.com, LLC, Fair Hous. Council of San Fernando Valley v. Roommates.Com, LLC, 521 F.3d. 1157 (9th Cir. 2008) (No. CV-03-09386-PA (RZx)), 2005 WL 2106305.

234. *See, e.g.*, Global Royalties v. Xcentric Ventures, No. 07-956-PHX-FJM, 2007 WL 2949002 (D. Ariz. Oct. 10, 2007). Although the court ultimately refused to revert back to common law practice without an amendment of the CDA by Congress, it suggested that by eliminating common law publisher liability the CDA "render[s] plaintiffs helpless against website operators who refuse to remove allegedly defamatory content." *Id.* at *4.

235. Stratton Oakmont, Inc. v. Prodigy Servs. Co., 1995 WL 323710, at *4 (N.Y. Sup. Ct. 1995), *superseded by statute*, Communications Decency Act of 1996, Pub. L. No. 104-104, 110 Stat. 133 (codified as amended in scattered sections of 47 U.S.C.).

236. In a recent Seventh Circuit case involving Fair Housing Act claims against Craigslist, the popular classified advertising website, Judge Easterbrook observed that requiring the leanly-staffed website to vet millions of postings would be impractical. Chi. Lawyers' Comm. for Civil Rights Under Law, Inc. v. Craigslist, Inc., 519 F.3d 666, 668–89 (7th Cir. 2008).

237. DARIO MILO, DEFAMATION AND FREEDOM OF SPEECH 216 (2008) (internal citations omitted).

F. A Proposed Solution to Zeran*'s Distributor Liability Problem:A Notice-and-Take-Down Statute Modeled on the Digital Millennium Copyright Act*

One solution proposed by a few commentators[238] and courts[239] involves enacting legislation containing "notice-and-take-down" provisions modeled upon the Digital Millennium Copyright Act (DMCA).[240] Relevant provisions of the DMCA provide a liability shield for websites and ISPs for copyright-infringing content posted by third parties, but only if they do not have "actual knowledge that the material or an activity using the material on the system or network is infringing" and are "not aware of facts or circumstances from which infringing activity is apparent," and "upon obtaining such knowledge or awareness, [they act] expeditiously to remove, or disable access to, the material."[241] The DMCA also provides for notification procedures for plaintiffs, including a requirement that the complainant be authorized to act on behalf of the owner of the allegedly infringed copyright and a requirement that a notice of claimed infringement include a statement verifying its accuracy.[242] An analogous statute concerning liability for hosting defamatory third-party content would preserve liability upon notice, and would have the advantage of vetting meritless claims. The statute would preserve a limited safe harbor for websites and ISPs that were initially ignorant of and played no role in creating defamatory or otherwise offensive postings, but would also give websites incentives to remove offending postings.

However, imposing such a statutory regime for preserving distributor liability would involve significant practical challenges. Copyright infringement and defamation, while they may occur through similar means online, are very different in nature. While copyright results from a delineated federal statutory scheme administered exclusively by federal courts, defamation is a common law creature that does not enjoy the same uniformity. Although the constitutional limits on defamation law partially mitigate this problem, a DMCA-like statute, while creating a uniform federal ap-

238. *See, e.g.*, Medenica & Wahab, *supra* note 89, at 239 (2007); David E. Hallett, *How to Destroy a Reputation and Get Away With It: The Communications Decency Act Examined: Do the Policies and Standards Set Out in the Digital Millennium Copyright Act Provide a Solution for a Person Defamed Online?*, 41 J. L. & TECH. 259, 278 (2001).

239. *See, e.g.*, Batzel v. Smith 333 F.3d 1018, 1031–32 n.19 (9th Cir. 2003).

240. Digital Millenium Copyright Act, Pub. L. No. 105-304, 112 Stat. 2860 (1998) (codified as amended in scattered sections of 17 U.S.C.).

241. 17 U.S.C. § 512 (c)(1)(A)(i)–(iii) (2006).

242. *Id.* § 512(c)(3)(A)(vi).

proach, would also invite the invocation of different states' substantive laws. It might require websites to comply more fully with the defamation laws of multiple jurisdictions, undoing the advantage of uniformity that section 230's liability shield currently provides. While websites must ostensibly contend with states' defamation law now, courts' interpretations of section 230 have rendered them immune in most circumstances. Uniformity prevails, if only in the form of a shield from different states' defamation laws. On the Internet, legal uniformity has enormous practical advantages. Michael L. Rustad and Thomas H. Koenig write that the "e-business community will be handicapped if it is subject to multiple conflicting procedural and substantive ground rules."[243] One commentator highlights another potential problem, writing that "[i]t is easier to establish who holds a copyright than whether a statement is defamatory."[244] Lastly, perhaps the biggest practical problem with "these DMCA-like distributor liability proposals is that they generally require Congress to act and amend the CDA."[245]

