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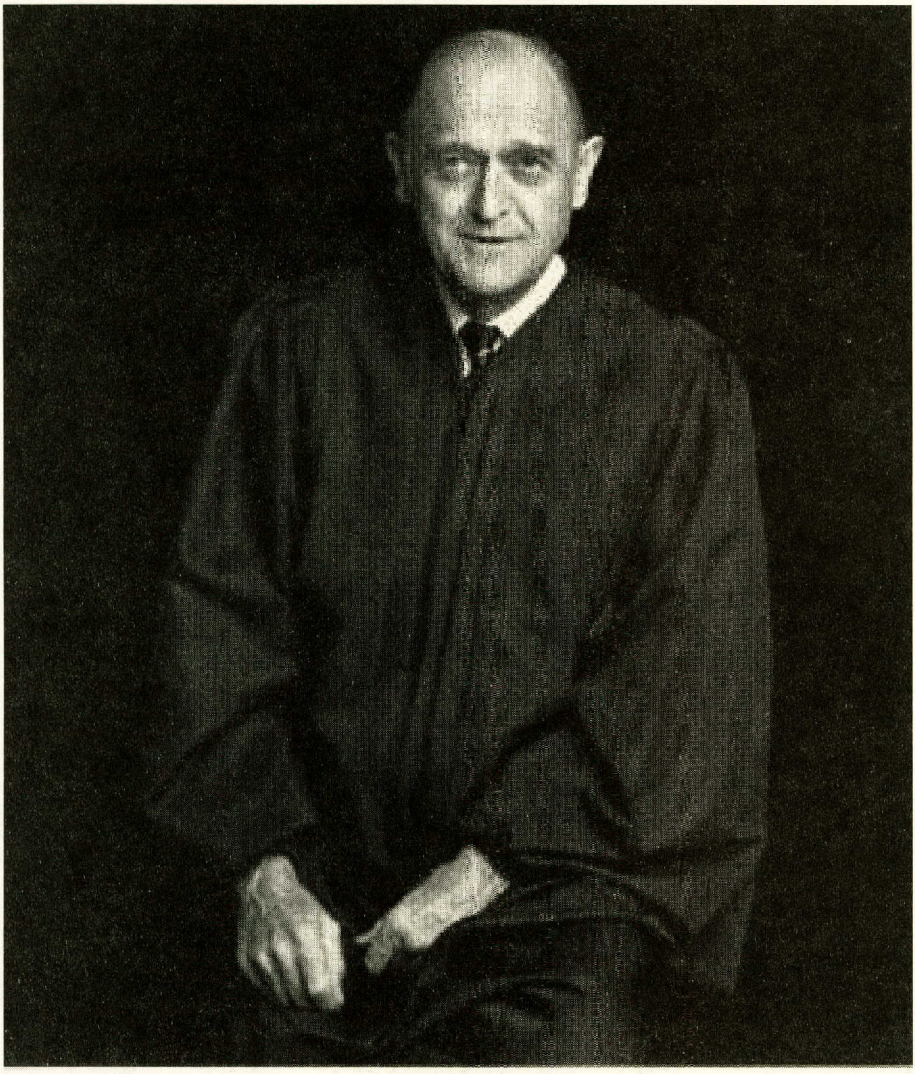
NOTES



WILLIAM WAYNE JUSTICE

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Texas Law Review

Volume 89, Number 1, November 2010

In Memoriam

William Wayne Justice

Keith P. Ellison*

For those of us who follow so very far behind him in the profession, Wayne Justice's life is both a rebuke and an exemplar. He was, easily, the most important Texas judge, arguably the most important Texan, of the twentieth century.

But, it is not his importance to which we aspire. Rather, it is the steadiness of purpose and clear-eyed courage with which he acquitted himself in doing a judge's job. Wayne and his beloved wife Sue endured almost incomprehensible vilification and threats, including two documented murder plots. Wayne both understood and demonstrated that which all judges need to understand: "Courage is not simply one of the virtues, but the form of every virtue at the testing point."[1]

In taking the vilification and confronting the danger that became career constants, Wayne was part of a noble and heroic pedigree—sons of the South who, on the bench, overcame regional, and even familial, habits of mind and made lasting contributions to racial progress. Indeed, Wayne may have represented the tradition's last living scion.

Among his earliest forbears, of course, was the first Justice John Marshall Harlan. Although he was from Kentucky and had been a slave owner, Justice Harlan provided the sole dissent from the Supreme Court's decision in *Plessy v. Ferguson*.[2] In the next generation, Circuit Judge James E. Horton, the son of a former slaveholder, in 1933 vacated the guilty verdict and death sentence imposed on Haywood Patterson, one of the Scottsboro Boys.[3] As Judge Horton well understood, his decision was certain to, and did, end his judicial career. In reflecting decades later on this fulcrum in his

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* United States District Judge, Southern District of Texas.

1. C.S. LEWIS, THE SCREWTAPE LETTERS 161 (HarperCollins 1996) (1942).
2. 163 U.S. 537, 552 (1896).
3. JACK BASS, UNLIKELY HEROES (1981).

career, Judge Horton invoked ancient wisdom, "*Fiat justicia ruat colelum*"—Let justice be done though the heavens may fall.[4]

Other judges within this sacred provenance were members of the old Fifth Circuit Court of Appeals, men whom Wayne knew well. Although the Supreme Court had pointed the way, the heavy lifting of integrating public schools in the South was done by appellate judges like John R. Brown of Texas, Richard Rives of Alabama, Elbert Tuttle of Georgia, John Minor Wisdom of Louisiana, and district judges like Frank Johnson of Alabama, and J. Skelly Wright of Louisiana.[5] All of them, except Judges Brown and Tuttle, had been raised in the South. All of them, like Wayne, and unlike some of their other colleagues, knew that racial oppression could not be squared with the Constitution. With decisive rulings they signaled that it was time for swift and irreversible change in the legal relations between blacks and whites. And, like Wayne, they were then left to face the consequences of their boldness without support, or even silent acquiescence, from their states' elected officials and their own neighbors.

Helping achieve school integration in Texas[6] is, however, only a part of Wayne's rich legacy in the law. He also wrote prescient and wildly unpopular opinions rectifying long-established abuses of those who, if possible, were possessed of even less political prowess than African-Americans. He invalidated a policy that required children of illegal immigrants to pay tuition to public schools that were free of charge to all other children,[7] forced the State to improve its penal institutions,[8] protected the State's detained juveniles[9] and mentally challenged citizens,[10] integrated public housing,[11] came to the defense of long-haired students who had been barred from admission by Tyler Junior College,[12] and defended free speech for union members,[13] students,[14] and hospital workers.[15]

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4. JOHN TEMPLE GRAVES, THE FIGHTING SOUTH 209 (1943).

5. Full disclosure is in order. I clerked for Judge Wright from 1976 to 1977 when he was on the D.C. Circuit Court of Appeals.

6. *See* United States v. Texas, 321 F. Supp. 1043 (E.D. Tex. 1970), *modified and supplemented*, 330 F. Supp. 235 (E.D. Tex. 1971), *aff'd in part, modified in part, and remanded*, 447 F.2d 441 (5th Cir. 1971); *see also* United States v. Tatum Indep. Sch. Dist., 306 F. Supp. 285 (E.D. Tex. 1969).

7. *See* Doe v. Plyler, 458 F. Supp. 569 (E.D. Tex. 1978), *aff'd*, 628 F.2d 448 (5th Cir. 1980).

8. *See* Ruiz v. Estelle, 503 F. Supp. 1265 (S.D. Tex. 1980), *aff'd in part and vacated in part*, 679 F.2d 1115 (5th Cir. 1982), *amended in part*, 688 F.2d 266 (5th Cir. 1982).

9. *See* Morales v. Turman, 364 F. Supp. 166 (E.D. Tex. 1973).

10. *See* Lelsz v. Kavanagh, 98 F.R.D. 11 (E.D. Tex. 1982), *appeal dismissed*, 710 F.2d 1040 (5th Cir. 1983).

11. *See* Young v. Pierce, 544 F. Supp. 1010 (E.D. Tex. 1982); *see also* Stephens v. City of Plano, 375 F. Supp. 985 (E.D. Tex. 1974).

12. *See* Lansdale v. Tyler Junior Coll., 318 F. Supp. 529 (E.D. Tex. 1970), *aff'd*, 470 F.2d 659 (5th Cir. 1972).

13. *See* Nash v. Texas, 632 F. Supp. 951 (E.D. Tex. 1986), *aff'd in part, rev'd in part sub nom.* Nash v. Chandler, 848 F.2d 567 (5th Cir. 1988), *reh'g denied*, 859 F.2d 1210 (5th Cir. 1988).

14. *See* Duke v. N. Tex. State Univ., 338 F. Supp. 990 (E.D. Tex. 1971), *rev'd*, 469 F.2d 829 (5th Cir. 1972).

Only a leap of faith enables other judges to believe all that this one judge accomplished. Juxtaposed with his career, our careers seem of little moment. On top of what he achieved, and no less impressive, is what he endured. He was denigrated as "the czar of Texas,"[16] "the real governor of Texas,"[17] "the law east of the Pecos,"[18] and "the most hated man in Texas."[19] One-sixth of the residents of Tyler, Texas, where Wayne made his professional home for three decades, signed a petition calling for his impeachment,[20] churches told him he would not be welcome there,[21] hateful words were spoken.[22] As hard as this was for Wayne, it was harder still for him to watch the effect on his wife Sue. As Wayne recounted, he worked in an office where his work met with approval, but Sue had to face hostility at every turn as she made her way among the public.[23]

As implied by the derisory titles with which Wayne's enemies labeled him, a large part of the criticism centered on an unelected judge having the temerity to override school officials, state employees, state legislators, and even the governor. But, if Wayne's jurisprudence is to be faulted on this ground, then surely we must also fault the U.S. Supreme Court where, in 1954, nine unelected justices declared unconstitutional school segregation throughout the country.[24] The answer to such critics is an obvious one—at least since *Marbury v. Madison*,[25] judges are charged with the awesome responsibility of invalidating laws that are found to be inconsistent with our Constitution. If criticism is to be made on such lines, it is criticism that must be directed at the entire concept of judicial review, not with the judges who take that responsibility to heart. And, no one doubted that Wayne took his responsibilities very much to heart.

Some commentators have found it helpful to compare judges with baseball players.[26] The baseball players to whom Wayne could be usefully compared are many. Joe DiMaggio is one possibility, a near contemporary who brought such uncommon grace to his work. Another is Jackie Robinson, the first African-American to play in the major leagues, who willingly took on derision, hate, and rejection as he strived, just as Wayne

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15. *See* Albright v. Good Shepherd Hosp., No. TY-850453-CA (E.D. Tex. 1988), *rev'd sub nom.* Albright v. Longview Police Dep't, 884 F.2d 835 (5th Cir. 1989).

16. Frank Klinko & Evan Moore, *Czar of Texas*, HOUS. CHRON., Jan. 11, 1987, at 1.

17. Paul Burka, *The Real Governor of Texas*, TEXAS MONTHLY, June 1978, at 113.

18. Mike Cochran, *Judge's Justice Makes Texans Talk—But He Won't*, EL PASO TIMES, Mar. 1, 1981, at 22A.

19. FRANK R. KEMERER, WILLIAM WAYNE JUSTICE: A JUDICIAL BIOGRAPHY (1991).

20. *Id.* at 94.

21. *Id.* at 95.

22. *Id.* at 94.

23. *Id.* at 96.

24. *See* Brown v. Bd. of Educ., 347 U.S. 483 (1954).

25. 5 U.S. (1 Cranch) 137 (1803).

26. Robert M. Cover, *Your Law—Baseball Quiz*, N.Y. TIMES, Apr. 5, 1979, at A23.

did, to tear down a racial barrier that never should have been erected. But, in the end, my vote as the best baseball counterpart to Wayne goes to two players from very different eras, Lou Gehrig and Cal Ripken, Jr. As is known by every Little Leaguer, these men are, by a huge margin, the players who compiled the two longest consecutive-games-played streak in baseball annals. Like Wayne, they played when they were hurt, they played when they were ill, they played when opposing teams seemed stronger, they played when all seemed lost, and they were at their best when the stakes were highest.

History is, of course, every judge's judge. No judge's merits or demerits can be fairly tallied when decisions are first made and opinions first issued. But, we can place our bets. My bet is that Wayne will be judged to have repeatedly been right and, eventually, to be seen as the preeminent Texas judge of all time, going back well before statehood. Even with the passage of only two or three decades, it seems abundantly obvious that Wayne, rather than his enemies, was correct in his decisions in favor of African-American school children and in favor of so many of the disenfranchised to whom society offered no voice and little future. Wayne will be vindicated just as Justice Harlan has been, and just as have all those whom we count in this heroic lineage. Far from having violated his judicial oath, I think no judge ever showed more fidelity to it.

His life calls to mind the words of F. Scott Fitzgerald in describing one of his contemporary heroes: He "did a heroic thing, and for a moment people set down their glasses in country clubs and . . . thought of their old best dreams."[27] Wayne's life stands as a solemn reminder of the reasons all of us went to law school, of why our youthful idealism must not be attenuated, of the genius of the Constitution, of all that has been accomplished in achieving justice, and of all that remains to be done. We ask blessings upon his memory.

27. F. SCOTT FITZGERALD, THE CRACK-UP (Edmund Wilson ed., New Directions 1993) (1936).

Such a Good Guy

T. John Ward*

Judge Justice served in the Eastern District for thirty years. For seven years he was Chief Judge. I write primarily from the perspective of a lawyer who practiced before Judge Justice for thirty years. My first appearance before Judge Justice was in July of 1968 after being in the practice of law for six months. I did not know it at the time, but I later learned it was the first hearing he presided over as U.S. District Judge. I can assure you that it was a much more memorable occasion for me than him.

I was never an attorney in one of the landmark cases that Judge Justice became so well known for, but his decisions had a significant impact on me. Early on I recognized that he was having a profound positive effect on the lives of a large number of people who had previously had no meaningful access to our justice system. Judge Justice brought about profound fundamental changes in policies at all levels of government.

Many of these decisions were very unpopular among a large number of the local population. Judge Justice and his family were subjected to insults and indignities that should not occur in a civilized society. He was undaunted and continued his dedicated performance as a U.S. District Judge. He set the gold standard for all who came after him.

I consider him to be one of the most courageous public servants of my entire professional career.

Judge Justice was fiercely dedicated to the preservation of the Rule of Law. When you appeared before him, you knew you would be treated fairly and the law would be applied evenly and without favor. He believed in the Constitution. Judge Justice always did what he thought was right in accordance with his understanding of the law. That will be a significant part of his legacy.

In the courtroom he could be a tough taskmaster. As long as you were prepared, candid with him, and followed the rules, times were good. However, if you failed to follow his rules you would hear those words—"counsel approach"—and if by the time you reached the bench the top of his head was taking on a shade of red, well, you knew no good was going to come of this. He would not tolerate incivility in the courtroom and insisted on the highest degree of professionalism from those lawyers appearing before him.

Judge Justice loved the legal profession and strongly believed it to be a noble profession. He really liked lawyers. He had a very compassionate side and a wonderful sense of humor.

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* United States District Judge, Eastern District of Texas.

In the early 1970s, I was introduced to Leighton Cornett who had served as First Assistant U.S. Attorney under Judge Justice when he was U.S. Attorney for the Eastern District of Texas.

A part of that conversation is indelibly imprinted on my memory, and I hope it illuminates some of my impressions of Judge Justice.

Mr. Cornett: "I just wanted to meet the man who filed a motion for continuance based upon the fact that the Monday trial setting was immediately following the opening of quail season on Saturday—and—lived to tell about it." To which I replied: "Not only did I live to tell about it, but I got the two weeks continuance I requested."

Judge Leonard Davis was President George W. Bush's first appointment to the Eastern District in 2002. On the date of Judge Justice's death, we had a phone conversation about Judge Justice. Judge Davis had previously related an exchange that he had when he appeared before Graham Hutchison committee before his nomination by President Bush.

One of the questions to then Mr. Davis was, "Who is the judge you most admire?" and he responded Judge William Wayne Justice. Given the political makeup of the committee, he had some explaining to do. He ended his explanation to the committee the same way he ended our phone conversation when he said, "Judge Justice was just such a great guy," and he shall always be remembered as such by this writer.

A Tribute to Judge William Wayne Justice

Morris S. Dees*

Judge Justice. Rarely has a name so perfectly defined the individual upon whom it was bestowed. To countless residents of Texas who were the victims of discrimination, deprivation, neglect, or abuse, William Wayne Justice was their only chance for justice.

Judge Justice was the only child of a former school teacher and a flamboyant and highly successful criminal trial lawyer in East Texas. Unlike his father, the future judge was a rather shy and retiring lifelong bookworm whose childhood was marred by poor health. Active participation in politics resulted in an appointment as U.S. Attorney of Texas and then a 1968 presidential appointment to the U.S. District Court for the Eastern District of Texas, sitting in the picturesque little city of Tyler. To the casual observer, it was just another example of middle class success and certainly no threat to the established status quo. Nothing could have been further from reality.

Although never himself the victim of discrimination or deprivation, he possessed deeply held humanitarian views and readily identified with the plight of the oppressed.

Judge Justice's legacy began in 1970 when he ordered the State of Texas to finally end racial segregation in public schools, impacting over 1,000 school districts and 2 million school children statewide.

In 1977, the judge ordered Texas to provide free education for illegal immigrants and their children.

In 1980, Judge Justice ordered an exhaustive overhaul of the Texas prison system in order to address overcrowding, inadequate medical care to inmates, severe understaffing, and official toleration of rampant violence among inmates and between guards and inmates.

Other rulings by Judge Justice forced improvements to the Texas juvenile justice system, dismantled racial barriers in public housing, expanded voting opportunities, and provided bilingual education to immigrant children. In short, as the late columnist Molly Ivins said, "Judge Justice lived up to his name and brought the United States Constitution to Texas."

As with all great men, Judge Justice, and his family, paid a price for his heroic decisions. The Justices were social outcasts in their own community. Repair people refused to work in his home, patrons exited restaurants where the Justices entered, thousands of his neighbors signed a petition for his

* Founder & Chief Trial Counsel, Southern Poverty Law Center, Montgomery, Alabama.

impeachment, and he was continually referred to as "the most hated man in Texas." Through it all, he calmly stayed the course.

On a personal note, my most memorable contact with Judge Justice came in 2006 in New York City when I presented him with the "Morris Dees Justice Award." This award was created in my name by the international law firm of Skadden, Arps, Slate, Meagher & Flom and the University of Alabama School of Law, to be given annually to a lawyer who has devoted his career to serving the public interest and pursuing justice, and whose work has brought about positive change in the community, state, or nation. In making the presentation, I told the Judge and those assembled that I had never met anyone in the legal profession more deserving of such a recognition and that had it been left to me, it would have been named the "William Wayne Justice Award."

In requesting these words of tribute, the Texas Law Review asked me to provide a perspective of Judge Justice's impact on national civil rights issues. Obviously, many of Judge Justice's rulings in Texas have become models for progressive reform across the nation and some were the basis for U.S. Supreme Court decisions that positively impacted the country as a whole. These speak for themselves. For me, the judge's greatest legacy to the nation is that a single individual armed with decency, perseverance, and moral courage working within our system of justice can change the conscience of the nation. That is exactly what William Wayne Justice did and Texas and the nation are much the better for it.

Our Hero

Lawrence G. Sager*

Some legal thinkers are inclined to devalue the importance of judges charged with the enforcement of our Constitution, even in times of tumultuous change in the name of the Constitution. Some insist that meaningful change originates in the commitments and concerns of political elites; others see change as bubbling up from below, in the cauldrons of social movements. In either account, judges are at most handmaidens, not protagonists.

Views of this sort are not likely to enjoy the assent of those thousands upon thousands of school children, prisoners, and persons involuntarily institutionalized as developmentally disabled, whose lives were indelibly changed for the better by the insistence of Judge William Wayne Justice that principles of equality and human dignity prevail in the public institutions that fell under his constitutional gaze. Nor are those who admired, indeed, loved Judge Justice for his relentless pursuit of those principles—or those who despised him for the same reason—likely to be drawn to the view that his career on the bench was merely an echo of extrajudicial forces.

William Wayne Justice made a staggering difference in the lives of persons who desperately needed his help, and he did so under circumstances that made him and his wife pariahs in their community. He had the moral imagination, the generosity of spirit, and the courage to be guided by the compass of the Constitution, however treacherous the seas that he was required to traverse. He was, quite simply, a hero.

At The University of Texas School of Law, we have created the William Wayne Justice Center for Public Interest Law, and under the umbrella of the Justice Center we have launched a robust pro bono program to match our students with public interest legal enterprises; we have arranged and supported student fellowships and internships that focus on service in the public interest; we have launched a Loan Repayment Assistance Program for students who pursue public service, as well as a number of public service linked scholarships. Inspired in no small part by Judge Justice's example, we have shaped a curriculum congenial to public service, with seventeen distinct student clinics that together enjoy the enrollment of over half of our student body. Withal, we have graduated a generation of students to whom the concept of justice under law is both familiar and attractive.

William Wayne Justice's life has been for us an important source of direction and conscience. We are very fortunate to have him as our hero.

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* Dean, John Jeffers Research Chair in Law, and Alice Jane Drysdle Sheffield Regents Chair in Law, The University of Texas School of Law.

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Reflections: The Honorable William Wayne Justice†

Heather K. Way*

I had the good fortune of serving as a law clerk for William Wayne Justice. For the ninety-five or so of us who clerked for Judge Justice over his long career, Judge was not only our boss, our mentor, and our friend—he was our family. He and his wife Sue welcomed us into their home and made us one of their own.

What first drew us in as clerks for Judge in Tyler, and then in Austin, was Judge's legendary commitment to the politically disenfranchised, his fidelity to the U.S. Constitution in the face of zealous political opposition, and his steadfast courage to wipe out bigotry and brutality from our political institutions.

As it turned out, what made clerking for Judge such a watershed event in our lives was the impact he had on our hearts and souls. Working for Judge was the opportunity of a lifetime, not only to work for one of the greatest trial judges of all generations, but also to work for one of the greatest persons. While he did teach us about the law at its best, he also taught us about how to be decent human beings.

This is true for everyone who had the good fortune to befriend this kind, generous, and loving man. People could not help but be drawn to Judge's warmth, his wit, his infectious laughter, and his joyful embrace of life's offerings, which included Texas barbeque, soul food restaurants that served oxtail and sweet potato pie, enormous unabridged dictionaries, and sports cars. Most importantly, he embraced and loved his family and his work as a lawyer and a judge—which is why even into his late 80s he was still hearing cases.

The word Judge Justice liked best to describe himself was "populist." The word was emblazoned for many years on the coffee mug he used during our daily 8 a.m. ritual when staff would gather, oftentimes joined by Judge's friends, to share East Texas folklore, the latest UT football scores, and colorful memories from prior cases.

For Judge, at his core, being a populist meant embracing all people and treating them with equal respect and kindness. Whether he was presiding over a trial or greeting someone at the post office, he was genuinely

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† These reflections are adapted from the eulogy delivered at Judge Justice's funeral on October 19, 2009, at St. David's Episcopal Church in Austin, Texas.

* Director, Community Development Clinic, J.D. 1996, The University of Texas School of Law. Special thanks to Judge Justice's extended law clerk family for sharing their favorite remembrances of Judge Justice with me and assisting in the preparation of his eulogy.

interested in the lives of all he met. He embraced their struggles, their quirks, their humanity.

Judge introduced his clerks to these principles of populism from day one, during our clerkship interviews. These interviews began with Judge picking us up at 6 a.m. from our Tyler motel and driving us over to Dee's Diner, where we would watch his eyes light up as he exchanged greetings with the local wait staff. Even as his fame as a judge grew, he remained the most modest man who was simply incapable of pretension; his attention always remained focused on others.

Judge's populism and compassion for humanity served as an anchor and moral compass in all that he ever did. As an attorney and a judge, it meant that our legal system did not work unless it worked for everyone, rich or poor. As Judge once said, "The law ought to be decent, if nothing else. It ought to afford justice."[1] He never once yielded these principles. And that is why, in every single matter ever presented to his court, he demanded and vigorously pursued a just result.

During our clerkships, we quickly learned that the petition scrawled out on scrap paper by a pro se petitioner was to receive the same due attention as a carefully crafted case filed by a big law firm. Judge also made sure that all parties were treated with dignity in his courtroom, which meant sending clerks out to buy a button-down shirt from the local Walmart for a defendant who could not afford one.

Nowhere was Judge's compassion for people more evident than when he was around his clerks' children—who were known as the "grand clerks." When you brought a grand clerk to visit Judge, you could easily find yourself deeply engaged in political discourse with Judge when he would suddenly break out into a game of peek-a-boo, flapping his hands over his eyes and yelling out, "Pee-Paw." One grand clerk who was attending preschool announced one day to her parents that she had learned the Pledge of Allegiance. When she attempted to recite this feat and got to the last phrase, she said quite eloquently, "with liberty and Judge Justice for all."

Three years ago Judge Justice told a newspaper reporter, "I hope people remember me for someone trying to do justice. That's what I tried to do."[2] I will indeed remember Judge for doing just that and so much more. Even though I grieve Judge Justice's passing and the loss of his friendship, I find cause for joy in knowing that his impact on this country and our lives continues. He has been an inspiration and role model to generations of lawyers to stay true to what we believe in, and how to do so with humility, passion, and grace.

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1. Laura Richardson & Jo Clifton, *William Wayne Justice: An Interview*, TEXAS OBSERVER, Jan. 20, 1978, at 5.

2. Franisco Vara-Orta, *"Activist" Judge Still Battling Injustice*, AUSTIN AMERICAN-STATESMAN, Aug. 12, 2006, at A1.

And we will do our best, although it will not be good enough, to teach our children and grandchildren to strive for the same high standards of integrity, commitment to justice, and respect for others.

* * *

Articles

Insulating Agencies: Avoiding Capture Through Institutional Design

Rachel E. Barkow*

So-called independent agencies are created for a reason, and often that reason is a concern with agency capture. Agency designers hope that a more insulated agency will better protect the general public interest against interest group pressure. But the conventional approach to independent agencies in administrative law largely ignores why agencies are insulated. Instead, discussions about independent agencies in administrative law have focused on three features that have defined independent agencies: heads who are removable for cause by the President, an exemption from having to submit regulations to the President's Office of Information and Regulatory Affairs for cost–benefit analysis, and a multimember structure.

But these traditional characteristics of an independent agency are not the only, or necessarily even the most effective, ways in which insulation from interest groups and partisan pressure can be achieved. In fact, under modern conditions of political oversight, other design elements and mechanisms are often just as important if the goal is to create an agency that is best suited to achieve a long-term public-interest mission free from capture. This is particularly true of agencies tasked with protecting the general public in the face of one-sided and intense political pressure. This kind of lopsided pressure can be seen in a range of areas, from criminal justice to consumer protection.

The goal of this Article is to move the conversation about insulation beyond the traditional hallmarks of independence and identify overlooked elements of agency design, deemed "equalizing factors," that are particularly well-suited to addressing the problem of capture in the context of asymmetrical political pressure. The Article identifies five such equalizing factors that have received little or no attention in the legal literature on independent agencies but that are critically important for insulation against one-sided interest group dominance. The Article then compares the effectiveness of traditional and equalizing factors in the context of consumer

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* Professor of Law and Faculty Director, Center on the Administration of Criminal Law, NYU School of Law. Thanks to Nick Bagley, Anthony Barkow, Jacob Gersen, Daniel Ho, Mike Livermore, Rick Pildes, Cristina Rodriguez, and the participants in the Furman Workshop at NYU and the Yale Law Women Workshop for their helpful comments and conversations. Thomas Bennett, Kirti Datla, David Edwards, Jonathan Grossman, David Lin, and Darryl Stein provided exemplary research assistance. I acknowledge with gratitude the financial support of the Filomen D'Agostino and Max E. Greenberg Faculty Research Fund at NYU.

protection, an area with the kind of one-sided interest group pressure that is a breeding ground for capture. The Article explores the relationship between the institutional design of the Consumer Product Safety Commission and its effectiveness and uses those lessons to analyze the Bureau of Consumer Financial Protection, the most significant new federal agency created in decades. This analysis of consumer protection regulatory agencies showcases both the continuing danger of capture and the critical importance of institutional design in policing it.

Introduction

According to the existing legal literature and case law, the defining hallmark of an independent agency is that it is headed by someone who cannot be removed at will by the President but instead can be removed only for good cause.[1] This one design feature has spawned countless law review articles about the meaning of separation of powers, the nature of the unitary executive, and the constitutional pedigree of the New Deal and the explosion of agencies with this attribute.[2] The Supreme Court and lower courts have considered the removal question at length, with the latest chapter coming last Term when the Court held that it was unconstitutional for Congress to place "dual for-cause limitations on the removal" of members of the Public Company Accounting Oversight Board (PCAOB) by vesting the removal power in the Securities and Exchange Commission (SEC), whose members

1. *See, e.g.*, Jacob E. Gersen, *Designing Agencies*, *in* RESEARCH HANDBOOK ON PUBLIC CHOICE AND PUBLIC LAW 333, 347 (Daniel A. Farber & Joseph O'Connell eds., 2010) ("Independence is a legal term of art in public law, referring to agencies headed by officials that the President may not remove without cause."); Marshall J. Breger & Gary J. Edles, *Established by Practice: The Theory and Operation of Independent Federal Agencies*, 52 ADMIN. L. REV. 1111, 1138 (2000) ("The critical element of independence is the protection—conferred explicitly by statute or reasonably implied—against removal except 'for cause.'"); Lisa Schultz Bressman & Robert B. Thompson, *The Future of Agency Independence*, 63 VAND. L. REV. 599, 610 (2010) ("[W]hat gives agencies their independence or what otherwise distinguishes them from their executive-branch counterparts [is that] the President lacks authority to remove their heads from office except for cause.").

2. For a sampling of this vast literature, see STEVEN G. CALABRESI & CHRISTOPHER S. YOO, THE UNITARY EXECUTIVE: PRESIDENTIAL POWER FROM WASHINGTON TO BUSH (2008); Steven G. Calabresi & Saikrishna B. Prakash, *The President's Power to Execute the Laws*, 104 YALE L.J. 541 (1994); Steven G. Calabresi & Kevin H. Rhodes, *The Structural Constitution: Unitary Executive, Plural Judiciary*, 105 HARV. L. REV. 1153 (1992); Stephen L. Carter, *Constitutional Improprieties: Reflections on* Mistretta, Morrison, *and Administrative Government*, 57 U. CHI. L. REV. 357 (1990); Harold J. Krent, *From a Unitary to a Unilateral Presidency*, 88 B.U. L. REV. 523 (2008); Gary Lawson, *The Rise and Rise of the Administrative State*, 107 HARV. L. REV. 1231 (1994); Lawrence Lessig & Cass R. Sunstein, *The President and the Administration*, 94 COLUM. L. REV. 1 (1994); Lee S. Liberman, Morrison v. Olson*: A Formalistic Perspective on Why the Court Was Wrong*, 38 AM. U. L. REV. 313 (1989); Geoffrey P. Miller, *Independent Agencies*, 1986 SUP. CT. REV. 41; Richard J. Pierce, Jr., *Saving the Unitary Executive from Those Who Would Distort and Abuse It: A Review of* The Unitary Executive, *by Steven G. Calabresi and Christopher S. Yoo*, 12 U. PA. J. CONST. L. 593 (2010).

themselves cannot be removed by the President except for cause.[3] The Court divided five to four and produced more than 100 pages on the subject.[4]

The obsessive focus on removal as the touchstone of independence is curious because insulation from the President is often not the dominant reason why policy makers seek to create independent agencies in the first place. Rather, the goal of insulation is frequently to allow an agency to protect the diffuse interest of the general public or a vulnerable segment of the public that, because of collective action problems or resource limitations, is often outgunned in the political process by well-financed and politically influential special interests. The insulated agency, its designers hope, will better resist short-term partisan pressures and instead place more emphasis on empirical facts that will serve the public interest in the long term. Put another way, the creation of an independent agency is often motivated by a concern with agency capture.[5]

What the conventional discussion of administrative law and agency design has overlooked is that the traditional metrics for an independent agency are not the only, or necessarily even the most effective, ways in which insulation from interest groups and partisan pressure can be achieved. In fact, under modern conditions of political oversight, other design elements and mechanisms are often just as important to an agency's ability to achieve its long-term mission relatively free from capture. This is particularly true of agencies tasked with protecting the interests of politically powerless groups, including the dispersed general public, where the political pressure to rule for more powerful, organized interests will be intense and one-sided.[6]

The goal of this Article is to move the conversation about insulation beyond the traditional independent agency structure of a multimember commission with for-cause removal protection and address overlooked elements of agency design that are particularly well-suited to addressing the problem of capture when interest groups line up on one side of an issue. This kind of lopsided pressure can be seen in a range of areas, from criminal justice to consumer protection.[7] Recent major events—from the failure of

3. Free Enter. Fund v. Pub. Co. Accounting Oversight Bd., 130 S. Ct. 3138, 3147–48, 3151, 3154–55 (2010).

4. *Id.* at 3146.

5. MANCUR OLSON, THE LOGIC OF COLLECTIVE ACTION 3 (2d ed. 1971) (defining capture).

6. *See* Nicholas Bagley & Richard L. Revesz, *Centralized Oversight of the Regulatory State*, 106 COLUM. L. REV. 1260, 1285 (2006) ("[More recent explanations of agency capture] look to how agencies cooperate with interest groups in order to procure needed information, political support, and guidance; the more one-sided that information, support, and guidance, the more likely that agencies will act favorably toward the dominant interest group."). This Article focuses on the question of one-sided interest group pressure. If there are powerful interests on different sides of an issue (for example, labor versus management or competing industry groups fighting over antitrust policy), different design strategies may come into play.

7. *See* Rachel E. Barkow, *Administering Crime*, 52 UCLA L. REV. 715, 730 (2005) (describing one-sided pressures toward harsher punishments in criminal justice and analyzing how effective

banking agencies to guard against lending abuses[8] to the Minerals Management Service's lack of oversight of offshore drilling that led to the British Petroleum disaster[9]—make clear that addressing capture remains an urgent need. The brightest prospect for doing so lies in intelligent agency design that moves beyond the simple focus on presidential removal decisions and other traditional features of agency independence.

The Article begins in Part I by identifying the main reasons why policy makers seek to create independent agencies in the first place, highlighting that a concern with agency capture and lopsided partisan and interest group pressure has been a driving force. Part II then explores the traditional factors associated with independent agencies. Removal protection for agency heads is the touchstone, but independent agencies are also typically characterized by their multimember structure and the fact that, unlike executive agencies, they do not have to submit cost–benefit analyses of proposed rules for review by the President's Office of Information and Regulatory Affairs. Part II explains the relationship between these traditional characteristics and the goal of limiting capture and one-sided political pressure. Part III then goes beyond the conventional mechanisms to address additional design features that have largely gone under the radar of administrative law scholarship. These features are an agency's funding source; qualifications for appointment and post-employment restrictions for agency officials; the agency's relationship with other federal agencies; the agency's relationship with state-level actors; and various political tools, including the agency's ability to generate politically powerful information, its ability to recruit political benefactors, and the potential for public advocates to become part of the agency structure. Part III argues that these factors, deemed "equalizing factors," are more robust checks against agency capture under asymmetrical political conditions than the use of traditional factors alone.

To illustrate the limits of the traditional factors and the promise of the equalizing factors, Part IV focuses on consumer-protection agencies, where capture is a significant threat because the public interest is pitted against one-sided powerful interest group pressure. The creation this year of the Bureau of Consumer Financial Protection (CFPB)—the most important federal agency created in decades and one charged with the Herculean task of regulating the financial services industry to protect consumers—provides an ideal case study for considering the importance of institutional design. The structure of the CFPB was the subject of heated debate in Congress, and its ultimate success or failure will likely depend on whether the agency is, in

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different agency designs have been in neutralizing those pressures); *infra* Part III (analyzing interest group dynamics in consumer regulation).

8. Patricia McCoy, *Another View: The Best Way to Protect Borrowers*, N.Y. TIMES DEALBOOK BLOG (Mar. 8, 2010), http://dealbook.blogs.nytimes.com/2010/03/08/another-view-the-best-way-to-protect-borrowers.

9. Ian Urbina, *Inspector General's Inquiry Faults Actions of Federal Drilling Regulators*, N.Y.TIMES, May 25, 2010, at A16.

fact, sufficiently insulated against industry pressure. In addition, the CFPB follows in the footsteps of the Consumer Products Safety Commission (CPSC), an agency that provides vivid proof of the limits of the traditional hallmarks of agency independence. Part IV thus considers how agency design affected the CPSC's function, and how it will likely influence the work of the CFPB. This Article thus provides one of the first in-depth studies of the new CFPB. Part V concludes.

I. Why Insulation

"From the perspective of institutional design," as Jacob Gersen recently noted, "the optimal bureaucratic structure depends on the ends to be achieved."[10] This is a critical point to keep in mind in thinking about independent agencies and their design, as one cannot begin to think about what makes an agency independent without thinking about what the agency is supposed to be independent of.

The main aim in creating an independent agency is to immunize it, to some extent, from political pressure.[11] But that, in turn, raises the question of why political pressure would be bad. After all, one person's political pressure is another person's democratic accountability. What policy makers who seek insulation want to avoid are particular pitfalls of politicization, such as pressures that prioritize narrow short-term interests at the expense of long-term public welfare. This Part explores the different goals of insulation and the particular political shortcomings it seeks to avoid.

A. Expertise and Nonpartisan Decision Making

The classic explanation for agency independence is the need for expert decision making.[12] New Deal architect and administrative law scholar James

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10. Gersen, *supra* note 1, at 334.

11. *See* Marshall J. Breger & Gary J. Edles, *Established by Practice: The Theory and Operation of Independent Federal Agencies*, 52 ADMIN. L. REV. 1111, 1113 (2000) ("They are 'independent' of the political will exemplified by the executive branch, yet they are also multimember organizations, a fact that tends toward accommodation of diverse or extreme views through the compromise inherent in the process of collegial decisionmaking."); Neal Devins & David E. Lewis, *Not-So Independent Agencies: Party Polarization and the Limits of Institutional Design*, 88 B.U. L. REV. 459, 463 (2008) ("Independent agencies are preferred to executive agencies because long commissioner tenure, staggered terms, and political insulation are intended to facilitate a nonpolitical environment where regulatory experts can apply their knowledge to complex policy problems."); Daryl J. Levinson & Richard H. Pildes, *Separation of Parties, Not Powers*, 119 HARV. L. REV. 2311, 2376–77 (2006) ("These institutions were conceived as means to limit the sphere over which partisan political power could exert control."); Paul R. Verkuil, *The Purposes and Limits of Independent Agencies*, 1988 DUKE L.J. 257, 259–60 (noting that the characteristics of independent agencies are "designed to isolate those decisionmakers from politics").

12. *See, e.g.*, Humphrey's Ex'r v. United States, 295 U.S. 602, 625 (1935) ("Thus, the language of the act, the legislative reports, and the general purposes of the legislation as reflected by the debates, all combine to demonstrate the congressional intent to create a body of experts . . . ."); Bressman & Thompson, *supra* note 1, at 612 ("Independence was traditionally justified, particularly during the New Deal era, as promoting expertise."); Devins & Lewis, *supra* note 11, at 463

Landis succinctly put it as follows: "With the rise of regulation, the need for expertness became dominant."[13] The idea is that an agency could be created that would be insulated from short-term political pressures so that it could adopt public policies based on expertise that would yield better public policy over the long term.[14] Thus, the New Dealers hoped to create apolitical agencies that would be guided by information and not politics. Of course, it is impossible to remove politics and political judgments from agencies, particularly given the discretionary authority afforded to them. But it is possible to make politics *relatively* less pronounced and expertise *relatively* more of a basis for decision making.[15]

Related to the goal of expertise is a desire to insulate agency decisions from the sort of political horse-trading that is anathema to impartial decision making.[16] In this sense, expertise and nonpartisanship can be seen as two sides of the same coin. The Progressive reformers who pushed for additional independent agencies in the early part of the 20th century wanted both to eliminate partisan politics and to replace it with nonpartisan expertise.[17] "The Progressives had an abiding faith in regulation, expertness, and the capacity of American government to make rational decisions provided experts

("Commission expertise is the traditional, 'good government' justification for Congress's choice to create independent agencies.").

13. JAMES M. LANDIS, THE ADMINISTRATIVE PROCESS 23 (1938).

14. Bressman & Thompson, *supra* note 1, at 613–14; Gersen, *supra* note 1, at 348.

15. *See, e.g.*, Devins & Lewis, *supra* note 11, at 491 ("[P]olitical polarization strengthens the institutional design of independent agencies—both with respect to the willingness of opposition-party commissioners to check the President and the willingness of the opposition party in the Senate to use the confirmation power to push for commissioners who will not simply rubberstamp the President's decisions."); Anne Joseph O'Connell, *Political Cycles of Rulemaking: An Empirical Portrait of the Modern Administrative State*, 94 VA. L. REV. 889, 953–54 (2008) (finding that executive agencies typically engage in more regulatory activity in the final quarter of a president's administration than do independent agencies). A recent empirical study of the Federal Communications Commission (FCC), for example, found that partisanship accounts for roughly 75% of the FCC's nonunanimous decisions. *See* David E. Lewis, *The Adverse Consequences of the Politics of Agency Design for Presidential Management in the United States: The Relative Durability of Insulated Agencies*, 34 BRIT. J. POL. SCI. 377 (2004) (finding that agencies insulated from presidential control are more durable than other agencies); Daniel E. Ho, Congressional Agency Control: The Impact of Statutory Partisan Requirements on Regulation 35 (Feb. 12, 2007) (unpublished manuscript), http://dho.stanford.edu/research/partisan.pdf (concluding partisan balance requirements for independent agency commissioners have "the largest and most robust explanatory power over votes compared to presidential affiliation").

16. *See* ROBERT E. CUSHMAN, THE INDEPENDENT REGULATORY COMMISSIONS 189–90 (1972) (discussing the debates surrounding the creation of the FTC that emphasized the need to establish an independent body as a means of correcting the partisan and pressure-controlled management of the antitrust laws by the Department of Justice); *see also Humphrey's Ex'r*, 295 U.S. at 625 (explaining that it was "essential that the [FTC] should not be open to the suspicion of partisan direction").

17. STEVEN J. DINER, A VERY DIFFERENT AGE: AMERICANS OF THE PROGRESSIVE ERA 201 (1998); THE ISSUE OF FEDERAL REGULATION IN THE PROGRESSIVE ERA 50 (Richard Abrams ed., 1963); Breger & Edles, *supra* note 1, at 1131.

in the administrative agencies could remain free from partisan political considerations."[18]

But nonpartisanship can also be seen as a separate justification that aims for balanced decision making whether or not it is driven by technical expertise.[19] Indeed, one can see the desire for unbiased decision making as a separate, central concern in the development of independent agencies. Robert Cushman points out in his seminal work on the creation of the first modern independent agency, the Interstate Commerce Commission in 1887, that the impetus behind it was a desire to avoid "one-sided partisan control."[20] The Federal Trade Commission's (FTC) creation in 1914 was similarly prompted by a desire to avoid "partisan and pressure-controlled" antitrust enforcement.[21] The Banking Act of 1935, which established the modern structure of the Federal Reserve, aimed to give the agency more insulation so that it would serve the "general public interest" and not "special interests."[22]

B. Insulation from Capture

To achieve either expert or nonpartisan decision making, one must avoid undue industry influence, or "capture."[23] Unfortunately, as Richard

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18. MARVER H. BERNSTEIN, REGULATING BUSINESS BY INDEPENDENT COMMISSION 23 (1955).

19. *Compare* Bressman & Thompson, *supra* note 1, at 612–14 (identifying the promotion of expertise as a separate justification from the inhibition of narrow political interests), *and* Geoffrey P. Miller, *Independent Agencies*, 1986 SUP. CT. REV. 41, 79–83 (separating the justification of expertise from the justification of insulation from political pressure), *with* William H. Hardie III, Note, *The Independent Agency After* Bowsher v. Synar*—Alive and Kicking*, 40 VAND. L. REV. 903, 914–18 (1987) (subsuming the expertise justification under the broader goal of "apolitical" rulemaking), *and* Keith S. Brown & Adam Candeub, *Independent Agencies and the Unitary Executive: An Empirical Critique* 32 (Mich. State Univ. Coll. of Law Legal Studies Research Paper Series, Paper No. 06-04, 2008), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1100125 (combining the expertise and nonpartisan justifications into a single professional, objective claim).

20. *See Humphrey's Ex'r*, 295 U.S. at 624 (explaining that the FTC was to be "non-partisan" and "from the very nature of its duties, act with entire impartiality"); CUSHMAN, *supra* note 16, at 61 (noting that the independence of the Interstate Commerce Commission "if it meant anything, appears to have meant bipartisanship, as a guarantee of impartiality" and pointing out that "independence of one-sided partisan control was a matter of great moment").

21. CUSHMAN, *supra* note 16, at 189.

22. H.R. REP. NO. 74-742, at 1, 6 (1935).

23. Capture, for the purposes of agency design, may be defined as responsiveness to the desires of the industry or groups being regulated. *See* ROGER G. NOLL, REFORMING REGULATION 99–100 (1971) (explaining that capture happens most often when an agency assigns undue weight to the interests of the regulated industries as against those of the public); Steven P. Croley, *Theories of Regulation: Incorporating the Administrative Process*, 98 COLUM. L. REV. 1, 5 (1998) (describing the concept of agency capture as an essential component of the public-choice theory of regulatory process, which maintains that agencies cater to the regulatory needs of well-organized interest groups). For helpful overviews of capture, see PAUL J. QUIRK, INDUSTRY INFLUENCE IN FEDERAL REGULATORY AGENCIES (1981); Bagley & Revesz, *supra* note 6, at 1260; Richard B. Stewart, *The Reformation of American Administrative Law*, 88 HARV. L. REV. 1667 (1975); George J. Stigler, *The Theory of Economic Regulation*, 2 BELL. J. ECON. & MGMT. SCI. 3 (1971). For helpful

Stewart has observed, "[i]t has become widely accepted, not only by public interest lawyers, but by academic critics, legislators, judges, and even by some agency members, that the comparative overrepresentation of regulated or client interests in the process of agency decision results in a persistent policy bias in favor of these interests."[24]

This bias operates for a few central reasons. First, regulated industries are well-financed and well-organized, especially when compared to the general public and public interest groups.[25] Industry groups are thus better positioned to monitor agencies closely and to challenge any and all agency decisions that will negatively affect them.[26] All else being equal, agencies would prefer not to become mired in legal challenges, so they may seek to work with, rather than against, these organized interests. Although there are some important and influential groups that seek to represent the public interest, these interest groups do not have the funding or resources of industries. Thus, they often cannot monitor and challenge all the potentially negative rules and orders from an agency or marshal the same resources as industry representatives when they do bring a challenge.[27]

Second, agency capture is further exacerbated by the fact that industry groups are also well positioned to contribute to political campaigns and to lobby, which in turn gives them influence with the agency's legislative overseers on the relevant oversight committees.[28] For example, Arthur Levitt, the

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overviews of agency-capture literature, see B. DAN WOOD & RICHARD W. WATERMAN, BUREAUCRATIC DYNAMICS: THE ROLE OF BUREAUCRACY IN A DEMOCRACY 18 (1994) and Michael E. Levine & Jennifer Forrence, *Regulatory Capture, Public Interest, and the Public Agenda: Toward a Synthesis*, 6 J.L. ECON. & ORG. 167 (1990).

24. Stewart, *supra* note 23, at 1713.

25. Bagley & Revesz, *supra* note 6, at 1284–85.

26. STAFF OF S. COMM. ON GOV'T AFFAIRS, 96TH CONG., PRINCIPAL RECOMMENDATIONS AND FINDINGS OF THE STUDY ON FEDERAL REGULATION 25 (Comm. Print 1979); *see also* Bagley & Revesz, *supra* note 6, at 1298 ("[I]ndustry will have an advantage in monitoring agencies and in setting off [fire] alarms when its interests are threatened."); Marissa Martino Golden, *Interest Groups in the Rule-Making Process: Who Participates? Whose Voices Get Heard?*, 8 J. PUB. ADMIN. RES. & THEORY 245, 252–57 (1998); Mark Seidenfeld, *Bending the Rules: Flexible Regulation and Constraints on Agency Discretion*, 51 ADMIN. L. REV. 429, 464 (1999); Wendy E. Wagner et al., *Air Toxics in the Board Room: An Empirical Study of EPA's Hazardous Air Pollutant Rules* 17 (Ariz. Legal Studies Discussion Paper No 10-01, 2009), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1531243. *See generally* Croley, *supra* note 23, at 126–42 (summarizing studies showing that regulated interests participate to a much greater extent than public interest groups).

27. *See* Scott R. Furlong & Cornelius M. Kerwin, *Interest Group Participation in Rule Making: A Decade of Change*, 15 J. PUB. ADMIN. RES. & THEORY 353, 361 (2005) (finding that businesses are participating twice as much as public interest groups); Seidenfeld, *supra* note 26, at 464 ("A regulated entity frequently is a large corporation with resources to appeal agency decisions at every level.").

28. Einer R. Elhauge, *Does Interest Group Theory Justify More Intrusive Judicial Review?*, 101 YALE L.J. 31, 42 (1991); *see also, e.g.*, J.R. DeShazo & Jody Freeman, *The Congressional Competition to Control Delegated Power*, 81 TEXAS L. REV. 1443, 1489–90 (2003) (explaining that an oversight committee's actions "can obstruct and delay the agency's agenda" and influence its decisions); Barry R. Weingast & Mark J. Moran, *Bureaucratic Discretion or Congressional*

chair of the SEC from 1993–2001, describes the SEC during his tenure as being constantly threatened with budget cuts by the SEC's congressional overseers if it pursued aggressive regulations.[29]

Third, capture operates because of the revolving-door phenomenon: the heads of agencies often anticipate entering or returning to employment with the regulated industry once their government service terminates.[30] As a result, they do not want to make enemies within the industry by regulating with what the industry will view as a heavy hand.

A fourth factor that helps give regulated entities disproportionate influence over agencies is their information advantage. For an agency to regulate an industry effectively, it needs to know how the industry works and what it is capable of doing. But that information is often in the exclusive control of the regulated entity.[31]

These dynamics can be seen operating across a range of agencies.[32] Even if an agency has a promising beginning of "vigorous and independent regulation," it "often becomes closely identified with and dependent upon the industry it is charged with regulating."[33] To be sure, it is sometimes hard to identify when an agency decision is the product of undue interest group pressure as opposed to an exercise of the agency's independent judgment.[34] But the difficulty in assessing *ex post* whether a decision is the result of capture is all the more reason why policy makers often hope *ex ante* to create structural checks on capture by designing the agency to better protect it from one-sided political pressure.

Politics cannot be removed from agency decision making, so of course one can never hope to avoid all hints of capture. But as with expertise, the question is whether one can achieve *some* insulation from interest group

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Control? Regulatory Policymaking by the Federal Trade Commission, 91 J. POL. ECON. 765, 779, 788–92 (1983) (asserting that "firms located in districts represented on [FTC] oversight committees are favored in the commission's antitrust decisions" and that "the statistical evidence implies that the FTC is remarkably sensitive to changes in the composition of its oversight subcommittee").

29. *See* ARTHUR LEVITT WITH PAULA DWYER, TAKE ON THE STREET 132–33 (2002) (describing an incident in which the SEC's attempt to institute auditor-independence rules resulted in a threatened cut in funding).

30. KAY LEHMAN SCHLOZMAN & JOHN T. TIERNEY, ORGANIZED INTERESTS AND AMERICAN DEMOCRACY 342 (1986).

31. Seidenfeld, *supra* note 26, at 464; Stewart, *supra* note 23, at 1713–14.

32. For a list of recent studies providing evidence of SEC capture, see Amanda M. Rose, *The Multienforcer Approach to Securities Fraud Deterrence: A Critical Analysis*, 158 U. PA. L. REV. 2173, 2209 n.88 (2010).

33. Thomas W. Merrill, *Capture Theory and the Courts: 1967-1983*, 72 CHI.-KENT L. REV. 1039, 1060 (1997) (citing MARVER H. BERNSTEIN, REGULATING BUSINESS BY INDEPENDENT COMMISSION, 79–94 (1955)).

34. *Protecting the Public Interest: Understanding the Threat of Agency Capture: Hearing Before the S. Subcomm. on Admin. Oversight and the Courts*, 111th Cong. 5–6 (2010) (statement of Nicholas Bagley, Assistant Professor of Law, University of Michigan Law School).

pressure.[35] The goal of many independent agency designers has been to create this extra buffer against interest group pressures that might harm relatively weaker political interests, including the collective public interest of the general electorate or a vulnerable subgroup.[36]

C. *Stability*

A related goal of agency independence is to insulate the agency from future political changes in either Congress or the presidency.[37] This can be done either to cement in place current congressional policy preferences or to allow the agency to make an initial policy decision that is not subject to wide fluctuations over time.[38]

Stability has been a driving motivator since the creation of the earliest independent agencies. When the FTC was created, for instance, the Senate Committee Report emphasized the need "for an administrative board . . . which would have precedents and traditions and a continuous policy and would be free from the effect of such changing incumbency."[39] The Federal Reserve was also created with stability in mind—to insulate monetary policy from the changing whims of presidents who serve four-year terms.[40] After initially creating a Board of Governors to serve ten-year terms, Congress extended term lengths to fourteen years in 1935.[41] The need for long-term stability in monetary policy explains why not just the Fed, but most financial regulatory agencies were designed with independence as the framework.[42]

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35. *See* Cristina M. Rodriguez, *Constraint Through Delegation: The Case of Executive Control Over Immigration Policy*, 59 DUKE L.J. 1787, 1826 (2010) ("[T]hough complete insulation from political control may be unattainable . . . the structure of an independent agency at least enables tensions between political actors to keep politically motivated decisionmaking at bay.").

36. Rui J. P. de Figueiredo, Jr., *Electoral Competition, Political Uncertainty, and Policy Insulation*, 96 AM. POL. SCI. REV. 321, 331 (2002) (observing that groups that are electorally weak are more likely to insulate their preferred policies by designing independent agencies).

37. Bressman & Thompson, *supra* note 1, at 613–14; Gersen, *supra* note 1, at 347–48.

38. *See* Lewis, *supra* note 15, at 381 (noting that when political groups "worry about losing power, they remove agencies from political control by fixed terms for appointees, party balancing requirements, independence, specific statutes and other means"); *id.* at 400 ("In insulated agencies the impact of changing administrations is muted so that policies have less variance and the variance occurs around an ideal point set by the enacting Congress or the current Congress."); Matthew D. McCubbins, Roger G. Noll & Barry R. Weingast, *Structure and Process, Politics and Policy: Administrative Arrangements and the Political Control of Agencies*, 75 VA. L. REV. 431, 444 (1989) (arguing that enacting coalitions can mirror ex ante agreements and stack the deck to limit undesirable policy drift while allowing policy changes that would be acceptable).

39. 51 CONG. REC. 10,376 (1914).

40. Devins & Lewis, *supra* note 11, at 465–66.

41. *Id.* at 466 n.39.

42. *See* Gersen, *supra* note 1, at 348 (noting that the need for long-term stability explains central bank independence in the United States and elsewhere); Marc Quintyn & Michael W. Taylor, *Regulatory and Supervisory Independence and Financial Stability* 10 (Int'l Monetary Fund, Working Paper No. 02/46, 2002), *available at* http://ssrn.com/abstract=879439 (arguing that financial stability requires regulatory and supervisory independence in the same way that monetary stability requires central bank independence); *see also* Bressman & Thompson, *supra* note 1, at

Stability is related to the goal of preventing capture because it aims to keep an agency free from unwanted political forces even as the enacting coalition fades from power. It is insufficient to insulate an agency from one-sided interest group pressures only as long as the designers stay in power. A policy maker concerned with the agency's long-term success must create insulating measures that will work even as the presidency and Congress undergo shifts in party leadership.

D. Less Presidential Control, More Congressional Power

The creation of the first independent agencies appears not to have been motivated by a desire to decrease executive control or to buttress legislative power,[43] but subsequent agencies have been established with these interests in mind.[44] David Epstein and Sharyn O'Halloran examined the agencies created between 1947 and 1990 and found that Congress used independent agencies more often during periods of divided government than unified government,[45] a result consistent with the idea that Congress uses independent agencies at least in part to keep power away from a President of the opposite party.[46]

Although historically this has not always been the driving force in agency creation, much of the criticism of "independent agencies" has focused on the question of what these agencies mean to the presidential/congressional relationship. Scholars concerned with maintaining the power of the unitary executive have made much of the fact that independent agencies shift power from the President to Congress.[47] Justices who endorse a formal view of the separation of powers have similarly honed in on this aspect of independent agencies. A recent opinion by Justice Scalia captures this concern. He noted

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607–08 (supporting the assertion that financial agencies are among the most prominent independent agencies by highlighting numerous examples).

43. *See* CUSHMAN, *supra* note 16, at 19, 60–61 (discussing the formation of the Interstate Commerce Commission (ICC), the first independent regulatory commission, and noting the limited debate at the time about the relationship between Congress and the ICC and the absence of any discussion of presidential responsibility for the Commission); Breger & Edles, *supra* note 1, at 1116 & n.12 (noting that the Commission's independence developed years after its formation due to executive supervision).

44. *See* B. Dan Wood & John Bohte, *Political Transaction Costs and the Politics of Administrative Design*, 66 J. POL. 176, 199 (2004) (arguing that "when there is high executive-legislative conflict," enacting coalitions design independent agencies to "constrain the president and future legislative coalitions").

45. DAVID EPSTEIN & SHARYN O'HALLORAN, DELEGATING POWERS: A TRANSACTION COST POLITICS APPROACH TO POLICY MAKING UNDER SEPARATE POWERS 154–62 (1999).

46. *See* Devins & Lewis, *supra* note 11, at 464 ("When members of Congress fear the administrative influence of the current President on policies post-enactment, they are more likely to create independent commissions to implement their policies."); Lewis, *supra* note 15, at 383 ("If the president's influence is diminished but Congress's is not, insulated agencies will produce policy outputs systematically closer to the ideal of the congressional median than other agencies.").

47. *See, e.g.*, Steven G. Calabresi & Saikrishna B. Prakash, *The President's Power to Execute the Laws*, 104 YALE L.J. 541, 582–83 (1994) (arguing that without presidential control, independent agencies are subject only to congressional oversight).

"independent agencies are sheltered not from politics but from the President, and it has often been observed that their freedom from presidential oversight (and protection) has simply been replaced by increased subservience to congressional direction."[48]

Importantly, as Part II will discuss in greater detail, insulating agencies from presidential oversight may also protect them from capture because interest groups can exert pressure on the President to rein in agencies. But focusing solely on presidential authority over agencies is an incomplete inquiry if the goal is to reduce capture and one-sided political pressure because it will ultimately do little to protect agencies if interest groups use congressional pressure or the pressure of other agencies to achieve the same ends.

II. The Traditional Lodestars of Independence

Given the varied goals of insulation, different design elements may be better suited for some goals and not others. This Part considers three design features traditionally associated with independent agencies: the President's ability to remove an agency head only for cause, which has been the defining feature of an independent agency; freedom from oversight by the President's Office of Information and Regulatory Affairs; and a multimember design that is the structural setup of most agencies with heads removable only for cause. This Part takes a fresh look at these design features with a particular question in mind: how well do they address the problem of capture and one-sided political pressure.

This is not, of course, intended to be an exhaustive list of mechanisms that have been associated with the insulation of agencies from industry dominance, whether exercised directly on the agency or through political benefactors. There are, in particular, three notable means of insulating agencies against capture that will not be covered here but that have received substantial attention in the literature. First, this Part will not address the use of substantive legal standards to constrain the power of interest groups. Obviously, if Congress itself takes a position on what must be done in clear terms, no amount of interest group pressure can override that substantive standard unless the statute is repealed or supplemented. But analyzing substantive limits is field specific, so it is not possible to speak of substantive boundaries in general terms of institutional design. Second, and relatedly, judicial review may help to police the original substantive framework of the statute, so it, too, can be a line of defense against capture to the extent that the original standard itself has those aims.[49] Because the relationship between judicial review for adherence to statutory standards and industry capture has been covered at length in the literature, I will not rehash it here.

48. Fed. Commc'ns Comm'n v. Fox Television Stations, Inc., 129 S. Ct. 1800, 1815 (2009).

49. *See* Merrill, *supra* note 33, at 1043 (noting that federal judges began to police the administrative state for instances of agency capture in the 1960s).

Third, procedural mechanisms may help equalize the playing field by, for example, giving the public notice of agency policy changes and standing to challenge agencies' decisions in court. While these mechanisms can help protect the public, that is not always the case. In fact, just the opposite may occur because parties with more resources are often in the best position to take advantage of procedural mechanisms, as Part IV explains in the context of the Consumer Products Safety Act and the history of procedural elements that were designed to help consumers but ended up benefitting the industry instead.

All three of those mechanisms are important, but because they have been discussed at length elsewhere in the legal and political science literature with a particular focus on their relationship to capture, this Part will not rehash what we already know about these features. Instead, this Part looks to the traditional hallmarks of independence through the lens of capture avoidance, an emphasis that is often lacking in the discussion of these design features.

A. For-Cause Versus At-Will Removal Provisions

Whether an agency head should be removable at will or serve a term of years and be removable only for cause before his or her term expires is, as noted, the insulation design feature that is most often used to demarcate an agency as "independent."[50] If this is the definition of independence, independent regulatory agencies abound across a wide range of policy fields. They include, for example, the FTC,[51] the Consumer Product Safety Commission,[52] the Federal Energy Regulatory Commission,[53] and the Nuclear Regulatory Commission.[54] The heads of these agencies can be removed only for good cause, which typically means "inefficiency, neglect of duty, or malfeasance in office."[55] Though the issue has not been decided by the Supreme Court, most commentators agree that it is not good cause for removal if an agency performs a lawful regulatory agency action that the President disagrees with as a matter of policy.[56] If this view is correct, the

50. *See supra* note 1 and accompanying text.

51. Federal Trade Commission Act, 15 U.S.C. § 41 (2006).

52. Consumer Product Safety Act, 15 U.S.C. § 2053 (2006).

53. 42 U.S.C. § 7171(b)(1) (2006).

54. 42 U.S.C. § 5841(e) (2006).

55. *Id.* This limitation on Presidential removal power has been upheld by the Supreme Court. *See* Humphrey's Ex'r v. United States, 295 U.S. 602, 627–32 (1935) (distinguishing officers of quasi-legislative or quasi-judicial agencies from executive officers who are removable at will by the President). However, the Court has never defined these terms. *See* Bowsher v. Synar, 478 U.S. 714, 729 (1986) ("These terms are very broad and, as interpreted by Congress, could sustain removal . . . for any number of actual or perceived transgressions . . . .").

56. *See, e.g.*, Peter M. Shane, *Independent Policymaking and Presidential Power: A Constitutional Analysis*, 57 GEO. WASH. L. REV. 596, 609 (1989) (asserting that the President can only remove officers for failing to comply with the law). For the alternate view, see Lessig & Sunstein, *supra* note 2, at 110–11 (arguing that because the Supreme Court has not defined "good

President cannot control independent regulatory agency policy making with the threat of removal.[57]

Empirical studies on when Congress opts for good-cause provisions support the view that this design feature seems largely aimed at stopping presidential pressure in particular and not necessarily at preventing interest group or partisan influence in general. The independent model of for-cause removal is typically selected during divided government when Congress is controlled by a different party than the presidency.[58] Thus, Congress is interested in making sure that the minority party in the legislature does not exert greater influence over the agency through presidential power.[59] When Congress and the presidency are controlled by the same party, Congress is more likely to delegate authority to an executive agency whose head is removable at will by the President.[60]

But this does not mean that current party politics is the only explanation for removal restrictions. Even if Congress is controlled by the same party as the current President, it may prefer a for-cause removal provision if the need for stability in policy is relatively great. This concern, for instance, was the driving force behind the removal of the Secretary of Treasury and the Comptroller General from the Federal Reserve Board in 1935.[61] Similarly, Congress may agree with the current President's policies but worry that the

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cause" the President may have retained a large degree of power to remove officers from independent agencies).

57. *See* Mistretta v. United States, 488 U.S. 361, 410–11 (1989) ("[L]imitation on the President's removal power . . . is specifically crafted to prevent the President from exercising 'coercive influence' over independent agencies."); DAVID E. LEWIS, PRESIDENTS AND THE POLITICS OF AGENCY DESIGN 47 (2003) ("Political appointees who serve for fixed terms are insulated from presidential control since they cannot be removed without cause."); Levinson & Pildes, *supra* note 11, at 2376–77 ("These institutions were conceived as means to limit the sphere over which partisan political power could exert control."); Thomas O. Sargentich, *The Emphasis on the Presidency in U.S. Public Law: An Essay Critiquing Presidential Administration*, 59 ADMIN. L. REV. 1, 8 (2007) (suggesting that possibility of termination is an ex ante deterrent to executive agency heads' willingness to negotiate strongly with the White House).

58. LEWIS, *supra* note 57, at 58–60; *see also* David Epstein & Sharyn O'Halloran, *The Nondelegation Doctrine and the Separation of Powers: A Political Science Approach*, 20 CARDOZO L. REV. 947, 983–85 (1999) (finding increased congressional–executive conflict leads to decreased delegation of authority to the executive).

59. *See* Levinson & Pildes, *supra* note 11, at 2358 ("When Congress confronts a President who disagrees with its policy objectives, in other words, it directs its delegations to the executive branch actors most insulated from presidential control, and perhaps also most susceptible to congressional control.").

60. David Epstein & Sharyn O'Halloran, *Divided Government and the Design of Administrative Procedures: A Formal Model and Empirical Test*, 58 J. POL. 373, 391 (1996) ("[U]nder unified government Congress is more inclined to increase the president's discretionary authority, and the president will certainly not be averse to accepting it.").

61. During hearings, the banking lobby argued that because Congress was concentrating "greater power than ever before" in the Federal Reserve Board, it should enjoy "absolute independence" from political considerations through elimination of the Secretary of the Treasury and the Comptroller of the Currency positions on the Board. *Banking Act of 1935: Hearings Before the H. Comm. on Banking and Currency*, 74th Cong. 514–15 (1935) (statement of D.J. Needham, Gen. Counsel, American Bankers Association).

short-term preferences of future administrations could undermine the long-term goals of law.[62]

The President, too, may support the creation of an independent agency in the name of stability and of helping the agency to avoid future partisan pressure from the opposite party.[63] For example, as part of his economic recovery plan, President Obama proposed a Consumer Financial Protection Agency (CFPA) as an independent regulatory agency with broad authority over consumer financial services and lending statutes.[64]

A concern with long-term stability helps explain why most financial agencies, including the Board of Governors of the Federal Reserve System[65] and the SEC,[66] have heads removable only for cause. Though the President and these agencies share a common long-term goal of economic growth, achieving that goal often requires politically unpopular actions in the short term.[67]

Giving agency officials tenure for a term of years can also foster expertise, as agency heads gain wisdom from their experience on the job.[68] The terms must be sufficiently long to allow agency heads to gain the relevant experience. And in the case of multimember agencies, the terms of the members must be staggered so that institutional expertise can accumulate without gaps.[69]

Removal protections can also help serve the goal of reducing capture. To the extent powerful groups operate to influence the President, they can

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62. *See* Bressman & Thompson, *supra* note 1, at 613–14 ("When continuity was an end unto itself, as was the case with monetary policy, agency independence was a means."); Devins & Lewis, *supra* note 11, at 465 ("Members of Congress worry not only about the current President but also about the impact of future Presidents on agency policy and implementation.").

63. *See* Devins & Lewis, *supra* note 11, at 468 (noting that Congress and the President can "lock in" a set of policies by creating independent regulatory agencies with sympathetic appointees); *see also* Bressman & Thompson, *supra* note 1, at 636 ("The President may have trouble resisting the short-term pressures in deference to other interests and thus may seek an independent regulator for fortitude."); Verkuil, *supra* note 11, at 965 n.116 (pointing out President Carter's rejection of a proposal that would have shifted responsibility for nuclear power safety away from the Nuclear Regulatory Commission and to the Department of Energy).

64. U.S. DEP'T OF TREASURY, FINANCIAL REGULATORY REFORM: A NEW FOUNDATION 58 (2009), http://www.financialstability.gov/docs/regs/FinalReport_web.pdf (recommending that the CFPA "be structured to promote its independence and accountability"); *see also* Jackie Calmes & Sewell Chan, *Obama Pressing for Protections Against Lenders*, N.Y. TIMES, Jan. 19, 2010, at B1 (describing President Obama's efforts to persuade Congress to create the CFPA as an independent agency).

65. 12 U.S.C. § 242 (2006).

66. Though there is no explicit removal provision that governs the SEC, the Supreme Court recently accepted the argument that its commissioners are subject to removal only for "inefficiency, neglect of duty, or malfeasance in office." Free Enter. Fund v. Pub. Co. Accounting Oversight Bd., 130 S. Ct. 3138, 3148, 3154 (2010).

67. Bressman & Thompson, *supra* note 1, at 603.

68. *See* S. REP. NO. 63-597, at 10–11 (1914) (noting that the seven-year terms of FTC commissioners would "give them an opportunity to acquire the expertness in dealing with these special questions concerning industry that comes from experience").

69. *Id.* at 11.

also influence agencies by virtue of the President's threat to remove agency officials if they do not serve those interests. A removal restriction undoubtedly gives an agency head greater confidence to challenge presidential pressure.

But one must be careful not to overstate the functional difference between at-will and for-cause removal and thus the effect of removal protections on capture. For starters, even at-will agency heads have greater protection than their formal status suggests because, as Paul Verkuil puts it, "removal is a doomsday machine" that is politically costly for presidents.[70] On the flipside, just because agency officials have for-cause job protection does not mean they are immune from political pressure. Presidents seem to be able to remove them without litigating the question of good cause because officials typically voluntarily accept a presidential request for their resignation or otherwise fail to challenge their removal.[71] Even without a presidential request to leave, the average presidential appointee is likely to leave his or her position after about two years, giving the President authority to fill the vacancy.[72]

More fundamentally, agency officials with for-cause protection who are members of the same party as the President typically want to fall in line with the President's agenda. This could be for substantive policy reasons. Reed Hundt, a former chairman of the FCC, explained that "naturally I, and any agency head, preferred the White House to approve of my agenda. Few are successful in any endeavor without learning the value of partnership."[73] Or, as discussed in greater detail below, it could be for their own career advancement.[74] Regardless of the reason, presidential acceptance is likely to matter to agency heads even without the threat of removal hanging over them.

This is not to say that removal restrictions do not matter. Rather, it emphasizes the need to look beyond removal if the goal is to create the strongest barrier possible against capture.

B. Oversight by the Office of Information and Regulatory Affairs

Threats of removal are not the only way presidents control agency heads. Presidents also aim to steer agency policy through the Office of

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70. Paul R. Verkuil, *Jawboning Administrative Agencies: Ex Parte Contacts by the White House*, 80 COLUM. L. REV. 943, 957 (1980); *see also* CALABRESI & YOO, *supra* note 2, at 413–14 (noting that the removal of U.S. attorneys by President George W. Bush was politically costly); Pierce, *supra* note 2, at 607–10 (describing the political costs to removing at-will agency officials).

71. Breger & Edles, *supra* note 1, at 1149–50; Pierce, *supra* note 2, at 604–05; Verkuil, *supra* note 70, at 955.

72. Anne Joseph O'Connell, *Vacant Offices: Delays in Staffing Top Agency Positions*, 82 S. CAL. L. REV. 913, 919 n.23 (2009).

73. REED E. HUNDT, YOU SAY YOU WANT A REVOLUTION: A STORY OF INFORMATION AGE POLITICS 130 (2000).

74. *See infra* subpart III(B).

Information and Regulatory Affairs (OIRA) in the Office of Management and Budget (OMB). One of OIRA's main functions is to coordinate administration policy across agencies,[75] so if OIRA discovers an outlier position, it will inevitably seek to pressure the agency to fall in line with the larger administration position. Another key OIRA function involves its review of proposed regulations. Every president since Ronald Reagan has used OIRA to require agencies under OIRA's jurisdiction to justify their proposed regulations using cost–benefit analysis.[76] OIRA also requires all agencies (executive and independent) to submit an agenda of all regulations they have under development or review.[77] Finally, in addition to OIRA's oversight of regulations, it also reviews legislation and congressional testimony proposed by covered agencies.[78] Presidential appointees control OMB and OIRA, so channeling regulations through OIRA is an effective way for the President to monitor their compliance with his or her overall agenda and to pressure the agency to make changes if necessary.[79]

Empirical evidence confirms OIRA's influence on agency policy. A recent Government Accountability Office (GAO) report, for example, found that OIRA review prompted significant or material changes to eight of twelve agency rules being considered.[80]

A key question of agency design is thus whether the agency must submit regulations for OIRA review. It is an open constitutional question whether the President could require traditional independent agencies (defined for these purposes as an agency whose head is removable for cause) to submit cost–benefit analyses of proposed regulations to OIRA for review, or if

75. U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-09-205, FEDERAL RULEMAKING: IMPROVEMENTS NEEDED TO MONITORING AND EVALUATION OF RULES DEVELOPMENT AS WELL AS TO THE TRANSPARENCY OF OMB REGULATORY REVIEWS 8 (2009) [hereinafter GAO OMB STUDY] (noting that OMB is responsible for making sure that "decisions made by one agency do not conflict with the policies or actions taken or planned by another agency").

76. Exec. Order No. 12,291, 3 C.F.R. 127 (1981), *revoked by* Exec. Order No. 12,866, 3 C.F.R. 638 (1993), *reprinted in* 5 U.S.C. § 601 (2000); Exec. Order No. 13,422 3 C.F.R. 191 (2008), *revoked by* Exec. Order No. 13,497, 74 Fed. Reg. 6,113 (Feb. 4, 2009).

77. *See* Exec. Order No. 12,866 § 4 ("For purposes of this subsection, the term 'agency' or 'agencies' shall also include those considered to be independent regulatory agencies . . . . Each agency shall prepare an agenda of all regulations under development or review, at a time and in a manner specified by the Administrator of OIRA.").

78. Breger & Edles, *supra* note 1, at 1151.

79. *See* Elena Kagan, *Presidential Administration*, 114 HARV. L. REV. 2245, 2338 (2001) ("[I]t is difficult to identify instances of [Executive Office of the President] intervention in agency action that deviated markedly from the policy orientation of the President.").

80. GAO OMB STUDY, *supra* note 75, at 30. An earlier study by the General Accounting Office determined that OIRA significantly impacted twenty-four of the eighty-five rules studied "by suggesting changes that revised the scope, impact, or costs and benefits of the rules, returning the rules for reconsideration by the agency, or, in one case, requesting that the agency withdraw the rule from review." U.S. GEN. ACCOUNTING OFFICE, GAO-03-929, RULEMAKING: OMB'S ROLE IN REVIEWS OF AGENCIES' DRAFT RULES AND THE TRANSPARENCY OF THOSE REVIEWS 5 (2003).

Congress has the power to prevent such review.[81] But ever since OIRA started engaging in extensive oversight of agency regulations, presidents have avoided this constitutional confrontation by making the political choice to exempt independent agencies that are defined in the Paperwork Reduction Act from having to submit a cost–benefit analysis of their rules to OIRA.[82]

Thus, right now the key marker of whether an agency must submit cost–benefit studies of proposed rules to OIRA is whether the agency is listed in the Paperwork Reduction Act as an independent agency. Notably, not all agencies with heads who are removable for cause are exempt from OIRA review under this definition. For example, the head of the Social Security Administration (SSA) is removable for cause,[83] and the Act creating the SSA states that it shall be "an independent agency in the executive branch."[84] But the SSA is not among the agencies listed in the Paperwork Reduction Act.[85] The SSA, in turn, has complied with executive orders on regulatory review,

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81. *See, e.g.*, Memorandum from the Dep't of Justice, Office of Legal Counsel to David Stockman, Dir., Office of Mgmt. and Budget 7–8 (Feb. 12, 1981), *reprinted in Role of OMB in Regulation: Hearing Before the Subcomm. on Oversight and Investigations of the H. Comm. on Energy and Commerce*, 97th Cong. 158 (1981) (claiming that an attempt by Congress to prevent a cost–benefit analysis requirement would be met with skepticism by the Supreme Court); Robert W. Hahn & Cass R. Sunstein, *A New Executive Order for Improving Federal Regulations? Deeper and Wider Cost–Benefit Analysis*, 150 U. PA. L. REV. 1489, 1534–35 (2002) (contrasting the narrow and broad views of independent agency autonomy, including the possibility of cost–benefit analysis); Lessig & Sunstein, *supra* note 2, at 112 (stating that the issue of presidential authority over independent agencies does not yet have precise contours); Richard H. Pildes & Cass R. Sunstein, *Reinventing the Regulatory State*, 62 U. CHI. L. REV. 1, 29–32 (1995) ("The legal question . . . [of] whether the President has any legal authority to supervise [independent agencies] . . . has not been answered."); Peter Shane, *Independent Policymaking and Presidential Power: A Constitutional Analysis*, 57 GEO. WASH. L. REV. 596, 611 (1989) (arguing that the Constitution allows for textual arguments supporting both a narrow and a broad view of independent agency autonomy from the President); Peter L. Strauss, *The Place of Agencies in Government: Separation of Powers and the Fourth Branch*, 84 COLUM. L. REV. 573, 596 (1984) (stating that the text of the Constitution makes it difficult to describe the administrative state's position with respect to the three branches of government "in purely legal or theoretical terms"); Memorandum from Richard L. Revesz & Michael A. Livermore, Inst. for Policy Integrity, N.Y. Univ. Sch. of Law to Office of Info. & Regulatory Affairs 5 (Feb. 13, 2009), *available at* http://www.reginfo.gov/public/jsp/EO/fedRegReview/Revesz_Livermore.pdf ("While there are plausible legal arguments that the President may have the authority to require cost–benefit analysis, this question is far from settled.").

