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THE DIGEST

The Law Journal of the National Italian American Bar Association

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2006-2007 EDITORIAL BOARD

THE DIGEST

Two-Thousand and Seven

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Published annually by the members of the NATIONAL ITALIAN-AMERICAN BAR ASSOCIATION, Washington, D.C. Editorial Office: NIABA, 2020 Pennsylvania Avenue N.W., Suite 932, Washington, D.C. 20006. Publication Office: Joe Christensen, Inc., P.O. Box 81269, 1450 Adams St., Lincoln, NE 68501.

Single issue volumes are available through the Editorial Office at a price of $25.00. Rates for bulk copies quoted on request.

POSTMASTER: Send change of address and new subscriptions to THE DIGEST, National Italian-American Bar Association, 2020 Pennsylvania Avenue N.W., Suite 932, Washington, D.C. 20006, at least 45 days before the date of the issues with which it is to take effect. Duplicate copies will not be sent without charge.

Justice Scalia's Theory of Constitutional Interpretation: Another Form of Pragmatism?

ELTON T. FUKUMOTO*

INTRODUCTION

In various jurisprudential essays, Justice Antonin Scalia has called his philosophy of constitutional interpretation "originalism"[1] or "textualism."[2] But what is the name of the opposing view? Scalia has referred to it as "nonoriginalism"[3] and "evolutionism."[4] Yet another name for this view is "pragmatism," and Scalia suggests this in the following remark, which describes "The Living Constitution," another label for the disfavored view: "The argument most frequently made in favor of The Living Constitution is a pragmatic one."[5] This article will employ the term "pragmatism" to indicate the view opposed to originalism and explore the relationships between the two theories of interpretation.

Behind pragmatism as an interpretive theory lies a general, perhaps typically American, attitude and philosophical movement. The pragmatic attitude emphasizes practicality over principle. But even pragmatism of this commonly understood sort is capable of generating its own jurisprudence. The most prominent contemporary legal pragmatist, Richard Posner, claims to defend "everyday," not philosophical pragmatism.[6] Nevertheless, Posner does go on to say that the two pragmatisms are related.[7] This essay will treat the two pragmatisms as largely indistinguishable and moreover, go on to expand the scope of philosophical pragmatism from that of Peirce, James, and Dewey, to the neopragmatism of Richard Rorty, and to all of the philosophers he considers pragmatic. Legal pragmatism is also largely continuous with philosophical pragmatism. We will move on to describe what Scalia's originalism is and then critique it from a pragmatic perspective.

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1. *See* Antonin Scalia, *Originalism: The Lesser Evil*, 57 U. CIN. L. REV. 849, 852-53 (1989).

2. See Antonin Scalia, *Common-Law Courts in a Civil Law System: The Role of United States Federal Courts in Interpreting the Constitution and Laws, in* A MATTER OF INTERPRETATION: FEDERAL COURTS AND THE LAW 3, 23-25 (Amy Gutmann ed., 1997).

3. *See* Scalia, *supra* note 1, at 852.

4. *See* Scalia, *supra* note 2, at 45.

5. *Id.* at 41.

6. RICHARD A. POSNER, LAW, PRAGMATISM, AND DEMOCRACY 4 (2003).

7. *Id.*

This essay focuses on making a philosophical rather than a political argument. In brief, the argument asserts that originalism depends upon an outmoded and unfashionable philosophical theory. Originalism and the philosophical theory behind it survive because they are still attractive to the ordinary person. The alternative, pragmatism, should become increasingly appealing because it has become dominant in academic circles and because it also represents a central feature of the American character and intellectual traditions. In the end, even Scalia's actual practice of interpreting the Constitution has substantial pragmatic elements.

I. PRAGMATISM

"Pragmatism" is a word we use to describe what is perhaps one of the central features of the American character. Contributing to the meaning of that term is the school of American philosophy also called "pragmatism." This section describes the two main stages of philosophical pragmatism—the classical or canonical stage and neopragmatism—and then moves on to cover legal pragmatism. Next will be a brief exposition of the essay's major claim: that broadly conceived pragmatism is so dominant, and the consensus supporting it so broad, that ideas or positions dependent upon an older view are in danger of being swept aside by the tide of intellectual history. Finally, we will look closely only at those pragmatic principles or ideas which bear most directly on an evaluation of originalism.

Pragmatism has been America's major contribution to world philosophy.[8] Although Charles Sanders Peirce first set out the basic principles of pragmatism in his 1878 article *How to Make Our Ideas Clear,*[9] philosophical pragmatism did not receive substantial attention until William James and John Dewey wrote and published on pragmatism at the turn of the last century. One of the developments that helped to popularize the movement was James's use of the term "pragmatism" in his 1898 lectures at Berkeley,[10] a term which Peirce had not come up with.[11] Pragmatism dominated American philosophy departments for roughly the first quarter of the twentieth century and was gradually replaced by analytical or analytic philosophy, which has its origins in the work of Bertrand Russell, G. E. Moore, Gottlob Frege, Ludwig Wittgenstein, and Rudolf Carnap.

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8. H. S. THAYER, MEANING AND ACTION: A CRITICAL HISTORY OF PRAGMATISM 3 (1968).

9. 5 CHARLES SANDERS PEIRCE, *How to Make Our Ideas Clear, in* COLLECTED PAPERS OF CHARLES SANDERS PEIRCE 5.388 (1978) (references to Peirce's COLLECTED PAPERS indicate volume number followed by section number).

10. *See* WILLIAM JAMES, PRAGMATISM: A NEW NAME FOR SOME OLD WAYS OF THINKING 29 (Fredson Bowers ed., Harvard Univ. Press 1975).

11. *Id.* at 160 nn.28 & 34.

Nevertheless, pragmatism has had a revival ever since Richard Rorty published his major work *Philosophy and the Mirror of Nature* in 1979.[12]

Before James's and Dewey's work became widely known in the first decades of the twentieth century, legal pragmatism developed concurrently with, but also largely independently of, philosophical pragmatism.[13] Both kinds of pragmatism may have had their origins in the discussions of The Metaphysical Club, of which Peirce, James, and Oliver Wendell Holmes, Jr., among others, were members, in the late 1860's and early 1870's.[14] Justice Holmes, the founder of legal pragmatism, although he did not call it that, was succeeded by the legal realists, who by that time were directly influenced by James and Dewey.[15] Later versions of legal pragmatism included the legal process school, critical legal studies, and the school of legal neopragmatism.[16] Richard Posner is almost certainly the most prominent contemporary self-identified legal pragmatist, although, as we shall see, from the pragmatist view of this essay, virtually everyone in law is a legal pragmatist.

One of the major points of this essay is that pragmatism, broadly conceived, has become the dominant perspective of our time. Rorty's work from *Philosophy and the Mirror of Nature* onwards redescribes philosophical history since Nietzsche as being largely pragmatist because most of the major philosophers of the period share basic pragmatist beliefs such as anti-Platonism or antifoundationalism.[17] To Rorty, Wittgenstein, Heidegger, and Dewey, representing three major strands of twentieth century philosophy, broke away from the traditional conception of philosophy as foundational and systematic and instead viewed it as therapeutic.[18] In Rorty's view, analytic philosophy, culminating in the work of W. V. O. Quine, the later Wittgenstein, Wilfrid Sellars, and Donald Davidson, returned to its roots in the pragmatism of James and Dewey, and in turn, this Anglo-American philosophy is converging with Continental philosophy in the Nietzsche-Heidegger-Derrida tradition.[19]

But the same rising tide of the pragmatic attitude is also sweeping across the other social science and humanities disciplines. According to Stanley Fish, a literary and legal theorist and pragmatist, the same antifoundationalist argument that we saw in philosophy is also being made in anthropology, history, sociol-

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12. *See generally* RICHARD RORTY, PHILOSOPHY AND THE MIRROR OF NATURE (1979).

13. *See* Thomas C. Grey, *Holmes and Legal Pragmatism*, 41 STAN. L. REV. 787, 864-70 (1989).

14. M. H. Fisch, *Justice Holmes, the Prediction Theory of Law, and Pragmatism*, 39 J. OF PHILOSOPHY 85, 87-88 (1942); LOUIS MENAND, THE METAPHYSICAL CLUB: A STORY OF IDEAS IN AMERICA 201 (2001).

15. STEPHEN M. FELDMAN, AMERICAN LEGAL THOUGHT FROM PREMODERNISM TO POSTMODERNISM: AN INTELLECTUAL VOYAGE 113-14 (2000).

16. RICHARD A. POSNER, OVERCOMING LAW 388-89 (1995).

17. RICHARD RORTY, PHILOSOPHY AND SOCIAL HOPE xvi (1999).

18. RORTY, *supra* note 12, at 5-7.

19. RICHARD RORTY, CONSEQUENCES OF PRAGMATISM (ESSAYS: 1972-1980) xviii-xxi (1982).

ogy, history of science, history of art, legal theory, and literary theory.[20] Fish says that this is the "*going* argument," i.e., the one currently in vogue, yet "it would be *too much* to say that the foundationalist argument lies in ruins."[21] There are still pockets of resistance, but I argue that the traditional non-pragmatist world view is becoming increasingly difficult to maintain.

Finally, to return to the field of law and legal theory, we find several pragmatic legal theorists claiming that pragmatism is pervasive in the law. Posner agrees with Rorty in finding that pragmatic legal theorists not only include those belonging to the schools previously mentioned but also those not usually considered pragmatist, such as Roberto Unger and Ronald Dworkin.[22] If even staunch anti-pragmatists can be characterized as pragmatist, then perhaps we are all pragmatists now. Moreover, the same is true of legal practitioners. Posner says that "although the discourse of judges has always been predominantly formalist, most American judges have been, at least when faced with difficult cases, practicing pragmatists."[23] Thomas Grey goes further: "I am convinced that pragmatism is the implicit working theory of most good lawyers."[24] In the eyes of Daniel Farber and Suzanna Sherry, most of the past and current Supreme Court justices are pragmatists.[25] In short, from the pragmatist's perspective pragmatism dominates in legal theory and practice. "Dominance" doesn't necessarily mean that there is a lack of viable alternatives to the pragmatic world view. But it does imply that pragmatism is at least the preferred choice among a range of other options. This essay argues that pragmatism's prominent position is well earned because it provides compelling answers to questions philosophy asks.

What follows is a brief account of some of the major features of pragmatism broadly conceived, but only those features relevant to our discussion of originalism, which is a theory of interpretation. Pragmatism succeeds or supersedes traditional or Platonic philosophy. Whereas for Platonism truth is eternal and unchanging and independent of context, pragmatic truth depends on context

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20. STANLEY FISH, DOING WHAT COMES NATURALLY: CHANGE, RHETORIC, AND THE PRACTICE OF THEORY IN LITERARY AND LEGAL STUDIES 345 (1989).

21. *Id.*

22. POSNER, *supra* note 16, at 389; Richard Rorty, *The Banality of Pragmatism and the Poetry of Justice*, 63 S. CAL. L. REV. 1811, 1813 (1990); *See* Ronald Dworkin, *Pragmatism, Right Answers, and True Banality, in* PRAGMATISM IN LAW AND SOCIETY 359, 359 (Michael Brint & William Weaver eds., 1991) (Dworkin strenuously resists being characterized as a pragmatist and has scathing criticism of Rorty's work. "I shall try to explain . . . why I believe that what Professor Rorty calls the 'new' pragmatism has nothing to contribute to legal theory, except to provide yet another way for legal scholars to be busy while actually doing nothing.").

23. POSNER, *supra* note 16, at 401.

24. Thomas C. Grey, *Hear the Other Side: Wallace Stevens and Pragmatist Legal Theory*, 63 S. CAL. L. REV. 1569, 1590 (1990).

25. DANIEL A. FARBER & SUZANNA SHERRY, DESPERATELY SEEKING CERTAINTY: THE MISGUIDED QUEST FOR CONSTITUTIONAL FOUNDATIONS 3 (2002).

and changes over time. Ironically, Platonism defined itself in opposition to an earlier form of pragmatic discourse, poetry. Plato demanded "that a discourse of 'becoming,' that is of endless doings and of events, be replaced by a discourse of 'being,' that is of statements which. . . are free from time-conditioning."[26]

Pragmatism is indeed a discourse of "becoming." Peirce's definitions of "reality" and "truth" show how these concepts depend upon a community of investigators operating over time:

> The real, then, is that which, sooner or later, information and reasoning would finally result in, and which is therefore independent of the vagaries of me and you. Thus, the very origin of the conception of reality shows that this conception essentially involves the notion of a COMMUNITY, without definite limits, and capable of a definite increase in knowledge.[27]

"The opinion which is fated to be ultimately agreed to by all who investigate, is what we mean by the truth."[28] Truth is the goal of this communal activity of investigators (modeled after scientific disciplines); truth is that which would be settled upon in the long run.

For pragmatism, inquiry into philosophical questions occurs within a disciplinary activity or discourse, and this departs from the traditional philosophical view. Describing Platonism, which he calls "metaphysical realism," analytic philosopher and pragmatist Hilary Putnam says, "[On the perspective of metaphysical realism], the world consists of some fixed totality of mind-independent objects. There is exactly one true and complete description of 'the way the world is.' Truth involves some sort of correspondence relation between words or thought-signs and external things and sets of things."[29] From this perspective, it is possible to view the world from "a God's Eye point of view."[30] In contrast, from the pragmatist perspective (which Putnam calls the 'internalist' perspective), questions about what kinds of objects there are only make sense "*within* a theory or description."[31] Because this point bears repeating, I quote at length Stanley Fish, who is not an analytic philosopher and who might even be thought of as anti-analytic, making the same point as Putnam:

> Anti-foundationalism teaches that questions of fact, truth, correctness, validity, and clarity can neither be posed nor answered in reference to some extracontextual, ahistorical, nonsituational reality, or rule, or law, or value; rather, anti-foundationalism asserts, all of these matters are intelligible and

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26. ERIC A. HAVELOCK, PREFACE TO PLATO 182 (1963).

27. PEIRCE, *supra* note 9, at 5.311-5.312.

28. *Id.* at 5.407.

29. HILARY PUTNAM, REASON, TRUTH AND HISTORY 49 (1981).

30. *Id.*

31. *Id.*

> debatable only within the precincts of the contexts or situations or paradigms or communities that give them their local and changeable shape.[32]

From the older philosophical point of view, two main objections to this pragmatic principle arise: indeterminacy and relativism. For example, from a fundamentalist perspective, if interpreters depart from a literal reading of the Bible, they appear to be just making up religious or moral beliefs as they go along (indeterminacy). If the text does not constrain them, nothing else can. The pragmatist answer is that even if one gives up the search for the acontextual, one-and-only-one correct meaning, interpretation relative to a context is still subject to constraints. As Fish explains:

> Interpreters are constrained by their tacit awareness of what is possible and not possible to do, what is and what is not a reasonable thing to say, and what will and will not be heard as evidence, in a given enterprise; and it is within those same constraints that they see and bring others to see the shape of the documents to whose interpretation they are committed.[33]

There is nothing deeper, no foundations behind these contextual constraints. When the later Wittgenstein thought about how it is that we can follow a rule, he surmised that there was nothing more basic than our being able or not able to follow the rule. For example, if a person correctly performed a mathematical calculation, she didn't discover a pre-existent Platonic entity by being guided by rules thought of as rails guiding her. We can't get behind the activity to something deeper:

> "How am I able to obey a rule?"—if this is not a question about causes, then it is about the justification for my following the rule in the way I do. If I have exhausted the justifications I have reached bedrock, and my spade is turned. Then I am inclined to say: "This is simply what I do."[34]

"Obeying a rule is a practice."[35] If people are able to follow a rule, they do so not because of an explicit verbal agreement but because they share a "form of life": "'So you are saying that human agreement decides what is true and what is false?'—It is what human beings *say* that is true and false; and they agree in the *language* they use. That is not agreement in opinions but in form of life."[36]

But if a dispute or disagreement does break out, then how do we resolve it? If we only have practices and forms of life and a neutral God's eye point of view is unavailable, we seem to be in the position of having to accept cultural relativism, that is, if a belief relative to my culture conflicts with one relative to yours, nothing more can be done. The pragmatist has at least two responses.

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32. FISH, *supra* note 20, at 344.
33. FISH, *supra* note 20, at 98.
34. LUDWIG WITTGENSTEIN, PHILOSOPHICAL INVESTIGATIONS 85, para. 217, (G. E. M. Anscombe trans., 3d ed. 1968) (1953).
35. *Id.* at 81, para. 202.
36. *Id.* at 88, para. 241.

First, disputes can break out within a culture. Because truth is provisional and not permanent, the doctrine of fallibilism applies. Any belief, no matter how settled, is subject to revision. In analytic philosopher Wilfrid Sellars's well-known formulation, "empirical knowledge, like its sophisticated extension, science, is rational, not because it has a *foundation* but because it is a self-correcting enterprise which can put *any* claim in jeopardy, though not *all* at once."[37] Second, related to this point, if the conflicting beliefs are from different practices, cultures, or traditions, these disputes are not frozen in an irresolvable stalemate; the reason is that the cultures themselves are subject to internal criticism. Putnam has expressed this idea in terms of two paired principles:

> I have already said that, in my view, truth and rational acceptability—a claim's being right and someone's being in a position to make it—are relative to the sort of language we are using and the sort of context we are in. . . . This does not mean that a claim is right *whenever* those who employ the language in question would accept it as right in its context, however. There are two points that must be *balanced,* both points that have been made by philosophers of many different kinds: (1) talk of what is 'right' and 'wrong' in any area only makes sense against the background of an *inherited tradition;* but (2) traditions themselves can be *criticized.*[38]

Hence, in the pragmatic accounts I have summarized, constraints and corrective mechanisms internal to a practice or tradition mitigate the lack of a God's eye point of view and defend against the charges of indeterminacy and relativism.

To sum up, let me characterize the interpretive theories of originalists and pragmatists with highly simplified (and, one hopes, not simplistic) metaphors. Originalists think of texts as containers with objects within. The task of the interpreter is to extract the meaning out of the container, meaning which was put there by the author. This metaphor sees texts on the model of the Bible, which contains eternal truths revealed by God. Pragmatic theorists, on the other hand, view texts as textiles (exploiting etymology). A text has connections, filiations with a con-text. They are not separate, autonomous objects. As contexts change, the text itself changes. Because contexts inevitably change as societies evolve, the text and its meaning inevitably change over time.[39]

II. SCALIA'S ORIGINALISM

Justice Scalia's theory of constitutional interpretation is a subtle and well-balanced (even to the point of being self-critical) account of how to properly read that document. This essay first details the main features of originalism and

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37. WILFRID SELLARS, EMPIRICISM AND THE PHILOSOPHY OF MIND 79 (1997).

38. 3 PUTNAM, REALISM AND REASON: PHILOSOPHICAL PAPERS, 234 (1983).

39. The preceding account has many sources. I list only two here: JACQUES DERRIDA, OF GRAMMATOLOGY 30-65 (Gayatri Spivak trans., Johns Hopkins 1976) (1967); FREDERIC JAMESON, POSTMODERNISM OR, THE CULTURAL LOGIC OF LATE CAPITALISM 6-16 (1991).

then explores the two main arguments, philosophical and political, in support of it.

A. WHAT ORIGINALISM IS

Although Scalia is seemingly well known as the most prominent exponent of originalism, it is surprisingly hard to find a good abstract definition of the theory in his articles on the subject. The best comes from his discussion of Chief Justice Taft's opinion in *Myers v. United States*,[40] which Scalia holds up as a prime example of the "originalist" approach:[41]

> The objective of the Chief Justice's lengthy opinion was to establish the meaning of the Constitution, in 1789, regarding the presidential removal power. He sought to do so by examining various evidence, including not only, of course, the text of the Constitution and its overall structure, but also the contemporaneous understanding of the President's removal power (particularly the understanding of the first Congress and of the leading participants in the Constitutional Convention), the background understanding of what "executive power" consisted of under the English constitution, and the nature of the executive's removal power under the various state constitutions in existence when the federal Constitution was adopted.[42]

Also helpful in defining what originalism means is the contrast with its opposite: non-originalism, or what I call pragmatism. "But the Great Divide with regard to constitutional interpretation is not that between Framers' intent and objective meaning, but rather that between *original* meaning (whether derived from Framers' intent or not) and *current* meaning."[43] Those non-originalist opinions, and there are many of them, have "been rendered not on the basis of what the Constitution originally meant, but on the basis of what the judges currently thought it desirable for it to mean."[44] Another useful phrase to highlight the differences in the theories is "The Living Constitution," which is precisely what the Constitution should not be: "The Living Constitution, a body of law that (unlike normal statutes) grows and changes from age to age, in order to meet the needs of a changing society."[45]

Although Scalia asserts that the layperson would be surprised to find out that originalism was not the sole means of interpreting the Constitution,[46] the refinements and subtleties in Scalia's version of originalism make it doubtful that the

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40. 272 U.S. 52 (1926).

41. Scalia, *supra* note 1, at 851-852.

42. *Id.* at 852. Scalia goes on to emphasize how hard it is to practice originalism: "It is easy to understand why this [opinion] would take almost three years and seventy pages. . . [D]one perfectly it might well take thirty years and 7,000 pages." *Id.*

43. Scalia, *supra* note 2, at 38.

44. Scalia, *supra* note 1, at 852.

45. Scalia, *supra* note 2, at 38.

46. Scalia, *supra* note 1, at 852.

ordinary person would have an intuitive grasp of his interpretive theory. On the one hand, one must follow the text, and arguments based on legislative intent or extratextual considerations are disfavored. But on the other, originalism as an interpretive theory seems to require historical research into extratextual documents in order to understand what the text meant at the time it was ratified.

In a discussion of *Church of the Holy Trinity v. United States*,[47] Scalia explains why legislative intent and legislative history should play only a minor role, at best, in statutory interpretation. In that case when the Church of the Holy Trinity contracted with an Englishman to become its pastor, it apparently violated a federal statute making it unlawful to assist in the migration of any alien into the United States for employment purposes.[48] The Supreme Court held that although the action of the Church fell within the letter of the statute, it did not fall within the spirit of the statute or within the intent of Congress.[49] The Court used extratextual sources, including legislative history, to argue that the statute was meant to apply only manual labor.[50]

Scalia does not approve of this sort of argument based on extratextual sources. "Well of course I think that the act was within the letter of the statute, and was therefore within the statute: end of case. . . . [T]he decision was wrong because it failed to follow the text. The text is the law, and it is the text that must be observed."[51] Here, the argument based on legislative intent "is nothing but an invitation to judicial lawmaking."[52]

Scalia's view of constitutional interpretation is the same as his view of statutory interpretation, in which the search for intent is disfavored: "What I look for in the Constitution is precisely what I look for in a statute: the original meaning of the text, not what the original draftsmen intended."[53] Nevertheless, extratextual historical research is required as part of constitutional interpretation. Scalia does consult the writings of Hamilton and Madison, not because they were Framers and therefore possessed an authoritative intent, but rather because their writings are just like those of other intelligent people of the time, the collective writings of which "display how the text of the Constitution was originally understood."[54] Scalia distinguishes between "what the text would reasonably be understood to mean, rather than . . . what it was intended to mean" and says that the focus should be upon the former rather than the latter.[55]

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47. 143 U.S. 457 (1892).
48. Scalia, *supra* note 2, at 18-19.
49. *Id.* at 19.
50. *Id.*
51. *Id.* at 20, 22.
52. *Id.* at 21.
53. *Id.* at 38.
54. *Id.*
55. Scalia, *Response, in* A MATTER OF INTERPRETATION: FEDERAL COURTS AND THE LAW 144 (Amy Gutmann, ed. 1997).

This is a subtle distinction indeed, so fine that I do not think it can be maintained. I agree with Farber and Sherry that the aim of Scalia's interpretive theory is constraining judges rather than following the Framers.[56] That aim forces him to employ an unusual sense of "meaning," one that the ordinary person would not know is part of the meaning of "meaning." In Scalia's interpretive theory, a person understands what a word means when he or she understands what objects or activities the word refers to and what it does not. This sense of "meaning" is technical rather than everyday; it is familiar to analytic philosophers as part of the distinction made by Gottlob Frege between "sense" and "reference."[57] Scalia's "meaning" corresponds to Frege's "reference."[58]

Without potentially confusing the reader by exploring or even stating Frege's distinction, I wish to offer my own Frege-inspired distinction-that between dictionary meaning and referential meaning-that highlights the problems with Scalia's theory.[59] The constitutional text that illustrates this distinction is the Eighth Amendment's prohibition of the infliction of "cruel and unusual punishments." One way of finding out what this phrase meant in the late eighteenth century is to look up "cruel," "unusual," and "punishment" in the Oxford English Dictionary or in a dictionary from that period. If we want to know whether our understanding of the phrase corresponds to the way it was understood at the time of ratification, we compare the dictionary meaning of the words at that time with the meaning now. If the dictionary meanings are the same or largely the same, our sense of the phrase is the same as those of the ratifiers.

That is not Scalia's procedure. The Eighth Amendment prohibits what was considered cruel at the time.[60] The text of the Amendment does not state what sorts of activities the Amendment covers. Therefore, historical research is needed to discover what was considered cruel and unusual in late eighteenth century America. The phrase refers to some activities and not to others; some fall within its scope and some do not. Examples of punishments that do not fall

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56. FARBER & SHERRY, *supra* note 25, at 29, 49.

57. *See* Christopher R. Green, *Originalism and the Sense-Reference Distinction,* 50 ST. LOUIS U. L. J. 555, 560 (2006) (citing Gottlob Frege, *Über Sinn und Bedeutung,* 100 ZEITSCHRIFT FÜR PHILOSOPHIE UND PHILOSOPHISCHE KRITIK 25 (1892), translated in 57 PHIL. REV. 209, 210 (1948)).

58. Green's article goes on to discuss two similar distinctions: Rudolf Carnap's intension and extension and John Stuart Mill's connotation and denotation. *See id* at 564-65. Green concludes that "the sense of a constitutional expression is fixed at the time of the framing, but reference is not, because it depends on the facts about the world, which can change." *Id.* at 560.

59. This is similar but not the same as Ronald Dworkin's distinction between semantic intention and expectation intention and between semantic originalism and expectation originalism. *See* Ronald Dworkin, *Comment, in* A MATTER OF INTERPRETATION: FEDERAL COURTS AND THE LAW 116-120 (Amy Gutmann, ed. 1997).

60. *See* Scalia, *supra* note 55, at 145.

within the scope of "cruel and unusual" are public flogging, handbranding, and capital punishment.[61]

Because his view of proper Constitutional interpretation requires extratextual, historical research in order to determine referential meaning, Scalia cannot maintain the distinction between what is within the letter of the text and what is intended but not in the text (legislative intent), and he cannot continue to disfavor the latter. If Scalia genuinely favored the letter of the law and deferred to the words actually in the statute or constitutional provision, his theory should emphasize dictionary meaning. In interpretation the focus should first be upon the meaning of the words actually in the text. But, as we saw with the example of "cruel and unusual punishments" above, the interpreter needs to go outside of the text in order to determine the extension or extent of the reference of the words in the text.