G. A Proposal: A Judicially-Created Objective Bad Faith Exception

An implied bad faith exception to section 230 immunity for distributors of defamatory content would allow more plaintiffs with meritorious claims to prevail, and would be easier to implement and administer. The exception would prevent websites and ISPs from asserting section 230 immunity if they acted unreasonably in either posting or failing to remove defamatory content. While bad faith operates to undermine a party's defenses in some other contexts,[246] courts evaluating section 230 claims usually refuse to inquire into the behavior of the Internet entity hosting allegedly defamatory content.[247]

However, some courts have taken steps, albeit limited ones, in the direction of recognizing this exception. Most recently, in *Roommates*, the Ninth Circuit ruled that a website that matched prospective roommates could not claim section 230 immunity because it required users to answer impermissible questions in violation of the

243. Michael L. Rustad & Thomas H. Koenig, *Harmonizing Internet Law: Lessons from Europe*, 9 No. 11 J. INTERNET L. 3, 7 (2006).

244. Miller, *supra* note 215, at 239.

245. *Id.* at 240.

246. *See, e.g.*, WILLIAM J. HOLLOWAY & MICHAEL J. LEECH, EMPLOYMENT TERMINATION: RIGHTS AND REMEDIES 101–02 (2d ed. Supp. 2003).

247. *See, e.g.*, Blumenthal v. Drudge, 992 F. Supp. 44, 49 (D.D.C. 1998); Global Royalties, Ltd. v. Xcentric Ventures, LLC, 544 F. Supp. 2d 929, 933 (D. Ariz. 2008).

Fair Housing Act.[248] While the court did not explicitly rule on the question of distributor liability or defamation law, holding that the website became an "information content provider" because it "created content," the court indicated that there are limits to the control that websites may have over third-party content if they are to claim section 230 immunity: "The Communications Decency Act was not meant to create a lawless no-man's land on the Internet."[249] *Roommates* suggests that courts may be willing to police the boundaries of section 230 immunity, and that a bad faith exception does not present a great doctrinal obstacle. Taking the court at its word that it did not inquire into the merits of the underlying discrimination claims,[250] its analysis might apply to a website such as Ripoff Report that seems to invite defamatory content. Although the *Global Royalties* court ruled that Ripoff Report enjoyed immunity because it did not solicit *particular* defamatory content, future courts might reject this analysis as overly formalistic, focusing instead on the site's apparent awareness of the offending material.

One commentator has proposed a narrow, "mens rea-based" exception to section 230 immunity to address the distributor liability problem, which would hold an online entity liable when it intends to create "an identifiable space . . . overwhelmingly filled with some identifiable kind of illegal content."[251] While subjective intent will often be implicit in a determination of a web entity's acting in bad faith, an objective bad faith standard is more comprehensive and easier to administer. In the insurance context, where the doctrine is the most fully developed, bad faith is essentially a reasonableness standard.[252] Adapted for purposes of defamation law on the Internet, a website or ISP acts unreasonably if it either allows defamatory content postings or fails to remove them once notified. While this language sounds of negligence, the bad faith standard

248. Fair Hous. Council of San Fernando Valley v. Roommates.Com, 521 F.3d 1157, 1175 (9th Cir. 2008).

249. *Id.* at 1164. The court suggested that there may be limitations on section 230 immunity that depend the subject matter of the underlying claims, writing that Internet businesses "must comply with laws of general applicability." *Id.* at 1164 n.15.

250. Judge McKeown's dissent posited that the majority's holding that Roommates.Com was not immune from suit resulted from its apparent conclusion that the website's conduct violated the Fair Housing Act. *Id.* at 1178 (McKeown, J., dissenting).

251. *Federal District Court Denies § 230 Immunity*, *supra* note 10, at 2248–49.

252. Wisconsin, for example, defines the procedural contours of the doctrine: "[B]ad faith can be alleged only if the facts pleaded would, on the basis of an objective standard, show the absence of a reasonable basis for denying the claim. . . ." Anderson v. Cont'l Ins. Co., 271 N.W.2d 368, 376–77 (Wis. 1978).

would rely on *affirmative* acts such as failure to remove an obviously defamatory posting, making the effective level of culpability higher. Instead of relying on malicious intent, which is difficult to show, courts could apply this flexible standard based on all of the circumstances of the case before deciding whether the website or ISP is entitled to section 230 immunity.[253] This would inject the equitable consideration of the defendant's conduct into the court's decision, allowing the plaintiff a chance to defeat the claim of immunity while still preserving it in many circumstances. Only particularly egregious conduct would trigger liability. Although the standard would necessarily result in higher litigation costs for defendants, courts could still impose Rule 11 or analogous state-law sanctions to discourage frivolous claims while preventing online entities from "abusing" CDA immunity.