82. *See* Exec. Order No. 12,866 § 3(b), 50 Fed. Reg. 51,735, 51,737 (Sept. 30, 1993) (including all agencies within its ambit except those "considered to be independent regulatory agencies" as defined by statute); 44 U.S.C. § 3502(10) (1988) (defining independent agencies under the Paperwork Reduction Act); *see also* Exec. Order No. 12,044 § 6(b)(5), 3 C.F.R. 152 (1979), *reprinted in* 5 U.S.C. § 553 (1994) (excluding "regulations issued by the independent regulatory agencies" from its application).

83. 42 U.S.C. § 902(a)(3) (2006).

84. *Id.* § 901.

85. 44 U.S.C. § 3502(5) (2006). Though the Act's definition of "independent regulatory agencies" includes a catchall for "any other similar agency designated by statute as a Federal independent regulatory agency or commission," *id.*, there appears to be no court decision interpreting this definition to include the SSA.

including the appointment of a regulatory policy officer when President George W. Bush's executive order required it.[86]

In thinking about whether Congress should list an agency among the independent regulatory agencies in the Paperwork Reduction Act to exempt it from OIRA review, it is important to return to the goals of insulation.[87] Obviously, if the goal of insulation is to limit presidential control, OIRA review should be avoided.

If the goal of insulation is to enable decisions to be made on expert information, the analysis is more complicated because OIRA review can cut both ways. On the one hand, OIRA review helps the President coordinate policies across the Executive Branch, which can rationalize government decision making overall and include the input of other expert agencies that are dealing with the same topic.[88] In addition, requiring an agency to submit a cost–benefit analysis of a proposed regulation to OIRA can have potentially positive disciplining effects because OIRA brings a fresh set of eyes to the issue and expertise at economic analysis.[89] Cass Sunstein and Richard Pildes, for example, believe "strong policy reasons favor including the

86. *See Agency Regulatory Policy Officers (as of June 19, 2008)*, GEORGE W. BUSH: WHITE HOUSE ARCHIVES, http://georgewbush-whitehouse.archives.gov/omb/inforeg/regpol/agency_reg_policy_officers.pdf. For President Bush's requirement that Regulatory Policy Officers be used, see Exec. Order No. 13,422, 3 C.F.R. 191 (2008). Relatedly, even though the Federal Emergency Management Agency has been characterized as an "independent agency in the Executive Branch," see notes following 15 U.S.C. § 2202 (2006) (referring to FEMA as an independent agency), its head lacks removal protection and the agency is subject to presidential oversight. *See, e.g.*, 6 U.S.C. § 313 (2006) (setting forth the responsibilities of FEMA but failing to give the head of FEMA removal protection); Assistance to Firefighters Grant Program, Interim Final Rule, 66 Fed. Reg. 15,968 (proposed Mar. 21, 2001) (to be codified at 44 C.F.R. pt. 152) (noting that a FEMA rule has been reviewed by OMB for compliance with Executive Order No. 12,866).

87. Note that if one's goals were different—say, increasing democratic accountability—the analysis may change. For example, because some argue that the President represents a national constituency, subjecting agency rules to OIRA review may increase democratic accountability. *See* Kagan, *supra* note 79, at 2335 (arguing that the President's national constituency causes him to consider the interests of the general public rather than parochial interests). *But see* Evan J. Criddle, *Fiduciary Administration: Rethinking Popular Representation in Agency Rulemaking*, 88 TEXAS L. REV. 441, 457–63 (2010) (arguing that voters do not select presidents based on policy platforms, administrative procedures obscure Presidential control and decrease accountability, and agencies receive conflicting advice from White House officials rather than national perspectives); Jide Nzelibe, *The Fable of the Nationalist President and the Parochial Congress*, 53 UCLA L. REV. 1217, 1248 (2006) (comparing the incentives of Congress and the President and arguing that "in many circumstances, the president has an incentive to exhibit a parochial preference in his policies that exceeds that of the median member of Congress"). But the point of the Article is to think about these design elements as they relate to the specific end goals of insulation, which by their nature cut against increased accountability.

88. Bagley & Revesz, *supra* note 6, at 1264; *see also* Rodriguez, *supra* note 35, at 1837 (pointing out in the context of immigration that "some White House scrutiny and coordination may well be warranted, given both the political nature of the agency's mandate and the sprawl of the immigration bureaucracy across the executive branch").

89. *See* Steven Croley, *White House Review of Agency Rulemaking: An Empirical Investigation*, 70 U. CHI. L. REV. 821, 873 (2003) ("White House review appears to be at least partially technocratic and at any rate not ad hoc."); Strauss, *supra* note 81, at 593–94 (pointing out that better policy can result from getting the President's broader perspective on policy).

independents within some degree of presidential authority."[90] They argue that OIRA review can "diminish some of the characteristic pathologies of modern regulation—myopia, interest group pressure, draconian responses to sensationalist anecdotes, poor priority setting, and simple confusion."[91] Although there is some delay with OIRA review, in recent years the process has been relatively expeditious, taking roughly a month of additional time.[92]

On the other hand, the agency has subject-matter expertise that can get lost in OIRA review. For example, Thomas McGarity points out that OIRA lacks the technical expertise necessary to adequately review many agency actions.[93] The relationship between expertise and OIRA is thus a complicated one.[94]

If the goal of insulation is to further nonpartisan decision making that is not captured by a particular interest and to encourage stability, the case for OIRA review weakens. Consider first the relationship between OIRA review and a desire to insulate an agency from biased decision making, particularly bias in favor of a politically powerful regulated entity. Some have argued as a matter of theory that presidential oversight via OIRA review is needed to curb the capture of independent agencies.[95] But Nicholas Bagley and

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90. Pildes & Sunstein, *supra* note 81, at 28.

91. *Id.* at 4. The concern about excessive costs of regulation motivated a 2002 proposal by the Center for Regulatory Effectiveness to impose OIRA review on independent agencies. CTR. FOR REGULATORY EFFECTIVENESS, A BLUEPRINT FOR THE OMB REVIEW OF INDEPENDENT AGENCY REGULATIONS 1 (2002).

92. *See OIRA's Role in the Obama Administration Examined*, OMB WATCH (June 16, 2009), http://www.ombwatch.org/node/10115 (quoting OIRA associate administrator Michael Fitzpatrick as describing the pace of review as "expeditious" and stating that the average length of review for most regulations was twenty-eight days, while for economically significant regulations it was thirty-two days).

93. THOMAS O. MCGARITY, REINVENTING RATIONALITY 281 (1991); *see also* RENA STEINZOR & SIDNEY SHAPIRO, THE PEOPLE'S AGENTS AND THE BATTLE TO PROTECT THE AMERICAN PUBLIC: SPECIAL INTERESTS, GOVERNMENT, AND THREATS TO HEALTH, SAFETY, AND THE ENVIRONMENT 204–05 (2010); Lisa Schultz Bressman & Michael P. Vandenbergh, *Inside the Administrative State: A Critical Look at the Practice of Presidential Control*, 105 MICH. L. REV. 47, 97 (2006) (describing criticisms that OIRA may lack the expertise to effectively review agencies' scientific decisions).

94. Bagley & Revesz, *supra* note 6, at 1312–13 (noting the complexity of determining when centralized review in OIRA makes sense).

95. *See, e.g.*, BERNSTEIN, *supra* note 18, at 291–97 (arguing that independent agencies "have proved to be more susceptible to private pressures, to manipulation for private purposes, and to administrative and public apathy than other types of governmental organizations"); Christopher C. DeMuth & Douglas H. Ginsburg, *White House Review of Agency Rulemaking*, 99 HARV. L. REV. 1075, 1080–81 (1986) (assuming that the fact that "regulation tends to favor narrow, well-organized groups at the expense of the general public" means that OIRA review is needed to check against the failings of regulation); Lessig & Sunstein, *supra* note 2, at 96 ("[A]n independent agency is highly likely to fall victim to factional capture."); John O. McGinnis, *Presidential Review as Constitutional Restoration*, 51 DUKE L.J. 901, 905, 913 n.45 (2001) (suggesting that OIRA review is even more justified for independent regulatory agencies than executive agencies because "at the margin independent agencies are even more likely to be dominated by special interests than are agencies whose heads are not insulated from presidential removal" and offering his view that "the pressure for special interest regulation is greater than for special interest deregulation"); Cass R. Sunstein,

Richard Revesz have persuasively shown that "the assumption that agencies will be routinely plagued by regulatory capture, but that OIRA will never be, is not very plausible."[96]

On the contrary, OIRA review is likely to add to the problem of capture by industry. As Bagley and Revesz effectively demonstrate, agencies are more likely to underregulate than overregulate because industry groups are far more likely than public interest groups to have the organization and resources to capture agencies.[97] Yet OIRA is poorly positioned to check the problem of underregulation. Just the opposite, OIRA itself is prone to be captured by the very same industry forces because "the President will be particularly attentive to those groups that can provide him with the resources, support, or votes to win elections or promote his political agenda."[98] And because the OIRA review process is less transparent than the agency process, it is that much easier for industry groups to influence OIRA without being checked.[99] This is not just a matter of theory; empirical evidence confirms OIRA's strong deregulatory bias and sympathy for industry views.[100] Thus, Bagley and Revesz conclude that "solidifying the President's already substantial control over the administrative state may have the perverse result of amplifying the power of those groups that are in a position to exert undue influence on the President while doing nothing to minimize industry group influence at the administrative level."[101]

This is all the more likely when the agency at issue has been set up to be relatively insulated from interest group pressures. That is because any insulation of the agency will be lost if interest groups can achieve their desired policies once the agency's rules reach the level of presidential review.

Thus, for agencies charged with regulating in an area where there is no powerful interest in favor of regulation to counterbalance the deregulatory forces that line up on one side—the problem this Article seeks to address—OIRA review is likely to exacerbate agency bias, not neutralize it.[102] And

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Paradoxes of the Regulatory State, 57 U. CHI. L. REV. 407, 426–28, 439–40 (1990) (arguing that independent agencies have been "highly susceptible to the political pressure of well-organized private groups").

96. Bagley & Revesz, *supra* note 6, at 1306, 1308.

97. *Id.* at 1287–90 (using theory and empirical evidence to refute the claim that agencies will be captured by public interest groups seeking more regulation).

98. *Id.* at 1305; *see also id.* at 1306 (pointing out that industry groups will have the same incentives to bid for regulatory outputs at OIRA as they do at other agencies).

99. *Id.* at 1309–10.

100. *See, e.g.*, *id.* at 1306–07 (citing Erik D. Olsen, *The Quiet Shift of Power: Office of Management & Budget Supervision of Environmental Protection Agency Rulemaking Under Executive Order 12,291*, 4 VA. J. NAT. RESOURCE L. 43, 56–57 (1984)) (summarizing empirical evidence that "OIRA was a 'conduit' for industry views").

101. *Id.* at 1312; *see also* Verkuil, *supra* note 70, at 950–51 ("Powerful private lobbies, increasingly frustrated in obtaining preferential access to administrators, can be expected to use White House political advisors to achieve equivalent clout.").

102. OIRA may well be needed in other circumstances where the risks of overregulation are present, as Bagley and Revesz concede as well. Bagley & Revesz, *supra* note 6, at 1283.

although many urge OIRA to take a more aggressive role in policing agency inaction[103]—thus theoretically serving as an additional check on an agency that is not regulating enough to protect the public interest—policing agency inaction will always be more difficult than supervising agencies' affirmative acts.[104] For example, even after OIRA committed itself to making greater use of prompt letters "to a regulator, that a rulemaking be initiated or completed, that information relevant to a regulatory program be disclosed to the public, or that a piece of research or analysis relevant to rulemaking be conducted,"[105] very few were actually sent.[106]

More fundamentally, OIRA will rarely pay much heed to interest groups that are unorganized and lack power in the political process. These groups are unlikely to have the resources to participate actively in the OIRA process.[107] Even when they do, OIRA may opt to intervene in areas where more powerful groups take an interest to help the President get reelected.[108]

And of course, a president with a deregulatory, pro-business agenda is hardly likely to use OIRA to prompt more regulations. While a president with that ideological outlook is likely to influence independent agencies as well through his or her appointments and other means,[109] the independent agency will nevertheless be relatively more insulated from industry pressure, so keeping its decisions away from OIRA will, on net, produce less of a deregulatory bias.

In the same vein, OIRA review undermines the goal of stability because the more susceptible an agency is to presidential oversight, the more likely the agency's policies will shift as new administrations take power. Dramatic shifts hinder business planning and create legal uncertainty, thus leading to greater destabilization.

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103. *See, e.g.*, Hahn & Sunstein, *supra* note 81, at 1521–24 (praising OIRA's use of prompt letters to encourage agency action); Revesz & Livermore, *supra* note 81, at 1–3 (encouraging OIRA to take advantage of opportunities to review agency inaction).

104. Michael A. Livermore, *Cause or Cure? Cost–Benefit Analysis and Regulatory Gridlock*, 17 N.Y.U. ENVTL. L.J. 107, 132 (2008) ("Because of the structure of regulatory review, there is currently ample opportunity for affected interests to bog down the regulatory process . . . .").

105. U.S. GEN. ACCOUNTING OFFICE, *supra* note 80, at 48; John D. Graham, *Saving Lives Through Administrative Law and Economics*, 157 U. PA. L. REV. 395, 460 (2008) (citations omitted).

106. Bagley & Revesz, *supra* note 6, at 1277–78 (noting that fourteen prompt letters were sent between 2001 and 2006).

107. *See id.* at 1306–07 (discussing empirical studies showing a relative lack of public interest participation in the OIRA review process).

108. Strauss, *supra* note 81, at 664–65; *see also* MCGARITY, *supra* note 93, at 288 ("White House political operatives promised to intervene in an ongoing OSHA rulemaking in exchange for a large contribution from the textile industry to the Committee to Re-elect the President."). This concern initially caused a legal debate as to whether OIRA review was constitutional even as applied to executive agencies. David J. Barron, *From Takeover to Merger: Reforming Administrative Law in an Age of Agency Politicization*, 76 GEO. WASH. L. REV. 1095, 1110 (2008).

109. *See infra* note 123.

Having said all this, it is important to reiterate that even if a president is restricted from removing agency officials and cannot exercise review through OIRA, he or she will undoubtedly still exercise informal pressures that may be just as powerful. For example, even though agencies are not required to submit to OIRA regulatory review, some do on a voluntary basis to stay in the President's good graces and ensure access to resources such as coordination with other agencies, office space, and legal services.[110] Elena Kagan has similarly observed that presidents achieve influence through personal ties, sanctions, and institutional incentives.[111]

One recent study found that during the Bush I and Clinton Administrations, nineteen White House offices (including OIRA) were involved in EPA rulemaking to some degree.[112] Vice President Cheney exercised considerable influence on agency decisions by contacting lower-ranked agency officials directly.[113] Some believe these informal contacts further the White House's agenda even more than OIRA review.[114] Thus, any attempt at curbing presidential influence must seek to address these more subtle mechanisms of influence.

C. Single Agency Head Versus Multimember Commission

It is often remarked that independent agencies are characterized not only by their statutory for-cause removal protections but also by the fact that they are typically multimember bodies.[115] Thus, another traditional question of agency design is whether to opt for a single agency head or to have a commission or board structure with a number of voting members.

This question of institutional design is a bedrock inquiry that is reflected in the Constitution. The unitary executive model of Article II was selected for efficiency and accountability.[116] But a single head also means less deliberation and debate. A multimember agency, in contrast, "tends toward accommodation of diverse or extreme views through the compromise

110. Strauss, *supra* note 81, at 593–94, 663.

111. Kagan, *supra* note 79, at 2376.

112. Lisa Schultz Bressman & Michael P. Vandenbergh, *Inside the Administrative State: A Critical Look at the Practice of Presidential Control*, 105 MICH. L. REV. 47, 68 (2006).

113. Jo Becker & Barton Gellman, *Leaving No Tracks*, WASH. POST, June 27, 2007, at A1.

114. Pierce, *supra* note 2, at 600 ("Largely invisible ad hoc White House jawboning is now, and always has been, far more important in its impact on agency policy decisions.").

115. Bressman & Thompson, *supra* note 1, at 610. In *Free Enter. Fund v. Public Co. Accounting Oversight Bd.*, the Supreme Court assumed that SEC commissioners are removable for cause, even in the absence of a statutory for-cause removal restriction, and that was likely due in part to the multimember structure of the agency and the fixed terms for its commissioners. 139 S. Ct. 3138, 3153 (2010).

116. *See* THE FEDERALIST NO. 74, at 447 (Alexander Hamilton) (Clinton Rossiter ed., 1961) (noting that "the sense of responsibility is always strongest in proportion as it is undivided"); Lessig & Sunstein, *supra* note 2, at 93 ("The framers believed that unitariness advanced the interests of coordination, accountability, and efficiency in the execution of the laws.").

inherent in the process of collegial decision making."[117] And having only one person at the apex can also mean that the agency is more easily captured.[118]

Presidents may have relatively less direct influence over multimember agencies, if only because these agencies have members who serve staggered terms,[119] meaning that presidents typically cannot appoint a full slate of officers immediately upon taking office.[120]

It is important, however, not to understate the President's power over independent multimember commissions. Dating to the presidency of Warren G. Harding, presidents have been able to obtain majorities for their party on independent commissions within thirteen to fourteen months after taking office from a prior president of a different party.[121] Recently, the process has slowed, with Presidents Clinton and George W. Bush taking an average of twenty months to obtain a majority for their respective parties.[122] Once the President has a majority of members of his or her party, the commissions fall in line with the President's priorities and positions.[123]

The President's influence can occur even more quickly than noted because he or she often has the power to demote the chair of independent commissions and appoint a new one.[124] The chair in many cases has significant authority over the agency's budget and personnel decisions, and often has a large influence over the agency's day-to-day decision making as

117. Breger & Edles, *supra* note 11, at 1113.

118. CUSHMAN, *supra* note 16, at 153 ("It seem[s] easier to protect a board from political control than to protect a single appointed official.").

119. Bressman & Thompson, *supra* note 1, at 610.

120. *See* Devins & Lewis, *supra* note 11, at 468–69 (finding that it takes presidents on average nine or ten months after taking office to obtain majorities on commissions).

121. *Id.* at 470. New presidents who are of the same party as the previous president obtain a majority for their party much more quickly, within one to two months. *Id.*

122. *Id.* at 472. It takes a bit longer (about one more month) for presidents to appoint absolute majorities of commissioners (for example, appointing three out of five commissioners, regardless of party), but this is less relevant because party polarization means that once a president has a majority of party votes, the agency tends to follow the President's lead. *Id.* at 469–73, 492.

123. For a more detailed model of how elected officials change the policies of multimember agencies depending on the sequence and timing of open seats on the agency, see Susan K. Snyder & Barry R. Weingast, *The American System of Shared Powers: The President, Congress, and the NLRB*, 16 J.L. ECON. & ORG. 269 (2000). That independent agencies ultimately fall in line with presidential priorities because of party loyalty shows the wisdom of Daryl Levinson and Rick Pildes's plea to administrative law scholars to spend more time focusing on party affiliation rather than formal structural separation of powers. Levinson & Pildes, *supra* note 11, at 2364.

124. *See* Verkuil, *supra* note 70, at 955 & n.75 (noting that the President appoints the chairman of the FTC, FCC, SEC, and National Labor Relations Board (NLRB)). Typically, when the President demotes a chair, the chair opts to resign and not serve the remainder of his or her term, thus giving the President a new appointment as well. Daniel E. Ho, *Measuring Agency Preferences: Experts, Voting, and the Power of Chairs*, 59 DEPAUL L. REV. 333, 338 (2010). The President does not have the power to select the chair of all independent agencies. The chair of the Federal Reserve Board, for instance, has a fixed tenure of four years. 12 U.S.C. § 242 (2006).

well.[125] In many agencies, the chair has the right to appoint staff directly[126] and is the public voice of the agency.[127] These powers allow the chair to exercise significant control over the agency's agenda.[128]

In the case of multimember agencies, another design question of import is whether the members should be relatively balanced among political parties. Most independent commissions can have no more than a bare majority of the members from the same political party.[129] For example, the Federal Deposit Insurance Corporation (FDIC) has a five-member board, and its authorizing statute provides that no more than three members may be of the same political party.[130] The FTC is also governed by a five-member body, and its authorizing statute similarly insists that no more than three of its commissioners can be members of the same political party.[131] The National Credit Union Administration (NCUA) follows this same model: of

125. *See, e.g.*, Reorganization Plan No. 4 of 1961, 26 Fed. Reg. 6,191 (1961), *reprinted in* 74 Stat. 837 (1961) (Federal Trade Commission); Reorganization Plan No. 6 of 1961, 26 Fed. Reg. 7,541 (1961), *reprinted in* 75 Stat. 838 (1961) (Federal Home Loan Bank Board); Reorganization Plan No. 8 of 1950, 15 Fed. Reg. 3,175 (1950), *reprinted in* 64 Stat. 1264 (1950) (Federal Trade Commission); Reorganization Plan No. 9 of 1950, 15 Fed. Reg. 3,175 (1950), *reprinted in* 64 Stat. 1265 (1950) (Federal Power Commission); Reorganization Plan No. 10 of 1950, 15 Fed. Reg. 3,175 (1950), *reprinted in* 64 Stat. 1265 (1950) (Securities and Exchange Commission); *see also* Breger & Edles, *supra* note 1, at 1165 ("[M]ost chairmen are essentially the agencies' chief executive and administrative officers. They appoint and supervise the staff, distribute business among the agency's personnel and administrative units, and control the preparation of the agency's budget and the expenditure of funds."); Verkuil, *supra* note 70, at 958. In 1971, Miles Kirkpatrick, then chairman of the FTC, described his position as follows:

> I should make it clear that in the management of the Commission's day-to-day affairs, there are no collegial decisions. Management of the Commission, save for the appointment of top policy making positions and policy decisions having to do with the allocation of major resources, is placed squarely on the Chairman. In my experience, matters having to do with the management of the Commission's staff are not the subject of debate among the Commissioners.

DAVID M. WELBORN, GOVERNANCE OF FEDERAL REGULATORY AGENCIES 31 (1977) (quoting Miles W. Kirkpatrick, *Dinner Address*, 40 ANTITRUST L.J. 332 (1971)). With respect to the allocation of funds among various projects, however, the commission as a whole generally decides. *See* WELBORN, *supra*, at 22 ("In the Civil Aeronautics Board, Federal Power Commission, Federal Trade Commission, and Securities and Exchange Commission, authority is reserved to revise or approve budget estimates and to allocate appropriated funds among 'major programs and purposes.' In the Interstate Commerce Commission, budget authority is phrased somewhat differently but to the same effect."); Breger & Edles, *supra* note 1, at 1173–74 ("Many statutes affirmatively accord the agency as a whole the right to approve the annual budget .... [T]he chairman's unitary authority often does not extend beyond the preparation or drafting of budget documents ...."); *see also, e.g.*, 15 U.S.C. § 41 (2006) (reserving the right of the FTC to approve the agency's budget).

126. Breger & Edles, *supra* note 1, at 1173 n.317 (describing the differences in the hiring power of the chairman at various agencies, and noting that FCC Chairman Reed Hundt hired 200 staff members during his four years in office).

127. Ho, *supra* note 124, at 360.

128. *Id.* at 338; Glen O. Robinson, *Independent Agencies: Form and Substance in Executive Prerogative*, 1988 DUKE L.J. 238, 245 n.24.

129. Breger & Edles, *supra* note 1, at 1139.

130. 12 U.S.C. § 1812(a)(2) (2006).

131. 15 U.S.C. § 41 (2006).

the three members of its board, only two may be members of the same party.[132]

There are, however, some multimember bodies that lack a bipartisanship requirement, including the National Labor Relations Board and the Federal Mine Safety and Health Review Commission.[133] The Federal Reserve Board of Governors also lacks a requirement that it be politically balanced.[134] Even in those independent agencies that have less formal requirements on the balance of members, there exists political pressure for continuity in patterns of membership.[135]

Appointees who are of the opposite party as the President who appoints them tend to be "ideological partisans committed to the agenda of the opposition party."[136] And appointees who are of the same party as the President who appoints them are likely to be equally committed to the President's party and therefore his or her agenda. Thus, these agencies ultimately shift as presidential power shifts. While one might think this divergence undercuts the goals of having independent agencies, there are reasons to believe that having a mix of ideologies at agencies facilitates some of the aims of insulation.

In particular, a partisan balance requirement can help achieve two goals of insulation: it can avoid extremely partisan decisions and help facilitate more stable agency policy. As a wealth of empirical research demonstrates, a group composed solely of ideologically like-minded people tends toward extreme decision making.[137] Liberals and conservatives alike become more liberal and conservative, respectively, when they deliberate only with like-

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132. 12 U.S.C. § 1752a(b)(1).

133. Breger & Edles, *supra* note 1, at 1139. The original proposal for the CFPA lacked a requirement of partisan balance. Consumer Financial Protection Agency Act of 2009, H.R. 3126, 111th Cong. § 112 (2009).

134. 12 U.S.C. § 241 (2006). The legislation creating the Board of Governors does state, however, that, in "selecting the members of the Board, not more than one of whom shall be selected from any one Federal Reserve district, the President shall have due regard to a fair representation of the financial, agricultural, industrial, and commercial interests, and geographical divisions of the country." *Id.*

135. *See* WILLIAM L. CARY, POLITICS AND THE REGULATORY AGENCIES 61–62 (1967) (describing pressure on President Johnson to maintain balance between consumer- and industry-minded commissioners at the Federal Power Commission).

136. Devins & Lewis, *supra* note 11, at 461.

137. *See, e.g.*, David Schkade et al., *What Happened on Deliberation Day?*, 95 CALIF. L. REV. 915, 917 (2007) (discussing the results of an experiment that shows that liberals and conservatives become more liberal and conservative, respectively, as a result of deliberation amongst like-minded people); Cass R. Sunstein, *Deliberative Trouble? Why Groups Go to Extremes*, 110 YALE L.J. 71, 74 (2000) [hereinafter Sunstein, *Deliberative Trouble*] ("In brief, group polarization means that members of a deliberating group predictably move toward a more extreme point in the direction indicated by the members' predeliberation tendencies."); Cass R. Sunstein et al., *Ideological Voting on Federal Courts of Appeals: A Preliminary Investigation*, 90 VA. L. REV. 301, 306 (2004) (discussing data that shows that unified groups of three Democrat-appointed or Republican-appointed judges are far more likely to vote in a "liberal" or "conservative" manner, respectively, than Democrat-appointed or Republican-appointed judges who are part of a divided bench).

minded people. Thus, as Cass Sunstein has observed, "[a]n independent agency that is all Democratic, or all Republican, might polarize toward an extreme position, likely more extreme than that of the median Democrat or Republican, and possibly more extreme than that of any member standing alone."[138] This kind of polarization could mean wide fluctuations in policy as presidential administrations change.[139] Thus, the designers of the ICC—which became the template for later independent agencies[140]—insisted on partisan balance (with not more than three of the five members permitted to come from the same political party) based on a desire to create "impartiality, or at least neutrality."[141] Indeed, Robert Cushman notes that this neutrality "was looked upon as more important than expertness."[142] Put another way, a commission of five members all of the same party would be even more polarized than one in which a bare majority is of the same party.

A multimember commission that is politically balanced is beneficial for another reason. As noted above, one of the concerns with agencies that regulate powerful, wealthy industries is that those industries tend to dominate the agency's agenda because they have greater resources to monitor what the agency is doing. But, when an agency is composed of members of different parties, it has a built-in monitoring system for interests on both sides because that type of body is more likely to produce a dissent if the agency goes too far in one direction.[143] That dissent, in turn, serves as a "fire alarm" that alerts Congress and the public at large that the agency's decision might merit closer scrutiny.[144]

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138. Sunstein, *Deliberative Trouble*, *supra* note 137, at 103.

139. One might wonder why the Federal Reserve Board of Governors lacks a partisan balance requirement if it is so central to stability. But the Board of Governors seems to be checked by other measures. First, the members serve long terms of fourteen years, thereby increasing stability. In addition, they have perhaps the most powerful agency positions in the country because of their authority to set monetary policy. Monetary policy cannot fluctuate in an extreme manner as administrations change because of the deleterious effect it would have on the economy. It is therefore unsurprising that even without a requirement that the Board be politically balanced it is one of the most stable agencies in government and the most independent.

140. *See* CUSHMAN, *supra* note 16, at 188 ("A controlling force moving legislative leaders to create the independent Federal Trade Commission was the model of the Interstate Commerce Commission.").

141. *Id.* at 63.

142. *Id.*

143. A recent empirical study of the FCC, for example, found that partisanship accounts for roughly 75% of the FCC's nonunanimous decisions. Ho, *supra* note 15, at 35.

144. *See* Hugo Hopenhayn & Susanne Lohmann, *Fire Alarm Signals and the Political Oversight of Regulatory Agencies*, 12 J.L. ECON. & ORG. 196, 197–98 (1996) (discussing the effect of external information flows on oversight of regulatory agencies); Mathew D. McCubbins & Thomas Schwartz, *Congressional Oversight Overlooked: Police Patrols versus Fire Alarms*, 28 AM. J. POL. SCI. 165, 166 (1984) (describing the congressional approach of designing a "fire-alarm" system that "enable[s] individual citizens and organized interest groups to examine administrative decision[s]"); *cf.* David S. Law, *A Theory of Judicial Power and Judicial Review*, 97 GEO. L.J. 723, 747–51 (2009) (noting that the "expression of competing viewpoints" enhances a court's monitoring function).

III. The Equalizing Insulators

While the traditional hallmarks of agency independence serve important insulating functions, they have shortcomings. In particular, these metrics do not offer much help to an agency that must protect politically disadvantaged groups, including the general public, against powerful interests that may capture the agency. To be sure, not having the traditional hallmarks of independence can make things worse for these agencies because anything that increases their political accountability necessarily increases the ability of powerful political forces to control them. Thus, presidential oversight in the form of at-will removal power or OIRA review of regulations can limit an agency's ability to protect a politically weak and unorganized group. But while these features may be necessary for independence, they are insufficient if the goal is to create a buffer against one-sided interest group pressure and capture.

This Part therefore turns to design features that have been largely ignored in the cases and legal literature on independent agencies,[145] but that can be effective tools in the battle against agency capture and can help even the political playing field. Because these features can be helpful to agencies charged with protecting a diffuse public interest against one-sided interest group pressure, the Article refers to them as "equalizing" insulators. They include the agency's funding source; restrictions on agency personnel both in terms of initial hiring requirements and limits on subsequent employment; the rulemaking and enforcement relationships between the agency and other agencies, including state agencies; and political tools to make the agency's public interest mission more salient.

A. Agency Funding Sources

If you want to locate power in Washington (and just about any place else), you must follow the money. This holds true for agency authority as well. Agencies cannot survive without resources, so the source of their funding is a critical, though largely overlooked,[146] key to their power.[147] If

145. While legal scholarship has ignored most of these features, political scientists have recognized the value of some of them, such as funding and appointments. But even this literature has ignored some key elements, such as the role of state law enforcement and the power of information generation.

146. Steven A. Ramirez, *Depoliticizing Financial Regulation*, 41 WM. & MARY L. REV. 503, 517 (2000) (noting with "surpris[e] that most proposals for regulatory reform have not focused on" agency financing).

147. *See* STEINZOR & SHAPIRO, *supra* note 93, at 65 (pointing out that four regulatory agencies—the Consumer Product Safety Commission, the Environmental Protection Agency, the Occupational Safety and Health Administration, and the National Highway Transportation and Safety Administration—have not received significant budget increases, adjusted for inflation, since 1980); Daniel P. Carpenter, *Adaptive Signal Processing, Hierarchy, and Budgetary Control in Federal Regulation*, 90 AM. POL. SCI. REV. 283, 284, 298 (1996) (studying the FCC and FDA and finding that elected officials exercise authority over agencies through the budget's signaling effects rather than resource constraints).

agencies must rely on OMB for budget requests, the President has a huge lever of power over the agency, whether or not the head of the agency is removable at will.[148] Similarly, if Congress provides the agency's funding at its discretion, partisan considerations will certainly play a role in the agency's decision making.[149]

To be sure, the power of the purse is one of the key ways in which democratic accountability is served.[150] But if the purpose of insulation is to curb political pressures in favor of powerful regulated interests, then to some extent accountability has to be sacrificed or tempered. And giving agencies greater control over their funding is a way to do so while still allowing political actors to oversee an agency's substantive agenda.

One way to limit political control through budgetary oversight is to allow agencies to submit budget proposals directly to Congress without having to go through OMB and thus the President.[151] Alternatively, Congress can allow agencies to submit their budget requests concurrently to OMB and Congress, which eliminates the President's ability to change agency policy before Congress sees the agency's original proposal.[152] These mechanisms bypass one political pressure point—the President—but still allow political influence to operate through Congress's budgetary control. Thus, if the goal of insulating an agency is simply to shift presidential authority to Congress, this mechanism effectively does so. But if the goals of

148. *See* MICHAEL E. MILAKOVICH & GEORGE J. GORDON, PUBLIC ADMINISTRATION IN AMERICA 373 (10th ed. 2009) (describing President Reagan's use of the budget to control agencies); Haoran Lu, *Presidential Influence on Independent Commissions: A Case of FTC Staffing Levels*, 28 PRESIDENTIAL STUD. Q. 51, 61 (1998) ("[P]residents do use budget, specifically staff level, to influence independent agencies.").

149. *See* RICHARD F. FENNO, JR., THE POWER OF THE PURSE: APPROPRIATIONS POLITICS IN CONGRESS 291 (1966) ("Once the [Appropriations] Committee's ability to hurt it is recognized, the most obvious way for the agency to ensure a favorable kind of relationship with the Committee is simply to do . . . what the Committee tells it to do."); Randall L. Calvert et al., *A Theory of Political Control and Agency Discretion*, 33 AM. J. POL. SCI. 588, 605 (1989) (noting that Congress's budgeting power may contain aspects of both active and latent control); Weingast & Moran, *supra* note 28, at 792 ("The statistical evidence implies that the FTC is remarkably sensitive to changes . . . in its budget."); B. Dan Wood & Richard W. Waterman, *The Dynamics of Political Control of the Bureaucracy*, 85 AM. POL. SCI. REV. 801, 822 (1991) ("The EPA's hazardous waste enforcement program illustrates the importance of . . . budgeting to political control."); Bruce Yandle, *Regulators, Legislators and Budget Manipulation*, 56 PUB. CHOICE 167, 178 (1988) ("[B]udget manipulation is the most effective sanction available to Congress.").

150. *See* J. Gregory Sidak, *The President's Power of the Purse*, 1989 DUKE L.J. 1162, 1164 ("The most plausible purpose of the appropriations clause is to encourage efficiency in the production of public goods by the federal government and to impose fiscal accountability on both Congress and the President."); Kate Stith, *Congress' Power of the Purse*, 97 YALE L.J. 1343, 1356 (1988) ("All funds belonging to the United States . . . are public monies, subject to public control and accountability.").

151. Breger & Edles, *supra* note 1, at 1152; *see also* Verkuil, *supra* note 70, at 963 (observing that Congress has the authority to withdraw agencies from OMB jurisdiction).

152. *See* Lewis, *supra* note 15, at 389 & n.41 (noting that the Commodity Futures Trading Commission and Federal Aviation Administration submit budget requests to OMB and Congress contemporaneously).

independence include shielding the agency from partisan pressure and creating a more stable policy making space that does not change as majorities change in the House and Senate, then this method falls short. Interest groups can put pressure on members of Congress to exercise control over an agency through the budget, which Congress has done. The CPSC, despite its ability to submit its budget directly to Congress and OMB at the same time, has gone decades without a budget increase.[153]

A more powerful alternative is to provide agencies with an independent funding source, such as by requiring regulated interests to pay mandatory fees to the agency. For example, the Federal Reserve is authorized to levy assessments against member banks to fund its operating budget.[154] So, too, is the Office of Thrift Supervision,[155] the Office of the Comptroller of the Currency,[156] and the PCAOB.[157] With independent funding, the agency is insulated from Congress as well as the President.[158]

Providing independent funding is not, by itself, a guarantee of independence. In the case of banking regulators, it has had the opposite effect because of the ability of the regulated industries to opt out of one agency's jurisdiction and switch to another's.[159] Stark illustrations of this dynamic come from the experience of the Office of Thrift Supervision (OTS) and the Office of the Comptroller of the Currency (OCC). The OTS has jurisdiction over national thrifts[160] and the OCC has jurisdiction over national banks.[161] States regulate state thrifts and banks. But banks and thrifts have a great deal of flexibility in determining whom they wish to be chartered by,

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153. STEINZOR & SHAPIRO, *supra* note 93, at 65; *see also* GEN. ACCOUNTING OFFICE, GAO/HRD-87-47, CONSUMER PRODUCT SAFETY COMMISSION: ADMINISTRATIVE STRUCTURE COULD BENEFIT FROM CHANGE 4 (1987) [hereinafter GAO, ADMINISTRATIVE STRUCTURE] (noting that although the CPSC is authorized to submit its original budget requests to Congress at the same time they go to OMB, "this 'has not kept the President or OMB from making changes'").

154. 12 U.S.C. § 243 (2006).

155. *Id.* § 1467(a).

156. *Id.* § 482.

157. 15 U.S.C. § 7211(f)(5) (2006); *see also* Richard H. Pildes, *Putting Power Back into Separation of Powers Analysis: Why the SEC-PCAOB Structure is Constitutional*, 62 VAND. L. REV. EN BANC 85, 92 (2009) (explaining that the "industry-funded dedicated fee structure" was designed to "ensure the Board's independence").

158. *See* Joel Seligman, *Self-Funding for the Securities and Exchange Commission*, 28 NOVA L. REV. 233, 256 (2004) ("An independent budgetary process would be more effective in adjusting the size of the SEC staff to the Agency's regulatory needs during the good times, which ironically are when the SEC is more vulnerable to a lack of budgetary support."); Yandle, *supra* note 149, at 178 (arguing that Congress can sanction agencies by manipulating budgets). *But see* Lewis, *supra* note 15, at 390 n.42 (noting that being outside the normal budget process might make the agency ultimately more vulnerable to termination if Congress views the agency costs as greater than termination costs).

159. Ramirez, *supra* note 146, at 534 ("When a regulated industry has the ability to choose their regulator, a giant channel towards capture is opened.").

160. 12 U.S.C. § 1464 (2006).

161. *Id.* § 481.

and it has little effect on their business plans.[162] As a result, financial entities can shop around for the regulator they prefer. This has created an unhealthy (from the public's perspective) competition between the OTS and OCC to attract regulated entities to charter with them to gain their operating fees.[163] How have these agencies competed for the "business" of the regulated entities? They agreed to use their regulatory authority to preempt state consumer protection laws that would otherwise govern the activities of banks and thrifts.[164]

Thus, the lesson with respect to funding independence—as it is with all elements of agency design—is that no one particular feature can be viewed in isolation. It is critical to assess the overall structure of the agency. This is true for all of the goals of insulation, but particularly important if the goal is insulation from partisan and interest group pressures. Any cracks in the agency structure will be exploited by these powerful interests, so attention must be paid to every design feature.

B. Employment Restrictions

Although the traditional focus on the relationship between personnel and independence has focused on how agency officials are removed, the requirements for appointment are just as critical to an agency's ability to serve the goals of independence—indeed, arguably more so. Especially in recent decades, individuals selected to head agencies are picked based on ideological agreement with the President, not expertise.[165] Given the modern vetting

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162. *See* Carl Felsenfeld & Genci Bilali, *Is There a Dual Banking System?*, 2 J. BUS. ENTREPRENEURSHIP & L. 30, 53–58 (2008) ("American banking history has proven that when one regulator fails to provide banks with the right conditions, banks will find other opportunities elsewhere, mainly by switching to another charter."); Geoffrey P. Miller, *The Future of the Dual Banking System*, 53 BROOK. L. REV. 1, 1 (1987) (observing that "a depository institution dissatisfied with its regulator can, for a nominal expense, convert from federal to state charter or vice versa"); Daniel Schwarcz, *Regulating Insurance Sales or Selling Insurance Regulation?: Against Regulatory Competition in Insurance*, 94 MINN. L. REV. 1707, 1722 n.61 (2010) ("Banks that charter at the federal level have some degree of choice among multiple regulatory bodies . . . ."); Kenneth E. Scott, *The Dual Banking System: A Model of Competition in Regulation*, 30 STAN. L. REV. 1, 8–13 (1977) ("[R]egulatory diversity in effect allows new banks to choose the set of laws and administrators under which they will operate."); Editorial, *Regulator Shopping*, N.Y. TIMES, May 21, 2009, at A34 (noting that prior to the recent financial crisis "firms switched at will among various overseers, in search of the loosest rules and laxest regulators"). *But see* Henry N. Butler & Jonathan R. Macey, *The Myth of Competition in the Dual Banking System*, 73 CORNELL L. REV. 677, 683–93 (1988) (arguing that "assumptions about competitive interaction in the dual banking system are false").

163. *See* Oren Bar-Gill & Elizabeth Warren, *Making Credit Safer*, 157 U. PA. L. REV. 1, 81–83, 93–94 (2008) (arguing that competition for charters results in fewer constraints on banks).

164. *See Regulator Shopping*, *supra* note 162, at A34 (noting the regulatory "race to the bottom" resulting from firms searching for the "loosest rules and laxest regulators").

165. *See* Bruce Ackerman, *The New Separation of Powers*, 113 HARV. L. REV. 633, 700 (2000) (observing that the "overriding criteria in making these appointments will be loyalty to the president and her program"); Barron, *supra* note 108, at 1096 ("Agencies are now to an unprecedented extent governed by a thick cadre of political appointees" who "have been chosen either for having close ties to the President or for making strong prior commitments to his regulatory vision."); Breger &

process and party partisanship that produces extreme party loyalty, presidents typically can predict with great accuracy how an appointee will decide issues of importance to the Administration.[166] As a result, tenure protection becomes less important because the need for removal never arises unless the vetting process fails or the appointee goes through a fundamental shift in position.[167] That shift is all the more unlikely because defying the President and the party would diminish or destroy the possibility of future appointments and influence.[168]

Even if appointees in charge of an agency are not focused on their future within the government, they may be thinking about their prospects in the private sector when their terms at agencies expire. Because the most likely private-sector job on the horizon would be with the very industry the agency regulates, an agency head's independence may be compromised. Put another way, a concern with post-agency employment may make these officials reluctant to impose regulations that an industry views as too aggressive or obtrusive. It may dim an official's job prospects or make that job more difficult if the official has to live with the rules upon leaving the agency.[169]

The effect of the revolving door is often cited as one of the reasons why the SEC failed to adequately protect consumers by addressing pressing problems in the trading industry. For example, although late trading and market timing were widespread and well known, the SEC did not act to regulate the practices and stepped in only after the New York Attorney General (AG) brought an enforcement action under state law.[170] Similarly, it was the New York AG who led the fight to stop investment bankers from influencing

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Edles, *supra* note 1, at 1140 & n.147 (citing a Senate Government Operations Committee report that found partisan politics driving the appointment process to an "alarming" extent and expertise and competence coming in as "only secondary considerations"); Devins & Lewis, *supra* note 11, at 481–83 (pointing out that beginning with President Reagan, "ideological loyalty has become a hallmark of presidential appointments").

166. *See* Devins & Lewis, *supra* note 11, at 461 ("[P]arty identity is an especially good proxy for commissioner ideology."); Kagan, *supra* note 79, at 2277 (explaining how President Reagan "staff[ed] the agencies with officials remarkable for their personal loyalty and ideological commitment" who would adhere to the President's "policy agenda even in the face of competing bureaucratic pressures").

167. *See* Pierce, *supra* note 2, at 603 (noting that Executive Branch officials are typically selected because of "agreement with the President on policy issues related to their areas of responsibility, long-time loyalty to the President's political party, and/or personal loyalty to the President," and therefore "Presidents rarely need to resort to explicit or implicit threats to remove an officer to persuade the officer to act in accordance with the President's policy preferences").

168. Robinson, *supra* note 128, at 245–46.

169. *See* JERRY L. MASHAW & DAVID L. HARFST, THE STRUGGLE FOR AUTO SAFETY 16 (1990) (noting that agency officials may take into account "social and business relations and the prospects of further career opportunities in the private sector"); Jonathan R. Macey & Geoffrey P. Miller, *Reflections on Professional Responsibility in a Regulatory State*, 63 GEO. WASH. L. REV. 1105, 1117 (1995) ("[G]overnment lawyers have the risk of being 'captured' by the private law firms they later hope to practice with.").

170. John C. Coffee, Jr., *A Course of Inaction: Where was the SEC When the Mutual Fund Scandal Happened?*, LEGAL AFF. 46 (Apr. 2004).

the reports of firm analysts.[171] Experts on SEC practice have noted that the SEC did not initially address these problems because of a prevailing view among SEC officials that given the "rapidly revolving door between the SEC and private legal practice . . . , unless an issue has become high profile, it is best not to rock the boat."[172] The SEC became overpopulated with members who "identified with the market participants they were ostensibly regulating."[173] These pressures may have led the agency to adopt an overly lax view of its enforcement and regulatory functions.[174]

What can be done about these pressures? First consider the problem of partisan appointments.[175] One way to create greater independence is to specify qualifications for appointees so that the pool of potential candidates from which the President picks is more limited and he or she cannot select solely on the basis of partisan leanings. For example, because food and drug regulation is a highly technical subject, presidents are more limited in whom they select to head the Food and Drug Administration (FDA) as a practical matter because they are looking for scientific expertise as well as party affiliation.[176] As a result, the FDA is relatively more independent than other executive agencies, with its heads often advocating for drug regulation regardless of the position of their appointing president.[177]

Although most statutes fail to specify qualifications for appointees, there are exceptions.[178] For instance, at least two members of the three-member Surface Transportation Board must have a professional background in

171. *Id.*

172. *Id.*

173. Jonathan R. Macey, *Wall Street in Turmoil: State-Federal Relations Post-Eliot Spitzer*, 70 BROOK. L. REV. 117, 128 (2004).

174. Rachel E. Barkow, *The Prosecutor as Regulatory Agency*, *in* PROSECUTORS IN THE BOARDROOM: USING CRIMINAL LAW TO REGULATE CORPORATE CONDUCT (Anthony Barkow & Rachel Barkow eds., forthcoming), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1428934.

175. Barron, *supra* note 108, at 1133 (proposing that a way to limit the politicization of agencies through appointments is to cabin the number of political appointees at agencies). This would create a relatively greater role for civil servants who are often well positioned to blow the whistle on agency actions that harm the public interest in favor of a powerful interest, but that might not come to the public's attention in the absence of an agency insider pointing them out.

176. C. Frederick Beckner, III, Note, *The FDA's War on Drugs*, 82 GEO. L.J. 529, 542 (1993).

177. *See id.* ("As a result [of the need for FDA Commissioners to have scientific expertise], FDA policy remains the policy dictated by Congress when it passed the 1962 Kefauver-Harris Amendment."). This is not to say, of course, that the FDA does not suffer from capture problems. *See, e.g.*, Merrill Goozner, *Conflicts of Interest in the Drug Industry's Relationship with the Government*, 35 HOFSTRA L. REV. 737, 738–42 (2006) (describing capture problems at the FDA); Gardiner Harris, *Regulation Redefined: The F.D.A. Shifts Focus; at F.D.A., Strong Drug Ties and Less Monitoring*, N.Y. TIMES, Dec. 6, 2004, at A1 (reporting the widespread view that resource shifting has resulted in inadequate methods for uncovering the dangers of approved drugs).

178. Breger & Edles, *supra* note 1, at 1139. For a detailed examination of expertise and experience requirements for politically appointed positions, see Anne Joseph O'Connell, *Qualifications of Agency Leaders*, at 11–14 (2010) (unpublished manuscript) (draft on file with author).

transportation.[179] The PCAOB consists of five members, two of whom must be certified public accountants.[180] The members of the Defense Nuclear Facilities Safety Board must be "respected experts in the field of nuclear safety."[181] The Consumer Product Safety Act (CPSA) provides that a person cannot hold the office of Commissioner if he or she is "in the employ of, or holding any official relation to, any person engaged in selling or manufacturing consumer products" or owns "stock or bonds of substantial value in a person so engaged" or "is in any other manner pecuniarily interested in such a person."[182] In addition, CPSC Commissioners are also barred from "engag[ing] in any other business, vocation, or employment."[183]

Requiring appointees to possess certain qualifications can help limit partisan decision making, and it also facilitates expert decision making because individuals are hired not with an eye toward having them become experts on the job but with the idea that they will join the agency with the relevant skill set. For this to work, the agency must present itself as an attractive place for an expert to work. This may be possible either by the agency's independence *qua* independence[184] or by making commissioner compensation competitive with that of the industry from which the expert is drawn.[185]

Even if appointees are selected for particular qualifications, there is still a question of whether post-agency-employment incentives will influence their decision making while at the agency. This revolving-door problem has been noticed by many good government scholars,[186] and the standard solution is to place meaningful limits on the ability of agency heads and other high-level officials to work for regulated industries in positions that would involve dealings with the agency after their service with the agency comes to an end.[187] Many agency officials are subject to such limits to create greater insulation from partisan bias. For example, the legislation creating the PCAOB charges it with

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179. 49 U.S.C. §§ 701(b)(1)–(2) (2006).

180. 15 U.S.C. §§ 7211(e)(1)–(2) (2006).

181. 42 U.S.C. § 2286(b)(1) (2006).

182. 15 U.S.C. § 2053(c) (2006).

183. *Id.*

184. *See* HENRY J. FRIENDLY, THE FEDERAL ADMINISTRATIVE AGENCIES 153–54 (1962) (noting that experts would be unlikely to be attracted to an agency if their decisions were constantly second-guessed by politicians and their assistants). *But see* Miller, *supra* note 19, at 80–81 (questioning the theory that independent agencies offer greater challenge and responsibility).

185. *See* Bressman & Thompson, *supra* note 1, at 613 & n.64 (noting that PCAOB members are paid more than SEC commissioners).

186. *See, e.g.*, Rafael Gely & Asghar Zardkoohi, *Measuring the Effects of Post-Government-Employment Restrictions*, 3 AM. L. & ECON. REV. 288, 290–92 (2001) (describing attempts to limit this behavior).

187. *See* Joseph I. Hochman, Comment, *Post-Employment Lobbying Restrictions on the Legislative Branch of Government: A Minimalist Approach to Regulating Ethics in Government*, 65 WASH. L. REV. 883, 902 (1990) (supporting a one-year ban on lobbying employment after leaving government work).

> establish[ing] ethics rules and standards of conduct for Board members and staff, including a bar on practice before the Board (and the [SEC], with respect to Board-related matters) of 1 year for former members of the Board, and appropriate periods (not to exceed 1 year) for former staff of the Board.[188]

The Federal Board of Governors also imposes post-employment restrictions on its members, making them "ineligible during the time they are in office and for two years thereafter to hold any office, position, or employment in any member bank."[189] Members of the Board of the Farm Credit Administration are also ineligible to work for "any institution of the Farm Credit System" while they are in office and for two years thereafter.[190]

Post-employment restrictions are not without costs, of course. To the extent the restrictions are too onerous, it might be difficult to attract people with the relevant expertise to join the agency in the first place if they are concerned that they will be foreclosing too many job prospects in the future. Some attention must therefore be paid to the field of employment to be sure that a restriction will not unduly impede one's ability to land a job after government service. In most cases, barring an individual from taking a position that would require him or her to appear before or interact directly with the agency where he or she previously worked should not be too burdensome. And to the extent it is, it might be possible to increase the salary during government service, as was done with the PCAOB, to counterbalance the disincentives that might be created by post-government job restrictions.

Even with this kind of attention to circumstance, appointment and post-employment restrictions are no panacea. Even when the list of appointees is narrowed by expertise, the President is likely to find individuals who share his or her vision for the agency.[191] And post-employment restrictions for a year or two after leaving government service might temper officials' incentives not to anger the industry in which they might work, but they will hardly eliminate them. That said, every little bit helps when it comes to protecting against capture. Moreover, enacting these kinds of limits might help to express a commitment to independence and thereby help to influence the culture of the agency.

C. The Role of Other Agencies in Setting Regulatory Policy

The typical discussion of agency independence considers the relationship between the federal agency and its government overseers: the

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188. 15 U.S.C. § 7211(g)(3) (2006).

189. 12 U.S.C. § 242 (2006). This restriction does "not apply to a member who has served the full term for which he was appointed." *Id.*

190. *Id.* § 2242(a).

191. *See* Barron, *supra* note 108, at 1135 (arguing that it is difficult to meaningfully constrain the President with employment restrictions because qualified individuals representing different ideological views typically can be found within any profession).

President and Congress. But agencies can face pressure and receive support from other governmental actors. In particular, agencies can share substantive regulatory responsibilities with other federal agencies and with state governmental entities, and these shared responsibilities can either foster or frustrate the goals of insulation.

1. Regulation by Other Federal Agencies.—One of the first decisions for political designers is how much responsibility to give a single agency as opposed to splitting functions among agencies. Expertise concerns may dictate giving one actor the ability to balance a variety of complementary or competing concerns,[192] or those same concerns might suggest splitting functions among specialists.

From the perspective of avoiding capture, it may be helpful to have agencies with broad jurisdictions to make them more likely to resist pressure from any one interest group.[193] However, a key danger to avoid is giving a single agency conflicting responsibilities that require the agency to further the goals of industry at the same time that it is responsible for a general public-interest mission. In that scenario, there is a significant risk that industry pressure and a focus on short-term economic concerns that are easily monitored will trump the long-term effects on the public that are harder to assess.[194] Eric Biber has demonstrated, for example, how these competing pressures pushed the Forest Service to prioritize timber production at the expense of the agency's other mission of conservation.[195] J.R. DeShazo and Jody Freeman observe a similar dynamic at licensing agencies, such as the Atomic Energy Commission, the Federal Energy Regulatory Commission, and the Army Corps of Engineers, where economic development trumped environmental concerns.[196] Indeed, it was precisely this conflict of missions that ultimately led Congress to decouple the development and safety mis-

192. For a discussion of the types of policy problems that cannot be addressed through the simple aggregation of agency efforts and merit centralized coordination, see J.B. Ruhl & James Salzman, *Climate Change, Dead Zones, and Massive Problems in the Administrative State: A Guide for Whittling Away*, 98 CALIF. L. REV. 59, 83–92 (2010).

193. Jonathan R. Macey, *Organizational Design and Political Control of Administrative Agencies*, 8 J.L. ECON. & ORG. 93, 99–100 (1992).

194. *See* Bagley, *supra* note 34, at 8 ("Because the agency must prioritize one task at the expense of the other, industry group pressure can easily cement an agency's preference for the task that favors industry."); Eric Biber, *Too Many Things to Do: How to Deal with the Dysfunctions of Multiple-Goal Agencies*, 33 HARV. ENVTL. L. REV. 1, 7 (2009) ("[A]gents will have systematic incentives to privilege certain goals over others—specifically, to privilege goals that are easily measured over conflicting goals that are difficult to measure.").

195. *See* Biber, *supra* note 194, at 17–30 (arguing that the Service's historic charge to produce timber, the relative ease with which this goal could be measured, and pressure from outside groups led to the adoption of an incentive structure that favored timber production to the detriment of the Service's conflicting conservation-based goals).

196. *See* J.R. DeShazo & Jody Freeman, *Public Agencies as Lobbyists*, 105 COLUM. L. REV. 2217, 2220 (2005) (noting the reluctance of the stated agencies to comply with the National Environmental Policy Act (NEPA), the Clean Water Act (CWA), and the Endangered Species Act (ESA), among other environmental laws, when first passed in the 1960s and 1970s).

sions of the Atomic Energy Commission and place each within separate agencies, the former going to the Department of Energy and the latter residing with the Nuclear Regulatory Commission.[197]

Even if a single agency does not have competing internal goals, conflict can emerge from the agency's relationship with a separate agency that is looking out for a different interest.[198] To assess the effect of relationships between agencies in terms of capture, it is necessary to distinguish the different types of agencies, in terms of institutional design, that might be sharing authority.

Consider first the dynamics if the shared authority is between an agency that has been designed to be an insulated agency along the lines discussed in this Article and an executive agency with a head that answers to the President. If the executive agency has the authority to veto or dictate the insulated agency's policies,[199] the other design features of the insulated agency are meaningless because the insulated agency answers to a political entity that shares none of its insulating features.

If the relationship between the two agencies is less hierarchical, and the insulated agency and executive agency must consult one another[200] or monitor each other's proceedings to avoid conflicting policies[201] without a clear line of authority that will break a tie, the insulated agency may still find that its power is diminished. This is because the executive agency can sound fire alarms to interested groups early in the insulated agency's regulatory decision-making process that allow interest groups to mobilize and attempt to block the insulated agency's actions (through congressional overrides or court challenges).[202] Of course, interest groups could do this even in the absence of executive agency consultation requirements, but if a statute requires an insulated agency to contact an executive agency early in its decision-making process—which is often the case when consultation requirements are imposed—that gives the interest group that much more advance notice to mount its attack. To be sure, a monitoring role can facilitate decision making

197. Biber, *supra* note 194, at 33.

198. For a thorough discussion of the various interagency relationships Congress has prescribed, see generally, Cornelius P. Cotter & J. Malcolm Smith, *Administrative Responsibility: Congressional Prescription of Interagency Relationships*, 10 W. POL. Q. 765 (1957).

199. Eric Biber refers to this model as "'agency as regulator' of another agency." Biber, *supra* note 194, at 6. An example is the Secretary of Energy's ability to "propose rules, regulations, and statements of policy" in areas that fall under the jurisdiction of the Federal Energy Regulatory Commission (FERC), a traditional independent agency located within the Department of Energy. Department of Energy Reorganization Act of 1977, 42 U.S.C. §§ 7171, 7173(a) (2006). FERC must act upon the proposals within the Secretary's time limits. *Id.* § 7173(b).

200. *See* Lisa Schultz Bressman, *Procedures as Politics in Administrative Law*, 107 COLUM. L. REV. 1749, 1799 & n.275 (2007) (listing statutes containing consultation requirements).

201. J.R. DeShazo and Jody Freeman refer to this model as "agencies as lobbyists." DeShazo & Freeman, *supra* note 196, at 2217.

202. *See* Jacob E. Gersen, *Overlapping and Underlapping Jurisdiction in Administrative Law*, 2006 SUP. CT. REV. 201, 214 ("[U]sing multiple agents may also provide for monitoring and reporting of agent behavior by competing agents themselves.").

in the public interest if the monitor is more responsive to the public interest than the monitored agency that has been captured.[203] But the effects are likely to cut against the public interest if a politically sensitive agency is charged with monitoring one with equalizing insulators that help promote the public interest.

Similarly, whether multiple agencies limit or buttress the power of the President depends on what the single agency alternative looks like. If power would otherwise reside in an insulated agency alone, the President gains power when an executive agency takes on a partnership role. But if power would otherwise reside in an executive agency, Congress may prefer to inject multiple agencies into the decision-making process to limit presidential control. David Epstein and Sharyn O'Halloran have found that "Congress does play agencies off against each other more under divided government, despite the reductions in efficiency and centralized control that this might entail."[204] By increasing the costs of coordination for the President, Congress may be able to insulate certain policy decisions from presidential control.

Now consider the effects if the agencies sharing rulemaking authority are both independent in the traditional sense, but one of them has been insulated using some or all of the equalizing mechanisms discussed in this Article and the other has not. If the traditionally independent agency has veto authority over the insulated agency, it will undermine those insulating mechanisms. The effect may not be as pronounced as when an executive agency has veto power, but it will nevertheless undercut the insulated agency's ability to resist partisan pressure and create less stable policies because, as noted above, traditionally independent agencies are more prone to shift policies with changes in presidential administrations than agencies that have the additional protection of equalizing factors.

A consultation or veto requirement that gives either executive or traditionally independent agencies more power over an insulated agency with equalizing factors may, however, serve a different goal of insulation, namely expertise. Consultation may bring more experts into the process and improve decision making by presenting competing viewpoints.[205]

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203. *See* Iver P. Cooper, *The FDA, the BATF, and Liquor Labeling: A Case Study of Interagency Jurisdictional Conflict*, 34 FOOD DRUG COSM. L.J. 370, 375–76 (1979) (describing the Food and Drug Administration's initiative to regulate alcohol ingredient labeling after the Bureau of Alcohol, Tobacco, and Firearms proved unwilling to regulate the industry); DeShazo & Freeman, *supra* note 196, at 2221–22 (discussing the role of fish and wildlife agencies as monitors of FERC).

204. DAVID EPSTEIN & SHARYN O'HALLORAN, DELEGATING POWERS 159–60 (1999). Epstein and O'Halloran found specifically that the number of agencies per unit of delegated discretion was 58.89 under divided government and 29.55 under unified government.

205. *See* Anne Joseph O'Connell, *The Architecture of Smart Intelligence: Structuring and Overseeing Agencies in the Post-9/11 World*, 94 CALIF. L. REV. 1655, 1676 (2006) ("Redundant institutional design may increase diversity in viewpoints if workers identify primarily with their own agency."); Louis J. Sirico, Jr., *Agencies in Conflict: Overlapping Agencies and the Legitimacy of the Administrative Process*, 33 VAND. L. REV. 101, 126–27 (1980) (noting that conflicting agency views force an agency to confront and refute the evidence and positions taken by the

If authority is shared between two or more agencies that have been designed to be maximally insulated, the effect is harder to predict. On the one hand, shared responsibility may create a healthy competition between the two agencies,[206] and it will be harder to capture two agencies instead of one.[207] On the other hand, shared authority may undercut the goals of both agencies. Because these agencies may be charged with serving somewhat different politically vulnerable populations, they may undermine each other by engaging in costly and time-consuming turf battles.[208]

Thus, an assessment of the effect of an interagency relationship on insulation will depend on which of the sometimes competing goals of insulation the policy makers are seeking to further and on the particular structures and design features of the respective agencies.

2. Regulation by States.—Federal agencies may share regulatory authority not only with each other, but with states. For purposes of this section, the question is what role state law should play in regulation to foster the goals of insulation. (The role of states as enforcers of federal law is taken up in the next section.) Thus, the question is really one of preemption. When should an insulated agency's interpretation of federal law be the exclusive regulatory regime and when should it co-exist with state law? The question of when agencies should preempt state law is obviously a compli-

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opposing agency); *cf.* Nancy Staudt, *Redundant Tax and Spending Programs*, 100 NW. U. L. REV. 1197, 1227–28 (2006) (discussing the benefits of redundancy in the context of congressional committee jurisdiction).

206. *See* O'Connell, *supra* note 205, at 1677 ("Competition may encourage redundant entities to work harder and more creatively, generating a race to the top in performance; competition may also motivate one entity to correct mistakes made by another entity."); *see also* Andrew B. Whitford, *Adapting Agencies: Competition, Imitation, and Punishment in the Design of Bureaucratic Performance*, *in* POLITICS, POLICY, AND ORGANIZATIONS 160, 164 (George A. Krause & Kenneth J. Meier eds., 2003) ("Agencies will respond to comparison, competition, and information revelation because of the real world implications of failure."); Gersen, *supra* note 202, at 213 ("The threat of jurisdictional loss is a sanction for the failure to produce desirable informational expertise."); Neal Kumar Katyal, *Internal Separation of Powers: Checking Today's Most Dangerous Branch from Within*, 115 YALE L.J. 2314, 2324–25 (2006) (describing the benefits of competition).

207. *See* O'Connell, *supra* note 205, at 1677 (arguing that it is difficult for any one interest group to capture a multiagency process and that the interest group cooperation that might make capture possible is costly for the groups).

208. *See* John C. Coffee, Jr., *Competition Versus Consolidation: The Significance of Organizational Structure in Financial and Securities Regulation*, 50 BUS. LAW. 447, 460–66 (1995) (chronicling some costs associated with the interagency conflict over jurisdiction between two traditionally independent agencies, the SEC and the Commodities Futures Trading Commission); Pildes, *supra* note 157, at 93 (noting that Congress created the PCAOB as a unit within and under the control of the SEC because of a concern that creating a new agency with overlapping jurisdiction with the SEC would "spawn jurisdictional battles, create redundant regulation, or make it hard to ensure regulatory coherence"); Ruhl & Salzman, *supra* note 192, at 71 ("The transaction costs of strong coordination, the differing internal incentives of each agency, the loss of autonomy, and other collective action challenges often overwhelm ambitions towards coordination."); *cf.* Whitford, *supra* note 206, at 164 (observing that information revealed by competition may help interest groups and partisan overseers).

cated topic that goes beyond the scope of this Article.[209] But it is important to flag the relationship between state law and the goals of insulated agencies, particularly the aim of reducing capture.

If the concern is that a federal agency will be captured by one-sided industry interests at the expense of the general public, there is value in making federal regulations a floor and allowing states to enact laws that are even more protective of the public.[210] This is true even if the federal agency is an insulated one, because no amount of insulation will ever be foolproof. As a result, having states regulate might provide a critical check against the dangerous combination of a captured agency and federal preemption. An example of this phenomenon is the aggressive preemption of state predatory lending and consumer protection laws by the OCC and the OTS.[211] After preempting state laws, the OCC and OTS subsequently largely ignored federal consumer protection laws.[212] Thus, the federal government stepped in at the behest of industry to prevent states from taking action against lending abuses, which, in turn, contributed to the economic crisis. If states had been permitted to play a greater role, some of the damage would have been mitigated.[213]

To be sure, the value of state law as a check against capture must be weighed against the need for uniformity in an area.[214] But in engaging in that calculus, it is important to note that states might be more sensitive to the

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209. For a sampling of some of the complicated issues at play in the federal–state relationship over regulatory authority, see William W. Buzbee, *Asymmetrical Regulation: Risk, Preemption, and the Floor/Ceiling Distinction*, 82 N.Y.U. L. REV. 1547 (2007); Roderick M. Hills, Jr., *Against Preemption: How Federalism Can Improve the National Legislative Process*, 82 N.Y.U. L. REV. 1 (2007); Richard L. Revesz, *Rehabilitating Interstate Competition: Rethinking the "Race-to-the-Bottom" Rationale for Federal Environmental Regulation*, 67 N.Y.U. L. REV. 1210 (1992); Catherine M. Sharkey, *Products Liability Preemption: An Institutional Approach*, 76 GEO. WASH. L. REV. 449 (2008); Richard B. Stewart, *Pyramids of Sacrifice? Problems of Federalism in Mandating State Implementation of National Environmental Policy*, 86 YALE L.J. 1196 (1977).

210. Buzbee, *supra* note 209, at 1597–98 (arguing that pervasive forms of regulatory failure—including "interest group distortions of the regulatory process, agency self-interest, information limitations, and inertia"—argue in favor of federal floor preemption).

211. Arthur E. Wilmarth, Jr., *Comptroller Dugan Is Wrong About the Causes of the Financial Crisis and the Scope of Federal Preemption*, FINREG21 (Nov. 2, 2009), http://www.finreg21.com/lombard-street/comptroller-dugan-is-wrong-about-causes-financial-crisis-and-scope-federal-preemption.

212. *See* Bar-Gill & Warren, *supra* note 163, at 90–95 (criticizing the banking agencies' lack of interest in consumer protection and focus on bank profitability).

213. *See* Anne Milgram & Rachel E. Barkow, *Keeping Consumer Cops on the Beat*, POLITICO (May 13, 2010), http://www.politico.com/news/stories/0510/37148.html (citing studies showing, for example, that financial institutions subject to state consumer laws had lower default rates); *Preemption and Regulatory Reform: Restore the States' Traditional Role as "First Responder,"* NAT'L CONSUMER L. CTR. 10–15 (2009), http://www.nclc.org/images/pdf/preemption/restore-the-role-of-states-2009.pdf (explaining how "[p]reemption has played a role in every major consumer protection failure in recent years").

214. *See, e.g.*, Samuel Issacharoff & Catherine M. Sharkey, *Backdoor Federalization*, 53 UCLA L. REV. 1353, 1354 (2006) (noting that a desire for nationwide uniformity and the benefits that flow from uniformity may explain Supreme Court cases preempting state regulation).

public interest, either because of ballot initiatives that give consumers a more direct voice or because some states are particularly harmed by an industry interest (for example, by pollution) and so stand in a good position to vindicate a more general public interest.

Thus, in all these scenarios, if the goal is insulation from partisan pressures to protect interest group dominance, it is critically important to pay attention to the relationship with other agencies.

D. The Role of Other Agencies as Enforcers

Another important question of agency design is whether the agency will have exclusive enforcement power under its authorizing statute or whether other actors will also be permitted to enforce the statute. That is, even if a single agency has the sole power to set the governing regulations for the industry under a statute, it is still possible to have multiple agencies with the authority to enforce those rules or the underlying statute itself. As with shared rulemaking authority, shared enforcement responsibility can help achieve some of the goals of agency independence and hinder others, and again it depends critically on which agencies are sharing authority and the nature of that relationship.

1. Federal Enforcers.—We start again with the relationship between agencies that were designed to be insulated from partisan pressures and other federal agencies. Most agencies, including independent agencies, have substantial civil litigation authority outside of Supreme Court practice.[215] Thus, if the insulated agency's enforcement authority is merely shared with another agency, but the other agency does not have the ability to veto the insulated agency's enforcement decisions, this structure does not formally undercut the insulated agency's authority to bring actions to protect the beneficiaries of the regulation. Rather, this structure puts more cops on the beat to ensure that an agency's rules or a statute's requirements are taken seriously.[216] And "[r]edundancy or overlap can prevent capture of agencies

215. Devins & Lewis, *supra* note 11, at 488; Neal Devins, *Unitariness and Independence: Solicitor General Control Over Independent Agency Litigation*, 82 CALIF. L. REV. 255 (1994). Some agencies, such as the Federal Communications Commission and Nuclear Regulatory Commission, have authority under the Hobbs Act to intervene in any proceeding, including one before the Supreme Court, that involves the question of whether one of its orders should be enjoined. 28 U.S.C. § 2348 (2006). This authority is significant because, if the agency must be represented by the Solicitor General in the Supreme Court, the Administration can put forth its own views on policy instead of the views of the agency. *See, e.g.*, Bressman & Thompson, *supra* note 1, at 645 ("The Solicitor General sometimes has taken positions on securities cases that diverge from the SEC view.").

216. *Cf.* Jennifer J. Johnson, *Private Placements: A Regulatory Black Hole*, 35 DEL. J. CORP. L. 151, 195 (2010) (arguing that federal regulators like the SEC do not have sufficient resources to fill regulatory gaps on their own); Michael A. Perino, *Fraud and Federalism: Preempting Private State Securities Fraud Causes of Action*, 50 STAN. L. REV. 273, 331 (1998) (suggesting concurrent enforcement of certain types of securities regulation by state and federal agencies).

because an interest group must incur greater costs to capture several agencies instead of just one."[217] If anything, one would think that the agency that is not insulated from pressure will be unlikely to bring an enforcement action where the insulated agency has not because the uninsulated agency is more likely to side with the regulated industry.

But enforcement overlap can have potential costs in terms of the zeal of the insulated agency's enforcement agenda. Unless the insulated agency is given primary responsibility, there is the risk that it will not be as active because it is of the view that the other agency will take the lead or pick up any slack.[218] When only one agency has responsibility for enforcement, it is more likely to be diligent in pursuing that task because it knows it will be accountable for any failures.[219] It is all too easy for agencies to point fingers at each other with no one ultimately held accountable. Indeed, that scenario is eerily similar to the lead-up to the recent financial crisis, with each overlapping regulatory agency essentially casting blame on others. To remedy this risk and achieve a check on capture, the insulated agency should be designated as the primary enforcer to ensure greater accountability and to increase the incentives for the responsible agency to take action.

A designated primary law enforcer also serves the expertise function of insulation because enforcement actions have a policy-making component. It is impossible to bring actions against every law violator, so ultimately agencies need to prioritize. In addition, if regulatory standards are vague or uncertain, the decision of whether to bring an enforcement action in the face of an ambiguity also involves a substantive policy judgment. To the extent that these questions arise, there is the same risk of inconsistent standards discussed above. Having a designated enforcer addresses this problem because the agency with primary enforcement authority can be vested with the power to intervene in actions by other agencies that it views as inconsistent with the statute's objectives.

2. State Enforcers.—As with shared regulatory authority, shared enforcement authority can also exist with state actors, typically the state AG.[220] Allowing state AGs to bring enforcement actions can be a very effective check against capture. These are elected posts in most states, and although state AGs can and do become beholden to powerful interests, they

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217. Gersen, *supra* note 1, at 352.

218. *See* O'Connell, *supra* note 205, at 1680 (arguing that redundancy may actually decrease reliability).

219. *Cf.* Rachael Rawlins & Robert Paterson, *Sustainable Buildings and Communities: Climate Change and the Case for Federal Standards*, 19 CORNELL J.L. & PUB. POL'Y 335, 354 (2010) ("Relying on discretionary local regulation risks the free-rider problem and the tragedy of the commons.").

220. Margaret H. Lemos, *State Enforcement of Federal Law*, 86 N.Y.U. L. REV. (forthcoming 2011) (manuscript at 8–9), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1685458.

often win elections by appealing to broad consumer interests and bringing suits against fraudulent practices.[221] In addition, the fifty state AGs will undoubtedly represent different parties, so even if an administration is in power that is partial to business interests, there is likely an AG of the opposite party who is more sympathetic to consumer claims.[222] For example, during the 1980s when the federal government leaned heavily toward deregulation, state enforcement surged.[223]

There are numerous examples of state-initiated enforcement actions filling a void left by federal enforcers. These include Eliot Spitzer's more aggressive enforcement of securities violations as compared to the SEC,[224] as well as a host of multistate consumer protection efforts, ranging from suits against the tobacco industry to prescription drug marketing programs.[225] More recently, states joined forces to pursue fraud charges against various subprime lenders, including Household, Ameriquest, and Countrywide.[226] State AGs would have pursued fraudulent lending practices even further, but the federal regulators preempted them from going after lenders who affiliated with national banks and thrifts.[227] Although the federal financial agencies did not shift their stance on mortgage abuses in light of these state suits, in some other cases federal enforcers have followed the states and changed their own views of an issue.[228] And although many examples of states filling federal voids involve state AGs suing under state law, the incentives and effects are the same when state AGs bring actions under federal law.

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221. *See* Colin Provost, *State Attorneys General, Entrepreneurship, and Consumer Protection in the New Federalism*, 33 PUBLIUS 37, 38 (2003) ("[S]tate attorneys general have strong incentives to build up their record of political accomplishments by helping consumers and pursuing high levels of enforcement.").

222. *Id.* at 51 (observing that AGs from more liberal states join more consumer protection actions than those from more conservative states).

223. Andrew I. Gavil, *Reconstructing the Jurisdictional Foundation of Antitrust Federalism*, 61 GEO. WASH. L. REV. 657, 661–62 (1993); *see also* Cornell W. Clayton, *Law, Politics, and the New Federalism: State Attorneys General as National Policymakers*, 56 REV. POL. 525, 538 (1994) (stressing the budget increases of state AG offices during the 1980s).

224. *See* Barkow, *supra* note 174, at 10 (describing Spitzer's aggressive use of the Martin Act in order to regulate companies with the SEC joining in shortly after).

225. Lemos, *supra* note 220, at 21.

226. *Consumer Credit and Debt: The Role of the Federal Trade Commission: Hearing Before the Subcomm. on Commerce, Trade, and Consumer Prot. of the H. Comm. on Energy and Commerce*, 110th Cong. 8–11 (2009) [hereinafter *Consumer Credit Hearing*] (statement of James E. Tierney, Director, National State Att'y Gen. Program, Columbia Law School).

227. Robert Berner & Brian Grown, *They Warned Us About the Mortgage Crisis*, BLOOMBERG BUSINESSWEEK, Oct. 9, 2008, *available at* http://www.businessweek.com/magazine/content/08_42/b4104036827981.htm; Milgram & Barkow, *supra* note 213; Wilmarth, *supra* note 211.

228. Barkow, *supra* note 174, at 10–11 (chronicling how the SEC joined the efforts of former New York AG Eliot Spitzer to reform in-house mutual fund brokerage practices); Lemos, *supra* note 220, at 25 (noting that the FTC changed its policy on restitution in light of state actions seeking monetary remedies); Milgram & Barkow, *supra* note 213 (noting that the House version and Senator Dodd's proposed version of a consumer financial protection bill "recognize[d] the important role that states" played).