Embracing either dictionary meaning or referential meaning leads to problems for Scalia's theory. If dictionary meaning is the focus, originalism as we know it disappears. In the "cruel and unusual punishments" example, if the current dictionary meanings largely correspond to the dictionary meanings in 1791, then the phrase has pretty much the same meaning for us as it did for the framers and ratifiers. Hence, we are following the letter of the law when we read the phrase to proscribe what is "cruel and unusual" to *us*. On the other hand, if referential meaning is the focus, Scalia will be unable to maintain the distinction between "what the text would reasonably be understood to mean" and "what it was intended to mean."[62] Both are really the same kind of meaning, referential, and the only difference is that one consults a larger group of texts in order to find out the former than the latter. Moreover, referential meaning is an unusual kind of meaning, and originalism's recourse to it undermines claims that originalism captures the common person's understanding of what interpreting the text of the law means.

B. TWO ARGUMENTS FOR ORIGINALISM

The case for originalism rests upon two pillars: one philosophical and one political. The second pillar, which Scalia calls (misleadingly, in my view) the argument for "theoretical legitimacy," is that originalism is "more compatible with the nature and purpose of a Constitution in a democratic system" than the nonoriginalist alternative.[63] This section will also briefly cover that argument later, but the main focus of this essay is on the first pillar.

Scalia presents a philosophical argument for originalism, although (once again misleadingly) he calls this argument the "practical" argument: "I also

61. Scalia, *supra* note 1, at 861, 863.
62. Scalia, *supra* note 55, at 144.
63. Scalia, *supra* note 1, at 862.

think that the central practical defect of nonoriginalism is fundamental and irreparable: the impossibility of achieving any consensus on what, precisely, is to replace original meaning, once that is abandoned. The practical defects of originalism, on the other hand, while genuine enough, seem to me less severe."[64] The aim of finding the original meaning of the text constrains interpreters. Perhaps surveying the many alternatives proposed by law professors, Scalia doesn't see that there are any constraints upon nonoriginalist interpretation and as a result, agreement or convergence of nonoriginalist opinion is impossible:

> Perhaps the most glaring defect of Living Constitutionalism, next to its incompatibility with the whole antievolutionary purpose of a constitution, is that there is no agreement, and no chance of agreement, upon what is to be the guiding principle of the evolution. *Panta rei* is not a sufficiently informative principle of constitutional interpretation. What is it the judge must consult to determine when, and in what direction, evolution has occurred? Is it the will of the majority, discerned from newspapers, radio talk shows, public opinion polls, and chats at the country club? Is it the philosophy of Hume, or of John Rawls, or of John Stuart Mill, or of Aristotle?[65]

As a group, the evolutionists "follow nothing at all" and divide themselves "into as many camps as there are individual views of the good."[66] Because Scalia concludes that this confusion is inevitable, he thinks "evolutionism" is not a "practicable constitutional philosophy."[67]

This is a *philosophical* objection to nonoriginalism or pragmatism. Behind this argument lies the philosophical opposition between being and becoming. Through the use of an allusion to Greek philosophy, *panta rei,* Scalia aligns the evolutionists with the views of the pre-Socratic philosopher Heraclitus (becoming) while the originalists identify themselves with Plato (being). *Panta rei* ("all things flow") recalls Heraclitus's saying about stepping into a river, a saying well-known even in Plato's time.[68] This version of it is from Plato's dialogue the *Cratylus:* "SOCRATES: Heraclitus is supposed to say that all things are in motion and nothing at rest; he compares them to the stream of a river, and

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64. Scalia, *supra* note 1, at 862-63.

65. Scalia, *supra* note 2, at 44-45.

66. *Id.*

67. *Id.* at 45.

68. "[T]he whole of reality is like an ever-flowing stream, and . . . nothing is ever at rest for a moment. . . . This is summed up, appropriately enough in the phrase 'All things are flowing' (*panta rei*), though this does not seem to be a quotation from Herakleitos. Plato, however, expresses the idea quite clearly. 'Nothing ever is, everything is becoming'; 'All things are in motion like streams'; 'All things are passing and nothing abides.'" JOHN BURNET, EARLY GREEK PHILOSOPHY 146 (4th ed. reprint 1961)(1930). *See also* CHARLES H. KAHN, THE ART AND THOUGHT OF HERACLITUS: AN EDITION OF THE FRAGMENTS WITH TRANSLATION AND COMMENTARY 168 (1979) ("It is curious that the most celebrated and in a sense the most profound saying of Heraclitus, that you cannot step twice into the same river, is not unmistakably attested in his own words. It was already a famous saying in Plato's time.").

says you cannot go into the same river twice."[69] At the end of the dialogue Socrates expresses the Platonic view that if there are such things as knowledge, the good, or the beautiful, they must be unchanging:

> SOCRATES: Nor can we reasonably say, Cratylus, that there is knowledge at all, if everything is in a state of transition and there is nothing abiding. . . . But if that which knows and that which is known exist ever, and the beautiful and the good and every other thing also exist, then I do not think that they can resemble a process or flux.[70]

Scalia refuses to acknowledge that there is a serious philosophical alternative to the Platonic account.[71] The goal is to attain the God's eye point of view, singular and unchanging. Without that, discourse becomes unconstrained by anything and hence chaotic, lacking in agreement, and pluralistic without any hope of convergence.

Other exponents of originalism are more doctrinaire in their Platonism. Scalia is willing to admit that there is disagreement even among originalists and that there is room for disagreement.[72] On the other hand, according to Farber and Sherry, other originalists "seem to view constitutional interpretation as a simple exercise that inevitably leads to a single right answer."[73] For example Frank Easterbrook "argues that judicial review cannot be justified unless we believe both 'that there [is] one right answer to a problem,' and that the judiciary ought to be the source of that right answer."[74] Scalia's pragmatist leanings come out when he acknowledges that the constraints of the originalist interpretive theory do not result in the One Right Answer but in a limited range of possible answers. If Scalia were to recognize that pragmatist interpretation was also constrained in a limited fashion, the difference between the two interpretive theories would be one of degree and not of kind.

The second pillar or argument supporting originalism is political and is not the main subject of this essay, but I summarize it here to present a more com-

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69. PLATO, THE COLLECTED DIALOGUES OF PLATO INCLUDING THE LETTERS 439 (402a) (Edith Hamilton & Huntington Cairns eds., 1973).

70. PLATO, *supra* note 69, at 474 (440a-b).

71. Farber and Sherry argue that Scalia's jurisprudence harks back to the formalism of the nineteenth century, a formalism which conceived of the law in Platonic terms. FARBER & SHERRY, *supra* note 25, at 36-37. They quote a passage from a book of legal history by Grant Gilmore: "The post-Civil War judicial product seems to start from the assumption that the law is a closed, logical system. Judges do not make law: they merely declare the law which, in some Platonic sense, already exists. The judicial function has nothing to do with the adaptation of rules of law to changing conditions; it is restricted to the discovery of what the true rules of law are and indeed always have been. Past error can be exposed and in that way minor corrections can be made, but the truth, once arrived at, is immutable and eternal." GRANT GILMORE, THE AGES OF AMERICAN LAW 62 (1977).

72. Scalia, *supra* note 2, at 45.

73. FARBER & SHERRY, *supra* note 25, at 13.

74. *Id.* (quoting Frank H. Easterbrook, *Approaches to Judicial Review, in* THE BLESSINGS OF LIBERTY: AN ENDURING CONSTITUTION IN A CHANGING WORLD 147, 154 (Jack David & Robert B. McKay eds., 1989)).

plete exposition of Scalia's interpretive theory. The central aspect of this argument is that originalism promotes judicial restraint and expunges judicial discretion.[75] Nonoriginalism, on the other hand, fails to restrain judges who are then free to follow their own personal views. This countermajoritarian jurisprudence in turn provokes the real danger: that the people will react to these willful decisions by exerting political pressure on the judiciary.

Scalia's complaints against the countermajoritarian direction of the Court's jurisprudence exist mainly in the form of sharply worded dissents to the Court's pragmatist decisions. He is quite direct and specific in pointing out the majority's elitism. In a dissent to *Romer v. Evans*,[76] in which the Court held that an amendment to Colorado's Constitution made homosexuals unequal to everyone else and hence violated the Equal Protection Clause, Scalia lodged this protest: "This Court has no business imposing upon all Americans the resolution favored by the elite class from which the Members of this institution are selected, pronouncing that 'animosity' toward homosexuality . . . is evil."[77] "When the Court takes sides in the culture wars, it tends to be with the knights rather than the villeins[,] . . . reflecting the views and values of the lawyer class from which the Court's Members are drawn."[78] Scalia expressed similar sentiments in his dissent to the majority opinion in *Roper v. Simmons*,[79] which held that the execution of an offender who committed a capital crime when he was younger than eighteen violated the Eighth Amendment: "The votes in today's case demonstrate that the offending of selected lawyers' moral sentiments is not a predictable basis for law—much less a democratic one."[80] "[A]ll the Court has done today . . . is to look over the heads of the crowd and pick out its friends."[81]

But Scalia elsewhere states that the courts should be countermajoritarian in protecting the rights enumerated in the Constitution. The rights enshrined by the Framers are not supposed to be eroded by the different values of a later society: "The purpose of constitutional guarantees . . . is precisely to prevent the law from reflecting certain changes in original values that the society adopting the Constitution thinks fundamentally undesirable."[82] The Constitution binds later generations to its moral values.[83] Thus, according to Farber and Sherry, "for Scalia the trouble with judicial activism is apparently not that it is antimajoritarian, but that it is antimajoritarian in the wrong way."[84] Scalia im-

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75. *See* FARBER & SHERRY, *supra* note 25, at 29, 49.
76. 517 U.S. 620 (1996).
77. *Id.* at 636 (Scalia, J., dissenting).
78. *Id.* at 652 (Scalia, J., dissenting).
79. 543 U.S. 551 (2005).
80. *Id.* at 616 n.8 (Scalia, J., dissenting).
81. *Id.* at 617 (Scalia, J., dissenting).
82. Scalia, *supra* note 1, at 862.
83. FARBER & SHERRY, *supra* note 25, at 43.
84. *Id.*

plicitly recognizes that the Constitution insulates the judiciary from the popular will. Protecting the rights established by the framers is the function of the judiciary; imposing the judges' own values is not. Such judicial activism invites a backlash from the majority. The people are willing to leave the judiciary alone if they believe it is doing "essentially lawyers' work," but if they believe that the Constitution is now being interpreted according to "evolving standards," "they will look for judges who agree with *them* as to what the evolving standards have evolved to."[85] To Scalia, the potential outcome could be utterly disastrous:

> If the courts are free to write the Constitution anew, they will, by God, write it the way the majority wants; the appointment and confirmation process will see to that. This, of course, is the end of the Bill of Rights, whose meaning will be committed to the very body it was meant to protect against: the majority. By trying to make the Constitution do everything that needs doing from age to age, we shall have caused it to do nothing at all.[86]

III. PRAGMATISM OR ORIGINALISM?

Because Scalia's view is so nuanced—he readily admits in *Originalism: the Lesser Evil* to originalism's shortcomings[87]—the question here is whether he might actually be more of a pragmatist.[88] In the end, Scalia too belongs on the list of pragmatists, although, like Dworkin, in the category of those pragmatists who appear to accept Platonist arguments about correct outcomes in hard cases or original meanings while making substantial concessions to pragmatist concerns.[89] To be sure, Scalia is an epistemologically conservative pragmatist; nevertheless, I argue the philosophical differences between his views and those of the pragmatists on the Court are those of degree rather than of kind.

Most of Scalia's writings, both academic and judicial, on constitutional interpretation have been in response to the "evolutionary constitutional jurisprudence" that to him has held sway since the Warren Court.[90] This newer form of pragmatic jurisprudence marks an increasing departure from the Platonist for-

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85. Scalia, *supra* note 2, at 46-47.

86. *Id.* at 47.

87. *See* Scalia, *supra* note 1, at 852.

88. *See* FARBER & SHERRY, *supra* note 25, at 39, 49 (noting the pragmatic aspects of Scalia's views).

89. That both Dworkin and Scalia vigorously argue against pragmatism shows that this is a philosophical, not a political position since their politics are quite different. For Dworkin's argument that even hard cases may have correct answers, see Dworkin, *Is There Really No Right Answer in Hard Cases?* in A MATTER OF PRINCIPLE 119 (1985), For Dworkin's criticisms of pragmatism see DWORKIN, *Pragmatism, Right Answers, and True Banalitiy, in* PRAGMATISM IN LAW AND SOCIETY 359, 361 (Michael Brint & William Weaver eds., 1991) ("[P]ragmatism self-destructs whenever it appears.").

90. Scalia, *supra* note 55, at 149 (Scalia says that evolutionary jurisprudence has held sway "for only forty years or so," and his essay was published in 1997).

malism of law as a solely rule-governed activity, a departure corresponding to the growing dominance of pragmatist thought in academic disciplines.

Even before the recent ascendancy of evolutionary thinking on the Court, pragmatist legal devices such as totality of the circumstances tests or balancing of factors tests had already become standard features of jurisprudence in American courts.[91] These tests are pragmatic because they allow judges to be more sensitive to the context in which the case occurs instead of binding them to apply rules in a mechanical way even where the result would be undesirable.[92]

Nevertheless, in the last several decades the Court has become more explicit about the evolving or changing nature of the standards or moral beliefs. Phrases like "evolving standards of decency" in Eighth Amendment jurisprudence[93] and "emerging awareness" and "emerging recognition" in the area of substantive due process[94] exemplify this trend. Furthermore, inquiry into "evolving standards" may take two forms. First, the Court looks for "objective indicia of society's standards, as expressed in legislative enactments and state practice" with respect to the issue at hand.[95] More controversially, the Court goes on to say that the inquiry does not necessarily end there but may involve the Court's "own judgment."[96]

Atkins v. Virginia exemplifies this new phase of pragmatist constitutional jurisprudence. In light of "evolving standards of decency," the Court held that the execution of mentally retarded criminals exceeded what is permissible under the Eighth Amendment.[97] In its reasoning, the Court first asserted that claims of excessive punishment are not judged by the standards prevailing at the time the Bill of Rights was adopted, but rather "by those that currently prevail."[98] The justification for this position is entirely consistent with the pragmatic philosophical view that truth, meaning, and moral beliefs are relative to a context and change over time: "'The basic concept underlying the Eighth Amendment is nothing less than the dignity of man. . . . The Amendment must draw its meaning from the evolving standards of decency that mark the progress of a maturing society.'"[99] In order to determine what these standards are the Court first looks for objective evidence: "We have pinpointed that the 'clearest and most reliable objective evidence of contemporary values is the legislation enacted by the

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91. *See* Antonin Scalia, *The Rule of Law as a Law of Rules,* 56 U. CHI. L. REV. 1175, 1182 (1989).

92. This description should not be read to imply that a purely pragmatist jurisprudence would not have any rules at all and would have every dispute decided on a case-by-case basis. That would be unpragmatic because it would be impractical. Pragmatism also sees value in the efficient administration of justice.

93. *See* Atkins v. Virginia, 536 U.S. 304, 312 (2002).

94. *See* Lawrence v. Texas, 539 U.S. 558, 572 (2003).

95. Roper v. Simmons, 543 U.S. 551, 563 (2005).

96. *Id.* at 563.

97. *Atkins*, 536 U.S. at 321.

98. *Id.* at 311.

99. *Id.* at 311-12 (quoting Trop v. Dulles, 356 U.S. 86, 100-01 (1958) (plurality opinion)).

country's legislatures.' "[100] But there is a further step because objective evidence does not "'wholly determine' the controversy, 'for the Constitution contemplates that in the end our own judgment will be brought to bear on the question of the acceptability of the death penalty under the Eighth Amendment.' "[101] Therefore, according to the procedure followed by the Court in *Atkins,* the Court first reviews the judgment of the legislatures and then considers "reasons for agreeing or disagreeing with their judgment."[102]

The Court has also adopted a pragmatic analysis in the area of substantive due process under the Fourteenth Amendment. In *Lawrence v. Texas,* the Court overruled *Bowers v. Hardwick*[103] and found that the defendants' liberty interest had been violated by Texas's "Homosexual Conduct" law.[104] In determining whether the defendants had a liberty interest, the Court looked to the traditions of the past half century and found that they showed an "emerging awareness that liberty gives substantial protection to adult persons in deciding how to conduct their private lives in matters pertaining to sex."[105] The justification for this procedure constitutes a sweeping rejection of the originalist view and a direct assertion of the pragmatic philosophy that the Constitution is "living":

> Had those who drew and ratified the Due Process Clauses of the Fifth Amendment or the Fourteenth Amendment known the components of liberty in its manifold possibilities, they might have been more specific. They did not presume to have this insight. They knew times can blind us to certain truths and later generations can see that laws once thought necessary and proper in fact serve only to oppress. As the Constitution endures, persons in every generation can invoke its principles in their own search for greater freedom.[106]

Whether or not the ratifiers actually knew what the Court says they did, the pragmatic jurisprudence expressed here is consonant with the overwhelming academic consensus that texts and their meanings inevitably change as their contexts change. Truth, meaning, and moral values change over time—even Robert Bork recognizes this.[107] This essay does not claim that pragmatic philosophy determines that one theory or constitutional interpretation is correct and the other is not. However, it does assert that the view of the constitution as

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100. *Atkins*, 536 U.S. at 312 (quoting Penry v. Lynaugh, 492 U.S. 302, 331 (1989)).

101. *Id.* (quoting Coker v. Georgia, 433 U.S. 584, 597 (1977) (plurality opinion)).

102. *Atkins*, 536 U.S. at 313.

103. 478 U.S. 186 (1986).

104. *Lawrence*, 539 U.S. at 564, 578.

105. *Id.* at 572.

106. *Id.* at 578-79.

107. Robert H. Bork, *Introduction to* A COUNTRY I DO NOT RECOGNIZE: THE LEGAL ASSAULT ON AMERICAN VALUES xi (Robert H. Bork, ed., Hoover Institution Press, 2005) ("Morality inevitably evolves.").

changing in meaning as society's standards and values change, is compatible with our best understanding of how textual meaning works. Originalism is not.

Nevertheless, originalism remains a compelling view because of the "inherent intuitive appeal"[108] of its interpretive theory. This appeal can make the nonoriginal alternative look indeterminate, relativistic, and capricious. As this essay briefly sketched out, the pragmatic answer is that there are institutional, disciplinary, and social constraints on what counts as rationally acceptable. There is nothing behind that to produce further constraints. There might be more popular appeal to this pragmatist view if it is tied to the inevitability of judicial discretion, a point which we will turn to in a moment.

But, as we have seen, Scalia's version of originalism is too carefully qualified and has too unusual a sense (referential) of what meaning is to deserve the intuitive appeal of simpler versions. In addition, this essay argues that it makes sense to classify Scalia's jurisprudential practice as pragmatic instead.

In order to present the best argument for Scalia's pragmatism, we return to the most seemingly radical of the current Court's pragmatic principles, at least in the Eighth Amendment area: that in the end what is "cruel and unusual" is a matter of the Justices' own judgment. In his dissents in cases in this area Scalia has to make at least three sorts of arguments: standards do not evolve; the evidence, as shown by a survey of state legislatures does not establish the consensus the majority claims; and judges should not be in the business of using their "own judgment" to decide these matters.

The last prong of the analysis is the one Scalia finds least palatable. "On the evolving-standards hypothesis, the only legitimate function of this Court is to identify a moral consensus of the American people. By what conceivable warrant can nine lawyers presume to be the authoritative conscience of the Nation?"[109] Scalia finds the arrogance of this assumption of power breathtaking.[110] There seem to be no constraints on a jurisprudence which is at bottom a matter of the personal feelings of whoever is on the Court: "'[I]n the end,' it is the *feelings* and *intuition* of a majority of the Justices that count—'the perceptions of decency, or of penology, or of mercy, entertained . . . by a majority of a small and unrepresentative segment of our society that sits on this Court.'"[111]

One of the fullest explanations of the Court's jurisprudence is in *Rhodes v. Chapman,* in which the Court, accepting the "evolving standards" framework, strove to balance the need to limit judicial discretion and the desire that the

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108. Theodore P. Seto, *Originalism vs. Precedent: An Evolutionary Perspective,* 38 LOY. L.A. L. REV. 2001, 2001 (2005).

109. *Roper,* 543 U.S. at 616 (Scalia, J., dissenting).

110. *Atkins,* 536 U.S. at 348-54 (Scalia, J., dissenting).

111. *Id.* (quoting Thompson v. Oklahoma, 487 U.S. 815, 873 (1988) (Scalia, J., dissenting)).

Justices have the final say.[112] "The court has held. . . that 'Eighth Amendment judgments should neither be nor appear to be merely the subjective views' of judges.[113] In the next sentence the Court shifts to the other side: "To be sure, 'the Constitution contemplates that in the end [a court's] own judgment will be brought to bear on the question of the acceptability' of a given punishment."[114] Finally, the Court returns to the first concern: "But such 'judgment[s] should be informed by objective factors to the maximum possible extent.'"[115]

My pragmatic argument in favor of properly limited judicial discretion is this: how could it be otherwise?[116] Both Scalia and the pragmatists agree that judging is largely a rule-governed activity in which pre-existing rules are applied to new sets of facts. For a substantial majority of cases judges are indeed just doing "lawyers' work." But at times the rules run out or the application of the existing rule would lead to a controversial or undesirable result. These are what Dworkin calls "hard cases."[117] In these cases the judge is thrown back upon his or her own moral intuitions. Like their counterparts in the legislative branches, judges make a small number of decisions as a matter of conscience rather than by deferring to the popular will.

Holmes expressed this pragmatic position. Although he famously said that it was his job to enforce a statute he doesn't agree with ("[I]f my fellow citizens want to go to hell, I will help them"),[118] such a wooden application of rules had its limits. "[W]e accept the judgment unless it makes us puke."[119] Richard Posner comments on this pragmatic stance:

> The point is only that our deepest values—Holmes's "can't helps"—live below thought and provide warrants for action even when we cannot give those values a compelling or perhaps any rational justification. This holds even for judicial action. It is a comfort for a judge to know that he does not have to ratify a law or other official act or practice that he deeply feels to be terribly unjust, even if the conventional legal materials are not quite up to the job of constitutional condemnation. He preserves that role for conscience that we would have liked the German judges to play during the Third Reich. It is easy

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112. 452 U.S. 337, 346 (1981).

113. *Id.* at 346. (quoting Rummel v. Estelle, 445 U.S. 263, 275 (1980)).

114. *Rhodes*, 452 U.S. at 346 (quoting Coker, 433 U.S. at 597 (plurality opinion)).

115. *Rhodes*, 452 U.S. at 346 (quoting Rummel, 445 U.S. at 274-75 (quoting Coker, 433 U.S. at 592)).

116. Another argument I am not exploring is that we do not live in a civil-law country, where judicial discretion is severely curtailed.

117. *See* DWORKIN, TAKING RIGHTS SERIOUSLY 81 (1977).

118. Letter from Oliver Wendell Holmes, Jr. to Harold Laski (Mar. 4, 1920), *in* 1 HOLMES-LASKI LETTERS: THE CORRESPONDENCE OF MR. JUSTICE HOLMES AND HAROLD J. LASKI, 1916-1935, at 249 (Mark DeWolfe Howe ed., 1953).

119. Letter from Oliver Wendell Holmes, Jr. to Harold Laski (Oct. 23, 1926), *in* 2 HOLMES-LASKI LETTERS: THE CORRESPONDENCE OF MR. JUSTICE HOLMES AND HAROLD J. LASKI, 1916-1935, at 888 (Mark DeWolfe Howe ed., 1953).

> for legal professionals, and intellectuals of every stripe, to ridicule so pragmatic an approach . . . . But the alternatives are unpalatable.[120]

But here even Posner concedes too much to the non-pragmatist opponent. Our deepest values, our moral intuitions are not somehow irrational. They came from somewhere: from education and training and living in our society. As Putnam expressed it, those notions of right and wrong come out of an inherited tradition.[121] Judgments based on intuitions are constrained by the various contexts that inform our beliefs. As Wittgenstein said, in a situation in which justifications have come to an end, all the judge can say is "This is what I do,"[122] or in jurisprudential terms, "I'm exercising my 'own judgment' as a matter of conscience."[123] But that judgment has already been shaped by both legal and extra-legal contexts. It is not wholly arbitrary. Holmes said as much at the beginning of legal pragmatism. Not only the logic of rules but the influence of extra-legal contextual constraints such as "[t]he felt necessities of the time," "intuitions of public policy," and "even the prejudices which judges share with their fellow men," have determined what the law is.[124]

Scalia becomes pragmatic when he concedes that he too has his "can't helps," when he has to depart from the strictures of his originalist theory. He admits to being a "faint-hearted originalist" when he cannot imagine himself or any other judge imposing flogging as a punishment.[125] This admission does not

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120. POSNER, *supra* note 16, at 192 (quoting Letter from Holmes to Laski (Jan. 11, 1929), *in* 2 HOLMES-LASKI LETTERS, at 1124.).

121. PUTNAM, *supra* note 38.

122. *See* WITTGENSTEIN, *supra* note 34, at 85, para. 217. For Wittgenstein, even the most logical of activities, mathematics, depends on the ability to follow a rule. There is no further justification for it and we have to say, "This is simply what I do."

123. A contemporary expression of similar sentiments from a pragmatic member of the current Court is this general statement of principle from Justice Breyer: "A legal system is based on rules; it also seeks justice in the individual case. Sometimes these ends conflict. To take account of such conflict, the system often grants judges a degree of discretion, thereby providing oil for the rule-based gears. When we tell the Court of Appeals that it cannot exercise its discretion to correct the serious error it discovered here, we tell courts they are not to act to cure serious injustice in similar cases. The consequence is to divorce the rule-based result from the just result." *Bell v. Thompson*, 125 S. Ct. 2825, 2846 (2005) (Breyer, J., dissenting). This essay will not discuss Justice Breyer's work of pragmatic jurisprudence. *See* STEPHEN BREYER, ACTIVE LIBERTY: INTERPRETING OUR DEMOCRATIC CONSTITUTION (2005).