Without aggressive judicial action or an amendment to the CDA, overbroad immunity would persist and the exception may swallow the rule. As the Ninth Circuit did in *Roommates*, courts must take continued steps to constrain the reach of section 230(c)(1) immunity to defamation claims, and should go no further than extending it to those torts that implicate similar personal, reputation-type interests, such as invasion of privacy and infliction of emotional distress. Although *Roommates* illustrates that there are other avenues to limiting the subject matter of immunity, such as holding websites liable as primary publishers or as creators of content,[254] courts should confront this issue head-on.

First, courts should address whether to dismiss a plaintiff's claims on the merits before applying section 230's immunity provision. Too often, courts interpreting section 230 have addressed the question of entitlement to immunity before fully considering the merits of the substantive claims. This disciplined approach would reinstate section 230's rightful place as the exception, not the rule. Having a similar rationale to the canon of constitutional avoidance,[255] this approach would mandate that if a court can dismiss a claim on either section 230 grounds or its underlying merits, the court should choose to dismiss solely on the merits.[256]

253. Of course, the plaintiff would still have to make a prima facie showing of the underlying defamation claim before the court applies the bad faith standard.

254. *See Roommates*, 521 F.3d at 1175.

255. According to the canon, ambiguous statutes should be construed to avoid reaching constitutional questions. RICHARD E. LEVY, THE POWER TO LEGISLATE: A REFERENCE GUIDE TO THE UNITED STATES CONSTITUTION 129 (2006).

256. The District Court and Court of Appeals opinions in *Doe v. Sexsearch.com*, a 2008 case decided in the Sixth Circuit, respectively demonstrate the wrong and the right ways to apply this approach. The plaintiff in *Sexsearch* had sex with a

Second, before deciding whether an online entity is immune because of the type of entity it is or the type of role it played in disseminating illegal content, courts should consider whether section 230 should apply based on the theory of liability advanced by the plaintiff. Courts should first assess the nature of the harm the plaintiff alleges she suffered, and evaluate whether she claims defamation-type harms, like injury to reputation, invasion of privacy, and emotional distress. As discussed, the statute should be interpreted in light of its language, which clearly sounds in defamation law. Allowing certain claims that are close to textbook defamation will help clear up whether the plaintiff has artfully pleaded garden-variety tort claims in order to evade the proper boundaries of section 230. Courts should almost never dismiss other claims, such as allegations under civil rights laws or breach of contract claims, on section 230 grounds, for they are much too far removed from the tort of defamation. If those claims are meritless, they should be dismissed on the merits instead of by application of the statute.

CONCLUSION

After more than a decade, section 230 of the Communications Decency Act has become an Internet institution. The Internet has indeed "flourished . . . with a minimum of government regulation."[257] This laissez-faire attitude is reflected in the policies of the FCC, for example, which wields its limited regulatory power over the Internet sparingly.[258] Defendants invoking section 230 are quick to selfishly co-opt this anti-regulatory view, often implying that imposing liability in their case risks eroding free speech or sabotaging legitimate commercial interests.[259] These fears may be overblown.

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fourteen-year-old girl he met on an adult website and was prosecuted for unlawful sexual conduct with a minor. The girl had claimed to be eighteen in her Sexsearch "profile." He brought a variety of claims, including breach of contract (related to the website's terms of service agreement) and a variety of state-law negligence claims. The District Court dismissed his claims on the merits and also based upon section 230 immunity. The District Court opinion included a lengthy exposition of why section 230 precluded the plaintiff from advancing his wide array of claims. The Sixth Circuit, by contrast, ruled only on the merits, declining to reach issues pertaining to section 230. Doe v. Sexsearch.com, 551 F.3d 412, 415–16 (6th Cir. 2008).

257. 47 U.S.C. § 230(a)(4) (2006).

258. *See* Daniel L. Brenner, *Creating Effective Broadband Network Regulation*, 62 FED. COMM. L.J. 13, 14–15 (2010).

259. *See, e.g.*, Brief of Appellee Yahoo!, Inc. at 34–36, Barnes v. Yahoo, Inc., 570 F.3d 1096 (9th Cir. 2009) (No. 6:05-CV-926-AA).

As for re-establishing some version of distributor liability, the prospect of the rare plaintiff prevailing in a defamation action will not impose an undue burden on free speech. Courts will remain reluctant to impose ruinous liability on websites, and under the proposed bad faith exception to section 230 immunity, websites will predominantly lose immunity only as a result of their own unscrupulous conduct.

The case for restricting the subject matter of section 230 immunity is equally strong. Plaintiffs suing web entities over third-party content for ordinary tort and contract claims would have significant hurdles to climb even without section 230's safe harbor, since establishing vicarious liability is often difficult. And again, cases where defendants prevail will be limited to instances of web entities' more egregious misdeeds. One thing is for certain: unless courts narrow their interpretations of section 230, deserving plaintiffs will be without redress.