State AGs can also serve a valuable equalizing function by bringing enforcement actions when a federal agency shares the state's outlook on regulation but lacks the resources to police all infractions.[229] When Congress vests shared enforcement responsibility with state AGs, it often remarks on the increased resources AGs bring.[230] Federal regulators often recognize this as well. Former Federal Reserve Chairman Alan Greenspan has acknowledged that federal regulators need the resources of state AGs to effectively police the lending industry for abuses.[231] The FTC also has a long, if not consistent, history of working together with states to address consumer fraud.[232]

Critically, state AG enforcement checks against a particular federal failing: underenforcement, not overenforcement, of the law. If one is concerned with agency capture by powerful interests, that is precisely the threat to be avoided. Thus if the goal of insulation is about something else—say, congressional aggrandizement—then the relationship between state AGs and federal agencies might yield a different conclusion. Similarly, if one is more concerned with other values, such as uniformity or stability in policy, again the calculus might be different.

But if the concern is capture, then AG involvement makes sense. A multiple enforcer model with an insulated agency and state AGs is likely to be more effective than a multiple enforcer model involving only federal agencies because the federal agencies are all likely to ultimately fall in line with the President's priorities, and those priorities will frequently be dictated by powerful political interest groups.

E. Political Tools

Agencies are political creatures; even if one Congress sets up an agency in a way that maximizes its insulation from political pressures, another Congress may disagree and pass legislation that undermines it. That is the nature of our governmental structure, and this Article does not attempt to do the impossible by taking the politics out of agency design or operation. On the contrary, to help an agency charged with protecting relatively powerless

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229. *See, e.g.*, *Hearing on H.R. 4040 Before the Subcomm. on Commerce, Trade, and Consumer Prot. of the H. Comm. of Energy and Commerce*, 110th Cong. (2007) (testimony of Rachel Weintraub, Director, Product Safety, Consumer Federation of America) ("[State AG enforcement] will be a critical tool that will help buttress the CPSC's limited enforcement capabilities, help consumers to obtain redress for harms they have suffered, and deter wrongful conduct."); Robert M. Langer, *Point: State Attorneys General Should Have Broad Powers to Enforce a Federal Telemarketing Law*, 5 ANTITRUST 36, 36 (1991) ("[T]he sheer number of actions the FTC can bring in any year is insignificant compared to the nature and scope of the consumer protection problems plaguing consumers and honest businesses in the United States.").

230. Lemos, *supra* note 220, at 12 n.67 (providing examples).

231. Jane Wardell, *Greenspan Defends Subprime*, WASH. POST (Oct. 2, 2007), www.washingtonpost.com/wp-dyn/content/article/2007/10/02/AR2007100200784.html.

232. *Consumer Credit Hearing*, *supra* note 226, at 7–8 (statement of James E. Tierney, Director, National State Att'y Gen. Program, Columbia Law School).

interests requires one to be particularly attentive to the political environment in which it operates and to give the agency tools that help it negotiate that landscape as effectively as possible.

Although much of this is situational, this subpart discusses some general principles that can fortify agencies against lopsided partisan pressures in the agencies' efforts to achieve long-term public interest goals.

1. Information.—One of the most powerful weapons policy makers can give agencies is the ability to generate and disseminate information that is politically powerful. If an agency is charged with resisting short-term partisan pressures in the name of long-term public interest, then assuming the agency is faithfully pursuing that task, large numbers of voters stand to gain if the agency is allowed to operate without undue influence from elected officials that may be more focused on special interests. This mass of voters may lack political power, however, for two main reasons. First, is the classic collective action problem.[233] The general public lacks the organization to fight for its own benefit. Second, the public may have no idea that there is even an issue worth fighting for because it lacks the resources to monitor agencies and government operations and therefore loses out to the organized interests that constantly keep tabs on government action to steer government policy in the direction the interest groups prefer.[234]

Giving the agency the power to generate and disseminate information that can sway votes can go a long way toward addressing both of these issues. Most obviously, the power to provide information can remedy the public's information disadvantage vis-à-vis industry. The agency must make the public aware of pending issues so that industry is not the only one who knows about them. That is not enough, however. The key is to give the agency the authority to study and publicize data that will be of interest to the public and help energize the public to overcome collective action problems and rally behind the agency.[235] The precise content of that information is going to be subject-matter specific. For example, achieving long-term criminal justice policies that benefit the public requires data about recidivism, the effectiveness of incarceration and rehabilitative programs, and, critically, the costs of different policies.[236] In the area of consumer-protection policy, identifying dangerous products and services is a key means of generating

233. OLSON, *supra* note 5, at 11–22.

234. *See* Golden, *supra* note 26, at 257 ("[B]usiness groups—whether they are corporations or trade associations—utilize much more sophisticated monitoring techniques than the smaller advocacy groups do.").

235. *Cf.* Christopher S. Elmendorf, *Representation Reinforcement Through Advisory Commissions: The Case of Election Law*, 80 N.Y.U. L. REV. 1366, 1388 (2005) (noting that legislatures often accede to districting commission recommendations and positing that "the prospect of public outcry seems to be an important part of the story").

236. *See* Barkow, *supra* note 7, at 806–12 (discussing importance of fiscal costs in helping agencies influence sentencing policy).

public support for regulations that industry may oppose. The point here is not to identify all the salient information that can help agencies in different areas. Rather, the aim is to highlight how important information is to an agency's mission, above and beyond the information agencies need to regulate effectively. Agencies also need to be able to obtain and broadcast information that matters in political debates over the agency's policy decisions. Once key information gets highlighted in the popular press, the mass of voters may take sufficient interest in how it is handled that they will register their approval or disapproval at the ballot box.

The question for agency design, then, is how to imbed information generation and dissemination into an agency's structure. One way is to create a research arm in the agency to produce reports and studies and ensure that it is adequately funded.[237] If getting information from industry is likely to be a problem, the agency can be given subpoena or inspection power so that it has access to the materials it needs to study an issue.

Another structural feature that promotes information dissemination is to give the agency the authority to provide testimony at oversight hearings and in public without having to obtain preclearance from political actors who may censor the agency's positions. Unless Congress specifies otherwise, the default rule for agencies is that they must preclear testimony and written responses to congressional inquiries with the OMB.[238] To avoid the possibility that interest groups will pressure the OMB to keep the lid on testimony damaging to their interests, it would be preferable to allow agencies to speak directly to Congress without having to seek approval in advance.

2. Political Benefactors.—Another crucial weapon for an agency facing an army of powerful interest groups on one side of an issue is to have a powerful political ally on the side of the agency.[239] Now, one might think this is impossible because the very situation hypothesized is one in which all the interest groups are favoring one side of an issue. But political power comes from sources other than interest groups. There may be particular legislators who care about the issue and the public's interest and have electoral security because of their positions in other areas. Or, if the agency presents politically saleable information, a policy entrepreneur might take up the cause of public crusader in the hopes of winning enough votes as a consumer cham-

237. *See* Elmendorf, *supra* note 235, at 1412–13 (stating that it is important to give agencies the capacity to communicate reform proposals with an adequate budget and research capabilities).

238. Lewis, *supra* note 15, at 389 n.40 (citing OFFICE OF MGMT. & BUDGET, EXEC. OFFICE OF THE PRESIDENT, CIRCULAR NO. A-11 (1996)).

239. *See* Barkow, *supra* note 7, at 800–04 (noting the importance of political ties to the success of sentencing commissions); Heather K. Gerken, *The Double-Edged Sword of Independence: Inoculating Electoral Reform Commissions Against Everyday Politics*, 6 ELECTION L.J. 184, 192 (2007) ("[T]he empirical work on independence suggests that the reform commissions that have proved most successful in persuading the public to back a reform proposal have been able to harness the skills of those elites in the service of reform.").

pion or sensible reformer. In addition, the head of the agency may himself or herself have a base of authority because of prior public service or outreach.

The question becomes how to hardwire these connections into the very design of an agency, instead of relying on the fortuity that these links will emerge because of the particular actors involved.

Although this is a difficult task, a few avenues are promising and relate to some of the equalizing measures already discussed. One possibility is to require the agency head to have policy making experience in the subject matter. A specific requirement of policy making experience—as opposed to advocacy or field work—should increase the number of candidates with congressional experience, which in turn might give the agency head greater political capital. This is no guarantee, of course, because political capital often fades with electoral turnover.[240] But it may prove helpful in at least some circumstances.

Second, it is important for agencies to give politicians information that can help them mobilize voter support. Agencies should obtain information about what proposals are politically viable by sounding out interested groups and using pilot projects to test public reaction. For example, Heather Gerken notes that the United Kingdom's Electoral Commission succeeded in part because it "use[d] pilot projects and opinion research to test the political waters before committing to a particular reform proposal."[241] Similarly, the Minnesota Sentencing Commission succeeded in getting its reform agenda passed in large measure because it sought feedback from interest groups.[242] And all of the most successful sentencing commissions have used fiscal impact statements to achieve reforms because legislators are able to support proposals that they can tout as money savers.[243]

A third option is to give designated legislators a sense of ownership in the agency's mission so that they are more likely to support it. States have done this by making legislators voting or ex officio members of

240. The experience of Mike Pertschuk at the FTC is an illustration of the limits. Pertshuk was a high-level staffer on Capitol Hill who went on to head the FTC. But by the time Pertschuk assumed the helm of the agency, the composition in Congress changed and the leading consumer advocates who could provide him with political assistance had left office.

241. Gerken, *supra* note 239, at 191.

242. *See* Barkow, *supra* note 7, at 773–77 (describing how the Minnesota Sentencing Commission's effectiveness can be traced to its appreciation of the fact "that it would have to satisfy the interest groups concerned with criminal justice"); Richard S. Frase, *Sentencing Guidelines in Minnesota, Other States, and the Federal Courts: A Twenty-Year Retrospective*, 12 FED. SENT'G REP. 69, 76 (1999) ("[T]he Minnesota Guidelines allow sentencing policy to be significantly influenced by each of the major actors and stakeholders: the legislature, the [Sentencing] Commission, trial and appellate courts, the prosecution and defense, crime victims and community groups, probation officers, and prison officials.").

243. *See* Barkow, *supra* note 7, at 804–12 (explaining how sentencing commissions have been most successful influencing legislatures when they have focused on resource impact statements); Rachel E. Barkow, *Federalism and the Politics of Sentencing*, 105 COLUM. L. REV. 1276, 1285–90 (2005) (describing the influence of cost considerations on criminal justice reforms).

commissions.[244] Separation of powers limitations may eliminate this option at the federal level, so admittedly less effective alternatives must be sought. There is a natural link between members of Congress who serve on oversight committees and agencies, but unfortunately these relationships are tainted because committees themselves are often captured by special interests.[245] Thus, if the goal is to insulate the agency from partisan pressures, committee oversight hardly fits the bill.

But one can mitigate those concerns somewhat by placing the agency within the jurisdiction of an oversight committee that is more likely to favor a broad public interest than industry interests. For example, in the House, placing a consumer financial protection agency under the jurisdiction of the Banking Committee will yield different results than placing oversight responsibilities with the Subcommittee on Commerce, Trade and Consumer Protection. The latter is far more likely to be attuned to consumer interests than the former. Again, this protection will only go so far because all members of Congress will be concerned with powerful groups that can marshal money and votes. But the goal of design is to put the agency in as favorable a position as possible given the political environment in which all agencies must operate.

A fourth option is to enlist other agencies that have been fulfilling their public service mission to play a greater role in the target agency's process. As noted above, one must be careful with this approach not to give an agency that is itself captured by interests too much oversight over an insulated agency. But as J.R. DeShazo and Jody Freeman effectively demonstrate, "interagency lobbying" can in some cases "give voice to a set of interests that might balance or neutralize the influence of private—and usually well-financed and industry-dominated—groups."[246]

3. Public Advocates.—Another way to get political support for an agency's position is to build within the agency's structure a formal position of public advocate who is charged with representing the public's interest before the agency. Two examples of this model show both the potential pitfalls and promise of this avenue of agency design.

The Federal Reserve Board of Directors provides an illustration of the shortcomings of this model when the selection of the representative is too tied up with industry interests and the advocate lacks sufficient focus on the general public interest. Class B and Class C directors on the Board are

244. Barkow, *supra* note 7, at 800–04 (describing the benefits of having legislators on sentencing commissions).

245. *See* Steven G. Calabresi & Nicholas Terrell, *The Fatally Flawed Theory of the Unbundled Executive*, 93 MINN. L. REV. 1696, 1701–02 (2009) (explaining how special interests capture legislative committees).

246. DeShazo & Freeman, *supra* note 196, at 2231.

charged with representing the public.[247] In practice, however, these directors have been more representative of industry, for several reasons. First, the legislation stating that they should represent "consumers" also states that they should be selected with "consideration to the interests of agriculture, commerce, industry, services, [and] labor."[248]

Second, and more importantly, banks play a major role in the selection process. Class B directors are elected by the same banks that elect Class A directors.[249] Class C directors are appointed by the Board of Governors.[250] As a result, the Class B and Class C directors generally have strong ties to regulated industries as opposed to consumers.[251]

Third, regardless of affiliation, it is unlikely that the Class B and Class C directors are able to conduct sufficient oversight over state-member banks. Given the significant responsibilities that each of these directors appears to have apart from their position at the Fed, it is unlikely that any of them have sufficient time, staff, or energy for supplemental oversight that is sufficient to protect consumers.

There are, then, at least two larger lessons to draw from the experience of public advocates at the Federal Reserve. First, the selection process for a consumer representative or public advocate is critically important. Because anyone is a consumer or member of the public—even high-powered financiers—it is important to have processes and selection criteria that target people who have a greater interest in consumer and public welfare than in any particular industry in which they participate. The selection, moreover, should not be made by the industry being regulated. Second, no consumer or public interest representative can succeed without sufficient resources to look for agency transgressions. Representing the public cannot be a part-time job. It is a full-time task that requires sufficient staffing and funding to allow public advocates to properly monitor agency actions and to challenge those actions where appropriate.

A more successful deployment of the public advocate model is found in the many states that have created public-utility consumer advocates to give

247. 12 U.S.C. § 302 (2006).

248. *Id.*

249. *Id.* § 304.

250. *Id.* § 305.

251. For example, in Boston, the Class B representatives are affiliated with The Kraft Group, MassMutual Life Insurance Company, and BJ's Wholesale Club. *Officers and Directors*, FEDERAL RESERVE BANK OF BOSTON (2010), http://www.bos.frb.org/about/officers.htm#directors. Class C directors generally appear little different from their Class B counterparts. Generally, the positions are filled with Presidents and CEOs of small- and medium-sized companies. One former Class C director of the Federal Reserve Bank of Chicago, and the then-chair, was concurrently the chairman of Madison Dearborn Partners—which specialized in management buyout and special equity investing—and managed over $10 billion of committed capital and portfolio investments. *See* Jeff Bailey, *Q & A: Madison Dearborn Partners Chairman John A. Canning, Jr.*, CHICAGOMAG.COM (Apr. 2010), http://www.chicagomag.com/Chicago-Magazine/April-2010/Q-and-A-Madison-Dearborn-Partners-chairman-John-A-Canning-Jr/.

consumers a greater role in the ratemaking processes of state utilities.[252] In some jurisdictions, such as Arizona, this consumer representative is directly appointed by the governor.[253] In other jurisdictions, such as the District of Columbia, there is an independent agency with a head appointed by the mayor and confirmed by the city council.[254] Other states have a special division within the AG's office charged with representing consumers in ratemaking proceedings.[255]

Studies have found that participation by a consumer advocate leads to lower utility rates,[256] which suggests that these advocates can make a difference in substantive agency policy. The most consumer-friendly outcomes occur when the advocate is an independent entity in the bureaucracy.[257]

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As many equalizing insulators as possible should be employed if the goal is guarding against capture in an environment of lopsided interest group pressures. These features are critical supplements to the traditional design characteristics associated with independent agencies. Indeed, if designers fail to pay attention to these equalizing features, an agency will hardly deserve the appellation "independent" at all.

IV. Case Studies in Insulation Against Capture

The best way to illustrate the limits of the traditional hallmarks of independence and the importance of equalizing insulators is to describe a real-world agency facing precisely the kind of uphill one-sided political battle that insulation is supposed to help fight. This Part considers a prototypical example of asymmetrical interest group pressure opposing the general public interest: consumer protection. Subpart A discusses the doomed effort to create a robust protector of the public interest in the CPSC by using the traditional features of independence, and mostly ignoring

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252. Darryl Stein, Note, *Perilous Proxies: Issues of Scale for Consumer Representation in Agency Proceedings*, 67 N.Y.U. ANN. SURV. AM. L. (forthcoming 2011).

253. ARIZ. REV. STAT. ANN. § 40-462 (2009).

254. D.C. CODE § 34-804(b) (2009).

255. *See, e.g.*, *What the Office of Consumer Advocate Does for Pennsylvania Utility Consumers*, PA. OFF. CONSUMER ADVOC. (2010), http://www.oca.state.pa.us/information_links/brochure.htm (describing the role of the Office of Consumer Advocate, within the AG's office, for representing consumers in policy making decisions and legal proceedings).

256. *See, e.g.*, Stephen Littlechild, *Stipulated Settlements, the Consumer Advocate and Utility Regulation in Florida*, 35 J. REG. ECON. 96, 97 n.1 (2009) (highlighting a quantitative study that demonstrated lower rates in environments with consumer advocates); Robert N. Mayer et al., *Consumer Representation and Local Telephone Rates*, 23 J. CONSUMER AFF. 267, 279–80 (1989) (finding rates for basic telephone service higher where a member of a public utility commission or of the AG's office represents consumers instead of a consumer advocate).

257. *See* Mayer et al., *supra* note 256, at 281 ("Consumer advocates ought to be pursuing . . . the establishment of an independent consumer counsel as a means of holding down rates for flat-rate residential service.").

equalizing insulators. Subpart B then turns to the most recently created agency charged with protecting consumer interests: the CFPB. Subpart B analyzes the CFPB in light of the experience of the CPSC and what we know about agency design in an environment of one-sided interest group dominance.

A. The Consumer Products Safety Commission

Agencies charged with protecting consumers have a difficult task because the industries they are charged with regulating are typically far more powerful and well financed than the consumers whose interests they are charged with protecting.[258] Though select public interest advocacy groups,[259] such as Public Citizen, have had some success representing consumer interests, they are no match for the resources and political clout of the industries that oppose consumer protection laws.[260] As a result, consumer protection agencies tend to be less likely to worry about satisfying consumer groups than the more powerful regulated industries. This, in turn, creates the ideal breeding ground for agency capture and one-sided political pressure.[261]

The experience of the CPSC provides a prime illustration of how even a structurally independent agency by traditional measures, with just a few equalizing insulators, can be captured. The CPSC was created in 1972 to "protect the public against unreasonable risks of injury associated with consumer products."[262] At the time it was established, the CPSC was charged

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258. *See* RAJ DATE, CAMBRIDGE WINTER, REGULATOR UNBOUND: SOLVING AN OLD PROBLEM AT A NEW REGULATORY AGENCY 2–3 (2009), *available at* http://www.cambridgewinter.org/Cambridge_Winter/Archives/Entries/2009/7/2_REGULATOR_UNBOUND_files/regulator%20unbound%20070209.pdf (discussing the tendency of agencies to align with the powerful firms they regulate and arguing that the influence these firms have on their regulators should come as no surprise).

259. As Peter Schuck notes, public interest organizations can be defined as those that "purport[] to represent very broad, diffuse, noncommercial interests which traditionally have received little explicit or direct representation in the processes by which agencies, courts, and legislatures make public policy." Peter H. Schuck, *Public Interest Groups and the Policy Process*, 37 PUB. ADMIN. REV. 132, 133 (1977).

260. *See* PETER M. SHANE, MADISON'S NIGHTMARE: HOW EXECUTIVE POWER THREATENS AMERICAN DEMOCRACY 162 (2009) ("[T]he parties with adequate resources and organization to make themselves effectively heard within the administrative process are far more likely to be antiregulatory voices of big business than even well-known public interest groups such as the Sierra Club or the Natural Resources Defense Council."); Jason Webb Yackee & Susan Webb Yackee, *A Bias Toward Business?: Assessing Interest Group Influence on U.S. Bureaucracy*, 68 J. OF POL. 128, 129 (2006) ("[B]usiness interests enjoy disproportionate influence over rulemaking outputs despite the supposedly equalizing effects of notice and comment procedures.").

261. *See generally The Proposed Consumer Financial Protection Agency: Implications for Consumers and the FTC: Hearing Before the H. Subcomm. on Commerce, Trade, and Consumer Prot.*, 111th Cong. (2009) (Statement of Rachel E. Barkow); Amy Widman, *Advancing Federalism Concerns in Administrative Law Through a Revitalization of Enforcement Powers: A Case Study of the Consumer Product Safety and Improvement Act of 2008*, 29 YALE L. & POL'Y REV. (forthcoming 2010) (observing that "[c]onsumer protection has arguably seen some of the most egregious political capture").

262. 15 U.S.C. § 2051(b)(1) (2006).

with enforcing statutes that were previously administered by other agencies and was vested with broad new powers as well.[263] Its jurisdiction covered an estimated ten thousand consumer products and more than a million sellers and producers.[264] The CPSC was authorized to research and investigate the safety of consumer products, test consumer products, develop testing methods and devices, and train others in product safety research, investigation, and testing.[265] Congress gave the CPSC the power to promulgate safety standards[266] or ban products if a safety standard would be infeasible.[267] Its enabling legislation also gave the CPSC the power to seek judicial orders of seizure and condemnation for "imminently hazardous" products,[268] as well as orders mandating public notification of hazards, recalls, repairs, reimbursements, or replacements.[269] With this range of powers and given the breadth of its jurisdiction, the CPSC was heralded at its inception as the "most powerful Federal regulatory agency ever created."[270]

When the agency was initially proposed, there was a debate about whether it should be an executive agency or a traditional independent commission. President Nixon originally proposed housing the new consumer agency within the Department of Health, Education, and Welfare.[271] Consumer groups and their proponents in Congress, however, worried that placing the agency under executive control would undercut consumer interests because they doubted President Nixon's commitment to protecting consumers at the expense of powerful business interests.[272] The consumer advocates won this particular battle, and the CPSC "generally parallels" the structure of other traditional independent regulatory agencies.[273] There are five commissioners who are appointed by the President with the advice and consent of the Senate who serve staggered, seven-year terms.[274] The President chooses the Chairman from the commissioners with the advice and

263. Robert S. Adler, *From "Model Agency" to Basket Case—Can the Consumer Product Safety Commission Be Redeemed?*, 41 ADMIN. L. REV. 61, 65–66 (1989).

264. Teresa M. Schwartz, *The Consumer Product Safety Commission: A Flawed Product of the Consumer Decade*, 51 GEO. WASH. L. REV. 32, 43 (1982).

265. 15 U.S.C. § 2054(b).

266. Standards can be for performance or labeling and must be "reasonably necessary to prevent or reduce an unreasonable risk of injury." 15 U.S.C. § 2056(a).

267. *Id.* § 2057.

268. *Id.* § 2061(a).

269. *Id.* § 2064.

270. Schwartz, *supra* note 264, at 43–44 (quoting David Swit, *An Overview of Public Law 92-573*, *in* PROCEEDINGS OF THE BRIEFING CONFERENCE ON THE CONSUMER PRODUCT SAFETY ACT 7 (1973)).

271. Terry M. Moe, *The Politics of Bureaucratic Structure*, *in* CAN THE GOVERNMENT GOVERN? 267, 290 (John E. Chubb & Paul E. Peterson eds., 1989).

272. Devins & Lewis, *supra* note 11, at 465; Moe, *supra* note 271, at 290–91.

273. Antonin Scalia & Frank Goodman, *Procedural Aspects of the Consumer Product Safety Act*, 20 UCLA L. REV. 899, 904 (1973).

274. 15 U.S.C. § 2053(b) (2006).

consent of the Senate.[275] The commissioners can be removed only "for neglect of duty or malfeasance in office but for no other cause."[276] There is no requirement of partisan balance among the Commission, but the President is required to consider candidates who possess a "background and expertise in areas related to consumer products and protection of the public from risks to safety."[277] The CPSC is defined as an independent regulatory agency in the Paperwork Reduction Act,[278] which exempts it from OIRA review of its regulations but not from the regulatory planning process.[279] Congress also gave the agency independent litigation authority.[280] Thus, the CPSC checks all the boxes of traditional independent design and includes the additional insulating factor of having the President select on the basis of expertise in the area.

Despite these indicators of independence, the CPSC has fallen far short of its statutory mandate. The major reason is that the CPSC has been chronically underfunded and understaffed.[281] From the outset, the agency was subject to prescribed budget ceilings, a statutory framework that differed from other federal agencies that have had the authority to seek all necessary sums for their operation.[282] And the CPSC's budget decreased over time. The CPSC budget, adjusted for inflation, decreased 60% from 1975 to 1990 and staffing decreased by 41%.[283] The budget shortfall affected every aspect of the agency's operation—limiting its investigations, reducing its ability to gather and disseminate data, and requiring it to close offices.[284] As a result, the CPSC has been no match for the industry participants it is charged with regulating.

Product manufacturers have used their resource advantage on all fronts, including by capitalizing on various procedural rules in the CPSA that were aimed at protecting consumers.[285] Section 7 of the CPSA created what was known as the offeror process, which required the CPSC to solicit and utilize

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275. *Id.* § 2053(a).

276. *Id.* § 2053(a). Congress effectively reduced the number of commissioners to three in 1993 by refusing to authorize funding for a full five-member commission. U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-09-803, CONSUMER SAFETY: BETTER INFORMATION AND PLANNING WOULD STRENGTHEN CPSC'S OVERSIGHT OF IMPORTED PRODUCTS 1–2 (2009). The Consumer Product Safety Improvements Act of 2008 returned the Commission to a five-member body. Consumer Product Safety Improvement Act of 2008, Pub. L. No. 110-314, 122 Stat. 3016, 3040.

277. 15 U.S.C. § 2053(a).

278. 44 U.S.C. § 3502(5) (2006).

279. Exec. Order No. 12,866, 3 C.F.R. 638 (1993), *reprinted in* 5 U.S.C. § 601 (2000).

280. Adler, *supra* note 263, at 82 n.123.

281. Schwartz, *supra* note 264, at 44.

282. Scalia & Goodman, *supra* note 273, at 902 n.24.

283. U.S. GEN. ACCOUNTING OFFICE, GAO/HRD-92-37R, INFORMATION ON CPSC 7–9 (1992).

284. Adler, *supra* note 263, at 75–76.

285. Schwartz, *supra* note 264, at 57–58.

people from outside the agency to draft its safety standards.[286] The CPSC would put out a notice in the Federal Register describing the need for some standard and inviting people to propose or offer to develop a standard.[287] After the offeror submitted its proposal, the CPSC could adopt or revise it and then seek comments on the resulting standard. In theory, offerors could be consumer groups, standard-setting organizations, other agencies, or industry groups. In reality, the process was dominated by industry.[288] Because submitting a proposal was resource intensive, consumer groups and standards organizations found the process too burdensome; the process was "affordable only to industry groups with an economic stake in the outcome."[289] Industry representatives did not just dominate the drafting stage, they often controlled the outcomes. Industry representatives brought successful challenges to most of the CPSC's rules in court.[290] Ultimately, Congress viewed the offeror process as a failure and abolished it.[291]

Section 10 of the CPSA, which was designed to give consumers a greater say with the agency, suffered a similar fate. Section 10 established a process whereby interested persons could petition the agency to issue rules, and the CPSC would have to respond to those requests with a statement of reasons within 120 days and face de novo judicial review.[292] This framework was enacted with the intent to allow the public to "overturn bureaucratic inertia."[293] In fact, however, the process itself impeded the agency from fulfilling its mandate because the CPSC was overrun with petitions, including many from industry participants who had economic incentives to get the agency to pass particular standards.[294] Section 10's 120-day deadline and requirement of judicial review were therefore also ultimately revoked in 1981.[295]

These consumer protection mechanisms thus fell far short of their goals, and a more robust equalizing mechanism that could have helped the agency never got off the ground. The bipartisan study group that recommended the creation of the CPSC also endorsed the creation of a Consumer Safety Advocate who would be appointed by the President and would be charged with representing consumers in the CPSC's decision-making process to

286. *Id.* at 59.

287. *Id.*

288. *Id.*

289. *Id.* at 63–64.

290. *Id.* at 66.

291. *Id.* at 71.

292. Consumer Product Safety Act, Pub. L. No. 92-573, § 10, 86 Stat. 1207, 1217 (1972), *repealed by* Consumer Product Safety Amendments of 1981, Pub. L. No. 97-35, § 1210, 95 Stat. 703, 721.

293. 118 CONG. REC. 21,854 (1978) (statement of Sen. Magnuson).

294. Schwartz, *supra* note 264, at 52–53 (noting the CPSC commitment to review each petition led to a backlog that prevented the CPSC from meeting the 120-day deadline).

295. Consumer Product Safety Amendments, § 1210, 95 Stat. at 721.

"defend consumer safety against exploitation, excess, or neglect."[296] But Congress rejected the suggestion, thus eliminating a possible avenue for generating more political support for the agency's efforts.[297] To be sure, the consumer advocate would have faced a difficult task in trying to generate support for this under-resourced agency. But having a permanent position in the agency looking out for consumer interests might have at least raised the public profile of the agency, thus paving the way for some politicians to take up the mantle of rejuvenating the agency.

The CPSC faced another obstacle in achieving its mission: Congress restricted its ability to disclose information to the public. Under section 6(b) of the CPSA, "before the Commission can release any information from which the public can readily ascertain the identity of a manufacturer, the agency must submit the information to the manufacturer."[298] The manufacturer then has thirty days to comment on the information, at which point the CPSC is required to take reasonable steps to ensure the information is accurate and releasing it to the public would further the purposes of the CPSA.[299] No other agency responsible for regulating health and safety operates under similar restrictions.[300] The CPSC is further barred from releasing reports about substantial product hazards that manufacturers file with it under section 15(b) of the Act.[301] These information distribution restrictions apply whether the CPSC seeks to release the information on its own initiative or in response to a FOIA request.[302] Thus, the CPSC operates at a significant disadvantage because it is unable to use the power of this information in its efforts to win public support and equalize the political-power imbalance that so heavily favors industry.

Another shortcoming of the original CPSA was that it preempted state product-safety requirements. States were forbidden from establishing or continuing requirements "unless such requirements [were] identical to the requirements of the Federal standard."[303] The statute allowed states to apply for exemptions if the state proposed a requirement imposing "a higher level of performance than the Federal standard," but a state could do so only if there were "compelling local conditions" and if doing so would not "unduly

296. NAT'L COMM'N ON PROD. SAFETY, FINAL REPORT PRESENTED TO THE PRESIDENT AND CONGRESS 115 (1970).

297. Scalia & Goodman, *supra* note 273, at 951–52 ("[T]he elimination of the consumer-advocate proposal of the original NCPS bill is highly significant, since it was specifically designed to insure that these 'extra-agency' initiatives would be taken for the benefit of the consumer.").

298. Adler, *supra* note 263, at 107–08.

299. *Id.* at 108.

300. *Id.* at 107.

301. *Id.* at 110.

302. *Id.* at 108–10.

303. Consumer Product Safety Act, Pub. L. No. 92-573, § 26, 86 Stat. 1207, 1227 (1972) (codified at 15 U.S.C. § 2075 (2006)).

burden interstate commerce."[304] These two provisions were "probably inherently contradictory"; only one state applied for an exemption and none were granted.[305] Critically, along with hampering the development of state product-safety standards, states were not authorized to enforce the CPSA.[306] Taken together, these provisions allowed dangerous products to remain on the market long after state AGs had identified them.[307] Even after a product recall or ban on a product, the understaffed and underfunded CPSC could not effectively monitor implementation to ensure the product was no longer available to consumers.[308]

Congress sought to address some of these shortcomings with the Consumer Product Safety Improvement Act of 2008 (CPSIA),[309] which allows for a more cooperative relationship between the CPSC and state AGs. The CPSIA of 2008 left the preemption provisions in place but significantly changed the relationship between the CPSC and the state AGs when it comes to enforcement. State AGs still cannot seek civil penalties, but they can now bring actions to enjoin the sale of products that violate CPSC regulations after providing CPSC with thirty days notice.[310] They can also bring actions to protect their citizens from "substantial product hazard[s]" after notifying the Commission of a determination that immediate action is necessary.[311] With this reform, the CPSC now treats state AGs as "partners," according to

304. *Id.*

305. Dennis B. Wilson, *What You Can't Have Can't Hurt You! The Real Safety Objective of the Firearms Safety and Consumer Protection Act*, 53 CLEV. ST. L. REV. 225, 259–61 & 260 n.179 (2006).

306. Consumer Product Safety Act, § 29(a), 86 Stat. at 1230 (codified at 15 U.S.C. § 2078). The CPSC was authorized only to accept assistance from the states in the form of data collection, investigation, and educational programs if the state authority was already engaged in those activities and compensated in advance. States could also be commissioned as CPSC officers to aid in investigations and inspections. *Id.*; *see also* Widman, *supra* note 261, at 18 (explaining that prior to the Consumer Product Safety Improvement Act of 2008, only the CPSC could define whether a product was a "substantial product hazard"); Victor E. Schwartz & Christopher E. Appel, *The Plaintiffs' Bar's Covert Effort To Expand State Attorney General Federal Enforcement Power*, LEGAL BACKGROUNDER (Wash. Legal Found., Wash., D.C.), July 10, 2009, at 3 n.7, *available at* http://www.wlf.org/Upload/legalstudies/legalbackgrounder/071009Schwartz_LB.pdf (noting that state AGs did not previously bring actions for injunctive relief under the CPSA and that "if they had clear authority to do so, it would [have been] unnecessary" for Congress to pass the Consumer Product Safety Improvement Act of 2008 giving AGs that power).

307. *See Enhancing the Safety of Our Toys: Lead Paint, the Consumer Product Safety Commission, and Toy Safety Standards: Hearing Before Subcomm. of the S. Comm. on Appropriations*, 110th Cong. 6–8 (2007) (statement of Lisa Madigan, Att'y Gen., State of Illinois) (describing serious injuries children suffered during a six-year effort to obtain CPSC recall of Magnetix toys).

308. *See id.* at 8–9 (describing finding Magnetix toys on Illinois shelves more than fourteen months after the initial recall).

309. Consumer Product Safety Improvement Act of 2008, Pub. L. No. 110-314, 122 Stat. 3016 (2008) (to be codified at 15 U.S.C. § 2051).

310. 15 U.S.C.S. § 2073(b)(1)–(2) (2010).

311. 15 U.S.C.S. § 2073(b)(2)(C) (2010).

current CPSC Chairman Inez Tenenbaum.[312] Because it is so recent, it remains to be seen how this one equalizing change will address the CPSC's historical shortcomings.

What we do know is that the experience of the CPSC before the 2008 legislative changes provides a cautionary tale both of the limits of the traditional markers of independence and of how even well-intended provisions can cut against the ultimate success of a statute. The CPSC on paper looks like a textbook independent agency, yet is widely regarded as one of the least politically independent and influential agencies in government.[313] In its first five years, the CPSC issued only one safety standard—for swimming pool slides[314]—and only seven safety standards after ten years.[315] At many points, Congress and the President intervened in the agency's operation to block or weaken pending regulations.[316] The OMB considered recommending that President Carter abolish the CPSC and ultimately did advise President Reagan to do so, though Congress refused.[317] Procedural rights aimed at benefitting consumers and creating better policy became hijacked by well-financed and well-organized industry representatives. Thus, "[v]irtually every authorization hearing and appropriation hearing" for the CPSC has included a debate over proposed structural changes to the CPSC.[318] Proposed structural changes, however, have focused largely on the traditional design elements of independence, such as moving from five commissioners to a single administrator[319] or placing the CPSC within an executive branch agency.[320] As discussed above, these changes are unlikely to do much to improve the fate of the CPSC. More promising is the CPSIA's inclusion of state AGs as enforcement partners.[321] But even that is only one step toward

312. *Hearing on FY 2011 CPSC Budget Before the S. Subcomm. on Fin. Serv. and Gen. Gov't of the S. Comm. on Appropriations*, 111th Cong. (2010) (statement of Inez Tenenbaum, Chairman, Consumer Product Safety Commission).

313. *See* Adler, *supra* note 263, at 70–71 (describing many of the criticisms of the agency).

314. *Id.* at 70.

315. Schwartz, *supra* note 264, 61 & n.206.

316. Adler, *supra* note 263, at 89.

317. *Id.* at 74 n.82.

318. *Id.* at 83 n.126.

319. A 1987 GAO study examined whether a single administrator rather than five commissioners should head the CPSC, as was the case with seven of the eight other health and safety agencies. It noted that commissioners tended to vote with the Chairman and a single administrator would save money and regulate more efficiently. GAO, ADMINISTRATIVE STRUCTURE, *supra* note 153, at 5. All former CPSC chairpersons recommended a change to a single-administrator structure. *Id.* at 6.

320. GAO, ADMINISTRATIVE STRUCTURE, *supra* note 153, at 7–9; Adler, *supra* note 263, 42 n.63.

321. The recognition that CPSC's dependence on the Department of Justice and its own small staff was rendering it ineffective was a major impetus for the CPSIA of 2008.

> The mere fact that the States have this authority gives a local hammer to the CPSC that they do not have right now. Right now, what we have to do is rely on the Justice Department or we have to rely on CPSC employees to turn around and try to enforce those out in the various States . . . . It is hurting enforcement.

equalizing the enormous power imbalance between dispersed consumer interests and the highly organized, fully funded lobbying of products manufacturers.

B. The Bureau of Consumer Financial Protection

Despite its shortcomings, the CPSC was the inspiration for the recent creation of an agency charged with regulating financial products to protect consumer interests.[322] Professor Elizabeth Warren advocated for the creation of such an agency in 2007, and the financial meltdown that followed provided the political impetus to turn the idea into reality. In 2010, Congress created the CFPB, an agency tasked with making sure that "consumers are provided with timely and understandable information to make responsible decisions about financial transactions" and with protecting consumers "from unfair, deceptive, or abusive acts and practices."[323]

The institutional framework for the CFPB was a hotly contested issue from the beginning. And because capture was an obvious concern, many of the issues discussed in Parts II and III were expressly debated as industry groups fought to avoid powerful equalizing measures.

A foundational issue involved whether a new agency responsible for consumer protection should be created or whether an existing agency could be given new authority. The Obama Administration initially proposed the creation of a freestanding commission whose members would have removal protection,[324] and consumer advocates embraced this model as well.[325] Consumer groups wanted a new agency to protect consumer interests because the existing banking regulators with consumer protection responsibilities largely had ignored those interests and focused instead on their duties

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154 CONG. REC. S1505 (daily ed. Mar. 4, 2008) (statement of Sen. Pryor).

322. *See* Elizabeth Warren, *Unsafe at Any Rate*, DEMOCRACY, Summer 2007, at 8, 16 (proposing a "Financial Product Safety Commission" modeled on the CPSC).

323. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010) (to be codified at 12 U.S.C. § 5511(b)).

324. *See, e.g.*, *Creating a Consumer Financial Protection Agency: A Cornerstone of America's New Economic Foundation: Hearing Before the S. Comm. on Banking, Housing and Urban Affairs*, 111th Cong. 14 (2009) (statement of Michael S. Barr, Assistant Secretary of the Treasury for Financial Institutions) ("We just experienced what it is like to have massive failure in a system in which bank supervisors do safety and soundness and also do consumer protection."); *The Proposed Consumer Financial Protection Agency: Implications for Consumers and the FTC: Hearing Before the H. Subcomm. on Commerce, Trade and Consumer Prot.*, 111th Cong. 6 (2009) (statement of Michael S. Barr, Assistant Secretary of the Treasury for Financial Institutions) ("A new agency with a focused mission, comprehensive jurisdiction, and broad authorities is also the only way to ensure consumers and providers high and consistent standards and a level playing field across the whole marketplace without regard to the form of a product—or the type of its provider.").

325. *See, e.g.*, *CFPA One-Pager: Support Strong Protection for Consumers*, AMERICANS FOR FIN. REFORM (Jan. 11, 2009), http://ourfinancialsecurity.org/2009/01/cfpa-one-pager/ ("AFR supports creating a stand-alone CFPA that eliminates the conflicts of interest inherent in the existing banking agencies and brings a stronger and streamlined focus on consumer protections.").

to ensure the safety and soundness of financial institutions.[326] The House agreed that a new agency was required and approved a bill that would create a freestanding agency.[327]

But the financial services sector vehemently opposed the establishment of any new agency. In their view, consumer protection could not be divorced from safety and soundness concerns, thus they proposed giving consumer protection responsibilities to an existing banking regulator.[328] Opposition to a new agency by these powerful interests (which included the Mortgage Bankers Association[329] and the CEOs of at least six major financial firms[330]), plus the resistance of congressional Republicans[331] and the current Chairman of the FDIC,[332] ultimately pushed the Administration to give up on a free-standing agency to get the legislation passed in the Senate.

After debating whether to place the agency within Treasury or the Federal Reserve, the Dodd-Frank Wall Street Reform and Consumer Protection Act established the CFPB within the Federal Reserve System.[333] The risk with this structure is that "historical inertia" within the Fed on con-

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326. *See* John C. Coffee, Jr. & Hillary A. Sale, *Redesigning the SEC: Does the Treasury Have a Better Idea?*, 95 VA. L. REV. 707, 724 (2009) ("It approaches the self-evident to note that a conflict exists between the consumer protection role of a universal regulator and its role as a 'prudential' regulatory intent on protecting the safety and soundness of the financial institution."); Christopher L. Peterson, *Federalism and Predatory Lending: Unmasking the Deregulatory Agenda*, 78 TEMP. L. REV. 1, 73 (2005) ("[T]he primary mission and long-standing cultural focus of federal depository institution regulators has been monitoring the safety and soundness of their institutions, rather than consumer protection.").

327. Wall Street Reform and Consumer Protection Act of 2009, H.R. 4173, 111th Cong. (2009).

328. Some existing regulators also entered the debate, with a commissioner of the FTC arguing that the FTC should be given new financial oversight responsibilities because it already had the infrastructure and experience to address consumer issues. J. Thomas Rosch, Comm'r, Fed. Trade Comm'n, Managing Irrationality: Some Observations on Behavioral Economics and the Creation of the Consumer Financial Protection Agency, Remarks Before the Conference on the Regulation of Consumer Financial Products (Jan. 6, 2010), *available at* http://www.ftc.gov/speeches/rosch/100106financial-products.pdf.

329. *See Perspectives on the Consumer Financial Protection Agency: Hearing Before the H. Comm. on Fin. Servs.*, 111th Cong. 6–7 (2009) (statement of Mortgage Bankers Association).

330. *See* E-mail from Richard Davis, Chairman, Chief Exec. Officer, President, U.S. Bancorp, to John Dugan, Comptroller of the Currency (Jan. 15, 2010), *available at* http://www.politico.com/pdf/PPM130_comptroller_response.pdf (arguing for consumer protection "enforced by prudential regulators and not a new government agency").

331. Sewell Chan, *Dodd Proposes Giving Fed the Task of Consumer Protection*, N.Y. TIMES, Mar. 2, 2010, at B2 ("[A]dvocates, mindful of fierce Republican opposition to a stand-alone agency, have said that they are less concerned about where the entity is housed than the scope of its authority and the independence of its leadership and budget.").

332. *Hearing on Federal Regulator Perspectives on Financial Regulatory Reform Proposals Before the H. Comm. on Financial Services*, 111th Cong. 8 (2009) (statement of Sheila Bair, Chairman, Federal Deposit Insurance Corporation) ("Separating consumer protection examination and supervision from [risk supervision] could undermine the effectiveness of both . . . .").

333. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010).

sumer issues might plague the new division.[334] But it really depends on how integrated the CFPB will be within the overall Fed culture. The CFPB will be headed by a single director who serves a five-year term and is removable by the President only for cause,[335] so he or she will have formal independence from the Fed's hierarchy.

But, as Part II explained, it is not just the agency's place in an organization hierarchy that matters. Indeed, for precisely that reason, other aspects of the agency attracted controversy. Debate also revolved around whether the new entity would have independent rulemaking authority or if it would merely be an enforcement body that policed rules enacted by existing banking regulators. Consumer advocates insisted on independent rulemaking authority,[336] with industry groups vehemently opposed.[337] The U.S. Chamber of Commerce started a campaign to "Stop the CFPA" and released a counterproposal that explicitly reserved rulemaking authority for federal banking regulators, who would collectively sit on a "Consumer Financial Protection Council."[338]

The final legislation struck a compromise between these two views. The CFPB has independent and exclusive rulemaking authority under the statute for federal consumer financial law and is to be treated as the sole agency interpreting the Act for purposes of judicial deference.[339] The Board of Governors of the Federal Reserve has no approval or review authority.[340] But the CFPB must consult prudential regulators during the rulemaking process and publish any applicable objections those prudential regulators may have.[341]

Most critically, all CFPB regulations are subject to review by the Financial Stability Oversight Council, which may reject any regulation on safety and soundness concerns with a two-thirds vote.[342] This Financial Stability Oversight Council is similar to the council proposed by the

334. Biber, *supra* note 194, at 17.

335. Dodd-Frank Wall Street Reform and Consumer Protection Act § 1011(c).

336. *See* Shahien Nasiripour, *Fight for the CFPA is 'A Dispute Between Families and Banks,' Says Elizabeth Warren*, HUFFINGTON POST (Mar. 3, 2010), http://www.huffingtonpost.com/2010/03/03/fight-for-the-cfpa-is-a-d_n_483707.html (listing independent rulemaking authority as one of four crucial aspects that should be included in the new agency).

337. *See* Jim Kuhnhenn, *Talks on Bank Rules Zero in on Consumer Protection*, MEMPHIS DAILY NEWS (Mar. 3, 2010), http://www.memphisdailynews.com/editorial/Article.aspx?id=48263 ("Business and banking groups also were cool to the idea of a consumer financial protection agency . . . that had independent rule writing power.").

338. *See* Brody Mullins, *Chamber Ad Campaign Targets Consumer Agency*, WALL ST. J., Sept. 8, 2009, at A4 (describing the history of the Chamber of Commerce's opposition to the CFPA).

339. Dodd-Frank Wall Street Reform and Consumer Protection Act § 1011(b)(1).

340. *Id.* § 1012(c)(3).

341. *Id.* §§ 1022(b)(2)(B)–(C).

342. *Id.* § 1023(c)(3)(A).

Chamber of Commerce.[343] The voting members consist of the Secretary of the Treasury, the Chairman of the Board of Governors, the Comptroller of the Currency, the Director of the CFPB, the Chairman of the SEC, the Chairperson of the FDIC, the Chairperson of the CFTC, the Director of the Federal Housing Finance Agency, the Chairman of the NCUA, and an independent member who has insurance expertise and who is appointed by the President and confirmed by the Senate.[344] Most of its members have a long history of favoring the industries they are charged with regulating, making the threat of veto a real one. One analysis of the Council (that included all of its members except the chair of the NCUA) found that it would have vetoed an attempt by the CFPB to regulate nontraditional mortgages.[345] In addition, even if the Council does not have sufficient votes to veto the CFPB, any single member of this Council may stay the CFPB's regulations for up to ninety days.[346] Thus, the CFPB's design includes precisely the kind of involvement by other agencies that can undermine the CFBP's own structural protections.

Another hotly contested issue involved preemption and the relationship of the CFPB to state AGs. The financial services industry fought hard to ensure that state consumer laws would remain preempted under any new legislation or agency framework.[347] They argued that uniformity of regulatory laws is critical because the alternative, patchwork system would not function effectively and would impose enormous compliance costs.[348] They further alleged that innovation in financial products would decline without preemption because products would have to be tested in each state, thus raising costs.[349]

The Treasury Department and some consumer advocates pushed instead for floor preemption that would allow states to enact more consumer-friendly

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343. *Compare* Mullins, *supra* note 338, at A4 (describing the Chamber of Commerce's proposal for a council of federal banking regulators and representatives from state banking and consumer regulators), *with* Dodd-Frank Wall Street Reform and Consumer Protection Act § 1011(b)(1), (4) (including a substantially similar group of regulators on the Financial Stability Oversight Council (FSOC)), *and id.* § 1023 (providing procedures for FSOC review and veto of CFPB regulations).

344. Dodd-Frank Wall Street Reform and Consumer Protection Act § 1111(b).

345. Raj Date, Cambridge Winter, Losing the Last War 7 (2010), *available at* http://cambridgewinter.org/Cambridge_Winter/Archives/Entries/2010/3/21_LOSING_THE_LAST_WAR_files/cfpa%20veto%20032110_1.pdf.

346. Dodd-Frank Wall Street Reform and Consumer Protection Act § 1023(c)(1).

347. *See Banking Industry Perspectives on the Obama Administration's Regulatory Reform Proposals: Hearing Before the H. Comm. of Fin. Servs.*, 111th Cong. 58 (2009) (statement of Edward L. Yingling, President, American Bankers Association) (noting the costs associated with the failure to maintain national standards).

348. *Id.* at 13.

349. *Testimony of Edward L. Yingling On Behalf of the American Bankers Association Before the Sen. Comm. on Banking, Housing and Urban Affairs*, 111th Cong. 13 (2009); *see also* Suzanne Kapner & Tom Braithwaite, *US Consumer Protection Proposals Attacked*, FIN. TIMES, Mar. 18, 2010 (quoting, among others, John Dugan, the Comptroller of the Currency).

regulations adjusted to local conditions.[350] Consumer advocates touted the states as laboratories of regulatory experimentation and argued that states could check the possible capture of a federal agency by industry.[351]

Congress largely agreed with the consumer groups, preempting state law only to the extent it is "inconsistent" with the Dodd-Frank Act. And the Act clarifies that a state law is not inconsistent if it provides consumers with greater protection than the federal law.[352] Thus, the law goes some distance to avoid the kind of preemption by the OCC and OTS that precipitated the current fiscal crisis.[353]

Legislators took up the related question of who should have the power to enforce consumer-protection regulations promulgated by the CFPB. State AGs urged Congress to permit them to bring enforcement actions,[354] and in its initial white paper, the Department of the Treasury also supported concurrent enforcement "subject to appropriate arrangements with prudential supervisors."[355] It further supported the idea that the consumer agency should help to coordinate information sharing between the states.[356] Despite resistance from industry, Congress did ultimately pass legislation that allows state AGs to enforce CFPB regulations.[357] States must provide the CFPB with notice before bringing any action (unless it is an emergency),[358] and the CFPB retains the right to intervene in any state-initiated action, so the federal agency will be well positioned to ensure that its views are known to the court if it disagrees with the AG's position in the case.[359]

The CFPB has primary enforcement responsibility vis-à-vis other federal agencies that may be authorized to bring federal consumer finance actions.[360] Other federal agencies can recommend that the CFPB bring an

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350. U.S. DEP'T OF TREASURY, *supra* note 64, at 61; *Hearing on Consumer Financial Protections in Financial Services: Past Problems, Future Solutions Before the Sen. Comm. on Banking, Housing, and Urban Affairs*, 111th Cong. 25 (2009) (statement of Patricia A. McCoy, University of Connecticut School of Law) ("A federal floor would preserve the states' ability to protect their citizens.").

351. *Id.*

352. Dodd-Frank Wall Street Reform and Consumer Protection Act § 1041(a)(2).

353. Robert Berner & Brian Grown, *They Warned Us About the Mortgage Crisis*, BLOOMBERG BUSINESSWEEK (Oct. 9, 2008), http://www.businessweek.com/magazine/content/08_42/b4104036827981.htm.

354. *Cf.* Letter from 23 State Attorneys General to Sen. Christopher Dodd, Sen. Richard Shelby, Rep. Barney Frank, and Rep. Spencer Bachus (Aug. 17, 2009), *available at* http://www.iowa.gov/government/ag/latest_news/releases/aug_2009/CFPA_sign_on_letter.pdf (noting that a federal agency will necessarily be faced with limited resources, a common contributor to agency capture). *But see* Bar-Gill & Warren, *supra* note 163, at 99 n.325 ("It is not clear that diffuse authority is less prone to regulatory capture than concentrated authority.").

355. U.S. DEP'T OF TREASURY, *supra* note 64, at 61.

356. *Id.*

357. *See* Dodd-Frank Wall Street Reform and Consumer Protection Act § 1042(a)(1).

358. *Id.* § 1042(b)(1).

359. *Id.* § 1042(b)(2). The CFPB can also remove the action to federal court and has a right to appeal to the same extent as if it were a party. *Id.*

360. *Id.* §§ 1024(d)(1), 1025(c)(1), 1026(d)(1).

enforcement action, and if the CFPB opts not to initiate an enforcement proceeding after 120 days, the requesting agency may bring such a proceeding on its own.[361] The Act thus has safeguards if the CFPB itself is lax in enforcing its own regulations.

The Act employs other equalizing insulators as well. Proponents of the agency successfully obtained an independent source of funding for it apart from the usual budget approval process. Senator Dodd pushed this through because he wanted to insulate the agency from the political pressures that go along with budgetary oversight.[362] The CFPB's funding is to be provided by the Board of Governors of the Federal Reserve in an "amount determined by the Director to be reasonably necessary to carry out the authorities of the CFPB under Federal consumer financial law" but marked at between ten and twelve percent of the total operating budget of the Federal Reserve.[363] As industry fees fund the Federal Reserve, they in turn fund the CFPB. But the CFPB's jurisdiction is not optional, so the CFPB need not make any effort to attract fee-paying entities. The CFPB's access to this guaranteed funding stream gives it a critical advantage that the CPSC lacked.

In addition, the Act gives the CFPB and its director some tools to generate political support. The Director and CFPB officers need not get testimony or legislative recommendations preapproved by the Board of Governors or any other agency.[364] Thus, the agency has a direct pipeline to Congress, voters, and the media to express concern over issues.

The CFPB also has the capacity to generate information that may ultimately prove helpful in the political debate. The Act creates a specific unit in the CFPB responsible for researching, among other things, consumer financial products that pose risks to consumers, and for increasing "consumer awareness and understanding of costs, risks, and benefits" of financial products and services.[365] To assist the CFPB in monitoring for risks to consumers, the Act gives it authority to gather information from examination reports provided to prudential regulators and to require regulated firms to respond to CFPB requests for additional information.[366] Although the CFPB must keep proprietary and customer identification information confidential, it is authorized to make public information in an aggregate form.[367] This function can help the CFPB flag industry abuses and garner public support

361. *Id.* § 1025(c).

362. Robert G. Kaiser, *The CFPA: How a Crusade to Protect Consumers Lost Its Steam*, WASH. POST, Jan. 31, 2010, at G01.

363. Dodd-Frank Wall Street Reform and Consumer Protection Act § 1017(a). The total cap on the budget slowly increases from 10% in FY 2011, to 11% in FY 2012, to the permanent rate of 12% beginning in FY 2013. *Id.* § 1017(a)(2)(A).

364. *Id.* § 1012 (c)(4).

365. *Id.* § 1013(b)(1).

366. *Id.* § 1022(c)(4)(B).

367. *Id.* § 1022(c)(3)(B).

for regulation if it is otherwise facing resistance from the Council, Congress, or the President.

The CFPB also possesses independent civil litigation authority, so it can bring its own actions in federal court without having to go through the Department of Justice.[368] In addition, the CFPB has jurisdiction to represent itself before the Supreme Court and need not cede control over an appeal to the Solicitor General.[369]

The Act seemingly seeks to address consumer interests in other ways, though some of these methods seem structurally unlikely to influence a Director who is otherwise more concerned with banking interests. The prime example of this is the Act's creation of a Consumer Advisory Board to "advise and consult with the Bureau" on consumer finance laws and emerging consumer financial products, services, and trends.[370] The Director appoints the members of the Board and is charged with selecting individuals with expertise in consumer protection, community development, fair lending, and service to underserved communities.[371] Six members of this body must be selected from recommendations of the regional Federal Reserve Bank Presidents, but the Act does not specify the total number of members. This body is to meet at least twice a year,[372] but it holds no legal authority over the Director, so it is entirely up to the Director as to how much weight to place on recommendations from this body.[373] This Board is thus a poor substitute for a vigorous, full-time public advocate.

It remains to be seen how this mix of traditional and equalizing insulators will play out for the CFPB. The CFPB is a relatively insulated body compared to most agencies, but a critical exception is the check on its regulations possessed by the Financial Stability Oversight Council. The Council's veto threat appears to be the greatest limit on the agency's independence.

But whether the CFPB succeeds or fails, it is promising that so much attention was paid to equalizing insulators in the debate over the agency's creation. It appears that the CFPB's designers learned some important lessons from the CPSC. Unlike the bulk of legal scholarship that continues to obsess over removal as the touchstone of independence, the CFPB's proponents viewed removal as nothing more than a starting point for insulation. They recognized that much more needs to be done for an agency to further the public interest when all the strong interest groups line up against that mission.

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368. *Id.* § 1054(b).

369. *Id.* § 1054(e).

370. *Id.* § 1014(a).

371. *Id.* § 1014(b).

372. *Id.* § 1014(c).

373. *See id.* § 1014(a) (requiring the Board to "advise and consult with" the CFPB but lacking any indication that the Director must adopt the Board's recommendations).

V. Conclusion

The goal of this Article has been to think about agency independence from the perspective of what independence is trying to accomplish: specifically, the goal of deflecting one-sided interest group pressure to further the public interest. If the goal of insulation is to obtain long-term rational policy decisions that benefit the public at large and do not reflexively yield to interest group demands, more sophisticated agency design mechanisms should be considered than those typically associated with independent agencies. Removal, OIRA review, and the multimember commission structure are not irrelevant to capture, but they are hardly enough to insulate an agency from asymmetrical political pressures.

Of course, no agency can be completely immunized from such pressure even with a sharp focus on all the possible equalizing factors. Agencies will remain political bodies regardless of their design. But even if a complete barrier against politics is not possible (or desirable), buffers can be put in place to reduce unwarranted political pressure that can harm the public interest.

This Article aimed to identify a list of general factors to consider in designing agencies, but it is not possible to create a one-size-fits-all template for all the substantive areas covered by agency oversight. Future research will need to assess the strengths and tradeoffs associated with particular design features in the context of specific regulatory contexts.[374] What works for criminal law may not work for consumer regulation, and each substantive area might require design modifications not discussed here.[375] And certainly what is practically possible will depend on the political environment.

But hopefully the discussion in this Article of previously underappreciated equalizing features will draw more attention to them as possible solutions to problems of political imbalance that cut against the public interest. Unlike removal restrictions, these are not features that spark core constitutional debates about the separation of powers. But they are mechanisms that matter in the real world of agency design, and if the goal in creating agencies is to promote good government, they deserve far more attention than they have received.

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374. For a persuasive call to administrative law scholars to closely examine the design and internal functioning of agency processes, see Philip J. Weiser, *Institutional Design, FCC Reform, and the Hidden Side of the Administrative State*, 61 ADMIN. L. REV. 675, 721 (2009) (arguing that institutional "processes—as well as the culture and structure of the agencies themselves—must be critically examined and debated by the academy and policy makers just like the substantive decisions that result from those processes").

375. For example, in designing prosecutors' offices, some thought should be given to internal separation within the agency. Rachel E. Barkow, *Institutional Design and the Policing of Prosecutors: Lessons from Administrative Law*, 61 STAN. L. REV. 869, 888–93 (2009).

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Veil-Piercing

Peter B. Oh*

From its inception veil-piercing has been a scourge on corporate law. Exactly when the veil of limited liability can and will be circumvented to reach into a shareholder's own assets has befuddled courts, litigants, and scholars alike. And the doctrine has been bedeviled by empirical evidence of a chasm between the theory and practice of veil-piercing; notably, veil-piercing claims inexplicably seem to prevail more often in Contract than Tort, a finding that flouts the engrained distinction between voluntary and involuntary creditors.

With a dataset of 2,908 cases from 1658 to 2006, this study presents the most comprehensive portrait of veil-piercing decisions yet. Unlike predecessors, this study examines Fraud, a long-suspected accessory to veil-piercing, as well as specific subclaims in Contract, Tort, and Fraud, to provide a fine-grained portrait of voluntary and involuntary creditors. And this study analyzes the rationales instrumental to a piercing decision.

The findings largely comport with our legal intuitions. The most successful civil veil-piercing claims lie in Fraud or involve specific evidence of fraud or misrepresentation. Further, claims not only prevail more often in Tort than Contract, but they also adhere to the voluntary–involuntary creditor distinction. Surprisingly, though, veil-piercing presents a greater risk to individual shareholders than corporate groups.

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Introduction

The origins of corporate veil-piercing are unknown.[1] This is perhaps because the limitation on shareholder liability has never been absolute.[2] For as long as limited liability has existed, courts have disregarded the form of malfeasant corporate entities to access a shareholder's own assets.[3] With characteristic flair, I. Maurice Wormser once declared that "[t]he refusal of the courts to allow quiddits and quillets to stand in the way of justice is nowhere better exemplified" than by veil-piercing, "Our Lady of the Common Law."[4]

Unfortunately, in this venue, Lady Justice measures with metaphors. At the turn of the twentieth century, courts began borrowing from agency law the imagery of a corporate "alter ego"[5] and "instrumentality"[6] to adjudicate veil-piercing claims. The migration, and subsequent mutation,[7] of such

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1. *See, e.g.*, STEPHEN B. PRESSER, PIERCING THE CORPORATE VEIL § 1:3, at 1-12 (2004) ("There is some authority . . . for suggesting that the doctrine that shareholders of corporations were not normally responsible for the corporation's debts found its way into American common law immediately after the Revolution. The precise reach of corporate shareholder limited liability in the early United States is, however, uncertain.").

2. The genesis of American limited liability, like its flip side, is subject to interpretive debate. *See, e.g.*, EDWIN MERRICK DODD, AMERICAN BUSINESS CORPORATIONS UNTIL 1860, at 84–93 (1954) (suggesting that support for the idea of imposing unlimited liability on shareholders in certain situations existed as early as the 1830s in England and America); Phillip I. Blumberg, *Limited Liability and Corporate Groups*, 11 J. CORP. L. 573, 587–95 (1986) (contending that "acceptance was far from inevitable" for the idea of limiting liability of shareholders, which thus was not perceived always as an essential principle of American corporate law); Roger E. Meiners et al., *Piercing the Veil of Limited Liability*, 4 DEL. J. CORP. L. 351, 362 (1979) (arguing that the advent of limited liability did not impact immediately the number of incorporations). *But see* PRESSER, *supra* note 1, § 1:3, at 1-17 (arguing that Blumberg's interpretation of Dodd "is flawed, insofar as it minimizes the effects of limited liability on the historical development of American industry").

3. In the United States, "the cradle of piercing of the corporate veil doctrines," KAREN VANDEKERCKHOVE, PIERCING THE CORPORATE VEIL 76 (2007), the earliest general shareholder liability statute preceded the earliest judicial reference to veil-piercing by a mere twelve days. *Compare* Act of Mar. 3, 1809, ch. 65, § 6, 1809 Mass. Acts 464, 466 (requiring officers of manufacturing corporations to pay judgments against their corporation when the corporation lacks sufficient property to pay the judgment), *with* Bank of the U.S. v. Deveaux, 9 U.S. (5 Cranch) 61, 75 (1809) (referring to a saying that "you may raise the veil which the corporate name interposes" in an opinion dated March 15, 1809).

4. I. MAURICE WORMSER, DISREGARD OF THE CORPORATE FICTION AND ALLIED CORPORATION PROBLEMS 40, 44 (1927).

5. *See, e.g.*, United States v. Milwaukee Refrigerator Transit Co., 142 F. 247, 253 (E.D. Wis. 1905) (describing a firm as the "alter ego" of a "dummy" corporation); Cheeney v. Ocean S.S. Co., 19 S.E. 33, 35 (Ga. 1893) (describing an agent as an "alter ego").

6. HARRY G. HENN, HANDBOOK OF THE LAW OF CORPORATIONS AND OTHER BUSINESS ENTERPRISES § 146, at 250 n.2 (2d ed. 1970).

7. Litigants seeking to pierce the veil have had to establish that a corporate defendant was, *inter alia*, a(n) "adjunct," "agent," "alias," "alter ego," "alter idem," "arm," "blind," "branch," "buffer," "cloak," "coat," "cover," "creature," "curious reminiscence," "delusion," "department," "double," "dry shell," "dummy," "fiction," "form," "instrumentality," "mouthpiece," "name," "nominal identity," "phrase," "puppet," "screen," "sham," "simulacrum," "snare," "stooge," "subterfuge," "tool," *id.*, "conduit," Edwards Co. v. Monogram Indus., Inc., 700 F.2d 994, 995 (5th Cir. 1983),

imagery eventually prompted Justice Cardozo to issue his now famous functionalist caution that "[m]etaphors in law are to be narrowly watched, for starting as devices to liberate thought, they end often by enslaving it."[8]

Cardozo's fear has proven to be prophetic. To beat the metaphorical veil of limited liability, courts slavishly continue to demand metaphorical proof.[9] The most common veil-piercing test requires a plaintiff to demonstrate that a corporation was an "alter ego" or "mere instrumentality," as evidenced by complete control and domination, of a shareholder used to perpetuate a fraud, wrong, or injustice that has proximately caused unjust loss or injury to the plaintiff.[10] Quite aptly, veil-piercing has been called "jurisprudence by metaphor or epithet."[11]

The inherent imprecision in metaphors has resulted in a doctrinal mess. Courts have resorted to compiling ever-expanding lists of ex post fact-specific factors, no one of which is dispositive or necessarily connected to the underlying harm.[12] And these factors have inflicted damage in collateral contexts. Veil-piercing tests have been assimilated to unincorporated business entities, such as the limited liability company (LLC) and limited liability partnership (LLP).[13] Veil-piercing tests also have been transmitted to

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"curtain," Kinney Shoe Corp. v. Polan, 939 F.2d 209, 212 (4th Cir. 1991), "device," Morris v. N.Y. State Dep't of Taxation & Fin., 623 N.E.2d 1157, 1161 (N.Y. 1993), "marionette," InSITE Servs. Corp. v. Am. Elec. Power Co. (*In re* InSITE Servs. Corp.), 287 B.R. 79, 97 (Bankr. S.D.N.Y. 2002), "monkey's paw," People v. Clauson, 41 Cal. Rptr. 691, 694 (Cal. Dist. Ct. App. 1964), "paraphernalia," Kingston Dry Dock Co. v. Lake Champlain Transp. Co., 31 F.2d 265, 267 (2d Cir. 1929), "shell," Associated Vendors, Inc. v. Oakland Meat Co., 26 Cal. Rptr. 806, 814 (Cal. Dist. Ct. App. 1962), or "umbilication," Berger v. Columbia Broad. Sys., Inc., 453 F.2d 991, 996 (5th Cir. 1972), of a controlling shareholder.

8. Berkey v. Third Ave. Ry. Co., 155 N.E. 58, 61 (N.Y. 1926). Ironically, Cardozo's eloquence obscured, if not undermined, his own attempt to analyze and fix the doctrine. *See* PRESSER, *supra* note 1, § 1:4, at 1-21, 1-24 ("Shrouding his own analysis irretrievably in the mists of metaphor," Cardozo's "ringing phrases, when analyzed, yield little of substance"); *infra* note 204 and accompanying text; *cf.* FAST TIMES AT RIDGEMONT HIGH (Refugee Films 1982) ("Relax, all right? My old man['s] . . . got this ultimate set of tools. I can fix it." (Jeff Spicoli, played by Sean Penn)).

9. *Cf.* Fred S. McChesney, *Contractarianism Without Contracts? Yet Another Critique of Eisenberg*, 90 COLUM. L. REV. 1332, 1336 (1990) ("[I]t takes a model to beat a model." (citing GEORGE J. STIGLER, THE THEORY OF PRICE 7 (4th ed. 1987))).

10. *See, e.g.*, FREDERICK J. POWELL, PARENT AND SUBSIDIARY CORPORATIONS: LIABILITY OF A PARENT CORPORATION FOR THE OBLIGATIONS OF ITS SUBSIDIARY § 3 (1931) (denoting a three-element test for piercing the corporate veil). Another approach has been to cull from Powell a checklist of factors. *See, e.g.*, PRESSER, *supra* note 1, § 1:6, at 1-30 to 1-34 (detailing a list of questions taken from Powell's work to ask to determine whether to pierce the corporate veil); *infra* note 12 and accompanying text.

11. PHILLIP I. BLUMBERG, THE LAW OF CORPORATE GROUPS: PROCEDURAL PROBLEMS IN THE LAW OF PARENT AND SUBSIDIARY CORPORATIONS § 1.02, at 8 (1983).

12. *See, e.g.*, *Associated Vendors*, 26 Cal. Rptr. at 813–15 (listing twenty factors); Cathy S. Krendl & James R. Krendl, *Piercing the Corporate Veil: Focusing the Inquiry*, 55 DENV. L.J. 1, 52–55 (1978) (listing thirty-one factors, none of which is necessarily "a logical or preferable measure" for veil-piercing).

13. *See, e.g.*, Robert B. Thompson, *The Limits of Liability in the New Limited Liability Entities*, 32 WAKE FOREST L. REV. 1, 7 (1997) ("[W]e can expect a regular flow of cases seeking to pierce the veil of these new limited liability entities addressed to closely held businesses.").

extracorporate areas of the law, including agriculture, antitrust, arbitration, bankruptcy, civil procedure, criminal, discrimination, employment, environmental, estate and trust, family, pension, tax, and workers' compensation.[14] Not surprisingly, veil-piercing has been decried as an "intellectually disturbing"[15] and "incoherent"[16] doctrine whose "ambiguity and randomness"[17] resembles "lightning, [in that] it is rare, severe, and unprincipled."[18] There even has been a coincidental chorus to eliminate the doctrine altogether.[19]

Moreover, our understanding of veil-piercing has been complicated by empirical analysis. Almost two decades ago, Robert Thompson conducted a pioneering content analysis of approximately 1,600 federal and state veil-piercing cases.[20] Despite the oft-expressed judicial presumption respecting

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14. *See infra* notes 123–32 and accompanying text. For an example of veil-piercing tests being transmitted to criminal law as well as estate and trust law, see *Ex parte Chambers*, 898 S.W.2d 257, 260 (Tex. 1995) (holding that a corporate officer or director can be guilty of criminal contempt even though a court's order is directed solely at the corporation and not the officer or director), and *Henry I. Siegel Co. v. Holliday*, 663 S.W.2d 824, 827 (Tex. 1984) (analogizing the role of a board of directors to the role of trustees when directors transfer property of the corporation to directors of the corporation).

15. ROBERT CHARLES CLARK, CORPORATE LAW 38 (1986).

16. David Millon, *Piercing the Corporate Veil, Financial Responsibility, and the Limits of Limited Liability*, 56 EMORY L.J. 1305, 1381 (2007).

17. Allied Capital Corp. v. GC-Sun Holdings, 910 A.2d 1020, 1042 (Del. Ch. 2006).

18. Frank H. Easterbrook & Daniel R. Fischel, *Limited Liability and the Corporation*, 52 U. CHI. L. REV. 89, 89 (1985).

19. *See generally* Stephen M. Bainbridge, *Abolishing Veil Piercing*, 26 J. CORP. L. 479 (2001); Douglas C. Michael, *To Know a Veil*, 26 J. CORP. L. 41 (2000) (both advocating the elimination of the veil-piercing doctrine). Less radical are numerous proposals to codify the veil-piercing test. *See, e.g.*, Rebecca J. Huss, *Revamping Veil Piercing for All Limited Liability Entities: Forcing the Common Law Doctrine into the Statutory Age*, 70 U. CIN. L. REV. 95, 96 (2001) (urging codification to "accomplish[] the goals of veil piercing in a more consistent manner"); John H. Matheson & Raymond B. Eby, *The Doctrine of Piercing the Veil in an Era of Multiple Limited Liability Entities: An Opportunity to Codify the Test for Waiving Owners' Limited-Liability Protection*, 75 WASH. L. REV. 147, 152 (2000) (stressing the necessity of "eliminating free-form decisionmaking" in favor of codification). A century ago, though, Wormser dismissed such codification efforts as "not only impossible but preposterous." WORMSER, *supra* note 4, at 37–38.

Nevertheless, there have been some legislative attempts to control veil-piercing. *See, e.g.*, CAL. CORP. CODE § 300(e) (West 2009) ("The failure of a close corporation to observe corporate formalities relating to meetings of directors or shareholders in connection with the management of its affairs . . . shall not be considered a factor tending to establish that the shareholders have personal liability for corporate obligations."); WIS. STAT. § 180.1835 (2009) ("The failure of a statutory close corporation to observe usual corporate formalities or requirements relating to the exercise of its corporate powers or the management of its business and affairs is not grounds for imposing personal liability on the shareholders for obligations of the corporation."); *infra* note 35 and accompanying text. The Model Business Corporation Act, for instance, provides that "a shareholder of a corporation is not personally liable for the acts or debts of the corporation except that he may become personally liable by reason of his own acts or conduct." MODEL BUS. CORP. ACT § 6.22(b) (2002); *see also id.* § 7.32(f) (providing that a shareholder agreement "shall not be a ground for imposing personal liability on any shareholder . . . even if the agreement or its performance . . . results in failure to observe . . . corporate formalities").

20. Robert B. Thompson, *Piercing the Corporate Veil: An Empirical Study*, 76 CORNELL L. REV. 1036, 1044 (1991) [hereinafter Thompson, *Empirical Piercing*]; *see also* Robert B.

the separation between a corporation and its shareholders,[21] Thompson found that veil-piercing claims succeeded 40.18% of the time, and exclusively against close corporations.[22] Further, not only did veil-piercing occur far less often against corporate parents than individual shareholders,[23] but success was not highly correlated with evidence of shareholder domination, a failure to observe corporate formalities—such as conducting meetings or keeping records—or inadequate capitalization.[24] Most notably, Thompson found that veil-piercing claims arose and prevailed more often in Contract than Tort.[25]

These results project a broad chasm between the theory and practice of veil-piercing. That litigants apparently enjoy far more success against individual shareholders belies a diverse collection of arguments and predictions about veil-piercing being more compelling against corporate groups.[26] Similarly confounding is the apparently weak relationship between a decision to pierce and evidence of domination or a failure to observe formalities,[27] as well as inadequate capitalization, particularly for claims in Tort.[28]

But it is the asymmetrical result between Contract and Tort that has become one of corporate law's most notorious, counterintuitive puzzles. For almost as long as veil-piercing has existed, commentators have distinguished

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Thompson, *Piercing the Veil Within Corporate Groups: Corporate Shareholders as Mere Investors*, 13 CONN. J. INT'L L. 379, 380 & n.4 (1999) [hereinafter Thompson, *Group Piercing*] (providing a limited update on ten additional years of cases).

21. *See, e.g.*, Kashfi v. Phibro-Salomon, Inc., 628 F. Supp. 727, 732–33 (S.D.N.Y. 1986) ("Courts are reluctant to disregard the separate existence of related corporations by piercing the corporate veil, and have consistently given substantial weight to the 'presumption of separateness.'" (citations omitted)); EnduraCare Therapy Mgmt. v. Drake, 681 S.E.2d 168, 171 (Ga. Ct. App. 2009) (maintaining the presumption of separation in the absence of sufficient allegations within the complaint).

22. Thompson, *Empirical Piercing*, *supra* note 20, at 1047–48 & tbl.1.

23. *Id.* at 1056.

24. *Id.* at 1063 tbl.11.

25. *Id.* at 1058. Substantive claims have been capitalized to distinguish them from factors within the veil-piercing test.

26. *See, e.g.*, Easterbrook & Fischel, *supra* note 18, at 110–11 ("Courts' greater willingness to allow creditors to reach the assets of corporate as opposed to personal shareholders is . . . consistent with economic principles."); Jonathan M. Landers, *A Unified Approach to Parent, Subsidiary, and Affiliate Questions in Bankruptcy*, 42 U. CHI. L. REV. 589, 623 (1975) ("[C]ourts may have a greater proclivity to reach corporate, as opposed to individual, stockholders."); *infra* notes 168–69, 172–73 and accompanying text.

27. *See, e.g.*, David H. Barber, *Piercing the Corporate Veil*, 17 WILLAMETTE L. REV. 371, 377–78 (1981) ("Courts nearly always cite disregard of corporate formalities as one prong of the test used to determine when the veil should be pierced. . . . The intent behind the formalities prong of the piercing test . . . is to prevent shareholder-owners from impairing the interests of other parties by carrying this unity of interest too far.").

28. *See, e.g.*, William P. Hackney & Tracey G. Benson, *Shareholder Liability for Inadequate Capital*, 43 U. PITT. L. REV. 837, 867 (1982) ("The courts seem more inclined to hold shareholders liable for the torts of their corporations than for their contracts when . . . inadequate capitalization is present, and the textwriters generally support this position."); *infra* notes 101–06 and accompanying text.

between claims grounded in Contract versus Tort.[29] That distinction is commonly recast as one between voluntary and involuntary creditors, but the fulcrum remains constant: "Contract creditors . . . are compensated ex ante for the increased risk of default ex post. Tort creditors, by contrast, are not compensated."[30] The inability of involuntary creditors to bargain or insure themselves against risk has led "almost every commentator" to conclude that veil-piercing is more compelling in Tort than Contract.[31]

Indeed, prior to Thompson's study, there had been numerous observations to this effect. Commentators believed veil-piercing claims were being adjudicated correctly, citing impressionistic evidence that courts were generally "more likely to disregard the corporate entity in [T]ort cases than in [C]ontract cases."[32] This claim, in turn, started to permeate actual judicial reasoning.[33] And after a controversial decision by its supreme court,[34] Texas even amended its business-corporation statute with a stiffer standard for veil-piercing claims couched in Contract.[35]

All of this was thrown into a lurch by Thompson's findings. According to Thompson, the infrequency of claims in Tort "suggests that piercing law is rooted in concerns of inequitable bargains."[36] But even he is pressed to explain the disparity in veil-piercing rates, merely observing that "[T]ort settings seem to involve different concerns than [C]ontracts cases," or that some exogenous factors may be at work.[37] As he simply acknowledged, the

29. *See, e.g.*, William O. Douglas & Carrol M. Shanks, *Insulation from Liability Through Subsidiary Corporations*, 39 YALE L.J. 193, 195 (1929) (bifurcating their analysis of veil-piercing cases into claims in Contract versus Tort).