124. OLIVER WENDELL HOLMES, THE COMMON LAW 1 (Sheldon Novick, ed. 1991) (1881). The intuitive appeal of this pragmatic view might be to return to the popular sense of pragmatism, which is compatible with the account of philosophical pragmatism presented in this essay. Americans in general are a pragmatic people. Everyday pragmatism is popularly characterized as being opposed to rule following: is a person principled or pragmatic? In law that means this: do you want a judge who follows the rule all the time or do you want a judge who departs from the rule when he or she feels the result would be sufficiently unjust? The intuitive appeal of the pragmatic view is that it allows for the judge to use his or her own common sense to override rules which would result in absurd or unjust outcomes.

125. Scalia, *supra* note 1, at 864.

trouble Scalia because he cannot imagine such a case actually arising.[126] Nevertheless, cases like that, which are of landmark importance, do come before the Court and confront originalists with the choice of sticking with the theory or departing from it in the interests of justice. One such case would be *Brown v. Board of Education.*[127] Farber and Sherry note that Robert Bork and other originalists have a *Brown* problem because originalist theory would indicate that the case was wrongly decided: "As Bork acknowledges, there is powerful evidence that the drafters and ratifiers of the Fourteenth Amendment did not intend to outlaw segregated schools."[128] As evidence of this, they cite "the fact that at the time Congress proposed the Fourteenth Amendment, it also rejected a bill outlawing segregated schools in Washington, D.C."[129]

Scalia's favorite alternative to judicial activism, the constitutional amendment, would probably fail here.[130] In 1954, seventeen states required the racial segregation of public schools,[131] a bloc of states more than large enough to prevent the adoption of any amendment outlawing segregation. Therefore, the question is whether Scalia would have voted in a manner consistent with his theory to uphold state-sponsored segregation for perhaps generations, or whether his moral intuitions would force him to do otherwise. Thus faint-hearted originalism probably comes into play in absolutely critical cases as well as in marginal ones.

Pragmatism provides the best account of what happened between *Plessy v. Ferguson*[132] and *Brown* and between *Bowers* and *Lawrence:* society had changed. Law is not solely an autonomous, rule-governed activity. It responds to the "felt necessities" of the time. At the time the later cases were decided, the majority was simply reflecting that standards had evolved.

In sum then, here is the case for seeing Scalia as a pragmatist. He accepts the doctrine of *stare decisis,* and originalism does not apply to those cases.[133] It only applies "in the rejection of usurpatious new [principles]."[134] Where *stare decisis* applies, Scalia acts like a nonoriginalist justice. Even in cases in which he expresses his originalist views, in the "vast majority of [his] dissents from nonoriginalist thinking," he has to accept the evolutionary framework, and the case really turns upon fact-specific judgments about whether there is an ade-

126. *Id.*

127. 347 U.S. 483 (1954).

128. FARBER & SHERRY, *supra* note 25, at 22.

129. *Id.*

130. *See* Scalia, *supra* note 2, at 47 (citing the Nineteenth Amendment as an example of the proper way to change the Constitution).

131. JAMES T. PATTERSON, BROWN V. BOARD OF EDUCATION: A CIVIL RIGHTS MILESTONE AND ITS TROUBLED LEGACY xiv (2001).

132. 163 U.S. 537 (1896).

133. Scalia, *supra* note 55, at 139.

134. *Id.*

quate "indication that any evolution in social attitudes has occurred."[135] Finally, in those few cases in which Scalia might be forced to use his "own judgment," he may indeed turn out to be a "faint-hearted originalist." Thus, despite the substantial differences in theory between originalism and pragmatism, his theory will not result in an actual difference in the way he decides a substantial majority of cases.

CONCLUSION

Justice Scalia says that the philosophical problem with nonoriginalism is that "[y]ou can't beat somebody with nobody."[136] There is not any agreement among nonoriginalists as to what the alternative theory to originalism should be.[137] This essay suggests that the alternative is pragmatism. But pragmatism does not provide unitary theoretical answers but rather a plurality or multiplicity of possible answers. Unlike Platonism, which seeks the One True Answer, pragmatism, like Walt Whitman, embraces multitudes. Pragmatism is at once the name of a central feature of the American character and the name of America's chief contribution to Western philosophy. Legal pragmatism began with Holmes and has become entrenched in the Supreme Court jurisprudence of the past half century. Thus, pragmatism is a substantial alternative to originalism. One day, perhaps even Justice Scalia may find that he has been pulled into its current.

135. Scalia, *supra* note 1, at 864.
136. Scalia, *supra* note 1, at 855.
137. *Id.*

Defamation.Blogspot.Com: Why the Broad Immunity of 47 U.S.C. § 230 Cannot Be Applied to Blogs

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INTRODUCTION

Blogs. Today, it seems like everyone has one. The mainstream media has acknowledged their incredible potential – if not in words, then in practice.[1] Indeed, even President George W. Bush has encouraged the use of them.[2] With over ten million blogs worldwide,[3] and more being developed every day, it seems that blogging has passed into mainstream culture. However, in the constantly evolving world of cyberlaw, what is decidedly unclear is the standard of defamation liability that should be applied to blogs and blogging.

This much is known: the Communications Decency Act[4] ("CDA") provides immunity from distributor, or "knowledge-based" defamation liability, for interactive computer services.[5] In interpreting the extent of that immunity, the courts have held that a distributor of third-party content enjoys a broad protection from any form of defamation liability under § 230(c)(1), provided they acted strictly as a distributor, and did not have a hand in the creation of the defamatory content.[6] Put simply, if a person or entity did not create the defamatory content in question, but rather, redisseminated the material, they are completely immune to defamation liability and the aggrieved plaintiff is rendered legally impotent. Because it seems likely that blogs would fall under the definition of an interactive computer service as defined by the CDA, they would likely enjoy the same broad immunity as distributor liability.

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1. Numerous major media outlets now utilize blogs as a method of dissemination. *See Wall Street Journal* Law Blog, http://blogs.wsj.com/law (last visited Oct. 19, 2006); *see also* David Carr - Carpetbagger, http://carpetbagger.nytimes.com/index.php (last visited Oct. 19, 2006) (Carr, a correspondent for the *New York Times*, maintains his own blog on the *Times'* web space).

2. *See* John O'Neil, *Bush Says 'It's Time' for Unity Government in Iraq*, N.Y. TIMES, Mar. 22, 2006, at W1.

3. Tom Zeller, Jr., *Link by Link; Are Bloggers Setting the Agenda? It Depends on the Scandal*, N.Y. TIMES, May 23, 2005, *available at* http://select.nytimes.com/search/restricted/article?res=F50A17F63E5D0C708EDDAC0894DD404482.

4. Pub. L. No. 104-104, 110 Stat. 133 (1996) (codified as amended at 47 U.S.C. § 230 (2000)).

5. 47 U.S.C. § 230(c)(1) (2005) ("No provider or user of an interactive computer service shall be treated as the publisher or speaker of any information provided by another information content provider.").

6. 47 U.S.C. § 230(f)(3) (2005) ("The term 'information content provider' means any person or entity that is responsible, in whole or in part, for the creation or development of information provided through the Internet or any other interactive computer service.").

It has been said that the Internet allows anyone with a connection to it to "become a town crier with a voice that resonates farther than it could from any soapbox."[7] If that is so, then the blog is, in some ways, the ultimate evolution of speech on the Internet. Because they can be established and maintained for free,[8] blogs give virtually anyone with a computer and Internet access a forum to articulate anything they wish.[9] Under such circumstances, the potential for defamatory content is high.

Indeed, blanketing a dissemination medium as powerful as blogs with immunity to defamation liability is a recipe for potential disaster. There is little question that information, as well as misinformation, spreads on the Internet with the speed of a highly infectious virus.[10] This is especially true between blogs, as many blog authors make it a practice to quote other blogs that contain accordant content.[11] Political bloggers are perhaps the best example of this: because they are typically extremely passionate about the material they disseminate, political bloggers frequently cite like-minded authors in their criticisms and debasements of those they consider to be their political opponents.[12]

For example, on March 22, 2006, blogger Scott Johnson, in a critique of a paper involving the social implications of the middle-eastern war, republished heavily critical language that originated from another blogger.[13] Gossip blogger Wonkette makes it a practice to redistribute any and all rumors "she"[14] hears about various political figures. Speaking generally, the more damaging the rumor, the better.[15] For example, Wonkette recently republished a transcript

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7. Doe v. Cahill, 884 A.2d 451, 455 (Del. 2005) (quoting Reno v. ACLU, 521 U.S. 844, 896-97 (1997)).

8. Numerous blog publishing tools allow users to create and maintain a personal blog for free. Among these are Blogger, http://www.blogger.com/start (last visited Oct. 19, 2006), LiveJournal.com, http://www.livejournal.com/ (last visited Oct. 19, 2006), and Blogster.com, http://blogster.com/ (last visited Oct. 19, 2006). Each of these services will maintain a user's blog indefinitely for absolutely no cost.

9. Rebecca Blood, http://www.rebeccablood.net/essays/weblog_history.html (Sept. 7, 2000, 12:03 EST).

10. *Id.*

11. *Id.*

12. *See* Paul S. Gutman, *Say What?: Blogging and Employment Law in Conflict*, 27 COLUM. J.L. & ARTS 145, 146 (2003).

13. *See generally* Posting of Scott Johnson to Powerline, http://powerlineblog.com/archives/013494.php (Mar. 22, 2006, 6:14 EST) (Within this posting, Johnson republished a statement from Professor Daniel Drezner's blog, which called Professor John Mearsheimer and Dean Stephen Walt's approach to a Middle-Eastern research paper "piss-poor, monocasual social science.").

14. The original "Wonkette," one Ana Marie Cox, recently stepped down and has allowed a male author to continue to post under her surname. *See* Amy Argetsinger & Roxanne Roberts, *Wonkette's Sex Change*, WASH. POST, Jan. 4, 2006, at C1.

15. Wonkette, *Rumors on the Internet*, http://www.wonkette.com/politics/rumors-on-the-internets/rumors-on-the-internets-people-are-really-pissed-off-today-162036.php (last visited Mar. 22, 2006). This posting features a number of rumors, including a statement that columnist Michelle Malkin "sleeps on a king-size Lego bed, in a Lego tower, surrounded by an adhesive image of a moat. Naivete sold separately."

of a talk-radio show that accidentally referred to Secretary of State Condoleeza Rice as a "coon."[16]

Victims of such rumor-mongering have expressed their frustration at their legal impotence in these matters. In December 2005, John Seigenthaler, Sr., former White House aide and Assistant Attorney General to Robert Kennedy, was defamed on the popular Internet "encyclopedia," Wikipedia.[17] Almost immediately thereafter, the same defamatory language appeared on two other popular web sites: Reference.com and Answers.com.[18] Seigenthaler expressed his frustration both with discovering the identity of the defamer, and with the immunity § 230 provided to Wikipedia, Reference.com, and Answers.com.[19] While Wikipedia is not a blog,[20] Seigenthaler's story highlights the two-fold problem CDA immunity presents: that interactive computer services have little to fear because of the broad CDA immunity they enjoy, and that such immunity almost totally forecloses an aggrieved plaintiff from any method of recovery.[21]

Like any other new medium, blogs present unique challenges for both the law and society.[22] As with radio and television before it, it was not long before undesirable content appeared on the Internet, and specific to this Note, on blogs. Indeed, the courts struggled with a similar problem in the mediums of television, radio, and the telegraph when those technologies first appeared, and ultimately decided to apply a slightly altered version of traditional defamation liability to them.[23]

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16. Wonkette, *We Are Totally, Totally, Totally, Totally, Totally Sorry for This*, http://wonkette.com/politics/condoleezza-rice/we-are-totally-totally-totally-totally-totally-sorry-for-this-162462.php (last visited Mar. 23, 2006). While this Author acknowledges that the Wonkette site is typically tongue-in-cheek humor, this is one of many examples where a blog walks the line between humor and character assassination.

17. *See generally* Daniel J. Solove, Concurring Opinions, *Fake Biographies on Wikipedia*, http://www.concurringopinions.com/archives/2005/12/fake_biographie.html (last visited Dec. 1, 2005) (stating that Seigenthaler's Wikipedia was altered to suggest that Seigenthaler was directly involved in the assassinations of both John F. Kennedy and Bobby Kennedy).

18. John Seigenthaler, *A False Wikipedia "Biography,"* USA TODAY, Nov. 29, 2005, at 11A.

19. *Id.*

20. *See generally* Wikipedia, http://en.wikipedia.org/wiki/Wikipedia:Introduction. Wikipedia "is an encyclopedia written collaboratively by many of its readers"; as such, any user who can access Wikipedia is capable of editing it.

21. *See generally* Robert T. Langdon, *Make Sense? Or Nonsense – A Private Person's Inability to Recover if Defamed in Cyberspace*, 73 ST. JOHN'S L. REV. 829 (1999) (articulating how, with the current CDA immunity, a plaintiff is virtually foreclosed from recovery in a distributor defamation suit).

22. Jae Hong Lee, Note, *Batzel v. Smith & Barrett v. Rosenthal: Defamation Liability for Third-Party Content on the Internet*, 19 BERKELEY TECH. L.J. 469 (2004) (noting that "[a]lthough every new medium presents new challenges for society and the law, closer inspection uncovers a rather unflattering truth . . . the inevitable appearance of undesirable content").

23. *See* W. Union Tel. Co. v. Lesesne, 182 F.2d 135, 136-37 (4th Cir. 1950) (applying the traditional distributor defamation liability standard to telegraph companies); *see also* Am. Broad.-Paramount Theatres, Inc. v. Simpson, 126 S.E.2d 873, 877-82 (noting that the then-new mediums of television and radio presented unique legal problems for the courts). *Paramount Theatres* also attempted to create a

Those technologies, however, were more difficult to access than blogs currently are. Though anyone with the appropriate equipment can broadcast a radio or television signal, it is unlikely that a person doing so would have the same access to the populace as a major television or radio network. Blogs, however, suffer no such limitation: anyone with a computer can develop and maintain their own blog. Indeed, the immense popularity and mass-accessibility of blogs, combined with the immunity to distributor defamation they would likely enjoy under § 230(c)(1), creates an environment with the potential for unfettered dissemination of defamatory statements on the Internet.

This Note will attempt to diffuse that potential before a true disaster occurs. Part I will detail a brief history of blogs and their current level of influence in today's society. Part II provides, as a matter of background, a brief outline of traditional defamation jurisprudence. Part III is a look at 47 U.S.C. § 230 and the split of authority that has arisen regarding the extent of the immunity it provides. Part IV is a suggestion as to what kind of action the courts and Congress should take to deal with this issue.

I. BLOGS

"Blogs," short for weblogs, have humble beginnings. In the 1980s and 1990s, when the Internet was in its infancy, blogs were simply a method for Internet users to inform their peers of varying links of interest.[24] Because their web "surfing" had essentially been done for them,[25] this service was considered invaluable during a time when Internet service providers ("ISPs") typically charged by the hour.[26] First-generation blogs commonly contained links to websites visited by the author, and occasionally included a short commentary about each specific link.[27]

Today, blogs have evolved far beyond that initial purpose. Since the advent of personal blogging software in 1999, blogs are no longer the sole province of the technologically savvy,[28] and the popularity of blogs as a medium of publica-

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new standard of defamation liability on television called a "defamacast" – a standard that, ultimately, was not followed. *Id.* at 877-82.

24. For an example of this "classic" style of blogging, see law school blogs. Law School Blogs, http://www.JD2b.com (last visited Oct. 19, 2006).

25. *See generally* Rebecca Blood, http://www.rebeccablood.net/essays/weblog_history.html (Sept. 7, 2000, 12:03 EST).

26. Gutman, *supra* note 12, at 145; *see also* Gregory Boyd Bell, *Blogs Here, Blogs There*, THE HAMILTON SPECTATOR, Aug. 31, 2002, at M13 (noting that before switching to a flat fee, ISP America Online charged per hour).

27. Bell, *supra* note 26.

28. Leander Kennedy, *The Web the Way It Was*, WIRED NEWS, Feb. 24, 2000, http://www.wired.com/news/culture/0,1284,34006,00.html ("Thanks to new easy-to-use software, the number of weblogs on the Net seems to be growing at an unprecedented rate.").

tion has exploded.[29] No longer simply a series of links, blogs today span a wide range of content. From marketing to politics, or functioning as an online diary, blogs are as diverse as the users who publish them.[30] Indeed, there is even a sub-section of blogging, known as "blawgs," which are dedicated almost entirely to the discussion of legal issues and policy.[31]

A. WHAT IS A BLOG?

Because the topics and styles of blogs are so wildly varied, no precise definition can be attached to them.[32] However, there are a few common factors that a blog possesses that distinguishes it from a standard web page.[33] Typically, a blog will contain a number of postings, usually written by a single author.[34] A singular posting breaks down into specific categories: the post's title, its primary body or content, the date of the posting, and finally, a "permalink," which contains the Uniform Resource Locator ("URL") specific to that particular posting.[35] A blog entry may also contain a "comments" section, wherein readers of the blog can post feedback which can be read by the author, as well as other readers.[36] Speaking generally, most blogs appear in reverse order, meaning the most recent posting appears at the top of the page.[37]

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29. Associated Press, *Popularity of 'Blogs' Surges,* CBS NEWS, Jan. 4, 2005, http://www.cbsnews.com/stories/2005/01/04/tech/main664638.shtml.

30. Gutman, *supra* note 12, at 186 n.6 ("Personal blogs are written primarily by a single person, and can range from articulate essays to trivial thought bubbles, while portal-like blogs tend to serve as content aggregators by offering links to personal blogs, news stories, discussion threads, and other electronic content.").

31. *See* The Blawg Review, http://www.blueblanket.net/Blawgreview (last visited Oct. 19, 2006); *see also* The Blawg Ring, http://www.geocities.com/blawgring (last visited Oct. 19, 2006) (consisting of numerous blawg sites).

32. Dictionary.com defines the word blog in two ways: (1) "[A]n online diary; a personal chronological log of thoughts published on a Web page; also called Weblog, Web log," and (2) "[A] personal Web site that provides updated headlines and news articles of other sites that are of interest to the user, also may include journal entries, commentaries and recommendations compiled by the user; also written web log, Weblog; also called blog." Dictionary.com, http://dictionary.reference.com/search?q=blog (last visited Oct. 19, 2006).

33. Wikipedia - Blog, http://en.wikipedia.org/wiki/blog (last visited Mar. 22, 2006).

34. *See* Merriam-Webster Online, http://www.m-w.com/info/04words.htm (last visited Oct. 19, 2006) (defining a "blog" as "a Web site that contains an online personal journal with reflections, comments, and often hyperlinks provided by the writer").

35. Wikipedia - Blog, *supra* note 33.

36. *Id.*

37. BlogsCanada, http://www.blogscanada.ca/BlogDefinition.html (last visited Oct. 19, 2006).

B. STATE OF THE BLOG: A POPULAR PLATFORM, AND GROWING DAILY

The modern blog operates more as a soap box than a guide to the Internet,[38] though the original function of the blog as a series of links remains intact.[39] Most important to this Note is that today, publishing a blog is so easily done that one does not even need to own a personal computer to do so.[40] Thus, the barrier to publication is considerably lower than it has been in the recent past.[41] For example, Apple Computers recently incorporated software that allows a user to create, maintain and update his or her own personal blog.[42] Such incorporation highlights the popularity and growing importance of the blog as a medium of publication,[43] and for the purposes of this Note, information dissemination. Indeed, blogs have become so popular that when a popular anonymous blogger reveals his or her identity, it is now considered national news.[44]

Of late, more traditional outlets have begun to embrace blogs and blogging. For example, the University of California at Berkley's Graduate School of Journalism now offers a class dealing specifically with blogs.[45] The University of Michigan's Law Review has also recognized the vast potential of the blog, and has created an innovative new outlet utilizing the blog format. This platform, called *First Impressions: An Online Companion to the Michigan Law Review*, features "op-ed length articles by academics and practitioners," and was developed to fill the gap "between the blogosphere and the traditional law review article" by allowing legal pundits to publish commentary instantly, without the limitation of slower dissemination that printed law review volumes typically

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38. Wikipedia - Blog, *supra* note 33.

39. Blog linking has since evolved into a concept known as "blogrolling." Even the *New York Times* has created its own "blogroll." *See* N.Y. Times Blogroll, http://www.nytimes.com/ref/technology/blogs_101.html (last visited Oct. 19, 2006).

40. *See generally* Kevin Barbieux, The Homeless Guy, http://thehomelessguy.blogspot.com (last visited Oct. 19, 2006) (At one point, Mr. Barbieux, did not have a home nor did he own a computer; rather, he accessed the Internet through computers available at local public libraries. His blog deals mainly with the struggles with homelessness and the mental effects of it, but his is a shining example of how easily someone can achieve publication through blogging.).

41. Gutman, *supra* note 12, at 147.

42. *See* Apple Computers – iLife, http://www.apple.com/ilife/ (last visited Oct. 19, 2006).

43. Gutman, *supra* note 12, at 147.

44. *See* Posting of Peter Lattman to WSJ.com Law Blog, http://blogs.wsj.com/law/2006/01/17/opinionistas-blogger-revealed/trackback (Jan 17, 2006, 15:34 EST) ("Opinionistas, the blogger who has spent the last ten months detailing the inner workings of life at a large New York law firm, is coming out of the anonymous-blogger closet, according to Gawker. The woman behind the site is 27-year-old Melissa Lafsky. . ..").

45. Noah Shachtman, *Blogging Goes Legit, Sort Of*, WIRED NEWS, June 6, 2002, http://www.wired.com/news/school/0,1383,52992,00.html; *see also* UC Berkley Journalism, http://www.journalism.berkeley.edu/program/newmedia (Blogs have been implemented into the University of California at Berkley's curriculum. New media course offerings included Introductory Multimedia Reporting and Advanced Multimedia Reporting, Computer Assisted Reporting and several courses that use Weblogs to cover news events.).

impose on an author.[46] Even the traditional media has also embraced the blog as a method of dissemination, as many popular television and print personalities now consistently maintain their own blogs.[47]

C. CAUSE AND EFFECT: THE BLOG IN PRACTICE

As mentioned above, there is no shortage of blogs with agendas, particularly in the political "blogosphere."[48] For example, the scandal surrounding Senator Trent Lott was instigated primarily by bloggers.[49] Senator Lott, at a party honoring Strom Thurmond,[50] commented that America would have been better off had Senator Thurmond been elected president.[51] Because Senator Thurmond was well-known for his staunch resistance to racial segregation, Lott's critics saw these statements as an endorsement of those beliefs.[52] Despite heavy coverage of the event, the traditional media passed over these comments quickly.[53] Bloggers, however, refused to let the issue pass with the day's news cycle and held fast to the story.[54] Eventually, Senator Lott was forced to rescind his bid for Senate Majority Leader—a direct result of the blogosphere's unremitting vigilance.[55]

Similarly, in September 2004, CBS anchor Dan Rather reported that he had documents suggesting that President George W. Bush received preferential treatment in the Texas Air National Guard.[56] Conservative blogs went into a frenzy, relentlessly insisting that the documents were fraudulent.[57] One blog went so far as to develop an animated graphic file which depicted how easily a false document could be created using today's word-processing software.[58] CBS eventually apologized and retracted the report. Rather subsequently re-

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46. *See* Michigan Law Review, http://students.law.umich.edu/mlr/first_impressions.htm (last visited Oct. 19, 2006) (noting that "[t]his extension of our printed pages aims to provide a forum for quicker dissemination of the legal community's first impressions of upcoming and recent judicial decisions").

47. Among these personalities are MSNBC's Keith Olbermann. *See* Bloggerman, http://www.msnbc.msn.com/id/6210240 (last visited Mar. 24, 2006); *see also* David Pogue, Pogue's Posts http://pogue.blogs.nytimes.com/ (last visited Mar 17, 2006) (Therein, *New York Times* technology reviewer David Pogue blogs about varying issues.).

48. Wikipedia - Political Blog, http://en.wikipedia.org/wiki/Political_blog (last visited Mar. 17, 2006).

49. Bamblog, http://www.bamberg-gewinnt.de/wordpress/archives/82 (Jun. 21, 2004, 12:33 EST)

50. *Id.*

51. Wikipedia - Blog, *supra* note 33.

52. *Id.*

53. Noah Shachtman, *Blogs Make the Headlines*, WIRED NEWS, Dec. 23, 2002, http://www.wired.com/news/culture/0,1284,56978,00.html.

54. Paul Krugman, *The Other Face,* N.Y. TIMES, Dec. 13, 2002, at A39.

55. *Id.*

56. Howard Kurtz, *Dan Rather to Step Down at CBS*, WASH. POST, Nov. 24, 2004, at A01.

57. *Id.*

58. Little Green Footballs, http://littlegreenfootballs.com/weblog/?entry=12615&only (last visited Sept. 14, 2004).

signed in March, 2004, ending a 43-year career as a broadcaster and journalist.[59]

Blogs can also adversely affect the users who publish them. Jessica Cutler, who posted under the surname "washingtonienne," depicted in great detail her romantic encounters with various men during her time as a staff assistant to Senator Mike DeWine.[60] When the blog was discovered, Cutler was fired; nevertheless, her story made national news.[61]

Another, more bizarre use of blogs has been to create flash mobs. Loosely translated, flash mobs are sudden gatherings of people at a designated time and place, and are perhaps best described as a large-scale practical joke.[62] Attendees of these flash mobs learn the specific time and place they should "mob" by reading a particular blog.[63] For example, in 2003, a group of approximately seventy-five "mobbers" assembled in a Washington D.C. bookstore.[64] Once there, each member of the group picked up a different magazine and read aloud from it; once their reading was complete, the group dispersed as quickly as it had appeared.[65]

II. THEY SAID WHAT?! THE TORT OF DEFAMATION

Because the ultimate goal of this Note is to present a viable, alternative standard to the immunity provided by § 230, it is critical to review and understand the traditional body of defamation jurisprudence. As will be shown, since traditional defamation liability grants an aggrieved plaintiff a method of recovery, it seems that this standard of liability is more desirable.

Defamation is a common law tort that guards against false oral or written statements that could damage one's good name and standing in the community.[66] The alleged defamatory statement must be made to a third-party, and can be done either orally, or through a publication of the statement made by the defamer.[67] Accusations of untruthfulness or criminal conduct are considered

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59. Kurtz, *supra* note 56.

60. *The Lost Washingtonienne* (Wonkette Exclusive, etc., etc.), http://www.wonkette.com/archives/the-lost-washingtonienne-wonkette-exclusive-etc-etc-0 (last visited Feb. 11, 2006).

61. April Witt, *Blog Interrupted,* WASH. POST, Aug. 15, 2004, at W12.

62. Wikipedia–Flash Mob, http://en.wikipedia.org/wiki/Flash_mob (last visited Feb. 23, 2006) ("Flash mobs started as pointless stunts, but the concept has already developed for the benefit of political and social agendas.").

63. *See* Flashmob.com, http://www.flashmob.com (last visited Jan. 17, 2006) (listing upcoming flash mobs willing participants can attend).

64. Jackie Spinner, *A Fast-Moving Fad Comes Slowly to Washington,* WASH. POST, Aug. 21, 2003 at A01.

65. *Id.*

66. Danielle M. Conway-Jones, *Defamation in the Digital Age: Liability in Chat Rooms, On Electronic Bulletin Boards, and in the Blogosphere,* SK 102 A.L.I. – A.B.A. 63, 66 (2005).

67. Stephanie Blumstein, Note, *The New Immunity in Cyberspace: The Expanded Reach of the Communications Decency Act to the Libelous "Re-Poster,"* 9 B.U. J. SCI. & TECH. L. 407, 409 (2003).

defamatory, but simple crudeness or mockery usually will not suffice.[68] Today, many jurisdictions simply apply the Restatement (Second) of Torts test for defamation to determine liability.[69]

Moreover, in order to make a prima facie case, a plaintiff must show that an allegedly defamatory statement is not an opinion, satire or hyperbole, and even then, both knowledge and the proper degree of fault must be shown—a difficult standard to establish.[70] Moreover, truth acts as an affirmative defense against an accusation of defamation, as a defendant can escape liability by proving that the defamatory statements were true.[71]

Furthermore, traditional defamation law has defined three types of information disseminators, to which very different standards were applied to determine defamation liability.[72] The three groups are as follows:

PUBLISHERS: While the common law of defamation applied to both publishers and distributors, the standards of liability differed between those who published writings and those who merely disseminated them. Publishers, as the primary authors and editors of potentially defamatory content, are subject to strict liability.[73]

DISTRIBUTORS: Distributors are subject to a less strict standard for defamation liability, in that they must have knowledge that the material they are disseminating is defamatory.[74] Section 581(1) of the Restatement (Second) of Torts provides that "one who only delivers or transmits defamatory matter published by a third person is subject to liability if, but only if, he knows or has reason to know of its defamatory character."[75] Most courts have adopted that language almost exactly.[76] This is the most important type of defamation liability for this Note, and indeed, this Note will ultimately advocate for the application of this model of defamation liability to blogs and blogging.

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68. *Id.*

69. RESTATEMENT (SECOND) OF TORTS § 558 (1977). It provides:

> To create liability for defamation, there must be: (a) a false and defamatory statement concerning another; (b) an unprivileged publication to a third party; (c) fault amounting at least to negligence on the part of the publisher; and (d) either actionability of the statement irrespective of special harm or the existence of special harm caused by the publication. *Id.*

70. *See* Barrett v. Rosenthal, 9 Cal. Rptr. 3d 142, 162-63 (Cal. App. 1 Dist. 2004).

71. *See* Media3 Techs., LLC v. Mail Abuse Prevention Sys., LLC., No. 00-CV-12524-MEL, 2001 WL 92389, *8 (D. Mass. Jan. 2, 2001) ("However, even if the statement is subject to a defamatory construction, truth is a complete defense.") (citing Dulgarian v. Stone, 652 N.E.2d 603, 606 (Mass. 1995).

72. Lee, *supra* note 22, at 471.

73. *Id.*

74. *Id.*

75. RESTATEMENT (SECOND) OF TORTS § 581(1) (1977).

76. *Barrett*, 9 Cal. Rptr. 3d at 150 ("Distributors. . .are subject to an intermediate standard of responsibility and may only be held liable as publishers if they know or have reason to know of the defamatory nature of the matter that they disseminate.").

COMMON CARRIERS: This kind of disseminator only transmits information with no knowledge or control over the content.[77] Therefore, the common carrier is not subject to tort liability.[78]

III. THE SAFE HARBOR PROVISION OF 47 U.S.C. § 230

Before an argument advocating a change from the current § 230 standard for defamation liability can be made, the staggering scope of the immunity that § 230 provides, and how precisely that immunity came about, must be understood.

Section 230 was initiated in the House of Representatives as the Cox-Wyden Amendment.[79] Its supporters recognized that the Internet was an intriguing new medium,[80] and that they had to develop cutting-edge legislation around it.[81] Subsequently, the CDA was enacted in 1996 with the understanding that "[t]he rapidly developing array of Internet and other interactive computer services available to individual Americans represent[s] an extraordinary advance in the availability of educational and informational resources to our citizens."[82] Congress, with considerable foresight, stated that it was the policy of the United States to promote the development of the Internet, as well as other interactive computer services,[83] with a minimal amount of government regulation.[84] Moreover, Congress hoped to preserve the competitive free market that existed on the Internet without interference from State or Federal regulation.[85]

However, § 230(c)(1) of the CDA ushered in a significant change to traditional defamation jurisprudence.[86] It was a "dream come true"[87] for ISPs, as Congress made it clear that no interactive service provider could be classified as a publisher in terms of defamation liability, as long as a third-party had pro-

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77. Lee, *supra* note 22, at 471.

78. *Id.*

79. *See* 141 CONG. REC. H8468-8472 (Aug. 4, 1995).

80. Lee, *supra* note 22, at 488.

81. *See* 141 CONG. REC. H8468-8470 (Aug. 4, 1995). *See also* Lee, *supra* note 22, at 487-88 (providing, in pertinent part: "As Representative Wyden noted during House discussions . . . '[the Internet] is simply different. We have the opportunity to build a [twenty-first] century policy for the Internet employing the technologies and the creativity designed by the private sector'").

82. 47 U.S.C. § 230(a)(1) (2006).

83. *Id.* § 230(b)(1) ("It is the policy of the United States to promote the continued development of the Internet and other interactive computer services and other interactive media").

84. *Id.* § 230(a)(4) ("The Internet and other interactive computer services have flourished, to the benefit of all Americans, with a minimum of government regulation").

85. *Id.* § 230(b)(2) (noting that Congress hoped "to preserve the vibrant and competitive free market that presently exists for the Internet and other interactive computer services, unfettered by Federal or State regulation"). *See also* Michael L. Rustad & Thomas H. Koenig, *Rebooting Cybertort Law,* 80 WASH. L. REV. 335, 368 (2005) (explaining that the Congressional intent behind § 230 was to preserve the "vibrant and competitive" free market that exists on the Internet).

86. Conway-Jones, *supra* note 66, at 66-67.

87. Rustad & Koenig, *supra* note 85, at 368.

vided the defamatory content.[88] Congress's purpose in implementing such a broad protection was to prohibit the chilling of speech online, as well as to promote self-regulation and self-policing by ISPs.[89] Because the Internet was considerably smaller and less prevalent in 1995, such protection seemed not only viable, but desirable.[90]

However, the application of § 230's immunity by the courts has been met with considerable scholarly criticism,[91] and it has been suggested that the current application of § 230 has made defamation on the Internet into a reverse image of traditional defamation law.[92] A substantial amount of this criticism focuses on the court's overly broad interpretation of § 230 immunity. Further, some commentators have noted that by granting such extensive immunity to defamation liability, the courts have granted broader protections for the Internet than any other medium has previously enjoyed.[93]

Moreover, the courts have stretched Congress's express language in § 230 from the narrow purpose of immunizing ISPs as publishers to the broader purpose of shielding virtually every information distributor on the Internet from almost all forms of tort liability.[94] It is feared that this departure from traditional defamation jurisprudence, which distinguishes between publishers and distributors, may have a long-term impact in Internet cases where almost anyone can be simultaneously considered an ISP, an Internet service user, a publisher, and a distributor of information.[95] Even some courts have critiqued the broad immunity provided by the current interpretation of § 230, noting that the current CDA immunity converts an act designed to promote decency into a shield for indecency, which Congress could not have intended.[96]

The majority of decisions interpreting § 230 have immunized ISPs from liability resulting from third-party defamatory content,[97] and one went so far as to hold that the operator of a listserv who republished a defamatory third-party e-

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88. 47 U.S.C. § 230(c)(1) (2006) ("No provider or user of an interactive computer service shall be treated as the publisher or speaker of any information provided by another information content provider").

89. Lee, *supra* note 22, at 470.

90. Rustad & Koenig, *supra* note 85, at 335.

91. *See also* Lee, *supra* note 22, at 470; *see also* Jeffrey Lipschutz, *Internet Dating . . . Not Much Protection Provided by The Communications Decency Act of 1996 Based on Carafano v. Metrosplash.com, 339 F.3d 1119 (9th Cir. 2003)*, 23 TEMP. ENVTL. L & TECH. J. 225, 226 (2004) (critiquing CDA immunity). *See also* MATTHEW COLLINS, THE LAW OF DEFAMATION AND THE INTERNET 385-389 (2001) (explaining how cases under 47 U.S.C. § 230 would have been decided differently in the United Kingdom and Australia).

92. Rustad & Koenig, *supra* note 85, at 351.

93. Lee, *supra* note 22, at 470.

94. Rustad & Koenig, *supra* note 85, at 335.

95. Conway-Jones, *supra* note 66, at 66-67.

96. *Barrett*, 9 Cal. Rptr.3d at 152.

97. Zeran v. Am. Online, Inc., 129 F.3d 327, 330 (4th Cir. 1997).

mail enjoyed statutory immunity under § 230.[98] However, while no decision articulating a standard specific to blogs has been passed down, it seems very plausible that a blogger could escape defamation liability if he was simply "re-posting" a derogatory e-mail or post from another source, as § 230 practically gives license to a blogger to spread hurtful commentary with ease and impunity.[99] When combined with the considerable ease with which a blogger can obtain and republish defamatory information, it seems clear that there is potential for disaster with the current interpretation of § 230.

A. CASES UNDER § 230

The leading case regarding § 230 interpretation is *Zeran v. America Online, Inc.*[100] Therein, the plaintiff brought suit against America Online ("AOL") for unreasonable delay in the removal of some defamatory postings by an unknown third-party.[101] On April 25, 1995, just six days after the Oklahoma City bombing, an unidentified person posted an advertisement on AOL bulletin boards.[102] This post described the sale of T-shirts containing offensive slogans related to the bombing.[103] Those who desired to purchase these shirts were instructed to call "Ken" at a phone number, which ultimately turned out to be Zeran's.[104] Zeran began receiving threatening phone calls, and requested that the posting be removed.[105] The posting was eventually removed; nonetheless, another advertisement with Zeran's home number was posted on April 26, 1995.[106] Soon thereafter, an Oklahoma City radio station and newspaper also disseminated Zeran's home phone number.[107] AOL, in response to Zeran's negligence claim, cited immunity under § 230 as an affirmative defense, and the district court granted AOL's motion for a judgment on the pleadings.[108] Zeran appealed to the Fourth Circuit, claiming that § 230 immunity abrogated publisher liability, but left distributor liability intact.[109] The Fourth Circuit rejected Zeran's argument, and held that distributor liability was "merely a subset, or a species, of publisher liability, and is therefore also foreclosed by § 230."[110]

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98. Batzel v. Smith, 333 F.3d 1018, 1031-35 (9th Cir. 2003).
99. *Id.* at 1038. (Gould, J., concurring in part, dissenting in part).
100. *See generally Zeran*, 129 F.3d at 327.
101. *Id.*
102. *Id.* at 329.
103. *Id.*
104. *Id.*
105. *Id.*
106. *Zeran*, 129 F.3d at 329.
107. *Id.*
108. *Id.* at 329-30.
109. *Id.* at 330-31.
110. *Id.* at 332.

Cases that followed *Zeran* expanded § 230 immunity to new levels. In *Blumenthal v. Drudge,*[111] the D.C. district court held that AOL was not liable for defendant Matt Drudge's ("Drudge") commentary that Sidney Blumenthal had a history of spousal abuse.[112] Drudge, author of the "Drudge Report,"[113] depicted in detail interviews with "top" republican officials, as well as other White House "insiders" that suggested that Blumenthal had a history of violence towards his wife.[114]

At the time of this particular column's publication, Drudge was engaged in a licensing agreement with AOL, which gave AOL significant editorial control over the column.[115] Drudge was also obligated to upload the column to AOL before AOL would make it available online.[116] However, despite AOL's knowledge of the column's content before its distribution to AOL subscribers, the district court, citing heavily to *Zeran*, determined that AOL could not be held liable due to the immunity provided by § 230.[117] The court reasoned that because AOL did not ultimately exercise any of its potential editorial control, it was not an information content provider, and thus, could not be held subject to liability under § 230.[118] However, the court seemed perturbed by its own decision, stating that, wisely or not, Congress did decide to immunize providers of interactive computer services from defamation liability with respect to third-party material redistributed by them, but created by others.[119]

In *Batzel v. Smith,*[120] the Ninth Circuit addressed the issue of whether the moderator of a listserv can be held liable for posting a defamatory e-mail authored by a third-party.[121] The court held that a service provider or user is immune from liability under § 230(c)(1) when a third person or entity furnished [information] to the provider or user under circumstances in which a reasonable person in the position of the service provider or user would conclude that the information was provided for publication on the Internet or other "interactive computer service."[122] Justice Gould, in a scathing dissent, remarked that by providing immunity for parties that distribute defamatory third-party writings,

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111. Blumenthal v. Drudge, 992 F. Supp. 44, 44 (D.D.C. 1998).

112. *Id.* at 47-48.

113. Drudge Report 2006, http://www.drudgereport.com (last visited Jan. 9, 2006).

114. *Blumenthal,* 992 F. Supp. at 46.

115. *Id.* at 47 (This control included the ability to "remove content that AOL reasonably determine[s] to violate AOL's then standard terms of service.").

116. *Id.* at 47-48 (Drudge uploaded the Blumenthal column to AOL before its widespread release.).

117. *Id.* at 47-48.

118. *Id.* at 50.

119. *Id.* at 49 ("Whether wisely or not, [Congress] made the legislative judgment to effectively immunize providers of interactive computer services from civil liability in tort with respect to material disseminated by them but created by others.").

120. Batzel v. Smith, 333 F.3d 1018 (9th Cir. 2003).

121. *Id.* at 1020.

122. *Id.* at 1034.

the majority has developed a rule that "encourages the casual spread of harmful lies,"[123] and essentially "licenses professional rumor-mongers and gossip-hounds to spread false and hurtful information with impunity."[124]

B. THE LINE IS DRAWN: *BARRETT V. ROSENTHAL*

Subsequently, in *Barrett v. Rosenthal*,[125] the Court of Appeals in California refused to follow the *Zeran* interpretation of § 230. Appellants Stephen J. Barrett and Terry Polevoy were physicians who were known for combating the use and promotion of "alternative" healthcare practices and products.[126] Both maintained websites where they questioned the viability of various alternative remedies,[127] and provide information in the hopes that consumers will make what they consider to be "intelligent healthcare choices."[128] Respondent Rosenthal, who frequently posted on two usenet "newsgroups" that focused on alternative medicine and treatments, reposted defamatory messages allegedly designed to injure the reputation of appellants.[129] One such posting, which Rosenthal received from another defendant and reposted to the newsgroup, depicted appellant Polevoy as a stalker.[130] Shortly after Rosenthal reposted the message, appellants asked that it be removed, "and threatened suit if it was not."[131] Rosenthal refused and posted thirty-two additional messages to the newsgroup, wherein she used various colorful terms to describe the appellants, including calling them "quacks."[132]

The trial court, citing *Zeran*, found Rosenthal immune to liability for reposting the stalker message, holding that § 230 protected her from liability for her republication, even if the statement was indeed defamatory.[133] The district court, however, declined to follow *Zeran*, and held that the immunity granted by § 230 did not apply,[134] and went on to describe the *Zeran* interpretation of § 230 immunity as too broad.[135] Specifically, the court held that the *Zeran* characterization of § 230 was misleading in the sense that it suggested § 230

123. *Batzel*, 333 F.3d at 1038. (Gould, J., concurring in part, dissenting in part).

124. *Id.*

125. Barrett v. Rosenthal, 9 Cal. Rptr. 3d 142 (Cal. Ct. App. 2004), *review granted and opinion superseded by* 87 P.3d 797 (Cal. Ct. App. 2004).

126. *Id.* at 144.

127. *Id.* (stating that the appellant's website "attack[s] 'products, services and theories that are marketed with claims that [are] false, unsubstantiated, and/or illegal' ").

128. *Id.*

129. *Id.* at 144-45.

130. *Id.* at 145.

131. *Barrett*, 9 Cal. Rptr. 3d at 145-46.

132. *Id.* at 146.

133. *Id.*

134. *Id.* at 150.

135. *Id.* at 153 ("The most consequential aspect of the Fourth Circuit's opinion in *Zeran* is its conclusion that § 230 immunized providers and users of interactive computer services from liability not only as *primary publishers* but also as *distributors*.").

reflected a "superseding congressional 'desire to promote unfettered speech on the Internet.'"[136] The court then noted the considerable difference between publisher and distributor liability, and stated that if Congress had intended to lump publisher and distributor liability together, it would have expressly done so in the statute.[137] Finally, the court determined that § 230 did not abrogate traditional distributor defamation jurisprudence, because a statute must speak directly to the question addressed by the common law in order to abrogate it.[138]

IV. § 230 IMMUNITY CANNOT APPLY TO BLOGS

Put simply, the current interpretation of § 230 immunity cannot be applied to blogs and blogging because the protection it provides is too extensive. Further, as will be shown, Congress could not have predicted such a powerful medium of dissemination like blogs would become available when it developed § 230, nor could it have intended to virtually foreclose plaintiff recovery in defamation suits.

Because blogs have become a widely used platform for expression on today's Internet, the potential for defamation, as well as uneven results in the courts, is immense.[139] While a decision directly involving blogs has yet to be handed down, it seems all too possible under *Zeran* and *Batzel* for a popular blog to republish a defamatory statement without fear of liability.[140] *Batzel,* in particular, could grant blogs and bloggers considerable license to repost defamatory material without fear of liability because the court there greatly expanded the meaning of interactive computer service,[141] and a blog could easily fit within that definition.[142]

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136. *Barrett,* 9 Cal. Rptr. 3d at 153 (citing Zeran v. Am. Online, Inc., 129 F.3d 327, 334 (4th Cir. 1997)).

137. *Id.* at 156.

> [I]f [Congress] intended § 230 to immunize providers and users not merely from primary publisher liability but also from distributor liability it would have made this clear, as, for example, by adding the word 'distributor,' and not merely barring liability 'as the publisher or speaker' of information provided by another. *Id.* at 156.

138. *Id.* at 166-67 (citing *United States v. Texas,* 507 U.S. 529, 534 (1993) ("In such cases, Congress does not write upon a clean slate. In order to abrogate a common-law principle, the statute must 'speak directly' to the question addressed by the common law.")).

139. Euclid Managers Blog, http://blog.euclidmanagers.com/home/the-world-wide-web-of-potential-liability.html (Feb. 4, 2005 14:34 EST) ("The internet cannot be underestimated as a tool, nor can we underestimate its potential to generate [defamation] liability.").

140. Many blogs, including Wonkette, frequently ask readers to e-mail stories and information of interest. *See generally* Wonkette, http://wonkette.com (the site's author has a prominent e-mail address on the main page, which solicits readers to send in any and all rumors).

141. *Batzel,* 333 F.3d at 1034.

142. *See id.* at 1030 ("There is, however, no need here to decide whether a listserv or website itself fits the broad statutory definition of 'interactive computer service,' because the language of § 230(c)(1)confers immunity not just on 'providers' of such services, but also on 'users' of such services."); Because a blogger functions as both a user and provider of an interactive computer service, it

Congress's intent with the CDA was an admirable one. In implementing § 230, Congress noted the awesome potential of the Internet as an informational resource,[143] and provided legislation designed to protect a growing medium and the companies that enabled users to access the Internet.[144] Congress intended the CDA to encourage self-regulation amongst ISPs by allowing them to exercise their editorial control without becoming subject to strict liability for defamation.[145]

For the most part, Congress has accomplished its goal, as ISPs have been protected, and the Internet has grown at an enormous rate.[146] However, it seems that the Internet is no longer in need of this protection. Rather, it is now a robust medium.[147] Blogs themselves are an excellent example of the Internet's startling growth, as there are an estimated 10 million blogs worldwide.[148] Further, when developing § 230, Congress could not possibly have predicted the phenomenon of blogs or the kind of impact they would have on mainstream culture, and it is merely a coincidence that such a powerful and accessible method of dissemination like blogging would seemingly fall under § 230 immunity. Because Congress has had no opportunity to design legislation specific to blogs and blogging, the courts should exercise caution when determining whether § 230 applies to blogs.

Moreover, the current judicial interpretation of § 230 immunity has virtually foreclosed recovery for plaintiffs in a defamation suit, even where the defendant distributor possessed some form of editorial control over the defamatory material.[149] For example, should a rumor grow out of control, as it did in the case of John Seigenthaler, Sr.,[150] the injured party will have little legal recourse under

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is likely that a court following the *Batzel* precedent would hold that a blog is entitled to § 230 immunity; *see also* 47 U.S.C. § 230(f)(2) (2005) (defining an interactive computer service as "any information service, system, or access software provider that provides or enables computer access by multiple users to a computer server, including specifically a service or system that provides access to the Internet and such systems operated or services offered by libraries or educational institutions").

143. 47 U.S.C. § 230(a)(1) (2005).

144. *Id.* § 230(b)(1).

145. Lee, *supra* note 22, at 470.

146. Zeran v. Am. Online, Inc., 129 F.3d 327, 333 (4th Cir. 1997) (The *Zeran* court, for its part, seemed extremely cognizant of the legislative intent to protect ISPs from liability, as it surmised that ISPs "would face potential liability each time they receive notice of a potentially defamatory statement.").

147. Ashley Seager, *Internet Shopping Reaches 10% of Retail Sales*, THE GUARDIAN, (U.K.) Jan. 20, 2006, *available at* http://business.guardian.co.uk/story/0,,1690776,00.html (noting that in 2005, Internet sales took up approximately 10 percent of retail sales).

148. Carl Bialik, *Measuring the Impact of Blogs Requires More than Counting*, WALL ST. J., May 26, 2005, *available at* http://online.wsj.com/public/article/SB111685593903640572.html.

149. Blumstein, *supra* note 67, at 424; *see also* Barry J. Waldman, *A Unified Approach to Cyber-Libel: Defamation on the Internet, a Suggested Approach*, 6 RICH J.L. & TECH. 9, 51 (1999) (providing that "the courts have nearly foreclosed the possibility of recovery for Cyber-Libel").

150. John Seigenthaler, *A False Wikipedia "Biography,"* USA TODAY, Nov. 29, 2005, at 11A.

the current interpretation of the CDA. Applying the current § 230 standard to blogs would only aggravate this problem.

A. PRIOR DEVIATIONS FROM TRADITIONAL DEFAMATION LAW HAVE FAILED

As noted above, the Internet is not the first new method of dissemination to pose problems for the courts. For example, when the telegraph was a new technology, the courts struggled to find an appropriate standard of defamation liability for telegraph operators.[151] Eventually, the courts would settle on a distributor-type standard of liability, which held the telegraph company or operator liable if they knew that the sender of the telegram was acting in bad faith with the purpose of defaming another.[152]

Television went through a similar process.[153] One court, confused as to whether a television broadcast should be classified as a libel or slander, endeavored to implement a new subcategory of defamation, known as a "defamacast."[154] However, no other courts adopted this approach, and eventually, the traditional approach to defamation liability was simply altered to properly apply to the television medium.[155]

When the Internet emerged as the new medium of dissemination, the courts did not attempt to apply a new standard of defamation liability to it.[156] Instead, their original instinct was to apply the traditional defamation standard and to categorize interactive computer services as distributors, subjecting them to knowledge-based liability for defamation.[157] Congress altered this intuitive application of the law with the implementation of the CDA, and the *Zeran* and *Batzel* courts eviscerated it totally with their broad interpretation of the § 230 immunity.[158]

While there is no question that the Internet is capable of transmitting vast quantities of information with incredible speed,[159] similar characteristics were seen in radio and television when they were considered new mediums.[160] How-

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151. Lee, *supra* note 22, at 486; Finley P. Maxson, *A Pothole on the Information Superhighway: BBS Operator Liability for Defamatory Statements*, 75 WASH. U. L.Q. 673, 676 (1997).

152. W. Union Tel. Co. v. Lesesne, 182 F.2d 135, 136-37 (4th Cir. 1950).

153. Maxson, *supra* note 151, at 676-77.

154. Am. Broad.-Paramount Theatres, Inc. v. Simpson, 126 S.E.2d 873, 877-82 (Ga. Ct. App. 1962); *see also* Lee, *supra* note 22, at 486 (providing, in relevant part: "One court seemed to give up rather quickly on the notion that traditional categories of defamation could be applied to the relatively new media of radio and television, and chose instead to introduce a novel defamation category which it called a 'defamacast' ").

155. Maxson, *supra* note 151, at 676-77; Lee, *supra* note 22, at 486-87.

156. *See* Stratton Oakmont, Inc. v. Prodigy Servs. Co., 1995 WL 323710, at *5 (N.Y. Sup. Ct. May 25, 1995) ("Computer bulletin boards should generally be regarded in the same context as bookstores, libraries and network affiliates.").

157. *See id.*

158. Lee, *supra* note 22, at 487.

159. *Id.* at 488.

160. *Id.* at 486.

ever, Congress did not see fit to blanket either television or radio with an extensive liability to defamation.[161] It seems the same logic should apply to blogs: while the Internet and blogs present an intriguing new form of dissemination, they are not so wildly unique as to require a distinctive form of defamation jurisprudence.[162]

B. APPLYING TRADITIONAL DEFAMATION JURISPRUDENCE TO BLOGS WOULD BE A MORE REASONABLE STANDARD

Some commentators have suggested that a return to traditional defamation jurisprudence on the Internet would impose a heavy burden on free speech.[163] The *Zeran* court thought so,[164] and indeed, perhaps the most intuitive argument against applying traditional defamation jurisprudence to blogs would be the potentially heavy burden it would place on free speech. However, the *Barrett* court questioned whether knowledge-based liability would actually have an unduly chilling effect on cyberspeech, and accused the *Zeran* court of overstating the dangers the application of traditional defamation jurisprudence would have on Internet speech.[165]

The protections Congress intended § 230 to grant to interactive computer services, such as the protection of Internet speech, are already built-in to the traditional defamation doctrine.[166] For example, to make a prima facie case, a plaintiff must show that an allegedly defamatory statement is not an opinion, satire or hyperbole, and even then, both knowledge and the proper degree of fault must be shown – a difficult standard to establish.[167] Further, a defendant can escape liability by proving that the defamatory statements were true.[168] Because many statements on blogs function as opinion, satire or hyperbole, a plaintiff would have a difficult time establishing a prima facie case against a blogger. Thus, a blogger would have little to fear in terms of having speech chilled; and by proxy, Internet speech remains protected, just as Congress intended. At the same time, a plaintiff would no longer be totally foreclosed from

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161. Maxson, *supra* note 151, at 690.