30. Easterbrook & Fischel, *supra* note 18, at 112.

31. *See* 2 PHILLIP I. BLUMBERG ET AL., BLUMBERG ON CORPORATE GROUPS § 57.04, at 57-8 (2d ed. 2010) ("[V]ery special pressures in [T]ort law require a treatment different from that in [veil-piercing] cases arising in other areas of law, such as [C]ontract."); David W. Leebron, *Limited Liability, Tort Victims, and Creditors*, 91 COLUM. L. REV. 1565, 1601 (1991) ("[A]lmost every commentator has paused to note that limited liability cannot be satisfactorily justified for [T]ort victims . . . ."); *infra* note 91 and accompanying text.

32. 1 WILLIAM MEADE FLETCHER ET AL., FLETCHER CYCLOPEDIA OF THE LAW OF CORPORATIONS § 41.85, at 269–70 (rev. vol. 2006); *see also* Easterbrook & Fischel, *supra* note 18, at 112 ("Courts are more willing to disregard the corporate veil in [T]ort than in [C]ontract cases.").

33. *See, e.g.*, Cascade Energy & Metals Corp. v. Banks, 896 F.2d 1557, 1577 (10th Cir. 1990) ("[T]he analysis of corporate veil issues is different in a consensual transaction, such as a breach of contract case, than in a nonconsensual transaction, such as many tort cases . . . ."); Gray v. Edgewater Landing, 541 So. 2d 1044, 1046 (Miss. 1989) ("Since [C]ontract liability arises from an essentially consensual relationship, courts generally decline to disregard the corporate entity . . . .").

34. *See* Castleberry v. Branscum, 721 S.W.2d 270, 273 (Tex. 1986) (permitting veil-piercing merely upon proof of constructive fraud).

35. *See* Willis v. Donnelly, 199 S.W.3d 262, 272 n.12 (Tex. 2006) ("In response to *Castleberry*, Article 2.21 of the [Texas Business Corporation Act] was amended in 1989 to establish a clear legislative standard . . . [for] the liability of a shareholder . . . in the context of contractual obligations . . . ." (citing TEX. BUS. CORP. ACT ANN. art. 2.21 cmt. (West 2003))).

36. Thompson, *Empirical Piercing*, *supra* note 20, at 1068.

37. *Id.* at 1069; *see also infra* notes 143–51 and accompanying text.

inexplicable results, "more than any other in the project, go against the conventional wisdom."[38]

That was almost two decades ago. The results now "appear to be on their way to becoming the conventional wisdom."[39] Despite Thompson's caution,[40] courts cite his study in adjudicating veil-piercing claims.[41] States utilize his results to attract potential incorporators,[42] and lawyers rely on his findings in providing business guidance.[43] Further, his methodology has been replicated in empirical studies of veil-piercing around the world.[44] The incontrovertible fact is that Thompson's study has influenced how we perceive and engage the doctrine.

Yet to this day, no one has explained the dominance of veil-piercing in Contract over Tort. Some interpret Thompson's findings as evidence of a predisposition toward using Contract as a substantive vehicle for veil-piercing.[45] Others regard the findings as "simply illustrat[ing] how badly the courts have been handling piercing cases,"[46] and thus "yet another black mark against" the doctrine.[47] And one commentator even "cling[s] to the economists' notion that the veil is more likely to be pierced in [T]ort than in [C]ontract cases."[48] With veil-piercing, people seem to see what they want to see.

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38. Thompson, *Empirical Piercing*, *supra* note 20, at 1058.

39. PRESSER, *supra* note 1, § 1:7, at 1-36 n.5; *see also infra* note 73 and accompanying text.

40. *See* Thompson, *Group Piercing*, *supra* note 20, at 392 ("I would discourage devoting too much attention to whether corporate law conflicts with [T]ort law . . . ."). *But see infra* notes 89–92 and accompanying text.

41. *See, e.g.*, Coltec Indus., Inc. v. United States, 62 Fed. Cl. 716, 724 (2004); Theberge v. Darbro, Inc., 684 A.2d 1298, 1303 (Me. 1996); Garcia v. Coffman, 946 P.2d 216, 227 (N.M. Ct. App. 1997) (all referencing Thompson's veil-piercing study).

42. *See, e.g.*, *Nevada v. California*, CORPORATE SERV. CTR., http://corporateservicecenter.com/nevada-california-comparison.html (claiming that "Nevada provides a much stronger corporate veil" by citing Thompson's finding that, "among the states with the largest number of reported veil piercing decisions, California courts pierce the corporate veil at the highest rate—45% of attempted veil piercing cases in California are successful").

43. *See, e.g.*, John Wootton, *Corporation Owner's Survival Guide*, EMPOWEREDWEALTH.COM 1, http://www.empoweredwealth.com/documents/WoottonSurvivalGuideReport_000.pdf ("What's more, over 50 percent of the time, you will lose your protection and the court will hold you personally liable." (citing Thompson, *Empirical Piercing*, *supra* note 20, at 1055)). *Contra* Thompson, *Empirical Piercing*, *supra* note 20, at 1054–55 & tbl.7 (noting that "[a]mong close corporations, those with only one shareholder were pierced in almost 50% of the cases" and reporting a 49.64% veil-piercing rate in that specific context).

44. *See infra* note 74 and accompanying text.

45. *See, e.g.*, Nicholas L. Georgakopoulos, *Contract-Centered Veil Piercing*, 13 STAN. J.L. BUS. & FIN. 121, 127 (2007) ("[C]ourts and litigants demonstrate a bias in favor of piercing in [C]ontract disputes compared to [T]ort disputes. In part, this bias is evidenced in the research of Professor Robert Thompson . . . ."); *infra* note 73.

46. Franklin A. Gevurtz, *Piercing Piercing: An Attempt to Lift the Veil of Confusion Surrounding the Doctrine of Piercing the Corporate Veil*, 76 OR. L. REV. 853, 859 (1997).

47. Bainbridge, *supra* note 19, at 512 n.159.

48. PRESSER, *supra* note 1, § 1:7, at 1-37 n.5.

Or perhaps what they see is simply incomplete. The controversy about the empirics of veil-piercing, particularly in Contract and Tort, may be akin to the classic fable about the disagreement among a group of blind men over their perception of an elephant.[49] In this case the elephant in the room is not veil-piercing but its long-suspected accessory: Fraud. The omission of this claim from Thompson's study, as well as its progeny, is crucial in light of Fraud's substantively hybrid nature;[50] certain species of Fraud, for instance, can be characterized as a Contract or Tort, or have been regarded by some as a complete substitute for Contract claims.[51] But there has been no investigation into, much less speculation about, whether seepage of Fraud into Contract or Tort could explain the wayward path apparently being taken by courts.

The present study charts a different course. An entirely new dataset is constructed from 1658 up to and including 2006, thus adding twenty-one years to the time frame originally examined by Thompson.[52] This dataset is not only bigger, but broader, as more expansive search terms were used in Westlaw, whose database coverage has become more complete in the two decades since Thompson's study was published.[53] The initial yield of 15,188 cases approximately doubles the number that Thompson's terms would have obtained over the same time frame;[54] after exclusions are applied, the final dataset of 2,908 federal and state cases presents the most comprehensive empirical portrait of veil-piercing decisions yet.[55] Moreover, the present study substantially revises and refines Thompson's methodology. For the first time the dynamics of veil-piercing in Fraud are revealed,[56] and data were collected for specific subclaims in Contract, Tort, and Fraud to provide not only a fine-grained portrait of different types of actions, but also insight into the distinction between voluntary and involuntary creditors. And the *rationes decidendi* of veil-piercing cases are examined to discern how veil-piercing claims are being adjudicated.

The results largely confirm our legal intuitions about veil-piercing. Federal and state courts pierce almost 50% of the time and only the veil of close corporations whose potential for consolidated shareholding permits a

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49. *See generally* MASNAVĪ I MA'NAVĪ, TEACHINGS OF RUMI 122–26 (E.H. Whinfield trans., Octagon Press 1994) ("The eye of outward sense is as the palm of a hand,/The whole of the object is not grasped in the palm."); JOHN GODFREY SAXE, POEMS 259–61 (1868) ("And so these men of Indostan/Disputed loud and long,/Each in his own opinion/Exceeding stiff and strong,/Though each was partly in the right/And all were in the wrong!").

50. *See infra* notes 81–83 and accompanying text.

51. *See infra* notes 81, 87 and accompanying text.

52. This is not an arbitrary time frame. *See infra* notes 111, 113 and accompanying text.

53. *See infra* note 143.

54. *See infra* note 114 and accompanying text.

55. *See infra* note 114 and accompanying text.

56. *See supra* text accompanying notes 49–51; *infra* text accompanying notes 80–100.

requisite finding of control or domination.[57] As expected, the most successful civil veil-piercing claims are grounded in Fraud or supported by specific evidence of fraud or misrepresentation. Moreover, veil-piercing claims prevail more often in Tort than Contract, reversing the counterintuitive asymmetry found by Thompson's study; the superiority of veil-piercing rates in Tort over Contract not only holds but expands when those claims are recast into claims between involuntary and voluntary creditors. Although not as sharp as expected, the disparity in rates for these distinctions squares with what commentators, courts, and practitioners have long believed but thus far been unable to prove.[58] Similarly, quite predictable suspects comprise the most common instrumental rationales: commingling, control or domination, injustice or unfairness, fraud or misrepresentation, and inadequate capitalization. Somewhat surprisingly, though, evidence of inadequate capitalization is comparably frequent and instrumental in Contract, Tort, and Fraud claims; quite unexpectedly, the relative sophistication of bargaining parties yields no appreciable difference in veil-piercing success, while courts reach more often into the assets of individual shareholders than corporate groups.

Part I reviews Thompson's methodology before delineating the hypotheses and methodology of the present study. Part II then systematically presents the study's results from the perspective of the types of courts, the state law applied, the types of substantive claims, and the rationales instrumental to a decision whether to pierce; Part II concludes by reexamining all of these results in terms of voluntary and involuntary creditors.

I. Methodology

Veil-piercing is misdubbed the most litigated issue in corporate law.[59] But as the primary exception to limited liability, the doctrine is a staple of

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57. *See infra* note 165 and accompanying text.

58. *See infra* notes 88–92.

59. *Contra* Robert B. Thompson, *Agency Law and Asset Partitioning*, 71 U. CIN. L. REV. 1321, 1325 (2003); Thompson, *Empirical Piercing*, *supra* note 20, at 1036; Thompson, *supra* note 13, at 1; Robert B. Thompson, *Piercing the Veil: Is the Common Law the Problem?*, 37 CONN. L. REV. 619, 619 (2005) [hereinafter Thompson, *Common Law Piercing*] (all describing piercing the veil as "the most litigated issue in corporate law"). This proposition, which is based on searches Thompson conducted in Lexis and Westlaw with the same terms used in his study versus terms such as "corporate takeover" and "hostile takeover," has been cited by numerous courts, academics, and practitioners. *See, e.g.*, Coltec Indus., Inc. v. United States, 62 Fed. Cl. 716, 741 (2004) ("'[P]iercing claims constitute the single most litigated area in corporate law . . . .'" (alteration in original) (emphasis removed) (quoting FRANKLIN A. GEVURTZ, CORPORATION LAW § 1.5, at 70 (2000))); Darrell D. Dorrell & Gregory A. Gadawski, *Counterterrorism: Conventional Tools for Unconventional Warfare*, U.S. ATT'YS' BULL., Mar. 2005, at 1, 2, *available at* http://www.justice.gov/usao/eousa/foia_reading_room/usab5302.pdf; Stephen B. Presser, Commentary, *Thwarting the Killing of the Corporation: Limited Liability, Democracy, and Economics*, 87 NW. U. L. REV. 148, 154 n.21 (1992) (both stating that "'[p]iercing the corporate veil is the most litigated issue in corporate law'" (quoting Thompson, *Empirical Piercing*, *supra* note 20, at 1036)). Searches using Westlaw's Key Search Topics prior to 1986 and to the present, however, reveal that references to

corporate law that impacts virtually every aspect of business planning.[60] And our empirical knowledge of veil-piercing has been shaped indelibly by Robert Thompson's landmark study, which occupies a prominent place within any discussion of the doctrine. Cited in hundreds of articles, briefs, and opinions,[61] the study has spawned numerous derivative studies in the United States and around the world.[62]

However sincere, methodological imitation is not necessarily a form of flattery. Thus far, the critical spotlight has focused almost exclusively on the results, and not the methodology, of Thompson's study. This Part redirects the spotlight, examining that study's design before proceeding to advance some hypotheses and then to delineate the present study's methodology. Part I concludes with some cautionary notes about the limits of both studies.

A. Thompson's Methodological Tree

Thompson's study actually covers two time frames. His original dataset contained approximately 1,600 veil-piercing cases in Westlaw, up to and including 1985;[63] Thompson subsequently expanded the dataset with an additional 2,200 cases from 1986 up to and including 1996.[64] The update yielded results consistent with the original findings:[65]

1. Courts pierced the corporate veil in approximately 40% of all reported cases;
2. Piercing . . . is a doctrine directed exclusively at close corporations and corporate groups . . . ;

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numerous claims, including "Liabilities of Officers and Directors" ((TO(101x(c)) (TO(101x(d))) /p Liab!) (101k653 /p (officer director))) and "Dissolution" (TO(101x(v))), all yield more hits than Thompson's search terms. *See* Scotland M. Duncan, Lifting the Veil of Misconception About the Most Litigated Issue in Corporate Law 18 (2009) (unpublished manuscript) (on file with author) (noting that from 1986 to 2008, Key Search references to veil-piercing increased more than any other topic with at least 3,000 hits).

60. *See, e.g.*, GEVURTZ, *supra* note 59, § 1.5, at 70 (describing veil-piercing as "the area of corporation law which the attorney seeking to avoid corporate practice is most likely to confront"); Easterbrook & Fischel, *supra* note 18, at 89 ("Limited liability is a fundamental principle of corporate law."); Leebron, *supra* note 31, at 1566 ("No principle seems more established in capitalist law or more essential to the functioning of the modern corporate economy [than limited liability]."); Robert B. Thompson, *The Basic Business Associations Course: An Empirical Study of Methods and Content*, 48 J. LEGAL EDUC. 438, 440 fig.1 (1998) (reporting veil-piercing as the only topic taught by all seventy-one Business Associations/Corporations professors responding to a survey).

61. A search of ((Robert /2 Thompson) /s ("Piercing the Corporate Veil: An Empirical Study")) in Westlaw's ALLCASES, BRIEF-ALL, and TP-ALL databases yielded 245 hits.

62. *See infra* notes 73–74 and accompanying text.

63. *See infra* notes 77–78 and accompanying text.

64. *See* Thompson, *Group Piercing*, *supra* note 20, at 385 ("A preliminary examination of the recent data indicates that these results fit within the pattern of the original study."). *But see infra* text accompanying note 164. The 2,200 cases apparently comprise the initial yield and not the final dataset. By comparison there were only 802 cases in this study's final dataset from 1986 up to and including 1996.

65. Thompson, *Group Piercing*, *supra* note 20, at 385.

3. Courts pierce the veil more often to get to an individual who is a shareholder [43.13%, 786 cases] than to reach another corporation who is a shareholder [37.21%, 637 cases] . . . [;]
4. Courts are less likely to pierce the veil in cases involving [T]ort claims [30.97%, 226 cases] as opposed to those involving [C]ontractual [41.98%, 779 cases] or [S]tatutory claims [40.58%, 552 cases] . . . ;
5. Undercapitalization [53.22%, 171 cases] and corporate informalities [46.46%, 226 cases] often lead to piercing, but appear in a relatively small percentage of all cases in which courts pierce and an even smaller number of the [T]ort cases.[66]

Moreover, "even if we eliminate[d] the [M]isrepresentation cases from the [C]ontracts group, the piercing results [would] still remain higher in [C]ontract cases."[67] According to Thompson, these results suggest that, for close corporations, veil-piercing is "strongly rooted in the bargain setting,"[68] and that "courts interfere when there has been wrongful conduct by the proprietor that inappropriately changes the bargain the parties struck."[69]

For both time frames, Thompson utilized the same methodology.[70] Combinations of two search terms, "piercing the corporate veil" and "disregard! the corporate entity," as well as four unidentified Key Numbers were run in Westlaw.[71] A team of law students then collected data on a decision's year, the court's jurisdiction and type, the type of plaintiff and defendant, the number and type of shareholders, the substantive claims connected to veil-piercing, the frequency with which eighty-five possible rationales were mentioned in all cases, and the court's ultimate decision whether to pierce.[72]

Thompson's study has served as the methodological foundation for all subsequent empirical studies of corporate disregard. In the United States, pairs of Wake Forest law students have sampled the last twenty years of veil-piercing cases in Westlaw, and "[b]ecause [their] method was intended to mirror Professor Thompson's, [they] closely followed his methodology."[73]

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66. *Id.* at 384–85 (citations omitted). The bracketed figures come from Thompson, *Empirical Piercing*, *supra* note 20, at 1055 tbl.7, 1058 tbl.9; *see also* Thompson, *supra* note 13, at 9 ("After additional analysis of that data base, I can make a broader statement. Piercing occurs only within corporate groups or in close corporations with fewer than ten shareholders.").

67. Thompson, *Empirical Piercing*, *supra* note 20, at 1069.

68. *Id.* at 1071.

69. Thompson, *Common Law Piercing*, *supra* note 59, at 629.

70. *Compare* Thompson, *Empirical Piercing*, *supra* note 20, at 1044–47, *with* Thompson, *Group Piercing*, *supra* note 20, at 385–88.

71. Thompson, *Empirical Piercing*, *supra* note 20, at 1036 n.1.

72. *Id.* at 1044 & n.48.

73. Lee C. Hodge & Andrew B. Sachs, Empirical Study, *Piercing the Mist: Bringing the Thompson Study into the 1990s*, 43 WAKE FOREST L. REV. 341, 347 (2008) (analyzing 228 cases

Thompson's methodology also has been replicated by Australian and British studies, both of which incidentally find a similar asymmetry for Contract over Tort.[74]

Far less prevalent, though, has been any critical reflection on Thompson's methodology.[75] His study presents the frequency of and success

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from 1986 to 1995); *see also* Rich McPherson & Nader Raja, Corporate Justice: An Empirical Study of Piercing Rates and Factors Courts Consider When Piercing the Corporate Veil 12 (2009) (unpublished note) (on file with author) (examining 236 cases from 1996 to 2005). Both studies sampled one-sixth of all cases and found that the overall veil-piercing rate apparently declined. *See* Hodge & Sachs, *supra*, at 347, 349–50 (analyzing 483 cases out of 2,901 returned in the initial search and "showing an increasing reluctance of courts to pierce the corporate veil"); McPherson & Raja, *supra*, at 12 (analyzing every sixth case arranged chronologically to create a sample of 638 cases from an initial yield of 3,821 cases). Notably, Hodge and Sachs's sample found that veil-piercing claims prevail more often in Tort (35.71%) than Contract (31.11%). Hodge & Sachs, *supra*, at 354 tbl.8; *see also* PRESSER, *supra* note 1, § 1:7, at 1-37 n.5 ("The review of the cases that I did in preparing this treatise for publication in 1991, particularly with regard to cases decided since 1985, the end of the Thompson study period, does suggest that the idea that courts ought to pierce less frequently in [C]ontract cases is gaining ground."). *But see infra* note 244 and accompanying text. McPherson and Raja's sample, however, found that veil-piercing claims prevail more often in Contract (30.70%) than Tort (15.00%). McPherson & Raja, *supra*, at 21 tbl.10.

Another corporate veil-piercing study drawing on Thompson's methodology is by Nicholas Georgakopoulos. His study simply examines Westlaw Key Number references to veil-piercing in Contract and Tort, from 1947 up to and including 2003, to generate a prediction about the frequency with which litigants pursue these claims. Georgakopoulos, *supra* note 45, at 127–28. Georgakopoulos's study, however, does not involve any coding and, by extension, any veil-piercing rates. Moreover, his study is highly vulnerable to false positives because of the remedial nature of veil-piercing and evidence suggesting asymmetrical settlement rates in Tort versus Contract. *See infra* notes 147, 152 and accompanying text.

Thompson's study also has served as a methodological template for empirical studies examining specific applications and arguable extensions of veil-piercing. *See generally* John H. Matheson, *The Modern Law of Corporate Groups: An Empirical Study of Piercing the Corporate Veil in the Parent-Subsidiary Context*, 87 N.C. L. REV. 1091 (2009) (examining 360 parent–subsidiary cases from January 1, 1990, to March 1, 2008); Fred S. McChesney, *Doctrinal Analysis and Statistical Modeling in Law: The Case of Defective Incorporation*, 71 WASH. U. L.Q. 493 (1993) (examining 102 defective incorporation cases from 1818 to 1945); Geoffrey Christopher Rapp, *Preserving LLC Veil Piercing: A Response to Bainbridge*, 31 J. CORP. L. 1063 (2006) (examining sixty-one LLC veil-piercing cases up to and including 2005). *But see* Timothy R. Wyatt, Note, *The Doctrine of Defective Incorporation and Its Tenuous Coexistence with the Model Business Corporation Act*, 44 WAKE FOREST L. REV. 833, 847–51 (2009) (criticizing McChesney's conclusion that defective incorporation is a subset of veil-piercing).

74. *See* Charles Mitchell, *Lifting the Corporate Veil in the English Courts: An Empirical Study*, 3 COMPANY FIN. & INSOLVENCY L. REV. 15, 18 (1999) (examining 290 British cases from 1888 up to and including 1998 with a methodology that "was inspired by the example of two similar studies which have been undertaken, one of a large group of American cases, the other of a smaller group of Australian cases"); Ian M. Ramsay & David B. Noakes, *Piercing the Corporate Veil in Australia*, 19 COMPANY & SEC. L.J. 250 (2001) (examining 104 Australian cases up to and including 1999). *But see generally* Peter B. Oh, Piercing v. Lifting 1, 8–10 (2010) (unpublished manuscript) (on file with author) (examining 188 British cases from 1888 up to and including 2006 with the same methodology used here and finding, *inter alia*, corporate-disregard claims prevail more often in Tort than Contract).

75. Ramsay and Noakes have made one of the few substantive refinements in all subsequent empirical veil-piercing studies, which is to code cases for claims on a nonexclusive basis. *See* Ramsay & Noakes, *supra* note 74, at 264 ("There are 109 cases listed, more than the overall study,

rates for veil-piercing within four substantive claims: Contract, Criminal, Statute, and Tort.[76] But the total number of claims is less than the total number of cases, which indicates that none of the cases contained multiple claims or that they were reduced subjectively to just one type of claim.[77] Similarly, the number of defendant shareholders is dramatically less than the total number of cases, despite the possibility that there may be bundled claims against corporate groups and individuals.[78] Further, his study presents only the frequency with which a rationale is mentioned in cases and the extent to which

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as in some cases the piercing argument was made in more than one context."). One criticism of Thompson's study is that the results are not replicable. *See* David S. Goldman, *Legal Construct Validation: Expanding Empirical Legal Scholarship to Unobservable Concepts*, 36 CAP. U. L. REV. 79, 123 (2007) ("While [Thompson's] article precisely describes the specific searches conducted, it does not completely explain how the results were filtered."). Thompson actually does not specify the four Key Numbers used in connection with his search terms, *see infra* note 114, and he does not provide complete results for combinations of variables, such as the veil-piercing rate for claims and rationales. *See, e.g.*, *infra* note 209 and accompanying text.

Another set of criticisms has been advanced by Fred McChesney:

> [T]he rethinking . . . carried forward by Thompson is not wholly satisfactory methodologically. Merely counting cases and sorting them into various pigeonholes according to expressed judicial rationales . . . suffers from at least two deficiencies. . . .
>
> First, the stated reasons for judges' holdings may not always explain the complete rationale for their decisions. . . .
>
> Second, courts typically designate more than one factor as relevant or important in the ultimate decision, rather than expound a bright-line, single-factor rule.

McChesney, *supra* note 73, at 515. With respect to the second concern, McChesney's constructive suggestion is to use multiple regression, "a statistical technique that can solve the problems of calculating the influence of individual case factors, identifying their relative weights, and accounting for the simultaneous presence of different factors." *Id.* at 519; *see also id.* at 515 n.82 ("Thompson is aware of the methodological shortcomings of merely sorting cases, and reports that he is at work on a multiple regression model for the veil-piercing cases."). This suggestion has been applied productively by John Matheson's recent study of veil-piercing in corporate groups, which notes that "[a]though Thompson recognized the need for a more sophisticated 'logit analysis, a form of statistical regression analysis,' the supposed 'model and the results' have never been reported." Matheson, *supra* note 73, at 1106 n.48 (quoting Thompson, *Empirical Piercing*, *supra* note 20, at 1046 n.62). Thompson actually did perform regression analysis but limited it to statistical differences and presented it on a selective basis. Thompson, *Empirical Piercing*, *supra* note 20, at 1049 nn.77–79, 1052 nn.83 & 87, 1055 n.100, 1057 nn.111 & 114, 1058 n.116. Only summary statistics are presented here, as regression analysis will be part of a future project. As for McChesney's concerns about judicial rationales, this study focuses on a case's *rationes decidendi* rather than their mere mention. *See infra* subpart II(D). Some of his functionalist concerns are addressed here, but there are unavoidable selection effects that apply not only to this study, but also to Matheson's and McChesney's. *See infra* notes 143–51 and accompanying text.

76. Thompson, *Empirical Piercing*, *supra* note 20, at 1044.

77. *Compare* Thompson, *Empirical Piercing*, *supra* note 20, at 1058 tbl.9 (reporting 1,572 Contract, Tort, Criminal, and Statute cases), *with id.* at 1048 tbl.1 (reporting 1,583 cases), *id.* at 1049 tbl.2 (reporting a total of 1,585 cases over time), *and id.* at 1050 tbl.4 (reporting 1,577 cases by court); *compare also* Thompson, *Group Piercing*, *supra* note 20, at 386 tbl.2 (reporting 445 Contract, Tort, and Statute cases), *with id.* at 386 tbl.1 (reporting 547 corporate-group cases).

78. *Compare* Thompson, *Empirical Piercing*, *supra* note 20, at 1055 tbl.7 (reporting 1,423 shareholders), *with id.* at 1048 tbl.1 (reporting 1,583 cases), *id.* at 1049 tbl.2 (reporting 1,585 cases over time), *and id.* at 1050 tbl.4 (reporting 1,577 cases by court). Thompson presented results for only corporate and individual shareholders, but even the addition of governmental owners seems unlikely to account for the difference.

the rationale's absence or presence coincides with decisions to pierce; although useful, those data do not reflect whether a particular rationale's absence or presence played a dispositive role in the court's ultimate decision.[79] Evidence of control or domination, for instance, may appear with equal frequency in Contract and Tort claims, but its absence or presence may serve as dicta in certain situations and a dispositive justification in others.

Moreover, Thompson's study does not recognize Fraud as a distinct substantive claim. Instead, Fraud claims were recharacterized as Contract, Criminal, Statute, or Tort claims on an exclusive basis.[80] But the lines for recharacterization are not always so clear. For instance, although Fraudulent Misrepresentation claims can be characterized as either Contract or Tort,[81] they frequently receive ambiguous treatment in opinions.[82] And courts frequently conflate the distinction between Contract-based warranty and Tort-based deceit claims.[83] The versatility in the characterization of Fraud claims presents a potentially distortive effect on Thompson's findings about the frequency of and rates for veil-piercing in Contract and Tort.

Thompson's omission of Fraud is puzzling given its long-suspected role as an accessory to veil-piercing. Stephen Presser, for instance, has observed

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79. *Id.* at 1063 ("[T]he same reasons seem to appear in cases which pierce the veil and those decisions which do not." (citation omitted)). Although failed and successful attempts to pierce do mention the same four rationales with the most frequency, their proportional representation varies substantially. For instance, more than any other rationale, the absence of fraud or misrepresentation is mentioned in decisions not to pierce, but its presence is far less prominent in successful veil-piercing cases. *Compare id.* at 1063 tbl.11, *with id.* at 1064 n.141.

80. *See supra* note 77 and accompanying text.

81. *See, e.g.*, Thomas C. Galligan Jr., *Contortions Along the Boundary Between Contracts and Torts*, 69 TUL. L. REV. 457, 462–63 (1994) (identifying six considerations for deciding whether to characterize a claim in Contract or Tort). Moreover, as is evident in conflicts of laws, characterization can be a difficult problem. *See, e.g.*, A. H. ROBERTSON, CHARACTERIZATION IN THE CONFLICT OF LAWS 176–83 (1940) (examining the problem of characterization for Contract and Tort).

82. *See, e.g.*, Moses v. Martin, 360 F. Supp. 2d 533, 543–44 (S.D.N.Y. 2004) (denying a motion to dismiss a Fraud claim that was allegedly a restatement of a breach-of-contract claim on the basis that the defendant owed a fiduciary duty); Ziegler v. Inabata of Am., Inc., 316 F. Supp. 2d 908, 916–17 (D. Colo. 2004) (denying a motion for summary judgment for claims based on an ownership interest, "thereby invoking claims for breach of contract and fraudulent, or at a minimum, negligent misrepresentation").

83. *See, e.g.*, William L. Prosser, *The Fall of the Citadel (Strict Liability to the Consumer)*, 50 MINN. L. REV. 791, 800 (1966) (characterizing warranty as a "freak hybrid born of the illicit intercourse of [T]ort and [C]ontract"); Glenn D. West & W. Benton Lewis, Jr., *Contracting to Avoid Extra-Contractual Liability—Can Your Contractual Deal Ever Really Be the "Entire" Deal?*, 64 BUS. LAW. 999, 1009–10 (2009) ("Even since courts have enforced express warranties as contractual promises, many courts have continued to recognize a separate [T]ort claim for breaches of those express warranties to the extent that such claims also satisfy the culpability, materiality, and reliance requirements of a [M]isrepresentation claim brought in [T]ort."). The economic-loss doctrine represents a judicial attempt to clarify this distinction. *See, e.g.*, United Vaccines, Inc. v. Diamond Animal Health, Inc., 409 F. Supp. 2d 1083, 1094 (W.D. Wis. 2006) ("The economic loss doctrine is intended to keep a party from effecting an end run around [C]ontract law to recover under [T]ort law what it could not recover under [C]ontract law and through [C]ontract remedies." (citation omitted)).

that veil-piercing "often incorporates and bears a strong resemblance to [F]raud."[84] And Robert Clark has gone so far as to argue that most veil-piercing claims may be seen as simply Fraudulent Transfers disguised.[85] Even Stephen Bainbridge, who despises veil-piercing, believes that "[F]raud and [M]isrepresentation asks the right questions and seems far more likely to lead to correct outcomes."[86] In a similar vein, Richard Posner has suggested that, "[s]ince [F]raud is independently actionable, one may question the need for a doctrine of piercing the corporate veil in [C]ontract cases."[87]

Posner's skepticism presumes that the orthodox economic distinction between voluntary and involuntary creditors is judicially compelling.[88] In theory limited liability does not present a moral-hazard problem of externalizing risk to voluntary creditors because they can and will take optimal precautions.[89] But when the transaction costs of precautions are prohibitively high, the probability that a corporation will engage in risk-shifting activity increases.[90] Imposing Tort liability compensates involuntary creditors while also creating incentives for corporations to engage in an efficient amount of care.[91] This distinction should be obviated only when there is fraudulent

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84. PRESSER, *supra* note 1, § 1:1, at 1-7.

85. *See* Robert Charles Clark, *The Duties of the Corporate Debtor to Its Creditors*, 90 HARV. L. REV. 505, 540–53 (1977) (excepting veil-piercing of corporations with inadequate initial capitalization from his assertion).

86. Bainbridge, *supra* note 19, at 519.

87. Torco Oil Co. v. Innovative Thermal Corp., 763 F. Supp. 1445, 1451 (N.D. Ill. 1991) (Posner, J., by designation). *But see* Krendl & Krendl, *supra* note 12, at 31 ("Fraud cases are difficult to prove, and the quantum of evidence available in most corporate veil cases is considerably smaller than would be required to carry the burden on a fraud claim.").

88. *But see infra* note 287 and accompanying text.

89. *See, e.g.*, Richard A. Posner, *The Rights of Creditors of Affiliated Corporations*, 43 U. CHI. L. REV. 499, 503 (1976) (contending that lenders will exact higher interest rates on limited liability corporations as a risk premium); *cf.* PRESSER, *supra* note 1, § 1:7, at 1-37 to 1-38 ("Posner's veil-piercing article . . . is simply developing an argument . . . already advanced by [Frederick] Powell.").

90. *See, e.g.*, Easterbrook & Fischel, *supra* note 18, at 105 ("This is a simple application of the Coase Theorem."); *id.* at 104–09 (explaining that some of a firm's costs for risky activities are shifted to involuntary creditors when high transaction costs prevent affected parties from charging an appropriate risk premium).

91. *See generally* Henry Hansmann & Reinier Kraakman, *Toward Unlimited Shareholder Liability for Corporate Torts*, 100 YALE L.J. 1879, 1879–81 (1991) [hereinafter Hansmann & Kraakman, *Unlimited Liability*] (suggesting a rule of pro rata shareholder liability for corporate Torts); Leebron, *supra* note 31, at 1568–69 (arguing that the justifications for limited liability do not apply to noncontractual creditors). Hansmann and Kraakman's suggestion has been criticized on essentially enforcement grounds. *See, e.g.*, Janet Cooper Alexander, *Unlimited Shareholder Liability Through a Procedural Lens*, 106 HARV. L. REV. 387, 388–90 (1992) (contending that Hansmann and Kraakman's proposal would encounter too many procedural barriers and might not be implementable); Joseph A. Grundfest, *The Future of Unlimited Liability: A Capital Markets Perspective*, 102 YALE L.J. 387, 389–91 (1992) (criticizing a pro rata rule for shareholder liability because it does not account for how capital markets actually would react to that rule). *But see generally* Henry Hansmann & Reinier Kraakman, *A Procedural Focus on Unlimited Shareholder Liability*, 106 HARV. L. REV. 446 (1992) [hereinafter Hansmann & Kraakman, *Procedural Focus*] (responding to Alexander's criticisms); Henry Hansmann & Reinier Kraakman, *Do the Capital*

conduct, as it impedes the ability of parties to assess accurately the optimal level of precautions.[92]

Thompson's methodology permits only a crude assessment of this account's validity. His study does provide limited insight into the success of veil-piercing claims in Contract and Tort, as well as the frequency with which courts mention rationales.[93] But a more fine-grained analysis would examine the relative sophistication of contracting parties to see whether veil-piercing truly "is rooted in concerns of inequitable bargains."[94] And one would want to examine intentional, negligent, and quasi-contractual Torts to see whether "[T]ort settings seem to involve different concerns than [C]ontracts cases."[95]

Moreover, one would want to examine the rationales that seem instrumental to a court's ultimate decision whether to pierce. As Frank Gevurtz has pointed out,

> The question is not what sort of creditor more deserves piercing in the abstract. Rather, the question is what specific facts justify piercing in favor of either type of creditor. The utility of the [T]orts versus [C]ontracts distinction is that the facts which should justify piercing may be different when dealing with the different types of claimants.[96]

Although not a prerequisite in most tests, evidence of "fraud or something like it" is demanded by Delaware courts[97] and is often given significant weight in other jurisdictions;[98] if veil-piercing indeed concerns inequitable bargains, Thompson has suggested that, in those settings, "the role of the court will be similar to that in other [C]ontract contexts—has there been fraud or some other reason why the bargain struck by the parties should not be respected by the court?"[99] Alternatively, if fraud or misrepresentation is absent or insufficient, evidence of commingled assets or a failure to observe

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Markets Compel Limited Liability? A Response to Professor Grundfest, 102 YALE L.J. 427 (1992) [hereinafter Hansmann & Kraakman, *Capital Markets*] (rebutting Grundfest's criticisms). For an analysis of the origins of this carve out, see Daniel R. Kahan, Note, *Shareholder Liability for Corporate Torts: A Historical Perspective*, 97 GEO. L.J. 1085, 1102–03 (2009).

92. *See, e.g.*, Easterbrook & Fischel, *supra* note 18, at 112 ("Th[e] distinction between [C]ontract and [T]ort creditors breaks down when the debtor engages in fraud or misrepresentation . . . [because] the creditor will not demand adequate compensation.").

93. Thompson, *Empirical Piercing*, *supra* note 20, at 1063 tbl.11, 1068–70.

94. *Id.* at 1068.

95. *Id.* at 1069.

96. Gevurtz, *supra* note 46, at 859.

97. *See, e.g.*, Mobil Oil Corp. v. Linear Films, Inc., 718 F. Supp. 260, 268 (D. Del. 1989) ("Fraud or something like it is required." (citations omitted)).

98. *See, e.g.*, Associated Vendors, Inc. v. Oakland Meat Co., 26 Cal. Rptr. 806, 813 (Cal. Dist. Ct. App. 1962) ("[W]hile the doctrine does not depend on the presence of actual fraud, it is designed to prevent what would be fraud or injustice, if accomplished."). Not surprisingly, this requirement has mutated. *See, e.g.*, Kuibyshevnefteorgsynthez v. Model, Civ. A. No. 93-4919, 1995 WL 66371, at *15 (D.N.J. Feb. 6, 1995) ("'[I]njustice or the like' will suffice." (citation omitted)).

99. Thompson, *Common Law Piercing*, *supra* note 59, at 622.

basic corporate formalities might assert itself more when veil-piercing litigants succeed in Contract than in Tort.[100]

One other rationale meriting specific attention is undercapitalization. For years commentators and courts have debated how such evidence should be weighed for veil-piercing cases. Early commentators argued that undercapitalization was a serviceable proxy for fraud or misrepresentation that warranted veil-piercing in all contexts,[101] and, despite difficulties in determining the amount and sufficiency of capital possessed by a defendant corporation,[102] this evidence seemed to command judicial attention.[103] In particular, courts focused on the amount of initial capital supplied by an incorporator, grounded in the fact that minimum statutory requirements had replaced individual legislative scrutiny over when to grant a corporate charter.[104] But the gradual relaxation of these statutory requirements to a nominal, if any, amount over the course of the twentieth century has eroded the utility of initial capital for veil-piercing purposes.[105] As a result, the focus has expanded to include whether there was sufficient capital at the time of the alleged misconduct or, alternatively, if assets had been siphoned for a

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100. *See, e.g.*, Millon, *supra* note 16, at 1335 (acknowledging that veil-piercing may be justified "if shareholders have deliberately ignored corporate formalities to mislead creditors into believing they were dealing with the shareholders directly rather than with agents of a corporation").

101. *See, e.g.*, ELVIN R. LATTY, SUBSIDIARIES AND AFFILIATED CORPORATIONS § 36, at 128 (1936) ("[I]n the case of the inadequately financed corporation . . . the creditor [can] be said to rely on the capital or financial resources reasonably to be expected of an owner . . . . The law cannot compel business success; it can compel fair dealing."); Adolf A. Berle, Jr., *The Theory of Enterprise Entity*, 47 COLUM. L. REV. 343, 349 n.15 (1947) ("In all cases insufficient capitalization is persuasive evidence that the enterprise was not separate."). *But see* Tex. Indus., Inc. v. Dupuy & Dupuy Developers, Inc., 227 So. 2d 265, 269 (La. Ct. App. 1969) ("Inadequate capitalization is not of itself a badge of fraud.").

102. *See, e.g.*, Radaszewski v. Telecom Corp., 981 F.2d 305, 309–10 (8th Cir. 1992) (interpreting "properly capitalized" as including "financial responsibility" on the way to assessing the sufficiency of a defendant's liability insurance); James R. Gillespie, *The Thin Corporate Line: Loss of Limited Liability Protection*, 45 N.D. L. REV. 363, 386–87 (1969) ("Courts are . . . hard pressed to indicate what they actually mean by inadequate capitalization in the absence of predetermined statutory or legal standards and perhaps the paucity of economic evidence and evaluation in the individual cases.").

103. *See, e.g.*, Douglas & Shanks, *supra* note 29, at 214 ("[A]n analysis of the cases seems to indicate that the courts are more impressed by an obvious inadequacy of capital on the part of the subsidiary than they are by the presence of any of the other indicia of identity between the corporations . . . ."); Hackney & Benson, *supra* note 28, at 859 ("There is no question today but that inadequate capital is considered by all courts to be one of the most important factors in cases imposing liability on shareholders for corporate obligations.").

104. *See, e.g.*, Hackney & Benson, *supra* note 28, at 851–52 (describing how state legislatures shifted from granting corporate charters by scrutinizing individual operational plans to "adopt[ing] general conditions to be met by all who sought to incorporate, including minimum capitalization requirements").

105. *See, e.g.*, Millon, *supra* note 16, at 1337 ("[T]aken by itself initial capitalization should be of limited relevance to the question of shareholder liability for corporate obligations. Corporation statutes no longer include requirements for minimal initial capitalization or ongoing levels of capital.").

shareholder's own use.[106] Whatever the relevant time, the sufficiency of capital would seem to bear more directly on the moral-hazard problem and thus have more relevance in Tort.[107]

Thompson's study seems to suggest otherwise. Undercapitalization appears in only a small fraction of veil-piercing cases in Tort (as well as Contract), and its mention is correlated with a modest overall veil-piercing rate of 53.22%.[108] According to Thompson, these findings paint undercapitalization's role in Tort as "an issue that appeals to commentators for reasons other than its predictive significance."[109] Merely examining the frequency of a rationale's mention in cases, however, tells only part of the story. Undercapitalization may not appear often with Tort, but it may nevertheless play a disproportionately more instrumental role in an ultimate decision to pierce there than with Contract. Without such data, the predictive value of this or any other rationale seems unclear, at best.

B. A New Methodological Leaf

This study examines veil-piercing cases in Westlaw from 1658 up to and including 2006.[110] Combinations of two search phrases, "pierc! /s veil" and "disregard! /s (entity entities)," were run in two comprehensive Westlaw databases whose coverages both begin in 1658.[111] The same searches also

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106. *See, e.g.*, Pierson v. Jones, 625 P.2d 1085, 1089 n.1 (Idaho 1981) (Bistline, J., dissenting) ("As to the issue of undercapitalization, the issue is not whether the corporation was initially undercapitalized, but whether [the defendant] drained the corporate assets for his own use."). *But see, e.g.*, Secon Serv. Sys., Inc. v. St. Joseph Bank & Trust Co., 855 F.2d 406, 416 (7th Cir. 1988) ("A requirement to provide continuing capitalization, as [plaintiff] urges, probably would injure noncontrolling creditors, rather than helping them, by precipitating unnecessary forced sales."); Douglas G. Smith, *Piercing the Corporate Veil in Regulated Industries*, 2008 BYU L. REV. 1165, 1174 ("[G]enerally one must look to the capitalization of the corporation when it is formed—not during subsequent periods of operation.").

107. *See, e.g.*, Robert E. Dye, Note, *Inadequate Capitalization as a Basis for Shareholder Liability: The California Approach and a Recommendation*, 45 S. CAL. L. REV. 823, 836 (1972) ("The case for inadequate capitalization as a basis for shareholder liability is perhaps strongest where the corporate creditor is a [T]ort victim with an unpaid judgment."). *But see* Hackney & Benson, *supra* note 28, at 869 ("It should, however, be noted that in almost every [T]ort case . . . where undercapitalization was stressed in the denial of limited liability, the court has found additional factors constituting misuse of the corporate form . . . .").

108. *But see* Thompson, *Empirical Piercing*, *supra* note 20, at 1066 n.149 (reporting undercapitalization present in 12 Torts cases with a 75.00% veil-piercing rate versus 87 Contracts cases with a 70.11% veil-piercing rate); *id.* at 1063 tbl.11 (reporting a total of 120 cases with a 73.33% veil-piercing rate).

109. *Id.* at 1067.

110. *Cf.* Brian N. Lizotte, *Publish or Perish: The Electronic Availability of Summary Judgments by Eight District Courts*, 2007 WIS. L. REV. 107, 134 (examining summary judgment cases and finding that "Lexis and Westlaw were highly consistent in the cases they reported" and "[t]he agreement between the services was statistically strong").

111. *Scope of ALLCASES*, WESTLAW, http://web2.westlaw.com/scope/default.aspx?db=ALLCASES&RP=/scope/default.wl&RS=WLW10.08&VR=2.0&SV=Split&FN=_top&MT=208&MST=; *Scope of ALLCASES-OLD*, WESTLAW, http://web2.westlaw.com/scope/default.aspx?db=

were performed in specialized Westlaw databases and then cross-checked to ensure the dataset's completeness.[112] The dataset terminates at 2006 to determine whether veil-piercing rates vary in "published" versus "unpublished" dispositions, a distinction within federal courts that was implemented around 1973 and effectively terminated as of January 1, 2007.[113]

The searches yielded an initial dataset of 15,188 cases.[114] I discarded cases without any relevant or meaningful reference to veil-piercing and then coded the remaining dataset of 11,546 cases. I collected data for a decision's year, publication status, and precedential value; the court's jurisdiction and type; the source of the law applied; the type of defendant and shareholder; all of the substantive claims connected to veil-piercing; and all of the rationales that appeared instrumental to the court's decision whether to pierce.

Five groups of cases then were set aside. The first group comprises cases against only an unincorporated business entity, such as an LLC or LLP.[115] The second group comprises direct liability,[116] director or officer

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ALLCASES-OLD&RP=/scope/default.wl&RS=WLW10.08&VR=2.0&SV=Split&FN=_top&MT=208&MST=.

112. The specialized databases are ALLFEDS, SCT, CTA, DCT, DCT-OLD, ALLSTATES, and ALLSTATES-OLD.

113. *See* FED. R. APP. P. 32.1 (permitting citations of all decisions "designated as 'unpublished,' 'not for publication,' 'non-precedential,' 'not precedent,' or the like"); David R. Cleveland, *Overturning the Last Stone: The Final Step in Returning Precedential Status to All Opinions*, 10 J. APP. PRAC. & PROCESS 61, 85, 94 (2009) (discussing the history of the precedential value of unpublished decisions). Numerous states, however, continue to permit unpublished or nonprecedential decisions. *See* Shenoa L. Payne, *The Ethical Conundrums of Unpublished Opinions*, 44 WILLAMETTE L. REV. 723, 754 (2008) ("[S]tate courts are still free to promulgate their own rules of court regarding unpublished state court decisions.").

114. The broader search terms yield almost twice as many cases as Thompson would have collected over his initial time frame. By comparison, Thompson's search terms would have yielded 7,148 cases over the same time frame. Thompson also used four unidentified Westlaw Key Numbers, Thompson, *Empirical Piercing*, *supra* note 20, at 1036 n.1, but searches using the four most likely candidates (101k1.4!, 101k1.5!, 101k1.6!, 101k1.7!) yield only an additional 1,379 cases, for a total just over half the amount obtained here.

115. *E.g.*, Faulkner v. Kornman (*In re* The Heritage Org.), 413 B.R. 438, 514 n.64 (Bankr. N.D. Tex. 2009) ("It is unclear if the alter ego theory applies to limited partnerships in Delaware."); Pinebrook Props., Ltd. v. Brookhaven Lake Prop. Owners Ass'n, 77 S.W.3d 487, 499 (Tex. App.—Texarkana 2002, pet. denied) ("The theory of alter ego, or piercing the corporate veil, is inapplicable to partnerships."). Courts in most jurisdictions, in agreement with most commentators, permit veil-piercing of LLCs. *See, e.g.*, Ditty v. CheckRite, Ltd., 973 F. Supp. 1320, 1335 (D. Utah 1997) ("While there is little case law discussing veil piercing theories outside the corporate context, most commentators assume that the doctrine applies to limited liability companies."). But a number of relevant substantive differences between LLCs and corporations militate against unified analysis. *See, e.g.*, Hollowell v. Orleans Reg'l Hosp., No. Civ.A. 95-4029, 1998 WL 283298, at *9 (E.D. La. May 29, 1998). In *Hollowell*, the court noted,

> Professor Kalinka cautions that the analyses between corporate veil piercing and limited liability company veil piercing may not completely overlap, noting that "[b]ecause the Louisiana LLC law requires fewer formalities such as annual elections of directors, keeping minutes, or holding meetings, failure to follow these formalities should not serve as grounds for piercing the veil of an LLC."

Id. (alteration in original) (quoting 9 SUSAN KALINKA, LOUISIANA LIMITED LIABILITY COMPANIES AND PARTNERSHIPS § 1.32, at 64 (1997)); *see also* Stephen M. Bainbridge, *Abolishing LLC Veil*

participation,[117] or successor liability cases,[118] all of which are often conflated with veil-piercing.[119] The third group comprises cases involving reverse-piercing or triangular-piercing, both of which are substantively distinct from orthodox veil-piercing.[120] The fourth group comprises cases that were decided subsequently by a higher court, those remanded or vacated without instructions, and those not decided by trial, such as motions to dismiss, for judgment notwithstanding the verdict, or for summary judgment.[121] And the final group comprises so-called attribution cases[122] in which a shareholder's action or status is imputed to the defendant corporation for the purposes of, *inter alia*, agriculture,[123] arbitration,[124] bankruptcy,[125]

Piercing, 2005 U. ILL. L. REV. 77, 77 ("This extension of a seriously flawed doctrine into a new arena is not required by statute and is insupportable as a matter of policy.").

116. *E.g.*, Wicks v. Milzoco Builders, Inc., 470 A.2d 86, 89 (Pa. 1983) ("There is a distinction between liability for individual participation in a wrongful act and an individual's responsibility for any liability-creating act performed behind the veil of a sham corporation.").

117. *E.g.*, Advanced Constr. Corp. v. Pilecki, 901 A.2d 189, 195 (Me. 2006) ("Corporate officers who participate in wrongful acts can be held liable for their individual acts, and such liability is distinct from piercing the corporate veil.").

118. *E.g.*, Explosives Corp. of Am. v. Garlam Enters. Corp., 615 F. Supp. 364, 368 (D.P.R. 1985) ("[T]he doctrine of disregarding the corporate entity is distinct from the question of a successor's liability . . . .").

119. *See, e.g.*, *Wicks*, 470 A.2d at 88–90 (discussing the Superior Court's erroneous conflation of direct liability with veil-piercing).

120. *See, e.g.*, Nursing Home Consultants, Inc. v. Quantum Health Servs., Inc., 926 F. Supp. 835, 840 n.12 (E.D. Ark. 1996). In *Nursing Home Consultants*, the court described triangular-piercing and reverse-piercing as follows:

> Conceptually, a triangular pierce results from a sequential application of the traditional piercing doctrine and the 'reverse piercing' doctrine[,] which is itself controversial in that it allows corporations to be held liable for the acts of their shareholders, . . . permits two related, though independent, corporate entities . . . , corporations which hold no ownership interest in each other, to be held liable for the malfeasance of the other.

Id.

121. *See, e.g.*, Carte Blanche (Sing.) PTE., Ltd. v. Diners Club Int'l, Inc., 758 F. Supp. 908, 914 (S.D.N.Y. 1991) ("The Second Circuit has noted that the question of piercing the corporate veil is a fact-intensive issue that generally must be submitted to the jury." (citing Am. Protein Corp. v. AB Volvo, 844 F.2d 56 (2d Cir. 1988))). Segregating summary judgment cases is also justified because of the asymmetrical standard and the different meanings to be ascribed to an outcome based on overwhelming evidence versus a genuine issue of material fact. *See, e.g.*, Joe S. Cecil et al., *A Quarter-Century of Summary Judgment Practice in Six Federal District Courts*, 4 J. EMPIRICAL LEGAL STUD. 861, 886–89 (2007) (finding that 72% of motions in 2000 were filed by defendants (with a 49% success rate) versus 28% by plaintiffs (with a 36% success rate)); Kevin M. Clermont, *Litigation Realities Redux*, 84 NOTRE DAME L. REV. 1919, 1941 (2009) ("[I]t is easier to obtain summary judgment against the party who will bear at least the burden of production at trial . . . .").

122. *See, e.g.*, Sternberg v. O'Neil, 550 A.2d 1105, 1126 n.45 (Del. 1988) ("Under the attribution theory, only the precise conduct shown to be instigated by the parent is attributed to the parent; the rest of the subsidiary's actions still pertain only to the subsidiary. The two corporations remain distinct entities." (citation omitted)).

123. *See, e.g.*, Morris Okun, Inc. v. Harry Zimmerman, Inc., 814 F. Supp. 346, 348 (S.D.N.Y. 1993) ("PACA [The Perishable Agricultural Commodities Act] establishes a statutory trust for the benefit of sellers and suppliers. . . . This legal framework is to be distinguished from the piercing the veil doctrine . . . .").

discrimination,[126] environmental,[127] ERISA/Social Security,[128] jurisdiction,[129] labor,[130] tax,[131] and workers' compensation claims.[132]

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124. *See, e.g.*, Laborers' Int'l Union v. Foster Wheeler Corp., 868 F.2d 573, 576 (3d Cir. 1989) ("The requirement for a judicial determination of the [contractual] obligation to arbitrate may not be circumvented in this case by relying on the parent-subsidiary relationship . . . .").

125. *See, e.g.*, Zubik v. Zubik, 384 F.2d 267, 273 (3d Cir. 1967) ("Cases in bankruptcy . . . call for an entirely different evaluation of 'fraud' or 'injustice' than cases of controlled corporate subsidiaries, or as in this instance, a case of corporate tort." (citations omitted)).

126. *See, e.g.*, Dearth v. Collins, 441 F.3d 931, 933 (11th Cir. 2006) ("[T]here is nothing in Title VII that supports [the] claim that individual capacity liability can be imposed on the basis of the alter ego doctrine, and the only circuit that we found to have addressed the issue rejected the argument."); Worth v. Tyer, 276 F.3d 249, 262 (7th Cir. 2001) ("Our rejection of the 'alter ego' theory is further supported by Congress' aversion to individual liability under Title VII."). *But see* Papa v. Katy Indus., Inc., 166 F.3d 937, 940–41 (7th Cir. 1999) (abrogating the "integrated enterprise" test for corporate parents under the Americans with Disabilities Act, Age Discrimination in Employment Act, and Title VII in favor of certain possibly justified scenarios). In *Papa*, Judge Posner reasoned,

> If because of neglect of corporate formalities, or a holding out of the parent as the real party . . . a parent (or other affiliate) would be liable for the torts or breaches of contract of its subsidiary, it ought equally to be liable for the statutory torts created by federal antidiscrimination law. . . .
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> . . . .
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> . . . [W]e cannot think of a good reason why the legal principles governing affiliate liability should vary from statute to statute, unless the statute, or the particular policy that animates the statute, ordains a particular test.

Id. at 941. But "[t]he primary purpose of the Civil Rights Act, and Title VII in particular is remedial. . . . To effectuate its purpose of eradicating the evils of employment discrimination, Title VII should be given a liberal construction." Armbruster v. Quinn, 711 F.2d 1332, 1336 (6th Cir. 1983), *abrogated on other grounds*, Arbaugh v. Y&H Corp., 546 U.S. 500 (2006). This conflicts with the common law presumption against corporate disregard, which also involves an inquiry into control or domination that is substantively distinct from whether a parent constitutes an "employer" under the various statutes. *See, e.g.*, *Worth*, 276 F.3d at 259–61 (analyzing separately a defendant's qualification as an employer under Title VII and its status as an alter ego of another corporation).

127. *See, e.g.*, Comm'r v. RLG, Inc., 755 N.E.2d 556, 563 (Ind. 2001) ("The responsible corporate officer doctrine is distinct from piercing the corporate veil, and explicitly expands liability beyond veil piercing.").

128. *See, e.g.*, Lumpkin v. Envirodyne Indus., Inc., 933 F.2d 449, 461 (7th Cir. 1991) ("[T]he corporate veil may be pierced more easily in ERISA cases than in pure [C]ontract cases in order to promote the federal policies underlying the statute . . . .").

129. *See, e.g.*, Marine Midland Bank v. Miller, 664 F.2d 899, 903 (2d Cir. 1981) ("In deciding whether the corporation is a real or a shell entity, the appropriate standard should not be the very stringent test, normally applied in other contexts, for piercing the corporate veil. . . . The fiduciary shield doctrine . . . is not concerned with liability. It is concerned with jurisdiction . . . .").

130. *See, e.g.*, UA Local 343 of the United Ass'n of Journeymen v. Nor-Cal Plumbing, Inc., 48 F.3d 1465, 1475 (9th Cir. 1994) ("The alter ego doctrine as developed in labor law is analytically different from the traditional veil-piercing doctrine as developed in corporate law.").

131. *See, e.g.*, Norman v. Murray First Thrift & Loan Co., 596 P.2d 1028, 1031 (Utah 1979) ("[T]here are two separate and independent doctrines which act as a basis for the disregard of the corporate fiction. The one is the equitable alter ego doctrine; the other involves disregarding the corporate fiction whenever it serves the purposes of the tax statute.").

132. *See, e.g.*, Crissman v. Healthco Int'l, Inc., No. 89 C 8298, 1992 WL 223820, at *7 (N.D. Ill. Sept. 2, 1992) ("The traditional definition of a corporation's alter ego . . . springs from an

These exclusions resulted in a final dataset of 2,908 cases. Whenever a court applied separate veil-piercing analyses to different codefendant shareholders, the decision was split into separate entries.[133] There are thus a total of 2,929 observations in the final dataset. And whenever multiple claims, shareholders, or rationales appeared in a case, all of them were coded on a nonexclusive basis, and thus the totals for those observations exceed the total number of cases.

To obtain a more fine-grained portrait, I collected data on specific subclaims. Fraud claims were classified as Common Law Deceit or Fraud, Fraudulent Misrepresentation, Fraudulent Transfer, Innocent Misrepresentation, or Negligent Misrepresentation.[134] Using Meir Dan-Cohen's scheme for measuring bargaining power, Contract claims were classified as bargains between individual(s) and organization(s), or between organization(s) and organization(s).[135] And using Prosser and Keeton's architecture, Tort claims were classified as Intentional Tort Against a Person, Intentional Tort Against Property, Negligence, Strict Liability, or Tortious Interference with Contract.[136]

I also collected data on the rationales that seem instrumental to a court's ultimate decision whether to pierce. Fifteen categories were used: agency, alter ego, assumption of risk, commingling, control or domination, fraud or misrepresentation, informalities, injustice or unfairness, instrumentality, procedure, sham or shell, siphoning of funds, statutory policy, undercapitalization, and other.[137] Subcategories also were used for certain rationales. Commingling was divided into whether it involved advertising, accounts or assets, contracts, directors, employees, officers, records, retirement plans, stationery, or taxes. Fraud or misrepresentation was divided into

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entirely different context having little bearing upon the concerns underlying the Workers' Compensation Act.").

133. This virtually tracks the distinction between corporate and individual shareholders.

134. Also included within the Common Law Deceit or Fraud group were cases with an ambiguous reference to some kind of fraud claim.

135. *See* MEIR DAN-COHEN, RIGHTS, PERSONS, AND ORGANIZATIONS 83 (1986) ("If organizations are to be acknowledged as distinctive legal actors, . . . the law has to deal with interactions among organizations (O-O relations), and with 'mixed' interactions, in which individuals interact with organizations (O-I relations)."). Dan-Cohen's scheme actually comprises three types of relations, *id.*, but bargains as between individual(s) and individual(s) are not applicable here as one of the parties in a veil-piercing situation must be a corporation.

136. *See* W. PAGE KEETON ET AL., PROSSER AND KEETON ON THE LAW OF TORTS § 7, at 31–32 (5th ed. 1984) (noting that "[t]here are many possible approaches to the law of [T]orts, and . . . [b]y some odd coincidence, the classifications usually have gone by threes, and nearly everyone has found some 'tripartite division,'" and proceeding to divide the area into three parts, based on the Restatement of Torts: intent, negligence, and strict liability). But their treatise actually is organized around the five classic types of torts that are used here. *Id.* at xv.

137. *But cf.* Thompson, *Empirical Piercing*, *supra* note 20, at 1044 (using a universe of eighty-five possible rationales organized into "several major categories"). Thompson, however, presented select results for only twelve different rationales. *See id.* at 1063 tbl.11, 1064–65 n.141. Many of these rationales were used here to facilitate comparison, along with a few others based upon a survey of the cases.

whether it concerned a defendant corporation's assets, ultimate shareholder's identity, or some ambiguous reference. Informalities was divided into a failure to conduct meetings, failure to maintain records, or some other irregularity. Procedure was divided into whether it involved a failure to raise veil-piercing, inadequate pleading, or a jurisdictional defect.[138] And undercapitalization was divided into whether there was inadequate capital at incorporation or some later time.

The instrumental rationale data are the product of a subjective process. Thompson's study collected data on whether a rationale simply was mentioned in connection with the decision whether to pierce.[139] In contrast the present study's data on instrumental rationales merely may indicate what courts choose to cite in support of their ultimate decision.[140] To an extent this functionalist concern is constrained by the evidence available to a court as well as the court's integrity in articulating a justification.[141] More importantly, extracting a case's *ratio decidendi* is fundamental to our precedent-based system, and publicly available cases are the only insight into judicial reasoning accessible to entrepreneurs, litigants, and other courts.[142] Accordingly, the present data most directly reflect what actually informs these parties' deliberations.

Thompson's and this study's results are subject to selection bias. Both studies ran particular search phrases within Westlaw's electronic database of cases over a certain time frame.[143] Although Westlaw does feature

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138. The procedure rationale concerns the nature of the reason cited by a court in disposing of a case and not the issue in which veil-piercing was couched. Thompson does not include procedure as a rationale for which data were collected, but he does devote a separate subsection to cases involving procedural questions, such as the fiduciary shield doctrine, that were included in his dataset. *See id.* at 1059–60.

139. *See id.* at 1044 ("[T]he reasons courts gave to explain their decision to either pierce or not pierce the corporate veil were collected. These were less objective than the inquiries made above and reflected a judgment by the court to cite the presence or absence of certain factors.").

140. *See, e.g.*, JEROME FRANK, LAW AND THE MODERN MIND 104 n.* (1930) ("'I saw where justice lay, and the moral sense decided the court half the time; I then sat down to search the authorities . . . but I almost always found principles suited to my view of the case . . . .'" (emphasis removed) (quoting a personal letter from "a great American judge," Chancellor Kent)).

141. *See, e.g.*, RONALD DWORKIN, LAW'S EMPIRE 238–40 (1986) (articulating his theory of adjudication, "Law as [I]ntegrity").

142. *See, e.g.*, Theodore Eisenberg & Sheri Lynn Johnson, *The Effects of Intent: Do We Know How Legal Standards Work?*, 76 CORNELL L. REV. 1151, 1195 (1991) ("Published opinions are all most of us ever work from."); Alan L. Tyree, *Fact Content Analysis of Case Law: Methods and Limitations*, 22 JURIMETRICS J. 1, 2 (1981) ("[U]sing the reported facts of the judgment . . . is precisely what every lawyer does when reading a case for the purpose of applying it to, or distinguishing it from, the case which is currently being argued."). *But cf.*, Mark A. Hall & Ronald F. Wright, *Systematic Content Analysis of Judicial Opinions*, 96 CALIF. L. REV. 63, 97 (2008) ("As the quip goes in the world of computers: garbage in, garbage out.").

143. Thompson deserves considerable credit for his use of Westlaw, which had been introduced only about fifteen years prior to the completion of his study. *See, e.g.*, William G. Harrington, *A Brief History of Computer-Assisted Legal Research*, 77 LAW LIBR. J. 543, 543 (1985) (stating, in 1985, that twenty years ago "[l]egal research by computer was unknown"). Some, including this author, may recall the excruciating experience of working with user-unfriendly Westlaw-only

"unpublished" and "nonprecedential" dispositions, even these represent only a fraction of matters involving veil-piercing.[144] Some matters arise and are resolved before even reaching a court.[145] Further, after a complaint has been filed, some matters are arbitrated, mediated, settled, dismissed, or summarily adjudged prior to a trial,[146] and there is evidence suggesting that settlement rates may vary based on the type of claim.[147] Litigants' attorney-fee arrangements, estimated probabilities of success, perceived significance of the dispute, and resources all also can affect a matter's outcome.[148] Moreover, the decision to make a case available to Westlaw can be the product of selective discretion.[149] Accordingly, publicly available decisions may reflect a myriad of dynamics independent of a matter's merits. Indeed, Thompson has speculated that some of these selection effects may explain the asymmetry of veil-piercing in Contract versus Tort:

> There may be some selection bias in this area or the parties may have different stakes in the outcome. The change in [P]roduct-[L]iability

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computer terminals and waiting for tortoise-paced printouts. More relevantly, ever since its debut, Westlaw has been expanding its databases' coverage. *See, e.g.*, Peter W. Martin, *Reconfiguring Law Reports and the Concept of Precedent for a Digital Age*, 53 VILL. L. REV. 1, 21 (2008) ("It was not until the mid- to late 1990s that [Lexis and Westlaw] attained sufficient scope and functionality to become comprehensive research environments—virtual libraries—rather than simply places to begin case research."). The databases at Thompson's disposal thus may have featured much narrower coverage than what was available for this study.

144. *See, e.g.*, Kevin M. Clermont & Theodore Eisenberg, *Litigation Realities*, 88 CORNELL L. REV. 119, 125–26 (2002) ("On the one hand, judicial decisions represent only the very tip of the mass of grievances. . . . On the other hand, published decisions are a skewed sample of that tip of judicial decisions."); David A. Hoffman et al., *Docketology, District Courts, and Doctrine*, 85 WASH. U. L. REV. 681, 710 (2007) (examining dockets from four federal district courts and finding only 3.10% of judicial actions that resulted in an opinion).

145. *See, e.g.*, David M. Trubek et al., *The Costs of Ordinary Litigation*, 31 UCLA L. REV. 72, 85–87 & fig.2 (1983) (conducting a survey of 5,000 households and finding that only about 5% of grievances, albeit only in excess of $1,000, result in a court filing).

146. *See, e.g.*, Marc Galanter, *A World Without Trials?*, 2006 J. DISP. RESOL. 7, 8 (reporting that, from 1962 to 2004, the number of terminated civil cases increased 400% while trials fell 32%).

147. *See, e.g.*, Theodore Eisenberg & Charlotte Lanvers, *What Is the Settlement Rate and Why Should We Care?*, 6 J. EMPIRICAL LEGAL STUD. 111, 133 (2009) (examining two federal district court jurisdictions and finding that Tort cases settle at a higher rate than Contract cases).

148. *See generally* Theodore Eisenberg, *Testing the Selection Effect: A New Theoretical Framework with Empirical Tests*, 19 J. LEGAL STUD. 337 (1990); Herbert M. Kritzer, *Lawyer Fees and Lawyer Behavior in Litigation: What Does the Empirical Literature Really Say?*, 80 TEXAS L. REV. 1943 (2002); George L. Priest & Benjamin Klein, *The Selection of Disputes for Litigation*, 13 J. LEGAL STUD. 1 (1984) (all discussing how various factors impact what disputes are litigated).

149. *See, e.g.*, Lee Epstein & Gary King, *The Rules of Inference*, 69 U. CHI. L. REV. 1, 107 (2002) ("While this [selection] rule commands that judges publish only those opinions that are 'of general precedential value,' a rather large body of literature suggests that the rule is sufficiently vague to permit circuit court judges to publish or not as they see fit." (citations omitted)); Kimberly D. Krawiec & Kathryn Zeiler, *Common-Law Disclosure Duties and the Sin of Omission: Testing the Meta-theories*, 91 VA. L. REV. 1795 app. A at 1883–87 (2005) (detailing limitations of Westlaw's databases and the possibility of systematic differences between federal and state court decisions); Karen Swenson, *Federal District Court Judges and the Decision to Publish*, 25 JUST. SYS. J. 121, 136 (2004) (finding that federal judges tend to publish opinions in which large corporations and other members of the "economic upper class" are parties).

> law and [T]ort law generally in recent decades may have led plaintiffs to bring suits that go beyond prior law. Additionally, the large number of corporate defendants may mean that they have more to lose than plaintiffs have to gain, pushing the results in the direction of less piercing.[150]

As a result, the findings in both studies may present a rather skewed portrait of veil-piercing claims.[151]

But this does not undermine the validity or utility of either study. As a preliminary matter, veil-piercing is a remedial instrument for satisfying a judgment that stands apart from a matter's substantive cause(s) of action;[152] a veil-piercing request is thus among the last things courts tend to hear within a dispute. This delayed ripeness would seem to mute selection effects somewhat, as the bulk of matters disposed by dismissal, summary judgment, or settlement will concern the substantive claim, and not veil-piercing; accordingly, the population of cases may be more representative here than for ordinary causes of action. Further, the undeniable impact that publicly available cases have on the behavior of courts, firms, and litigants would seem to be quite stable, as the overall pattern of veil-piercing cases in the present study has remained relatively constant over time.[153] Certainly, this study's results should be understood as limited in scope and treated with appropriate care. But the continuing importance of Thompson's study and its puzzling results within any discussion of veil-piercing provide sound reasons for conducting a new study with a comparable yet refined methodology.

II. Findings

Apparently the "mists of metaphor" envelop an empirical puzzle about veil-piercing.[154] Thompson's study suggests that veil-piercing claims are being adjudicated in unpredicted and inexplicable ways.[155] We thus are presented with a puzzle involving commentators, courts, and the empirical

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150. Thompson, *Empirical Piercing*, *supra* note 20, at 1069–70.

151. This is the premise of Christina L. Boyd and David Hoffman's project, *Disputing Limited Liability*, 104 NW. U. L. REV. (forthcoming 2010), *available at* http://ssrn.com/abstract=1483278, which uses dockets to follow a sample of veil-piercing claims as they move through federal district courts over a five-year period; notably, they find that 66% of cases containing a veil-piercing claim ultimately settle and obtain results largely consistent with Thompson's study. *Id.*

152. *See, e.g.*, Kern v. Gleason, 840 S.W.2d 730, 736 (Tex. App.—Amarillo 1992, no writ) ("The piercing of the corporate veil is not a separate cause of action . . . . The various doctrines for disregarding the corporate entity are only remedial, for they only expand the potential sources of recovery.").

153. *See infra* Table 2.

154. *See* Berkey v. Third Ave. Ry. Co., 155 N.E. 58, 61 (N.Y. 1926) ("The whole problem of the relation between parent and subsidiary corporations is one that is still enveloped in the mists of metaphor.").

155. *See* Thompson, *Empirical Piercing*, *supra* note 20, at 1038 ("The results [of this study] suggest that the factors affecting the judicial outcome are not necessarily as suggested by previous commentary.").

evidence. Determining which of these key pieces are amiss may suggest how to diagnose the problems that plague veil-piercing. And until this positive account of veil-piercing is resolved, engaging the normative question of what to do with the doctrine seems aimless.

This study reexamines the empirical piece of veil-piercing. Although basic statistics can reveal only so much, the doctrine's complex nature necessitates categorical reduction. This Part sifts through all the data and analyzes the most notable results as they pertain to a court's jurisdiction, the law applied, the supporting substantive claims, and the cited instrumental rationales; when valuable, results for combinations of these categories also are presented.[156] This Part concludes with the results of recasting all of the data in terms of voluntary and involuntary creditors.

A. Navigating the Jurisdictional Waters

The present study finds an overall veil-piercing rate of 48.51%. This is substantially higher than the 40.18% rate found by Thompson's study[157] and comports with George Priest and Benjamin Klein's hypothesis that plaintiffs and defendants will prevail with equal frequency in tried cases.[158] The overall rate vacillated until the 1960s, an amount of volatility that is not surprising given the relative paucity of cases up to that point.

Since the 1970s, the number of veil-piercing cases has increased markedly, and the rate has stabilized. The increase roughly coincides with the advent of unpublished and nonprecedential opinions, which comprise 20.70% of the final dataset but whose veil-piercing rates do not deviate considerably from the overall dataset.[159]

156. In the interest of economy, the discussion and tables do not present all the results for the numerous possible combinations of data.

157. Thompson, *Empirical Piercing*, *supra* note 20, at 1048 tbl.1.

158. *See* Priest & Klein, *supra* note 148, at 20 (noting that "the model has demonstrated a *tendency* toward 50 percent plaintiff victories in litigation"). *But see* Clermont & Eisenberg, *supra* note 144, at 140 ("[O]ur work has shown that one should not expect 50% win rates.").

159. *See infra* Tables 1A–B.

Table 1A. Veil-Piercing by Publication Status and Jurisdiction[160]

Status	*n*	V-P Rate (%)
Unpublished	605	**48.60**
Federal	194	**53.09**
State	411	46.67
Partially Published	12	8.33
Federal	12	8.33
State	0	--
Published	2312	**48.70**
Federal	647	46.68
State	1665	**49.49**

Table 1B. Veil-Piercing by Precedential Status and Jurisdiction

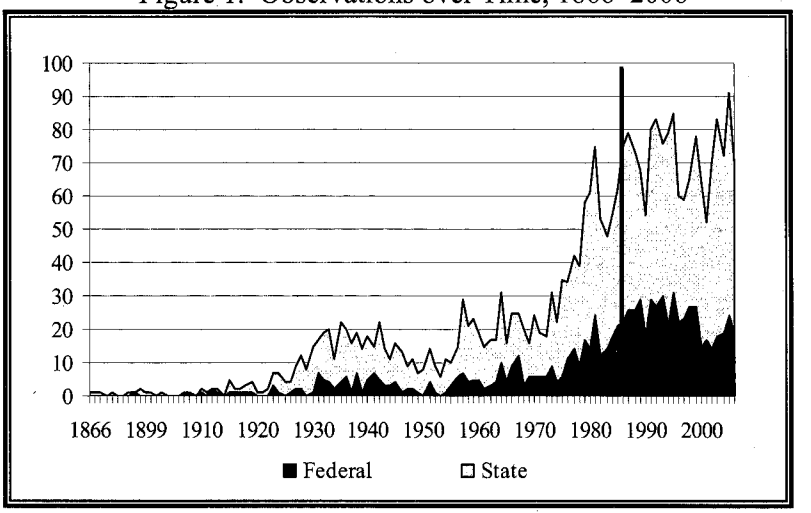
Status	*n*	V-P Rate (%)
Precedential	2323	**48.64**
Federal	647	46.68
State	1676	**49.50**
Non-Precedential	606	48.02
Federal	206	**50.49**
State	400	46.75

Veil-piercing cases then exploded during the 1980s at a rate lower than the nationwide trend for all filings.[161] All of these trends in the initial dataset are reflected in the number of final observations per year:

160. Veil-piercing rates in bold exceed the overall rate of 48.51%.

161. Prior to 1980 there was an average of 9.29 veil-piercing cases per year, which increased to 63.4 cases per year from 1980 to 1989. The highest number of veil-piercing cases for that entire decade came in 1989 and represents a 2.52% increase over the mean; 1989 also saw the highest number of federal and state filings for that entire decade and represents a 28.29% increase over the mean. ADMIN. OFFICE OF THE U.S. COURTS, FEDERAL JUDICIAL WORKLOAD STATISTICS (1980–1993) ("United States District Courts—National Judicial Caseload Profile"); ADMIN. OFFICE OF THE U.S. COURTS, STATISTICAL TABLES FOR THE FEDERAL JUDICIARY (1994–2006) ("Table C-2, U.S. District Courts—Civil Cases Commenced, by Basis of Jurisdiction and Nature of Suit During the Twelve Month Period Ended March 31"); COURT STATISTICS PROJECT, NAT'L CTR. FOR STATE COURTS, STATE COURT CASELOAD STATISTICS (1981–1982, 1985–2007) (no data were collected for 1983 and 1984).

Figure 1. Observations over Time, 1866–2006[162]



The line marks 1986, the end point of Thompson's original study.[163] Over the same time frame, there are 1,415 observations in this study;[164] from 1986 up to and including 2006, there are 1,514 observations.[165]

Table 2. Veil-Piercing by Decade

Decade	*n*	% of Total	V-P Rate (%)
1860–1869	1	0.03	0.00
1870–1879	1	0.03	**100.00**
1880–1889	1	0.03	0.00
1890–1899	6	0.20	**66.67**
1900–1909	4	0.14	**75.00**
1910–1919	23	0.79	**60.87**
1920–1929	55	1.88	47.27
1930–1939	173	5.91	**52.02**
1940–1949	136	4.64	42.65
1950–1959	145	4.95	**57.93**
1960–1969	199	6.79	**50.25**
1970–1979	319	10.89	**49.53**
1980–1989	646	22.06	46.75
1990–1999	718	24.51	46.38
2000–2006	502	17.14	**49.40**

162. *See infra* Table 2.

163. *See* Thompson, *Empirical Piercing*, *supra* note 20, at 1044 ("This project includes all Westlaw cases through 1985 concerning the issue of piercing the corporate veil.").

164. *Cf. id.* at 1049 tbl.2 (reporting 1,585 cases up to and including 1985).

165. *But see supra* note 64 and accompanying text.