162. Lee, *supra* note 22, at 488.

163. Paul Erlich, Note, *Communications Decency Act § 230*, 17 BERKLEY TECH. L.J. 401, 416-17 (2002).

164. Zeran v. Am. Online, Inc., 129 F.3d 327, 331 (4th Cir. 1997).

165. Barrett v. Rosenthal, 9 Cal. Rptr. 3d 142, 162-63 (Cal. Ct. App. 2004); *see also* Lee, *supra* note 22, at 492 (providing, in re'evant part: "[h]owever, the *Barrett* court was clearly skeptical, stating that it thought it 'debatable whether notice liability would actually have an unduly chilling effect on cyberspeech' and describing the *Zeran* court's concerns as 'speculative').

166. *Barrett*, 9 Cal. Rptr. 3d at 157.

167. *Id.* at 163.

168. *See* Media3 Techs., LLC v. Mail Abuse Prevention Sys., LLC, No. 00-CV-12524-MEL, 2001 WL 92389, at *8 (D. Mass. 2001) (citing Dulgarian v. Stone, 652 N.E.2d 603, 606 (Mass. 1995) (noting that truth is still a complete defense for a statement subject to defamatory construction)).

recovery, because while it is difficult to prove defamation under the traditional jurisprudence, it can still be done.

Other commentators have joined the *Barrett* court in remarking that a return to traditional defamation jurisprudence would be a clearer and more reasonable standard.[169] Congress, when creating the CDA, believed knowledge-based liability would impose too great a burden on ISPs.[170] However, it seems that a return to knowledge-based liability would not impose an unbearable burden on ISPs, as they would be required to remove defamatory postings only when they are made aware of such postings.[171] For bloggers, that burden would be even lighter, as blogs are generally smaller than ISPs, and have less material to keep watch over. Enforcing the requirement that bloggers answer the requests to remove offensive material seems not only realistic, but done with relative ease.[172]

C. POTENTIAL AMENDMENTS TO THE CDA

Rather than allowing the courts to continue to misinterpret the immunity of the CDA, Congress can remedy this situation simply by amending § 230.[173] Since the inception of the CDA, many new methods of dissemination on the Internet have grown to prominence, including blogs. Indeed, the district court that first heard the *Zeran* case noted that Congress would likely have reason to revisit the CDA in the future.[174]

The time to do so is now. Congress should clarify its intentions regarding CDA immunity as related to blogs by enacting guidelines that follow the common law standards for distributor-based defamation.[175] A simple notice-based liability standard would fit nicely.[176] A plaintiff alleging defamation would make the libelous blog aware of both the defamatory content, as well as the

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169. Lee, *supra* note 22, at 492; *see also* Blumstein, *supra* note 67, at 424 (suggesting that a return to traditional defamation law would be a more appropriate standard for Internet bulletin boards).

170. Lee, *supra* note 22, at 492.

171. *Id.* (stating that knowledge-based liability would not place an undue burden on ISPs).

172. Annemarie Pantazis, *Zeran v. America Online, Inc.: Insulating Internet Service Providers From Defamation Liability*, 34 WAKE FOREST L. REV. 531, 555 (1999); *see also* Blumstein, *supra* note 67, at 425 (suggesting that enforcing such a requirement would not impose an overly heavy burden on bulletin board moderators).

173. Blumstein, *supra* note 67, at 425.

174. *See* David R. Sheridan, *Zeran v. AOL and the Effect of Section 230 of the Communications Decency Act Upon Liability for Defamation on the Internet*, 61 ALB. L. REV. 147, 168-69 (1997); *see also* Lee, *supra* note 22, at 493 (stating that "[t]he district court that initially heard the Zeran case concluded that 'the Internet is a rapidly developing technology [and that]Congress is likely to have reasons and opportunities to revisit the balance struck in [the CDA].'" (quoting Sheridan, *supra* at 166-67)).

175. Blumstein, *supra* note 67, at 425-26; *see also* Pantazis, *supra* note 172, at 550 (suggesting that Congress would do well to implement statutory language that follows traditional distributor liability for defamation).

176. Blumstein, *supra* note 67, at 425.

damage it could potentially do to the plaintiff's character. Such notice would then give the blog a certain period of time, perhaps 30 days, to remove the alleged defamatory content.[177] The blogger can use this time to consult an attorney to determine whether the alleged material is truly defamatory and should be removed, which will save resources, as both the parties and the courts will be spared the expense of litigation. However, should the blogger chose not to remove the alleged defamatory material, the case will proceed to trial, and the court will apply the traditional defamation standard.[178]

CONCLUSION

Thus, the same standard used in traditional defamation jurisprudence should be imposed upon bloggers. As Mr. Justice Holmes once said, in some areas of the law, "a page of history is worth a volume of logic."[179]

177. New York State has a similar "notice of claim" system in place when an individual seeks to file suit against a municipality. *See* N.Y. GEN. MUN. LAW § 50-e (2006) (stating that before serving the summons and complaint, the plaintiff must file a "notice of claim" which makes the municipality aware of the potential lawsuit, but also gives it time to assess the merits of the plaintiff's claim and determine whether it should settle out of court).

178. RESTATEMENT (SECOND) OF TORTS § 558 (1977).

179. New York Trust Co. v. Eisner, 256 U.S. 345, 349 (1921).

SEC: Stay Out of the Hedges

SARAH GROSSMAN*

INTRODUCTION

The explosive growth of hedge funds and their alleged heavy use of leverage has caused many legislators and financial regulators to propound that the largely unregulated and opaque industry needs oversight.[1] Part of the rationale for regulation stems from the secrecy surrounding hedge funds, which makes it nearly impossible to state the exact number of funds in existence and the amount of capital they control.[2] Coupled with this uncertainty, is the realization that hedge fund investors are no longer just a few select wealthy individuals; pensions and institutions are now heavily invested in the industry.

Even though the assets of hedge funds comprise only a small portion of the overall market, they borrow heavily from large institutional banks, engage in credit swaps, and account for a high percentage of the trading volume of banks and prime brokerages.[3] Thus, a default by a hedge fund could lead to defaults by the lending institutions, which in turn would produce systemic shock in the markets; or so the argument goes. However, this fear is largely unfounded, and employs a naïve understanding of the industry.

Hedge funds, by their very structure, do not pose a systemic risk to the financial markets.[4] They are highly diverse in terms of size, capital, and investment styles.[5] They provide liquidity, eliminate market price gaps, and overall, make the market more efficient.[6] In fact, as the hedge fund industry has grown, market volatility has collapsed. Hedge funds employ a variety of different strategies, some conservative, and some highly risky. The focus should not be placed on hedge fund strategy, but rather on the benefit that they offer financial markets.

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1. *See* Willa E. Gibson, *Is Hedge Fund Regulation Necessary?*, 73 TEMP L. REV. 681 (2000).

2. *See Dead or Just Resting?*, THE ECONOMIST, May 28, 2005 (stating it is difficult to gauge the exact number of hedge funds in existence).

3. Rita Ragas De Ramos, *Concerns Over Hedge Funds Rise As Market Volatility Rises Globally,* WALL ST. J., June 15, 2006, at C5 ("[H]edge funds—which had 1.3 trillion in assets world-wide at the end of December—make up 40% to 50% of the average daily volume by value in major financial markets globally.").

4. Jonathan Macey, *Regulatory McCarthyism*, WALL ST. J., Oct. 24, 2006, at A18.

5. *Id.*

6. *Role of Hedge Funds in Our Capital Markets: Before the Subcomm. on Securities and Investment of the Senate Comm. on Banking, Housing, and Urban Affairs*, 109th Cong. (2006) (statement of Susan Ferris Wyderko, Acting Director of the Division of Investment Management, Securities and Exchange Commission).

The Securities and Exchange Commission (SEC) should stay out of the hedges and allow market discipline to regulate the industry. As articulated by U.S. Federal Reserve Chairman Ben Bernanke, "[t]he primary mechanism for regulating excessive leverage and other aspects of risk-taking in a market economy is the discipline provided by creditors, counter-parties and investors."[7] Regulators espouse two reasons to regulate. The first is to protect the markets, and the second is to protect investors. With regard to the first concern, the risk to the system is not from a hedge fund going bankrupt, but rather, from the large financial institutions who provide them leverage. Rather than regulate hedge funds themselves, the government should regulate the lending end of the equation and ensure that institutions are requiring sufficient capital and conducting a proper risk analysis before lending. With regard to the second concern, hedge funds are designed for sophisticated investors. If regulators are concerned that hedge funds pose a danger to investors, then the standards for who can invest need tightening. The minimum bar should be raised to ensure that those who invest are truly sophisticated.

In an effort to portray why regulation is unnecessary, and in fact would be counterproductive, this essay is broken down into the following sections. Section I briefly defines what a hedge fund is and is not, and then looks at the rapid growth of the industry. Section II looks at why hedge funds are exempt from the current regulatory scheme and analyzes *Goldstein v. Securities and Exchange Commission*.[8] Section III explains why hedge funds are beneficial to financial markets and why self-regulation is working. Additionally, this section will provide a brief case analysis of Amaranth Advisors and Long Term Capital Management (L.T.C.M.). Section IV outlines alternatives to direct regulation of the industry. Finally, this essay presents a conclusion to the argument.

I. WHAT IS A HEDGE FUND?

A. ORIGINS OF THE MODERN DAY HEDGE FUND

Hedge funds derive their name from their basic investment structure, where managers "hedge their bets" in order to reduce their exposure to risk. The origins of this phrase date back to when the Anglo-Saxons planted rows of brush, called hedges, to serve as secure boundaries.[9] During the seventeenth century, the word hedge grew to include making one's bets safer by making transactions

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7. Craig Torres, *Fed Chief Backs Greenspan on Hedge Fund Self-Regulation*, THE AGE (Australia), May 18, 2006, at A7.

8. Goldstein v. Sec. and Exch. Comm'n, 451 F.3d 873 (D.C. Cir. 2006).

9. OxfordOnlineDictionary.com ("Hedge," n. – Definition), http://dictionary.oed.com/cgi/entry/50104070?query_type=word&queryword=hedge&first=1&max_to_show=10&sort_type=alpha&result_place=2.

on opposing sides.[10] It is widely believed that the first financial manager to formally turn this into an investment strategy was Australian Alfred Winslow Jones, who in 1949 organized a partnership that operated a balanced, or hedged, portfolio.[11] Mr. Jones' strategy was to neutralize his portfolio so that its net worth would not fall due to declines in the market.[12] To do this, he employed the practice of hedging, where he took long and short positions on various stocks.[13]

> Like most investors he bought stocks he deemed to be cheap, but he also sold short seemingly overpriced stocks. At least in theory, Jones's portfolio was "market neutral." Any event—war, impeachment, a change in the weather—that moved the market either up or down would simply elevate one half of Jones's portfolio and depress the other half. His net return would depend only on his ability to single out the relative best and worst.[14]

Jones' strategy was not likely to reap large rewards, but his portfolio was insulated from suffering immense losses. Essentially, hedge funds emerged as conservative investment vehicles, which helped to reduce risk. However, since Mr. Jones, the industry has undergone some dynamic changes. Although there are still funds that employ hedging as a conservative means of producing steady returns, other funds now engage in a wide variety of investment strategies.[15] Additionally, some funds acquire large amounts of leverage in order to exponentially increase their growth potential. It is the use of this leverage that worries regulators and legislators.

B. HEDGE FUND DEFINED (OR NOT DEFINED)

Part of the reason why people have such vitriolic responses to hedge funds is that they are not widely understood. The term "hedge fund" does not appear anywhere in state or federal laws.[16] The participants of the 2003 SEC roundtable on hedge funds articulated fourteen different and distinct definitions.[17] From a mechanical standpoint, a hedge fund is a lightly regulated investment vehicle that can do anything from plain vanilla shorting stocks to highly sophisticated arbitrage. Essentially, a hedge fund "is a managed pool of capital for

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10. OxfordOnlineDictionary.com ("Hedge," v. – Definition), http://dictionary.oed.com/cgi/entry/50104071?query_type=word&queryword=hedge&first=1&max_to_show=10&sort_type=alpha&result_place=2.

11. ROGER LOWENSTEIN, WHEN GENIUS FAILED: THE RISE AND FALL OF LONG-TERM CAPITAL MANAGEMENT 25 (Random House 2000).

12. *Id.*

13. *Id.*

14. *Id.*

15. *Id.* at 26.

16. *Id.* at 24.

17. DAVID A. VAUGHAN, SELECTED DEFINITIONS OF "HEDGE FUND," COMMENTS FOR THE U.S. SEC. AND EXCH. COMM'N ROUNDTABLE ON HEDGE FUNDS (May 14-15, 2003), http://www.sec.gov/spotlight/hedgefunds/hedge-vaughn.htm.

institutional or wealthy individual investors that employs one of various trading strategies in equities, bonds, or derivatives, attempting to gain from market inefficiencies and, to some extent, hedge underlying risks."[18] These funds are traditionally private, open to a small number of extremely wealthy individuals, and managed by professional investment managers.[19] A common strategy employed by most hedge fund managers is to gain from market inefficiencies and hedge any underlying risk.

One reason why it is difficult to find a precise definition is that people often confuse strategy with a definition. Although hedge funds utilize a wide array of strategies, each is just an incentive compensation scheme for the people who work for the fund.[20] The investors, in essence, are the limited partners. Hedge funds come in a wide variety of shapes and sizes. Some funds manage small amounts of capital, while others are quite large. Some funds are primarily domestic, while others operate on the global market. Some engage in conservative trading practices, while others employ highly risky tactics. The traditional strategy of hedge funds in the 1990s was to engage in taking short and long positions and to magnify their results through acquiring an immense amount of leverage.[21] Today, however, the strategies are far more diverse and include arbitrage,[22] convertible arbitrage,[23] emerging markets,[24] funds of

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18. *What's In a Name; Hedging Terminology,* THE ECONOMIST, Mar. 4, 2006, at 64.

19. *Goldstein*, 451 F.3d at 875.

20. *See Rolling In It,* THE ECONOMIST, Nov. 18, 2006, at 76; *see also Hedge Funds: The New Money Men,* THE ECONOMIST, Feb. 19, 2005, at 64.

21. LOWENSTEIN, *supra* note 11, at 26. *See generally* Streetauthority.com, Short – Sale, http://www.streetauthority.com/terms/s/shortsale.asp ("A short sale is a three-step trading strategy that seeks to capitalize on an anticipated decline in the price of a security. First, the fund borrows shares of the security. Next, the investor will sell the shares immediately in the open market with the intention of buying them back at some point in the future. Finally, to complete the cycle, at a later date he/she will repurchase the shares (hopefully at a lower price) and will return them to the lender. In the end, the investor will pocket the difference if the share price falls, but will of course incur a loss if it rises. When leverage is added to this transaction, the small fraction of the change in the price can be magnified exponentially. However, as can any loss."). For example, a manager could go short on General Motors, and take a long position on Ford. Then, a boom in the auto industry will improve the fund's Ford position, but at the same time, it will hurt its General Motors position. However, the opposite is also true. The fund's short position on General Motors will insulate the fund from suffering huge losses if there is a decline in the Auto industry, because the funds short on General Motors will be profitable. Essentially, the two positions offset one another, insulating the fund against any general developments that affect the auto industry. *Id.*

22. *See generally* David Harper, *Introduction to Hedge Funds—Part One, Arbitrage,* http://www.investopedia.com/articles/03/112603.asp (Defining arbitrage as "the exploitation of an observable price inefficiency and, as such, pure arbitrage is considered riskless. Consider a very simple example. Say Acme stock currently trades at $10 and a single stock futures contract due in six months is priced at $14. The futures contract is a promise to buy or sell the stock at a predetermined price. So by purchasing the stock and simultaneously selling the futures contract, you can, without taking on any risk, lock in a $4 gain before transaction and borrowing costs.").

23. *See generally What's In a Name, supra* note 18, at 64 ("This involves going long in convertible securities (usually shares or bonds) that are exchangeable for a certain number of another form (usually common shares) at a preset price, and simultaneously shorting the underlying equities.").

funds,[25] global macro,[26] and market neutral.[27]

"Many experts contend it is a mistake to talk about hedge funds as an asset class; rather, the industry embraces a collection of trading strategies."[28] Hedge funds do not have a predictable rate of return, and as a group respond quite differently to economic situations.[29] The common thread that ties the industry together is that they are private partnerships with an incentive based compensation scheme.[30] Managers typically are paid a relatively low asset-based fee, around 1% of the fund's net worth (although many charge 2%), and then receive a large performance fee, around 20% of the profits.[31] It has been argued that this structure may lead managers to take outrageous risks.[32] However, the opposite can also be argued. A manager earns 20% of any profits, but is compensated with only a small fee if they are not successful. Additionally, because there are a large number of hedge funds for investors to choose from, managers are eager to establish a name for themselves through a steady record of performance. An added bonus to perform is that most hedge fund managers and their staffs are typically invested in the hedge fund along with their limited partner investors.[33] Therefore, not only will they see an increase in profits, but also their investments will grow along with their investors.

C. HEDGE FUNDS V. MUTUAL FUNDS

One way to understand hedge funds is to compare them to mutual funds. Unlike hedge funds, mutual funds must register with the SEC and are closely regulated.[34] Hedge funds, also known as private investment pools, do not have to register with the SEC and are only nominally regulated.[35] Under the Investment Company Act of 1940, mutual funds are restricted in the types of transac-

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24. *Id.* ("Investing in securities of companies in emerging economies through the purchase of sovereign or corporate debt and/or shares.").

25. *Id.* (As discussed in more detail later in the paper, these are funds that invest all, or a significant portion, of their fund in hedge funds.).

26. *Id.* ("Investing in shifts between global economies, often using derivatives to speculate on interest-rate or currency moves.").

27. *Id.* ("Typically, equal amounts of capital are invested long and short in the market, attempting to neutralize risk by purchasing undervalued securities and taking short positions in overvalued securities.").

28. *Id.*

29. Robert A. Dennis, *An Overview of Hedge Funds*, http://www.publicpensionsonline.com/members/images/Overview%20of%20Hedge%20Funds%20PERAC.pdf.

30. *A Hitchhiker's Guide to Hedge Funds,* THE ECONOMIST, Jun. 13, 1998 at 76.

31. *Id.*

32. *Id.*

33. *Id.*

34. Investment Company Institute, *The Difference Between Mutual Funds and Hedge Funds*, Jan. 2007, http://www.ici.org/funds/abt/faqs_hedge.html.

35. *Id.*

tions they may engage.[36] Mutual funds are generally not permitted to engage in the practice of short selling, nor may they trade on margin.[37] Hedge funds, on the other hand, are not subject to these regulatory constraints. Another key difference pertains to leveraging. Mutual funds are restricted in the amount of leverage that they can acquire.[38] "The SEC requires that funds engaging in certain investment techniques, including the use of options, futures, forward contracts and short selling, 'cover' their positions."[39] There is no such requirement on hedge funds, and using leverage is a core strategy of many funds.[40] Additionally, hedge funds differ from the common mutual fund in that the manager seeks absolute returns rather than reaching a market benchmark.[41] Hedge funds seek to perform in an up as well as in a down market.[42] Essentially, "the objective of the hedge fund manager is to deliver returns that have a low correlation with the standard stock and bond markets."[43]

Hedge funds are opaque with regard to their strategies and positions, often even to their investors.[44] Mutual funds, on the other hand, must comply with SEC disclosure requirements, must have independent boards of directors, and shareholder approval is required before the fund can engage in certain actions.[45] Hedge funds are structured as limited partnerships, which provide a separation of management from ownership.[46] Furthermore, hedge funds have a lock-up period, where investors are not permitted to withdraw their money. Traditionally this period is one year; however, some of the bigger names in the industry are now requiring investors to commit for four or five years.[47] "This restriction allows hedge funds to take positions in the most illiquid corners of the market including options, futures, derivatives, and unusually structured securities."[48] Again, this is a difference to mutual funds, which do not tend to require that investors commit to lengthy investment periods.

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36. *See generally* 15 U.S.C. § 80b (2000).

37. *Id. See generally* U.S. SEC. AND EXCH. COMM'N, MARGIN: BORROWING MONEY TO PAY FOR STOCKS, Aug. 6, 2005, http://www.sec.gov/investor/pubs/margin.htm (Trading on margin is "borrowing money from your broker to buy a stock and using your investment as collateral. Investors generally use margin to increase their purchasing power so that they can own more stock without fully paying for it. But margin exposes investors to the potential for higher losses.).

38. *See* 15 U.S.C. § 80a-18(a)(1)(A) (2000) (mandating that investment companies have a debt-to-asset ratio of approximately one to three).

39. *Id.*

40. Laura Edwards, *Looking Through the Hedges: How the SEC Justified Its Decision to Require Registration of Hedge Fund Advisers*, 83 WASH. U. L.Q. 603, 609 (2005).

41. *Id.*

42. *Id.*

43. *Id.* n.49 (quoting ROBERT A. JAEGER, ALL ABOUT HEDGE FUNDS 4 (2003)).

44. *Goldstein*, 451 F.3d at 875.

45. *Id.* at 876.

46. *Id.*

47. *Hedge Funds: The New Money Men, supra* note 20, at 64.

48. *Id.*

D. THE GROWTH OF HEDGE FUNDS

Because most hedge funds are not registered, and operate as private entities, it is difficult to ascertain the exact number of hedge funds and the capital under their management. In 1968, the SEC estimated that there were 215 funds operating in the United States.[49] In a similar study conducted in 1990, the estimate rose to 610 funds with over $39 billion in assets.[50] This number has since exploded even further. Today, it is estimated that there are over 10,000 hedge funds with over 1.3 trillion dollars in capital; this represents a growth of almost 3,000 percent in the past sixteen years.[51] It has been projected that by 2015, hedge funds may grow to $6 trillion dollars in assets.[52] This explosive growth can be partially attributed to the mystique of the industry, where potential investors think hedge funds provide exponential growth with little risk.[53] In more tangible terms, this growth can be attributed to the increase in institutional investors and the birth of "hedge funds of funds."

1. *Pensions and other institutions*

One cause behind the rise in hedge funds is that pensions and institutions are now heavily invested in the industry.[54] Many financial advisors espouse that even a conservative investment portfolio should invest in hedge funds as a means of diversifying risk.[55] The 1990s were a rocky time for many pensions and institutions because they were heavily invested in the equity markets, which suffered substantial losses in the 2000 to 2002 bear market.[56] After this, institutions looked for investments that would offset some of the risk associated with investing largely in equity markets. Institutions, and specifically pensions, are attracted to hedge funds because they offer a diversified source of return that is not directly correlated to the equity market.[57]

2. *Hedge Funds of Funds (HFOF)*

An HFOF is an investment company that invests all or a large portion of its assets in different hedge funds in order to maximize returns and further mini-

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49. LOWENSTEIN, *supra* note 11, at 26.

50. *Id.*

51. *Role of Hedge Funds in Our Capital Markets: Before the Subcomm. on Securities and Investment of the Senate Comm. on Banking, Housing, and Urban Affairs*, 109th Cong. (2006) (statement of Susan Ferris Wyderko, Acting Director of the Division of Investment Management, Securities and Exchange Commission).

52. *Id.*

53. LOWENSTEIN, *supra* note 11, at 25-26.

54. *Implications of the Growth of Hedge Funds, Staff Report to the Sec. and Exch. Comm'n*, 43-44 (2003).

55. *Id.* at 5.

56. *Hedge Funds: The New Money Men, supra* note 20, at 64.

57. *Implications of the Growth of Hedge Funds, supra* note 54, at 5.

mize risk.[58] Largely, institutional investors, who prefer these funds because they dilute the risk associated with placing all of one's money with just one hedge fund manager, have fueled the growth of HFOFs.[59] HFOFs traditionally invest in 15 to 25 funds, so the failure or underperformance of one hedge fund will not ruin the whole.[60] Essentially, investing in an HFOF provides an additional layer of risk protection to an investor.[61] However, this protection comes with added costs. Opponents of HFOFs argue that investors often do not realize that they are paying double the fees: one fee to the hedge fund manger, and another to the HFOF manager.[62] However, this criticism overlooks the benefit provided by HFOFs. Due to the opaqueness of hedge funds and the restrictions on marketing, it is often difficult for investors to find information on specific hedge funds and hedge fund managers. In an otherwise unregulated investment area, HFOFs provide necessary due diligence to their investors, offering them information about hedge funds and hedge fund managers that is otherwise lacking. The managers of HFOFs are accountable to their investors for ensuring that they are investing in profitable hedge funds, and for this service, they charge a fee.

II. REGULATION

A. SYNOPSIS OF THE REGULATORY SCHEME

Most hedge funds are exempt from government regulation under the Securities Act of 1933,[63] the Securities Exchange Act of 1934,[64] the Investment Company Act of 1940,[65] and the Investment Advisers Act of 1940.[66] Hedge funds are established in such a way that they purposely slip through each of these acts, permitting the SEC to have very little oversight on the industry.

"The Investment Company Act of 1940 directs the Commission to regulate any issuer of securities that 'is or holds itself out as being engaged primarily . . . in the business of investing, reinvesting, or trading in securities."[67] At first glance, it would appear that hedge funds would fall under this act, since a hedge fund engages in investing in securities on behalf of its shareholders.[68] How-

58. *Id.* at 67.
59. *Id.*
60. David Harper, *Introduction to Hedge Funds— Part Two* (Dec. 10, 2003), http://www.investopedia.com/articles/03/121003.asp.
61. *Id.*
62. U.S. SEC. AND EXCH. COMM'N, HEDGING YOUR BETS: A HEADS UP ON HEDGE FUNDS AND FUNDS OF HEDGE FUNDS (2006), http://www.sec.gov/answers/hedge.htm.
63. 15 U.S.C. § 77a (2000).
64. *Id.* U.S.C. § 78a.
65. *Id.* U.S.C. § 80a.
66. *Id.* U.S.C. § 80b.
67. *Goldstein*, 451 F.3d at 875 (citing 15 U.S.C. § 80a-3(a)(1)(A) (2000)).
68. Gibson, *supra* note 1, at 694.

ever, hedge fund organizers are careful to tailor their funds in such a way that they fall under one of the two exceptions to the Investment Company Act's definition of "investment company": sections 3(c)(1) and 3(c)(7).[69]

"Section 3(c)(1) . . . excludes from the definition of investment company any issuer whose outstanding securities (other than short-term paper) are beneficially owned not by more than 100 investors and which is not making and does not presently propose to make a public offering in its securities."[70] Keys to this exclusion are that institutions and pensions count as one investor, and the fund cannot market to the public.[71]

"Section 3(c)(7) excludes from the definition of investment company any issuer whose outstanding securities are owned exclusively by persons who, at the time of acquisition of such securities, are 'qualified purchasers,' and which is not and does not at that time propose to make a public offering of its securities."[72] The rationale for this exclusion is that there are certain sophisticated investors who do not need governmental protection.[73] These investors are capable of understanding the risks, and their net worth is capable of withstanding a large loss.[74] Funds qualifying for this exemption will usually have a maximum of 499 investors, in order to escape registration and reporting under the Securities Exchange Act of 1934.[75]

Hedge funds are exempt from registration and the prospectus distribution requirements of the Securities Act of 1933.[76] This act does not require securities companies to comply, provided they only make private offerings to "accredited investors."[77] Exemption under this rule also requires additional measures, including restrictions on advertising, soliciting, and reselling.[78]

Lastly, hedge fund managers are exempt from the Investment Advisers Act of 1940. Although they technically fall under the definition of "investment advisers,"[79] they escape SEC regulation under the 203(b) "private adviser exemp-

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69. *Id.* (citing 15 U.S.C. §§ 80a-3(c)(1), 80a-3(c)(7) (2000)).

70. *Implications of the Growth of Hedge Funds, supra* note 54, at 11.

71. *Id.* at 11-12.

72. *Id.* at 12-13.

73. *Id.* at 13 (citing S. Rep. No. 104-293, at 10 (1996), which states: "Generally, these investors can evaluate on their own behalf matters such as the level of a fund's management fees, governance provisions, transactions with affiliates, investment risk, leverage and redemption rights.").

74. *Id.*

75. Rory B. O'Halloran, Comment, *An Overview and Analysis of Recent Interest in Increased Hedge Fund Regulation*, 79 TUL. L. REV. 461, 468 (2004). Further examination as to why hedge funds are exempt from the Securities and Exchange Act of 1934 will not be conducted in this essay.

76. Joseph Hellrung, *Hedge Fund Regulation: Investors are Knocking at the Door, But Can the SEC Clean House Before Everyone Rushes In?*, 9 N.C. BANKING INST. 317, 323-24 (2005).

77. *Id.* at 324. *See* 15 U.S.C. § 77d(2) (2000) (Rule 501(a) defines 'accredited investor' as "a bank; directors, officers, partners of the issuer; any person with income in excess of $200,000 per annum.").

78. Hellrung, *supra* note 76 at 325.

79. *Goldstein*, 451 F.3d at 876 (citing *Abrahamson v. Fleschner*, 568 F.2d 862, 869 (2d Cir. 1977)) ("defining 'investment advisor' as one who 'for compensation, engages in the business of advising

tion."[80] Section 203(b) exempts, "any investment adviser who during the course of the preceding twelve months has had fewer than fifteen clients and who neither holds himself out generally to the public as an investment adviser nor acts as an investment adviser to any investment company under the. . . Act."[81] A hedge fund itself is considered a client in the above definition, so managers who operate fewer than 15 funds qualify for this exemption.[82] The rationale behind this is that each individual investor in the fund is not a client, but rather a limited partner of the fund.[83] Further, they have a fiduciary duty to the fund, and not to the individual investors.

It is important to note that hedge funds are still regulated under section 206 of the Investment Advisers Act of 1940, which prohibits an investment advisor, whether registered or not, from engaging in fraud.[84]

B. *GOLDSTEIN V. SECURITIES AND EXCHANGE COMMISSION*[85]

In 2004, the SEC passed the "Hedge Fund Rule," which sought to allow the SEC to regulate hedge funds under the Investment Advisers Act of 1940.

> The Hedge Fund Rule first defines a "private fund" as an investment company that (a) is exempt from registration under the Investment Company Act by virtue of having fewer than one hundred investors or only qualified investors; (b) permits its investors to redeem their interests within two years of investing; and (c) markets itself on the basis of the "skills, ability, or expertise of the investment adviser.[86]

The Hedge Fund Rule then goes on to explain that the funds that qualify under this definition of a private fund "must count as clients the shareholders, limited partners, members, or beneficiaries. . . of the fund."[87]

Essentially, through the Hedge Fund Rule, the SEC propounded that each *investor* in a hedge fund was in all actuality a *client* in terms of section 203(b)(3) of the Act. The court in *Goldstein* did not agree with the SEC's interpretation of client, "[t]he advisor does not tell the investor how to spend his money; the investor made that decision when he invested in the fund."[88] Furthermore, the court noted that a hedge fund manager owes fiduciary duties to

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others, either directly or through publications or writings, as to the value of securities or as to the advisability of investing in, purchasing, or selling securities'").

80. *Id.*

81. 15 U.S.C. § 80b-3(b)(3) (2006).

82. *Goldstein,* 451 F. 3d at 880.

83. *Id.*

84. 15 U.S.C. § 80b-6 (2006).

85. *Goldstein,* 451 F.3d at 873.

86. *Id.* at 877.

87. *Goldstein,* 451 F.3d at 877 (citing C.F.R. § 275.203(b)(3)-2(a)).

88. *Id.* at 880.

the fund, not to the individual investors in the fund.[89] The Commission articulated that the purpose behind the Hedge Fund Rule was to "provide the protections afforded by the Advisers Act to investors in hedge funds, and to enhance the Commission's ability to protect our nation's securities markets."[90] Although the purpose may have been genuine, the United States Court of Appeals for the D.C. Circuit determined that the SEC could not regulate hedge funds through the Hedge Fund Rule because the rule conflicted with the purpose underlying the statute.[91] Specifically, when turning to the legislative history, current practice, and hedge fund organization, *investors* are not *clients* within the scope of the Investment Advisers Act of 1940.[92]

III. BENEFITS OF HEDGE FUNDS, AND WHY MARKET AND SELF-REGULATION ARE EFFECTIVE

A. HEDGE FUNDS ARE BENEFICIAL TO THE MARKET

"At one extreme, hedge funds are attacked as dangerously unregulated cabals wielding newfangled instruments of finance like unguided missiles aimed at the heart of world capitalism. At the other, hedge funds are celebrated as the greatest market development since mutual funds."[93] As this demonstrates, there are starkly opposing views regarding hedge funds and their effect on the market. Although there are a small number of poorly managed funds that present a problem, what many critics fail to understand is that most hedge funds are not highly risky, and actually pose great benefits to the markets.

The vast majority of hedge funds are simple, straightforward, investment pools that pose no threat to the financial system. In fact, they actually reduce the frequency of crisis and add to the overall stability in the economy.[94] Hand in hand with the growth of hedge funds, we have seen a decline in market volatility and an increase in market liquidity as hedge funds make the market deeper and broader.[95] According to some researchers, the reduction in market volatility is not due to a long-term downward trend; but rather, it appears to be

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89. *Id.* at 881 (noting "[i]f the investors are owed a fiduciary duty and the entity is also owed a fiduciary duty, then the adviser will inevitably face conflicts of interest. Consider an investment advisor to a hedge fund that is about to go bankrupt. His advice to the fund will likely include any and all measures to remain solvent. His advice to an investor in the fund, however, would likely be to sell.").

90. Registration Under the Advisers Act of Certain Hedge Fund Advisers, 69 Fed. Reg. 72054 (proposed Dec. 10, 2004) (to be codified at 17 C.F.R. § 275.203(b)(3)-2).

91. *Goldstein*, 451 F.3d at 883-84.

92. *Id.* at 882.

93. David Wessel, *How Would Hedge Funds Behave in a Crisis*, WALL ST. J., Jul. 20, 2006, at A2.

94. Wessel, *supra* note 93, at A2.

95. *Asset Price Levels and Volatility: Causes and Implications, Before the Banco de Mexico International Conference*, (Nov. 15, 2005) (statement of Roger W. Ferguson, Jr., Vice Chairman, Fed. Reserve Bd.), http://www.federalreserve.gov/boardDocs/Speeches/2005/200511152/default.htm.

the result of a structural shift in the global economy.[96] From a microeconomic perspective, greater market liquidity has caused overall volatility to decrease.[97] The growth of hedge funds has added significant liquidity to the markets.

Hedge funds are an important tool in lowering market volatility because they provide liquidity and eliminate price gaps, which then leads to an increase in efficiency in the market.[98] A fear exists that hedge funds could lead to higher asset price volatility if investors suddenly withdraw their capital.[99] However, due to the basic structure of the funds, where investors lock in their money for a set period, this fear is unfounded.[100] Furthermore, the industry is extremely diverse and funds employ a multitude of strategies that are not in any way correlated to one another.[101] Thus, when some funds do well, others will perform poorly.[102] This leads many experts to speculate that systemic risk will not manifest because hedge funds are operating in very different areas of the market.[103]

An additional benefit that hedge funds provide is that they operate in many different sectors and niches of the market and are able to expose market irregularities.[104] Hedge funds also fix incorrect pricing in financial markets that could otherwise go unnoticed. "After all, it was hedge-fund short sellers who first unearthed financial jiggery-pokery at Enron and elsewhere and tipped off America's regulators."[105]

B. THE SEC WILL NOT BE ABLE TO EFFECTIVELY REGULATE

Former Chairman of the Federal Reserve Alan Greenspan has repeatedly articulated that the government is not in a position to regulate hedge funds.[106] In the first place, the SEC does not have the resources. The SEC is currently understaffed, rendering it very difficult to add additional regulatory burdens on the agency. Furthermore, doing so would divert federal resources from protecting the public to protecting wealthy "accredited investors" who do not need protection from the government. Furthermore, by requiring registration, the SEC may in effect be adding to retailization because the average investor will believe that they are protected from financial loss, since the SEC is overseeing

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96. *Id.*
97. *Id.*
98. *Id.*
99. *Id.*
100. *Id.*
101. Macey, *supra* note 4, at A18.
102. *Id.*
103. *Id.*
104. *Hedge Funds and Equity Research: Fair Comment or Foul,* THE ECONOMIST, Apr. 1, 2006, at 61.
105. *Id.*
106. Greg Robb, *Greenspan Wary of Federal Regulation of Hedge Funds*, May 5, 2005, http://www.marketwatch.com/News/Story/Story.aspx?guid={8724CEA5-6BD5-44D1-A226-168B405D8F1E}&siteid=google.

the industry. There is no evidence to show that registration will reduce the dangers of investing in hedge funds.

Secondly, "[i]t would be very difficult to design a set of capital requirements for hedge funds that is appropriately sensitive to the diversity and flexibility of investment strategies that different funds employ and to the lack of diversification in the portfolios of individual funds."[107] According to current Chairman of the Federal Reserve, Ben Bernanke, "regulators would probably create more harm than good if they tried to write rules for an industry that thrives on speed and inventiveness."[108] Regulation is not needed because the banks and brokers providing leverage to the industry are actively monitoring hedge funds in a more effective manner than the government would be able to do.[109] Additionally, many worry that if the SEC pushes to regulate, many hedge funds would move offshore, which would make it even more difficult for the government to have any sort of oversight over the industry.

> Most hedge funds are only a short step from cyberspace. Any direct U.S. regulations restricting their flexibility will doubtless induce the more aggressive funds to emigrate from under our jurisdiction. The best we can do in my judgment is what we do today: regulate them indirectly through the regulation of the sources of their funds. We are thus able to monitor far better hedge funds' activity, especially as they influence U.S. financial markets. If the funds move abroad, our oversight will diminish.[110]

Hedge funds do not exist in a regulatory vacuum. The institutions lending to hedge funds, clearing their trades, and holding their assets are directly regulated.

A further concern with regulation is that the success of hedge funds can be attributed to their creative and fast-paced investment styles. By requiring oversight, successful strategies and tactics will be copied, which would make it difficult for hedge funds to perform. Furthermore, regulating the industry would stifle the innovation that hedge funds thrive on.

Although the hedge fund industry has seen substantial growth in recent years, it is estimated that the average size of each hedge fund is still relatively small compared to other market players.[111] Based on this, some have argued that hedge funds cannot present a systemic risk.[112] Their portion of the overall market is just not large enough.

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107. *Id.*

108. *Id.*

109. *Id.*

110. *Private-Sector Refinancing of the Large Hedge Fund, Long-Term Capital Management, Before the House Comm. on Banking and Fin. Servs.*, 105th Cong. (Oct. 1, 1998) (statement of Alan Greenspan, Chairman, Fed. Reserve Bd.).

111. Greenspan statement, *supra* note 110.

112. *Id.*

C. MARKET REGULATION AND SELF-REGULATION ARE WORKING

One way that the effectiveness of self-regulation can be seen is in the fact that around 11% of hedge funds close each year with virtually no effect on the financial market.[113] The larger funds are generally thriving, growing, and becoming more productive. This is because they are well run, have sound risk control, and their managers are building a name for themselves in the industry. "[Three hundred] hedge funds manage more than $1 billion each and represent roughly 90% of the assets in the industry today."[114] According to Chairman Benjamin Bernanke, the fact that many funds go out of business is normal in a competitive market economy.[115] The smaller poorly run firms that do not have adequate risk controls are becoming a smaller and smaller part of the industry and if a fund is not successful, investors leave and the fund folds.[116]

An interesting trend is that many of the larger funds are voluntarily registering with the SEC. One reason why this is happening is that if a fund wants to manage ERISA pension funds, they must be registered with the SEC. Because these pension funds pose a huge growth potential, many of the larger funds are opting to register in order to be able to tap into this market.

D. RETAILIZATION OF HEDGE FUNDS IS BENEFICIAL TO SELF-REGULATION

"Investment vehicles that remain private and available only to highly sophisticated investors have historically been understood not to present the same dangers to public markets as more widely available investment companies. . . ."[117] One reason why regulators and legislators want to regulate the hedge fund industry is that they want to protect people from what they perceive as the "retailization" of hedge funds. "This retailization [is being] driven by hedge funds loosening their investment requirements, the birth of funds of hedge funds that [offer shares to the unaccredited public], and increased investment in hedge funds by pension funds, universities, endowments, foundations, and other charitable organizations."[118] The SEC is concerned that this presents public policy concerns.[119] In the first place, the SEC worries that although institutions themselves qualify as "accredited investors," the individual investors in the pensions and other institutions do not.[120] This, however, is unfounded. In the first place,

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113. Anita Raghavan, et al., *Despite Blue-Chip Gains, Hedge Funds Increasingly are Faltering and Closing*, WALL ST. J., Oct. 4, 2006, at C1.

114. *Id.*

115. *Federal Reserve Bank of Atlanta's 2006 Financial Markets Conference* (May 16, 2006), (remarks by Benjamin S. Bernanke, Chairman, Fed. Reserve Bd.), http://www.federalreserve.gov/Boarddocs/speeches/2006/200605162/default.htm.

116. *Id.*

117. *Implications of the Growth of Hedge Funds, supra* note 54, at 11-13.

118. *Goldstein*, 451 F.3d at 877.

119. *Implications of the Growth of Hedge Funds, supra* note 54, at 82.

120. *Id.*

pensions are pursuing hedge funds precisely because of the high returns they can provide, and many pension managers see hedge funds as an excellent tool for diversifying risk. Hedge funds usually comprise only a small percentage of a pension's overall portfolio and actually serve as a cushion for the "little guy" who regulators want to protect.[121] According to Mr. Goldstein, the plaintiff in *Goldstein v. Securities and Exchange Commission*, this fear should not lead to regulation of hedge funds, but should be dealt with by ensuring that pension fund managers are competent enough to provide the due diligence needed to successfully invest their portfolios.[122]

The growth of HFOFs has been worrisome to regulators, as investors of these funds do not have to meet the same statutory requirements that an investor of a hedge fund must meet. The minimum initial investment in an HFOF is less than in a traditional hedge fund, beginning as low as $25,000.[123] If regulators fear this hurdle is too low, then this minimum investment should be raised. However, what many critics fail to recognize is that the growth of HFOFs has actually been highly beneficial to the self-regulation of the hedge fund industry. HFOF managers research the backgrounds of hedge fund managers, their investment style and performance, and provided information to investors that would otherwise be difficult to obtain. Another key benefit that HFOFs provide is in terms of valuation. Some hedge funds invest in illiquid investments that are difficult and often highly subjective to value.[124] The managers of HFOFs are better equipped to grapple with complex valuations and arrive at a more realistic price than an investor.

When talking about regulation, and why the current self-regulation is working, it is important to note that many HFOFs actually register with the SEC even though they could fall under the exemptions. They do this because they want to be able to market their funds to the public.[125]

E. CASES IN POINT: LONG TERM CAPITAL MANAGEMENT (LTCM) AND AMARANTH ADVISORS

Since the collapse of Long Term Capital Management (LTCM) in 1998, regulators have been concerned about the risks posed by hedge funds. LTCM was an arbitrage fund that employed some of the nation's brightest financial minds and for a while was considered the golden child of the industry. In its first few years,"[t]he fund had racked up returns of more than 40 percent a year, with no

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121. Editorial, *Targeting Hedge Funds*, WALL ST. J., Oct. 31, 2006, at A18.

122. Daisy Maxey, *Hedge Funds Size Up Congress—Democrats May Target Retailization but Big Changes Aren't Likely*, WALL ST. J., Nov. 11, 2006, at B4.

123. *Id.*

124. U.S. SEC. AND EXCH. COMM'N, HEDGING YOUR BETS: A HEADS UP ON HEDGE FUNDS AND FUNDS OF HEDGE FUNDS (2006), http://www.sec.gov/answers/hedge.htm.

125. *Implications of the Growth of Hedge Funds*, *supra* note 54, at 68.

losing stretches, no volatility, seemingly no risk at all."[126] The fund amassed over $100 billion in assets, the majority of which was borrowed from a few Wall Street banks.[127] In addition to being highly leveraged, LTCM also had thousands of derivative contracts with nearly every bank on Wall Street that accounted for over $1 trillion worth of exposure.[128] One of the key strategies that the fund employed was to trade in government bonds of the G7 nations.[129] Trouble began with the devaluation of the Russian ruble, which then triggered devaluations throughout Asia and into Brazil and caused the fund to suffer massive losses.[130]

The problem this presented was far greater than just the collapse of LTCM. If LTCM defaulted on its obligations, the banks would be left with derivative contracts that were worthless.[131] The fear was that this would lead to a panic where banks would be trying to unload their derivative contracts.[132] In the face of this, the New York Federal Reserve encouraged the major banks to work in concert to avert worldwide panic.[133] All the major players stepped in and purchased LTCM's positions in order to avert a shock to the markets.[134] The individual investors in LTCM lost what they had invested in the fund, but the overall financial system was hardly affected. After the LTCM fiasco, the hedge fund industry grew without any major catastrophes. Then, in the fall of 2006, another large hedge fund with enormous levels of leverage made a catastrophic error.

Amaranth Advisors, a global hedge fund, took a position in energy that proved fatal to the $9.2 billion dollar fund.[135] Amaranth lost $6 billion in energy positions and the rest of the fund had to be liquidated to meet margin calls. This situation arose because a 32 year-old trader was permitted to take a large gamble that natural gas prices would rise.[136] Unfortunately, for the fund, there were no storms in the gulf this year, and the price of natural gas dropped. In order to cover margin calls, the fund had to sell off its positions.

Some have argued that Amaranth poses more of a political threat than a threat to the markets.[137] After the collapse of Amaranth, regulators and legisla-

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126. LOWENSTEIN, *supra* note 11, at xix.
127. *Id.*
128. *Id.*
129. Gibson, *supra* note 1, at 681.
130. *Id.*
131. *Id.* at 682.
132. *Id.*
133. *See* LOWENSTEIN, *supra* note 11, at xviii.
134. *Id.* at xix.
135. Ann Davis, *Moving the Market: Regulators Scrutinize Amaranth*, WALL ST. J., Sept. 25, 2006, at C3.
136. *Id.*
137. Editorial, *Targeting Hedge Funds*, WALL ST. J., Oct. 31, 2006, at A18.

tors began vociferously arguing for regulation once again.[138] However, the markets did not undergo any sort of systemic shock. JP Morgan Chase & Co. and Citadel Investment Group LLC, a major hedge fund, purchased all of Amaranth's energy portfolio, thereby profiting in the transactions.[139]

Both the LTCM and Amaranth situations actually prove that market and self-regulation of the hedge fund industry is working. "In both cases, the financial markets continued to operate seamlessly, without a hint that any sort of systemic risk would actually manifest itself."[140] Furthermore, market discipline prevailed, LTCM and Amaranth went out of business and the institutional managers who invested in them were held accountable and lost clients. Additionally, the clients of HFOFs are holding the managers accountable for their failure to perform the due diligence that the clients paid for.

Many are propounding that the reason why we have averted catastrophe thus far is that Amaranth was only invested in one sector of the market, and LTCM was bailed out. However, this fails to look at the big picture. Part of why systemic risk is averted has to do with the secrecy surrounding the industry.[141] Because hedge funds are not required to disclose their strategies and positions, others are prevented from copying their strategies. This "lack of transparency" is actually beneficial. "[F]rom an economic perspective, the absence of hedge fund regulation both increases wealth by protecting property rights in information, and eliminates systemic risk by preventing other investors from rushing like lemmings to copy the investment strategies developed by hedge fund managers."[142]

IV. A MORE EFFECTIVE WAY TO REGULATE

A. INCREASE THE MINIMUM INVESTMENT

If increased regulation is indeed needed, it should be done it in terms of the rules that govern hedge fund eligibility. Investors in hedge funds are by definition supposed to be sophisticated. In order to ensure this, the Investment Company Act of 1940 requires that investment is limited to people with a net worth of at least $1 million and an annual income of at least $200,000.[143] In order to stave off regulation, some hedge fund managers are requesting these levels to be raised to $1.5 million and $500,000 respectively.[144] According to SEC Chairman Christopher Cox, "under current rules—which count illiquid assets

138. *Id.*
139. *Id.*
140. Macey, *supra* note 4, at A18.
141. *Id.*
142. *Id.*
143. David Enrich & Arden Dale, *Hedge Fund, Regulate Thyself-Could Self-Policing Help Avoid More Government Oversight?*, WALL ST. J., Oct. 14, 2006, at B4.
144. *Id.*

such as homes toward an investor's overall net worth—many people who are eligible to invest in hedge funds can end up placing 'their entire life savings' in these unregistered vehicles."[145] The monetary threshold should be raised to reflect the inflation that has occurred since the rule was last amended in 1982.[146]

B. REGULATE THE LENDING INSTITUTIONS

The decisive factor that could lead to systemic shock pertains to the level of exposure that lending institutions have to hedge funds. Oftentimes, banks do not require sufficient collateral before lending vast sums of money to hedge funds. Regulators should examine whether investment institutions are requiring sufficient margin from hedge funds.[147] Additionally, lending to hedge funds should have higher capital requirements. It is important that banks recognize that additional collateral will be required when and if the market goes through a stressful period.[148] Providers of credit should require hedge funds to provide transparency regarding overall profile detailing their strategies and risks.[149]

Every hedge fund uses a brokerage firm, known as a prime broker, to process its securities, clear its trades, and provide leverage. Hedge funds are small companies lacking in the infrastructure necessary to operate in our financial markets. Hence, they depend on a prime broker to provide them with services. Hedge funds do not physically control their securities, the prime broker does. Prime brokers also provide leverage when they take short positions.

One alternative to governmental regulation is to look at prime brokerages. There are only a handful of brokerage firms providing prime broker services to thousands of hedge funds. To limit systemic risk and monitor aggregate hedge fund activity, it would be a lot easier, and more efficient, to monitor the industry from the prime broker side of the equation where the SEC can aggregate all of the information to better understand the overall risk. It is far easier to gain a snapshot of the industry this way than by trying to gain information on the highly fragmented hedge fund industry itself.

CONCLUSION

Increased regulation of hedge funds would slow innovation, limit liquidity and be detrimental to the financial markets. Hedge funds do not pose the sys-

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145. *Id.*

146. STAFF REPORT TO THE COMM'N, MANAGED FUNDS ASS'N, IMPLICATIONS OF THE GROWTH OF HEDGE FUNDS (Nov. 21, 2003), http://www.mfainfo.org/images/PDF/SEC_REPORT_LETTER_11_21.pdf.

147. Phil Izzo, *Moving the Market: Economists See Hedge-Fund Risks-Survey Indicates Concerns About a Lack of Oversight, Use of Borrowed Money*, WALL ST. J., Oct. 13, 2006, at C3.

148. *Id.*

149. *Id.*

temic risk that many legislators and regulators fear. Although hedge funds are by no means risk free, market discipline and industry self-regulation have proven effective. If the SEC attempts to regulate the industry, it will likely do more harm than good given the SEC's limited resources. If the SEC truly wants to protect investors, the current definition regarding who qualifies as a sophisticated investor should be amended.

eBay v. MercExchange: Are State Street's Days Numbered?

JOHN BEDNARZ

INTRODUCTION

The Supreme Court has held three categories of subject matter to be unpatentable: laws of nature, natural phenomena, and abstract ideas.[1] Under this line of reasoning, unpatentable laws of nature included mathematical formulas and computer programs.[2] However, in *Diamond v. Diehr* the United States Supreme Court held that a computer program, used in conjunction with a process for curing rubber, was patentable.[3] Later in *State Street Bank & Trust v. Signature Financial Group*, the Federal Circuit turned heads by holding that a business method was not an abstract idea as previously held, which instantly provided patent protection for various technologies via the business method patent.[4] In *State Street*, the court held that

> the transformation of data, representing discrete dollar amounts, by a machine through a series of mathematical calculations into a final share price, constitutes a practical application of a mathematical algorithm, formula, or calculation, because it produces 'a useful, concrete and tangible result' – a final share price momentarily fixed for recording and reporting purposes and even accepted and relied upon by regulatory authorities and in subsequent trades.[5]

Since this decision in 1998, many patents have been granted for business methods that have been implemented by means of software and the Internet. Computers and the Internet have saturated society to the point where anyone can check his or her e-mail or browse the Internet at nearly any place in the world much to the detriment of many family dinners.[6] While *eBay v. MercExchange* dealt with the injunction in patent cases, it is clear that the problems with the business method patent have finally caught the eye of the Supreme Court.

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1. Diamond v. Diehr, 450 U.S. 175, 185 (1981).

2. *See* Parker v. Flook, 437 U.S. 584 (1978) (holding that a novel and useful mathematical formula could not be patented); Gottschalk v. Benson, 409 U.S. 63 (1972) (holding that a computer program patent was too broad and sweeping).

3. *Diehr*, 450 U.S. at 192-193.

4. State St. Bank & Trust Co. v. Signature Fin. Group, Inc., 149 F.3d 1368 (Fed Cir. 1998).

5. *Id.* at 1373.

6. Frank Langfitt, *Blackberry or Crackberry?*, NPR, Jan. 12, 2005, http://www.npr.org/templates/story/story.php?storyId=4279486.