Veil-piercing claims prevail exclusively against close corporations.

Table 3. Veil-Piercing by Corporation Type

Corporation	*n*	V-P Rate (%)
Close	2925	**48.58**
Public	4	0.00

This is easily explained by the tendency of public corporations to feature disperse shareholding that in turn precludes a sufficient level of control or domination to justify veil-piercing.[166] There are some successful piercing claims against close corporations held by a public corporate affiliate or parent, but the total data are incomplete given the failure of some decisions to specify the shareholder's status.

More difficult to explain is that veil-piercing clearly presents a greater risk to individual shareholders than corporate parents.

Table 4. Veil-Piercing by Shareholder Type and Jurisdiction

Shareholder	*n*	V-P Rate (%)
Entity	889	41.17
Federal	377	37.14
State	512	44.14
Person	2047	**51.69**
Federal	482	**55.60**
State	1565	**50.48**

These results not only comport with Thompson's[167] but hold across federal and state courts, as well as for each and every type of substantive claim.[168]

166. *See, e.g.*, GEVURTZ, *supra* note 59, § 1.5.3, at 78–79 ("[R]equiring control screens out piercing against the shareholders of a publicly traded corporation . . . . This provides a doctrinal underpinning to explain the fact that there never has been a case in which the court pierced to hold shareholders in a public corporation liable for the company's debts.").

167. *Cf.* Thompson, *Empirical Piercing*, *supra* note 20, at 1055 tbl.7 (reporting a 43.13% rate for 339 individual-shareholder cases versus 37.21% for 237 corporate-parent cases); Thompson, *Group Piercing*, *supra* note 20, at 386 tbl.1 (reporting a 34.00% rate for 547 corporate-group cases up to and including 1996). Matheson's study finds a 20.56% veil-piercing rate: "This difference is substantial: substantive piercing in the parent-subsidiary context occurs approximately half as often as piercing does generally, and more than one-third less often than the most comparable database explored by other studies." Matheson, *supra* note 73, at 1114. Matheson's comparison with Thompson's as well as Hodge and Sachs's studies, however, makes the surprisingly simple error of mismatching time frames. Thompson's results concern *all* cases in his study up to and including 1996. Thompson, *Group Piercing*, *supra* note 20, at 385. Hodge and Sachs's sample consisted of cases from 1986 up to and including 1995. Hodge & Sachs, *supra* note 73, at 347. Matheson's study, in contrast, examines cases from January 1, 1990 up to March 1, 2008. Matheson, *supra* note 73, at 1108 n.51. The problem is that the veil-piercing rate for corporate groups may have declined over Matheson's time frame. And this is in fact the case. The present dataset finds a

The data collectively rebut a broad conviction that veil-piercing is more judicially compelling in the parent–subsidiary context.[169] This chasm may be due to a multilevel misunderstanding. There is apparently a prevailing belief and criticism that courts apply essentially the same test to corporate and individual shareholders.[170] While this was true at the turn of the twentieth century, when states began to permit corporate groups,[171] courts now seem to have shifted their view:

> An individual shareholder, by virtue of his ownership of shares, does not own the corporation's assets and, as a result, does not own subsidiary corporations in which the corporation holds an interest. . . . A corporate parent which owns the shares of a subsidiary does not, for that reason alone, own or have legal title to the assets of the

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42.63% rate for corporate-parent cases prior to 1990, versus a 38.96% rate for such cases from 1990 up to and including 2006. *Cf.* McPherson & Raja, *supra* note 73, at 18 (reporting a 16.46% veil-piercing rate against corporate parents from a sample of cases from 1996 up to and including 2005). The decline is not very steep and the rate is considerably higher than Matheson's, but this may be attributed to some considerable differences in the construction of the respective studies' datasets. *Compare* Matheson, *supra* note 73, at 1109–12 (detailing Matheson's methodology), *with supra* subpart I(B). Far more important is that all of the empirical studies using nonsampled data find that individual shareholders are much more vulnerable to veil-piercing than corporate parents.

168. *See infra* Figure 5; *cf.* Matheson, *supra* note 73, at 1122 tbl.7 (reporting specific results for claims against corporate groups).

169. *See, e.g.*, PHILLIP I. BLUMBERG, THE LAW OF CORPORATE GROUPS: TORT, CONTRACT, AND OTHER COMMON LAW PROBLEMS IN THE SUBSTANTIVE LAW OF PARENT AND SUBSIDIARY CORPORATIONS, at xl (1987) ("[M]ost of the presumed advantages of limited liability are simply irrelevant where corporate groups are involved."); *supra* note 26 and accompanying text. Stephen Presser presents an interesting argument that a commitment to democratic individualism may explain the diverse coalition of scholars who are critical of extending broader limited liability protection to corporate groups. *See* PRESSER, *supra* note 1, § 1:11, at 1-67.

170. Kurt Strasser, for instance, has expressed this view succinctly:

> While traditional corporate law has not articulated different rules for a parent company in its role as a shareholder than for individual investor shareholders, parent companies in fact present different policy issues and their limited liability should be determined by a different analysis. The core idea is that a parent company as a shareholder in its subsidiary companies is in quite a different economic role and performs quite a different management function than individual investor shareholders . . . . The parent is not an independent investor.

Kurt A. Strasser, *Piercing the Veil in Corporate Groups*, 37 CONN. L. REV. 637, 638 (2005). There is yet another level, of no consequence here, with regard to the use of agency principles:

> It is useful to distinguish situations in which liability is imposed on a parent because of the existence of the agency relation . . . from cases in which the corporate veil of the subsidiary is pierced for other reasons of policy. Unfortunately, however, the courts have not always observed the distinction between these two separate bases for parent's liability. . . . The erroneous language, however, has not resulted in unjust decisions in most cases.

RESTATEMENT (SECOND) OF AGENCY § 14M reporter's note (1958). Interestingly, this language did not survive revision. RESTATEMENT (THIRD) OF AGENCY § 1.01 reporter's note (2006).

171. *See, e.g.*, BLUMBERG, *supra* note 168, at xxxix–xl ("When . . . corporate groups became possible . . . courts applied the same standard to a shareholder that was in fact a parent corporation even though ultimate investors were not involved at all."); HENN, *supra* note 6, § 148, at 258 ("Generally-speaking, the principles governing one-man, family, and other close corporations are applicable to subsidiary and other affiliated corporations."). *But see supra* note 169.

> subsidiary; and, it follows with even greater force, the parent does not own or have legal title to the subsidiaries of the subsidiary.[172]

This sweeping generalization contrasts with the academic debate, which has focused on the structure of economic incentives. Some regard corporate shareholders as presenting a potentially greater moral-hazard problem,[173] while others view veil-piercing as a potential threat to stimulating investment in corporate parents.[174] That courts reach into the assets of individual shareholders more frequently does not mean the commentary is incorrect, merely that the antithetical positions seem to proceed from different premises.

Far more congruous are the federal and state veil-piercing rates. Federal litigants enjoy considerably more success in district court than in the court of appeals,[175] which suggests that trial defendants may have an added incentive to seek reversal of an unfavorable decision.[176]

Table 5. Veil-Piercing by Jurisdiction and Court

Court	*n*	V-P Rate (%)
Federal	853	47.60
Trial	413	**54.72**
Intermediate Appellate	432	40.74
Supreme	8	**50.00**
State	2076	**48.89**
Trial	192	44.79
Intermediate Appellate	1318	48.48
Supreme	566	**51.24**

172. Dole Food Co. v. Patrickson, 538 U.S. 468, 475 (2003) (citations omitted).

173. *See, e.g.*, Easterbrook & Fischel, *supra* note 18, at 111 ("[T]he moral-hazard problem is probably greater in parent-subsidiary situations because subsidiaries have less incentive to insure.").

174. *See, e.g.*, PRESSER, *supra* note 1, § 1:11, at 1-67 ("Presumably, those who profit by reducing the risk to the parent are the parent's shareholders, and, presumably, the more we reduce their risk and thereby raise the potential profit to them the more we will encourage their investment.").

175. The high veil-piercing rate in Supreme Court cases should be discounted given their miniscule number. Not easily dismissed, however, is that the veil-piercing rate in federal district courts is higher than that in any other level of federal or state court. This raises a potential representativeness concern with Boyd and Hoffman's exclusively federal sample. *See* Boyd & Hoffman, *supra* note 151 (manuscript at 27).

176. *But see, e.g.*, Chris Guthrie & Tracey E. George, *The Futility of Appeal: Disciplinary Insights into the "Affirmance Effect" on the United States Courts of Appeals*, 32 FLA. ST. U. L. REV. 357, 359–63, 360 figs.2 & 3 (2005) (reporting an increase in the affirmance rate of the courts of appeals from 72% in 1945 to 91% in 2003, in contrast to a steady rate for the Supreme Court). To be clear, this study does not establish whether there is a weaker "affirmance effect" for veil-piercing cases, as only the highest relevant decision from a case was coded and information on affirmances or reversals was not collected. For instance, one possibility may be that losing plaintiffs pursue futile appeals on a disproportionate basis.

Although a federal common law does exist,[177] veil-piercing is predominantly a creature of state law. Consistent with the nature of corporation statutes as well as the most common types of substantive claims, state courts produced 70.88% of the total observations. Surprisingly, unlike their federal peers, state litigants appear to experience increasing veil-piercing success at successively higher levels of the judicial system.[178] This, however, may reflect wrinkles within the original database's scope, as Westlaw does not feature comprehensive coverage of state trial and intermediate appellate court decisions;[179] the problem seems most pronounced at the trial court level, which accounts for only 9.25% of the total state observations.[180] Nevertheless, these results roughly comport with the rates for all other federal and state court levels as well as the overall rate; accordingly, if the state trial court results can be regarded as somewhat representative, then they suggest that plaintiffs with stronger cases tend to pursue appeals.[181]

B. Exploring the State of Veil-Piercing

Veil-piercing claims are susceptible to some forum shopping. Potential defendants can exert some control by deciding where to incorporate and then attempting to invoke the internal-affairs doctrine, which applies the law of the state of incorporation to resolve certain choice-of-law disputes.[182] Not all jurisdictions, however, apply the doctrine to veil-piercing disputes, either because a superior interest belongs to a nonincorporating state, or the traditional province of "internal affairs" concerns shareholder disputes with

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177. *See, e.g.*, Bergesen v. Lindholm, 760 F. Supp. 976, 986 (D. Conn. 1991) ("[This] court applies federal common law, importing into its decision those principles of state law which it finds both persuasive and appropriate to subsume.").

178. The standard of review for veil-piercing cases varies among federal circuits as well as states. *See, e.g.*, Craig v. Lake Asbestos of Quebec, Ltd., 843 F.2d 145, 148 (3d Cir. 1988) (citing cases that variously apply either a "clearly erroneous" or a plenary/de novo standard of review to veil-piercing decisions).

179. *See, e.g.*, Morris L. Cohen, *Researching Legal History in the Digital Age*, 99 LAW LIBR. J. 377, 386 (2007) ("Historical coverage of state court decisions in LexisNexis and Westlaw is still limited. Both systems cover the highest court of most states back to their published beginnings, but retrospective coverage of lower courts is much less extensive.").

180. *Cf.* Thompson, *Empirical Piercing*, *supra* note 20, at 1050 tbl.4 (reporting only 401 trial court versus 860 intermediate appellate court decisions).

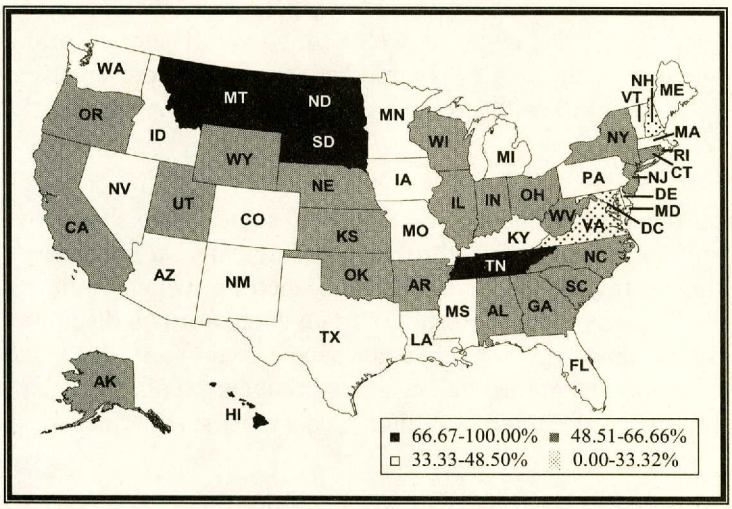
181. *But cf.* Theodore Eisenberg & Michael Heise, *Plaintiphobia in State Courts? An Empirical Study of State Court Trials on Appeal*, 38 J. LEGAL STUD. 121, 138 (2009) (finding that the reversal rates for state jury trials and appeals by defendants exceed those for plaintiffs).

182. *See, e.g.*, CTS Corp. v. Dynamics Corp. of Am., 481 U.S. 69, 89 (1987) ("No principle of corporation law and practice is more firmly established than a State's authority to regulate domestic corporations . . . ."); RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 304 (1971) ("The local law of the state of incorporation will be applied to determine the right of a shareholder to participate in the administration of the affairs of the corporation . . . except in the unusual case where . . . some other state has a more significant relationship . . . ."); *id.* §§ 145, 186–88 (indicating different choice-of-law rules for Tort versus Contract claims).

managers, not external creditors.[183] Comparatively clearer is the choice afforded to prospective plaintiffs, whether voluntary or involuntary,[184] by the opportunity to evaluate where to commence a suit. In this regard, one important consideration might be whether a jurisdiction exhibits a relatively lax stance towards piercing.

Veil-piercing rates vary substantially based on which state's law is applied.[185] Litigants prevail at least 50.00% of the time under the law of twenty-five different jurisdictions:

Figure 2. Overall v. State Law Veil-Piercing Rates[186]



183. *Compare* Frederick Tung, *Before Competition: Origins of the Internal Affairs Doctrine*, 32 J. CORP. L. 33, 94 n.311 (2006) ("Personal liability of officers, directors, and shareholders to the corporation and its creditors falls squarely within the traditional understanding of internal affairs."), *with* Jennifer J. Johnson, *Risky Business: Choice-of-Law and the Unincorporated Entity*, 1 J. SMALL & EMERGING BUS. L. 249, 272–73, 273 n.91 (1997) (observing that, while "[t]here is a general consensus that the doctrine . . . extends to the personal liability of shareholders for corporate debts," a few courts "have applied other conflicts theories to piercing issues").

184. *But cf.* Hansmann & Kraakman, *Procedural Focus*, *supra* note 91, at 450–51 (arguing for application of the internal-affairs doctrine only to voluntary creditors, versus traditional conflicts rules for involuntary creditors).

185. As with Thompson's study, the data here were not organized by jurisdiction as some cases may apply foreign law, and the origin of the relevant test has a more direct bearing on the ultimate decision to pierce. *See* Thompson, *Empirical Piercing*, *supra* note 20, at 1044 (stating that the factual data presented include which jurisdiction's law was applied in the case, not the jurisdiction in which the case was litigated).

186. *See infra* Table 6. Due to a lack of space, Table 6 omits data for cases applying the law of foreign jurisdictions (0.00%, 1 case), Guam (100.00%, 3 cases), Northern Mariana Islands (50.00%, 2 cases), Puerto Rico (50.00%, 6 cases), and the Virgin Islands (0.00%, 1 case). Of these jurisdictions Thompson reported data only from Puerto Rico. *See* Thompson, *Empirical Piercing*, *supra* note 20, at 1051 tbl.6. For the curious, using the 2000 Presidential Electoral College results, the veil-piercing rate was 49.75% in "Blue States" versus 45.77% in "Red States." *See 2000 Presidential Electoral and Popular Vote Table*, FED. ELECTION COMM'N, http://www.fec.gov/pubrec/fe2000/elecpop.htm (displaying the 2000 electoral college results broken up by Red States going to George Bush and Blue States going to Al Gore).

All of the shaded states have a veil-piercing rate above the overall rate of 48.51%, with the five darkest states featuring a rate in excess of 66.66%. The remaining states have a veil-piercing rate below the overall rate, with the three dotted states—Maryland, New Hampshire, and Virginia—featuring a rate less than 33.33%.

Table 6. Veil-Piercing by Jurisdiction Law Applied

State Law	*n*	% of Total	V-P Rate (%)
Alabama	40	1.37	**50.00**
Alaska	14	0.48	**57.14**
Arizona	30	1.02	33.33
Arkansas	44	1.50	**56.82**
California	232	7.92	**50.86**
Colorado	34	1.16	44.12
Connecticut	74	2.53	**54.05**
Delaware	35	1.19	34.29
District of Columbia	23	0.79	**52.17**
Federal	111	3.79	44.14
Florida	105	3.58	40.95
Georgia	86	2.94	**59.30**
Hawaii	8	0.27	**75.00**
Idaho	20	0.68	40.00
Illinois	80	2.73	**52.50**
Indiana	39	1.33	**61.54**
Iowa	33	1.13	39.39
Kansas	39	1.33	**61.54**
Kentucky	25	0.85	48.00
Louisiana	112	3.82	38.39
Maine	7	0.24	42.86
Maryland	31	1.06	25.81
Massachusetts	62	2.12	43.55
Michigan	83	2.83	39.76
Minnesota	51	1.74	47.06
Mississippi	17	0.58	47.06
Missouri	87	2.97	48.28
Montana	16	0.55	**68.75**
Nebraska	36	1.23	**61.11**
Nevada	16	0.55	43.75
New Hampshire	10	0.34	30.00
New Jersey	57	1.95	**49.12**
New Mexico	16	0.55	37.50
New York	269	9.18	**49.81**
North Carolina	32	1.09	**53.13**
North Dakota	7	0.24	**85.71**
Ohio	179	6.11	**55.87**

(continued)

Table 6 (cont.). Veil-Piercing by Jurisdiction Law Applied

State Law	*n*	% of Total	V-P Rate (%)
Oklahoma	27	0.92	**51.85**
Oregon	35	1.19	**65.71**
Pennsylvania	162	5.53	44.44
Rhode Island	15	0.51	**53.33**
South Carolina	25	0.85	**60.00**
South Dakota	6	0.20	**83.33**
Tennessee	47	1.60	**68.09**
Texas	211	7.20	40.76
Utah	26	0.89	**53.85**
Vermont	5	0.17	40.00
Virginia	55	1.88	29.09
Washington	69	2.36	44.93
West Virginia	14	0.48	**50.00**
Wisconsin	34	1.160	**61.76**
Wyoming	21	0.72	**61.90**

One might expect a sizable number of cases to apply Delaware law, as the jurisdiction is an epicenter of corporate law.[187] But this is not the case, perhaps because Delaware seems to be the preferred choice of relatively sophisticated incorporators that may have a keener awareness of the veil-piercing standard.[188] Despite the sea of ink spilled on the race for corporate charters, there has been a curiously limited amount of focus on whether a stiffer veil-piercing standard may enhance a jurisdiction's appeal to prospective incorporators.[189] In this regard, Delaware law does not disappoint, with a very low 34.29% veil-piercing rate and litigants prevailing a mere 21.43% of the time against corporate parents, as compared to 40.91% against

187. *See* David Rosenberg, *Supplying the Adverb: The Future of Corporate Risk-Taking and the Business Judgment Rule*, 6 BERKELEY BUS. L.J. 216, 239 (2009) (discussing factors that have "made Delaware a center of American corporate law for generations").

188. *See, e.g.*, Jens Dammann & Matthias Schündeln, *The Incorporation Choices of Privately Held Corporations* 9 tbl.2 (The Univ. of Texas Sch. of Law, Law & Econ. Research Paper No. 119, 2008), *available at* http://ssrn.com/abstract=1049581 (finding that 53.10% of corporations that incorporate outside of the state of their principal place of business choose Delaware).

189. While the Cary–Winter debate has raged for decades, *see generally* ROBERTA ROMANO, THE GENIUS OF AMERICAN CORPORATE LAW 14–31 (1993), veil-piercing has become involved only recently. *See, e.g.*, Dammann & Schündeln, *supra* note 187, at 18 tbl.4 (finding the risk of veil-piercing to be a statistically significant consideration in where to incorporate for corporations with at least 1,000 employees); Douglas G. Smith, *A Federalism-Based Rationale for Limited Liability*, 60 ALA. L. REV. 649, 669 (2009) ("To the extent limited liability is preserved, so is shareholder wealth. Thus, all other things being equal, one would expect that shareholders and corporate managers would be attracted to states with strong doctrines of limited liability."). *But see, e.g.*, Margaret M. Blair, *Locking in Capital: What Corporate Law Achieved for Business Organizers in the Nineteenth Century*, 51 UCLA L. REV. 387, 437–41 (2003) (arguing from history that limited liability may not have been a primary consideration for incorporators); Presser, *supra* note 59, at 159 ("[I]t is the quality of the investment opportunity itself, and not the elimination of possible personal liability, that leads an investor to commit his or her capital.").

individuals. These results suggest that the state's purported reputation for engaging in a "race to the bottom" remains intact.[190] And that reputation has roots within substantive law, as a long-standing strict requirement of "fraud or something like it" coheres with the observation that piercing the veil under Delaware law is "comparatively difficult."[191]

The distinction of being the most difficult jurisdiction in which to pierce belongs to Maryland. Veil-piercing claims prevailed a paltry 25.81% of the time and never against a corporate parent.[192] This appears to be the conscious product of Maryland's courts, which have described attempts to pierce the veil under their state law as a "[H]erculean task."[193] Like Delaware, this may be attributed to a "markedly restrictive approach" that requires proof of actual common law fraud or evasion of a statute to justify veil-piercing.[194]

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190. Guhan Subramanian, *The Disappearing Delaware Effect*, 20 J.L. ECON. & ORG. 32, 56–57 (2004) (explaining that the promanagement trajectory of Delaware law is consistent with a "race to the bottom"). *But see, e.g.*, Roberta Romano, *Law as a Product: Some Pieces of the Incorporation Puzzle*, 1 J.L. ECON. & ORG. 225, 279 (1985) (finding positive cumulative abnormal returns for firms that reincorporate in Delaware, suggesting that the state is actually leading a race to the top). By comparison, Thompson found absolutely no successful veil-piercing in eleven cases applying Delaware law prior to 1986. *See* Thompson, *Empirical Piercing*, *supra* note 20, at 1051 tbl.6. *Contra* Equitable Trust Co. v. Gallagher, 99 A.2d 490, 493 (Del. 1953) ("But the corporate entity is here of no importance. . . . We have here . . . the important facts that the defendant owned a clear majority of the stock . . . and that he personally dominated the corporation in all its operations . . . ."); Ford v. Harris Moving & Storage, Inc., C.A. No. 6359, 1981 WL 15151, at *1 (Del. Ch. June 16, 1981) ("Mr. Harris' manipulation of his corporation for his own benefit calls for a disregard of the corporate entity, the piercing of the corporate veil and the imposition of personal liability . . . ."); Ne. Loan v. Furniture Mart, C.A. No. 4901, 1977 WL 9536, at *6 (Del. Ch. Sept. 21, 1977) (holding that the "corporate identity will be disregarded if its purpose is to shield fraud, as I am satisfied was the case here"). Thompson also reported no successful veil-piercing in three cases applying Puerto Rican law. *See* Thompson, *Empirical Piercing*, *supra* note 20, at 1051 tbl.6, 1053 n.91. *Contra* Forastieri v. E. Air Lines, Inc., No. Civ. 79-2544(PG), 1983 WL 364564, at *7 (D.P.R. July 5, 1983) ("[W]hen the result was to cause the corporation to default before the principals of the corporation . . . it is fully justifiable for a court to pierce and disregard the corporate veil and find plaintiffs to be one with the corporation . . . .").

191. PRESSER, *supra* note 1, § 2:8, at 2-73; *see also supra* note 97 and accompanying text. Recent decisions relaxing the "fraud or something like it" requirement, however, suggest to Presser that "the days of Delaware as a state where it was exceptionally difficult to pierce the corporate veil may be numbered." PRESSER, *supra* note 1, § 2:8, at 2-88. From 1986 up to and including 2006, 38.46% of veil-piercing claims under Delaware law prevailed.

192. *But see* Thompson, *Empirical Piercing*, *supra* note 20, at 1051 tbl.6 (finding a comparatively liberal 40.00% rate in 15 pre-1986 cases).

193. Dixon v. Process Corp., 382 A.2d 893, 895 (Md. Ct. Spec. App. 1978) ("[W]oe unto the creditor who seeks to rip away the corporate facade in order to recover from one sibling of the corporate family what is due from another in the belief that the relationship is inseparable, if not insufferable, for his is a [H]erculean task.").

194. Ice. Telecom, Ltd. v. Info. Sys. & Networks Corp., 268 F. Supp. 2d 585, 591 (D. Md. 2003); *see also* G. Michael Epperson & Joan M. Canny, *The Capital Shareholder's Ultimate Calamity: Pierced Corporate Veils and Shareholder Liability in the District of Columbia, Maryland, and Virginia*, 37 CATH. U. L. REV. 605, 637 (1988) (describing Maryland's approach as a "bright-line test" that affords little judicial discretion).

Indeed, attempts to expand the standard to permit a mere showing of a need "to enforce a paramount equity" apparently have failed.[195]

If Maryland resembles Hercules, then North and South Dakota are the Scylla and Charybdis of veil-piercing.[196] Although there is a miniscule number of cases in these jurisdictions, North Dakota's 85.71% and South Dakota's 83.33% are two of the highest veil-piercing rates within the dataset.[197] And these states share more than just geographical proximity. Neither jurisdiction requires a showing of actual fraud, instead permitting proof of injustice or unfairness to suffice.[198] Further, both states find evidence of inadequate capitalization to be important, if not compelling.[199] Based on his comprehensive state-by-state review, Stephen Presser describes North Dakota as producing "one of the purest undercapitalization cases ever decided in the United States," that seems to "squarely fit within [Henry Winthrop] Ballantine's . . . theory that undercapitalization alone could support piercing the veil."[200]

Not surprisingly, California law is among the most frequently applied to veil-piercing cases and features a 50.86% rate.[201] Ballantine's "optimistic

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195. Residential Warranty Corp. v. Bancroft Homes Greenspring Valley, Inc., 728 A.2d 783, 789 (Md. Ct. Spec. App. 1999) ("Despite the proclamation that a court may pierce the corporate veil to enforce a paramount equity, arguments that have urged a piercing of the veil 'for reasons other than fraud' have failed in Maryland courts." (quoting Travel Comm., Inc. v. Pan Am. World Airways, Inc., 603 A.2d 1301, 1317 (Md. Ct. Spec. App. 1992))). Whether veil-piercing lies within law or equity, though, is a matter of dispute among some courts. *See, e.g.*, G-I Holdings, Inc. v. Bennet (*In re* G-I Holdings, Inc.), 380 F. Supp. 2d 469, 476 (D.N.J. 2005) ("A circuit split exists as to whether the nature of the relief in an action to pierce the corporate veil is legal or equitable.").

196. *Cf.* HOMER, THE ODYSSEY 217 (Robert Fitzgerald trans., Vintage Classics 1990) ("And all this time,/in travail, sobbing, gaining on the current,/we rowed into the strait—Skylla to port and on our starboard beam Kharybdis, dire/gorge of the salt sea tide.").

197. *Cf.* Thompson, *Empirical Piercing*, *supra* note 20, at 1051 tbl.6 (finding a 75.00% rate for 4 North Dakota cases and a 62.50% for 8 South Dakota cases). Guam's 100.00% rate is the highest, but the mere 3 cases in the dataset apply a test lifted from California law. *See, e.g.*, Associated Ins. Underwriters, Inc. v. Guam Int'l Insurers, Inc., Civ. No. 90-00059A, 1991 WL 336911, at *2 (D. Guam June 18, 1991) (applying the Ninth Circuit's alter-ego test, which is derived from California law).

198. *See, e.g.*, Jablonsky v. Klemm, 377 N.W.2d 560, 563–64 (N.D. 1985) ("We . . . follow the generally accepted rule that proof of fraud is not a necessary prerequisite for disregarding the corporate entity. . . . [T]here must exist an element of injustice or fundamental unfairness . . . ."); Mobridge Cmty. Indus., Inc. v. Toure, Ltd., 273 N.W.2d 128, 132 (S.D. 1978) (finding a sufficient reason for veil-piercing to be "when retention of the corporate fiction would 'produce injustices and inequitable consequences'").

199. The Dakotas, however, appear to take different approaches to the Contract–Tort distinction. *Compare Jablonsky*, 377 N.W.2d at 565 (embracing "the attitude toward judicial piercing of the corporate veil [that] is more flexible in [T]ort, as opposed to ordinary [C]ontract actions"), *with* Glanzer v. St. Joseph Indian Sch., 438 N.W.2d 204, 209 (S.D. 1989) (suggesting disagreement with the view that "some courts are more hesitant to pierce the corporate veil in [C]ontract cases than [T]ort cases").

200. PRESSER, *supra* note 1, § 2:38, at 2-443; *see also infra* notes 201–03 and accompanying text.

201. *Cf.* Thompson, *Empirical Piercing*, *supra* note 20, at 1051 tbl.6 (finding a 44.94% rate for 89 pre-1986 cases).

reading of prior cases"[202] about the sufficiency of undercapitalization arguably has contributed to California's reputation "as one of the jurisdictions most likely to pierce the corporate veil."[203] Robert Clark, however, has pointed out that undercapitalization alone is insufficient to justify veil-piercing in California.[204] Rather, the jurisdiction's relatively high veil-piercing rate may be attributable to an amorphous and liberal standard from that supreme court of which Cardozo would be proud:

> As the separate personality of the corporation is a statutory privilege, it must be used for legitimate business purposes and must not be perverted. When it is abused it will be disregarded and the corporation looked at as a collection or association of individuals, so that . . . the stockholders [will be] liable for acts done in the name of the corporation.[205]

This standard might suggest that individual shareholders are more vulnerable to veil-piercing than their corporate peers under California law,[206] but the results indicate that the distinction bears no difference. Courts reach into the assets of an individual shareholder 50.28% of the time, as compared to 51.79% of the time for corporate parents, which is among the more notable exceptions to the overall results in this regard.[207]

New York and Ohio law also rank among the most prominent producers of veil-piercing cases with a rate exceeding the total dataset.[208] As a

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202. Clark, *supra* note 85, at 547 n.108 ("California courts have emphasized the importance of inadequate capitalization. . . . These cases relied heavily on Ballantine's rather optimistic reading of prior cases . . . .").

203. PRESSER, *supra* note 1, § 2:5, at 2-31; *see also id.* § 1:9, at 1-51 to 1-52. *But see* Thompson, *Empirical Piercing*, *supra* note 20, at 1052 (speculating that California's relatively extended retention of a corporate statute providing for shareholder liability until 1931 "probably contributed to a perception that public policy in California favored piercing the corporate veil").

204. *See* CLARK, *supra* note 15, at 81 n.10 ("[A]t least in recent years, inadequate capitalization per se does not trigger veil piercing in California . . . .").

205. Mesler v. Bragg Mgmt. Co., 702 P.2d 601, 606 (Cal. 1985). In *Berkey v. Third Ave. Ry. Co.*, 155 N.E. 58 (N.Y. 1926), Justice Cardozo proposed his own opaque alternative to the metaphorical alter ego test:

> The logical consistency of a juridicial conception will indeed be sacrificed at times, when . . . essential to the end that some accepted public policy may be defended or upheld. . . . At such times unity is ascribed to parts . . . for the reason that only thus can we overcome a perversion of the privilege to do business in a corporate form.

Id. at 61. In essence Cardozo's test relies on basic agency principles unless there is insufficient evidence of control by a corporate parent; in that circumstance, a judicially identified public policy (that arguably requires some kind of statutory source) may be used to thwart a perceived "perversion" of concessionary privilege. *Id. But see* Michael, *supra* note 19, at 57 ("It makes no logical sense to base veil-piercing in a theory of corporate privilege.").

206. *See* PRESSER, *supra* note 1, § 2:5, at 2-46 (observing that California courts "seem to have adopted a more conservative approach to piercing the veil in recent cases involving parent-subsidiary corporations, [but] they may occasionally pierce the veil with less hesitation in cases involving individually-owned corporations").

207. *See infra* Table 4.

208. The top five producers of veil-piercing cases are, in order: New York, California, Texas, Ohio, and Pennsylvania. *But see* Larry E. Ribstein & Erin Ann O'Hara, *Corporations and the*

prominent rival to Delaware for corporations, New York has a veil-piercing doctrine described as "nearly impregnable."[209] This characterization would seem to be at odds with the 49.81% veil-piercing rate, but federal and state courts apply somewhat different tests for New York.[210] Federal courts in New York, which pierce 56.41% of the time, appear to apply the common alter ego test that requires proof of control or domination, as well as fraud or inequity;[211] in contrast, New York's state courts, which pierce 42.76% of the time, appear to require an additional prong of "perversion of the privilege to do business in a corporate form" that is a seeming tribute to their legendary jurist, Cardozo.[212] Ohio's 55.87% veil-piercing rate is considerably simpler to explain, as courts apply a fairly liberal standard that does not require proof of actual or constructive fraud.[213] What is perhaps most notable about the jurisdiction is the discrepancy between the mere fourteen cases applying

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Market for Law, 2008 U. ILL. L. REV. 661, 679–80 ("California, Delaware, Florida, Illinois, New York, and Texas each have statutes that provide for the automatic enforcement of choice-of-law clauses that designate the state's law in high value contracts."). Pennsylvania and Texas both feature a rate lower than the total dataset. When Pennsylvania law is applied, 44.44% of claims prevail, which suggests the "strong presumption" against veil-piercing professed by the state's Supreme Court may be aspirational. Lumax Indus., Inc. v. Aultman, 669 A.2d 893, 895 (Pa. 1995). *Cf.* Thompson, *Empirical Piercing*, *supra* note 20, at 1051 tbl.6 (finding a comparatively paltry 30.77% rate in 65 pre-1986 Pennsylvania cases). Moreover, the jurisdiction features an unsettled and unclear test, which has been described as "somewhat obscure." PRESSER, *supra* note 1, § 2:42, at 2-496; *see also* Good v. Holstein, 787 A.2d 426, 430 (Pa. Super. Ct. 2001) ("[T]here appears to be no clear test or well settled rule in Pennsylvania . . . as to exactly when the corporate veil can be pierced . . . ."); First Realvest, Inc. v. Avery Builders, Inc., 600 A.2d 601, 604 (Pa. Super. Ct. 1991) ("[T]here is no definitive test for piercing the corporate veil."). When Texas law is applied, 40.76% of claims prevail, although that jurisdiction has taken distinct approaches over time. *See infra* notes 214–28 and accompanying text; *cf.* Thompson, *Empirical Piercing*, *supra* note 20, at 1051 tbl.6 (finding a 34.91% rate in 106 pre-1986 Texas cases).

209. William D. Harrington, *Business Associations*, 43 SYRACUSE L. REV. 25, 65 (1992); *see also* William Wrigley Jr. Co. v. Waters, 890 F.2d 594, 600 (2d Cir. 1989) ("It is well settled that New York courts are reluctant to disregard the corporate entity.").

210. By comparison, Thompson found a 34.91% rate in 212 pre-1986 cases, but he does not provide federal and state splits. Thompson, *Empirical Piercing*, *supra* note 20, at 1051 tbl.6. The difference in New York federal and state courts also is manifest in their piercing rates based on the type of the shareholders. New York federal courts reach into the assets of an individual shareholder (70.49%) far more frequently than those of corporate parents (46.43%); these rates are both considerably higher than those of the state courts, which also reach into the assets of individual shareholders (48.67%) far more frequently than those of corporate parents (25.64%).

211. *See, e.g.*, David v. Glemby Co., 717 F. Supp. 162, 166 (S.D.N.Y. 1989) (describing New York's two-part test).

212. *See, e.g.*, Guptill Holding Corp. v. State, 307 N.Y.S.2d 970, 973 (N.Y. App. Div. 1970) ("Incorporations are, however, subject to 'tests of honesty and justice' and will be ignored if a 'perversion of the privilege to do business in a corporate form.' . . . Another factor looked to . . . is complete dominion and control . . . ."); *supra* note 204.

213. *See, e.g.*, Belvedere Condo. Unit Owners' Ass'n v. R.E. Roark Cos., 617 N.E.2d 1075, 1086 (Ohio 1993) (adopting the rule announced in Bucyrus–Erie Co. v. Gen. Prods. Corp., 643 F.2d 413, 419 (6th Cir. 1981) (holding that "[t]hough fraud is a frequent ground for application of the alter ego doctrine, it is not essential")). The veil-piercing rate for individual versus corporate shareholders approximates the overall dataset.

Ohio law in Thompson's study and the fifty-two observations in this dataset over the same time frame.[214]

Finally, Texas provides an interesting case study of different approaches to veil-piercing. Prior to 1986, Texas courts applied essentially an alter ego test, plus a catchall "exceptional situations"[215] provision that was criticized as so "difficult to describe"[216] as to be "almost totally useless,"[217] not to mention interpreted expansively by courts.[218] At the same time, courts also seemed to place inordinate emphasis on whether a defendant corporation had failed to follow basic formalities[219] or commingled affairs or assets,[220] contributing to the jurisdiction's overall reputation as relatively "lenient" for veil-piercing plaintiffs.[221]

In 1986 this leniency reached its apex. The Supreme Court of Texas ruled in *Castleberry v. Branscum*[222] that veil-piercing would be justified when there was evidence of an inequitable result, even when corporate formalities had been observed and commingling was absent.[223] Alternatively, and more significantly, a request for veil-piercing grounded in either Contract or Tort could prevail by demonstrating that the defendant corporation was a sham used to perpetuate merely constructive, and not

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214. *See* Thompson, *Empirical Piercing*, *supra* note 20, at 1051 tbl.6 (finding a 57.14% rate in 14 pre-1986 cases). The veil-piercing rate for Ohio law in the present study is roughly comparable over Thompson's time frame (55.77%) as well as the remaining period (55.91%), but the considerably larger number of Ohio observations (among other jurisdictions) in this dataset certainly contributes to the two studies' different overall rates.

215. *See, e.g.*, Bell Oil & Gas Co. v. Allied Chem. Corp., 431 S.W.2d 336, 339 n.3, 340 (Tex. 1968) (observing that "'individual officers, directors or stockholders'" will not be held liable "'except where it appears that the individuals are using the corporate entity as a sham to perpetuate a fraud, to avoid personal liability, avoid the effect of a statute, or in a few other exceptional situations'" (quoting Pace Corp. v. Jackson, 284 S.W.2d 340, 351 (Tex. 1955))).

216. 1 IRA P. HILDEBRAND, THE LAW OF TEXAS CORPORATIONS 43 (1942).

217. Robert W. Hamilton, *The Corporate Entity*, 49 TEXAS L. REV. 979, 982 (1971).

218. *See, e.g.*, *Bell*, 431 S.W.2d at 340 (noting that an arrangement that "in all probability will result in prejudice to those dealing with one or more of the units . . . or one which has actually resulted in the complaining party's having been placed in a position of disadvantage" easily would suffice); First Nat'l Bank v. Gamble, 132 S.W.2d 100, 103 (Tex. 1939) (finding that "an adherence to the fiction of the separate existence . . . would, under the particular circumstances, sanction a fraud or promote injustice").

219. *See, e.g.*, Coastal Shutters & Insulation, Inc. v. Derr, 809 S.W.2d 916, 921 (Tex. App.—Houston [14th Dist.] 1991, no writ) (listing "the degree to which the corporate formalities are followed" as the first of four factors used to establish an "alter ego" claim).

220. *See, e.g.*, State v. Swift & Co., 187 S.W.2d 127, 131–32 (Tex. Civ. App.—Austin 1945, writ ref'd n.r.e.) (describing the role of the courts in policing commingled stock ownership and corporate management as protecting "public convenience" and enforcing laws).

221. *See, e.g.*, Minchen v. Van Trease, 425 S.W.2d 435, 437 (Tex. Civ. App.—Houston [14th Dist.] 1968, writ ref'd) (observing that Texas courts are more lenient than other jurisdictions as to veil-piercing).

222. 721 S.W.2d 270 (Tex. 1986).

223. *Id.* at 271 (citing *Bell*, 431 S.W.2d at 340, as well as analogous applications to fiduciary duties, fraudulent transfers, and trust funds). Notably, the cited portion of *Bell* contains absolutely no mention of corporate formalities.

actual, fraud.[224] The ensuing "uproar in the business community"[225] eventually triggered a nullificatory reaction by the state legislature, which amended Article 2.21A of the Texas Business Corporation Act, effective August 28, 1989, to reinstate a requirement of actual fraud against only Contract creditors.[226]

These events have had a significant impact on veil-piercing cases. Prior to *Castleberry* 38.83% of all veil-piercing opinions under Texas law resulted in success, which indicates that the jurisdiction's reputation for leniency was unfounded.[227] But this overall rate exploded to 60.00% during the three years after the decision, and has retreated to 40.22% since the enactment of Article 2.21A up to and including 2006.

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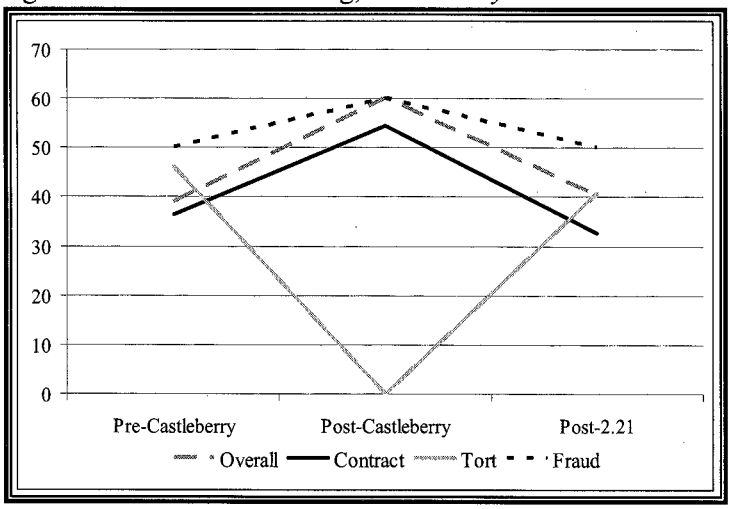
224. *Id.* at 273. The court had previously distinguished constructive fraud from actual fraud: "Actual fraud usually involves dishonesty of purpose or intent to deceive, whereas constructive [F]raud is the breach of some legal or equitable duty which, irrespective of moral guilt, the law declares fraudulent because of its tendency to deceive others, to violate confidence, or to injure public interests." Archer v. Griffith, 390 S.W.2d 735, 740 (Tex. 1964). *But see Castleberry*, 721 S.W.2d at 277–78 (Gonzalez, J., dissenting) ("This standard is so broad that it is not a standard. It fails to provide any guidance on the necessary elements to assert a cause of action under this theory. . . . *In his attempt to disregard the corporate entity in this case, Castleberry only pleaded an alter ego theory.*"). According to the slim majority, the failure to plead a sham theory was not fatal because "the purpose in disregarding the corporate fiction . . . 'should not be thwarted by adherence to any particular theory of liability.'" *Id.* at 273 (majority opinion) (quoting Gentry v. Credit Plan Corp., 528 S.W.2d 571, 575 (Tex. 1975)).

225. Farr v. Sun World Sav. Ass'n, 810 S.W.2d 294, 296 (Tex. App.—El Paso 1991, no writ).

226. Act of May 12, 1989, 71st Leg., R.S., ch. 217, § 1, 1989 Tex. Gen. Laws 974, 974–75. Due to some apparent confusion about the applicability of Article 2.21 to theories that were not identified explicitly, the Texas legislature further amended 2.21(A)(2) in 1993 to include "the alter ego of the corporation" or some "other similar theory" as invalid grounds for imposing shareholder liability. Act of May 7, 1993, 73rd Leg., R.S., ch. 215, § 2.05(A)(2), 1993 Tex. Gen. Laws 418, 446; *see also* W. Horizontal Drilling, Inc. v. Jonnet Energy Corp., 11 F.3d 65, 69 n.5 (5th Cir. 1994) ("[T]he Texas Supreme Court seems to be ignoring the amendments to article 2.21 and continues to permit a failure to observe corporate formalities as a means of proving alter ego."). Further, even though explicitly concerned with only Contracts, the provision also was applied to certain Torts. *See, e.g.*, Menetti v. Chavers, 974 S.W.2d 168, 174 (Tex. App.—San Antonio 1998, no pet.) ("[T]he actual fraud requirement should be applied, by analogy, to [T]ort claims, especially those arising from contractual obligations."). In an effort to "curb the creativity of the bench and the bar," Alan W. Tompkins & Ted S. O'Neal, *Corporations and Limited Liability Companies*, 51 SMU L. REV. 817, 825 (1998), the legislature again amended 2.21 by adding "any matter relating to or arising from the obligation" to "any contractual obligation." Act of May 13, 1997, 75th Leg., R.S., ch. 375, § 7(A)(2), 1997 Tex. Gen. Laws 1516, 1522.

227. *See supra* note 220 and accompanying text.

Figure 3. Texas Veil-Piercing, *Castleberry* to Article 2.21A[228]



Most interestingly, the post-*Castleberry* rate of veil-piercing claims in Contract is lower than before the decision. During the three years between the decision and Article 2.21A there was only one case involving a Tort claim. *Castleberry*'s liberalization of the requirements for veil-piercing in Contract thus may have incentivized litigants to recharacterize Tort claims when possible, but the overall paucity of cases combined with an extremely short time frame limits the reliability of the data for Tort, and, to an extent, for all other claims during that span.[229] Nevertheless, the data support a story of how changes to a jurisdiction's veil-piercing standard can affect litigant behavior and success.

C. *Reclaiming the Substantive Divide*

Due to its remedial nature, a veil-piercing request must be couched in a substantive cause of action.[230] Particular caution should be exercised with any data about substantive claims, however, as they feature a layer of ambi-

228. There are only two veil-piercing claims grounded in the corporation statute. *See* TEX. BUS. ORGS. CODE § 21.223(a)(1), (b) (West, Westlaw through 2009 Regular and First Called Sessions) (codifying Article 2.21A as effective January 1, 2010).

229. Between *Castleberry* and Article 2.21A there were only fifteen veil-piercing observations, of which eleven were in Contract and four were in Fraud. Ironically, *Castleberry* appears to have elevated the prominence of fraud or misrepresentation as an instrumental rationale. Prior to the decision, that rationale was relied upon infrequently, with only 45 observations and a 26.67% success rate. During the three years after the decision, however, the frequency of the rationale disproportionately increased to 8 observations with a 75.00% success rate. And after Article 2.21A's enactment, courts found fraud or misrepresentation to be instrumental in 38 cases, with litigants prevailing 44.74% of the time; when an ambiguous or general reference to fraud or deceit was instrumental, piercing occurred in 29.63% of cases, versus 66.67% or 100.00% when specific evidence of fraud concerning assets or identity, respectively, was instrumental.

230. *See supra* note 152 and accompanying text.

guity in addition to selection effects.[231] Not only are substantive claims subject to discretionary selection and characterization by litigants, but their sources can vary across jurisdictions. Specifically, certain kinds of Contract, Criminal, Fraud, and Tort claims can originate from, and even coexist in, the common law or statutes.[232] To an extent this issue has been addressed by coding all types of claims connected to veil-piercing, but no attempt has been made here to control even basic jurisdictional differences.

In line with the overall trend,[233] the frequency of each type of substantive claim increased over time, with a sharp rise beginning in the 1970s. As in Thompson's study, veil-piercing claims arise in Contract more than in any other substantive claim.[234]

Table 7. Veil-Piercing by Claim and Jurisdiction

Claim	*n*	V-P Rate (%)
Contract	1730	46.24
Federal	408	42.65
State	1322	47.35
Criminal	48	**66.67**
Federal	10	**50.00**
State	38	**71.05**
Fraud	400	**61.00**
Federal	157	**53.50**
State	243	**65.84**
Statute	897	**49.50**
Federal	383	**50.65**
State	514	**48.64**
Tort	377	47.75
Federal	129	48.06
State	248	47.58

This comports with available data on nationwide filings for all types of claims, veil-piercing or otherwise.[235] Since 1990, however, a surge in all

231. *See supra* notes 143–51 and accompanying text.

232. *See, e.g.*, Egudin v. Carriage Court Condo., 528 So. 2d 1043, 1044 (La. Ct. App. 1988) (addressing fraud); People *ex rel.* Potter v. Mich. Bell Tel. Co., 224 N.W. 438, 438–40 (Mich. 1929) (addressing public utility contracts); Covelli v. Jackson, 700 N.Y.S.2d 341 (N.Y. App. Div. 1999) (addressing negligent automotive repair); *Ex parte* Chambers, 898 S.W.2d 257, 258 (Tex. 1995) (addressing criminal contempt).

233. *See supra* note 160 and accompanying text.

234. Thompson, *Empirical Piercing*, *supra* note 20, at 1058 tbl.9.

235. *See supra* note 160.

such Tort filings within federal court has resulted in their outnumbering Contract claims, which have been declining.[236]

Civil veil-piercing claims prevail most often when couched in Fraud. The veil-piercing rate for Fraud exceeds that of any other type of civil substantive claim, in federal or state court as well as across all levels of courts.

Table 8. Veil-Piercing by Claim and Court

Claim	*n*	V-P Rate (%)
Contract	1730	46.24
Trial	281	48.04
Intermediate Appellate	1119	45.13
Supreme	336	47.02
Criminal	48	**66.67**
Trial	5	**60.00**
Intermediate Appellate	31	**58.06**
Supreme	12	**91.67**
Fraud	400	**61.00**
Trial	97	**57.73**
Intermediate Appellate	239	**56.49**
Supreme	67	**79.10**
Statute	897	**49.50**
Trial	271	**53.51**
Intermediate Appellate	452	46.24
Supreme	176	**51.14**
Tort	377	47.75
Trial	91	**53.85**
Intermediate Appellate	224	44.20
Supreme	63	47.62

Indeed, when Fraud is paired with another civil substantive claim, there is markedly more veil-piercing success than with that claim alone.[237] And, notably, subclaims for Fraud that can be characterized as Contract, such as Fraudulent Misrepresentation, feature lower veil-piercing rates than their counterparts for Tort, such as Deceit.[238]

236. ADMIN. OFFICE OF THE U.S. COURTS, *supra* note 160.

237. *See infra* Table 9.

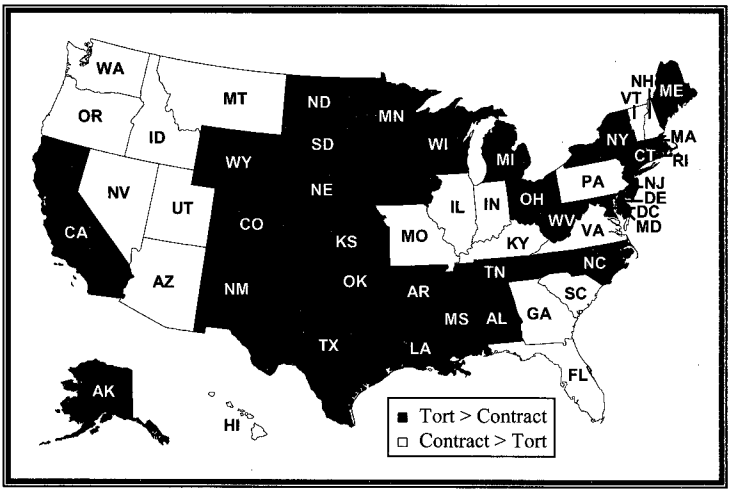
238. *See infra* Table 10.

Table 9. Veil-Piercing by Combinations of Claims

Claim	*n*	V-P Rate (%)
Contract	1393	45.37
Criminal	1	**100.00**
Fraud	77	**83.12**
Statute	707	47.95
Tort	215	44.65
Contract-Criminal	1	**100.00**
Contract-Fraud	155	**57.42**
Contract-Statute	125	42.40
Contract-Tort	44	45.45
Criminal-Fraud	6	**66.67**
Criminal-Statute	38	**63.16**
Criminal-Tort	2	**100.00**
Fraud-Statute	99	**53.54**
Fraud-Tort	51	**56.86**
Statute-Tort	53	**52.83**
Contract-Fraud-Tort	12	41.67

Veil-piercing claims prevail more often in Tort than Contract. Although slight, the disparity also holds in federal and state courts.[239] And this result is produced by the law in 60.78% of all jurisdictions.

Figure 4. Tort v. Contract Veil-Piercing Rates[240]



239. *See infra* Table 7. The disparity also holds true for both trial and supreme courts. *See infra* Table 8. The results for intermediate appellate courts should be discounted, as they depend heavily on state cases from an incomplete database. *See supra* note 178 and accompanying text.

240. Puerto Rico is the only nonstate whose rate in Tort (66.67%) exceeds Contract (50.00%).

The law from all the shaded states produces higher veil-piercing rates in Tort than Contract. There is no apparent connection between overall laxity in veil-piercing and whether that jurisdiction's law results in more success in Tort than Contract; the proportion of jurisdictions whose law results in piercing in excess of the overall rate is almost evenly divided between shaded and nonshaded states.[241]

These results do not square with Thompson's findings. Over his original time frame the veil-piercing rate for Tort was 52.94% versus 45.90% for Contract. And these disparities cannot be explained by Thompson's omission of Fraud. When the various subclaims for Fraud are recharacterized as either a Contract or Tort claim,[242] the gap between the veil-piercing rates prior to 1986 becomes even greater: 61.68% for Tort versus 47.23% for Contract; that gap remains over this entire dataset's time frame: 54.34% for Tort versus 47.23% for Contract.[243] The identity of rates in Contract across these time frames makes clear that veil-piercing litigants have been experiencing less success in Tort over the past two decades.[244]

This trend in Tort is apparent even in the main dataset, where Fraud claims are segregated. From 1986 up to and including 2006, veil-piercing claims actually prevail less in Tort, 43.48%, than Contract, 46.56%.[245] One plausible explanation is that Thompson's findings have altered litigation patterns, but only a handful of reported cases have cited the perplexing asymmetry, much less relied upon it, in deciding whether to pierce in Contract or Tort.[246] Another possibility is that Thompson's time frame coincides with some inflection point, but there is no discernable fork over the past three decades in the veil-piercing rates for Contract or Tort. A large part of this puzzle may lie in Fraud, whose veil-piercing rate has decreased con-

241. The most interesting state in this regard is Virginia, which features an extremely low piercing rate and yet favors piercing in Contract over Tort. Because of the paucity of cases, "[i]t is clearly more difficult in Virginia than in its neighboring jurisdictions to grasp the state's piercing doctrine." Epperson & Canny, *supra* note 193, at 632.

242. *See supra* note 80 and accompanying text. Material Misrepresentation and Innocent Misrepresentation subclaims were recharacterized as Contract, while Common Law Fraud or Deceit and Negligent Misrepresentation subclaims were recharacterized as Tort; Fraudulent Misrepresentation and Fraudulent Transfer subclaims were equally divided into Contract and Tort. To be sure, this is an imprecise way to reverse engineer Thompson's coding, particularly because of the presumed indifference between Fraudulent Misrepresentation and Fraudulent Transfer claims; recalibrating the allocation, however, seems unlikely to alter the gap, given its considerable size.

243. For these recharacterized claims, the veil-piercing rate for Tort exceeds the rate for Contract in federal or state court, as well as against an individual or corporate shareholder.

244. This is not inconsistent with Thompson's speculation that "change in [P]roduct-[L]iability law and [T]ort law generally in recent decades may have led plaintiffs to bring suits that go beyond prior law." Thompson, *Empirical Piercing*, *supra* note 20, at 1069.

245. *But cf. supra* Figure 4 (indicating that veil-piercing claims prevail more often in Tort than in Contract in the majority of jurisdictions).

246. *See* Theberge v. Darbro, Inc., 684 A.2d 1298, 1303 (Me. 1996) ("The distinction between [C]ontract and [T]ort creditors . . . breaks down when the debtor engages in fraud or misrepresentation.").

siderably over the past few decades.[247] The reason for this decrease is not clear and bears further investigation. At the very least, veil-piercing in Fraud does seem to correlate more strongly with that in Tort, as compared to Contract, and thus seems to have some distortive effect on Thompson's finding.

Moreover, veil-piercing is not rooted within inequitable bargains.[248] Comparing types of contracting parties as a proxy for relative sophistication reveals no appreciable difference in veil-piercing when a bargain involves only organizations, versus an organization with an individual.[249]

Table 10. Veil-Piercing by Claim and Subclaim

Claim	*n*	V-P Rate (%)
Contract	1730	46.24
Individual-Organization	678	45.43
Organization-Organization	1052	46.77
Criminal	48	**66.67**
Fraud	400	**61.00**
Fraud/Deceit	111	**68.47**
Fraudulent Misrepresentation	104	**53.85**
Fraudulent Transfer	161	**67.08**
Innocent Misrepresentation	2	0.00
Material Misrepresentation	5	20.00
Negligent Misrepresentation	17	17.65
Statute	897	**49.50**
Antitrust	21	42.86
Arbitration	3	33.33
Bankruptcy	107	**49.53**
Commercial	49	**61.22**
Constitution	15	33.33
Corporation	38	44.74
Criminal	35	**68.57**
Discrimination	7	14.29
Environmental	26	**61.54**
ERISA/Social Security	33	**66.67**

(continued)

247. *See, e.g.*, *supra* text accompanying notes 222–27; *supra* Figure 3. Certainly, another part of the puzzle may lie in the choice of exclusions, multiplicity of claims, and coding of cases.

248. *See infra* Table 10 (indicating that the veil-piercing rates for Contract claims between organizations, and between individuals and organizations, are 46.77% and 45.43% respectively).

249. To be sure, interorganizational contracting does not necessarily involve less disparate sophistication levels than those between organizations and individuals. A better measure would be to discern the amount of financial resources, quality of business expertise and legal counsel, as well as the specific contract terms; even if such data could be obtained, a reliable metric would be difficult to formulate. In any event, the endgame suggests no material difference.

Table 10 (cont.). Veil-Piercing by Claim and Subclaim

Claim	*n*	V-P Rate (%)
Fraudulent Transfer	38	**60.53**
Health	3	33.33
Housing	19	36.84
Insurance	15	40.00
Intellectual Property	34	47.06
Labor	48	37.50
Licensing	28	46.43
Liquor	16	43.75
Marital	46	**56.52**
Maritime	13	30.77
Other	22	45.45
Real Property	22	**54.55**
Remedial	49	44.90
Securities	19	42.11
Tax	42	42.85
Trust & Estate	35	42.86
Unfair/Deceptive Trade	58	**68.97**
Usury	12	41.67
Utility	27	40.74
Workers' Compensation	32	46.88
Tort	377	47.75
Intentional Tort-Person	15	20.00
Intentional Tort-Property	72	**59.72**
Negligence	242	45.04
Products Liability	22	36.36
Tortious Interference w/ K	44	**54.55**

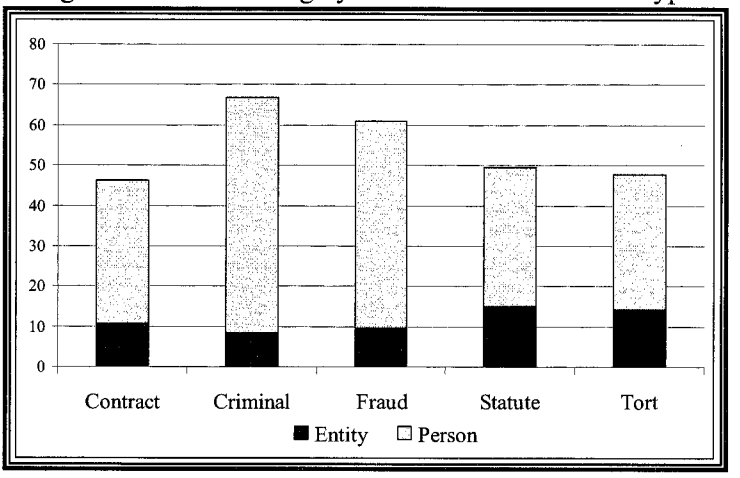
Indeed, piercing occurs more often against interorganizational bargains not only overall, but also across federal and state courts, and irrespective of whether the controlling shareholder is an individual or a corporate parent; this seems to dispel any sort of judicial predisposition to utilizing veil-piercing as an equitable shield for individual creditors from corporate wrongs. This, however, may somewhat reflect that parties with potentially superior stakes and resources will seek an advantage, such as higher quality legal services; although the veil-piercing rates are quite comparable overall for the different types of bargains, corporate parents do enjoy a bit more success defending themselves against claims by an individual Contract creditor than by another organization.[250]

250. Piercing occurs against corporate parents 40.91% of the time with interorganizational bargains versus 36.37% with individual–organization bargains. The rates against individual shareholders are comparable for the different types of bargains.

The results for specific subclaims in Tort are mixed. By a large margin, veil-piercing claims most frequently were couched in Negligence,[251] but that veil-piercing rate was considerably lower than that for Torts against Property or Tortious Interference with Contract, both of which require proof of intent.[252] The disparity in rates can be traced to the type of shareholder. As with the overall dataset, Negligence claims far more often result in judicial reaching into the assets of individual shareholders than those of corporate parents.[253] In contrast, when presented with an Intentional Tort against Property or Interference with a Contract, courts pierce with comparable frequency against both types of shareholders;[254] one plausible explanation may be that requiring evidence of deliberate tortious activity quells judicial concern about whether a corporate parent has an interest in or control over its subsidiary.[255]

Individual shareholders, though, remain more vulnerable than corporate parents for each and every substantive claim overall.

Figure 5. Veil-Piercing by Claim and Shareholder Type



The bars represent the overall veil-piercing rate for each type of claim, each of which is divided by the proportion due to piercing of corporate parents

251. *Cf.* KEETON ET AL., *supra* note 136, § 105, at 725 ("A great many of the common and familiar forms of negligent conduct . . . are in their essence nothing more than misrepresentation . . . .").

252. The distinction is not crisp as Intentional Torts Against Person feature a paltry 20.00% veil-piercing rate, but that result is quite unreliable given the miniscule number of cases.

253. Veil-piercing claims in Negligence succeed 51.88% against individuals versus 31.33% against corporate parents.

254. For Torts against Property, veil-piercing claims prevail slightly more often against an individual (62.00%) than against an entity (54.55%); for Tortious Interference with a Contract, claims prevail 54.55% of the time against either type of shareholder.

255. *See supra* notes 168–69 and accompanying text.

versus individuals; Statute and Tort claims thus feature a comparatively higher proportion of success against corporate parents. In absolute terms, though, the veil-piercing rate against corporate parents is slightly higher in Contract than Tort.[256]

Table 11. Veil-Piercing by Claim and Shareholder Type[257]

Claim	*n*	V-P Rate (%)
Contract	1730	46.24
Entity	458	39.96
Person	1268	**48.58**
Criminal	48	**66.67**
Entity	8	**50.00**
Person	40	**70.00**
Fraud	400	**61.00**
Entity	71	**54.93**
Person	328	**62.50**
Statute	897	**49.50**
Entity	318	41.51
Person	573	**53.93**
Tort	377	47.75
Entity	144	37.50
Person	233	**54.08**

This seems in line with economic arguments about veil-piercing generating potentially perverse incentives in Tort for corporate parents that can organize as separate ventures.[258] But such arguments may be imputing too much to

256. *See infra* Table 11.

257. This Table omits government shareholders.

258. *See, e.g.*, Easterbrook & Fischel, *supra* note 18, at 111 (presenting a hypothetical about taxi firms apparently inspired by the classic enterprise liability case, *Walkovszky v. Carlton*, 223 N.E.2d 6 (N.Y. 1966), in which veil-piercing would favor smaller, unaffiliated firms that have an incentive to carry minimal insurance: "[p]otential victims of torts would not gain from a legal rule that promoted corporate dis-integration"). If this account is correct, the results are not inconsistent with there being a considerable number of veil-piercing claims in Tort concerning that type of competitive context. *But see* Harvey Gelb, *Limited Liability Policy and Veil Piercing*, 9 WYO. L. REV. 551, 565–68 (2009) (arguing generally that "the perspective [that] courts in piercing the veil should be more hostile to [C]ontract creditors than [T]ort creditors may be fashionable in some quarters . . . but it is actually inappropriate," specifically because, *inter alia*, "courts have been reluctant to pierce entity veils" and "[p]rotecting [C]ontract creditors against egregious behavior by withdrawing the limited liability shield . . . should be the norm and not the exception"). Gelb's arguments rely heavily on observations that are at odds with the findings here and, in any event, prove too much as they ultimately aim to supplant the Contract–Tort distinction with an amorphously broad equitable test that would generate mixed incentives and costly uncertainty.

courts, as evidenced by their divergence from such views with respect to piercing individual versus corporate shareholders.[259]

Although highly frequent, Statute claims are very context dependent. The Statute data was divided into thirty different subtypes, which feature considerably variable veil-piercing rates. The exclusions applied to cases involving Arbitration, Bankruptcy, Discrimination, Environmental, ERISA/Social Security, Labor, Tax, Trust and Estate, and Workers' Compensation statutes concern substantively distinct analogies to veil-piercing,[260] and thus there are still some cases involving the classic corporate doctrine. Only the claims couched in Environmental and ERISA/Social Security statutes feature a rate higher than the overall dataset; this may be due to the Environmental claims involving a disproportionate amount of corporate torts, and a tendency toward construing ERISA/Social Security provisions liberally in favor of the beneficiary.[261] Not surprisingly, the largest share of Statute cases belongs to Bankruptcy, as insolvency is a natural complement to veil-piercing.[262] Notably, Commercial and Unfair or Deceptive Trade statutes account for a sizable share, which may be due to their being an alternative to Contract claims; their veil-piercing rates, though, are among the highest for Statutes and considerably higher than those for Contract claims.

D. Mapping the Wilderness of Judicial Reasons

A plethora of reasons is at the disposal of courts to support their decision whether to pierce. Courts may cite just the conclusory metaphorical aspects of the alter ego or instrumentality test.[263] Alternatively, courts simply may recite the litany of fact-specific factors, even when the factors are

259. *See supra* notes 169–73 and accompanying text.

260. *See supra* notes 124–28, 130–32 and accompanying text.

261. *See, e.g.*, Leddy v. Standard Drywall, Inc., 875 F.2d 383, 388 (2d Cir. 1989) (holding an officer–shareholder liable for required contributions under ERISA due to ERISA's legislative purpose, despite "the traditional conditions for piercing the corporate veil . . . not [being] met"); Lucia Ann Silecchia, *Pinning the Blame & Piercing the Veil in the Mists of Metaphor: The Supreme Court's New Standards for the CERCLA Liability of Parent Companies and a Proposal for Legislative Reform*, 67 FORDHAM L. REV. 115, 118 (1998) ("[C]ourts repeatedly face plaintiffs seeking to hold parent corporations liable for the CERCLA responsibilities of their subsidiaries. This has been justified primarily as an effort to cast a wide net for responsible parties and achieve CERCLA's oft-touted broad remedial purposes.").

262. *See, e.g.*, Clark, *supra* note 85, at 542 n.98 ("As is often said, a fraudulent conveyance is but the reflex of an insolvent man."). *But see, e.g.*, Adam J. Hirsch, *The Problem of the Insolvent Heir*, 74 CORNELL L. REV. 587, 621 n.164 (1989) ("Courts have not, however, been willing to pierce the corporate veil in [T]ort cases where the *sole* justification for doing so is involuntary insolvency.").

263. *See, e.g.*, Mesler v. Bragg Mgmt. Co., 702 P.2d 601, 607 (Cal. 1985) ("The essence of the alter ego doctrine is that justice be done. 'What the formula comes down to, once shorn of verbiage about control, instrumentality, agency, and corporate entity, is that liability is imposed to reach an equitable result.'" (citation omitted)).

attenuated from the underlying harm.[264] A factor's mere mention, however, is not necessarily reflective of a court's actual deliberations. As a result, a simple tally of factors appearing in decisions may provide an optical illusion, rather than an accurate portrait, of the reasons why veil-piercing succeeds.

This study presents two angles to the *ratio decidendi* of veil-piercing. The frequency data indicate the relative popularity of an instrumental rationale in veil-piercing decisions. And the veil-piercing rate data indicate the relative value of that rationale, as its absence or presence in a case depended on the veil-piercing claim's success.

Table 12. Veil-Piercing by Rationale

Rationale	*n*	V-P Rate (%)
Agency	152	**52.63**
Alter Ego	197	**62.94**
Assumption of Risk	104	3.85
Commingling	584	**61.30**
Advertising	7	**71.43**
Assets	440	**58.64**
Contracts	8	**62.50**
Directors	115	**69.57**
Employees	41	**75.61**
Officers	79	**72.15**
Records	29	48.28
Retirement Plans	0	--
Stationery	7	**71.43**
Taxes	40	**50.00**
Domination	787	**66.58**
Fraud/Misrepresentation	989	38.62
Fraud/Deceit	262	27.48
Assets	97	**62.87**
Identity	129	**65.12**
Informalities	354	**61.30**
Meetings	124	**64.52**
Records	146	**67.12**
Other	156	**55.77**

(continued)

264. *See supra* note 12 and accompanying text.

Table 12 (cont.). Veil-Piercing by Rationale

Rationale		*n*	V-P Rate (%)
Injustice/Unfairness		890	**51.35**
Instrumentality		143	**61.54**
Sham/Shell		286	**60.14**
Siphoning of Funds		278	**73.74**
Statutory Policy		251	**51.39**
Undercapitalization		411	**61.56**
	Incorporation	42	**64.29**
	Post-Incorporation	376	**61.97**
Other		550	33.45

For instance, assumption of risk accounts for only 1.74% of the total number of observations for instrumental rationales, which reflects its disfavor as a justification; the 3.85% veil-piercing rate reflects that the rationale overwhelmingly functions to justify a decision not to pierce.

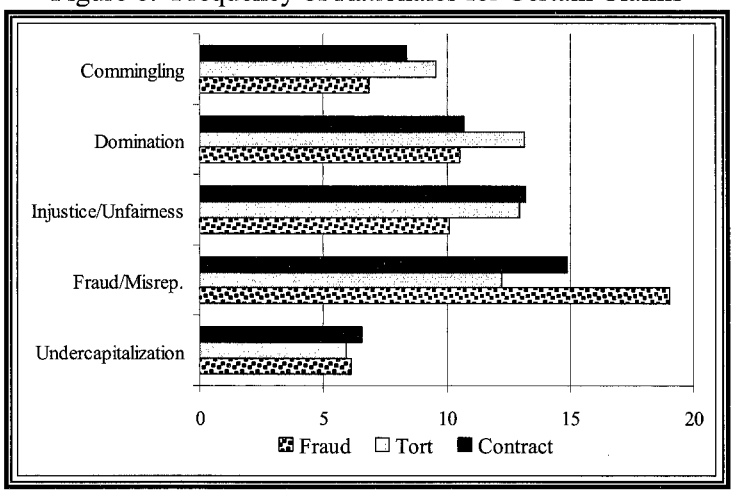
There are no surprises about the five most popular instrumental rationales. The top three—fraud or misrepresentation, injustice or unfairness, and domination—all commonly appear in veil-piercing tests, and are among the most compelling rationales within academic and practical commentary.[265] Similarly, there has been a durable belief about the relevance of commingling and undercapitalization to veil-piercing.[266]

All of these rationales also are the most popular in veil-piercing claims grounded in Contract, Fraud, or Tort.

265. *See* PRESSER, *supra* note 1, § 1:6, at 1-31 ("It was not enough, then, for Powell, for the subsidiary to be utterly dominated by the parent. In addition, there must be some 'injustice' perpetrated . . . ."); Rutheford B. Campbell, *Limited Liability for Corporate Shareholders: Myth or Matter-of-Fact*, 63 KY. L.J. 23, 37–39 (1975) ("[S]ome element of control seems indispensable to the disregard of the corporate entity."); Thompson, *Empirical Piercing*, *supra* note 20, at 1045 n.58, 1063 tbl.11, 1066 (reporting both domination and misrepresentation to be among the most frequently mentioned rationales, while reporting unfairness to be a commonly mentioned rationale that does not, however, rank among the top five); *supra* note 99 and accompanying text.

266. *See, e.g.*, Hamilton, *supra* note 216, at 985 ("The [Texas] courts often stress two factors—inadequate capitalization and the commingling of shareholder and corporate affairs—when determining whether shareholders should be held responsible for claims against their corporation.").

Figure 6. Frequency of Rationales for Certain Claims



This figure depicts how frequently a rationale was instrumental as a percentage of each claim's total number of rationale observations. The proportions for all these rationales are strikingly similar in Tort and Contract.[267] This is most surprising with respect to undercapitalization,[268] which some believe to be far more relevant in Tort than Contract.[269]

267. *See infra* Table 13.

268. *Cf.* Thompson, *Empirical Piercing*, *supra* note 20, at 1066 ("In both contexts [(Contract and Tort)] courts refused to pierce in 25 to 30% of the cases even when undercapitalization was present . . . .").

269. *See, e.g.*, Mark J. Roe, *Corporate Strategic Reaction to Mass Tort*, 72 VA. L. REV. 1, 44 n.123 (1986) ("An undercapitalization requirement may make good sense in some nontort, contractual settings."); *supra* notes 28, 107 and accompanying text.

Table 13. Veil-Piercing by Rationale and Claim

Rationale	Contract	Criminal	Fraud	Statute	Tort
Agency	**49.48**	**100.00**	36.36	**52.94**	40.91
Alter Ego	**61.11**	**50.00**	**71.88**	**62.32**	**67.86**
Assumption of Risk	3.16	**100.00**	0.00	10.00	0.00
Commingling	**56.15**	**100.00**	**65.15**	**65.27**	**65.85**
Domination	**66.81**	**89.47**	**70.30**	**70.17**	**54.87**
Fraud/Misrep.	34.75	**83.33**	**67.76**	38.55	40.95
Informalities	**61.92**	0.00	**69.44**	**56.47**	**56.25**
Injustice/Unfairness	**50.71**	**87.50**	**67.01**	**49.20**	**54.95**
Instrumentality	**60.26**	**100.00**	**73.33**	**61.11**	**61.90**
Sham/Shell	**60.57**	**75.00**	**75.00**	**60.56**	46.51
Siphoning of Funds	**69.84**	**75.00**	**74.29**	**77.97**	**75.86**
Statutory Policy	44.83	47.06	**60.00**	**51.41**	40.00
Undercapitalization	**61.79**	0.00	**61.02**	**59.55**	**60.78**
Other	33.53	18.18	47.62	30.99	29.55

Evidence of fraud or misrepresentation is the most popular rationale overall. The rationale is instrumental with comparable frequency in Contract and Tort, in line with commentary.[270] But the rationale is instrumental in only 45.75% of cases involving Fraud, which may be due to courts focusing on the claim rather than the evidence to justify veil-piercing.[271]

Popularity is not everything, however, and some of the less frequent instrumental rationales merit attention. Despite their conclusory nature, alter ego and instrumentality do not appear with much frequency overall.[272] And agency does not rank highly among the rationales, despite being a doctrinal precursor to veil-piercing and receiving considerable attention as a potential substitute for at least Contract claims;[273] the rationale seems to be comparably relevant to both Contract and Tort. In contrast courts not surprisingly cite assumption of risk far more often in Contract than Tort.

The mean veil-piercing rate for all observations of instrumental rationales is 53.16%.[274] Fraud or misrepresentation features among the

270. *See supra* note 92 and accompanying text.

271. *Cf., e.g.*, Krendl & Krendl, *supra* note 12, at 31 ("Clearly, if the plaintiff . . . had a good fraud claim he would plead it . . . .").

272. *See, e.g.*, HENRY WINTHROP BALLANTINE, BALLANTINE ON CORPORATIONS § 136, at 312 (rev. ed. 1946) ("All corporations are used as business instrumentalities.").

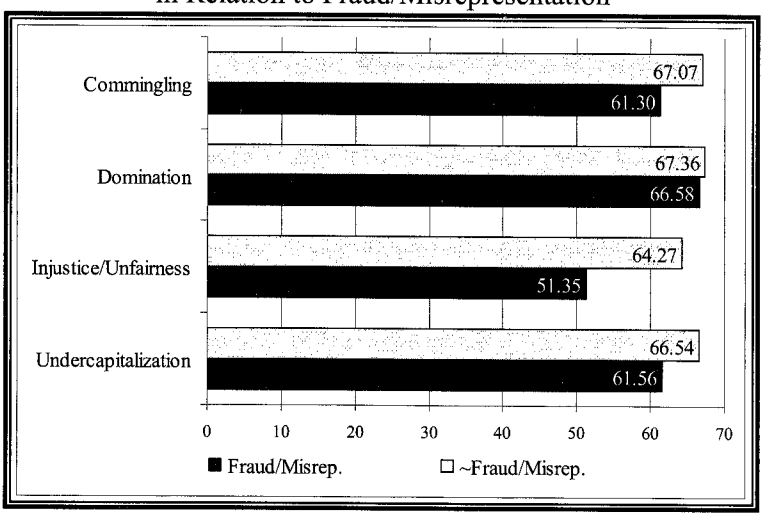
273. *See, e.g.*, Hamilton, *supra* note 216, at 983–94 ("[N]o conceptual problems emerge when liability is imposed upon shareholders under conventional theories of [A]gency or [T]ort law."). *But see, e.g.*, Millon, *supra* note 16, at 1331 ("If the courts . . . are serious about a finding of agency, there is no need to consider veil piercing at all."); *infra* note 290.