I. BACKGROUND OF *eBAY V. MERCEXCHANGE*

Petitioner MercExchange holds a number of patents, including a business method patent for "an electronic market designed to facilitate the sale of goods between private individuals by establishing a central authority to promote trust among participants."[7] Defendants eBay and Half.com operate very successful and popular websites that allow private sellers to list goods that they wish to sell, either through an auction or a fixed price, known on eBay as "Buy It Now."[8] MercExchange attempted to license its patent to eBay and Half.com, but the companies failed to reach an agreement.[9] MercExchange proceeded to file a patent infringement suit against eBay and Half.com in federal court in the Eastern District of Virginia.[10] A jury found that eBay and Half.com did infringe MercExchange's patents and the district court granted MercExchange $35 million in damages.[11] However, the district court later denied permanent injunctive relief and ruled that the "plaintiff's willingness to license its patents" and "lack of commercial activity in practicing the patents" was sufficient to establish that the patent holder would not suffer irreparable harm without an injunction.[12] The court applied a four factor test based on well-established principles of equity to determine whether a permanent injunction should issue: (1) that the plaintiff suffered an irreparable injury; (2) that remedies available at law, such as monetary damages, are inadequate to compensate for that injury; (3) that, considering the balance of hardships between the plaintiff and defendant, a remedy in equity is warranted; and (4) that the public interest would not be disserved by a permanent injunction.[13] The Court of Appeals for the Federal Circuit reversed and applied a completely opposite perspective by applying a "general rule that courts will issue permanent injunctions against patent infringement absent exceptional circumstances."[14] The Supreme Court of the United States then granted certiorari to determine the appropriateness of the Federal Circuit's rule, vacated the decision, and remanded.[15]

Writing for a unanimous Supreme Court, Justice Thomas wrote the majority opinion vacating the Federal Circuit's and the district court's decision. The Court held that both the district court and Federal Circuit failed to apply the traditional principles of equity fairly.[16] The Court based its decision on the

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7. U.S. Patent No. 5,845,265 (filed Nov. 7, 1995).

8. eBay Inc. v. MercExchange L.L.C., 126 S. Ct. 1837, 1839 (2006); *Buy It Now*, http://pages.ebay.com/help/buy/buyer-bin.html (last visited Mar. 18, 2007).

9. *eBay*, 126 S. Ct. at 1839.

10. *See* MercExchange L.L.C. v. eBay, Inc., 275 F.Supp.2d 695 (E.D. Va. 2003).

11. *Id.* at 698.

12. *Id.* at 712.

13. *Id.* at 711.

14. MercExchange LLC v. eBay, Inc., 401 F.3d 1323, 1339 (Fed. Cir. 2005).

15. *eBay*, 126 S. Ct. at 1841.

16. *Id.* at 1840.

statutory language of the Patent Act. The Patent Act indicates that injunctions "may" issue "in accordance with principles of equity, not 'must.'"[17] Furthermore, patents are to have attributes of personal property.[18] By drawing parallels to copyright law, the Court rejected the Federal Circuit's automatic injunction that followed a finding of patent infringement.[19]

In addition, the Court disapproved of the district court's expansive rule, which suggested that injunctions should not issue in a case such as this when a plaintiff was willing to license its patents and failed to practice its patents commercially.[20] The Court wrote that university researchers and self-made inventors, who choose to license their patents, rather than develop them commercially, could be harmed.[21] The Court tied its analysis to its nearly one-hundred year holding that exists in tension to the district court's ruling.[22] In *Continental Paper Bag v. Eastern Paper Bag Co.*, the Court rejected the notion that a court can deny injunctive relief to a patent holder who unreasonably declined to practice its patent.[23] Therefore, while the district court erred, the Court held the Federal Circuit's categorical grant of injunctions was too expansive. The Court remanded the case to the district court to in order to determine whether to grant or deny injunctive relief based on the equitable discretion of the district court in relation to the four factors.[24]

Although the Court chose not to advise the district court as to how decide the case upon remand, the Court provided two concurrences that shed some light on the Court's views. Chief Justice Roberts wrote a concurrence that was joined by Justice Scalia and Justice Ginsburg.[25] Roberts wrote separately to note his belief that history has shown that it is difficult for a patent holder to exclude through monetary remedies.[26] Roberts appears to favor a patent injunction and wrote that "a page of history is worth a volume of logic."[27]

Justice Kennedy wrote a concurrence that was joined by Justices Stevens, Souter, and Breyer.[28] Kennedy writes to note that history may not be very useful in deciding whether to issue injunctions for business method patents.[29] Kennedy writes that companies that chose to license their patents rather than

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17. 35 U.S.C. §283 (2006).
18. 35 U.S.C. §261 (2006).
19. *eBay*, 126 S. Ct. at 1840.
20. *Id.*
21. *Id.*
22. Cont'l Paper Bag Co. v. E. Paper Bag Co., 210 U.S. 405, 422-430 (1908).
23. *Id.* at 422-430.
24. *eBay*, 126 S. Ct. at 1841.
25. *Id.* (Roberts, C.J., concurring).
26. *Id.*
27. *Id.* at 1842, (Roberts, C.J., concurring) (quoting Justice Holmes's language in New York Trust v. Eisner, 256 U.S. 345, 349 (1921)).
28. *Id.* at 1843 (Kennedy, J., concurring).
29. *Id.*

practice them, and later attempt to use them as a bargaining tool to charge exorbitant fees, do not deserve an injunction.[30] In addition, Kennedy wrote that "injunctive relief may have different consequences for the burgeoning number" of "vague and suspect" business method patents.[31]

II. ANALYSIS OF *EBAY V. MERCEXCHANGE*

The Federal Circuit was established in 1982 in an effort to reconcile all patent appeals and to create a uniform body of case law and rules.[32] Today, however, some have begun to wonder whether the Federal Circuit has become too patent-friendly and has begun to stray off-track. For instance, the Supreme Court has questioned the Federal Circuit's decision apply a general rule that allowed for an injunction whenever patent infringement occurred instead of following the statute: "[t]he decision to grant or deny permanent injunctive relief is an act of equitable discretion by the district court, reviewable on appeal for abuse of discretion."[33] The Supreme Court has sat back and watched the Federal Circuit work from a distance and has rarely chosen to step in. For example, in 1998, when the Federal Circuit decided that a business method patent exception never existed in *State Street*, the Supreme Court accepted that determination without investigation.[34] Nonetheless, the Supreme Court's granting of certiorari in *eBay* has signaled that the Supreme Court realizes that there are problems with the current state of patent law and will not just sit by idly anymore. Justice Kennedy's concurrence makes this clear.

Since *State Street*, there have been a wash of ridiculous patents. Amazon.com and BarnesandNoble.com litigated for years over the "one-click patent" and Priceline.com's "name your own price" patent also was hotly contested.[35] During oral arguments in *eBay*, even Chief Justice Roberts wondered aloud whether he could have come up with patent 5,845,265 ('265).[36] The problem with '265 in *eBay v. MercExchange* is two-fold. First, companies like eBay are not even sure when they are infringing on such a vague patent. Secondly, MercExchange exists merely to license its patents and never actually uses its patents.

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30. *eBay*, 126 S. Ct. at 1843.

31. *Id.*

32. *Marcia Coyle*, Critics Target Federal Circuit, LAW.COM, Oct., 19 2006, http://www.law.com/jsp/law/LawArticleFriendly.jsp?id=1161162317072.

33. Weinberger v. Romero-Barcelo, 456 U.S. 305, 320 (1982).

34. *State St. Bank*, 149 F.3d 1368, cert. denied, 525 U.S. 1093 (1999).

35. James Gleick, *Patently Absurd*, Mar. 12, 2000, N.Y. TIMES, *available at* http://www.nytimes.com/library/magazine/home/20000312mag-patents.html.

36. Oral Argument Transcript at 49, *eBay*, 126 S. Ct. 1837 (2006) (No. 05-130).

A. VAGUENESS OF BUSINESS METHOD PATENTS

Business method patents are a disaster for patent law and our economy. A patent need only have a "useful or tangible result," and patent lawyers have tricked over-burdened patent examiners over and over.[37] The software/Internet industry is forced to walk through a minefield when developing any new technology. With each line of code, a software engineer has to tiptoe and wonder whether he has infringed upon the vast number of business method patents like '265. Rather than innovating, technology companies spend vast amounts of time litigating. Although the scope of patentable subject matter limits algorithms and formulas from being patented,[38] *State Street* has created the proviso that an algorithm can be patented as long as it is involved in something tangible. So by cloaking algorithms in smoke and mirrors, patents like '265 are issued everyday in growing numbers.

Although MercExchange argues that eBay infringed on its patent after licensing discussions, one is left to wonder what was going through eBay's attorneys' heads. With the language in the '265 patent, eBay clearly thought they had some wiggle-room to work with. Just what is an "an electronic market designed to facilitate the sale of goods between private individuals by establishing a central authority to promote trust among participants?" Chief Justice Roberts wondered aloud during oral argument how such a thing could have been patentable, and he was right to do so.

B. PATENT TROLLS

Although the Supreme Court is right in holding that the District Court's ruling was overly broad and could have the effect of harming inventors who work in their own garage and small companies, Justice Kennedy was right to voice his opinion in his concurrence. MercExchange is, for all intent and purposes, a patent troll. A patent troll is a company, usually small, that holds patents to merely license them and sue if licensing agreements are not reached.[39] Many instances occur in which a company invests years of research and development into a product only to realize that one small trinket or widget involved in the big picture infringes upon someone's vaguely worded business method patents. A company ends up settling for an exorbitant amount of money, much more than the license would be worth, in an effort to not scrap the entire project. *eBay* was not the first big example of a patent troll creating a mess for a company. In

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37. John R. Allison & Emerson H. Tiller, *The Business Method Patent Myth*, 18 BERKELEY TECH. L.J. 987, 1007-1012 (2003).

38. 35 U.S.C. §101 (2006).

39. *Underdog or Patent Troll*, BUSINESSWEEK, Apr. 24, 2006, http://www.businessweek.com/magazine/content/06_17/b3981070.htm.

the recent Blackberry case, Research in Motion settled for $612 million just to keep its business afloat and the Blackberry functioning.[40]

On the other hand, it is extremely important to not discourage the small high-tech companies from developing tomorrow's technology. Perhaps Kennedy's concurrence was motivated by his desire to assist big business. Many big companies hold hundreds and thousands of patents in an effort to drown out the small developers. But many small developers are the reason why the future is so bright. Without the full protection of a patent, which is realized through the injunction, there is little incentive for a small company or a single inventor to develop an invention only to have a large company come along and argue that an injunction is not warranted because this particular inventor chose to license his invention rather than practice it. Many small companies simply cannot afford to practice their patent and when a company or inventor licenses its patent, it should not be penalized. Although the issue on remand is whether an injunction should be issued in *eBay v. MercExchange*, this case illuminates the major problem with business method patents.

III. THE COURT SHOULD ADDRESS §101

The Supreme Court should use *eBay* as a stepping stone to realize that the Federal Circuit needs checking up on now and then. Although *eBay* was technically related to patent injunctions, Justice Kennedy's concurrence shows some justices' contempt for business method patents. The Supreme Court has not addressed the Patent Act's patentable subject matter provision, §101, since 1981.[41] The problem is not "patent trolls" but that business method patents have become too expansive, and honestly, ridiculous. Prior to *eBay v. MercExchange*, the Supreme Court punted away the option to voice its opinion on the Patent Act's patentable subject matter provision in §101 in *LabCorp v. Metabolite*.[42] Although this case was related to a patent for the process for diagnosing the deficiencies of two vitamins, Justices Breyer, Souter, and Stevens all dissented from the Court's dismissal of certiorari.[43] These three justices joined Justice Kennedy in his *eBay* concurrence, and it is apparent that at least four of the nine justices are dying for a chance to address patentable subject matter. In fact, the *Metabolite Labs* dissent notes that it has never held that a process is patentable even if it produces a "useful, concrete, and tangible result."[44] In fact, the Court held an opposite result in 1854, and it appears ripe to

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40. *Underdog*, *supra* note 39.

41. *See Diehr*, 450 U.S. 175 (1981).

42. Lab. Corp. of Am. Holdings v. Metabolite Labs., Inc., 126 S. Ct. 2921 (2006).

43. *Id.* at 2921 (Breyer, J., dissenting); Peter Zura's 271 Patent Blog, *Is An Attack on State Street in the Works?* http://271patent.blogspot.com/2006/08/is-attack-on-state-street-in-works.html (Aug. 15, 2006, 16:06 EST).

44. *Metabolite Labs*, 126 S. Ct. at 2928.

set the record straight.[45] Coupled with the Chief Justice's comments during *eBay*'s oral argument, despite his slightly favorable concurrence in *eBay*, he too showed his contempt for business method patents. So there is now a majority of current justices who have voiced their concern over business method patents.

Congress attempted in 2005 and 2006 to reform the current Patent Act in a number of ways.[46] Congress addressed the problem such as when one widget used in a project possibly infringes and can hold up an entire project. Congress also has a desire to help educate federal district judges in new technologies. However, Congress should focus on whether the current patent system is designed for the future. Software and the Internet changes at such a rapid pace that business method patents are far too vague and troublesome to be used in conjunction with rapidly advancing technologies.

CONCLUSION

With the flood of poor business method patents following the Federal Circuit's *State Street* decision, our country's patent system is awash with patents that are arguably at odds with the Patent Act's patentable subject matter provision, §101. While the Supreme Court has sat idly by since *State Street* in 1998, Justice Kennedy's concurrence in *eBay* and the Court's dissent in *Metabolite* show that the Court is itching for an opportunity to address patentable subject matter and attempt to begin an end to the madness and manipulation of the patent system. The Supreme Court has never upheld *State Street* and the business method patent has been nothing but a bane on the software industry and the Internet. Although the Supreme Court should address this issue, Congress, too, cannot sit idly by and must address business method patents.

45. O'Reilly v. Morse, 56 U.S. 62 (1854).

46. Patent Reform Act of 2005, H.R. 2795 108th Cong. (2005); Patent Reform Act of 2006, S. 3818, 109th Cong. (2006); District Court Patent Pilot Program, H.R. 5418, 109th Cong. (2006).

Buckeye Check Cashing, Inc. v. Cardegna: Congressional Policy Favoring Arbitration Remains the Law of the Land

NICHOLAS BIRCK

INTRODUCTION

The Supreme Court granted certiorari in *Buckeye Check Cashing, Inc. v. Cardegna* to resolve whether courts of law have jurisdiction over disputed contracts that contain arbitration clauses. The Court, relying on its own well-developed precedent, held that where a party challenges the legality of a contract as a whole, and not the legality of the arbitration clause contained therein, the case should go to the arbitrator to decide, and the courts, both federal and state, do not have jurisdiction. Federal law embodied in the Federal Arbitration Act preempted any other conclusion with its expression of national policy favoring arbitration.

I. FACTUAL BACKGROUND

Respondents John Cardegna and Donna Reuter entered into various deferred-payment transactions with petitioner Buckeye Check Cashing, Inc. (Buckeye), in which they received cash in exchange for personal checks in the amount of the cash plus a finance charge.[1] For each separate transaction entered into with Buckeye, the respondents signed a "Deferred Deposit and Disclosure Agreement."[2] Each agreement signed by the respondents included arbitration provisions allowing any dispute arising from the transaction to be resolved by binding arbitration.[3] These provisions required arbitration upon election by either party to the transaction, and declared that any claim, dispute, or controversy related to the agreement may be decided by "binding arbitration . . . pursuant to a transaction involving interstate commerce, and shall be governed by the Federal Arbitration Act ('FAA')."[4]

The respondents later brought a putative class action on behalf of all Florida customers of Buckeye, alleging that the check cashing business, as operated, charged usurious rates in violation of state law, rendering it facially criminal.[5] Respondents also argued that since the rates charged were usurious and criminal in nature, the agreements entered into between the parties were void *ab initio*

1. Buckeye Check Cashing, Inc. v. Cardegna, 126 S. Ct. 1204, 1207 (2006).
2. *Id.*
3. *Id.*
4. *Id.*
5. *Id.*

(from inception) and therefore could not be enforced against them.[6] After respondents filed suit in state court, Buckeye immediately moved for an order compelling arbitration.[7]

II. PROCEDURAL HISTORY

In the trial court, Buckeye moved to stay the proceedings and to compel arbitration, as per the terms of the contract.[8] The trial court denied the motion, relying on Florida precedent to hold that the courts, not arbitrators, should resolve claims that a contract is illegal and void *ab initio*.[9] The Florida appellate court reversed, holding that the arbitration agreement was enforceable because the customers were not challenging the arbitration provision itself but the contract as a whole.[10] The appellate court noted that the trial court erroneously failed to construe the arbitration agreement consistently with *Prima Paint Corp. v. Flood & Conklin Manufacturing Co.*,[11] in that "federal law controls because the arbitration agreement expressly provides that 'this arbitration Agreement is made pursuant to a transaction involving interstate commerce, and shall be governed by the Federal Arbitration Act. . . .'"[12]

On appeal, the Florida Supreme Court stated that the appellate court's decision created inconsistency among the Florida Districts and reversed in favor of the respondents.[13] The court held that since the contract as a whole was illegal *ab initio*, the arbitration clause was illegal, unenforceable, and unseverable.[14] The court declared that since the contract was "entirely void [and not voidable] as a matter of law, all of its provisions, including the arbitration clause, would be nullified as well."[15] It further reasoned that enforcing such an agreement to arbitrate could "breathe life into a contract that not only violates state law, but also is criminal . . . ."[16]

III. LEGAL FRAMEWORK

In an opinion by Justice Scalia, the Supreme Court ruled 7-1 that the Florida Supreme Court had erred in declining to follow *Prima Paints*.[17] The Court also

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6. *Buckeye Check Cashing*, 126 S. Ct. at 1207.
7. *Id.*
8. *Id.*
9. *Id.*
10. *Id.*
11. 388 U.S. 395 (1967).
12. Buckeye Check Cashing, Inc. v. Cardegna, 824 So.2d 228, 230 (Fla. Dist. Ct. App. 2002).
13. Cardegna v. Buckeye Check Cashing, Inc., 894 So.2d 860, 861 (Fla. 2005).
14. *Id.* at 861-63.
15. *Id.*
16. *Id.* (citing Party Yards, Inc. v. Templeton, 751 So.2d 121, 123 (Fla. Dist. Ct. App. 2000)).
17. *Buckeye Check Cashing*, 126 S. Ct. at 1209 (Alito, J., did not take part in the consideration of the case).

held that the Florida Court erred in making the distinction between contracts that are void and voidable as they pertain to the severability of arbitration clauses.[18] In making this decision, the Court relied heavily on precedent and continued its long tradition of recognizing a national preference for arbitration embodied in the Federal Arbitration Act.[19]

Justice Scalia began the Court's analysis with reference to the oft-stated policy reasoning the Court has given to the FAA: that Congress enacted the statute in order "[t]o overcome judicial resistance to arbitration" and to declare a national policy favoring arbitration.[20] He then outlined the two types of challenges to the validity of arbitration agreements, that is, those that challenge the validity of the arbitration agreement itself and those that attempt to challenge the validity of the contract as a whole.[21] He characterized the respondents' claim as the second type, an attack on the legality of the "contract as a whole (including its arbitration provision)[; that it] is rendered invalid by the usurious finance charge."[22]

After summarizing the case, Justice Scalia outlined the relevant precedent that had been rejected or ignored by the Florida courts.[23] The Court recognized that *Prima Paint* and *Southland Corp. v. Keating*[24] controlled the disposition of the case by establishing three propositions:

> First, as a matter of substantive federal arbitration law, an arbitration provision is severable from the remainder of the contract. Second, unless the challenge is to the arbitration clause itself, the issue of the contract's validity is considered by the arbitrator in the first instance. Third, this arbitration law applies in state as well as federal courts.[25]

In opposition to the argument of the respondents and the position adopted by the Florida courts, the Court held that because *Southland Corp.* applied federal arbitration law to state courts, this required a following of *Prima Paint*.[26] Under such precedential authority, "because respondents challenge the Agreement, but not specifically its arbitration provisions, those provisions are enforceable apart from the remainder of the contract. The challenge should therefore be considered by an arbitrator, not a court."[27]

The Court then moved to the issue that the Florida court found dispositive: whether the distinction between void and voidable contracts was a proper con-

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18. *Buckeye Check Cashing*, 126 S. Ct. at 1209.
19. 9 U.S.C. §§ 1-16 [Hereinafter 'FAA'].
20. *Buckeye Check Cashing*, 126 S. Ct. at 1207.
21. *Id.* at 1208.
22. *Id.*
23. *Id.* at 1208-1209.
24. *Prima Paint*, 388 U.S. at 395; Southland Corp. v. Keating, 465 U.S. 1 (1984).
25. *Buckeye Check Cashing*, 126 S. Ct. at 1209.
26. *Id.*
27. *Id.*

sideration for the state courts to use in justification of their inconsistency with *Prima Paint*.[28] According to the Florida court, "Florida public policy and contract law [permit] no severable, or salvageable, parts of a contract found illegal and void under Florida law."[29] According to Justice Scalia, "*Prima Paint* makes this conclusion irrelevant."[30] Thus, the answer given regarding whether a void contract was exempt from FAA preemption was a resounding negative.

In coming to this conclusion, the Court's opinion addressed the respondents' argument that the language of section 2 of the FAA applies only to a "contract," which, under state law, would not be possible where the agreement is void *ab initio* due to illegality.[31] Justice Scalia wrote, "We do not read 'contract' so narrowly."[32] According to the Court, since the word contract was used four times in section 2, and because its last use was to allow arbitration provision challenges upon grounds for the revocation of "any *contract*," "[t]here can be no doubt that 'contract' . . . must include contracts that later prove to be void."[33]

Justice Thomas was the lone dissenter of the case, taking a position in accord with the Florida court. He stated that he remained of the view that the "[FAA] does not apply to proceedings in state courts."[34] In his view then, the FAA could not displace a state law that prohibits the enforcement of an arbitration clause in a contract that would be unenforceable under state law.[35]

IV. DISCUSSION

In *Buckeye Check Cashing*, the Court properly concluded, based on a long tradition of precedent, that the FAA preempted state laws attempting to hamper the expressed national policy preference for arbitration. To hold otherwise would have allowed states to overcome Congress' expressed desire to favor arbitration. This, in turn, would have allowed the states to develop their own, inconsistent substantive laws, frustrating the purpose of the FAA. It would also turn well-developed Supreme Court precedent interpreting the national policy favoring arbitration on its head, overruling numerous important cases and creating potentially limitless litigation over the hundreds of thousands of contracts made in reliance on that tradition.

In enacting the FAA, Congress intended to promote a more uniform system of alternate dispute resolution among the states and to help companies relying on arbitration clauses to be able to better handle claims against them that might

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28. *Buckeye Check Cashing*, 126 S. Ct. at 1209.
29. *Cardegna*, 894 So.2d at 864
30. *Buckeye Check Cashing*, 126 S. Ct. at 1209.
31. *Id.* at 1210.
32. *Id.*
33. *Id.*
34. *Id.* at 1211 (Thomas, J. dissenting (citing Allied-Bruce Terminix Co. v. Dobson, 513 U.S. 265, 285-297 (1995) (Thomas J. dissenting)).
35. *Id.*

arise in different states around the country. This benefit to companies, in allowing them to be more prepared for claims, has resulted in a reduction in the costs of doing business nationally and internationally, thus allowing for the savings to be passed on to consumers. If arbitration clauses were not severable from otherwise illegal contracts, the costs to companies to fight claims in every jurisdiction would be enormous and highly detrimental to the national economy. Also, the hundreds of thousands of contracts made in reliance on the status quo of Supreme Court precedent would result in extraordinarily high primary, secondary, and tertiary administrative costs, as well as an overwhelming burden on judicial resources.

Further, upholding Congressional policy and Supreme Court precedent that favors private arbitration is the best decision in terms of institutional competence. The often technical disputes decided in such cases should be made by those who have devoted their lives to becoming experts in the relevant field. Courts of law and equity do not have the competence to become experts in the many varying types of factual and legal issues that are subject to resolution by arbitration. Such disputes that do go to courts often require the expense of far more time and resources by the parties in order to bring the judge up to speed with the relevant knowledge. Expert arbitrators are able to accelerate the process immensely merely by being experts. Favoring the continued development of arbitration will ensure that such expertise will be put to good use and not neglected in favor of overwhelming judicial dockets with cases that could be wrongly decided by the inexpert jurist.

Not only would the judicial resources and administrative costs be exceedingly overwhelming, but also the costs that would result from harming the highly developed, expert, and organized arbitration profession would be incalculable. If state courts could undermine Congressional preference for arbitration and private settlement of disputes, an entire industry that has grown in reliance on this would be irreparably damaged. Consumers would be able to attack every contract perceptibly illegal in some way and take the decision away from arbitrators.

V. AFTERMATH

Cases following the decision in *Buckeye Check Cashing* have for the most part been consistent with the opinion. State courts might have finally begun to recognize and accept that arbitration agreements will be enforced unless the agreement to arbitrate itself is challenged. Most cases filed by consumers challenging the contracts they entered on grounds of contract illegality have been

sent to arbitrators based on *Buckeye Check Cashing* and *Prima Paint*.[36] Cases distinguishing from *Buckeye Check Cashing* have rightfully done so on the one available ground, a challenge on the legality of the arbitration clause itself.[37]

Despite the overwhelming response by courts in following *Buckeye Check Cashing*, there have been a few cases where courts made dubious distinctions in order to escape compelling arbitration. A questionable distinction has been made in *Crawford v. United Servs. Auto. Ass'n Ins.*,[38] where the court held that since the contract in its entirety was an alternate dispute resolution agreement, and thus not a severable provision of a larger problematic contract, the court may determine the legality of the agreement as a whole.[39]

Alterra Healthcare Corp. v. Bryant makes another shaky distinction.[40] The court there made a tenuous finding that because the plaintiff challenged provisions that fell under the heading "Arbitration and Limitation of Liability Agreement" in the contract, it could refuse arbitration orders. This seems to be a misreading of *Buckeye Check Cashing*, which would require the attack to be made only on the provision requiring arbitration, not clauses that fall under the same heading yet do not relate to the agreement to arbitrate per se. The plaintiff must prove fraud or other illegality to void the actual provision that compels arbitration, not related provisions under the same heading.

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36. *See e.g.* Abduljaami v. Legalmatch.com, Inc., 2006 U.S. Dist. LEXIS 26327 (S.D.N.Y. 2006); Ornelas v. Sonic-Denver T, Inc., 2007 U.S. Dist. LEXIS 6214 (D. Colo. 2007); Feil v. MBNA Am. Bank, N.A., 417 F. Supp. 2d 1214 (D. Kan. 2006).

37. State ex rel. Vincent v. Schneider, 194 S.W.3d 853 (Mo. 2006); *see also* USA Payday Cash Advance Ctr. #1, Inc. v. Evans, 2006 Ga. App. LEXIS 1067 (Ga. Ct. App. 2006) (correctly noting that *Buckeye Check Cashing* left undiscussed what affect a waiver then reassertion of arbitration requirements might have, and thus followed state law and considerations of equity on the issue).