274. This varies from the overall veil-piercing rate of 48.51% due to the increased number of observations.

lowest rates, which seems to indicate that the rationale asserts itself most strongly in decisions not to pierce. But the particularized results tell a different story. Ambiguous or general references to the rationale result in piercing only 27.48% of the time; in contrast, specific evidence of fraud or misrepresentation as to assets or identity justifies piercing, respectively, 62.87% or 65.12% of the time.[275] These results indicate that, whether the jurisdiction's test explicitly requires proof, fraud or misrepresentation is a significant consideration for courts; its general absence is highly instrumental in deciding not to pierce, while specific evidence translates into superior odds for successful veil-piercing.

Even more fascinating, though, is what happens when evidence of fraud or misrepresentation is *not* instrumental. In such cases there is essentially a substitution effect: the veil-piercing rates for the other most instrumental rationales all increase.

Figure 7. Veil-Piercing Rates for Rationales in Relation to Fraud/Misrepresentation



The effect is most pronounced for injustice or unfairness, where the veil-piercing rate leaps to 64.27% when the cases also citing fraud or misrepresentation are excluded. And this effect is far stronger for all of the most popular rationales within state courts, particularly in the case of domination (70.81%) and undercapitalization (68.82%). These results circumstantially suggest that when instrumental, evidence of fraud or misrepresentation asserts itself more strongly than other prominent rationales, even though its presence alone tends to justify veil-piercing.

275. This pattern applies to claims in both Contract and Tort.

The results for undercapitalization are also illuminating. On the one hand, the relatively high veil-piercing rate indicates that the rationale tends to assert itself more strongly when courts decide to pierce;[276] this comports with widely held beliefs about undercapitalization's relevance and utility.[277] On the other hand, the rate is virtually uniform across veil-piercing claims in Contract, Tort, and Fraud, which may be surprising to some commentators.[278] Regardless, courts appear to have adjusted their use of the rationale appropriately to reflect the change in capitalization requirements, as attention over time has shifted from the initial point of incorporation to working amounts, which are now cited far more frequently. This shift conceptually complements another prominent rationale, siphoning of funds. And like undercapitalization, evidence of a corporation's accounts being pillaged for a shareholder's benefit is very instrumental in decisions to pierce for all types of substantive claims.

For the most part, however, the instrumental value of rationales does vary based on the type of substantive claim. When fraud or misrepresentation concerning a corporation's assets was instrumental in a Tort case, piercing occurred 90.91% of the time, by far the strongest rationale for any civil claim; yet fraud or misrepresentation about a shareholder's identity resulted in piercing only 60.00% of the time. Further, this sharp disparity in veil-piercing rates did not appear in either Contract or Fraud;[279] although the number of observations in Tort is quite small, the results may reflect a distinction in the kinds of fraud or misrepresentation that are most likely to occur within that context.

The emphasis on assets within Tort is manifest in its other instrumental rationales. In addition to siphoning of funds and undercapitalization,[280] evidence of commingling resulted in a high rate of veil-piercing. These results contrast with Contract, where commingling is fairly neutral; instead, evidence of domination and a failure to observe formalities were highly instrumental to a decision to pierce within the bargaining context.[281] For both Tort and Contract claims, though, veil-piercing claims experience comparably low rates of success when the plaintiff is found to have assumed risk or there is an absence of general evidence of fraud or misrepresentation.

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276. *But cf.* Thompson, *Empirical Piercing*, *supra* note 20, at 1063 tbl.11 (reporting that the presence of undercapitalization is correlated with decisions to pierce 73.33% of the time, which is substantially less than numerous other rationales).

277. *See supra* notes 28, 101–06 and accompanying text.

278. *See supra* notes 101–03 and accompanying text. *Cf.* Thompson, *Empirical Piercing*, *supra* note 20, at 1066 (finding undercapitalization present in only 18.65% of 327 Contract cases where piercing occurred, versus 12.86% of 70 Tort cases).

279. In Contract, the veil-piercing rates were 63.38% for assets and 62.86% for shareholder; in Fraud, the rates were 81.82% for assets and 82.61% for shareholder.

280. *See supra* notes 274–76 and accompanying text.

281. Different types of bargains yielded similar veil-piercing rates for domination, but when there was a failure to observe formalities, the veil-piercing for bargains between individuals and organizations (70.93%) was considerably higher than that between organizations (56.86%).

Fraud claims feature the most distinct group of instrumental rationales. Aside from siphoning of funds as well as specific evidence of fraud or misrepresentation, courts that decide to pierce predominantly resort to conclusory metaphors, such as evidence of a defendant corporation being the sham or shell, mere instrumentality, or alter ego of a controlling shareholder.[282] Such metaphors, along with domination, are common elements of most veil-piercing tests; accordingly, the results indicate that litigants capable of proving their Fraud claim already may have surpassed the evidentiary threshold for seeking relief from a controlling shareholder.[283]

The results collectively suggest that different claims do indeed represent distinct settings for veil-piercing.[284] Litigants that seek relief in Contract experience relatively more success upon proffering a set of evidence: excessive control, as manifest in domination or a failure to observe corporate formalities, that has resulted in a financially depleted corporation whose ultimate risk has been distorted by some kind of fraud or misrepresentation. In contrast, litigants in Tort enjoy superior odds when marshaling evidence about financial misconduct, with courts apparently recognizing that the element of control may be less relevant in such contexts.[285] And when litigants can meet the requirements for Fraud, they already have gone a considerable way toward demonstrating a case for veil-piercing. At their core, though, all substantive claims seem to be more compelling when supported by evidence that the corporation's inability to satisfy a judgment is due to some kind of asset-related abuse or malfeasance. Such evidence seems far more instrumental in decisions to pierce than injustice or unfairness, despite the latter's resilient popularity.

E. Staking Out the Voluntary–Involuntary Debate

The distinction between voluntary and involuntary creditors may strike some as an "argument from convenience."[286] There is a compelling intuition

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282. Arguably, sham or shell may be a substitute for fraud or misrepresentation. *See, e.g.*, WORMSER, *supra* note 4, at 59 ("Where a corporation is organized as a mere sham . . . courts, even without regard to actual fraud, are wont to disregard the entity theory.").

283. *See supra* note 269 and accompanying text.

284. *See supra* note 95 and accompanying text.

285. *See, e.g.*, Krendl & Krendl, *supra* note 12, at 6 ("The plaintiff may be . . . a tort victim who had no knowledge of the defendant prior to the incident giving rise to his claim.").

286. *See* PRESSER, *supra* note 1, § 1:7, at 1-34 to 1-35 ("I have called [economic analysis of limited liability] the 'argument from convenience' in order to invoke Holmes's theory that the law at any given time corresponds closely with what is then regarded as 'convenient.'"); OLIVER WENDELL HOLMES, JR., THE COMMON LAW (Little, Brown & Co. reprint) (Mark D. Howe ed., Harv. Univ. Press 1963) (1st ed. 1881) ("The substance of the law at any given time pretty nearly corresponds . . . with what is then understood to be convenient; but its form and machinery, and the degree to which it is able to work out desired results, depend very much upon its past."). Although Presser's comment is directed to orthodox economic treatments of limited liability, this may be construed more specifically about the economic recasting of the Contract–Tort distinction into one between voluntary and involuntary creditors. Robert Clark, for instance, dismisses Richard Posner's analysis of veil-piercing as merely complementary:

behind enforcing transactions against creditors that have had an ex ante opportunity to assess, bargain, and insure themselves against risk, versus those that have not.[287] While that intuition is commonly articulated for veil-piercing in economic terms, its roots actually lie in traditional doctrinal analysis.[288] Nevertheless, a few courts apparently refuse to adhere to this distinction,[289] which simply makes clear that part of its utility may be normative.

Less clear, though, are the lines demarcating Contract, Fraud, and Tort.[290] While the asymmetry between Contract and Tort runs throughout the veil-piercing jurisprudence and literature, the distinction may be conceptually misdrawn. Reexamining veil-piercing cases in terms of voluntary or involuntary creditors affords an alternative perspective that ultimately may confirm whether courts indeed perceive differences between civil bargains and wrongs, and adjudicate them appropriately.

This dataset's coding of specific subclaims provides a unique opportunity to analyze the creditor distinction. Accordingly, all of the results were recast. Voluntary creditors comprise all veil-piercing claims in Contract, Material Misrepresentation, Innocent Misrepresentation, and Tortious Interference with Contract; all veil-piercing claims in Intentional Tort (with Person or Property), Negligence, Strict Liability, Common Law Fraud or Deceit, and Negligent Misrepresentation comprise involuntary

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> Richard Posner's recent article on veil-piercing . . . seems to me . . . to constitute an elaboration and justification, in terms of microeconomic theory, of what I call the standard initial response to the problem. . . . In general, though I find Posner's analysis complementary rather than objectionable . . . and [do] not adopt[] his emphasis . . . [because] his elaborate arguments seem to me to be directed towards propositions which, in their essence, have been accepted by judges for decades.

Clark, *supra* note 85, at 542 n.98; *cf.* Presser, *supra* note 59, at 157 ("Posner did not rely to any significant extent on the historical purposes of the doctrine to support his analysis, which appears to have been implicitly based on the conditions of the modern credit market."). These misgivings seem to discount the efficiency of the common law hypothesis. *See generally* R. H. Coase, *The Problem of Social Cost*, 3 J.L. & ECON. 1 (1960).

287. *See, e.g.*, Barbara H. Fried, *Ex Ante/Ex Post*, 13 J. CONTEMP. LEGAL ISSUES 123, 123 (2003) ("No principle of ethics requires that Monte Carlo produce only winners." (quoting J. Mark Ramseyer & Minoru Nakazato, *Tax Transitions and the Protection Racket: A Reply to Professors Graetz and Kaplow*, 75 VA. L. REV. 1155, 1160 (1989))).

288. *See, e.g.*, BALLANTINE, *supra* note 270, § 137, at 315 ("A voluntary [C]ontract creditor stands in a somewhat different position from the involuntary [T]ort creditor."); *id.* § 137, at 315–18 (illustrating how, but for "intermeddling . . . in the affairs" of the subsidiary by the parent, or other "special circumstances," courts will not hold the parent liable on contracts of the subsidiary); LATTY, *supra* note 101, § 49, at 201 ("To make the classification [between Tort and Contract creditors] more significant, the line of distinction should perhaps be drawn between involuntary and voluntary creditors."); *id.* § 49, at 201–05 (exploring the intuition behind more strictly limiting the liability of a parent company for claims against its subsidiaries in Contract than in Tort).

289. *See, e.g.*, Phar-Mor, Inc. v. Coopers & Lybrand, 22 F.3d 1228, 1240 n.20 (3d Cir. 1994) ("In some states, . . . piercing the corporate veil and alter ego actions are allowed to prevent unjust or inequitable results; they are not based solely on a policy of protecting creditors.").

290. *See, e.g.*, KEETON ET AL., *supra* note 136, § 92, at 655 ("The distinction between [T]ort and [C]ontract liability . . . has become an increasingly difficult distinction to make.").

creditors. Fraudulent Misrepresentation and Fraudulent Transfer claims were divided equally between voluntary and involuntary creditors.

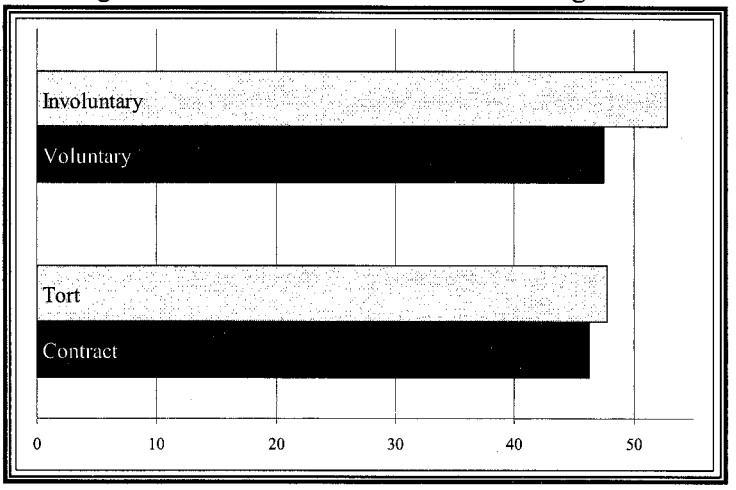
The results evince that veil-piercing claims prevail more often when they concern an involuntary (52.83%) versus a voluntary (47.50%) creditor. Although almost three times as frequent as their involuntary counterparts, voluntary-creditor claims thus virtually mirror the veil-piercing overall rate of 48.51% for the entire dataset.

Table 14. Veil-Piercing by Creditor and Jurisdiction

Corporation	*n*	V-P Rate (%)
Voluntary	1933.5	47.50
Federal	492	44.41
State	1441.5	**48.56**
Involuntary	627.5	**52.83**
Federal	216	**51.16**
State	411.5	**53.71**

And the disparity in veil-piercing rates for voluntary and involuntary creditors is greater than that for Contract and Tort.

Figure 8. Creditors v. Claims Veil-Piercing Rates



As with Tort, involuntary-creditor claims present a considerably greater risk of veil-piercing for individual shareholders than corporate parents.

Table 15. Veil-Piercing by Creditor and Shareholder Type

Claim	*n*	V-P Rate (%)
Voluntary	1933.5	47.50
Entity	511.5	41.35
Person	1420	**49.82**
Involuntary	627.5	**52.83**
Entity	171.5	41.45
Person	456	**57.22**

These results collectively suggest that courts may conceptualize veil-piercing as best suited to prevent a wrong from individual shareholders who externalize unforeseeable risk. Incidentally, this conception is compatible with the judicial view that corporate parents tend not to be shareholders in the classic sense.[291]

The five most popular instrumental rationales for Contract and Tort remain so in voluntary and involuntary creditor cases: fraud or misrepresentation, injustice or unfairness, domination, commingling, and undercapitalization.

Table 16. Veil-Piercing by Rationale and Creditor

Rationale	*n*	V-P Rate (%)
Agency	132	47.73
Voluntary	106	**49.06**
Involuntary	26	42.31
Alter Ego	172	**61.05**
Voluntary	125	**58.00**
Involuntary	47	**69.15**
Assumption of Risk	104	2.88
Voluntary	98.5	3.05
Involuntary	5.5	0.00
Commingling	512	**58.79**
Voluntary	391.5	**56.19**
Involuntary	120.5	**67.23**
Domination	697	**65.57**
Voluntary	518	**66.70**
Involuntary	179	**62.29**

(continued)

291. *See* BLUMBERG, *supra* note 168, at xl (asserting that the advantages of limited liability are mostly "irrelevant" in the context of corporate parents); Strasser, *supra* note 169, at 638 (noting that "different policy issues" are presented by parent companies, and thus "their limited liability should be determined by a different analysis").

Table 16 (cont.). Veil-Piercing by Rationale and Creditor

Rationale	*n*	V-P Rate (%)
Fraud/Misrepresentation	952	42.75
Voluntary	716.5	38.38
Involuntary	235.5	**56.05**
Informalities	333	**61.56**
Voluntary	257.5	**62.52**
Involuntary	75.5	**58.28**
Injustice/Unfairness	780	**53.85**
Voluntary	611.5	**51.76**
Involuntary	168.5	**61.32**
Instrumentality	116	**62.93**
Voluntary	86.5	**60.12**
Involuntary	29.5	**71.19**
Sham/Shell	265	**60.75**
Voluntary	198	**62.12**
Involuntary	67	**56.72**
Siphoning of Funds	260	**70.38**
Voluntary	206	**69.90**
Involuntary	54	**72.22**
Statutory Policy	61	**49.18**
Voluntary	38.5	48.05
Involuntary	22.5	**51.11**
Undercapitalization	406	**63.05**
Voluntary	308.5	**62.88**
Involuntary	97.5	**63.59**
Other	513	35.09
Voluntary	379.5	35.44
Involuntary	133.5	34.08

And as with the overall dataset, the relative proportion of these rationales remains roughly the same for both types of creditors. Although not among the more popular rationales, agency is instrumental in both types of cases with comparable frequency; this is somewhat surprising in light of the consensual nature of such relationships that also tend to exist in the voluntary-creditor context.[292] That dynamic is most apparent in assumption of risk, whose palpable presence in voluntary-creditor cases becomes almost nonexistent in the involuntary context.

292. *But see, e.g.*, Krendl & Krendl, *supra* note 12, at 3 n.9 (embracing Learned Hand's position about the limits of agency principles for veil-piercing purposes: "express agency would not provide a remedy because the consensual element would be lacking and . . . implied agency would be inappropriate because that would mean the veil would be pierced in every situation").

The differences are broader and sharper with respect to the veil-piercing rates. Both injustice or unfairness and commingling assert themselves far more strongly when courts decide in favor of involuntary creditors; this is also true for the conclusory metaphors of alter ego and instrumentality, similar to claims in Fraud.[293] Conversely, domination and a failure to observe formalities mirror their strength in Contract with decisions to pierce.[294] These results tend to reinforce that Tort and Fraud present relatively comparable scenarios with respect to judicial reasoning, as distinguished from Contract.

The greatest disparity, though, concerns evidence of fraud or misrepresentation. On the one hand, with respect to voluntary creditors, the rationale exhibits the same split as the overall dataset; ambiguous or general evidence of fraud is instrumental in decisions not to pierce, in contrast to specific evidence concerning assets or identity. On the other hand, with respect to involuntary creditors, the rationale is fairly neutral in a court's decision to pierce; this is because the most common type of evidence of fraud or misrepresentation is ambiguous or general evidence and is instrumental in 46.20% of cases that result in piercing. These results collectively provide some support for arguments that fraud or misrepresentation presents a compelling exception to ex ante bargaining and insurance, yet a broad-based justification for ex post compensation.[295] And the evidence is particularly noteworthy in light of the fact that very few jurisdictions require proof of fraud or misrepresentation specifically for voluntary-creditor claims.[296]

Conclusion

Some pieces to the veil-piercing puzzle now appear to be in place, as the findings here and from Thompson's study cohere in numerous ways. The presumption in favor of corporate separateness is hardly axiomatic, with veil-piercing claims prevailing over 40% of the time and with virtually equal success in federal and state courts.[297] Further, all courts will disregard the form of only close corporations[298] and reach into the assets of individual shareholders far more often than those of corporate parents;[299] both of these dynamics merit additional investigation into the specifics of corporate groups

293. *See supra* note 280 and accompanying text.

294. *See supra* note 279 and accompanying text.

295. Interestingly, this asymmetry does not obtain for siphoning of funds or undercapitalization. *Cf.* Bainbridge, *supra* note 19, at 517–26 (proposing a regime of direct liability predicated on fraud or misrepresentation, siphoning of funds, or undercapitalization).

296. Notable exceptions to this can be found in Texas and federal common law. *See* Subway Equip. Leasing Corp. v. Sims (*In re* Sims), 994 F.2d 210, 218 (5th Cir. 1993) ("Although a finding of fraud is not essential in [T]ort cases, 'in [C]ontract cases, fraud is an essential element of an alter ego finding.'" (citation omitted)); *supra* note 35.

297. *See supra* notes 157, 174–80 and accompanying text.

298. *See supra* note 165 and accompanying text.

299. *See supra* notes 166–72 and accompanying text.

to determine the composition of those shareholders and the ways in which they influence how veil-piercing claims are litigated and adjudicated. Also worth exploring are the reasons why veil-piercing continues to be grounded overwhelmingly within Contract,[300] which may require a more complete understanding about the litigation patterns and settlement rates for different substantive claims.[301]

But this study's findings do reveal that some empirics of veil-piercing need revision. The results affirm the central role that Fraud, as an instrumental rationale and as a substantive claim, must occupy within any account of veil-piercing; indeed, the extent to which the doctrine is permeated by Fraud is manifest, even in its absence as a rationale, by spurring a substitution effect with other prominent factors or as a claim by expanding the disparity in litigant success in Tort over Contract.[302] And the results realign the theory and practice of veil-piercing with respect to distinct types of creditors; courts find veil-piercing more compelling when faced with creditors in Tort or of the involuntary sort, particularly when the ultimate shareholder is an individual or there is evidence of financial misconduct.[303] In contrast, creditors in Contract or of the voluntary sort seem to face a fairly neutral setting for veil-piercing; courts apparently do not impute any special regard to the relative sophistication of bargaining parties or the type of shareholder, with litigants experiencing fairly stable rates of success over the past three decades.[304] If a story is to be constructed from the data, it may be that, with respect to veil-piercing, the comparison between Contract and Tort is less valuable than Contract serving as a reference point for the relationship between Tort and Fraud.

Nevertheless, we remain hostage to a mangled and muzzy doctrine. The lack of consistency within the collective results reinforces that veil-piercing would benefit from principled simplification, and if such options already exist, from disciplined judicial attention. Some of the doctrine's most vigorous criticisms have come from courts, which have condemned the use of metaphors, denigrated the attenuated multifactor approach, and bemoaned the confusing landscape of past decisions. Yet these problems were highlighted by I. Maurice Wormser's elegant synopsis almost a century ago and detailed by Robert Thompson's empirical study almost two decades ago. The results presented here afford us with an opportunity to engage in a reinvigorated debate that ultimately may produce a doctrine that truly befits the title of Our Lady of the Common Law.

300. *See supra* note 233 and accompanying text.
301. *See supra* note 147 and accompanying text.
302. *See supra* Figure 7.
303. *See supra* notes 277–78 and accompanying text.
304. *See supra* notes 242–49 and accompanying text.

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Book Review

Taking Responsibility for the Planet

REGULATING FROM NOWHERE: ENVIRONMENTAL LAW AND THE SEARCH FOR OBJECTIVITY. By Douglas A. Kysar. New Haven, Connecticut: Yale University Press, 2010. 314 pages. $45.

Daniel A. Farber*

Cost–benefit analysis (CBA) is central to current agency decisions, but its legitimacy is sharply contested. For the past three decades, regulatory agencies, like the Environmental Protection Agency (EPA), have been required to perform CBAs and to presumptively base their decisions on the results.[1] Economists applaud this practice; advocates for worker safety, consumer protection, and environmental regulation are less enthusiastic.[2]

In *Regulating from Nowhere*,[3] Professor Douglas Kysar makes an important contribution to the continuing debate over CBA and environmental policy.[4] He argues that, in moving toward a "cost-benefit state," we have lost

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1. Regulatory review takes place within the Office of Information and Regulatory Affairs (OIRA), part of the Office of Management and Budget (OMB). For a description of the development of OMB's role in regulatory oversight, along with some useful suggestions for improving CBA, see RICHARD L. REVESZ & MICHAEL A. LIVERMORE, RETAKING RATIONALITY: HOW COST-BENEFIT ANALYSIS CAN BETTER PROTECT THE ENVIRONMENT AND OUR HEALTH 21–42, 171–83, 188–89 (2008) (chronicling the rise of CBA from 1971 through 2007 and offering suggestions to both OIRA and the courts); Daniel H. Cole, *"Best Practice" Standards for Regulatory Benefit-Cost Analysis*, 23 RES. IN L. & ECON. 1, 5–9, 12–15, 20–33 (2007) (detailing the various executive orders mandating CBA at OMB and EPA and analyzing several proposed changes to the methods employed by both agencies); Winston Harrington et al., *Controversies Surrounding Regulatory Impact Analysis*, *in* REFORMING REGULATORY IMPACT ANALYSIS 10, 10 (Winston Harrington et al. eds., 2009) (noting the executive orders in the Reagan and Clinton Administrations that required CBA at OMB before regulations could be proposed); Winston Harrington et al., *What We Learned*, *in* REFORMING REGULATORY IMPACT ANALYSIS, *supra*, at 215, 221–36 (summarizing the authors' recommended reforms to regulatory impact analyses at the EPA); *see also* MATTHEW D. ADLER & ERIC A. POSNER, COST-BENEFIT ANALYSIS: LEGAL, ECONOMIC, AND PHILOSOPHICAL PERSPECTIVES (2000) (collecting papers reflecting the spectrum of views about CBA and its validity).

2. REVESZ & LIVERMORE, *supra* note 1, at 189 ("The association between cost-benefit analysis and the institutions of regulatory review has significantly tainted the practice of cost-benefit analysis in the eyes of many proregulatory interests such as consumer groups, organized labor, and environmentalists.").

3. DOUGLAS A. KYSAR, REGULATING FROM NOWHERE: ENVIRONMENTAL LAW AND THE SEARCH FOR OBJECTIVITY (2010).

4. Along with *Regulating from Nowhere*, two other recent books also significantly contribute to this debate and will feature in this Review: ERIC A. POSNER & DAVID WEISBACH, CLIMATE CHANGE JUSTICE (2010), an exemplary application of economic reasoning, and ROBERT R. M.

the wisdom behind our leading environmental statutes, a wisdom based on the precautionary principle.[5]

Part of Kysar's critique of CBA is pragmatic. He maintains that the accomplishments of the traditional environmental statutes have been underestimated.[6] He also notes the shortcomings of CBA in practice and points to climate change as a "poster child for the limitations of [CBA]."[7] Kysar drives home the practical weakness of this economic approach with case studies of the failure of the New Orleans flood control system[8] and a recent Supreme Court case regarding CBA under the Clean Water Act.[9] The feel of these case studies is perhaps best communicated by a single fact: prior to Katrina, economists protested that *too much* effort was being made to protect New Orleans from hurricanes.[10]

More fundamentally, Kysar argues that reliance on CBA can blind us to important ethical issues. This may be a genuine concern. Some of the positions taken by respected economists or economist/lawyers do suggest that something might be amiss in their ability to identify morally relevant considerations. Consider the following examples:

- According to leading advocates of CBA, if the United States is harming poor countries through emissions of greenhouse gases, those countries should bribe the United States so as to make a climate treaty in America's self-interest.[11]
- Mercury emissions cause children to have lower IQs, which is a bad thing, but government economists contend that this harm must be offset against a significant benefit: the children require fewer years of schooling at public expense because of their lower IQs.[12]
- According to a leading academic who now heads the governmental agency in charge of CBA, the government should devote more resources and attention to saving the lives of

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VERCHICK, FACING CATASTROPHE: ENVIRONMENTAL ACTION FOR A POST-KATRINA WORLD (2010), addressing some of the same theoretical issues as Kysar but from a perspective rooted in disaster issues.

5. KYSAR, *supra* note 3, at 2–3, 15; *see also* VERCHICK, *supra* note 4, at 11, 251–54 (discussing the need to live up to existing environmental laws). The precautionary principle is an approach to environmental law that advocates proceeding with caution when deciding whether to take an action that might significantly harm human health or the environment, despite a lack of proof establishing a cause-and-effect relationship between the action and the harm. KYSAR, *supra* note 3, at 9.

6. KYSAR, *supra* note 3, at 4–5.

7. *Id.* at 250.

8. *Id.* at 75–90.

9. *Id.* at 204–28.

10. *Id.* at 83.

11. *See infra* subpart II(A).

12. KYSAR, *supra* note 3, at 234–35.

> rich people than poor people[13] and perhaps more resources to whites than to racial minorities because of those wealth differentials.[14]

Something about the methodology they follow seems to be leading smart, decent people into morally treacherous terrain.

Although Kysar does not believe we should ignore the costs and benefits of government policies, he calls for reliance on the precautionary principle rather than CBA. For Kysar, the precautionary principle is primarily a reminder to political communities that "they stand in a relationship of responsibility not only to their own citizens but also to other states, other generations, and other forms of life."[15] Thus, like the Hippocratic Oath ("first, do no harm"), the "precautionary principle reminds [us] that life is precious, that actions are irreversible, and that responsibility is unavoidable."[16] Through the use of the precautionary principle, he hopes society can take a more morally defensible position than the amoral calculations of CBA.

The debate over CBA needs to be kept in perspective. As in many academic disputes, arguments between environmentalists and economists can exaggerate the true differences. It is true that ideological opponents of environmental regulation have seized on economic arguments and have distorted the application of CBA to achieve their goals.[17] But economists themselves generally "acknowledge that CBA does not incorporate all factors that can and should influence judgments on the social worth of a policy and that individual preference satisfaction is not the only criterion."[18] In the real world, opposition to environmental regulation stems less from economists than from special interest groups or ideologues who are hostile to any form of regulation on principle.[19] These voices are less represented in the academy, making the opposition between economists and environmentalists loom larger than it does in the world of environmental politics.

In my view, it is time for us to begin looking beyond the battles between economists and environmentalists that have consumed so much intellectual

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13. *Id.* at 278 n.40.

14. *Id.* at 114–15.

15. *Id.* at 12.

16. *Id.* at 16.

17. *See* REVESZ & LIVERMORE, *supra* note 1, at 26–28 (describing how CBA came to be seen as a tool for those biased against regulation); Daniel A. Farber, *Rethinking the Role of Cost-Benefit Analysis*, 76 U. CHI. L. REV. 1355, 1355–56 (2009) (reviewing REVESZ & LIVERMORE, *supra* note 1) (discussing Revesz and Livermore's perspective on CBA).

18. Harrington et al., *Controversies Surrounding Regulatory Impact Analysis*, *supra* note 1, at 13.

19. *See* STEPHEN H. SCHNEIDER, SCIENCE AS A CONTACT SPORT 259 (2009) (blaming the "political chicanery of ideologists and special interests" for blocking the implementation of clean energy strategies); Farber, *supra* note 17, at 1360 (accusing conservatives of using CBA as a tool in a deregulatory agenda).

energy over the past few decades. We should all be able to agree that economics is a useful tool and also that—as Kysar rightfully insists—it cannot provide our ultimate ethical yardstick. But traditional ways of thinking, whether environmentalist or economic, cannot fully address today's challenges. The issues that we face today, such as climate change, involve global effects on complex, interlinked economic and ecological systems. We will need new analytic tools to deal with these issues.

Part I of this Review discusses the ethical limitations of welfare economics (the basis for CBA) and Kysar's argument for an ethic of responsibility. Welfare economics is at best seriously incomplete as a guide to public policy. At worst, it can obscure the moral stakes in a decision, as Kysar successfully demonstrates.

Part II discusses Kysar's views about the objects of our sense of responsibility, such as poorer countries, future generations, and nature. For a welfare economist, these issues are not posed as questions of morality but rather as technical questions about how to value environmental benefits. Kysar is right that more than technical issues are at stake.

Part III discusses how to convert ethical responsibility from a general attitude into a workable approach to deciding on policy. *Regulating from Nowhere* has much to teach about the spirit in which we should address environmental issues. Expanding on Kysar's discussions of systemic complexity and uncertainty, Part III emphasizes the use of scenario analysis to address uncertainty and application of measures such as robustness, resilience, and sustainability to assess possible outcomes. Kysar is right that we need to take our responsibility to the planet seriously, but much work remains in creating the intellectual framework for doing so. Part III sketches some parts of such a framework.

I. From Welfare Economics to Moral Responsibility

CBA is founded on welfare economics. As Kysar explains, welfare economics is an offshoot of utilitarianism ("the greatest good for the greatest number").[20] Nevertheless, as we will see in subpart A, the fit is imperfect: the monetary yardstick of economics is only a rough measure of welfare. Subpart A also shows just how much we give up if we embrace welfare economics as an ultimate moral compass: we must eschew the idea of placing any independent value, however small, on individual rights or the intrinsic value of nature. Subpart B examines Kysar's central argument against utilitarianism, an argument that probably applies with even greater force to

20. Welfarism encompasses any ethical theory that uses some method of combining individual welfare as a factor in setting goals. *See* Amartya Sen, *Utilitarianism and Welfarism*, 76 J. PHIL. 463, 464 (1979) (defining welfarism). Utilitarianism is the most common form of welfarism, while welfare economics often approximates welfarism by taking preference satisfaction as the measure of individual well-being. *See id.* at 478 (equating outcome utilitarians with welfarists). For a discussion of utilitarianism, see KYSAR, *supra* note 3, at 27–34.

welfare economics than to other versions of utilitarianism. Although the issues may seem abstract, they are directly relevant to questions such as whether it makes any sense to say that we have a responsibility toward people we have harmed by our emissions.

A. The Shaky Ethical Foundations of Welfare Economics

As Kysar notes, the Pareto principle is generally considered to be the "gold standard" for economic policy analysis.[21] The Pareto standard arose out of nineteenth and early twentieth-century debates about utilitarianism. When economists abandoned the idea of interpersonal comparisons of individual welfare, which are basic to utilitarianism, they were left with a normative puzzle. Pareto provided the solution by limiting consideration to social policies that could obtain unanimous consent because they help at least some individuals and hurt no one.[22]

The Pareto principle simply says such policies are always good.[23] The basic intuition is simple: If some people prefer a certain outcome and it does not cost anything to anyone else, society should give them what they want. This intuition seems readily supportable on a variety of grounds. First, society is only the sum of its parts—if one person is better off and no one else is harmed, then society as a whole is better off. Second, we should honor people's individual autonomy by respecting their preferences: "All participants would, by definition, consent to a transaction which left them either better off or as well off as before"; hence, "a moral analysis based on autonomy and consent would approve of transactions that were Pareto superior."[24] Third, society should care about the welfare of its citizens and seek to promote their well-being. Each of these arguments is plausible, and some may seem almost self-evident. It is not surprising that the Pareto principle is considered axiomatic.[25]

Admittedly, even economists do not view the Pareto principle as a complete moral guide. Pareto optimality is, according to Amartya Sen, "a very limited kind of success" as "[a] state can be Pareto optimal with some people in extreme misery and others rolling in luxury, so long as the miserable cannot be made better off without cutting into the luxury of the

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21. *Id.* at 102.

22. Robert D. Cooter, *The Best Right Laws: Value Foundations of the Economic Analysis of Law*, 64 NOTRE DAME L. REV. 817, 820–21 (1989).

23. For definitions of the various Pareto standards, see BRIAN BIX, JURISPRUDENCE: THEORY AND CONTEXT 181 (2d ed. 1999).

24. *Id.* As Bix points out, theorists such as Kant actually have a much narrower concept of autonomy than economists. *Id.* at 181 n.13.

25. *See* ANDREU MAS-COLELL ET AL., MICROECONOMIC THEORY 313 (1995) (specifying Pareto efficiency as "an essential requirement" for an optimal economic outcome); MARK SEIDENFELD, MICROECONOMIC PREDICATES TO LAW AND ECONOMICS 54 (1996) (contending that economists are "enamored" of the Pareto principle because it does not require them to make utility comparisons between individuals).

rich."[26] Still, Sen says, though many unappealing states of the world are Pareto optimal, "it has been thought reasonable to suppose that the very best state must be *at least* Pareto optimal."[27] So Pareto optimality seems to be at least a necessary condition of the best outcome, though far from being a sufficient condition.

The Pareto principle has a strong intuitive appeal, part of which is captured by a common paraphrase: society should take an action "if one person is better off, and no one else is hurt."[28] But this rephrasing subtly recasts preferences (what people actually choose) with welfare (what is actually good for them). The principle itself is actually stated in terms of preferences and not in terms of welfare. There is a reason for this: preferences are presumably objective facts that can be inferred from actual choices, but determining a person's true welfare involves a normative judgment that most economists would prefer not to make. Yet, satisfying preferences is not as appealing a goal as improving well-being.

In reality, satisfying people's preferences may or may not make them happier, and people tend to overestimate the effect that life events will have on their happiness.[29] For example, studies by psychologists show that "the very wealthy do not have a substantially more favorable perception of the quality of their lives than do the middle class."[30] In contrast, education "produces more [happiness] than wealth equal to the education's price."[31] In short, while most people have a preference for increased wealth, satisfying this preference may not in fact be a good way of making them happier. It is even less clear that great wealth would necessarily advance their well-being

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26. AMARTYA SEN, ON ETHICS AND ECONOMICS 31–32 (1987). Sen goes on to say that, "Pareto optimality can, like 'Caesar's spirit', 'come hot from hell.'" *Id.* at 32.

27. *Id.* at 35.

28. *See* Cooter, *supra* note 22, at 821 (summarizing Pareto improvement as asking whether the "reallocation of resources can make at least one person better off without making anyone else worse off").

29. *See* John Bronsteen et al., Essay, *Hedonic Adaptation and the Settlement of Civil Lawsuits*, 108 COLUM. L. REV. 1516, 1526–36 (2008) (comparing the predicted psychological effects of major life events with reported happiness); Daniel T. Gilbert & Timothy D. Wilson, *Prospection: Experiencing the Future*, 317 SCI. 1351, 1353 (2007) (explaining the psychology behind the overestimation of effects on happiness).

30. Herbert Hovenkamp, *The Limits of Preference-Based Legal Policy*, 89 NW. U. L. REV. 4, 37 (1994).

31. *Id.* at 37–38. More recent research confirms these findings. *See* Bernd Hayo & Wolfgang Seifert, *Subjective Economic Well-Being in Eastern Europe* 24 J. ECON. PSYCHOL. 329, 341 (2003) (attributing a significant and positive influence on subjective economic well-being to education); Richard Florida et al., *Socioeconomic Structures & Happiness* 2, 21–24 (Martin Prosperity Inst., Working Paper No. 2, 2010), *available at* http://research.martinprosperity.org/papers/Socioeconomic%20Structures%20and%20Happiness-Florida-Mellander-Rentfrow.pdf ("[W]hen income rises beyond a certain level, a new system of post-industrial values centered on education, creativity, and openness become better predictors of happiness than income."). *But see* Alex C. Michalos, *Education, Happiness and Wellbeing* 13–14 (Apr. 2, 2007) (first draft for discussion), *available at* http://www.oecd.org/dataoecd/22/25/38303200.pdf (citing previous studies that find education, if defined in the formal sense, has little effect on individuals' happiness).

in any meaningful sense.[32] Preference satisfaction, then, is only loosely related to actual welfare so the Pareto principle is only contingently related to improvements in social welfare.

The Pareto principle, if taken as an absolute rule, also turns out to be at odds with other moral ideas such as individual liberty. It may be that, in many situations, we can best promote welfare by giving individuals the freedom to make their own choices. But this is contingent on the facts, and it is equally possible that people would be better off—in the sense of getting what they would really prefer if they understood their own welfare—if individual freedom were completely eliminated. When we can satisfy someone's preferences without asking their consent, nothing in the Pareto principle stands in the way. In practice, letting people make their own choices is usually the best way of satisfying their preferences. But in principle, a society could fully satisfy the Pareto principle without allowing individuals to make any decisions whatsoever on their own. There is no logical contradiction between perfect preference satisfaction and totalitarianism, although totalitarian regimes in practice may do poorly at satisfying preferences.

Although Kysar's focus is not on individual liberty as a value, he is surely not the first to remark on the totalitarian tendencies inherent in utilitarianism.[33] The Pareto principle (and with it welfare economics) turns out to be in deep logical tension with the value of liberty. Amartya Sen proved that no general method for making societal decisions based on individual preferences can both (1) satisfy the Pareto principle, and (2) guarantee that individuals have the right to control anything at all about their lives (for example, whether that individual reads or does not read a specific book).

If a minimal conception of liberalism is one in which individuals have the final say over at least one decision affecting themselves, Sen observed that the Pareto principle seems logically inconsistent with even that minimal form of liberalism.[34] Sen provided a seemingly contrived example of this paradox, in which two friends must decide whether one of them will read *Lady Chatterley's Lover*.[35] Because of the nature of the example, it is not

32. *See* Lewis A. Kornhauser, *A Weaved Up Folly?: Preference, Well-Being and Morality in Social Decision*, 10–13 (NYU Ctr. for Law & Bus., Working Paper No. CLB-01-009, 2001), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=286772 (examining three different conceptions of well-being). The case against equating well-being with a state of mind is summarized by DANIEL M. HAUSMAN & MICHAEL S. MCPHERSON, ECONOMIC ANALYSIS AND MORAL PHILOSOPHY 73–75 (1996).

33. *See, e.g.*, RICHARD A. POSNER, THE ECONOMICS OF JUSTICE 65 (1983) ("What makes so many moral philosophers queasy about utilitarianism is that it seems to invite gross invasions of individual liberty . . . ."); AMARTYA SEN, *Liberty, Unanimity, and Rights*, *in* CHOICE, WELFARE AND MEASUREMENT 291, 294–95 (1982) (demonstrating that even very weak forms of the Pareto principle can crowd out individual choice); Zenon Bańkowski, Book Review, 55 MOD. L. REV. 876, 877 (1992) (arguing that the law cannot keep the totalitarian tendencies of utilitarianism at bay).

34. AMARTYA SEN, *The Impossibility of a Paretian Liberal*, *in* CHOICE, WELFARE AND MEASUREMENT, *supra* note 33, at 285, 290.

35. *Id.* at 288.

difficult to dismiss the paradox as a very clever but practically insignificant hypothetical. Still, as Sen says, the logical implications are disturbing. For if we fully embrace the Pareto principle, "[s]ociety cannot then let more than one individual be free to read what they like, sleep the way they prefer, dress as they care to, etc., *irrespective* of the preferences of others in the community."[36] Sen concludes from such considerations that Pareto exhibits "unacceptability . . . as a universal rule."[37]

Louis Kaplow and Stephen Shavell have extended Sen's result to argue that Pareto is inconsistent with any nonwelfarist moral value whatsoever. They contend that "individuals will be made worse off overall whenever consideration of fairness leads to the choice of a regime different from that which would be adopted under welfare economics because, by definition, the two approaches conflict when a regime with greater overall well-being is rejected on grounds of fairness."[38] Thus, welfare economics precludes placing any independent value on human dignity, individual rights, cultural achievements, or nature.

The root of the difficulty is not hard to see. If some nonwelfare factor ever matters, then at least it must be able to break ties between two outcomes that have equal welfare. But then what happens if one outcome is microscopically better than the other in terms of welfare? There are only two possibilities. One is that the outcome that better serves that value should still be favored when the outcomes are very close (but not quite tied) in terms of welfare. This means that we can end up favoring a state of the world that violates the Pareto principle.[39] The other possibility, which does preserve the Pareto principle, is that the nonwelfare factor matters only when there is an exact tie in terms of welfare. In that case, the nonwelfare factor has little practical significance since exact ties are rare if not nonexistent in practice. So, modest and intuitively appealing as it may be, the Pareto principle requires that any nonwelfare consideration must be discarded whenever there is even a microscopic difference in social welfare between two possible outcomes. For instance, as Kysar observes, the Pareto standard excludes consideration of the interests of nonhuman life forms.[40]

In some situations, legal rules favored by the Pareto principle will be consistent with human liberty, equality, and other values. But there is no guarantee that this will always be so, and in case of conflict we must be pre-

36. *Id.* at 290.

37. SEN, *supra* note 33, at 291.

38. LOUIS KAPLOW & STEVEN SHAVELL, FAIRNESS VERSUS WELFARE 52 (2002).

39. *See* Louis Kaplow & Steven Shavell, *Any Non-welfarist Method of Policy Assessment Violates the Pareto Principle*, 109 J. POL. ECON. 281, 282 (2001) (arguing that in certain circumstances it may be socially desirable to make everybody worse off). *But see* Howard F. Chang, *A Liberal Theory of Social Welfare: Fairness, Utility, and the Pareto Principle* 110 YALE L.J. 173, 208 (2000) (arguing that Kaplow and Shavell have assumed an unreasonable notion of fairness and that the Pareto principle can be included in a fairness theory).

40. KYSAR, *supra* note 3, at 103.

pared to sacrifice human dignity and the like for greater social satisfaction of preferences. Of course the same argument applies to any other nonpreference consideration, such as whatever intrinsic value we might give to nature. Thus, to embrace the Pareto principle as a universal rule is to abandon much of what we care about in terms of morality.

B. Responsibility Versus Optimality

Kysar articulates a very powerful argument against any moral theory that is based on optimizing the welfare of society, whether utilitarianism or welfare economics. The argument is quite simple. It might be a fact that a certain government policy would improve social welfare. But why is that fact morally relevant?[41] In particular, why should anyone feel an obligation to improve social welfare?[42] Why not simply pursue our own welfare (or preferences)? True, some people might happen to have a taste for improving social welfare, just as some people have a taste for collecting stamps or surfing. But utilitarianism and welfare economics both view individuals as merely the bodily locations of pain and pleasure (in the case of utilitarianism) and rational pursuit of preferences (in the case of welfare economics). If those are the only morally relevant facts about individuals, it is hard to see how the idea of an individual moral obligation could even get a toehold. In short, if morality is just based on the overall condition of society, how do facts about this condition become obligations for action by individual moral agents? Why should anyone care about satisfying societal preferences or improving social welfare?

One answer might be that welfarism simply provides instruction on how to better satisfy a preference for moral actions, just as a cookbook might provide instruction on how to better satisfy a preference for chocolate cake. On this account, the desire to behave morally is just a taste like any other that may make someone feel better and thereby contribute to their welfare. In other words, welfarism is simply a recipe for satisfying a particular, perhaps unusual, taste. If so characterized, it is not clear that welfarism even qualifies as a moral theory, let alone a valid one, since it treats morality as an optional taste. The most one could say is that welfarism is a good principle for those whose preferences lie in that direction, just as vegetarianism is a good principle for people who do not want to eat meat. If people are as welfarism portrays them—mere vehicles for preferences or sensations of happiness—the whole idea of morality seems evanescent.

To qualify as a moral theory, it would seem that welfarism must find room for some concept of moral obligation. The case for welfarism would be strengthened if behaving morally were more than a taste—that is, if peo-

41. *See id.* at 33 (accusing utilitarians of converting an "is" into an "ought").

42. *See id.* at 33, 39–41, 186 (explaining that the utilitarian framework used in certain ethical systems is suboptimal and denies the significance of the individual's point of view).

ple actually do have obligations (rather than just preferences) to behave morally. But if human beings are the kind of creatures that are capable of having moral obligations, Kysar quite reasonably maintains that when we act on others, their own status as moral actors should matter.[43] For example, if people have an obligation to behave morally, one relevant issue in assessing a policy is whether it prevents them from doing so, not just whether or not the policy makes them happier or helps satisfy their preferences. For welfarism to work as a moral principle, the status of individuals as moral actors has to somehow be relevant to the adoption of welfarism but then have no further moral relevance, which seems implausible.

Surely, there is much more to be said on these philosophical issues, but Kysar's basic argument seems to carry considerable force. For that reason, he seems to be at least on defensible ground in placing the concept of moral responsibility front and center in his theory. Thus, rather than asking whether a government policy maximizes social welfare, he wants to ask whether it fulfills our responsibilities as moral actors.

It is critical for Kysar's purposes, however, to go a step beyond a theory of individual responsibility because social policies are collective rather than individual acts. Kysar speaks insistently of collective responsibility; for example, arguing that the community must "own" the harm it does[44] and that political communities have a particular status as holders of moral responsibility.[45] He also contends that society's values are "more reliably captured through society's willingness to act collectively" than by individual choices.[46] He then characterizes this sense of collective responsibility as critical to the precautionary principle.[47]

It seems to me that this argument requires more development than Kysar gives it—both to show that political communities should be considered morally responsible actors and to show that the particular political communities that now exist qualify for that moral status. Human communities and collectives are more tightly integrated than random sets of objects, but less so than organisms, which leaves their status as coherent entities somewhat in doubt. Perhaps for this reason, Kysar does not take a clear position about whether communities are actual moral agents or should merely be treated as such for pragmatic reasons. At some point, it seems to me, collective responsibilities have to cash out as responsibilities between individual human beings, which would make collective responsibility a kind of secondary concept deriving from the premise of individual responsibility.

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43. *Id.* at 44.

44. *Id.* at 13.

45. *Id.* at 22; *see also id.* at 53, 64–65, 116, 119, 244 (characterizing political communities as collective moral agents, emphasizing the "full power and responsibility of our collective agency," and remarking that the politics of a society seek to represent the values of "our better selves").

46. *Id.* at 114.

47. *Id.* at 64–65.

Kysar might be willing to adopt that view, although he does not seem to reject the opposing view that collectivities have their own moral obligations distinct from those of individuals. In any event, Kysar's philosophical discussion does not seem to bring closure to the issue or to delve deeply into the philosophical complexities.

Although Kysar makes some significant philosophical arguments, much of the discussion takes a different form, focusing on psychology rather than philosophy. One of Kysar's core claims is that welfarism is destructive to our integrity as human beings—and, Kysar also suggests, to the social glue that holds political communities together.[48] He points to some disturbing research findings, which suggest that engaging in utilitarian reasoning at the expense of other moral considerations is associated with damage to a specific portion of the brain.[49] Hammering the point home, he quotes the subject in one experiment designed to reinforce utilitarian thinking. Having finished the experiment, the subject exclaimed, "Jeez, I've become a killer."[50] Kysar worries that, in the long run, society's reliance on CBA will dull our moral perceptions. Although this conclusion is necessarily speculative, Kysar's supporting evidence does suggest grounds for concern. For that reason, his emphasis on collective responsibility seems appealing, at least as a counterweight to theories like utilitarianism that may undermine moral responsibility.

In general, Kysar's case for emphasizing the concept of moral responsibility is credible. His case for treating collectives as being themselves moral agents is less well elaborated. In the remainder of this Review, I will follow Kysar in assuming that environmental law is based on moral responsibility, but I will eschew treatment of collectives as independent moral agents. Instead, I will treat their individual members as moral actors but leave open the possibility that participation in a community or complex institution may create distinctive forms of moral responsibility.

Kysar's argument for a responsibility-centered vision of environmental law is promising. It provides a vocabulary for discussing environmental decisions that is morally richer than welfare economics without implying that human welfare is irrelevant. The following Part considers Kysar's efforts to flesh out this approach.

II. Responsibility to Whom?

Although his arguments are sketched in places rather than fully developed, Kysar makes a credible case for the concept of responsibility as central to moral reasoning and hence to policy decisions. This raises a question concerning the scope of those obligations. Kysar contends that the net

48. *Id.* at 67.
49. *Id.* at 34–38.
50. *Id.* at 38.

of responsibility should be spread broadly to include individuals outside our own country today, future generations, and other life forms.[51] The issues may seem abstrusely philosophical. Yet defining the scope of our responsibility is directly relevant to current issues of climate policy because climate change will affect humans globally and for generations to come while also impacting ecosystems and biodiversity.

A. Responsibility to Other Nations and the Problem of Climate Justice

Climate justice raises a key question: are we responsible if our emissions cause harm to other nations or does our moral responsibility stop at the border?[52] Even those who oppose the idea of climate justice agree with the basic facts: "that emissions in some countries have imposed serious risks on others, that the United States and China are expected to remain the world's leading contributors, and that some nations, including those in Africa, face serious risks even though their own emissions are trivial."[53] In particular, the United States, the wealthiest country in the world, contributes far more than its share of greenhouse gases.[54] Do Americans have any responsibility to make amends, either by shouldering more of the duty to reduce future emissions or by helping poorer nations cope with the risks of climate change?

Given Kysar's emphasis on collective responsibility[55] and on the desirability of treating governments as responsible moral agents,[56] these do not seem like particularly difficult questions from his perspective. If we conceive of the United States as one moral actor and, say, Bangladesh as another, it seems clear that the United States has a responsibility for harm to Bangladesh resulting from its carbon emissions. But that view is not univer-

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51. *Id.* at 18–19.

52. A related question is whether CBA should take into account harms to people who are not U.S. citizens or residents. This can have a substantial impact on the results of the analysis. *See* David Anthoff & Richard S.J. Tol, *On International Equity Weights and National Decision Making on Climate Change*, 60 J. ENV. ECON. & MGMT. 14, 18–19 (2010) (suggesting that different attitudes toward international equity imply radically different estimates of the social cost of carbon).

53. POSNER & WEISBACH, *supra* note 4, at 101.

54. *See* EDWARD A. PAGE, CLIMATE CHANGE, JUSTICE AND FUTURE GENERATIONS 36 (2006) (stating the United States was responsible for twenty-four percent of global emissions in 2000, an amount roughly the same as was released by all of Europe and the Russian Federation combined). *See generally* CHUKWUMERIJE OKEREKE, GLOBAL JUSTICE AND NEOLIBERAL ENVIRONMENTAL GOVERNANCE: ETHICS, SUSTAINABLE DEVELOPMENT, AND INTERNATIONAL CO-OPERATION 32–56 (2008) (surveying concepts of justice as they apply in the international realm); J. TIMMONS ROBERTS & BRADLEY C. PARKS, A CLIMATE OF INJUSTICE: GLOBAL INEQUALITY, NORTH-SOUTH POLITICS, AND CLIMATE POLICY (2007) (discussing scientific measures of climate change inequality). For a discussion of environmental justice in the domestic context, see VERCHICK, *supra* note 4, at 116–27.

55. *See supra* notes 43–46, 51 and accompanying text.

56. *See* KYSAR, *supra* note 3, at 150–51 (contending that the personality of states should be seen not merely as a set of instructions regarding risk assessment and welfare maximization, but rather as an "independently significant actor on the geopolitical stage, one that stands in relations of dependency and obligation with respect to other sovereigns").

sally accepted. Other authors find it "inconceivable" that the United States or other rich countries with high per capita emissions have a duty to make amends for their emissions.[57]

Two prominent opponents of the perspective championed by Kysar, Professors Eric Posner and Cass Sunstein, argue that justice is irrelevant to climate change policy.[58] Not only do they reject the idea of compensating victims of climate change in any way, they suggest that perhaps it is the victims who should be paying the emitters to reduce greenhouse gases. If the cost of reducing emissions is greater than the benefit to Americans of avoiding climate change, they say, the "standard resolution of the problem" indicates that "the United States should be given side-payments" in return for agreeing to participate in a global climate change agreement.[59] The "reason for this approach is straightforward,"[60] they continue: an agreement accompanied by side payments to the United States "could be designed so as to make all nations better off and no nation worse off.... Who could oppose [such] an agreement?"[61]

This attraction to an agreement that makes everyone "better off" is rooted in the Pareto principle—something that Posner and Sunstein seem to find axiomatic but, as we have discussed earlier, can really be quite problematic in application. Posner and Sunstein, however, profess to be puzzled by the fact that "almost everyone" rejects this idea of directing compensation from poor countries to wealthier ones.[62] This puzzlement seems to be rooted in a sense that the status quo of unrestricted emissions is a legitimate baseline without consideration of the possibility that the baseline should be one in which emissions are kept to a safe level. But whatever appeal the Pareto principle may have is rooted in a sense that the status quo is legitimate; a purely voluntary exchange based on an illegitimate status quo (such as a paying off a kidnapper) has no claim to moral acceptability.

Posner and Sunstein believe that the United States has no duty to reduce its own emissions in the absence of an international agreement. The argument here focuses on causation. They proceed from the premise that U.S. action would be futile unless other nations such as China also act.[63] Climate models, however, show that any addition to emissions, regardless of the

57. POSNER & WEISBACH, *supra* note 4, at 117.

58. Eric A. Posner & Cass R. Sunstein, *Climate Change Justice*, 96 GEO. L.J. 1565, 1610 (2008). As Kysar points out, Posner is clearly in the opposing camp regarding collective responsibility generally, arguing that states are not moral actors. *See* KYSAR, *supra* note 3, at 138–39. The arguments made in the Posner and Sunstein article have appeared more recently in POSNER & WEISBACH, *supra* note 4. Sunstein was unable to participate as a co-author on that book because of his appointment to a federal administrative post. *See id.* at vii–viii.

59. Posner & Sunstein, *supra* note 58, at 1569.

60. *Id.*

61. *Id.* at 1569–70.

62. *Id.* at 1570.

63. *Id.* at 1600.

existing level, causes incremental harm.[64] It is true that if other nations such as China do not reduce emissions, the total level of harm would be much higher than if everyone controlled emissions. Nevertheless, any reduction in emissions by the United States would still reduce or at least delay damage from climate change, even if the United States acted alone.[65]

Furthermore, even if no single country could unilaterally slow or moderate climate change, it does not follow that each country is free from responsibility. Tort law has long rejected the argument that, when harm proceeds from multiple sources, individuals can defeat liability by showing that it would have made no difference if they alone had acted properly.[66] The classic example is the destruction of property by two simultaneous negligently set fires. The courts consistently hold that both are liable; neither one is excused even though the property would have been destroyed by the other fire anyway.[67] According to the Restatement of Torts, the "rule that has evolved is that, at least where both causes involve comparable blameworthiness, both actors are liable, even though the conduct of either one was not a *sine qua non* of the injury because of the conduct of the

64. The Intergovernmental Panel on Climate Change (IPCC) synthesis of the physical science for policy makers shows that differences in CO_2 concentrations where concentrations are stabilized from 350 ppm to 790 ppm translate into temperature changes from 2.0°C to 6.9°C. INTERGOVERNMENTAL PANEL ON CLIMATE CHANGE, CLIMATE CHANGE 2007: SYNTHESIS REPORT: SUMMARY FOR POLICYMAKERS 20 tbl.SPM.6 (2007), *available at* http://www.ipcc.ch/pdf/assessment-report/ar4/syr/ar4_syr_spm.pdf.

65. *See, e.g.*, Robert Mendelsohn et al., *Country-Specific Market Impacts of Climate Change*, 45 CLIMATIC CHANGE 553, 558 (2000), *available at* http://www.springerlink.com/content/wj835313u172l412/fulltext.pdf (developing new climate impact models and noting that the response functions "imply that the net productivity of sensitive economic sectors is a hill-shaped function of temperature"); *see also* NICHOLAS STERN, THE ECONOMICS OF CLIMATE CHANGE: THE STERN REVIEW 166 fig.6.2 (2007) (discussing the various models). What this means is that the damages are a parabola rather than a straight line, mapped against the temperature change. So the greater the temperature increase, the larger the slope of the graph, meaning the higher the marginal effect of adding another small temperature increase on top of the existing temperature.

66. *See, e.g.*, RESTATEMENT (SECOND) OF TORTS § 432(2) (1965) ("If two forces are actively operating, one because of the actor's negligence, the other not because of any misconduct on his part, and each of itself is sufficient to bring about harm to another, the actor's negligence may be found to be a substantial factor in bringing it about.").

67. *See* KENNETH S. ABRAHAM, THE FORMS AND FUNCTIONS OF TORT LAW 111 (3d ed. 2007) (stating that this is the universal outcome and that it would be "absurd" to relieve either negligent party of liability). This position is also taken by the Third Restatement of Torts, which states that "[i]f multiple acts exist, each of which alone would have been a factual cause under § 26 of the physical harm at the same time, each act is regarded as a factual cause of the harm." RESTATEMENT (THIRD) OF TORTS: LIABILITY FOR PHYSICAL HARM § 27 (Proposed Final Draft No. 1, 2005). Courts have consistently applied this rule in toxic tort cases where the plaintiff has been exposed to the same toxic substance by multiple defendants. None of the defendants is allowed to escape liability on the grounds that the other exposures would have been enough to cause liability. *Id.* § 27 cmt. g. It should be noted that an actor making only a trivial contribution to causing the risk is exempted from these rules. *Id.* § 36. There is no reason to think that Chinese emissions would dwarf the U.S. contribution to such an extent as to make the U.S. emissions trivial in comparison.

other."[68] Thus, when a group of emitters contributes to saturating the atmosphere with a harmful gas, all of them should be considered responsible, even if no one of them acting alone could have prevented the harm.

Posner and Sunstein also find it absurd to blame Americans as a people for the failure of their government to take action against climate change. They view the idea of individual responsibility for governmental actions to be an outmoded absurdity, obsolete since at least World War II.[69] Indeed, they say, "[i]t is certainly plausible to think that voting for politicians who adopt bad policies, or failing to vote for politicians who adopt good policies, is not morally wrong except in extreme or unusual cases."[70] By the same token, presumably it is not morally *worthy* to vote for candidates who favor good policies or ethical ones. Being a citizen is a pleasantly light-hearted task, it would appear, involving no actual responsibility for democratic decisions.

Presumably, the policy makers themselves are not to blame—they almost always act in a group setting that makes individual responsibility hard to pin down, and, anyway, they merely act as agents for the voters. The citizens are not to blame, the politicians are not to blame, and the country itself is not a responsible moral agent. So, in the world posited by Posner and Sunstein, normal conceptions of morality simply vanish as relevant considerations in public policy, except perhaps in the rare case of criminal conduct by individual government officers. Certainly, the implications of their argument are consistent with Kysar's fears, discussed earlier, about the corrosive effect of CBA on societal ethics.

From Kysar's perspective, Posner and Sunstein are clearly wrong. For Kysar, the answer is that the right level of responsibility is collective rather than individual. Some readers may think that Kysar is too quick to attach moral rights and responsibilities to institutions or communities, but Posner and Sunstein's arguments can be challenged even from a more individualistic perspective.[71]

Posner and Sunstein are right that the linkages between individual Americans and harmful climate change are attenuated versions of typical

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68. Boeing Co. v. Cascade Corp., 207 F.3d 1177, 1183 (9th Cir. 2000) (citing 4 FOWLER V. HARPER ET AL., THE LAW OF TORTS § 20.3 (2d ed. 1986)).

69. Posner & Sunstein, *supra* note 58, at 1601.

70. *Id.*

71. If we view the relevant actors as individuals rather than collectivities, there is clearly reason to be concerned about the problem of matching responsible individuals on the one hand and actual victims on the other. If we cannot improve on random chance in awarding compensation from responsible individuals to victims, there is little point in thinking about compensation. But the objection is overdrawn in two ways. First, it goes more to the form of compensation than its desirability—if Posner and Sunstein are right, then individualists might want to avoid state-to-state climate compensation in favor of something more tailored. Second, it greatly exaggerates both the need for precision in matching victims and compensators and the degree to which compensation would impose burdens on wholly innocent parties.

torts of the kind we would see in a negligent car crash.[72] But more nuanced forms of responsibility also exist. Group activity necessarily involves more subtle connections between individuals and institutional actions. Many Americans have benefited from the failure of our society to face up to the problem of climate change well after a reasonable person would have realized the perils of unrestrained carbon emissions. As consumers, millions of Americans have had the benefit of cheap gasoline and low mileage standards, allowing them to drive SUVs, pickup trucks, and other vehicles that produce unduly high greenhouse emissions.[73] They obtain electrical power from cheap coal rather than more expensive renewable sources.[74] In the meantime, major American corporations have profited—American automobile companies from low mileage standards as well as American coal companies and oil companies from high sales.[75] Americans who own stock in these corporations, or whose pension plans own stock, have correspondingly benefited.

As we now know, many of these benefits were derived from actions that a reasonable person knew or should have known were harmful to others.[76] Short-term personal advantages, understandably enough, outweighed harms

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72. *See* Posner & Sunstein, *supra* note 58, at 1611 (noting that it is tempting to treat climate change as a kind of tort, but suggesting that the metaphor is imperfect since the principles of corrective justice that underlie tort law apply awkwardly to climate change).

73. *See* Nick Bunkley, *Cars Outsell Light Trucks for First Time Since 2002*, N.Y. TIMES, June 2, 2007, at C4 (reporting that light trucks, the category encompassing SUVs and pickups, outsold passenger cars every month from June 2002 to April 2007); James R. Healey, *Buyers Go Back to Thinking Big: What Gas Prices? SUV Sales Are Surging*, USA TODAY, July 30, 2010, at 1B (noting that SUV sales outperformed the overall auto market in the first half of 2010—rising 19% as compared to a 14% rise in compact cars and a 17% increase in the overall market—and arguing that stable fuel prices are partly responsible for the increase).

74. *See* U.S. ENERGY INFO. ADMIN., ELECTRIC POWER ANNUAL 2008, at 2 fig.ES1 (2010), *available at* http://www.eia.doe.gov/cneaf/electricity/epa/epa.pdf (reporting that coal accounted for 48.2% of U.S. electrical power generation for 2008, compared to 3.1% for renewables). Roughly one-third of all the U.S. greenhouse emissions can be attributed to individual behavior by consumers. *See* Michael P. Vandenbergh & Anne C. Steinemann, *The Carbon-Neutral Individual*, 82 N.Y.U. L. REV. 1673, 1694 (2007).

75. *See* David Welch et al., *Detroit Rides Alone*, BUSINESSWEEK, July 9, 2001 at 32 (stating that American auto manufacturers were attempting to avoid higher fuel mileage standards because low-mileage trucks were more profitable); *see also, e.g.*, Jad Mouawad, *Exxon Sets Profit Record: $40.6 Billion Last Year*, N.Y. TIMES, Feb. 1, 2008, at C3 (reporting Exxon's 2007 net income of $40.6 billion on increased sales of $404 billion); Patrick L. Thimangu, *High Energy: Coal Companies See Record Profits*, ST. LOUIS BUS. J., Aug. 8, 2008, http://stlouis.bizjournals.com/stlouis/stories/2008/08/11/story1.html (reporting soaring profits at several U.S.-based coal companies).

76. ELAINE KAMARCK, U.S. CLIMATE TASK FORCE, ADDRESSING CLIMATE CHANGE: THE POLITICS OF THE POLICY OPTIONS 3 (2009), *available at* http://www.climatetaskforce.org/2009/06/30/addressing-the-risks-of-climate-change-the-politics-of-the-policy-options/ ("The first front-page New York Times story on climate change appeared in 1981."). In 1985, the discovery of the hole in the ozone layer "helped to establish for many people the concept that human activity is, in fact, an influence on climactic conditions." *Id.* A Gallup poll in 1989 showed that sixty percent of Americans said they were worried a fair amount or a great deal about the greenhouse effect. *Id.* at 4 chart 1.

to others that were actually larger but harder to perceive because they were longer term and diffuse. Even those who did not benefit financially, such as children, enjoyed advantages from a way of life made possible by cheap fossil fuels. This does not seem to be a difficult case in which to apply the concept of unjust enrichment.[77]

It is also relevant that Americans had the capacity to limit these harms, not only as consumers but also as citizens. Given his theory of political responsibility, Kysar would base this obligation for compensation on the need for the United States as a collective body to "own" the harm it has done.[78] Even if we assume that only individuals can be holders of moral responsibilities, there seems to be a strong argument that individual American citizens bear some responsibility for U.S. policy.

For years, the United States has stood virtually alone among industrialized countries in opposing serious action on climate change.[79] Inaction regarding climate change is an important and widely discussed policy that was maintained over a considerable time period, such as the eight years of the Bush Administration. Thus, voters cannot reasonably claim to have been unaware of the issue. It is true that any individual voter has little power considered in isolation, but "little" is not zero (otherwise the cumulative power of all voters would also be zero, since a hundred million times zero is still zero). Moreover, as citizens, voters are engaged in a collective activity of governance from which they hope to benefit and on average receive substantial benefits, such as protection from foreign threats. Holding citizens responsible collectively at least to some degree for the resulting harm is not unreasonable.[80] This does not mean that citizens had a duty to support action against climate change at all costs, but allowing the government to stonewall on the issue is not easily defensible.

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77. Unjust enrichment is of course a familiar concept in American law. *See* Pyeatte v. Pyeatte, 661 P.2d 196, 202–07 (Ariz. 1982) (analyzing a restitution claim); ELAINE W. SHOBEN, WILLIAM MURRAY TABB & RACHEL M. JANUTIS, REMEDIES 780–81 (4th ed. 2007) (explaining the concept of unjust enrichment).

78. *See supra* text accompanying note 44.

79. *See, e.g.*, Richard W. Thackeray, Jr., *Struggling for Air: The Kyoto Protocol, Citizens' Suits Under the Clean Air Act, and the United States' Options for Addressing Global Climate Change*, 14 IND. INT'L & COMP. L. REV. 855, 881 (2004) ("[T]welve years after signing the U.N. Framework Convention on Climate Change, the United States [had] not instituted any domestic effort to reduce greenhouse gas emissions."). In addition, the United States withdrew "from international negotiations on a workable solution to the global threat of climate change." *Id.* By contrast, 193 other states and one regional economic organization have adopted the Kyoto Protocol. UNITED NATIONS FRAMEWORK CONVENTION ON CLIMATE CHANGE, STATUS OF RATIFICATION OF THE KYOTO PROTOCOL (1997), http://unfccc.int/essential_background/kyoto_protocol/status_of_ratification/items/5524.php.

80. A similar argument can be made about the responsibilities of shareholders in corporations. *See* CHRISTOPHER KUTZ, COMPLICITY: ETHICS AND LAW FOR A COLLECTIVE AGE 246 (2000) (contending that a corporation's investors are accountable when the corporation's activities result in harm, even though the investors may not be blameworthy due to their lack of control of those activities).

To apply the concept of moral responsibility to institutions or communities does not require a metaphysical belief that these entities exist apart from the individuals that compose them or that every individual is equally responsible for the actions of the group. In a complex world, it is often difficult to identify specific individuals who are responsible for decisions, and, indeed, collective structures can be deliberately manipulated to ensure that individual responsibility is difficult to trace. Yet these collective structures are far more powerful than any single individual. In a complex world, we would be hard-pressed to maintain the idea of moral responsibility for many important harms if we insist on limiting it to the identifiable actions of specific individuals.[81] Taken to excess, assigning collective responsibility can be unfair to individuals, but cautious implementation of the concept encourages individuals to take responsibility for institutional accountability. To say that voters have no responsibility after the fact for government policy is also to encourage them to take no responsibility beforehand, discouraging them from taking civic duties seriously.

Of course, climate skeptics are right that responsibility for climate change does not fall neatly within the paradigm of direct individual responsibility. Americans are clearly not responsible for the harm of climate change in the same way as a drunk driver is responsible for hitting a pedestrian. Americans' contributions to climate change may not fall neatly into either the traditional understanding of blameworthy conduct or the traditional understanding of blameless conduct.[82] Posner and Sunstein criticize the application of the traditional concept of blameworthiness to American climate policy, but an equally good argument can be made that American policy does not fit precisely within traditional concepts of moral innocence. Clearly, it would be wrong to consider American conduct criminal;[83] it might or might not fit within the traditional definition of a tort.[84] But why should

81. In an ideal world, we could fashion a remedy that was responsive to differences in individual responsibility, but the transaction costs involved probably would not be worthwhile. *See* Daniel A. Farber, *The Case for Climate Compensation: Justice for Climate Change Victims in a Complex World*, 2008 UTAH L. REV. 377, 399 (arguing that transaction costs would outweigh the benefit of "a remedy . . . responsive to differences in individual responsibility"). In any event, the simplest solution seems to be to recognize a duty of collective responsibility at the governmental level and then leave it to the government to sort out any issues of internal equity to the appropriate extent.

82. *See id.* at 387 (recognizing climate skeptics' argument that an understanding of corrective justice in tort law would not readily justify payments to developing countries despite the effect of Americans' actions on them).

83. Posner & Sunstein, *supra* note 58, at 1601; *see also* Marc Limon, *Human Rights and Climate Change: Constructing a Case for Political Action*, 33 HARV. ENVTL. L. REV. 439, 441, 473 n.175 (2009) (noting dismissal without prejudice of an Inuit petition against the United States that alleged responsibility based on principles of criminal liability for failure to limit greenhouse gas emissions).

84. *See* DAN B. DOBBS, THE LAW OF TORTS § 1 (2000) (defining a tort as "conduct that amounts to a legal wrong and that causes harm for which courts will impose civil liability").

our moral universe be limited to such brutal and obvious ethical violations? To say that a person cannot be held criminally or civilly liable is a long way from saying that he or she has behaved morally.

As the example of climate justice indicates, the idea of collective moral responsibility can be defended even without embracing Kysar's view of collectives as distinct moral agents. In practice, his view may be right more often than wrong, and it is clearly preferable to the Sunstein/Posner view under which the concept of moral responsibility simply vanishes unless the blame can attach to some identified individual wrongdoer.

B. Responsibility to Future Generations and the Discounting Puzzle

The upshot of the previous subpart is that we may have some degree of responsibility as members of collective groups toward members of other collective groups. But suppose those others have not yet been born. Are they part of our sphere of responsibility? In other words, does the concept of climate justice encompass responsibility for future generations?

Kysar devotes considerable attention to the issue of responsibility toward future generations.[85] In particular, he offers a sustained critique of the economic approach toward this issue, which is based on discounting future costs and benefits to present value.[86] It is understandable why discounting is controversial. As one economist remarked, discounting "forces us to say that what we might otherwise conceptualize as monumental events 'do not much matter' when they occur in future centuries or millennia."[87] Thus, many people share Kysar's sense that such "deep discounting" is morally problematic.[88]

American courts continue to struggle with the question of civil liability for contributions to climate change. *See, e.g.*, Connecticut v. Am. Elec. Power Co., 582 F.3d 309, 392–93 (2d Cir. 2009) (vacating and remanding a lower court's dismissal of a suit seeking civil damages for global warming purportedly resulting from defendants' carbon emissions). In a recent paper, Kysar argues for revamping tort law in order to cope with the increasingly complex and potentially catastrophic risks posed by climate change and other emerging problems. *See* Douglas A. Kysar, *What Climate Change Can Do About Tort Law* (Yale Law Sch., Research Paper No. 215, 2010), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1645871.

85. *See* KYSAR, *supra* note 3, at 150–75 (exploring this issue in a chapter entitled "Other Generations").

86. *Id.* My own view on this issue, along with a review of the literature up to that point, can be found in Daniel A. Farber, *From Here to Eternity: Environmental Law and Future Generations*, 2003 U. ILL. L. REV. 289, 301–08, 331–32. The issue continues to attract intense scrutiny from economists and philosophers. *See, e.g.*, David J. Pannell & Steven G.M. Schilizzi, *Time and Discounting in Economic Decision Making*, *in* ECONOMICS AND THE FUTURE: TIME AND DISCOUNTING IN PRIVATE AND PUBLIC DECISION MAKING 1, 7–10 (David J. Pannell & Steven G.M. Schilizi eds., 2006) (reviewing quantitative perspectives regarding future welfare); *cf.* PAGE, *supra* note 54, at 50–75 (surveying various philosophical approaches to the problem of intergenerational responsibility).

87. Martin L. Weitzman, *Why the Far-Distant Future Should Be Discounted at Its Lowest Possible Rate*, 36 J. ENVTL. ECON. & MGMT. 201, 201 (1998).

88. *Id.*; *see also* Geoffrey Heal, *Discounting: A Review of the Basic Economics*, 74 U. CHI. L. REV. 59, 60 (2007) (marshaling several authorities that question the ethics of discounting).

Economists emphasize two explanations for discounting: money could be invested for a greater future return (the opportunity cost of capital) and people are impatient (time preference).[89] The discount rate suggested by the impatience explanation—the social discount rate—is substantially lower than the rate indicated by the opportunity cost of alternative investments.[90] Essentially, the cost of capital compares a future environmental benefit with the returns from other investments; the social discount rate compares the future benefit with current consumption.

The argument seems right in principle. Money spent on environmental improvement might instead have gone into other investments. There is widespread agreement, even among critics of discounting, that these opportunity costs deserve consideration in some form.[91] We can account for the loss of alternate investment opportunities by using the rate of return on alternate investments as the rate for discounting future benefits.[92] This technique, however, involves significant factual issues. Discounting actually provides a measure of opportunity cost only if the lost opportunity actually *is* an investment whose returns will accrue in the same future year, which is not always easy to determine.[93] Proponents of the opportunity cost theory need to specify exactly how this alternative investment will take place. For instance, it is far from obvious that if we reduce our climate change expenditures by a million dollars today, our great-grandchildren will collect that amount with compound interest in 2110.

The choice of a discount rate has a profound effect on policy recommendations regarding climate change and other long-term environmental issues.[94] There is nothing approaching a professional

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89. See the discussion of the social discount rate in DAVID W. PEARCE & R. KERRY TURNER, ECONOMICS OF NATURAL RESOURCES AND THE ENVIRONMENT 212–17 (1990).

90. In a world without taxes, the social discount rate and the opportunity cost theoretically should be the same. But the tax system drives a wedge between the two. *See* Robert C. Lind, *A Primer on the Major Issues Relating to the Discount Rate for Evaluating National Energy Options*, *in* DISCOUNTING FOR TIME AND RISK IN ENERGY POLICY 21, 25–27 (Robert C. Lind et al. eds., 1982) [hereinafter Lind, *A Primer on the Major Issues*] (formulating discount rates in light of an "ideal economy").

91. *See* Tyler Cowen & Derek Parfit, *Against the Social Discount Rate*, *in* JUSTICE BETWEEN AGE GROUPS AND GENERATIONS 144, 151–52 (Peter Laslett & James S. Fishkin eds., 1992) (explaining how opportunity costs can affect investment decisions although nevertheless arguing against applying a discount rate); Lind, *A Primer on the Major Issues*, *supra* note 90, at 21–22 (listing "opportunity cost of a public investment" as one of the central concepts in a choice of discount rate).

92. *See* Edward R. Morrison, Comment, *Judicial Review of Discount Rates Used in Regulatory Cost-Benefit Analysis*, 65 U. CHI. L. REV. 1333, 1341–44 (1998) ("A standard measure of the opportunity cost of a public investment is the interest rate on assets with similar risk and duration in private financial markets.").

93. *See* Lind, *A Primer on the Major Issues*, *supra* note 89, at 50–52 (explaining the difficulties of comparing public and private investments).

94. As Cass Sunstein explained, "If a human life is valued at $8 million, and if an agency chooses a 10% discount rate, a life saved 100 years from now is worth only $581. 'At a discount rate of 5%, one death next year counts for more than a billion deaths in 500 years.'" Cass R.

consensus, however, about the appropriate rate. As Daniel Cole explains, "the choice of parameter values (including discount rates, coefficients of relative risk aversion, and per capita consumption growth rates) can decisively influence the outcome" of CBA—but "[u]nfortunately, the *Stern Review* and its critics also remind us of just how far away we remain from being able to specify a consensus 'best practice' for selecting parameter values."[95] The extent of disagreement about discounting can be seen in a recent law review symposium on the subject, where recommendations ranged from rejection of discounting entirely[96] to use of the riskless rate of return, perhaps coupled with hyperbolic discounting,[97] to use of an infinite discount rate by administrative agencies for effects beyond thirty to fifty years.[98]

One argument for discounting is that the government should respect individual preferences for how to allocate consumption over time. Richard Revesz argues that "most decisions that we make have future consequences"—including every time "we borrow money" and "every current expenditure [that] affects the amount that will be available for future expenditures."[99] For the government to second-guess these decisions "would open the door to government regulation of essentially every financial decision that we make," which would "constitute a serious affront to individual autonomy."[100] As Lisa Heinzerling points out, however, correcting deficien-

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Sunstein, *Cost-Benefit Default Principles*, 99 MICH. L. REV. 1651, 1711 (2001) (citations omitted) (quoting DEREK PARFIT, REASONS AND PERSONS 357 (1984)).

95. Daniel H. Cole, *The* Stern Review *and Its Critics: Implications for the Theory and Practice of Benefit-Cost Analysis*, 48 NAT. RESOURCES J. 53, 81 (2008). For a particularly interesting contribution to the discounting literature, which provides some support for Stern's choice of discount rates although on different grounds, see Martin L. Weitzman, *Risk-Adjusted Gamma Discounting*, 60 J. ENVTL. ECON. & MGMT. 1, 10 (2010) (arguing that discount rates can be substantially lower in situations involving catastrophic risks).

96. *See* Douglas A. Kysar, *Discounting . . . on Stilts*, 74 U. CHI. L. REV. 119, 119–20 (2007) (referring cynically in the article's title to Bentham's description of natural rights as "nonsense on stilts").

97. *See* W. Kip Viscusi, *Rational Discounting for Regulatory Analysis*, 74 U. CHI. L. REV. 209, 221, 239–40 (2007) (advocating the use of the riskless rate of return and opining that though hyperbolic discounting should not be incorporated into official discounting practices, it should be noted for its potentially substantial policy importance).

98. *See* Eric A. Posner, *Agencies Should Ignore Distant-Future Generations*, 74 U. CHI. L. REV. 139, 139–40 (2007) ("[B]eyond a few generations the effective discount rate should be infinity—that is, regulatory agencies should attach no weight to the interests of . . . 'distant-future generations' even if it would be ethically appropriate to attach equal weight to the interests of these future generations."). The title is misleading because the actual recommendation would affect not only distant generations but younger members of the current generation. For instance, if a chemical exposure would cause the certain death at age sixty of an infant who is already alive today, the agency would ignore that effect. If a cutoff is to be used, why not the "lives in being plus twenty-one years" of the rule against perpetuities? This would amount to about a century, rather than the fifty years proposed by Posner.

99. Richard L. Revesz, *Environmental Regulation, Cost-Benefit Analysis, and the Discounting of Human Lives*, 99 COLUM. L. REV. 941, 986 (1999).

100. *Id.*

cies in individual decisions is a well-established basis for regulation.[101] The recent financial meltdown, prompted by the collapse of the subprime mortgage market, suggests that individual financial decisions can have large social repercussions. More generally, although regulation of every individual transaction may be impractical and excessively burden autonomy, the government may want to take a hand to encourage savings and investment through more general social policies.

Individual preferences about time may not be worthy of automatic respect from regulators. We saw earlier that preferences are an uncertain guide to policy, and preferences about how to balance the future and the present may be a case in point. It is hard to tell how much of the reason for preferring immediate consumption is simply an inability to imagine more distant events as vividly as immediate ones. Normally, we consider impatience to be a childlike trait that should be ameliorated by maturity. In any event, Revesz himself rejects the relevance of private savings decisions to intergenerational discounting: "[H]ow one individual decides to time her expenditure of a fixed set of resources over her lifetime is a fundamentally different question from how society allocates a given set of resources among individuals in different generations."[102]

A second argument is that investing funds might allow us to earn enough money to save even more lives in the future than we could save through an expenditure on safety today.[103] Replying to this argument, Heinzerling asserts that the cost of obtaining an environmental benefit may increase if we delay and the problem becomes worse, and that in any event, regulatory agencies do not have the option of investing funds for later use.[104]

A third argument for discounting is that later generations will be wealthier than those alive today. Hence, if we fail to discount their interests, we will be transferring resources from a relatively poor current generation to a relatively rich future generation.[105] Kysar rejects this argument,[106] and it is at best speculative. There are several possible replies to this argument: the

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101. Lisa Heinzerling, *Regulatory Costs of Mythic Proportions*, 107 YALE L.J. 1981, 2048 (1998) ("A vast portion of our regulatory state interferes with private preferences . . . .").

102. Revesz, *supra* note 99, at 1015.

103. *See* John J. Donohue III, Correspondence, *Why We Should Discount the Views of Those Who Discount Discounting*, 108 YALE L.J. 1901, 1904–05 (1999) (suggesting that more lives can be saved in the future by investing money that would collect interest rather than spending that money on saving lives today).

104. *See* Lisa Heinzerling, *Discounting Life*, 108 YALE L.J. 1911, 1911, 1912 n.4 (1999) (observing that reinvestment of regulatory resources is both legally dubious and politically untenable); *see also* Revesz, *supra* note 99, at 990–91 (finding that the cost of correcting environmental harm may rise sharply over time, perhaps to infinity if the harm becomes irreversible).

105. For discussion of this argument, see Revesz, *supra* note 99, at 1003–07.

106. *See* KYSAR, *supra* note 3, at 161–71 (critiquing this particular defense of discounting as "more of a mood than an argument" and criticizing the practice of discounting in general for its various logical flaws).

valuation of environmental benefits or the cost of obtaining the benefits may also rise, neutralizing the difference in wealth levels;[107] the benefits may accrue to parts of the world that even in the future will be poorer than today's advanced economies;[108] and economic growth may not take the predicted upward path.[109]

The discounting issue is complex, but there seems to be something of a consensus on two points. First, some allowance must be made for opportunity costs, as Kysar concedes.[110] Even if we eschew CBA, unless we think tradeoffs are entirely irrelevant to environmental decisions, we will want to take opportunity costs into account. Second, as Kysar rightly concludes, the fact that people are generally impatient about receiving benefits within their own lifetimes, which causes them to demand compensation for investing their funds, has little relevance in the intergenerational context.[111]

Although deep discounting of the interests of future generations is jarring, so is the opposing view that those generations have a moral right to completely equal treatment.[112] Speaking of "rights" may not even be appropriate when considering unborn descendants, since our actions will determine which specific individuals will come into existence.[113] Similarly, it may be a mistake to take too literally the idea that members of the current generation are trustees for future generations, which would subordinate the interests of each generation to those of its successors.[114] There is much to be

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107. *See* Revesz, *supra* note 99, at 990–91 (demonstrating that damage from present ecological issues may compound over time if left uncured, thereby driving up the future cost of cleanup projects).

108. On the other hand, to the extent we are concerned about such distributional consequences, it might make more sense to help today's citizens of less developed countries, who are probably even poorer than their descendants will be. *See* Revesz, *supra* note 99, at 1005 (suggesting such an approach).

109. *See id.* at 1000 (positing that economies with high levels of consumption will see no economic growth and thereby suffer progressive intergenerational impoverishment by constant discounting).

110. *See* KYSAR, *supra* note 3, at 160–61 (explaining the argument for discounting on the basis of opportunity costs). Kysar emphasizes, however, that environmental policy might influence the rate of return for alternative investments. *Id.* at 165–67.

111. *See id.* at 159 (arguing that it is impossible to reliably predict what an individual's preference for present consumption will be for future generations).

112. For examples of the latter view, see Declaration on the Responsibilities of the Present Generations Towards Future Generations, U.N.E.S.C.O. 29 C/Res. 44, art. 1, (Nov. 12, 1997), *available at* http://unesdoc.unesco.org/images/0011/001102/110220e.pdf ("The present generations have the responsibility of ensuring that the needs and interests of present and future generations are fully safeguarded."); James C. Wood, *Intergenerational Equity and Climate Change*, 8 GEO. INT'L ENVTL. L. REV. 293, 298–99 (1996) ("[T]he implication of Rawls' theory is that persons in one generation have no preference in rights over members of any other generation.").

113. *See* Jeffrey M. Gaba, *Environmental Ethics and Our Moral Relationship to Future Generations: Future Rights and Present Virtue*, 24 COLUM. J. ENVTL. L. 249, 256 (1999) (positing that "not yet existent" humans may be seen as lacking "the insight and understanding necessary to classify them now as moral agents" capable of having rights).

114. *But cf.* Edith Brown Weiss, *The Planetary Trust: Conservation and Intergenerational Equity*, 11 ECOLOGY L.Q. 495, 498–99 (1984) (arguing that the current generation holds the natural

said instead in favor of Kysar's vocabulary, which stresses the "responsibility" of the current generation rather than rights or duties.[115] Finally, people do not view all future generations as equivalent. Members of the current generation clearly are felt to have a more compelling obligation toward the next generation (and perhaps at least to young grandchildren) than to succeeding generations.[116] This view may be myopic, but it seems an extravagant moral demand to expect people to give equally great weight to their own interests and those of individuals who will be born centuries from now.

Many of the concerns about discounting involve hypotheticals that are unlikely to face us because they presume unrealistic amounts of knowledge about the future and unrealistically stark choices. Whether or not we use discounting, however, we cannot reasonably view ourselves as equally responsible for all future time periods into infinity. This may mean that framing decisions as maximizing welfare over long periods of time is inappropriate, and that we need some different metric for long-term decisions. The puzzle of discounting may be a sign that something deeper is amiss in the effort to use CBA for intergenerational decisions.

Whether we use discounting or some other technique, another important issue discussed by Kysar is whether our obligations to future generations can be "cashed out" as financial investments or whether we instead have an independent obligation to preserve the environment on their behalf.[117] Kysar emphasizes that it is hard to know what value future generations will place on the environment and that this value will, to some degree, be shaped by what environment we bequeath them.[118] It may also be difficult to maintain a financial trust fund over many decades or centuries; the greater visibility and concreteness of natural features such as rain forests may lend themselves to a more powerful ethic of stewardship. Given that we have little ability to predict the challenges that might face future generations, it makes sense to provide them with as many options as possible; however, environmental harm often has the effect of irreversibly eliminating future options.[119]

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resources of the planet in trust for future generations and must act as prudent "trustees" for future beneficiaries, taking care to preserve the "corpus").

115. *See, e.g.*, KYSAR, *supra* note 3, at 151 (citing Congress's 1969 policy goal of fulfilling "the responsibilities of each generation").

116. PAGE, *supra* note 54, at 115. *But see* Edith Brown Weiss, *Our Rights and Obligations to Future Generations for the Environment*, 84 AM. J. INT'L L. 198, 200 (1990) (arguing that the "purpose of human society must be to realize and protect the welfare and well-being of every generation").

117. *See* KYSAR, *supra* note 3, at 153–54 (emphasizing the difficulty of cashing out the value of a coral reef). The argument for cashing out these obligations in the form of higher investments is emphasized in POSNER & WEISBACH, *supra* note 4, at 159.

118. *See* KYSAR, *supra* note 3, at 174–75 (noting that our actions toward the environment will influence future generations' needs and desires). Also, Kysar argues, even if some members of future generations would rather have the cash, others may be harmed without their consent in ways that we cannot justify simply by offering financial compensation. *Id.* at 170.

119. *See, e.g.*, Winter v. Natural Res. Def. Council, Inc., 129 S. Ct. 365, 372–73 (2008) (discussing the possibility of irreparable environmental harm); Cass R. Sunstein, *Irreversible and*

And finally, we may want to preserve nature for future generations in part because we think it is good to preserve nature, not simply because future generations may have a preference for nature over a cash investment, or even because our actions may further human welfare. Some may well doubt that any independent value should attach to nature (as opposed to human benefits from nature). As we will see in the next subpart, Kysar attempts to address that issue, but his attempts are not entirely satisfactory.

C. Responsibility to Nature

Environmental economists are not blind to the value of nature, whether in the form of scenic vistas or biodiversity.[120] They tend to view these values, however, in terms of human welfare and preferences. Kysar criticizes the ability of available economic methodologies to determine what people will pay to enjoy nature or would be willing to pay to preserve nature.[121] He argues instead that we have a direct moral responsibility to nature.[122] This part of the book delves the deepest into philosophical musings in a way that I found evocative but not entirely satisfying.

Kysar gives utilitarians credit for taking the interests of animals into account, but he thinks they are wrong simply to focus on animal suffering as the key to the moral relationship between animals and humans.[123] Instead, he stresses that ethical obligations are rooted in "the unknowability of the other's interior world"[124] and on our "primordial sense of awe and incomprehension regarding the other's being."[125]

Kysar's position requires a bit of unpacking. He explains that, "[o]nce named, the animal is objectified and made available for possession, exchange, and consumption, in the manner presupposed by welfare economics," whereas before this objectification, "there is simply a gaze of life."[126] Kysar continues that by considering the situation of

> [a]nyone who has been caught unawares by an animal—who perhaps found themselves being eyed during a hike by an elk that saw them long before their approach, or who perhaps, like Derrida, simply found

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Catastrophic, 91 CORNELL L. REV. 841, 847 (2006) (noting that "environmental harms are often irreversible" making it appropriate to "spend resources to maintain flexibility for the future").

120. *See* Jonathan Cannon & Jonathan Riehl, *Presidential Greenspeak: How Presidents Talk About the Environment and What It Means*, 23 STAN. ENVTL. L.J. 195, 243 (2004) (reflecting on the effort by environmental ethicists to "usher us into a moral universe in which the natural world is valued for itself and not simply for the use and enjoyment it provides").

121. KYSAR, *supra* note 3, at 108–10.

122. *See id.* at 244–45 (promoting the "unattainable but undeniable goal of universal recognition and respect").

123. *Id.* at 183–87.

124. *Id.* at 194.

125. *Id.* at 195.

126. *Id.* at 197.

> themselves after a shower standing naked before their housecat and felt a disorienting sense of being seen by a silent other.[127]

Such a person, he says, "would share Derrida's reaction that '[n]othing can ever take away from me the certainty that what we have here is an existence that refuses to be conceptualized.'"[128] Thus, Kysar says,

> the person caught naked before his cat cannot . . . help but recognize, even if only for a moment, that the animal before him—the animal seeing him from its own vantage point—*has* a vantage point, one that cannot be reduced to a name, a description, or a location in a hierarchy of being."[129]

In short, Kysar concludes, "[t]o honestly encounter other life-forms . . . we must remain open to the infinite possibilities of their existence.[130]

Kysar suggests that the question of who belongs within the sphere of moral concern cannot be resolved on an analytic basis, so a purely analytic response may be misplaced.[131] The fact that other life forms are capable of being aware of our existence and of our potential to affect them certainly seems morally relevant, and I share his sense that the issues may not be subject to purely analytic resolution. For that reason, I am reluctant to dismiss Kysar's approach entirely. But it seems to me that Kysar's emphasis on "the unknowability of the other's inner world" is not especially helpful in thinking about environmental regulation.

To begin with, I have doubts about the psychology underlying Kysar's view. If what creates a sense of obligation toward nature is nature's unknowability, one would think that increased knowledge would "kill the buzz." That also seems to be indicated by the epigraph of the book: Wordworth's lament that our "meddling intellect mis-shapes the beauteous forms of things" (followed by the famous: "We murder to dissect").[132] But this seems wrong as a matter of psychology. As Kysar himself notes, it is natural scientists, who know the most about nature, who are "increasingly desperate" to save nature from a "collision course" with human endeavors.[133]

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127. *Id.*

128. *Id.*

129. *Id.*

130. *Id.* at 195.

131. Kysar relies heavily on the writings of Levinas. Based on Kysar's description, I found myself somewhat in sympathy with the criticism that Levinas's project is "too wispy to guide lived experience." *Id.* at 297 n.66 (citing DAVID WOOD, THE STEP BACK: ETHICS AND POLITICS AFTER DECONSTRUCTION 68 (2005)). But it would be unfair for me to make such a judgment without more directly engaging with Levinas's writings.

132. The epigraph page is not paginated. The original poem may be found in THE POETICAL WORKS OF WILLIAM WORDSWORTH WITH INTRODUCTIONS AND NOTES 481 (Thomas Hutchinson ed., 1910).

133. KYSAR, *supra* note 3, at 180; *see also id.* at 253 (explaining that environmental issues require "more in the way of humility, striving, and unflagging self-awareness" than "scientistic or rationalist rigor"). For similar reasons, I am puzzled by Kysar's postmodernist critique of science, *id.* at 187, because undermining science seems to undermine rather than support environmentalism.

And for my own part, I have found that books like *How Monkeys See the World*[134]—a fascinating scientific exploration of primate cognition—increases my desire to preserve nature rather than diminish it.

This is not to say that the mysterious nature of other life forms (and of their inner mental lives) is irrelevant, but it seems incomplete as a description of the right stance toward other living things. A more balanced view would encompass both knowledge and mystery. As Jedediah Purdy writes, the natural world is both "deeply intelligible, composed of principles and relationships that, once grasped, enrich perception by making it patterned and significant;" yet "the world outstrips human understanding . . . so that intelligibility is always bounded by mystery."[135] It seems to me that Kysar's account overemphasizes the latter factor at the expense of the former one.

Kysar's approach may be unhelpful for another reason. Kysar's stress on the inner mental life and the gaze of the other seems relevant to only a small slice of environmental law. It might account for our moral responsibility towards whales or other higher animals, but it leaves much of the environment out of consideration. An ancient redwood evokes respect, but it clearly does not have an inner mental life. As this example illustrates, some aspects of nature that we hold most dear simply are not the kinds of entities whose physical organization would lend themselves to Kysar's approach, as he undoubtedly would agree. I can imagine that in some metaphoric sense the redwood forest "gazes back" at us, or at least reacts to our presence in an ordered way, but this seems like a tenuous basis for an environmental ethic.[136]

Although his specific argument for responsibility toward nature does not strike me as compelling, Kysar's broader argument about the role of responsibility in morality is powerful. While he does not develop the point fully, his argument for some forms of collective responsibility is worthy of further exploration, as is his claim that discounting fails to capture the scope of our responsibilities toward future generations. If we accept, at least provisionally, the reality of these responsibilities to the planet, we must then

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134. DOROTHY L. CHENEY & ROBERT M. SEYFARTH, HOW MONKEYS SEE THE WORLD: INSIDE THE MIND OF ANOTHER SPECIES (1990). Although now a bit dated, the book remains fascinating as a look inside the heads of other primates—and almost as equally interesting as a look at how scientists go about finding empirical evidence about questions that most of us would merely speculate about, such as whether monkeys are capable of attributing states of mind to others.

135. Jedediah Purdy, *The Politics of Nature: Climate Change, Environmental Law, and Democracy*, 119 YALE L.J. 1122, 1201 (2010). Purdy adds: "Taken together, the experience is simultaneously of beauty—an orderly world that we can understand and in which we belong—and of sublimity—a world beyond us, in which we are always in some degree alien and potentially overwhelmed." *Id.*

136. Kysar interweaves his discussion of nature with an attack on the ethics of genetic engineering of humans. That subject lies well outside the scope of this Review, but the effort to connect human genetic engineering with preservation of nature seems to rest on a conception of nature as standing apart from society—as the "other"—in terms of his more general analysis. KYSAR, *supra* note 3, at 182, 188, 191–92; *see also id.* at 251 (expressing concerns about our ability to meet the ethical challenges of the genetic age).

ask how to go about fulfilling them in the complex realm of environmental policy. Part III considers some strategies for doing so.

III. Fulfilling Our Responsibilities

Exercising environmental responsibility leads us to confront serious challenges. Environmental policy can involve substantial scientific uncertainty, difficult choices between regulatory instruments, and the perplexities of intervening in complex, highly interactive systems. Building on Kysar's observations about these issues, this Part suggests some strategies for dealing with their challenges.

Subpart A argues for the use of scenario analysis to deal with situations where we do not know the odds of various outcomes. Consideration of these scenarios is one way of operationalizing the precautionary principle favored by Kysar and would presumably be endorsed by him.

Subpart B suggests that both conventional regulations and economic tools may be useful and that economic tools may be even more helpful than usual in situations involving systemic effects. Concerns about the limitations of economics should not preclude us from taking practical advantage of economic insights. Here, Kysar may be a little too chary of economic insights, although his reluctance to embrace economic instruments may be understandable.

Finally, subpart C contends that, in dealing with long-term systemic issues, we should focus on metrics of system health rather than trying to make detailed projections of future outcomes. Among other advantages, focusing on metrics of system health avoids some of the perplexities of CBA of highly uncertain, long-term effects.

A. Uncertainty and the Precautionary Principle

CBA assumes that we can predict future costs and benefits well enough to discount them to present value. As Kysar stresses, however, many of the most important environmental problems involve intractable uncertainties rather than readily quantifiable risks.[137] Climate change is a prime example of a problem with large downside risks that are not well understood[138]—one reason Kysar is right to call it "a poster child for the limitations of cost-benefit analysis."[139] To understand these risks precisely, we would need to be able to predict future climate developments with precision and confidently

137. *See id.* at 71–98 (characterizing systems evaluated under environmental law and risk regulation as "complex adaptive systems" that both present unavoidable uncertainties and resist formalization).

138. *See id.* at 72–73 (lamenting the difficulties inherent in creating an "adequate approach" to environmental policy, given the procedural complexities that arise during knowledge generation, as well as the "complex and adaptive" nature of environmental systems that can generate unexpectedly regular and severe "catastrophic events").

139. *Id.* at 250.

estimate the harmful effects of those climate changes. As it turns out, we can be fairly sure of the lower end of the potential temperature increase but not of the higher end; we are even less sure about the scale of impacts on humanity from greater temperature increases.

As Daniel Cole explains, the stumbling block is the "wide range of possible temperature increases . . . including a five-percent possibility that temperature increases will equal or exceed 6°C and a two-percent probability of increases equal to or greater than 8°C within the next 100 to 200 years."[140] The term "model uncertainty" is sometimes used in this situation, where we have one or more models of the world but are unsure which one is right.[141] Dealing with model uncertainty is widely acknowledged to be difficult.[142] Nevertheless, useful techniques do exist.[143]

Some significant research exists on how to make rational decisions when the distribution of probabilities is unknown. As economist Sir Nicholas Stern explains, in these models of uncertainty, the decision maker, who is trying to choose which action to take, does not know which of several probability distributions is more or less likely for any given action.[144] He explains that it can be shown that the decision maker

> would act as if she chooses the action that maximizes a weighted average of the worst expected utility and the best expected utility . . . . The weight placed on the worst outcome would be influenced by concern . . . about the magnitude of associated threats, or pessimism, and possibly any hunch about which probability might be more or less plausible.[145]

These models are sometimes called α-maxmin models, with α representing the weighting factor between best and worst cases.[146] One way to understand these models is to consider a circumstance in which we might want to minimize our regret if we make the wrong decision, where we regret

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140. Cole, *supra* note 95, at 75. Feedback effects, such as methane releases triggered by temperature increases, threaten to accelerate temperature changes. Katey Walter Anthony, *Methane: A Menace Surfaces*, SCI. AM., Dec. 2009, at 69, 73.

141. *See, e.g.*, NAT'L RESEARCH COUNCIL OF THE NAT'L ACAD., SCIENCE AND DECISIONS: ADVANCING RISK ASSESSMENT 106 (2009) (modeling an example of determining the relative likelihood of a given value); Merlise Clyde & Edward I. George, *Model Uncertainty*, 19 STAT. SCI. 81, 82 (2004) (explaining that model uncertainty helps the user interpret information).

142. *See* NAT'L RESEARCH COUNCIL OF THE NAT'L ACAD., *supra* note 141, at 105–06 ("One of the dimensions of uncertainty that is difficult to capture quantitatively (or even qualitatively) involves model uncertainty.").

143. *See* DANIEL A. FARBER ET AL., CASES AND MATERIALS ON ENVIRONMENTAL LAW 539 (7th ed. 2006) (explaining alternative evaluation standards through the example of the requirements of the Clean Air Act).

144. STERN, *supra* note 65, at 39.

145. *Id.*

146. John Hof, *Carbon Fixation in Trees as a Micro Optimization Process: An Example of Combining Ecology and Economics*, 2 ECOLOGICAL ECON. 243, 255 (1990) (applying α-maxmin modeling to the ecological issue of carbon optimization in plants).

disastrous outcomes that lead to the worst-case scenario but we also regret having missed the opportunity to achieve the best-case scenario. Alternatively, α can be a measure of the balance between our hopes (for the best case) and our fears (of the worst case).

Using α-maxmin may seem to give too much weight to the most extreme possible outcomes. An interesting variant of α-maxmin uses a weighted average that includes not only the best-case and worst-case scenarios but also the expected value of the better understood, intermediate part of the probability distribution.[147] This approach "is a combination between the mathematical expectation of all the possible outcomes and the most extreme ones."[148] This tri-factored approach may be "suitable for useful implementations in situations that entangle both more reliable ('risky') consequences and less known ('uncertain'), extreme outcomes."[149] It requires a better understanding of the mid-range outcomes and their probabilities, however, than does α-maxmin.

In terms of process, α-maxmin has some important pluses. Rather than asking the decision maker to assess highly technical probability distributions and modeling, it simply presents the decision maker with three questions to consider: What is the best-case outcome that is plausible enough to be worth considering? What is the worst-case scenario that is worth considering? And how optimistic or pessimistic should we be in balancing these possibilities?[150] These questions are simple enough for politicians and members of the public to understand. More importantly, rather than concealing value judgments in technical analysis by experts, they present the key value judgments directly to the elected or appointed officials who should be making these value judgments. Finally, these questions also lend themselves to oversight by higher-level executive officials, legislators, and the press.

Another approach, which also finds its roots in consideration of worst-case scenarios, is to use scenario planning to identify unacceptable courses of action and then to choose the most appealing remaining alternatives. Robustness rather than optimality is the goal.

The search for robust solutions can benefit from the use of computer assistance in scenario planning.[151] RAND's Robust Decision Making (RDM)

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147. *See* Marcello Basili et al., *Precautionary Principle as a Rule of Choice with Optimism on Windfall Gains and Pessimism on Catastrophic Losses*, 67 ECOLOGICAL ECON. 485, 487–90 (2008) (modeling their variant of the precautionary principle).

148. *Id.* at 490.

149. *Id.*

150. *See* STERN, *supra* note 65, at 37, 39 (describing the analytical framework of decision making using expected utility).

151. *See* DAVID G. GROVES, NEW METHODS FOR IDENTIFYING ROBUST LONG-TERM WATER RESOURCES MANAGEMENT STRATEGIES FOR CALIFORNIA 12 (2006), *available at* http://www.rand.org/pubs/rgs_dissertations/2006/RAND_RGSD196.pdf [hereinafter GROVES, NEW METHODS] (mentioning the use of computers for data visualization, statistical analysis, and data mining in RDM); DAVID G. GROVES ET AL., PRESENTING UNCERTAINTY ABOUT CLIMATE

technique provides a systematic way of exploring large numbers of possible policies to identify robust solutions.[152] During each stage of the analysis, RDM "uses visualization and statistical analysis to identify policies . . . that perform well over many possible" situations.[153] It then uses data-mining techniques to identify the future conditions under which such policies fail.[154] New policies are then designed to cope with those weaknesses, and the process is repeated for the revised set of policies. As the process continues, policies become robust under an increasing range of circumstances, and the remaining vulnerabilities are pinpointed for decision makers.[155] "RDM evaluates policy models once for each combination of candidate policy and plausible future state of the world to create large ensembles of futures."[156] The analysis may include a few hundred to hundreds of thousands of cases.[157] In the context of long-term, global issues, the goal of this analysis is to "produce consensus on some sensible course of near-term action among the many different parties to a decision."[158]

The RAND methodology and α-maxmin are technical overlays on the basic idea of scenario analysis. Robert Verchick has emphasized the importance of scenario analysis—and of the act of imagination required to construct and consider these scenarios—in the face of nonquantifiable uncertainty.[159] As he explains, scenario analysis avoids the pitfall of projecting a single probable future when vastly different outcomes are possible, broadens knowledge by requiring more holistic projections, forces planners to consider changes within society as well as outside circumstances, and most importantly "forces decision-makers to use their imaginations."[160] He explains that "[t]he very process of constructing scenarios stimulates cre-

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CHANGE TO WATER-RESOURCE MANAGERS: A SUMMARY OF WORKSHOPS WITH THE INLAND EMPIRE UTILITIES AGENCY 74 (2008), *available at* http://www.rand.org/pubs/technical_reports/2008/RAND_TR505.pdf [hereinafter GROVES ET AL., PRESENTING UNCERTAINTY] (evaluating the performance of scenario analysis during water-management workshops held by the RAND Corporation and the Inland Empire Utilities Agency).

152. This is a more formalized version of the familiar technique of scenario analysis. For a description of scenario analysis, see JAMES A. DEWAR, ASSUMPTION-BASED PLANNING: A TOOL FOR REDUCING AVOIDABLE SURPRISES 130–41 (2002).

153. GROVES, NEW METHODS, *supra* note 151, at 125.

154. *Id.*

155. *See* David G. Groves & Robert J. Lempert, *A New Analytic Method for Finding Policy-Relevant Scenarios*, 17 GLOBAL ENVTL. CHANGE 73, 75 (2007) ("The central idea is to use multiple runs of computer simulation models to identify those scenarios most important to the choices facing decision makers. This scenario-identification process emerges naturally from robust decision making (RDM) . . . .").

156. GROVES, NEW METHODS, *supra* note 151, at 125.

157. *Id.*

158. ROBERT J. LEMPERT, STEVEN W. POPPER & STEVEN C. BANKES, SHAPING THE NEXT ONE HUNDRED YEARS: NEW METHODS FOR QUANTITATIVE LONG-TERM POLICY ANALYSIS 43–44 (2003).

159. VERCHICK, *supra* note 4, at 239–49.

160. *Id.* at 242–43.

ativity among planners, helping them to break out of established assumptions and patterns of thinking."[161] In situations where it is impossible to give confident odds on the outcomes, scenario planning may be the most fruitful approach.[162]

Whatever method we use to cope with uncertainty, ultimately we will need to deploy some regulatory mechanism in order to get the results we want. The next subpart considers the problem of instrument choice.

B. Regulations, Markets, and Other Mechanisms

Congress generally does not instruct EPA to engage in an open-ended balancing of costs and benefits or to consider other factors that EPA may deem relevant.[163] Instead, Congress usually gives more specific directions, generally by specifying the level of pollution control technology required in a given context.[164] For instance, in various settings, the Clean Air Act calls for the use of a number of technological standards, such as Reasonably Available Control Technology for existing sources in nonattainment areas, based on average industry performance; Best Available Control Technology for new sources in areas that exceed required air quality standards, based on the maximum feasible pollution reductions;[165] and Lowest Achievable Emission Rate for new or modified stationary sources in nonattainment areas, requiring the most stringent existing emissions limits achieved in practice by the industry or included in any state implementation plan even if not achieved in practice.[166] Clearly, these variegated standards cannot be collapsed into any single test such as CBA.

Kysar is quite right to emphasize the inappropriateness of using CBA in the face of these statutory demands as well as the potential merits of these existing forms of regulation. His model statute correctly insists that, before

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161. *Id.* at 243.

162. Scenario planning rests on a realization that plans need to take into account multiple possible futures. The flip side of this is the realization that our plans may not work out as we hope. This observation seems so obvious as not to be worth mentioning, but Dave Owen has shown how often the possibility of failure is entirely overlooked by government planning. *See generally* Dave Owen, *Probabilities, Planning Failures, and Environmental Law*, 84 TUL. L. REV. 265 (2009).

163. *See, e.g.*, Entergy Corp. v. Riverkeeper, Inc., 129 S. Ct. 1498, 1508 (2009) (concluding that silence in the Clean Air Act in regards to whether the EPA may engage in a CBA in making regulations "is meant to convey nothing more than a refusal to tie the agency's hands as to whether cost-benefit analysis should be used, and if so to what degree").

164. The development of this approach and the later controversies about its validity are described in RICHARD J. LAZARUS, THE MAKING OF ENVIRONMENTAL LAW 171–85 (2004), and Purdy, *supra* note 135, at 1180–90.

165. EPA views this provision as excluding consideration of risk levels with apparent support from the courts. Patricia Ross McCubbin, *The Risk in Technology-Based Standards*, 16 DUKE ENVTL. L. & POL'Y F. 1, 42–43 (2005). However, the author notes that evidence strongly suggests that EPA does covertly consider risk. *Id.* at 42.

166. This summary is derived from FARBER ET AL., *supra* note 143. For a listing of the similar set of standards under the Clean Water Act, see *id.* at 673–75.

applying CBA, the agency "first ascertain whether the statute being implemented is appropriate for the use of economic cost-benefit analysis at all."[167]

Nevertheless, even if we do not adopt economic analysis as a way of setting goals, economists may have useful advice about how to meet those goals. Although he does not fully develop the argument, Kysar seems skeptical of economically inspired ideas such as cap-and-trade schemes or markets for water.[168] It would seem misguided, however, to categorically rule out any tool that could help us achieve our environmental goals. And at least some economic instruments, such as carbon taxes, may be especially suited for broad application to an entire system rather than focused narrowly on particular types of conduct by businesses. For example, a broadly based carbon tax might apply to a wide range of activities contributing to climate change, unlike conventional sector-by-sector regulations.[169] As discussed in the next subpart, the systemic nature of some economic instruments may be matched by the systemic nature of environmental problems.

C. Sustainability and the Earth System

Kysar stresses the "deep interconnect[ivity]" that confronts environmental policy.[170] This interconnectivity makes it more difficult to trace causation, contributing to the uncertainties discussed in the previous subpart. It also makes it more difficult to distinguish sharply between different subsystems, such as the environment and the economy. An example may help clarify the nature of these interconnections.

To flesh out what Kysar aptly calls the "complicated tissue of events" connecting actors around the world, it is helpful to examine in depth an issue mentioned by Kysar[171]: the possibility that displacing fossil fuels with biofuels could actually cause an increase in greenhouse gases by driving up food prices and thereby causing the destruction of far-away grasslands or forests in order to expand croplands.[172]

To understand this issue, some background is necessary.[173] Biofuels are liquid fuels produced from biomass, and can be used either alone or blended

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167. KYSAR, *supra* note 3, at 256.

168. *Id.* at 106–07.

169. A carbon tax is a tax imposed on the carbon content of fossil fuels and other producers of carbon dioxide emissions. Reuven S. Avi-Yonah & David M. Uhlmann, *Combating Global Climate Change: Why a Carbon Tax Is a Better Response to Global Warming Than Cap and Trade*, 28 STAN. ENVTL. L.J. 3, 38 (2009).

170. KYSAR, *supra* note 3, at 124.

171. *Id.* at 8.

172. An important recent work on this topic is Richard J. Plevin et al., *The Greenhouse Gas Emissions from Biofuels' Indirect Land Use Change Are Uncertain, but May Be Much Greater Than Previously Estimated* (forthcoming 2010) (on file with authors).

173. A good source for basic biofuels information is INT'L ENERGY AGENCY, BIOFUELS FOR TRANSPORT: AN INTERNATIONAL PERSPECTIVE (2004).

with gasoline in vehicles.[174] Substitution of biofuels for gasoline helps reduce climate change and dependence on foreign oil. U.S. biofuels production grew by a factor of five from 2000 to 2008, and by 2022, production is expected to triple again because of federal mandates.[175] Corn-based biofuels are more than 90% of current U.S. production.[176] Indirect land use change (ILUC) is a particular concern with ethanol produced from corn kernels since corn is such a major food crop (and livestock feed) and international food commodity markets are relatively inelastic.[177]

A research team led by Timothy Searchinger sparked the debate about ILUC in a seminal 2008 article.[178] The basic theory is simple: use of cropland for biofuels raises food prices and thereby increases the incentive to convert forests and grasslands to crop production, thereby releasing stored carbon and decreasing future carbon sequestration.[179] Note that the effect is mediated by world food and fiber prices and therefore requires no geographic link between the land used for biofuels and the land converted to crops. The biofuels crops could be grown in Illinois, while the forest could be lost in Brazil through a chain of dominoes, including displacement of U.S. soybeans by corn, displacement of cattle by soybeans in Brazil, and displacement of forest by cattle raising, resulting in large CO_2 discharges from burning and decaying plant carbon stocks. Given that 20% of the U.S. corn crop went to ethanol production in 2006,[180] these effects could well be significant. According to the Congressional Research Service, the "ethanol-driven surge in corn demand has been associated with a sharp rise in corn prices."[181]

An obvious response to the Searchinger findings would be a call to protect grasslands and forests from conversion to cropland. Searchinger argued, however, that "[c]ounteracting increases in biofuels with controls or disincentives against land conversion would not only face great practical challenges but also have harsh social consequences."[182] The problem is that

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174. INTERGOVERNMENTAL PANEL ON CLIMATE CHANGE, CLIMATE CHANGE 2007: MITIGATION OF CLIMATE CHANGE 341 (2007).

175. PATRICIA KOSHEL & KATHLEEN MCALLISTER, NAT'L RESEARCH COUNCIL OF THE NAT'L ACAD., EXPANDING BIOFUEL PRODUCTION AND THE TRANSITION TO ADVANCED BIOFUELS 2 (2010).

176. *Id.* at 29.

177. *See* Timothy Searchinger et al., *Use of U.S. Croplands for Biofuels Increases Greenhouse Gases Through Emissions from Land-Use Change*, 319 SCI. 1238 (2008) (asserting that as more American croplands support corn-based ethanol, U.S. agricultural exports will decline significantly in meat and grain products, making increased foreign production necessary).

178. *See generally id.* (asserting that substituting biofuels for gasoline will lead to land-use changes that increase greenhouse emissions).

179. *Id.* at 1238; *see also* BRENT D. YACOBUCCI & KELSI S. BRACMORT, CONG. RESEARCH SERV., RL40460, CALCULATION OF LIFECYCLE GREENHOUSE GAS EMISSIONS FOR THE RENEWABLE FUEL STANDARD (2007) (providing an overview of lifecycle analysis and ILUC).

180. BRENT D. YACOBUCCI & TOM CAPEHART, CONG. RESEARCH SERV., RL34265, SELECTED ISSUES RELATED TO AN EXPANSION OF THE RENEWABLE FUEL STANDARD (RFS) 1–2 (2007).

181. *Id.* at 6.

182. Searchinger et al., *supra* note 177, at 1240.

reducing cropland means, all other things being equal, reducing food supplies, resulting in "poorer diets in developing countries."[183] In addition, decisions about protecting rainforests in other countries are under the control of other sovereigns, not the American policy makers who must decide on U.S. biofuel policy.

ILUC seems logical: because demand for food is relatively inelastic, less U.S. food production means higher food and fiber prices, which in turn encourages production increases elsewhere in the world, requiring the conversion of forests and grasslands to croplands.[184] As this chain of causation illustrates, it can be misleading to view the environment and the economy as two separate systems, connected only by direct physical impacts such as pollution. Complex market interactions may cause environmental impacts, while environmental policies may be linked to issues of economic development. The phrase "sustainable development" suffers from vagueness, but it does highlight the need to consider economic development (and hence the global economy) alongside the environment.

Robert Verchick highlights another aspect of the interaction between the environment and society. He emphasizes the importance of what he calls "natural infrastructure"—that is, the role of nature "as a substructure for human flourishing" in providing essential services such as protection against floods, carbon sequestration, and food supplies like fisheries.[185] In Verchick's view, "an infrastructure perspective helps remind us that natural goods and services come as part of larger, interconnected systems."[186]

Thus, economies and ecologies (and more broadly, the earth system) should be considered as part of an integrated system.[187] Much like the famous butterfly effect, the economic effects of a Midwestern farmer's decisions can cause ecological change halfway around the world. On a more localized scale, wetlands can provide buffers against storms and prevent damage in nearby cities, making the swamp part of the city's infrastructure, not just a natural feature. Moreover, as ILUC illustrates, it is not only environmental sustainability that is at stake because of the relationship among

183. *Id.*

184. The key question is the size of these effects. Prompted by Searchinger's findings, other research teams addressed the magnitude of ILUC. At this writing, the most recent estimate in the peer-reviewed literature is by a joint Berkeley/Purdue team led by Thomas Hertel. Thomas W. Hertel et al., *Effects of US Maize Ethanol on Global Land Use and Greenhouse Gas Emissions: Estimating Market-Mediated Responses*, 60 BIOSCIENCE 223 (2010).

185. VERCHICK, *supra* note 4, at 22.

186. *Id.* at 23.

187. The argument that closer ties between ecologists and economists are needed, even in the setting of CBA, is made in Scott Farrow, *Improving the CWIS Rule Regulatory Analysis: What Does an Economist Want?*, *in* REFORMING REGULATORY IMPACT ANALYSIS, *supra* note 1, at 176, 183–84.

biofuels, food supplies, and world hunger. At a global level, ecology, economy, and human welfare are deeply intertwined.[188]

Because of these complex interactions between ecologies and human activities, I am sympathetic to recent arguments asserting that we can no longer think purely in terms of "preserving nature" and instead must think about how to secure the kinds of ecosystems we value. Climate change has made the idea of untouched nature increasingly untenable, and we may need to intervene quite deliberately if we are to preserve biodiversity or other ecosystem traits that we value. For example, we may need to think about relocating some endangered species to more desirable environments, and this necessity may force a reconsideration of whether we are trying to preserve untouched nature or maintain biodiversity. A plausible case can be made for emphasizing Aldo Leopold's goals of "integrity, stability, and beauty" as a program for ecosystem management.[189] Given the uncertainties discussed in the last subpart, one might add to Leopold's list such key system attributes as robustness, resilience, and sustainability.

The shift from CBA to a policy based on system attributes may involve a less quantitative methodology. But as the RAND system of scenario analysis illustrates, a quality such as robustness can be investigated with sophisticated computational methods. Another technique would be "stress testing" future outcomes—for example, by modeling the ability of the world to respond to another global crisis with or without the added presence of major climate change.[190]

Resources for adapting to change, limiting potential catastrophic harms, and maintaining human flourishing over the long haul can come in various forms. Some are institutional, such as market systems that can be highly adaptive to new circumstances and are excellent ways of spreading risks, and political systems that can provide coordinated policy responses to problems. Others are intellectual—well-educated populations, deep and accessible information systems, and strong research establishments. Societal wealth is a resource in its own right since it can be deployed to respond to challenges. And some resources are natural—such as varied ecosystems, healthy watersheds, and biodiversity.

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188. To borrow a term from ecological economics, one might say that these systems are coevolving. *See* RICHARD B. NORGAARD, DEVELOPMENT BETRAYED: THE END OF PROGRESS AND A COEVOLUTIONARY REVISIONING OF THE FUTURE 26 (1994) (explaining the use of coevolutionary theories to describe how the relationship between two entities determines the evolution of those entities).

189. Purdy, *supra* note 135, at 1199–1202 (quoting Aldo Leopold, *The Land Ethic*, *in* A SAND COUNTY ALMANAC WITH ESSAYS ON CONSERVATION 167, 189 (2001)).

190. *See* Roger N. Jones, *An Environmental Risk Assessment/Management Framework for Climate Change Impact Assessments*, 23 NAT. HAZARDS 197, 197–200, 205–06 (2001) (describing various sensitivity or stress-testing models used to predict climate change outcomes and outlining a framework for creating such scenarios).

The problem is how to make decisions in situations where we can confidently trace in detail the long chains of causation that will ultimately control the outcome. Similarly, difficulties are posed by the problem of choosing the right chess move given an inability to foresee the development of the game many moves into the future. We can take a lesson from considering the cognitive skills that distinguish chess masters from run-of-the-mill players. Many people assume that chess masters can look more moves into the future than ordinary players, but the number of possibilities grows geometrically, overwhelming human cognitive capacity. For instance, if at each move there are two possible choices, then ten moves into the future there are a thousand possible positions to be assessed. Instead, research shows that chess masters normally look only a few moves into the future, just like ordinary players, but the masters are expert in assessing whether the resulting configuration of pieces is a strong foundation for later moves.[191]

Similarly, given our difficulty in forecasting the future states of the interlinked economic/ecological system, our best strategy may be to concentrate on plans that will lead to configurations possessing the resilience and robustness needed to handle future, as yet unknown, challenges.[192] We need to apply these standards to the earth system as a whole as well as to subsystems like the economy and the environment. Doing so may also eliminate the need to make highly debatable economic projections centuries into the future or to worry about whether to discount the results of those projections to present value. Admittedly, these standards have not yet been fully worked out and are likely to lack the simplicity of the Pareto principle. CBA may be suitable for decisions that are more localized in space and time, providing that we also keep in mind the need to adjust decisions to longer-term goals. But we also need new methods suited for the increasingly complex, global, and long-term problems faced by our planet.

* * *

Regulating from Nowhere is part of a ferment that is now underway in environmental scholarship. As Kysar's book illustrates, much of this effort is still devoted to defending traditional environmentalist views and critiquing competing approaches like CBA. In addition, however, there are promising signs of efforts, such as Kysar's, to lay out a new path for environmental protection.

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191. *See* Daniel A. Farber, *The Inevitability of Practical Reason: Statutes, Formalism, and the Rule of Law*, 45 VAND. L. REV. 533, 555 (1992) (chronicling a series of experiments, which determined that chess masters gain their advantage by swiftly analyzing "chunks" of relevant data rather than countless possibilities).

192. *See, e.g.*, Robert J. Nicholls & Julia Branson, *Coastal Resilience and Planning for an Uncertain Future: An Introduction*, 164 GEOGRAPHICAL J. 255, 256–58 (1998) (emphasizing the need for three kinds of resilience in coastal preservation).

Ever since Ronald Reagan took office, environmentalists have been playing defense against conservative attacks on environmental protection.[193] Understandably, environmentalists viewed CBA as simply another maneuver in the deregulatory campaign. We are hopefully moving into an era in which it is possible to think more constructively about what environmental law should be rather than simply arguing about what it should *not* be. Although much of Kysar's discussion takes the form of a critique of CBA, he also offers a more affirmative vision based on the concept of moral responsibility for environmental harms. Although CBA (like its foundation, the Pareto principle) may be a useful tool, it is too unidimensional to do justice to the nuances of our moral responsibilities. Kysar also provides a useful exploration of how our responsibilities extend to other countries, to other generations, and to some other living things—issues that fall outside the scope of CBA.

Beyond the traditional approaches to environmental law defended by Kysar, we need to be open to new approaches, such as the use of scenario planning to deal with intractable uncertainties and the use of measures of systemic strength such as sustainability, resilience, and robustness. The common theme here is that we must focus as much on the macro-level qualitative aspects of key global systems as on the micro-level quantitative impacts of policies. Identifying the best solution we can for each micro decision considered in isolation may not be the best way to sustain the system as a whole because small errors may be cumulative.

Factors that are too small to have much apparent importance for any one decision may dominate when we consider policies on a wider scale, just as the curvature of the earth is only significant over large distances. This fact figured in the first published paper by the famed economist Kenneth Arrow, which was not about economics but about airplane navigation.[194] As Arrow explained in an interview much later in life, "[a]ll the literature assumed that the world was flat, that everything was on a plane, which may be germane if you're flying a hundred miles."[195] Taking into account that the world is round changed the results—but this fact only becomes relevant on a large scale.

Similarly, as we begin to think about how human action changes the world on a large scale and over significant time periods, it may not be enough to cobble together analyses that focus narrowly on the traceable ef-

193. *See* ROBERT GOTTLIEB, FORCING THE SPRING: THE TRANSFORMATION OF THE AMERICAN ENVIRONMENTAL MOVEMENT 3–6 (rev. ed. 2005) (tracing the history of the environmental movement from the Reagan Administration through the first term of the George W. Bush Administration).

194. Kenneth J. Arrow, *On the Use of Winds in Flight Planning*, 6 J. OF METEOROLOGY 150, 150 (1949).

195. Interview by THE REGION with Kenneth Arrow, Professor Emeritus, Stanford University (December 1995), *available at* http://www.minneapolisfed.org/publications_papers/pub_display.cfm?id=3675.

fects of small, local policy changes. Instead, we may need to take a more global perspective, looking at the long-term prospects for large economic and environmental systems—although just as with airplanes, the global vision may be more useful for plotting a general course than for responding to the exigencies of local weather.

As our understanding of environmental problems grows, the solutions may become more complex, but we must never lose track of the demands of moral responsibility that Kysar elucidates. In a complex world, our standards for decisions—rather than being reducible to a formula such as CBA—must look beyond localized costs and benefits to encompass global responsibilities.

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Notes

A Proposed Solar Access Law for the State of Texas*

I. Introduction

Thirty-six states have passed laws recognizing homeowners' solar access rights and protecting the use of residential solar energy systems. Texas, however, a state with one of the highest solar power potentials in the country,[1] has yet to enact a solar access protection law.[2] Texas is the nation's leader in wind-powered energy-generation capacity, but the state's vast amount of direct solar radiation remains largely unexploited.[3] Texas's enormous solar potential even led one study to rank Texas as the second most attractive U.S. state for long-term solar energy development, behind only California.[4]

But rather than focusing on what individual homeowners can do to harness this great solar energy potential, Texas has directed its efforts toward large-scale solar incentive projects. In recent years, for example, Texas has granted a tax deduction for business franchises that utilize solar energy devices,[5] granted a tax exemption for business franchises that manufacture, sell, or install solar energy devices,[6] granted a property tax exemption for the amount of an appraised property value that stems from the installation or construction of a solar energy device that is primarily for on-site use,[7] and partnered with the U.S. Department of Energy and the Western Governors

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1. FRONTIER ASSOCS., TEXAS RENEWABLE ENERGY RESOURCE ASSESSMENT, at ix (2008), *available at* http://www.seco.cpa.state.tx.us/publications/renewenergy/pdf/renewenergyreport.pdf.

2. Over fifty bills promoting solar energy were filed with the 2009 Texas state legislature, but no solar access law passed. *See* Kate Galbraith, *Texas Aims for Solar Dominance*, N.Y. TIMES GREEN BLOG (Mar. 25, 2009, 6:49 AM), http://green.blogs.nytimes.com/2009/03/25/texas-aims-for-solar-dominance/ (stating that in 2009 there were sixty-nine renewable energy bills before the Texas legislature and that over fifty of these promoted solar power); *cf. Solar & Wind Access Laws for Renewable Energy*, DATABASE OF STATE INCENTIVES FOR RENEWABLES & EFFICIENCY, http://www.dsireusa.org/incentives/index.cfm?SearchType=Access&&EE=0&RE=1 (providing a state-by-state breakdown of the solar access laws currently in place in the United States that does not include any solar access laws in Texas).

3. *See* FRONTIER ASSOCS., *supra* note 1, at xvi ("Texas has only scratched the surface of the state's enormous developable potential solar, biomass, and geothermal capacity.").

4. *Id.* at 9-10.

5. TEX. TAX CODE ANN. § 171.107 (West 2008); *Solar Energy Incentives*, STATE ENERGY CONSERVATION OFFICE, http://www.seco.cpa.state.tx.us/re_solar_incentives.htm.

6. TAX § 171.056; *Solar Energy Incentives*, *supra* note 5.

7. TAX § 11.27; FRONTIER ASSOCS., *supra* note 1, at 3-24.

Association to install concentrating solar power systems.[8] This large-scale focus is further evidenced by the nonexistence of a Texas law protecting the solar access rights of individual homeowners. While the state's actions thus far to encourage the use of solar energy and the growth of the renewable energy industry are essential components of the overall movement toward increased solar energy use, Texas—a state with "a virtually unlimited solar energy supply"[9]—has not done enough. Texas has pursued policies that promote the use of solar energy, yet it has failed to recognize and protect its citizens' solar access rights. As Texas law now stands, the possibility that their neighbors can build structures or plant trees that block the sunlight reaching a solar energy unit will make homeowners reluctant to invest in solar energy devices, as their rights to solar access are not guaranteed.[10] Texas should therefore implement a law—such as the one detailed in this Note—that recognizes and protects Texans' solar access rights in order to encourage the installation and use of residential solar energy systems.[11]

Financial incentives certainly have an important place in promoting and increasing renewable energy use throughout the country as they work alongside solar access regulations toward the broader goal of increasing widespread solar energy use. While both devices act similarly to foster private preferences in line with the public interest, financial incentives are a mechanism for nurturing the broader industry as a whole, whereas solar access laws protect the homeowner as an individual.[12] In the interest of brevity, however, I will not discuss the function of financial incentives in this Note. Instead, I will focus solely on the mechanism of solar access laws as they pertain to the use of residential solar energy devices.

In Part II, I examine why Texans should value solar access rights in light of climate change awareness, fossil fuel prices, and national security concerns. I also explain the science behind solar energy use, focusing particularly on small-scale solar energy systems, and detail the history of property law governing solar access rights.

In Part III, I propose a solar access law for Texas to enact. The proposed law aims to encourage homeowners across Texas to utilize solar energy systems on the small scale by (1) establishing the right to solar access

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8. *Texas Solar Energy*, STATE ENERGY CONSERVATION OFFICE, http://www.seco.cpa.state.tx.us/re_solar.htm.

9. *Id.*

10. *See* Sara C. Bronin, *Modern Lights*, 80 U. COLO. L. REV. 881, 883–84 (2009) (asserting that government policies and economic measures that encourage investment in solar energy "while simultaneously failing to protect these investments by recognizing solar rights" will not incentivize individuals to fully embrace solar energy because they have no "legal assurance of long-term solar rights").

11. *See infra* subpart III(B).

12. *See* Bronin, *supra* note 10, at 883–84 (explaining that while various systemic incentives have nurtured the broader industry, solar access laws protecting long-term solar rights are required to "convince individuals" to act).

as an individual property right; (2) defining the term *solar energy system* expansively to cover both passive and active solar energy devices; (3) eliminating both preexisting and future restrictions on property deeds that limit homeowners' solar access; (4) restricting neighboring property owners from obstructing existing solar energy systems; (5) curbing the power of homeowners' associations to place limits on property owners' solar access; and (6) requiring localities to protect homeowners' solar access rights when designing zoning ordinances and prohibiting localities from passing ordinances that would inhibit the operation of residential solar energy systems.

In Part IV, I go on to address why the proposed solar access law is the best mechanism to protect and encourage the use of residential solar energy systems in comparison to alternative legal devices such as express easements, covenants, and assignments resulting from litigation.

I conclude this Note in Part V by calling on the State of Texas to adopt this proposed solar access law in order to take the next step forward in harnessing the state's great solar energy potential in the interest of environmental, economic, and national security concerns.

II. Background

Although solar energy has been described as "the most democratic of renewable energy resources" because of its availability everywhere on Earth in varying quantities,[13] maximizing the benefits of efficient solar energy systems demands that these systems have unobstructed access to sunlight.[14] Protecting property owners from the blockage of their access to sunlight so that they can utilize solar rays as an energy source thus requires recognizing solar access as a property right. One scholar has aptly defined a solar access right as "the ability of a property owner to enjoy or utilize a defined amount of sunlight on her parcel and to defend this right as against other property owners."[15] Before delving into a discussion of the legal history of this right, I will address the value of solar rights to Texans and briefly explain the science behind residential solar energy systems.

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13. *Texas Solar Energy*, *supra* note 8.

14. *See* Bronin, *supra* note 10, at 887–88 (describing the physical needs of the typical solar collector and noting that the sun "never shines directly above any piece of property in the United States"); Sanya Carleyolsen, *Tangled in the Wires: An Assessment of the Existing U.S. Renewable Energy Legal Framework*, 46 NAT. RESOURCES J. 759, 783 (2006). Carleyolsen observes,

> The first major barrier [to renewable energy projects] is a compromised right to access renewable energy sources, such as the sun's rays. The amount of energy that [solar panels] produce is dependent on a number of factors including the angle of the sun; climate, weather conditions and cloud cover; time of day; and solar flux. Several legal issues arise when access to any of these conditions is compromised.

Id.

15. Sara C. Bronin, *Solar Rights*, 89 B.U. L. REV. 1217, 1222 (2009).

A. Why Are Solar Rights Valuable to Texans?

Climate change awareness, rising fossil fuel prices, and national security concerns all highlight the importance of recognizing and protecting Texans' solar access rights. Sunlight offers Texans a sustainable energy source that addresses all of these issues.

In recent years, concerns about global warming and climate change have become a large part of public discourse.[16] As the country's biggest coal consumer, "Texas is also one of the largest emitters of carbon dioxide and sulfur dioxide in the nation."[17] Moreover, not only is the state's energy consumption the highest in the United States—accounting for almost 12% of the nation's total energy use—but Texas's residential electricity consumption is much higher than the national average as well, and the state's per capita energy consumption ranks fifth in the country.[18] Coupled with the state's growth—since 1995 the population of Texas has increased by approximately 28% to twenty-four million people[19]—these high levels of energy consumption highlight the important role that renewable energy can play in the future of the State of Texas. By recognizing and protecting Texans' solar access rights, the state can offer its citizens an alternative energy source that will counteract, rather than exacerbate, the deleterious effects that this pollution has had on the state's air quality.[20]

Solar energy is also an attractive option for Texas in the face of increasing fossil fuel prices and national security concerns.[21] Texas has historically been a national leader in the production and consumption of

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16. A search on the *New York Times* website for articles from the past year containing the term *climate change* elicited over one thousand results.

17. FRONTIER ASSOCS., *supra* note 1, at 1-6.

18. *Id.* at ix. According to the Report,

> Due to its large population and energy-intensive economy, Texas leads the nation in energy consumption, at 11.556 quadrillion Btu (2005), up from about 10 quads in 1995, accounting for 11.5 percent of total U.S. energy use. Texas' per capita energy consumption ranks fifth in the U.S. at 506 MMBtu per year (2005). Texas residential electricity consumption is significantly higher than the national average, due to high demand for air conditioning and the widespread use of electricity for home heating.

Id. (citations omitted).

19. *Id.*

20. *See id.* at 3-23. Surveying the benefits of solar energy, the report observes,

> The generation of energy from sunlight generally does not contribute to noise, air, or effluent pollution, and does not result in the release of carbon dioxide into the atmosphere. Producing energy from solar offsets energy produced from other, typically fossil, resources, and therefore reduces emissions that would otherwise be produced from those resources.

Id. While it is true that the manufacturing of solar equipment requires energy inputs and results in some pollution, small-scale solar energy devices—particularly passive residential systems—cause very little environmental harm, if any. *See infra* subpart II(B).

21. *See id.* at 3-1 (observing that "the increasing costs and price volatility of fossil fuels" have resulted in growth of the solar energy industry).

crude oil, petroleum products, and natural gas.[22] However, a recent decline in energy production levels, combined with increased energy consumption, has forced the state to rely on outside energy sources to make up for its energy deficit.[23] As a result, Texas, along with the rest of the United States, is increasing its reliance on foreign oil as an energy source.[24] This raises national security concerns, particularly in light of the current state of U.S. relations with oil-producing countries in the Middle East.[25] Solar energy offers Texas an affordable and secure domestic energy source that is not dependent on this tenuous relationship. In fact, the energy equivalent of 800 barrels of oil can be produced by harnessing the sunlight that falls on just one acre of land in West Texas each year.[26] Furthermore, residential solar energy systems can be separate from the larger energy grid. This setup provides the state with a more terrorism-proof energy source than vulnerable grids.[27] Recognizing Texans' solar access rights will not only reduce the state's dependence on foreign oil by offering a more cost-effective domestic option but also assuage anxiety that the state's energy supply could be cut off without warning—either literally or through prohibitive price increases—if U.S. relations with the Middle East were to sour.

B. The Science of Solar Energy

Solar energy can be harnessed on both the large and small scale.[28] Large-scale solar energy systems involve the use of "large tracts of rural land . . . to collect and distribute solar power to multiple end users," such as businesses and individual homeowners.[29] The decision to implement large-scale use of solar energy depends on many considerations, including present land and water use, the availability of adequate electricity transmission, and access to backup power sources and storage technologies.[30] While these elements create many obstacles to the implementation of large-scale solar

22. *See id.* at 1-4 ("Texas is the top producer and consumer of non-renewable fuels in the nation . . . . Texas is home to approximately one-fourth of the nation's oil reserves and leads the nation in the production of oil and gas . . . .").

23. *Id.*

24. *Id.*

25. *See* Michael R. Gordon, *Biden Visits Iraq for Major Step in Troop Pullout and to Meet Gridlocked Leaders*, N.Y. TIMES, Aug. 31, 2010, at A8 (describing the difficulty of establishing a new government in Iraq, especially a government "interested in building a long-term partnership with the United States"); Anthony Shadid, *Ambassador Leaves Iraq with Much Still Unsettled*, N.Y. TIMES, Aug. 13, 2010, at A10 (chronicling the political stalemate that has threatened to delay the American military withdrawal from Iraq); Robert F. Worth, *One of 3 Jailed U.S. Hikers Will Be Released, Iran Says*, N.Y. TIMES, Sept. 10, 2010, at A8 (explaining that the detention of American hikers by the Iranian government has "further strained relations between Iran and the United States, which have long been at odds over Tehran's nuclear program").

26. *Texas Solar Energy*, *supra* note 8.

27. *See infra* subpart II(B).

28. FRONTIER ASSOCS., *supra* note 1, at xi.

29. Bronin, *supra* note 15, at 1223–24.

30. FRONTIER ASSOCS., *supra* note 1, at xii.

energy devices, small-scale solar energy systems provide a more feasible alternative to individual homeowners. Small-scale solar energy systems mitigate the considerations that influence the use of larger systems because they produce power at or very close to the point of use and can be placed on existing buildings, eliminating the need for land dedicated solely to energy production.[31] Certain small-scale solar energy systems also do not consume water, unlike large-scale systems.[32] The small-scale solar energy systems that are currently available to residential property owners can be either active or passive.[33]

Access to sunlight is an essential component of both active and passive systems. Active solar energy systems function by collecting, storing, and converting sunlight into either photovoltaic (PV) electricity or thermal energy and are typically used for space and water heating.[34] It is common for residential property owners to actively harness solar energy through the use of PV systems,[35] which function by converting light into electric voltage.[36] PV systems are low impact, can be packaged in any size, and can be installed on existing homes, eliminating the need for land dedicated solely to energy production and the expense of extending miles of electric transmission lines to individuals that wish to install these systems in their homes.[37] If PV systems include storage devices, they may do away with the need to connect to an electric grid,[38] making the installation process easier and cheaper for homeowners. Additionally, while conventional energy costs are rising, the cost of PV electricity is declining.[39] And whereas some PV systems are interconnected with the utility grid, the use of stand-alone PV systems eliminates or reduces infrastructure challenges associated with large central power systems, such as transmission adequacy and land and water use.[40]

In contrast to active systems, passive solar energy systems make use of building materials, positioning, and architectural design to maximize the

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31. *Id.* at 3-4.

32. *Id.* at 3-5 to 3-6.

33. *Texas Solar Energy*, *supra* note 8.

34. *Id.*

35. *See* LARRY SHERWOOD, INTERSTATE RENEWABLE ENERGY COUNCIL, U.S. SOLAR MARKET TRENDS: 2009, at 2, 5 (2010), *available at* http://irecusa.org/wp-content/uploads/2010/07/IREC-Solar-Market-Trends-Report-2010_7-27-10_web1.pdf (noting that over 34,000 sites installed PV systems in 2009 and that residential installations have dominated the market since 2005).

36. *Photovoltaics: Solar Electricity*, STATE ENERGY CONSERVATION OFFICE, http://www.seco.cpa.state.tx.us/re_solar_pv.htm.

37. *Id.*

38. *Id.*

39. FRONTIER ASSOCS., *supra* note 1, at xii.

40. *Id.*; *see also* Carleyolsen, *supra* note 14, at 767 n.31 (asserting that decentralized PV systems are decreasing in cost, involve few maintenance fees, and do not require energy source backups or generators).

structure's access to sunlight and to the sun's thermal energy.[41] Homeowners who use this approach to solar energy use depend on the design of their home and its building materials to provide them with exposure to sunlight that will provide some or all of the energy they need to heat and cool their living space.[42] Because they are based solely on building design and structure, passive solar energy systems require no mechanical systems and require little maintenance beyond that of a regular house, making them a cost-effective option for solar energy use.[43]

C. *A Short History of Property Owners' Rights to Light*

Historically, property owners' access to sunlight was not always a legally protected property right. The earliest principle of land ownership allowed land owners to build structures that would block their neighbors' access to sunlight. Although the English common law moved away from this doctrine to a more permissive regime surrounding solar access rights, early American court decisions rejected the English common law in favor of legal rules that valued development and commercial use of land over solar access. However, in recent years U.S. court decisions have begun to recognize and protect property owners' solar access rights, laying the foundation for Texas to adopt a statute that does the same.

1. Ad Coelum *Doctrine.*—The earliest principle of land ownership was based in the doctrine of *cujus est solum, ejus est usque ad coelum et ad infernos*, meaning he who owns the soil also owns "up to the sky and down to the center of the earth."[44] According to the *ad coelum* doctrine, a property owner had rights to both the land below the surface of his property and the airspace above it.[45] Under this reasoning a property owner's right to build trumped a neighbor's right to unobstructed sunlight, leading courts to conclude that a landowner was within his rights to build on his own land even if it interfered with the light reaching a neighbor's land.[46]

2. Doctrine of Ancient Lights.—The English common law doctrine of ancient lights moved away from the basic principles of the *ad coelum* doctrine by providing landowners with the ability to obtain a prescriptive

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41. *Texas Solar Energy*, *supra* note 8; *see also* UTAH CODE ANN. § 57-13-1(3) (LexisNexis 2000) (defining a passive energy system as "a system which uses structural elements of the building, to provide for collection, storage, and distribution of solar energy for heating or cooling").

42. *Texas Solar Energy*, *supra* note 8.

43. *Id.*

44. 2 WILLIAM BLACKSTONE, COMMENTARIES *18; BLACK'S LAW DICTIONARY 42 (9th ed. 2009).

45. BLACK'S LAW DICTIONARY, *supra* note 44, at 42.

46. *See, e.g.*, Bury v. Pope, (1587) 78 Eng. Rep. 375 (Exch.) 375; Cro. Eliz. 118, 118 (holding that a property owner's desire to preserve unobstructed light and air should give way to a neighbor's right to build on adjoining property).

easement for the passage of light and air over an adjoining property.[47] Under the doctrine of ancient lights, where land had historically benefitted from the unhindered flow of light and air, a landowner could enjoin an adjacent property owner from taking action that would interfere with his existing access to light and air.[48] The doctrine thus rejected the notion that a property owner has unfettered rights to the airspace above his land and laid the foundation for the legal recognition of property owners' rights to solar access across neighboring property.

3. U.S. Departure from English Common Law.—Although the doctrine of ancient lights was well established in common law England, American courts were not receptive to the doctrine and quickly repudiated the idea. American court opinions reflected the sentiment that the doctrine of ancient lights would hinder land development in the United States, a new and rapidly growing country that had a significant interest in promoting the growth of cities and the commercial use of land.[49] This sentiment laid the basis for numerous court decisions refusing to recognize an implied easement for light or air.[50] Even early Texas case law reflected the idea that a property owner's right to build is more valuable than his neighbor's desire for unobstructed light and air.[51]

4. U.S. Law Evolves: Solar Access Laws and Judicial Interpretation.—Although courts initially refused to favor solar access rights over neighboring property owners' rights to build, in recent years some court decisions have indicated a trend toward increased recognition of solar access rights under both property law and other legal theories. For example, in *Prah v. Maretti*[52] the Wisconsin Supreme Court recognized an unprecedented private nuisance

47. *See* Prescription Act, 1832, 2 & 3 Will. 4, c. 71, § 3 (Eng.) (codifying the doctrine of ancient lights by establishing a permanent easement for property owners whose uninterrupted access to light has lasted for twenty years).

48. Debbie Leonard & Denise Pasquale, *Legal Tools to Protect Access to Solar and Wind Resources*, NEV. LAW., July 2009, at 14, 15.

49. *See id.* (asserting that the doctrine of ancient lights did not gain traction in the United States because society had a significant interest in encouraging land development).

50. *See, e.g.*, Hefazi v. Stiglitz, 862 A.2d 901, 911–12 (D.C. 2004) (holding that the appellants could not obtain a negative easement by prescription to prevent a homeowner from building a wall that completely obstructed one of the appellant's windows); Fontainebleau Hotel Corp. v. Forty-Five Twenty-Five, Inc., 114 So. 2d 357, 360 (Fla. Dist. Ct. App. 1959) (deciding that the law did not prevent the construction of a fourteen-story addition to a building that would shade the cabana, pool, and sunbathing area of the neighboring luxury hotel).

51. *See Ex parte* Maddox, 58 S.W.2d 516, 518 (Tex. Crim. App. 1932); Klein v. Gehrung, 25 Tex. 232, 243 (Supp. 1860); Harrison v. Langlinais, 312 S.W.2d 286, 288 (Tex. Civ. App.—San Antonio 1958, no writ); Boys Town, Inc. v. Garrett, 283 S.W.2d 416, 421 (Tex. Civ. App.—Waco 1955, writ ref'd n.r.e.); Dallas Land & Loan Co. v. Garrett, 276 S.W. 474, 475 (Tex. Civ. App.—Dallas 1925, no writ); Ft. Worth & Denver City Ry. Co. v. Ayers, 149 S.W. 1068, 1071 (Tex. Civ. App.—Amarillo 1912, no writ) (all holding that the owner of real estate may build on his property regardless of whether it obstructs his neighbor's access to sunlight).

52. 321 N.W.2d 182 (Wis. 1982).

law action for obstruction of sunlight to a solar collector.[53] However, courts have demonstrated reluctance to completely favor solar access rights over all other property rights[54] and have even allowed certain local regulations to trump established state policies that recognize property owners' solar access rights. If a state has an announced policy in favor of solar energy, courts have generally allowed homeowners' association (HOA) regulations to trump the state policy, provided that the regulations are reasonable as written and as applied.[55] Some states' solar access laws have followed suit;[56] others have begun to explicitly recognize property owners' solar access rights over neighboring property owners' rights to build on their land and have curbed state and local entities' abilities to infringe on these rights.[57] Whether judicial interpretations of these statutes will follow states' objectives in enacting the laws to protect private property rights to solar access remains to be seen.

III. A Proposed Solar Access Law for Texas

The preceding discussion demonstrates some of the difficulties property owners have encountered in their attempts to harness solar energy as a result of the lack of legal protection of their solar access rights. While a variety of legal mechanisms have emerged to deal with the current impediments to exercising solar access rights, the best legal course of action for the State of Texas is to enact a law that recognizes and protects the solar access rights of residential property owners. In this Part, I will discuss the goals underlying the proposed solar access law and then detail a solar access statute for Texas to adopt.

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53. *Id.* at 191.

54. *See, e.g.*, O'Neill v. Brown, 609 N.E.2d 835, 839–40 (Ill. App. Ct. 1993) (holding that the Illinois Comprehensive Solar Energy Act of 1977 was not intended to create a new property right in solar access but rather to initiate the development of solar energy use through education, research, and incentive programs).

55. *See, e.g.*, Garden Lakes Cmty. Ass'n v. Madigan, 62 P.3d 983, 988–89 (Ariz. Ct. App. 2003) (holding that a restrictive covenant imposed by an HOA that required committee approval for solar energy devices violated a state law by effectively prohibiting homeowners from installing solar energy devices but noting in dicta that HOAs can reasonably regulate the installation and use of solar energy devices).

56. *See, e.g.*, ARIZ. REV. STAT. ANN. § 33-1816(B) (Supp. 2009) ("An association may adopt reasonable rules regarding the placement of a solar energy device if those rules do not prevent the installation, impair the functioning of the device or restrict its use or adversely affect the cost or efficiency of the device.").

57. *See, e.g.*, VT. STAT. ANN. tit. 27, § 544(a) (Supp. 2009). According to this provision,

> A property owner may not be denied permission to install solar collectors or other energy devices based on renewable resources by any entity granted the power or right in any deed restriction, covenant, or similar binding agreement to approve, forbid, control, or direct alteration of property with respect to residential dwellings.

Id.

A. The Goals Underlying This Proposal

The primary objective of recognizing and protecting Texans' solar access rights through a statutory mechanism is that the absence of a legal framework governing solar access rights will suppress the use of solar energy systems altogether.[58] By orienting its policy to protect the solar access rights of Texas property owners, the state will eliminate many of the legal barriers that currently discourage Texans from installing solar energy systems in their homes and thus promote the increased use of solar energy throughout the entire state. Enacting a solar access law on the state level will ensure that Texans' solar access rights are protected not just by the state but by municipalities and counties as well by allowing for these rights to be advanced through additional local-level initiatives and regulations.[59]

Related to this primary purpose is the ancillary goal of making solar energy use a more feasible option for the State of Texas as a whole. Embedded in the protection of individual property owners' solar access rights is the aim of encouraging the use of small-scale solar energy systems rather than large-scale systems. Enacting a law that encourages residential property owners to utilize solar energy on the small scale is essential in a state that currently lacks the necessary infrastructure for large-scale solar energy systems.[60] There are many barriers to the large-scale utilization of solar energy: it requires large amounts of land to be reserved for collection, it has a high cost of generation, and its intermittent nature makes it difficult to integrate into existing energy infrastructure.[61] Small-scale solar energy systems on individual properties, by contrast, are more cost-effective, more efficient, and more reliable than their large-scale counterparts—in short, small-scale solar energy systems encounter none of the major obstacles that large-scale systems do.[62] At least one Texas company has already raised millions of dollars in venture capital to launch its first product for residential

58. *Cf.* N.M. STAT. ANN. § 47-3-7 (1995) (declaring the protection of solar energy rights to be "necessary to the public interest" because "solar energy may be used in small-scale installations and one of the ways to accomplish such encouragement is by protection of rights necessary for small-scale installations"); Bronin, *supra* note 15, at 1219 (discussing legal scholarship that argues that solar energy systems offer "an environmentally-friendly, inexhaustible, and economically secure alternative to carbon-based fuels" and that the law should therefore "encourage the proliferation of clean energy by providing rights to solar collector owners" so as not to have a "dampening effect" on the use of solar energy systems).

59. *See infra* section III(B)(6).

60. *See* FRONTIER ASSOCS., *supra* note 1, at 3-5 (highlighting the challenges that would be faced by an effort to integrate large-scale solar energy systems into the existing Texas energy infrastructure).

61. *Id.* at xii.

62. *See* Bronin, *supra* note 15, at 1224 (maintaining that individual solar collectors serve numerous end users that large solar installations do not reach, allow individuals to benefit directly from their investment rather than paying high rates for distribution from a large installation, and are more efficient than large installations because they are installed near the end user).

solar installations,[63] suggesting that homeowners would even have a local option for purchasing residential solar energy systems. By instituting a legal regime that recognizes and protects homeowners' solar access rights, the state can count on individuals to take advantage of their newly recognized solar access rights on the individual level instead of waiting for the state to create large-scale systems—making the use of solar energy a reality for Texas rather than a mere utopian aspiration.

B. Content and Structure of the Statute

This Note's proposal for an effective solar access law for Texas consists of six components. These provisions must be taken together in order to most successfully recognize and protect residential property owners' solar access rights.

1. Declare Solar Access a Property Right.—First and most importantly, the Texas law should plainly establish that solar access is a private property right. This language will make known the underlying goal of the law and give meaning to the other provisions of the law that function to further recognize and protect solar access as a private property right. New Mexico and Wyoming both have solar access laws that expressly create a private property right to solar access and serve as models for how the Texas solar access law can do the same.[64]

2. Expansive Definition of Solar Energy System.—The Texas law must define the term *solar energy system* expansively to cover both passive and active solar energy devices. This will reduce the ability of courts to impose a restrictive interpretation of the term if they attempt to hamper the statute's goal of protecting Texans' private property rights to sunlight. Solar access is a necessary component of both passive and active solar energy systems,[65] and the law should reflect its centrality to these systems so as to prevent future judicial encroachment upon this broad right. The Maryland and Oregon solar access laws both provide expansive definitions of a solar energy system that seem to cover passive and active systems but do not explicitly include these terms, leaving room for ambiguity in statutory interpretation.[66] The Texas

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63. Lori Hawkins, *SolarBridge Raises $15 Million*, AUSTIN AMERICAN-STATESMAN, Apr. 27, 2010, at B5.

64. *See* N.M. STAT. ANN. § 47-3-4A (1995) ("The legislature declares that the right to use the natural resource of solar energy is a property right . . . ."); WYO. STAT. ANN. § 34-22-103(a) (2009) ("The beneficial use of solar energy is a property right.").

65. *See supra* subpart II(B).

66. *See* MD. CODE ANN., REAL PROP. § 2-119(a)(3) (LexisNexis 2010) (defining "[s]olar collector system" as "a solar collector or other solar energy device, the primary purpose of which is to provide for the collection, storage, and distribution of solar energy for electricity generation, space heating, space cooling, or water heating"); OR. REV. STAT. § 105.880(3) (2009) (defining "solar energy system" as "any device, structure, mechanism or series of mechanisms which uses solar radiation as a source for heating, cooling or electrical energy").

law must expressly include passive and active systems in its definition of solar energy system in order to prevent statutory ambiguities from limiting the solar access property right that the law has created.

3. Eliminate both Preexisting and Future Restrictions on Property Deeds.—Additionally, the Texas law should dissolve preexisting local covenants, restrictions, or conditions attached to property deeds that restrict the use or installation of solar energy systems and also prohibit these devices from attaching to residential property deeds in the future. The law must both eliminate preexisting restrictions on solar energy access and prevent future impediments to solar energy access in order to orient state policy in favor of recognizing and protecting this access as a private property right. Nevada and Vermont have enacted solar access laws that do both of these things, and their statutes may serve as models for this proposal.[67] Delaware's solar access law, by contrast, offers a prime example of a law that falls short. The law prohibits future covenants or conditions attached to the property deed that restrict the use of solar energy systems but fails to dissolve preexisting restrictions that are attached to the property deed,[68] leaving homeowners whose property deeds are burdened by these types of restrictions without a property right to solar access. Texas must enact a law that disallows both preexisting and future restrictions on residential property deeds in order to protect homeowners not just from future encroachments on their rights to solar access but also from past restrictions on their property rights that could be carried on if not abolished.

4. Restrict Neighboring Property Owners from Obstructing Existing Solar Energy Systems.—The Texas statute should include a provision that prevents neighboring property owners from obstructing existing solar energy systems. This is rooted in the basic property law concept of "first in time,

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67. *See* NEV. REV. STAT. § 111.239(1) (2009). According to the Nevada provision,

> Any covenant, restriction or condition contained in a deed, contract or other legal instrument which affects the transfer or sale of, or any other interest in, real property and which prohibits or unreasonably restricts or has the effect of prohibiting or unreasonably restricting the owner of the property from using a system for obtaining solar energy on his or her property is void and unenforceable.

Id. The Vermont statute similarly incorporates both parts of this Note's proposal. *See* VT. STAT. ANN. tit. 27, § 544(a) (Supp. 2009) ("No deed restrictions, covenants, or similar binding agreements running with the land shall prohibit or have the effect of prohibiting solar collectors . . . from being installed on buildings erected on the lots or parcels covered by the deed restrictions, covenants, or binding agreements.").

68. DEL. CODE ANN. tit. 25, § 318(b) (2009). The provision states,

> No covenant, restriction, or condition contained in a deed, contract or other legal instrument which affects the transfer, sale or any other interest in real property that prohibits or unreasonably restricts the owner of the property from using a roof mounted system for obtaining solar energy on that owner's property shall be allowed in any deed contract or legal instrument recorded after January 1, 2010.

Id.

first in right" and is at the heart of recognizing and protecting homeowners' solar access rights. Imagine if a homeowner was allowed to install a solar energy system on her roof, but two months later her neighbor could plant tall trees that blocked all sunlight to the system during peak hours. A law that does not adequately guard the homeowner's absolute, long-term right to expose her solar energy system to sunlight will discourage her from installing a solar energy system in the first place.[69] New Mexico's solar access law models this proposal: it uses the first-in-time principle to prevent homeowners from constructing new buildings or planting new trees that will block their neighbors' access to sunlight for their solar energy systems.[70]

5. *Curb HOA Power.*—The Texas law must also curb HOAs' ability to prevent homeowners from installing solar energy systems by completely disallowing HOAs from placing any restrictions on homeowners that could jeopardize their property rights to solar access. Even allowing HOAs to impose "reasonable restrictions" on homeowners' installation and use of solar energy systems is too risky. If these allowable restrictions are not defined narrowly, HOAs could use them as a basis to prevent homeowners from exploiting their solar access rights—defeating the purpose of the statutory restriction on HOA power entirely.[71] Allowing HOA restrictions to trump the solar access property rights that the state has already granted its citizens could impede movement toward increased solar energy use. Some might argue that taking away power from the HOA—the most local entity—removes the HOA's power to impose requirements that possibly further solar energy use even more so than the state law purports to do. However, it is much more likely that HOAs will deter renewable energy use and accede to the demands and aesthetic concerns of their other residents. HOA power must therefore be constrained in order to prevent unwarranted encroachment upon homeowners' solar access rights.

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69. *See* Leonard & Pasquale, *supra* note 48, at 16 ("Without long-term commitments to the unrestricted access of . . . solar resources, it would likely be difficult to justify the considerable investment of time and resources required for the development of a renewable energy project.").

70. *See* N.M. STAT. ANN. § 47-3-4B(2) (1995) ("In disputes involving solar rights, priority in time shall have the better right . . . .").

71. For example, Maryland's solar access law states that any covenant, restriction, or condition contained in an HOA's bylaws or rules may not "impose or act to impose unreasonable limitations on the installation of a solar collector system on the roof or exterior walls of improvements." MD. CODE ANN., REAL PROP. § 2-119(b)(1) (LexisNexis 2010). The statute provides that an "unreasonable limitation" includes a limitation that "[s]ignificantly increases the cost of the solar collector system" or "[s]ignificantly decreases the efficiency of the solar collector system." *Id.* § 2-119(b)(2). This law does not go far enough to prevent HOA encroachment on homeowners' solar access rights because it gives HOAs leeway to place restrictions on property use when it is not unreasonable to do so, yet gives broad guidance as to the meaning of "unreasonable," leaving homeowners with the difficult burden of proving that HOA restrictions made their solar energy systems significantly more costly or significantly less efficient. This Note's additional proposal that the Texas solar access law dissolve preexisting and prevent future deed restrictions that could hinder property owners' solar access rights will also keep HOA power in check because it prevents HOAs from hampering property deeds with these types of restrictions. *See supra* section III(B)(3).

6. Require Localities to Protect Solar Access Through Zoning.—The Texas solar access law must also include a provision that requires localities to protect homeowners' solar access rights when designing zoning ordinances and a provision that prohibits localities from passing zoning ordinances that would inhibit the operation of solar energy systems. Zoning is the regulation of property uses; lot size and shape; and building size, shape, placement, and characteristics by a local governmental body that has been chosen to enact, interpret, and apply the zoning ordinance.[72] Zoning is an inherently local activity, but local authorities derive their power to impose zoning controls from enabling statutes enacted by the state government.[73] By including a requirement in the Texas solar access law mandating that local zoning regulations protect homeowners' solar access rights, the legislature will not set particular zoning requirements for the entire state, but instead will promulgate a policy at the state level that encourages zoning that promotes and protects solar access at the local level.[74] This is important to do because zoning alone does not bestow property owners with a true property right to solar access—it must be coupled with a firm, state-wide policy that unequivocally protects homeowners' solar access as a property right.[75]

States have taken varying approaches to protecting solar access rights through zoning. A few states require localities to consider solar access when enacting zoning ordinances.[76] Others explicitly prohibit localities from passing ordinances that would hamper the installation and use of solar energy systems.[77] In this Note, I propose that Texas adopt a law that does both. This is more favorable than the type of law that has been adopted in some states, which merely authorizes, rather than mandates, localities to zone for

72. *See* JOHN G. SPRANKLING, UNDERSTANDING PROPERTY LAW § 36.02 (2d ed. 2007) (explaining that zoning is commonly used to mean all forms of government land-use regulation including the division of communities into geographic districts and the regulation of building characteristics and placement).

73. 4 ANTIEAU ON LOCAL GOVERNMENT LAW § 56.02 (Sandra M. Stevenson ed., 2d ed. 2008).

74. *See* Sara C. Bronin, *The Quiet Revolution Revived: Sustainable Design, Land Use Regulation, and the States*, 93 MINN. L. REV. 231, 266–69 (2008) (calling on states to play a greater role in land-use regulations affecting sustainable development, including solar access issues).

75. *See* Bronin, *supra* note 15, at 1250 (arguing that zoning is one of the least effective property law mechanisms to ensure solar access rights "[b]ecause it does not provide an enduring, secure property right").

76. *See, e.g.*, ARIZ. REV. STAT. ANN. § 9-461.05(C)(1)(d) (2008) (requiring localities to consider "air quality and access to incident solar energy for all general categories of land use"); CONN. GEN. STAT. ANN. § 8-23(c) (West 2010) (requiring that a planning and zoning commission develop a conservation and development plan that takes into account "the use of solar and other renewable forms of energy"); IOWA CODE ANN. §§ 335.5, 414.3 (West 2001) (requiring county and city governments' zoning regulations to "be made in accordance with a comprehensive plan and designed . . . to promote reasonable access to solar energy").

77. *See, e.g.*, NEV. REV. STAT. § 278.0208(1) (2009) ("A governing body shall not adopt an ordinance, regulation or plan or take any other action that prohibits or unreasonably restricts or has the effect of prohibiting or unreasonably restricting the owner of real property from using a system for obtaining solar energy on his or her property.").

solar access.[78] The proposed law ensures that local zoning authorities further the statewide policy of protecting solar access rights while paying attention to local particularities—instead of just protecting homeowners' solar access rights if the locality so chooses. Recognizing solar access rights on the state level is only the first step in establishing goals and priorities for the entire State of Texas, which can then be implemented through zoning as community-level initiatives that account for local particularities.[79]

IV. Why Is the Adoption of a Solar Access Law the Most Desirable Option in the Face of Alternative Legal Methods of Solar Access Rights Allocation?

When combined, the provisions of the proposed solar access law described in subpart III(B) will work together to best establish and protect Texans' property rights to solar access. However, there are a variety of legal alternatives available to enacting the type of solar access law that I propose in this Note. One is to allow express agreements between private parties to allocate solar access rights. There are two types of express agreements between parties that can be used for this purpose: express easements and covenants. Another alternative is to leave solar access rights allocation to the courts. In this Part, I will demonstrate how these alternative legal mechanisms for dealing with solar access rights—express easements, covenants, and court assignments—are inadequate because they all fail to protect solar access rights in a way that will foster solar energy use rather than stifle it.

A. Express Easements

Express easements are one alternative property law mechanism that can be used to allocate solar access rights. Easements allow the owner of the dominant estate—the land that has the benefit of the easement—to have certain rights over the real property of the owner of the servient estate—the

78. *See, e.g.*, COLO. REV. STAT. § 31-23-301(1) (Supp. 2009) (authorizing localities to establish height, setback, and density requirements for the purposes of "energy conservation and the promotion of solar energy utilization"); NEB. REV. STAT. § 66-913 (2009) ("All counties or municipalities having zoning or subdivision jurisdiction are hereby authorized to include considerations for the encouragement of solar energy . . . use and the protection of access to solar energy . . . in all applicable zoning regulations or ordinances and comprehensive development plans."); TENN. CODE ANN. § 13-7-101(a)(1) (Supp. 2009) (allowing counties to consider "[p]rotection and encouragement of access to sunlight for solar energy systems . . . in promulgating zoning regulations"); WASH. REV. CODE ANN. § 36.70.560 (West Supp. 2010) (enabling local planning bodies to enact "[s]pecific regulations and controls pertaining to . . . the encouragement and protection of access to direct sunlight for solar energy systems").

79. *See* Bronin, *supra* note 15, at 1248 ("Because zoning occurs at the local level, zoning officials can enable solar access in a manner that responds to extant topography, vegetation, land uses, density, and building types."); Carleyolsen, *supra* note 14, at 785 ("[I]ncluding solar access rights and solar initiatives in comprehensive plans helps establish community goals that can then be implemented through zoning and other planning legislation.").

land that is burdened by the easement.[80] These rights can be either affirmative rights that give the dominant owner physical access to the servient estate for some purpose or negative rights that encumber the servient owner's use of her property and prevent her from taking certain actions on her land that might harm the owner of the dominant estate.[81] An easement allows the dominant landowner to enforce the rights contained in the easement against the servient owner.[82] Easements run with the land and are permanent and irrevocable, binding subsequent owners of both the dominant and servient estates.[83] Solar access easements are negative easements that can prevent a servient landowner from developing her property in a way that blocks sunlight that would otherwise fall on all or part of the dominant estate.[84] Many states have enacted statutes that allow private parties to voluntarily create express easements for solar access.[85] The statutes themselves do not create solar easements but instead allow for homeowners to create them if they so wish. Because express easements run with the land, most jurisdictions require these solar easements to be in writing and recorded on the property deed in order to provide notice to subsequent landowners.[86]

While proponents of express solar easements applaud their voluntary, private nature between neighboring property owners,[87] these characteristics of express solar easements actually form the basis of their insufficiencies. The voluntariness of express solar easements may actually prevent their widespread adoption as a result of the inability of neighboring property owners to reach mutually agreeable easement terms, the time it takes to negotiate, the high transaction costs of negotiations, and the difficulty of

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80. *See* 1 RESTATEMENT (THIRD) OF PROP.: SERVITUDES § 1.2 (2000) (decreeing that an easement "creates a nonpossessory right to enter and use land in the possession of another and obligates the possessor not to interfere with the uses authorized by the easement").

81. JOHN E. CRIBBET ET AL., PROPERTY 560 (9th ed. 2008).

82. 2 RESTATEMENT (THIRD) OF PROP.: SERVITUDES § 8.1.

83. CRIBBET ET AL., *supra* note 81, at 560. Throughout this Note, I am referring to easements appurtenant rather than easements in gross. An easement appurtenant "benefits its owner in connection with his ownership of neighboring land and is said to be appurtenant to that land," whereas an easement in gross "benefits one without regard for his ownership of any land" and was not recognized in common law England. *Id.*; *see also* 1 RESTATEMENT (THIRD) OF PROP.: SERVITUDES § 1.5 cmt. a–b (distinguishing between easements appurtenant, which run with the land, and easements in gross, which do not).

84. Bronin, *supra* note 15, at 1226; *see also* CRIBBET ET AL., *supra* note 81, at 560 ("An example [of a negative easement] is an easement entitling one to the free flow of light and air from adjoining land, which has the effect of restricting the erection of structures on the burdened land.").

85. *See, e.g.*, ALASKA STAT. § 34.15.145 (2008); CAL. CIV. CODE §§ 801, 801.5 (West 2007); IDAHO CODE ANN. § 55-615 (2007); KAN. STAT. ANN. § 58-3801 (2005); MINN. STAT. ANN. § 500.30 (West 2002); MONT. CODE ANN. § 70-17-301 (2009); N.J. STAT. ANN. § 46:3-25 (West 2003); UTAH CODE ANN. §§ 57-13-1 to -2 (LexisNexis 2000) (all allowing parties to voluntarily enter into solar easement contracts).

86. *See supra* note 85.

87. *See* Melvin M. Eisenstadt, *Access to Solar Energy: The Problem and Its Current Status*, 22 NAT. RESOURCES J. 21, 25 (1982) ("Easements afford the major advantage of providing a simple, private transaction between two parties.").

settling on the amount of money that the dominant landowner must pay the servient landowner.[88] These characteristics of express solar easements can seriously hinder the allocation of solar rights—impeding the use of solar energy rather than supporting it.

B. Covenants

Covenants are another type of express agreement that can allocate solar access rights to landowners. Covenants are similar to express easements in that they include conditions that run with the land, endure indefinitely, and must be recorded on the property deed in order to provide notice of the existence and substance of the covenant.[89] However, unlike express easements that may only be created by the dominant and servient estate owners and are nearly impossible to terminate, the right to enforce and terminate covenants is shared among the owner of a property with an attached covenant, other property owners burdened or benefitted by the same covenant, and subsequent purchasers.[90]

Although covenants may impose restrictions that promote solar access, such as limiting building and tree heights, covenants may also hinder solar access depending on the requirements they impose.[91] For example, developers may create covenants with aesthetic concerns in mind, only to discover later that these restrictions prevent homeowners from installing solar energy systems at all. The inconvenience and expense of litigation to clarify or eliminate the covenant may even cause homeowners to choose not to install a solar energy system altogether.[92] And even when covenants are created that promote rather than limit solar access, they can usually only be applied prospectively.[93] Without retroactive application, this does not do enough to fully protect homeowners' solar access rights.[94] Some states have sought to

88. *See* Adrian J. Bradbrook, *Future Directions in Solar Access Protection*, 19 ENVTL. L. 167, 180–81 (1988) (decrying the trouble and expense of negotiating a solar easement for residential property); Bronin, *supra* note 15, at 1229 (detailing the many transaction costs of express solar easements); Edna Sussman, *Reshaping Municipal and County Laws to Foster Green Building, Energy Efficiency, and Renewable Energy*, 16 N.Y.U. ENVTL. L.J. 1, 33 (2008) (explaining that easements granting solar access rights are "generally the product of a voluntary negotiation, require legal guidance, and may require the payment of some sum to obtain the easement" and suggesting that communities that seriously wish to promote solar energy use should "consider taking a more proactive step to assure that rights equivalent to an easement are obtained where the neighboring property owner refuses to grant the right").

89. *See* CRIBBET ET AL., *supra* note 81, at 617–34 (detailing the elements that are necessary for the creation of a covenant).

90. *See* 2 RESTATEMENT (THIRD) OF PROP.: SERVITUDES §§ 7.1–8.5 (2000); CRIBBET ET AL., *supra* note 81, at 626–34, 662–72 (both explaining how covenants can be enforced or terminated and by whom).

91. Bronin, *supra* note 15, at 1232.

92. *Id.*

93. *See id.* at 1234 ("Covenants are extremely difficult to impose retroactively on parcels in established neighborhoods . . . .").

94. *See supra* section III(B)(3).

mitigate these concerns by adopting laws that provide for the creation of covenants that only protect—not limit—solar access,[95] but these laws do not eliminate the high transaction costs and uncertainty associated with individual bargaining, nor do they provide a guarantee that parties will actually choose to covenant for solar access. Rather than allow for express easements and covenants that do not truly protect homeowners' solar access rights, this Note's proposed statutory scheme completely voids restrictive covenants or conditions in property deeds that limit property owners' solar access.[96]

C. Court Assignments Resulting from Litigation

Another alternative to establishing homeowners' solar access rights through a statutory scheme is to leave the decision whether to recognize solar access as a property right to the Texas courts. Courts can assign solar access rights to property owners through nuisance law, the law of prescriptive easements, or the law of implied easements.[97] However, these options offer little assurance that courts will protect property owners' rights to solar access in the way that this Note's proposed statutory scheme will. Courts across the country have been hostile to the creation of solar access rights through both property law and other legal mechanisms.[98]

Even if courts were receptive to the idea of recognizing solar access rights, there are many characteristics of litigation that make it an unfavorable option for establishing these rights. Litigation involves numerous transaction costs: money, time, and the emotional distress of the adversarial process.[99] Courts in different jurisdictions can apply different types of law to disputes over solar access, increasing the possibility of uncertain outcomes and disparate recognition of solar access rights across the state. Rather than leaving Texans' solar access rights to the costly and unpredictable litigation process, implementing the statute that I propose in this Note will move the entire state—including the legislative and judicial branches—in the direction of recognizing and protecting solar access as a property right.

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95. *See* MASS. GEN. LAWS ANN. ch. 184, § 23C (West 2003) ("Any provision in an instrument relative to the ownership or use of real property which purports to forbid or unreasonably restrict the installation or use of a solar energy system . . . shall be void."); OR. REV. STAT. § 105.880(1) (2009) ("No person conveying or contracting to convey fee title to real property shall include in an instrument for such purpose a provision prohibiting the use of solar energy systems by any person on that property.").

96. *See supra* section III(B)(3).

97. *See* Bronin, *supra* note 15, at 1250–65 (reviewing judicial treatment of solar access rights through nuisance, prescriptive easements, and implied easements).

98. *See supra* subpart II(C).

99. *See* Bronin, *supra* note 15, at 1222 (asserting that of all the methods for assigning solar rights, litigation comes with the highest transaction costs because of the expense and complexity of the litigation process).

V. Conclusion

As Texas Governor Rick Perry recently stated, "[E]nergy is and always will be an essential part of our state's identity and, more importantly, an essential contributor to our state's economic success. That success is dependent upon energy that is not only affordable, but also increasingly clean and renewable."[100] In order to turn this rhetoric into reality, Texas should adopt the solar access law that I have proposed in this Note. By enacting a law that recognizes and protects its citizens' solar access rights, Texas will open the door to an affordable, feasible method of harnessing the state's solar energy potential. If Texas implements this Note's proposed solar access law, the state will empower homeowners to install individual solar energy devices on their houses without the fear of challenges from neighbors, HOAs, local governing bodies, the state legislature, or the courts. By creating an individual property right to solar access and providing homeowners with assurances that this right will be protected, a Texas solar access law is only the first step in a move toward environmental awareness and energy security, which can lead to economic success both for the State of Texas and for the United States as a whole.[101] A solar access law like the one that I have proposed in this Note has the potential to convert Texas from a national leader in carbon emissions to a national pioneer in solar energy use.

—Jamie E. France

100. Rick Perry, Governor, State of Texas, Address Before the Texas Renewable Energy Industries Association (Nov. 9, 2009), http://governor.state.tx.us/news/speech/13951.

101. The Obama Administration recently made a move toward environmental awareness by announcing that it will be installing solar panels on the White House by early 2011. Darius Dixon, *Solar-Powered White House No Longer a 'Kooky' Idea*, N.Y. TIMES, Oct. 6, 2010, http://www.nytimes.com/cwire/2010/10/06/06climatewire-solar-powered-white-house-no-longer-a-kooky-72499.html?scp=6&sq=white %20house % 20solar%20panels&st=cse.

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Filling the "GAAP": Why Generally Accepted Accounting Principles Should Inform U.C.C. Article 9 Decisions*

I. Introduction: The "Perfect Circle of Lack of Responsibility"

In the 1992 comedy blockbuster *White Men Can't Jump*,[1] actors Wesley Snipes and Woody Harrelson are two basketball hustlers who team up to take on other streetball duos in Southern California. Though working together, they are constantly attempting to upstage each other, and their personal differences threaten to break up the successful team. It is only after the two settle their differences and learn to trust each other that they are able to elevate their performance as a team and become better individuals in the process.

Such is the relationship between attorneys and accountants. Though readily acknowledged as being "allied professions,"[2] attorneys and accountants are too often seen as discretely in charge of separate aspects of a transaction.[3] But this should not be the case. Such an attitude contributes to what Professor William Simon describes as a "perfect circle of lack of responsibility."[4] Professor Lawrence Cunningham describes this circle with an anecdote: "A familiar pass-the-buck *pas de deux* in deal meetings and conference calls occurs when the accountant says, after an impasse, 'that's a legal problem' while the lawyer says 'that's an accounting problem.'"[5]

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1. WHITE MEN CAN'T JUMP (20th Century Fox 1992).

2. *See* John C. Coffee, Jr., *Understanding Enron: "It's About the Gatekeepers, Stupid,"* 57 BUS. LAW. 1403, 1417–19 (2002) (opining on how attorneys and accountants can successfully deal with failings within the "allied professions" regarding financial scandals).

3. *See* Steven L. Schwarcz, *Financial Information Failure and Lawyer Responsibility*, 31 J. CORP. L. 1097, 1108 (2006) ("[L]awyers and accountants speak fundamentally different languages. It is as if accountants are from Mars, lawyers from Venus.").

4. *See* Steven L. Schwarcz, *The Limits of Lawyering: Legal Opinions in Structured Finance*, 84 TEXAS L. REV. 1, 21 n.108 (2005) ("Professor William Simon argues for a more fully interdisciplinary regime [between attorneys and accountants] in order to avoid the possibility of a 'perfect circle of lack of responsibility.'" (quoting William H. Simon, Arthur Levitt Professor of Law, Columbia Law Sch., Remarks at the Columbia Law School Symposium: The Limits of Lawyering: Legal Opinions in Structured Finance (Mar. 21, 2005))).

5. Lawrence A. Cunningham, *Sharing Accounting's Burden: Business Lawyers in Enron's Dark Shadows*, 57 BUS. LAW. 1421, 1454 (2002).

There is no better illustration of this circle than the collapse of Enron. One of the most famous scandals in corporate America[6] put the deficient relationship between accountants and attorneys on center stage. Though Enron was guilty of numerous schemes,[7] at the heart of the fraud was the company's legal and accounting treatment of special purpose entities (SPEs).[8] These SPEs were set up as outside companies of Enron in order to house liabilities that could be kept off the company's balance sheet.[9] By keeping large amounts of debt off the balance sheet, Enron was able to fool investors into believing the company was in better financial condition than it was, resulting in higher stock prices.[10] When the fraud was discovered, sorting out liability became a mess.[11]

In keeping with the circle, Enron's attorneys denied any responsibility, pointing the finger at accountants.[12] However, this was not a credible argument because the accounting decision for SPE transactions was based in part on legal opinions issued by attorneys.[13] And what was the legal opinion required? It was a determination that is critical under Article 9 of the Uniform Commercial Code (U.C.C.), which governs secured lending: Did transfers from Enron to these SPEs constitute a "true sale"?[14] This is a critical determination because if these transfers were not true sales, but rather disguised loans, the parties to these transactions would be vulnerable in bankruptcy proceedings absent any proof of a "backup" security interest.[15]

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6. *See* Miriam H. Baer, *Linkage and the Deterrence of Corporate Fraud*, 94 VA. L. REV. 1295, 1313 (2008) (citing Enron's off-balance-sheet transactions as one of the most famous frauds in the last decade).

7. *See* Third Interim Report of Neal Batson, Court-Appointed Examiner at 26–30, *In re* Enron Corp., No. 01-16034 (Bankr. S.D.N.Y. June 30, 2003) [hereinafter Third Batson Report] (describing several of Enron's fraudulent transactions including prepay transactions, a Nigerian barge transaction, a minority interest transaction, and two related-party transactions).

8. *See id.* at 24 (asserting that Enron's corporate officers breached their fiduciary duties by engaging in SPE transactions meant to manipulate financial statements).

9. *See id.* (describing how SPE transactions produced a "false and misleading presentation of the financial condition of Enron").

10. Second Interim Report of Neal Batson, Court-Appointed Examiner at 15, *In re* Enron Corp., No. 01-16034 (Bankr. S.D.N.Y. Jan. 21, 2003).

11. *See* Third Batson Report, *supra* note 7, at 4–5 (describing the basis for liability of corporate officers, accountants, attorneys, and financial institutions in their role within Enron's collapse, yet admitting that each has potential defenses against the strict knowledge requirement).

12. *See* Defendant Vinson & Elkins L.L.P.'s Motion to Dismiss and Memorandum in Support at 3, 15, Newby v. Enron Corp. (*In re* Enron Corp. Sec. Litig.), No. H01-3624 (S.D. Tex. May 8, 2002) (arguing that SPE transactions were "largely a matter of the application of GAAP" and "properly the province of accountants, not lawyers," and that GAAP is "a subject not within the purview of lawyers").

13. First Interim Report of Neal Batson, Court-Appointed Examiner at 38 n.98, *In re* Enron Corp., No. 01-16034 (Bankr. S.D.N.Y. Sept. 21, 2002) [hereinafter First Batson Report].

14. *Id.*; *see also* U.C.C. § 1-203 (2009) (providing the definition of a security interest).

15. *See* First Batson Report, *supra* note 13, at 38 (describing how the characterization of asset transfers to SPEs as "true sales" would give lenders a basis for claiming recovery but otherwise these assets would be "shared generally by the Debtors' unsecured creditors").

Enron's fraudulent transfers provide the perfect example of the connection between the U.C.C. secured lending provisions and Generally Accepted Accounting Principles (GAAP). At any point, either accountants or attorneys could have pulled the plug on these fraudulent transfers simply by adhering to their respective standards. Additionally, the Enron case demonstrates why it is critical that the U.C.C. and GAAP inform each other in complex transactions. As transactions become more complex, there is an increasing overlap of work performed by attorneys and accountants.[16] This complexity often makes attorneys and accountants legally responsible for one another.[17] Certain accounting decisions require a legal opinion before the accountant can move forward.[18] Moreover, some legal decisions first require an accounting decision.[19] As a result, attorneys can be held responsible for misrepresentations within financial statements.[20]

In order to transcend the perfect circle of lack of responsibility, the legal community must attempt to incorporate elements of GAAP into commercial law. In describing this incorporation, this Note proceeds in five parts. Part II describes conceptual issues with incorporating GAAP into U.C.C. provisions. Part III describes the potential practical issues of doing so. Part IV applies these concepts to a real-world headache for Article 9—the characterization of agreements as either leases or security interests. Finally, Part V briefly discusses some broader implications of considering GAAP within Article 9 provisions.

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16. *See* Final Report of Neal Batson, Court-Appointed Examiner at 22, *In re* Enron Corp., No. 01-16034 (Bankr. S.D.N.Y. Nov. 4, 2003) [hereinafter Final Batson Report] (observing that officers, directors, accountants, attorneys, and financial institutions all played a part in the complex SPE transactions of Enron); Schwarcz, *supra* note 3, at 1100 (declaring that the "increasing overlap of law and accounting" has brought about increased liability for attorneys because of responsibility for accountants' work).

17. *See* Schwarcz, *supra* note 3, at 1101 (noting that financial statements are primarily the responsibility of accountants but financial-transaction complexity has "further blurred the boundary between these legal and accounting duties" where these transactions have both legal and accounting consequences).

18. *See* FASB Transfers and Servicing, A.S.C. Section 860-50-25 (establishing that accounting treatment for transfers of assets turns in part on legal conclusions of true sale and nonconsolidation under bankruptcy law).

19. *See* Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, § 307, 116 Stat. 745, 784 (codified at 15 U.S.C. § 7245 (2006)) (stating the requirement that attorneys "report evidence of a material violation of securities law . . . to the chief legal counsel or the chief executive officer of the company"); Damaris Rosich-Schwartz, *Accounting Expertise and Attorney Compliance with the Sarbanes-Oxley Act of 2002*, 24 T.M. COOLEY L. REV. 533, 549–50 (2007) (noting that in order for attorneys to be able to fulfill their duty in reporting material financial misstatements, they must first make a reasonable determination of whether the violation is material).

20. *See* John C. Coffee, Jr., *Gatekeeper Failure and Reform: The Challenge of Fashioning Relevant Reforms*, 84 B.U. L. REV. 301, 338 (2004) (observing a "judicial shift—whether conscious or unconscious—toward imposing greater liability on gatekeepers," including attorneys in financial frauds).

II. Conceptual Issues with Incorporating GAAP into Commercial Law Analysis

A. The Purpose of GAAP: Accuracy in Financial Statements

The main argument against using GAAP to inform commercial law is the perceived difference of purpose.[21] The purpose of GAAP is to increase the accuracy of financial statements.[22] The purpose of Article 9 of the U.C.C. is to provide a system whereby lenders can secure collateral in an effort to recover should the debtor default on payments.[23] Additionally, different parties are served by each profession: accountants owe a professional duty to a third party or to the public at large while attorneys owe a duty to their client.[24] At first blush, it seems that these differences make it difficult, if not impossible, to have GAAP inform commercial law decisions. However, there are at least two reasons why this is not the case.

First, even if commercial law and accounting diverge in their overarching goals, this should not be dispositive in determining whether GAAP can inform commercial law. In fact, given that accounting and law are both critical to economic transactions, it would be helpful to see where their respective purposes diverge in order to more aptly describe how GAAP can fill holes within commercial law. Different purposes do not preclude the two related bodies of rules from interacting and informing each other.[25]

Second, I argue that the two do not have different purposes. The common characterizations of purpose for GAAP and Article 9 are, in reality, limited; they are merely statements of the end product produced by the two sets of standards. At such a limited level, it is easy to see that financial statements and status in bankruptcy are wholly different products. But one must take a step back in order to realize that the two bodies of rules have much in common.

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21. *See* Schwarcz, *supra* note 4, at 26–27 (concluding that the nature of the attorney's work in a transaction includes negotiating a legal opinion with outside parties, in essence an advocacy role, and that an accountant's goal of fair and objective presentation is "fundamentally different from the goals of traditional legal advocacy").

22. *See* Final Batson Report, *supra* note 16, at 25 ("The ultimate goal of GAAP is to set out financial information that is relevant, reliable and useful."); William W. Bratton, *Private Standards, Public Governance: A New Look at the Financial Accounting Standards Board*, 48 B.C. L. REV. 5, 26 (2007) (noting that the Financial Accounting Standards Board (FASB) chose external transparency as the primary goal of accounting theory).

23. *See* Jay Lawrence Westbrook, *The Control of Wealth in Bankruptcy*, 82 TEXAS L. REV. 795, 807 (2004) ("The first purpose of a secured-credit regime is a workable system to permit a debtor to sell a post-default priority in certain collateral to a creditor . . . .").

24. Final Batson Report, *supra* note 16, at 27.

25. *Cf.* Alan Schwartz, *The Continuing Puzzle of Secured Debt*, 37 VAND. L. REV. 1051, 1052–55 (1984) (explaining how the principles underlying the Modigliani–Miller hypothesis—a financial theory of how firm value relates to capital structure—informed an analysis of whether a legal regime favoring secured debt was justified).

From a wider perspective, the purpose of both accounting and commercial law is to correctly characterize the economic substance of transactions for the benefit of third parties to a transaction. From there, the product splits (accountants use economic substance to produce accurate financial statements; commercial attorneys use economic substance to determine which legal rules apply and how), but the underlying principles direct both professions to first determine the economic substance.

These underlying principles are readily found in the standards and accompanying interpretations.[26] Within the U.C.C., provisions such as the lease/security interest characterization directing economic substance to control the distinction[27] and even the general scheme that directs priority of claims based on the type of collateral are clear examples of Article 9's concern for economic substance identification.[28] Article 9 also gives third parties the ability to discover claims on property.[29] This is an important characteristic as it shows that aspects of Article 9 are intended to benefit third parties by providing information.[30] The same is true for GAAP. The main goal of GAAP is to produce reliable information that can be used by investors and creditors.[31] Thus, the two bodies of standards are not at odds in terms of broader goals.

B. The Accountant's Approach: Principles-Based Versus Rules-Based Methods

Other than the potential difference in respective purposes, another argument against using GAAP to inform commercial law focuses on the different approaches employed by accountants and attorneys. One characterization of legal advice is that it must necessarily be more nuanced than accounting advice.[32] This results from the different problems the professions

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26. The development of Article 9's functional approach, defining security rights based on the economic substance of the transaction, is discussed at length in 1 GRANT GILMORE, SECURITY INTERESTS IN PERSONAL PROPERTY 288–332 (1965).

27. U.C.C. § 1-203 cmt. 2 (2009).

28. *See* U.C.C. §§ 9-317, 9-320, 9-324 to -325, 9-327 to -330 (articulating the general priority rule (section 9-317) and the specific priority rules for separate types of collateral, including goods (section 9-320), purchase-money security interests (section 9-324), transferred collateral (section 9-325), deposit accounts (section 9-327), investment property (section 9-328), letters of credit (section 9-329), and chattel papers or instruments (section 9-330)).

29. *See* Charles W. Mooney, Jr., *The Mystery and Myth of "Ostensible Ownership" and Article 9 Filing: A Critique of Proposals to Extend Filing Requirements to Leases*, 39 ALA. L. REV. 683, 747 (1988) ("Thus, one benefit of the Article 9 filing regime is that it provides information to interested third parties who desire to uncover potential claims to the property of a debtor.").

30. *But see* Coffee, *supra* note 2, at 1417 (observing that attorneys design transactions but often do not provide certification to third parties).

31. Final Batson Report, *supra* note 16, at 25.

32. *See* Schwarcz, *supra* note 3, at 1107 ("Legal advice, in contrast [to accounting advice], usually focuses on explaining a nuanced range of likely consequences to clients, who then decide how to evaluate and act on the advice.").

address. Problems within accounting usually call for black-and-white solutions (for example, either cash received from a customer is revenue or it is not).[33] Problems for attorneys involve looking at the same information from multiple angles.[34]

The difference in approaches and their respective characterizations resembles the age-old rules-versus-principles debate. GAAP is often criticized as being a rules-based system.[35] Commercial law has been characterized as being a principles-based system.[36] The difference between the two shares a common theme with the above argument about approaches taken by attorneys and accountants. Principles are fair because of their ability to adapt to the facts of a situation.[37] Rules create more certainty than principles but may produce ridiculous results when blindly adhered to.[38] Rules-based accounting is seen as having contributed most greatly to the financial scandals of the early part of the decade[39] because management was able to obtain a desired result while still meeting the technical requirements of the rules. The variety and flexibility of commercial law interpretation and the resulting need for more nuanced advice suggest that commercial law is more principles based. If accounting decisions truly are black and white, then it would make sense that GAAP has adopted clear-cut answers to address commonly recurring problems.

There are two responses to this argument. First, it is at least arguable that neither system can be characterized as rules based or principles based. In reality, both are a mixture of rules and principles.[40] Within GAAP, there are several rules that are principles based while others are often viewed as quintessentially rules based.[41]

Second, even if the characterizations of GAAP and commercial law are true, this only increases the value GAAP can add to commercial law. In any

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33. *See id.* at 1108 (characterizing legal advice as "rarely black and white," in contrast to accounting advice).

34. *Id.* at 1107–08.

35. *See, e.g.*, Coffee, *supra* note 2, at 1416–17 (arguing that the Enron scandal has exposed GAAP as a rules-based system).

36. *See* A. Michael Sabino & Joseph J. Geraci, *The "True Lease vs. Disguised Security Interest" Question Continues with a Rebel of a Case*, SECURED LENDER, Jan. 2004, at 8, 24 (suggesting that certain provisions within the U.C.C. are "more of a set of guidelines than actual rules").

37. Lawrence A. Cunningham, *A Prescription to Retire the Rhetoric of "Principles-Based Systems" in Corporate Law, Securities Regulation, and Accounting*, 60 VAND. L. REV. 1411, 1423–24 (2007).

38. *Id.*

39. *See id.* at 1412 ("Many attributed the [corporate scandals such as Enron] to weaknesses in the United States accounting system, which they classified as 'rules-based.'").

40. *See id.* at 1413 (asserting that a complex system of standards contains a blend of rules and principles and cannot be characterized as strictly rules based or principles based).

41. *Id.* at 1458–59.

complex legal system, there will be an interaction of principles and rules.[42] This interaction is a necessary and beneficial element in order to avoid extremes.[43] A completely rules-based system would provide certainty but would be perceived as less fair in special circumstances.[44] A principles-based system would allow for more leeway in special circumstances but would lack proper guidance for parties to plan ahead.[45] If the two bodies really do lean in opposite directions, then there are likely some rules within GAAP that may help to provide more certainty to areas of Article 9 governed by principles.

Because accounting is a complex system of regulations,[46] it is more likely that there can be no single characterization of GAAP or how accountants approach problems. However, even if GAAP more often provides rules than principles, this is not dispositive of including guidance from GAAP in future revisions to Article 9. On the contrary, it provides even more support for considering how GAAP can fill potential deficiencies within Article 9 principles.

III. Practical Issues with Incorporating GAAP into Commercial Law Analysis

Despite the above-discussed perceptions of GAAP and Article 9, there is no conceptual antagonism between their respective goals that would make it impossible to believe GAAP could inform Article 9 analysis. But when it comes to applying this gap filling, there may be practical problems that must be sorted through.

A. Control over the Process

Some concerns may arise over institutional control of standard setting. For legislators who enact the U.C.C. into state commercial code, it may be seen as an intrusion on sovereignty to accept accounting standards set by a federal governmental entity.[47] Aside from just territorial concerns of state legislatures, having the FASB dictate accounting guidelines that will be

42. *Id.* at 1431.

43. *See id.* at 1433–34 (positing that specificity of rules is needed to prevent abuse of principles and that flexibility of principles is necessary to keep mechanical rule following from producing absurd results).

44. *Id.*

45. *Id.* at 1433.

46. *See* Neal Newman, *The "Carrot" Approach to Accounting Standard Setting*, 16 U. MIAMI BUS. L. REV. 227, 234 (2008) ("The United States has a complex and layered regime of standard-setters, complex and thorough accounting rules, as well as layers of oversight built into the financial reporting process . . . .").

47. *See, e.g.*, Sean J. Griffith & Myron T. Steele, *On Corporate Law Federalism: Threatening the Thaumatrope*, 61 BUS. LAW. 1, 21–22 (2005) (arguing that the flexibility of state laws may prove preferable to the inflexible federal preemption of corporate law).

incorporated into state commercial codes could run afoul of separation-of-powers principles in the Constitution.[48]

However, these concerns can be easily sidestepped upon realization of two facts. First, the process of creating uniform standards to be incorporated into state commercial codes is already removed from the state legislature. The U.C.C. is a body of standards sponsored by private organizations—the American Law Institute and the National Conference of Commissioners on Uniform State Laws.[49] Yet incorporating uniform standards has been seen as a benefit to state commerce because of its ability to support the free flow of goods.[50] As the earlier conceptual analysis suggests, incorporating uniform accounting rules into the U.C.C. may do much to further the purpose of the U.C.C. and aid in gap filling. Therefore, bringing in GAAP should not be seen as out of the ordinary in terms of the current process of commercial code standard setting.

Second, even in the current process, state legislatures have the ultimate power to determine what is and is not incorporated into state codes. Just as states have chosen not to incorporate certain parts of the U.C.C.,[51] states will have the ability to reject recommendations of incorporating GAAP into commercial standards. This should render moot any federalism concerns and put state legislators' minds at ease that they are not forced to accept outside standards.

Aside from state legislative concerns, there may be additional concerns once GAAP does become a part of interpretation of these standards. The principle question is, whose interpretation will be binding? For U.C.C. matters, courts interpret the commercial code enacted by a legislature in judging disputes.[52] In this regard, courts have had a tremendous impact on the development of U.C.C. provisions.[53] For GAAP, the FASB is in charge of giving any clarifications or interpretations.[54] This realization leads to an

48. *See id.* at 19–20 (arguing that post-Enron federal legislation regulating board decision making and composition constitutes an encroachment into an area where states have traditionally been predominant).

49. Kenneth C. Kettering, *Securitization and Its Discontents: The Dynamics of Financial Product Development*, 29 CARDOZO L. REV. 1553, 1707 n.509 (2008).

50. *See generally* Fred H. Miller, *The Future of Uniform State Legislation in the Private Law Area*, 79 MINN. L. REV. 861, 866–67 (1995) (maintaining that "facilitating interstate economic relations" is one potential benefit of having uniform laws).

51. *See, e.g.*, *In re* APB Online, Inc., 259 B.R. 812, 823 (Bankr. S.D.N.Y. 2001) (noting that the Connecticut legislature has chosen not to update the state commercial code to reflect revisions in the U.C.C. regarding lease characterization).

52. *See* U.C.C. § 1-103 (2009) (urging courts to construe the code liberally "to promote its underlying purposes and policies").

53. *See* Sabino & Geraci, *supra* note 36, at 8 (noting that judges put their own "unique imprimatur" on commercial law issues in spite of uniformity in the Bankruptcy Code and the U.C.C.).

54. *See* Anthony J. Luppino, *Stopping the Enron End-Runs and Other Trick Plays: The Book-Tax Accounting Conformity Defense*, 2003 COLUM. BUS. L. REV. 35, 140 ("[T]he SEC has placed

important question: Will courts have to refer cases to the FASB and ask for interpretations of financial accounting standards?

In all likelihood, the answer to this question is no. Courts will not have to ask for GAAP interpretations from the FASB nor will a court's interpretation of GAAP be binding on the FASB. Part of the reasoning for this conclusion is based in administrative law.[55] We can also simply point to court precedent. Courts have already waded into opinions based on GAAP interpretations.[56] This is possible because (1) in addition to accounting rules, FASB often provides guidance and interpretations that are readily available to courts,[57] and (2) where there are questions of ambiguity in GAAP, courts are fully capable of making an interpretative decision. The next step for the court is to not only make GAAP conclusions, but to incorporate GAAP into legal analysis when deciding commercial law cases.

B. Updating Commercial Law

Another practical concern of incorporating GAAP into commercial law is implementation. There are two aspects to this problem.

First, by what process should GAAP be incorporated? There are many possibilities, all with varying degrees of effectiveness and efficiency. The current process of updating the commercial code is drafting by the sponsors of the U.C.C.[58] Redrafting the U.C.C. would likely be the most effective method because this would be in line with the goal of uniformity of commercial law.[59] However, considering that the U.C.C. is redrafted so

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substantial confidence (and authority) in the accounting profession and, since 1973, in the FASB, to fashion and interpret the GAAP rules that control financial accounting.").

55. The Supreme Court has instituted a highly deferential standard regarding agency interpretations of statutes and their own promulgated regulations. *See* Nat'l Cable & Telecomms. Ass'n v. Brand X Internet Servs., 545 U.S. 967, 980 (2005) ("[A]mbiguities in statutes within an agency's jurisdiction to administer are delegations of authority to the agency to fill the statutory gap in reasonable fashion."). However, a discussion of administrative law is outside the scope of this Note.

56. *See, e.g.*, United States v. Simon, 425 F.2d 796, 805–06 (2d Cir. 1969) (holding that compliance with GAAP could not constitute a complete defense to material misstatements and stating that "the 'critical test' was whether the financial statements as a whole 'fairly presented the financial position of [the Company]'"); E. Coast Equip. Co. v. Comm'r, 222 F.2d 676, 677 (3d Cir. 1955) (noting that the purported buyer treated the transaction like a sale on its books); *In re* PSINet, Inc., 268 B.R. 358, 369 (Bankr. S.D.N.Y. 2001) (considering accounting treatment as a factor in determining whether a true sale took place).

57. *See* Luppino, *supra* note 54, at 133 (describing the FASB's efforts to promulgate accounting standards and promote uniform application of GAAP since the FASB's creation in 1973).

58. *See* Kettering, *supra* note 49, at 1707 n.509 (detailing the addition of "[e]lectronic chattel paper" to Revised Article 9).

59. *See In re* Ecco Drilling Co., 390 B.R. 221, 226 (Bankr. E.D. Tex. 2008) (observing that "changing business practices have led to changes in the statutory guidance [in the U.C.C.] provided to courts").

infrequently,[60] this might be the least efficient method. Because state legislatures ultimately decide what is included within commercial codes, individual state legislatures could act independently to incorporate GAAP. This might be only slightly more efficient, as some states could have more political will than others to move forward with GAAP incorporation; moreover, this would be substantially less effective in achieving uniformity. Courts on their own could begin to give greater weight to GAAP in U.C.C. cases.[61] Courts already include accounting determinations in their analysis,[62] so it would be consistent for courts to simply decide that in certain situations, GAAP determinations will be dispositive or at least have great weight. However, we again run into the problem of minimizing uniformity. Finally, contracting parties can simply write into the contract terms that GAAP determinations will be controlling. Considering that courts do not always honor the intent of parties,[63] it is questionable how effective this would be.

Second, exactly what parts of GAAP should be incorporated? GAAP is a complex regulatory system consisting of layers of opinions and interpretations.[64] GAAP deals with an array of financial matters from subjects as general as when to recognize revenue[65] to subjects as specific as when expected residual value for a specific type of asset must be adjusted.[66] However, though GAAP may be complicated, the FASB has made incorporating sections much easier with the completion of the Accounting Standards Codification project.[67] Now that GAAP is housed under one uniform code, searching for provisions and interpretations is not difficult. This should at

60. HARRY G. KYRIAKODIS, AM. LAW INST., PAST AND PRESENT ALI PROJECTS (2010), http://www.ali.org/doc/past_present_ALIprojects.pdf (listing the twenty-four revisions, amendments, and comments that have been made to the U.C.C. since the initial code was adopted in 1952).

61. *See In re* APB Online, Inc., 259 B.R. 812, 823 (Bankr. S.D.N.Y. 2001) (confirming that some Connecticut courts have applied revised sections of the U.C.C. in resolving disputes where such sections fill gaps in Connecticut law even though the Connecticut legislature has not adopted the revised sections).

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

63. *See* U.C.C. § 1-203 cmt. 2 (2009) (explaining that the four tests used to determine if a transaction results in a lease or a security interest all "focus on economics, not the intent of the parties").

64. *See supra* note 46 and accompanying text.

65. FASB Revenue Recognition, A.S.C. Section 605-10-25.

66. FASB Leases, A.S.C. Section 840-30-35.

67. FASB adopted a new U.S. GAAP hierarchy effective July 1, 2009, pursuant to FASB Statement of Financial Accounting Standards No. 168. *Summary of Statement No. 168*, FIN. ACCOUNTING STANDARDS BD., http://www.fasb.org/cs/ContentServer?c=Pronouncement_C&pagename=FASB%2FPronouncement_C%2FSummaryPage&cid=1176156308679. As the SEC explained in an interpretive release published on Aug. 18, 2009, as amended on Aug. 19, 2009, "[t]he FASB Codification reorganizes existing U.S. accounting and reporting standards issued by the FASB and other related private-sector standard setters, and all guidance contained in the FASB Codification carries an equal level of authority." Guidance Regarding the FASB's Accounting Standards Codification, Securities Act Release No. 9062A, Exchange Act Release No. 60519A, 74 Fed. Reg. 42,772 (Aug. 25, 2009).

least facilitate the task of sifting through GAAP to decide which provisions to incorporate into the U.C.C.

C. *Education*

One final practical concern is how incorporating GAAP into commercial law might affect legal education. Specifically, does incorporating GAAP mean that attorneys must now be trained as accountants, well versed in the language and dogma of GAAP?

As a freestanding question, the answer is admittedly difficult. In order to make accurate judgments of provisions in the law containing GAAP references, it is likely that an attorney will need some level of accounting knowledge. However, this should be addressed as a relative question. In reality, attorneys today should already be familiar with some elements of GAAP.[68] As illustrated by the Enron case, complex transactions already call on attorneys to render judgment on the activities of accountants.[69] Attorneys not capable of doing this are likely not fulfilling duties to their clients.[70]

Because some level of GAAP knowledge is already required of attorneys, the question is not whether legal education should incorporate some measure of accounting but how much more accounting will be required by incorporating GAAP into commercial law. This is a more manageable question. Legal scholars have noted that accounting education in law school has decreased significantly in recent decades.[71] This may be one reason why the U.C.C. today does not incorporate GAAP provisions even though the two bodies of standards, as I have argued, have a common purpose. If the U.C.C. were to incorporate elements of GAAP, this would further the case that legal education should include more accounting knowledge. If the addition of GAAP to commercial law would strengthen our field's understanding of transactions, then the addition to legal education would be beneficial.

IV. Incorporation in Action: Lease/Security Interest Characterization

At this point I have explained why, both conceptually and practically, GAAP can be incorporated into commercial law. In neither case is GAAP incompatible to a degree that makes incorporation impossible. However, it

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68. *See* Rosich-Schwartz, *supra* note 19, at 552–53 (explaining that an attorney must determine whether revenue recognition is in compliance with GAAP before he can determine whether a change in accounts receivable on a Form 10-Q constitutes a material misrepresentation as required by Sarbanes-Oxley).

69. *See supra* notes 18–20 and accompanying text.

70. *See* Rosich-Schwartz, *supra* note 19, at 538 (arguing that without any accounting expertise or understanding of a client's financials, a corporate attorney is not competent and will not be able to determine if a material violation of securities law has occurred).

71. *See* Cunningham, *supra* note 5, at 1439–41 (citing a study confirming that accounting teaching in law schools has declined since 1975 and offering the rise in modern finance theory as an explanation).

would be helpful to the analysis to provide a practical example of how GAAP can assist attorneys in making important commercial law determinations.

I am examining the lease/security interest characterization question because it is one of the most litigated issues in commercial law.[72] As such, it is a question that is in need of some assistance in resolving. Additionally, lease accounting has been criticized as one of the weakest areas of GAAP.[73] Thus, if GAAP can offer some assistance to the U.C.C. in this area, *a fortiori*, it should be able to assist in other U.C.C. provisions.

A. U.C.C. Rules for Lease Characterization: All over the Map

The lease/security interest characterization provisions of the U.C.C. become an especially important issue in bankruptcy proceedings.[74] If a transaction constitutes a lease, then the lessor can have past defaults cured and will either receive the property back or continue to get rent payments depending on whether the debtor's estate chooses to continue the lease.[75] If a transaction is characterized as a financing, then the lessor is only entitled to the same rights as other lenders under the Bankruptcy Code, which are often less advantageous.[76]

Bankruptcy courts have consistently held that state law will determine whether an agreement is a lease or a financing.[77] The U.C.C. provisions are

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72. *See In re* Grubbs Constr. Co., 319 B.R. 698, 709–10 (Bankr. M.D. Fla. 2005) (describing the lease/security interest characterization as a "vexatious and oft-litigated" issue under the U.C.C.); Steven C. Strong, Presentation at American Bankruptcy Institute's Rocky Mountain Bankruptcy Conference: Selected Issues Under Bankruptcy Code § 365 (Jan. 22, 2009), *available at* http://www.abiworld.org/committees/newsletters/busreorg/vol8num1/Branding_the_Cattle.pdf (calling the lease/security interest characterization one of the most litigated issues under Section 365 of the Bankruptcy Code).

73. *See* Cheri L. Reither, *What Are the Best and the Worst Accounting Standards?*, ACCT. HORIZONS, Sept. 1998, at 283, 284–85 tbl.1 (indicating that a survey completed by academics, standard setters, regulators, public accountants, and financial analysts revealed that accounting for leases was voted the worst accounting standard).

74. *See* Tracy L. Treger & Mark F. Hebbeln, *Is 'Lease' a Financing Agreement in Disguise?*, J. CORP. RENEWAL, July 2004, at 1, 2 (noting that whether a transaction is a true lease "rarely comes into play outside of a bankruptcy proceeding").

75. Thomas C. Homburger & Karl L. Marschel, *Recharacterization Revisited: A View of Recharacterization of Sale and Leaseback Transactions in Bankruptcy After Fifteen Years*, 41 REAL PROP. PROB. & TR. J. 123, 134 (2006).

76. *Id.*

77. *See In re* Ecco Drilling Co., 390 B.R. 221, 226 (Bankr. E.D. Tex. 2008) (observing that whether a lease constitutes a security interest under the Bankruptcy Code depends on state law); WorldCom, Inc. v. Gen. Elec. Global Asset Mgmt. Servs. (*In re* WorldCom, Inc.), 339 B.R. 56, 63 (Bankr. S.D.N.Y. 2006) ("[S]tate commercial law determines whether a contractual agreement is to be characterized as either a lease or security arrangement."); Ford Motor Credit Co. v. Hoskins (*In re* Hoskins), 266 B.R. 154, 157 (Bankr. W.D. Mo. 2001) (noting that courts must look to state law to determine property rights).

included in Section 1-203.[78] U.C.C. Section 1-203(a) provides that "[w]hether a transaction in the form of a lease creates a lease or security interest is determined by the facts of each case."[79] However, despite this assertion, U.C.C. Section 1-203(b) then provides a "bright-line test"[80] for making an initial determination whether a transaction is in fact a security interest:

> A transaction in the form of a lease creates a security interest if the consideration that the lessee is to pay the lessor for the right to possession and use of the goods is an obligation for the term of the lease and is not subject to termination by the lessee, and (1) the original term of the lease is equal to or greater than the remaining economic life of the goods; (2) the lessee is bound to renew the lease for the remaining economic life of the goods or is bound to become the owner of the goods; (3) the lessee has an option to renew the lease for the remaining economic life of the goods for no additional consideration or for nominal additional consideration upon compliance with the lease agreement; or (4) the lessee has an option to become the owner of the goods for no additional consideration or for nominal additional consideration upon compliance with the lease agreement.[81]

In reality, this bright-line test gives the courts little guidance.[82] Though the first two elements provide clear rules, the court more often finds itself analyzing whether additional consideration is nominal.[83] The court must then rely on U.C.C. Section 1-203(d), which states,

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78. Note that this section refers to the most recent amendments of the U.C.C., which have been incorporated by most states. However, some states continue to use older versions of the U.C.C. provisions. *See In re* APB Online, Inc., 259 B.R. 812, 817 (Bankr. S.D.N.Y. 2001) ("There are at least three versions of [the older provision] in effect throughout the nation."). For the most part, these older provisions are still consistent with the substance of the amendments, but some states continue to use the former intent-of-the-parties test. *See id.* (noting that Connecticut continues to use the 1972 version, which directs the court to determine the intent of the parties).

79. U.C.C. § 1-203(a) (2009).

80. *See In re Ecco Drilling*, 390 B.R. at 227; *WorldCom*, 339 B.R. at 65 (both referring to U.C.C. Section 1-201(37) (1987) as a "bright-line test").

81. U.C.C. § 1-203(b).

82. *See WorldCom*, 339 B.R. at 64 ("Though the concepts expressed in [Section] 1-201(37) are rather easily defined, the means to distinguish between [leases and financing agreements] in a rigorous manner has often eluded the courts."); David A. Hatch & Mark G. Douglas, *When Is a Lease Not a Lease? Seventh Circuit Adopts "Substance Over" Form Test for True Lease Determination*, JONES DAY (Jan.–Feb. 2006), http://www.jonesday.com/newsknowledge/publicationdetail.aspx?publication=3122 (arguing that the Bankruptcy Code does not provide adequate guidance for determining whether a transaction is a security interest in sold assets or a lease).

83. *See In re Ecco Drilling*, 390 B.R. at 228 (finding that the only dispute under the bright-line test was whether the purchase options could be considered nominal); *In re APB Online*, 259 B.R. at 818 (noting that only the question of nominality matters in the dispute).

> Additional consideration is nominal if it is less than the lessee's reasonably predictable cost of performing under the lease agreement if the option is not exercised. Additional consideration is not nominal if: (1) when the option to renew the lease is granted to the lessee, the rent is stated to be the fair market rent for the use of the goods for the term of the renewal determined at the time the option is to be performed; or (2) when the option to become the owner of the goods is granted to the lessee, the price is stated to be the fair market value of the goods determined at the time the option is to be performed.[84]

Courts have found that this definition of nominal consideration has not been helpful.[85]

If the bright-line test is not met (and courts often cannot make a determination using the bright-line test[86]), then courts return to the catchall provision of U.C.C. Section 1-203(a) and must consider the specific facts of the case.[87] At this point, there is a massive divergence of opinion about which factors determine whether an agreement is a lease or a security interest. Under the old version of the test, the U.C.C. specifically asked courts to determine the intent of the parties based on the facts of the case.[88] Under the new version, there is no such explicit direction as to what should be the driving determination when considering the facts of the case.[89] The only guidance the U.C.C. provides is that the economic substance of the agreement should control the decision, rather than the intent of the parties.[90]

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84. U.C.C. § 1-203(d). According to U.C.C. § 1-203(e), "[t]he 'remaining economic life of the goods' and 'reasonably predictable' . . . fair market value . . . must be determined with reference to the facts and circumstances at the time the transaction is entered into."

85. *See In re Ecco Drilling*, 390 B.R. at 228–29 (criticizing the nominality test in the U.C.C. as offering little assistance when circumstances are not extreme and declaring that as a result the court must revert to common law tests); *WorldCom*, 339 B.R. at 66 n.8 ("There is a certain lack of conceptual clarity evident in the case law concerning the various tests courts apply to determine nominality.").

86. *See WorldCom*, 339 B.R. at 70 (holding that a determination based on the bright-line test could not be made); *In re APB Online*, 259 B.R. at 824 (holding that the court could not conclude whether an agreement constituted a lease or a security interest).

87. *See* Mason v. Heller Fin. Leasing (*In re* JII Liquidating, Inc.), 341 B.R. 256, 268 (Bankr. N.D. Ill. 2006) (noting that if the bright-line test is not satisfied, the court must continue to analyze the facts of the case); *WorldCom*, 339 B.R. at 65 (stating that the "second test" following the bright-line test is to examine the facts of the case to determine whether a security interest was created); Ford Motor Credit Co. v. Hoskins (*In re* Hoskins), 266 B.R. 154, 161 (Bankr. W.D. Mo. 2001) (declaring that the court's analysis continues to the catchall test if the bright-line test is not met).

88. *See In re Ecco Drilling*, 390 B.R. at 226 (recognizing that under revised Section 1-201(37) "the intention of the parties has been abandoned as a proper tool by which to distinguish a true lease from a disguised security interest").

89. *See WorldCom*, 339 B.R. at 71 ("[T]he statute does not provide any standards for determining which facts are relevant or how relevant facts should be weighed in the final determination.").

90. *See* U.C.C. § 1-203 cmt. 2 (2009) (noting that a reference to the intent of the parties led to unintended results and explaining that the new framework for the lease/security interest characterization focuses on economics and the facts of each case).

The four factors direct the court to determine whether the lessor has retained any "residual value."[91] Though courts and commentators have mostly followed this indication,[92] there is no such explicit direction included in the U.C.C. The U.C.C. has provided a list of factors that *do not* necessarily cause a lease to be characterized as a security interest, but there is no "smoking gun" as to when a lease is in fact a security interest. Furthermore, there is no fundamental difference between the old test and the new.[93] If the drafters of the U.C.C. had hoped to provide guidance to reduce confusion about the lease/security interest distinction,[94] the revisions have not been successful.

Because courts are left to fashion tests more or less on their own,[95] court opinions have considered a wide variety of factors. Some courts have focused exclusively on whether any reasonable economic actor would exercise a lease option making it clear that the parties never intended for equipment to return to the lessor.[96] Some of these courts have looked to whether it was

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91. *See* Duke Energy Royal, L.L.C. v. Pillowtex Corp. (*In re* Pillowtex, Inc.), 349 F.3d 711, 718 (3d Cir. 2003); *In re Ecco Drilling*, 390 B.R. at 227 n.32; *WorldCom*, 339 B.R. at 65 (all referring to the four U.C.C. factors as "residual value factors").

92. *See In re Ecco Drilling*, 390 B.R. at 227 (observing that in a lease agreement the lessor gives up the right to possess the item but retains the right to residual value after the lease termination); *WorldCom*, 339 B.R. at 71 ("The majority of courts and commentators have agreed that the principle inquiry is 'whether the lessor has retained a *meaningful reversionary interest* in the goods.'" (quoting Addison v. Burnett, 49 Cal. Rptr. 2d 132, 136–37 (1996))); Mooney, *supra* note 29, at 691 ("The essence of a true lease is the existence . . . of a meaningful residual interest for the lessor at the expiration of the lease term."); Strong, *supra* note 72, at 12 (concluding that U.C.C. Section 1-203(b) focuses on whether the lessor has retained a meaningful economic interest in the leased property).

93. In *Ecco Drilling*, the court noted two key findings. First, because nominal consideration guidance is inadequate in the U.C.C., the court must revert to common law tests to determine nominality. *In re Ecco Drilling*, 390 B.R. at 229. Second, because nominality is a consideration in the catchall facts-and-circumstances test, there is no difference whether a decision is reached as a result of the bright-line test or the catchall test. *Id.* at 229 n.38. Therefore, one can conclude that the catchall facts-and-circumstances test dominates the court's analysis and relies on old common law tests. *See* Ford Motor Credit Co. v. Hoskins (*In re* Hoskins), 266 B.R. 154, 161 (Bankr. W.D. Mo. 2001) (noting that the factors relied upon by courts prior to the U.C.C. amendments are still relevant if the bright-line test is not met).

94. *See* Mason v. Heller Fin. Leasing (*In re* JII Liquidating, Inc.), 341 B.R. 256, 267 (Bankr. N.D. Ill. 2006) (highlighting that the U.C.C. revisions were intended to resolve an issue that "has created considerable confusion in the courts"); *WorldCom*, 339 B.R. at 64 (stating that the revised U.C.C. test "attempts to provide a more rigorous statutory standard to guide the courts in their analysis of the security interest question").

95. *See WorldCom*, 339 B.R. at 71 ("[C]ourts have been forced to fashion judicial standards and tests to analyze 'the facts of the case.'"); Homburger & Marschel, *supra* note 75, at 154–55 (observing that courts are split as to whether sale and leaseback transactions should be characterized as leases or loans and that this split is a result of varying opinions regarding the courts' freedom to examine economic substance).

96. *See Hoskins*, 266 B.R. at 162 (holding that the "pivotal factor" in characterization is whether an agreement contains an "absolute obligation" to purchase the equipment).

reasonable going into the agreement to expect this.[97] Others have looked to facts and conditions at the end of the agreement period.[98] Some courts have created an absolute standard as to what amount is considered nominal.[99] Other courts have gone even further in rejecting direct guidance from the U.C.C.[100] Still, some courts have looked to lease characterization in tax courts,[101] while others have not.[102] This variety of considerations has resulted in continued confusion for parties entering a lease agreement as litigation is almost made necessary.[103]

B. Incorporating GAAP

Lease accounting rules have been described as one of the weakest parts of GAAP.[104] Yet criticism is focused on the characterization that lease accounting rules are too formal.[105] As discussed in the principles-versus-

97. *See In re Ecco Drilling*, 390 B.R. at 230 (holding that the court must account for the parties' expectations of concluding value and not consider the actual value at the end of the lease term).

98. *See In re* Beam, No. 97-82752, 1998 WL 34065623, at *7 (Bankr. C.D. Ill. July 31, 1998) (holding that the "measuring rod" for determining whether an option price is nominal is the value of the leased property at the end of the agreements); *In re* Lerch, 147 B.R. 455, 458 (Bankr. C.D. Ill. 1992) ("The most significant factor in distinguishing the conditional sale masquerading as a lease and a true lease is the relationship of the option price to the value of the goods at the end of the lease term." (quoting *In re* Access Equip., Inc., 62 B.R. 642, 646 (Bankr. D. Mass. 1986))). Note that this is in direct contrast to guidance provided by the U.C.C. Yet because guidance is lacking, courts still continue to use factors they independently feel are important.

99. *See In re* Metrobility Optical Sys., Inc., 279 B.R. 35, 36–37 (Bankr. D.N.H. 2002) (holding that the nominality test is automatically satisfied when the option price is $1).

100. *See In re* Grubbs Constr. Co., 319 B.R. 698, 711 (Bankr. M.D. Fla. 2005) (commenting that some courts believe that the U.C.C. revisions were not intended to change the substantive law even though comments within the U.C.C. provide that the purpose of the revision was to shift the focus to "economic realities").

101. *See* United Air Lines, Inc. v. HSC Bank USA (*In re* UAL Corp.), 307 B.R. 618, 631 (Bankr. N.D. Ill. 2004) ("[C]onsistent with the legal standards developed under the UCC and federal tax law, a 'lease' under [Section] 365 of the Bankruptcy Code requires that the lessor retain significant 'risk and benefits as to the value of the . . . real estate at the termination of the lease.'"); Burke Investors v. Nite Lite Inns (*In re* Nite Lite Inns), 13 B.R. 900, 907 (Bankr. S.D. Cal. 1981) ("The [c]ourt will also place substantial reliance . . . on the approaches taken by the federal courts in tax cases.").

102. *See In re* PWS Holding Corp., 228 F.3d 224, 247 (3d Cir. 2000) ("[J]ust because a transaction is a sale or exchange for tax purposes does not mean that it is a sale within the meaning of the [Bankruptcy] Code.").

103. *See* WorldCom, Inc. v. Gen. Elec. Global Asset Mgmt. Servs. (*In re* WorldCom, Inc.), 339 B.R. 56, 74–75 (Bankr. S.D.N.Y. 2006) (holding that despite the fact that equipment could not physically be returned to the lessor because it was unidentifiable, the court was unable to conclude whether a lease or security interest had been created); *In re* APB Online, Inc., 259 B.R. 812, 824 (Bankr. S.D.N.Y. 2001) (holding that whether the agreement was a true lease was a question that could not be answered in summary judgment).

104. *See* Reither, *supra* note 73, at 283–85 tbl.1 (reporting the results of a survey of seventy-five professionals—academics, FASB standard setters, regulators, accountants, and financial analysts—and stating that the standard for accounting for leases is the overall worst standard).

105. *See id.* at 288 (listing, for example, the abuses resulting from the bright-line rule for lease capitalization as a reason for the standard's low marks).

rules analysis of Part II, it may be that this "weakness" is just what lease rules within the U.C.C. need in order to give stronger guidance to frustrated courts.[106]

The concern for distinguishing a lease from a financing is similar under lease accounting rules. Whereas for the U.C.C. the concern is treatment of the property in bankruptcy proceedings, under GAAP the concern is presentation within the financial statements. If an agreement is a lease, then the financial statements may reflect lease costs as operating costs and do not have to show the lease obligations as a liability on the balance sheet.[107] If an agreement is truly a sale or a financing, then the financial statements must reflect the property as a capital investment and show the obligations as a liability on the balance sheet.[108] This is an important distinction in accounting because the amount of debt on a balance sheet affects capital ratios, which in turn could affect credit ratings and the ability to obtain financing.[109] Though the end products produced by GAAP and the U.C.C. might be different, the purpose is the same: the economic substance of the agreement will determine how it is characterized under the standards.[110]

Lease accounting rules provide a four-part test to determine whether a lease is actually a sale and therefore capital. A.S.C. Section 840-10-25-1 of FASB Leases provides the following:

> a. Transfer of ownership. The lease transfers ownership of the property to the lessee by the end of the lease term. This criterion is met in situations in which the lease agreement provides for the transfer of title at or shortly after the end of the lease term in exchange for the payment of a nominal fee, for example, the minimum required by statutory regulation to transfer title.
>
> b. Bargain purchase option. The lease contains a bargain purchase option.
>
> c. Lease term. The lease term is equal to 75 percent or more of the estimated economic life of the leased property . . . .
>
> d. Minimum lease payments. The present value at the beginning of the lease term of the minimum lease payment . . . equals or exceeds

106. *See In re* Ecco Drilling Co., 390 B.R. 221, 230 n.42 (Bankr. E.D. Tex. 2008) (noting that "everyone in the transaction treated [the agreement] as a capital lease for accounting purposes" and that this accounting treatment conformed with the economic reality of the transaction); Mason v. Heller Fin. Leasing (*In re* JII Liquidating, Inc.), 341 B.R. 256, 271 (Bankr. N.D. Ill. 2006) ("*Unfortunately*, no 'bright line' test exists for determining whether consideration is nominal." (emphasis added)).

107. FASB Leases, A.S.C. Subtopic 840-20.

108. FASB Leases, A.S.C. Paragraph 840-30-50-4.

109. Newman, *supra* note 46, at 242.

110. *See* Laurel A. Franzen et al., Capital Structure and the Changing Role of Off-Balance-Sheet Lease Financing 4 (Aug. 14, 2009) (unpublished manuscript), *available at* http://www.frbatlanta.org/filelegacydocs/seminars/seminar_simin_101609.pdf ("The capital lease is a financing vehicle for the purchase of an operational asset and is essentially secured debt.").

> 90 percent of the excess of the fair value of the leased property to the lessor at lease inception . . . .[111]

A comparison of GAAP and the U.C.C. shows that there are many similarities. The focus for both tests is on economic substance and not form.[112] Both pinpoint that the lease term and the presence of lease options will be primary indicators of where residual value lies.

However, there are key differences between the rules. Under the U.C.C., the fact that the present value of payments is greater than the cost of the equipment is not dispositive of the existence of a lease. Under GAAP, the 90% test mandates that the present value of payments be less than 90% of the cost of the equipment. The U.C.C. provision was a recent amendment and was meant to overrule decisions of some courts in determining lease characterization.[113] The reasoning behind this was to allow the calculation of interest to be a larger factor within lease payments.[114] But GAAP guidelines are much more intent on providing clear guidance and so have drawn the 90% as a clear, bright-line determination. Additionally, it is difficult to imagine lease payments totaling more than the cost of the equipment while the lease term is not equivalent to the economic life of the equipment. If the lease term is less than the economic life of the equipment, yet lease payments are still greater than the equipment's cost, it is hard to imagine that the interest calculated into the payments is not borderline usury.[115] GAAP is able to defend its 90% test because of another key difference, the requirement that the lease term cannot exceed 75% of the economic life of the equipment.

One main argument against incorporating GAAP mirrors the rules-versus-principles argument. Perhaps the U.C.C. drafters intended for the lease characterization test to be principle driven and for courts to have wide

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111. FASB Leases, A.S.C. Paragraph 840-10-25-1.

112. *See* United Airlines, Inc. v. HSBC Bank USA, 416 F.3d 609, 612 (7th Cir. 2005) ("Although the statute does not answer [whether substance or form of a transaction distinguishes a true lease] . . . , every appellate court that has considered the issue holds . . . that substance controls . . . ." (citations omitted)); Newman, *supra* note 46, at 243 ("The aim of [lease accounting rules] is to have . . . economic reality reflected in the accounting treatment for that transaction.").

113. *See* WorldCom, Inc. v. Gen. Elec. Global Asset Mgmt. Servs. (*In re* WorldCom, Inc.), 339 B.R. 56, 64 n.4 (Bankr. S.D.N.Y. 2006) (explaining that the U.C.C. test incorporates several standards that were developed by courts under the previous provision and observing that the test also "clearly rejects" other standards). *But see In re* Ecco Drilling Co., 390 B.R. 221, 232 n.50 (Bankr. E.D. Tex. 2008) (suggesting that the agreement's requirement to make payments that were greater than the purchase price of the equipment further supported the determination that the agreement was not a true lease).

114. *See* Raymond T. Nimmer, U.C.C. Article 2A: The New Face of Leasing?, Address at the DePaul Business and Commercial Law Journal Symposium: Out with the Old, in with the New? Articles 2 and 2A of the Uniform Commercial Code (Apr. 7, 2005), *in* 3 DEPAUL BUS. & COM. L.J. 559, 566 (2005) (reasoning that the theory behind allowing higher present-value payments than the cost of the equipment is to allow lessees to "make a bad deal" and still be subjected to full payment).

115. *See id.* (explaining that under the U.C.C. a transaction can still be a lease even if full payment of the lease is more than the present value of the good).

discretion. There are two responses. First, given the revisions that were made, this does not seem to be the likely intent of the drafters.[116] It is doubtful that the U.C.C., with the goal of creating uniformity in commercial law, would allow courts to develop independent tests. A second question is whether the adoption of bright-line rules is warranted.[117] The answer depends on policy considerations. One key policy concern is the desire to reduce litigation. Under the current U.C.C. test, litigation is often necessary even when all the facts and circumstances are known.[118] The current test does not alleviate this confusion among courts. Another key policy consideration is whether parties in a lease agreement would be able to more readily abuse the U.C.C. guidelines. A common complaint against lease accounting standards is that they lend themselves to abuse by company management.[119] Would the same be true for parties if the U.C.C. was to incorporate GAAP into lease-distinction guidance? The answer to this is complicated. It is likely that some degree of abuse is ongoing even under the current U.C.C. provisions. Determining whether increased abuse would occur would likely need empirical evidence that is currently unavailable. One policy argument that can be made is that there is nothing inherently wrong with "creative compliance."[120] Parties to a transaction are allowed to set up the agreement in a way that is most advantageous to them. If they attempt to favor a certain legal conclusion, as long as they are not disingenuous about the economic substance or deliberately colluding in fraud, parties should be allowed to contract as they wish.[121] From this perspective, nothing should be seen as fundamentally wrong with making lease transactions more clear for the parties. Should they desire to enter into these kinds of agreements, the fact that there is more legal certainty is beneficial because it facilitates transactions.

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116. *Compare* U.C.C. § 1-201(37) (1972) (leaning heavily on the parties' intent to determine whether a transaction creates a security interest), *with* U.C.C. § 1-203(b) (2009) (specifying in detail circumstances when a lease creates a security interest).

117. *See* Cunningham, *supra* note 37, at 1470 (arguing that the choice between principles- and rules-based standards is a "false dichotomy" and that the real issue is which type of standard is better for a given situation).

118. *See supra* note 103 and accompanying text.

119. *See* Reither, *supra* note 73, at 288 (describing a survey of accounting experts who, considering prolific abuse, named accounting for leases the worst accounting standard).

120. *See* Cunningham, *supra* note 37, at 1478 ("To an extent, creative compliance is unobjectionable, as when structuring a business combination to avoid triggering shareholder voting or appraisal rights, or designing a lease to obtain capital treatment."). *But see generally* Victor Fleischer, *Regulatory Arbitrage*, 89 TEXAS L. REV. (forthcoming Dec. 2010) (providing a comprehensive theory of regulatory arbitrage and positing that parties who take advantage of gaps between the economics of a deal and its regulatory treatment contribute to distortions in regulatory competition and an overall lack of transparency and accountability).

121. *See* Cunningham, *supra* note 37, at 1478 (explaining that if a company is too aggressive with creative compliance, it can lead to unlawful results).

V. Future Implications

I have now laid out arguments as to why GAAP should be incorporated into commercial law. Despite opinions to the contrary, there are no conceptual or practical concerns that are so difficult to overcome that incorporating GAAP into commercial law is impossible. As demonstrated in the leasing example, elements of GAAP can help commercial law become clearer for parties engaging in transactions. Additionally, the merging of law and accounting in complex transactions means that attorneys must be more knowledgeable of accounting rules. Incorporating GAAP into commercial law creates more of an incentive for attorneys to stay abreast of this critical aspect of their client duties.

Looking forward, using GAAP to supplement commercial law could have even greater implications for commercial transactions. The FASB is currently undertaking a project along with the International Accounting Standards Board (IASB) to change accounting rules and require that all leases be characterized as capital leases.[122] This change is rooted in the belief that there is no way around the fact that leasing creates a long-term obligation that fits the definition of a liability.[123] As a result, the FASB is shifting towards viewing all lease agreements as financing arrangements. This shift of the FASB towards treating all leases as capital leases could provide a concrete justification for requiring all lease agreements to be accompanied by the filing of a financing statement. Though this topic is outside the scope of this Note, should commercial law take GAAP seriously, this Note would provide a basis for arguing for the elimination of the lease/security interest distinction under the U.C.C.

—Omar Ochoa

122. *See generally* Fin. Accounting Standards Bd., *Leases: Preliminary Views* (Financial Accounting Series, Discussion Paper No. 1680-100, 2009) (presenting the FASB and IASB's view on the current accounting model for lessees and proposing possible fixes).

123. *See id.* ¶ 3.26 ("The boards tentatively decided to develop a new approach to accounting for leases that would result in the recognition of the assets and liabilities identified as arising in a lease contract.").

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