38. U.S. Dist. LEXIS 46433 (D. Colo. 2006);

39. *Id.*

40. 937 So. 2d 263 (Fla. Dist. Ct. App. 2006).

Georgia v. Randolph: Warrantless Search and Seizure and Its Impact on Domestic Violence

ANDREA FERRO

INTRODUCTION

It has been readily determined that when the police receive the consent of one occupant, a warrantless search of the premises is lawful and any evidence seized is admissible. But what happens when the police have the consent of one occupant, when the other is present at the scene and expressly refuses consent? In the recent Supreme Court term, the court decided objection over consent in a warrantless search of a residence consisting of two or more cohabitants is not a permissible search. While this decision, on its face, appears to grant more protection of Fourth Amendment rights against unlawful searches and seizures, it also limits the ability of the police to aid domestic violence victims in domestic dispute calls. By not allowing the police to enter a home under consent of one and over the objection of the other, victims are at a severe disadvantage when the dominating partner is the objector.

Previous cases have stated that the consent of one of the cohabitants is enough to allow law enforcement officers to search the area without a warrant. This is also known as actual authority. "Permission to search [can be] obtained from a third party who possessed common authority over or other sufficient relationship to the premises or effects sought to be inspected."[1]

The courts have also expanded this and stated that consent to search on behalf of a defendant is extended to those with what is called apparent authority.[2] The court in *Illinois v. Rodriguez* held that even if a third party does not possess actual common authority over the area searched; the Fourth Amendment is not violated if the police, in good faith, relied on the person's apparent authority.[3] The court used a reasonable person standard to determine whether the police would believe that the person giving consent had this apparent authority. If someone of reasonable caution, in the same situation as the law enforcement officers, believed that the consenting party had the authority to consent, then the search does not violate the Fourth Amendment.[4] *Georgia v. Randolph*[5] deals with the next extension of this privilege that calls into question the actual or apparent authority of one cohabitant when the other cohabitant is present and objecting.

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1. United States v. Matlock, 415 U.S. 164, 170 (1974).
2. Illinois v. Rodriguez, 497 U.S. 177, 177 (1990).
3. *Id.* at 177.
4. *Id.* at 188.
5. Georgia v. Randolph, 126 S. Ct. 1515 (2006).

I. THE SUPREME COURT DECISION

In May 2001, Janet Randolph, wife of defendant Scott Randolph, left the marital residence in Americus, Georgia with their son to live in Canada with her parents.[6] On July 6, she and her son returned to the marital residence; the reason for their return was unknown and does not affect the holding.[7] While they were there, she called the police complaining of a domestic dispute and that her husband had taken their son and left.[8]

When the officers got to the home, Mrs. Randolph told them that her husband was a cocaine user whose addiction caused them financial troubles.[9] While the police were still there, Mr. Randolph returned to the home without their son, who he said he left with a neighbor because he feared that his wife would leave the country with him again.[10] He also denied any cocaine use and instead said it was Mrs. Randolph who had problems with drugs and alcohol.[11]

One of the officers took Mrs. Randolph to get her son and when they returned, she renewed her claims that her husband had drug problems and this time added that there were "items of drug evidence" in the house.[12] The officer asked Mr. Randolph for permission to search the home, which he denied.[13] The officer then asked Mrs. Randolph for her permission, which she granted.[14] Mrs. Randolph led the officers upstairs to a bedroom that she identified as "Scott's" and they found a drinking straw with powdery residue that the officer thought to be cocaine and was later confirmed as such.[15]

The officer then left the house to go to his police car to retrieve an evidence bag and to call the District Attorney who instructed the officers to stop the search and apply for a warrant.[16] When the officer returned to the house, Mrs. Randolph withdrew her consent.[17] The police took the straw and the Randolph's with them and applied for a search warrant, which they were granted.[18] They subsequently returned to the house and found more evidence of drug use, which was used as the basis to indict Scott Randolph for possession of cocaine.[19]

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6. *Randolph*, 126 S. Ct. at 1519.
7. *Id.*
8. *Id.*
9. *Id.*
10. *Id.*
11. *Randolph*, 126 S. Ct. at 1519.
12. *Id.*
13. *Id.*
14. *Id.*
15. *Id.*
16. *Randolph*, 126 S. Ct. at 1519.
17. *Id.*
18. *Id.*
19. *Id.*

At trial, Mr. Randolph, defendant, moved to suppress the evidence based on the fact that it was the product of an illegal warrantless search.[20] The trial court denied the motion because Mrs. Randolph had common authority to consent to the search based on *United States v. Matlock*.[21] The Court of Appeals reversed and was upheld by the Georgia State Supreme Court. They based their decision on the ground that "the consent to conduct a warrantless search of a residence given by one occupant is not valid in the face of the refusal of another occupant who is physically present at the scene to permit a warrantless search."[22] They distinguished this case from *Matlock* because Scott Randolph was not absent from the scene when they asked Mrs. Randolph for her permission.[23]

The Supreme Court granted certiorari to resolve the split of authority on whether one occupant could give the police consent to search the residence while the other occupant is present and objecting.[24] In a 5-4 decision, the Supreme Court affirmed the holding of the Georgia State Supreme Court that they could not.[25]

The majority stated that the decision that they made would have no bearing on the ability of the police to protect domestic violence victims.[26] They stated:

> so long as [the police] have good reason to believe such a threat exists, it would be silly to suggest that the police would commit a tort by entering. . .to determine whether violence (or threat of violence) has just occurred or is about to occur, however much a spouse or other cotenant objected.[27]

They said that the right of police to enter a residence in order to protect someone against domestic violence has nothing to do with the issue in the case.[28]

But the dissent makes a very valid argument, with which I agree, to the majority's conclusion that this holding will not affect domestic violence situations. "No sensible person would go inside in the face of a disputed consent" and an officer would have no more right to enter then if they had no consent at all.[29] However, the police in this situation did have a right to enter, "Mrs. Randolph did not invite the police to join her for dessert and coffee; the officer's precise purpose for knocking on the door was to assist with a dispute. . .Mrs. Randolph felt the need for the protective presence of the police."[30]

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20. *Randolph*, 126 S. Ct. at 1519.
21. *Id.*
22. *Id.*
23. *Id.* at 1520.
24. *Id.*
25. *Randolph*, 126 S. Ct. at 1520.
26. *Id.* at 1525.
27. *Id.*
28. *Id.* at 1526.
29. *Id.* at 1537 (Roberts, J. dissenting).
30. *Id.* at 1537-38 (Roberts, J. dissenting).

II. THE PROBLEM

This court found that even though this was a domestic dispute call, when Mrs. Randolph gave her consent to search the residence that she shared with Mr. Randolph, because Mr. Randolph objected, the warrantless search was impermissible. But was not this the very circumstance they said that the decision would not affect? What if the situation had been worse? What if the call came in that Mr. Randolph had threatened to kill Mrs. Randolph, and when the police arrived she said that she knew where "Scott's gun" was and gave her consent for them to search, but Mr. Randolph objected? Would they have to leave and apply for a warrant? And what if they did get a warrant, would Mrs. Randolph still be alive when they returned or would they now be investigating a homicide instead of a domestic violence claim because they were not allowed to search for the gun that killed Mrs. Randolph? If women knew that when they called the police those police would not be able to come in and help them because the abuser would object to the search, why would they call the police at all, especially if when they do and the police get there they only to have to leave again? Calling would only make the abuser angrier and while the police are gone trying to secure a warrant, the enraged abuser finishes what he started because he knows that when the police get back they will search the house and arrest him.

III. MY PROPOSAL

The court in *Rodriguez* stated that:

> what we hold today does not suggest that law enforcement officers may always accept a person's invitation to enter the premises. Even when the invitation is accompanied by an explicit assertion that the person lives there the surrounding circumstances could conceivably be such that a reasonable person would doubt its truth and not act upon it without further inquiry.[31]

Why can't we take this theory that the police need to further investigate before entering and apply it to the police making further inquiry before *leaving* when consent to search is being objected to?

In domestic violence situations, time is of the essence. The police need to be able to enter the premises over the objective of one cotenant when the consent is given by the other, especially where the police believe that the objecting cotenant is abusing the other. Just as the reasonable person standard is used to determine whether police can conduct a warrantless search of an area when consent is given under apparent authority, that same standard should be applied when there is objection over consent in a domestic dispute situation. If a reasonable person in the same situation as the police would have entered and searched the premises over the objection of one cotenant and the consent of the other to

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31. *Rodriguez*, 497 U.S. at 188.

protect a potential victim, then the warrantless search should be legal. If however, a reasonable person would not have entered, then it would be appropriate and consistent with precedent for the officers to obtain a warrant before entering the premises.

In addition, as a policy concern, when the police are there on legitimate police business, i.e. a domestic dispute call, then the precedent set out in *Texas v. Brown*[32] should rule and they should be allowed to search the premises over the objection. *Brown* states that when police are lawfully on the premises, there is no question that they could take evidence that was in plain view or take further action if it was supported by probable cause.[33]

Once the police are lawfully on the premises because they were called there for a domestic dispute, requiring them to get a warrant to further their investigation would cause them to lose valuable amounts of time. Evidence could turn up missing when the police return because the abuser knows that the police will find it once they get the warrant. The victim could change her story, keeping her in a situation where there could be continued violence because her abuser has convinced her that she should not cooperate with the police. Or even worse the victim could be killed to silence the accusations, all while the police were out trying to get a warrant to "help" her.

CONCLUSION

This decision of the Supreme Court of the United States could have detrimental effects on victims of domestic violence. When police are not allowed to enter and search the premises of cohabitants where one cohabitant consents and the other objects, and the call is in regards to a domestic dispute, the ramifications could be deadly. While the majority attempts to show that this decision will have no affect on this area of law, it most certainly will. The court needs to make the distinction between a warrantless search of an area that does not involving domestic violence and an area that does. The decisions of the court need to be on a case by case basis, using the reasonable person standard, in order to protect victims of domestic violence when they do finally get the courage to call the police for help. The distinction could mean the difference between life and death.

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32. Texas v. Brown, 460 U.S. 730 (1983).
33. *Id.*

Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Dabit: Limiting Forum Selection for Securities Fraud Class Action Lawsuits

ANDREW MAYO

INTRODUCTION

Many cases rest upon the seemingly simple issue of statutory interpretation. Often, the Court is divided between textualists, those Justices who wish follow the ordinary meaning of a statute, and those Justices who feel it is necessary to look to the intent of the legislature in drafting a statute or the problem that the statute was created to remedy. In *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Dabit*[1] (hereinafter "*Dabit*"), the Court was surprisingly undivided in its reasoning when it unanimously agreed on a broad interpretation of the Securities Litigation Uniform Standards Act of 1998 (hereinafter "SLUSA"), which preempts certain securities fraud class action suits that are brought under state law.[2] The Court relied on policy considerations and the purpose of the legislation, while ignoring a textualist approach.[3] It is not entirely clear whether the Court's interpretation of the statute is correct, although the implications of *Dabit* should be seen in the near future.

I. STATEMENT OF THE CASE

Shadi Dabit (hereinafter "Dabit") is a former broker of the investment banking firm Merrill Lynch, Pierce, Fenner & Smith, Inc. (hereinafter "Merrill Lynch" or "the firm").[4] Dabit filed a securities fraud class action against Merrill Lynch in the United States District Court for the Western District of Oklahoma on behalf of himself and other former and current brokers employed by the firm.[5] The suit was brought in federal court, however the claims invoked Oklahoma state law.[6] Dabit's claim was that Merrill Lynch manipulated stock prices by publishing misleading research, thereby breaching its fiduciary duty and covenant of good faith and fair dealing owed to its brokers.[7] This misleading research caused brokers and investors alike to hold on to overvalued stocks much longer than they would have, had they been given accurate research and

1. Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Dabit, 126 S. Ct. 1503 (2006).
2. *Id.* at 1515.
3. *Id.*
4. *Id.* at 1507.
5. *Id.*
6. *Dabit*, 126 S. Ct. at 1507.
7. *Id.*

analysis from the firm.[8] The stock prices dropped rapidly upon discovery of the truth about the incorrect research.[9] Dabit's claim to damages arose from the money that he lost from holding on to the overvalued securities, as well as the lost commissions from his clients, who took their business to other brokers upon the discovery of the misleading research.[10]

Merrill Lynch motioned to have the case dismissed under the SLUSA, which preempts securities fraud class action suits that are brought under state law that allege fraud "in connection with the purchase or sale of a security."[11] The district court granted Merrill Lynch's motion to dismiss, finding that Dabit's state law claims were clearly preempted by federal securities laws under the SLUSA.[12] The Court of Appeals for the Second Circuit[13] vacated the judgment and remanded, finding that Dabit's claims fell outside the preemptive scope of the SLUSA.[14] The Court of Appeals gave a narrow interpretation of the preemption clause of the SLUSA.[15] It stated that the alleged fraud of Merrill Lynch had merely caused the plaintiffs to "retain or delay selling their securities" and had not fraudulently induced them to specifically "purchase or sell" as required by the preemption clause of the statute.[16] The United States Supreme Court disagreed with the Second Circuit and gave a broad interpretation of the SLUSA, which had the effect of preempting Dabit's suit.[17]

II. COURT'S ANALYSIS

The issue in this case is whether Merrill Lynch's alleged fraud was "in connection with the *purchase or sale*" of a security.[18] The relevant portion of the SLUSA states:

> No covered class action based upon the statutory or common law of any State or subdivision thereof may be maintained in any State or Federal court by any private party alleging a misrepresentation or omission of a material fact in connection with the purchase or sale of a covered security.[19]

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8. *Dabit*, 126 S. Ct. at 1507.
9. *Id.*
10. *Id.*
11. *Id.*; Securities Litigation Uniform Standards Act of 1998, 15 U.S.C. § 78bb(f)(1)(A) (2006).
12. *Dabit*, 126 S. Ct. at 1508.
13. Many suits with claims similar to that of Dabit's were filed throughout the country simultaneously against Merrill Lynch, invoking both federal and state law. The Judicial Panel on Multidistrict Litigation transferred all of the suits against Merrill Lynch to the United States District Court for the Southern District of New York. The judge in that court dismissed Dabit's claim and the appeal to the Second Circuit followed. *Id.*
14. Dabit, 126 S. Ct. at 1508.
15. *Id.*
16. *Id.*
17. *Id.* at 1515.
18. *Id.*
19. Securities Uniform Litigation Uniform Standards Act of 1998, 15 U.S.C. § 78bb(f)(1)(A) (2006).

The Court interpreted this portion of the statute in a broad manner that includes "holders" of securities along with "purchasers and sellers."[20] This broad interpretation had the effect of preempting Dabit's class action claim.[21]

The Court begins with a brief history of the language used in the preemption clause of the SLUSA, which is virtually identical to language used in both Section 10(b) of the Securities and Exchange Act of 1934 (hereinafter "§ 10(b)") and in Securities and Exchange Commission Rule 10(b)(5) (hereinafter "Rule 10(b)(5)").[22] These two sections both prohibit fraud or misrepresentation "in connection with the purchase or sale of any security."[23] The Court decided in *Blue Chip Stamps v. Manor Drug Stores* that the remedies under Rule 10(b)(5) should be limited to "purchasers and sellers" of securities, rather than giving a broad interpretation which would allow plaintiffs who neither purchased nor sold to recover under the statute.[24] One of the main reasons for the Court's narrow interpretation of "purchasers or sellers" in *Blue Chip Stamps* was to prevent a flood of securities fraud claims.[25]

Next, the court discusses the enactment of the Securities Reform Act of 1995 ("Reform Act"), which was the Congressional response to a sharp increase in the number of securities fraud class action claims.[26] By passing the Reform Act, Congress supported some of the same policy considerations used by the Court in *Blue Chip Stamps*, and recognized that the increase in securities fraud class actions was having a negative effect on the entire economy.[27] The Reform Act became an attempt to reduce abusive litigation by limiting damages and attorney's fees, imposing restrictions on the selection of lead plaintiffs, imposing sanctions for frivolous litigation, and imposing heightened pleading requirements for any class who wished to bring a claim under § 10(b) and Rule 10(b)(5).[28]

An unintended consequence of the Reform Act was an increase in state law securities fraud class action suits.[29] In an attempt to avoid the burdensome requirements of the Reform Act, many plaintiffs avoided bringing claims under federal law altogether and began to bring claims under state law, and often in state court.[30] Prior to the Reform Act, securities fraud class actions brought

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20. *Dabit*, 126 S. Ct. at 1514.
21. *Id.*
22. *Id.* at 1509.
23. *Id.*
24. *Id.* at 1510 (citing Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 738 (1975)).
25. *Dabit*, 126 S. Ct. at 1510.
26. *Id.*
27. *Id.*
28. *Id.* at 1511 (citing Private Securities Litigation Reform Act of 1995, 15 U.S.C. §§ 77z-1 and 78u-4).
29. *Id.*
30. *Id.*

under state law had been quite rare.[31] In response to the increased number of state law class actions, Congress enacted the SLUSA in 1998 as an attempt to prevent these claims from "frustrating the objectives of the Reform Act."[32] The purpose of the Reform Act would be undermined if plaintiffs were able to easily plead around preemption due to a narrow application of the preemption clause.[33] Under a narrow interpretation, courts would still have an increased number of securities fraud class actions because plaintiffs who merely *held* their securities would be able to bring class actions invoking state law. The Court also gives a final argument that the SLUSA only preempts state law *class action* claims and has no effect on an individual plaintiff or groups of fewer than 50 plaintiffs. Under the Court's broad interpretation, those who are injured by securities fraud will still have the right to bring an individual suit under state law.

III. ARGUMENTS SUPPORTING THE COURT'S BROAD INTERPRETATION

There is a substantial amount of case law that deals with the Court's interpretation of the "in connection with the purchase or sale" phrase of Rule 10(b)(5) that supports a broad interpretation. The Court cites to *Superintendent of Insurance of New York v. Bankers Life & Casualty Co.*,[34] *United States v. O'Hagan*,[35] and *SEC v. Zanford*[36] as cases that give a broad and expansive meaning to the phrase. These cases support the view that the fraud only needs to "coincide" with a securities transaction and does not require a specific purchaser or seller.[37] The Court's broad interpretation used in these cases, as well as in *Dabit*, may seem to conflict with the narrow interpretation given in *Blue Chip Stamps*; however, the Court stated that in *Blue Chip Stamps* it was only defining the scope of a private right of action under Rule 10(b)(5) and was not defining the phrase "in connection with the purchase or sale of a security." Therefore, there is no conflicting interpretation between the Court's holding in *Blue Chip Stamps* and in *Dabit*.

Congress was well aware of the meaning that the Court had given to the phrase "in connection with the purchase or sale of a security" when it passed the SLUSA.[38] As the Court stated, when "judicial interpretations have settled the meaning of an existing statutory provision, repetition of the same language in a new statute indicates, as a general matter, the intent to incorporate its . . . judi-

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31. *Dabit*, 126 S. Ct. at 1511 (citing H. R. Rep. No. 105-640, at 10 (1998); S. Rep. No. 105-182, at 3-4 (1998)).

32. *Id.*

33. *Id.*

34. Superintendent of Ins. v. Bankers Life & Cas. Co., 404 U.S. 6 (1971).

35. United States v. O'Hagan, 521 U.S. 642 (1997).

36. SEC v. Zanford, 535 U.S. 813 (2002).

37. *Dabit*, 126 S. Ct. at 1513.

38. *Id.*

cial interpretations as well."[39] The meaning of the "in connection with" phrase from Rule 10(b)(5) has been determined by previous judicial interpretations, and these interpretations should be carried over and applied to Congress' use of the same language in the SLUSA.

Moreover, the purpose of the SLUSA was to prevent state law class actions from interfering with the goal of the Reform Act, which was to keep the number of securities fraud class action claims at a minimum. If the Court were to interpret the SLUSA in a narrow manner, then the number of securities fraud class action claims would increase and the purpose of the Reform Act would be defeated. Tied into this reasoning is that fact that under a narrow interpretation, plaintiffs could easily plead around the preemption requirements and thus render the statute completely useless. A broad interpretation will prevent plaintiffs from taking advantage of the language of the statute in an attempt to avoid its reach. This is probably the most compelling argument for a broad interpretation of the clause; however, it was only mentioned by the Court in dicta.

IV. ARGUMENTS AGAINST THE COURT'S BROAD INTERPRETATION

Some may find it surprising that the Justices who are normally strong supporters of textualsim, such as Justice Scalia, did not object to the broad interpretation adopted by the Court. Under a textualist argument, the ordinary meaning of the preemption clause in the SLUSA clearly only applies to investors who purchase or sell a security and is not applicable to one who simply holds a security due to fraudulent misrepresentation.[40] The statute does not mention "holders" of securities as being preempted from bringing class action suits under state law.[41] Congress clearly enumerated purchasers and sellers as the two categories of investors whose state law claims will be preempted and the Court should not read anything more in to the meaning of the statute than what is clearly written.[42]

This textualist argument is mentioned in a law review article written by Professor Jennifer O'Hare of Villanova University School of Law.[43] Professor O'Hare's article was written prior to the *Dabit* decision; however she makes several compelling arguments as to why courts should interpret the preemption clause of the SLUSA in a narrow manner.[44] O'Hare mentions policy considera-

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39. *Dabit*, 126 S. Ct. at 1511 (quoting Bragdon v. Abbott, 524 U.S. 624, 625 (1998)).

40. *See* 15 U.S.C. § 78bb(f)(1)(A) (2006).

41. *Id.*

42. *Id.*

43. *See generally* Jennifer O'Hare, *Preemption Under the Securities Litigation Uniform Standards Act: If It Looks Like a Securities Fraud Claim and Acts Like a Securities Fraud Claim, Is It a Securities Fraud Claim?*, 56 ALA. L. REV. 325 (2004).

44. *Id.* at 376-380.

tions and federalism concerns as two of the main reasons why the preemption clause should be interpreted narrowly.[45]

O'Hare discusses policy considerations that support a narrow interpretation of the preemption clause of the SLUSA.[46] The "in connection with" phrase from Rule 10(b)(5) is virtually identical to the language of the SLUSA.[47] The "in connection with" portion of Rule 10(b)(5) has been interpreted by courts in a broad manner, based on the policy considerations that were behind the enactment of the rule, which were to protect investors and to maintain a safe market that has a high level of integrity.[48] A broad interpretation was necessary for Rule 10(b)(5) in order to protect *all* investors from fraud and misrepresentation.[49] However, the SLUSA was not enacted with the same purpose of protecting investors and the market, but was enacted with the purpose of preventing plaintiffs from avoiding the requirements of the Reform Act by filing class action suits under state law.[50] This purpose does not require as broad of an interpretation of the "in connection with" phrase in the statute because the statute was not created to protect investors.[51] A narrow interpretation that would not preempt class actions brought by "holders" would not violate any of the policy reasons for which the SLUSA was created.[52] Therefore, because the two statutes were created for completely different purposes and are based on completely different policy considerations, courts should not use the same broad interpretation in the SLUSA that has been used with regard to the similar language of Rule 10(b)(5).[53]

O'Hare also mentions federalism concerns as another compelling reason why courts should interpret the preemption clause of the SLUSA in a narrow fashion.[54] In general, courts interpret removal and preemption provisions in a narrow manner in order to protect state law from being improperly interfered with by federal law.[55] ". . . [C]ourts should also consider the importance of state policies that might be frustrated if the state action is preempted."[56] The important and often overlooked policy of federalism should be taken into strong consideration when courts are interpreting the preemption clause of the SLUSA.[57]

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45. *Id.*
46. O'Hare, *supra* note 43, at 376.
47. *See* SEC Rule 10b(5); *see* 15 U.S.C. § 78bb(f)(1)(A) (2006).
48. O'Hare, *supra* note 43, at 376.
49. *Id.*
50. *Id.*
51. *Id.*
52. *Id.*
53. O'Hare, *supra* note 43, at 377.
54. *Id.*
55. *Id.*
56. *Id.* at 379.
57. *Id.*

CONCLUSION

The Court determined that the preemption clause of the SLUSA should be interpreted in a broad manner, which in effect, will preempt all future securities fraud class action claims that are raised under state law. The clause will preempt claims brought by those who allege damages from being fraudulently induced to *purchase* or *sell* securities, as well as those who allege that they were fraudulently induced to merely *hold* on to securities longer than they normally would have. The implications of *Dabit* can not yet be determined and only time will tell if the holding in this case will have a negative effect on investors who wish to bring their claims under state law.

Rice v. Collins: Reviewing Peremptory Challenges

LEILI MOGHARI

INTRODUCTION

The Supreme Court in *Rice v. Collins*,[1] considered how much deference to give to a state fact-finding in a federal habeas proceeding. The Court decided that issue within the context of reviewing a defendant's claim that a peremptory challenge was used discriminatorily.

I. BACKGROUND

The peremptory challenge system is a cornerstone of the United States judicial system, and despite at one point being used as means for discriminating against certain types of jurors, it has survived. The system has endured because the Court has implemented various strategies in an attempt to eliminate any discrimination in the jury selection process. The Court first addressed the abuse of the peremptory challenge system in *Strauder v. West Virginia*,[2] where the court struck down a statute restricting jury service to white men as being racially discriminatory. The Court held that a defendant was denied equal protection when members of his race were purposefully excluded from a jury.[3] After *Strauder*, the Supreme Court was silent on the issue of peremptory challenges for eighty-five years until the case of *Swain v. Alabama*,[4] where the Court again had to look seriously at the use and abuse of peremptory challenges. The question the Court looked at in *Swain* was whether an African-American defendant was denied equal protection when the prosecution used peremptory challenges to exclude all the members of the defendant's race from the jury.[5] The Court in *Swain* held that if a prosecutor continued to exclude African-Americans from the jury case after case, a presumption of purposeful discrimination would arise.[6] In its decision, the Court noted the extensive common law and statutory history of the peremptory challenge[7] and stressed the essential role that peremptory challenges have in the trial process.[8] What is interesting about *Swain* is that instead of requiring explanations for peremptory challenges, the Court delineated a test that presumed that the prosecutor's motive in using the peremp-

1. 126 S. Ct. 969, 969 (2006).
2. 100 U.S. 303, 304 (1880).
3. *Id.* at 310.
4. 380 U.S. 202 (1965).
5. *Id.* at 221.
6. *Id.* at 222-24.
7. *Id.* at 212-17.
8. *Id.* at 219.

tory challenge was to obtain a fair and impartial jury.[9] However, this presumption could be overcome if the defendant could provide evidence that the prosecution was discriminatorily using peremptory challenges in all its cases.[10] The *Swain* test created a difficult burden for the criminal defendant to meet because it required defendants to show a prosecutor's previous conduct over an indefinite amount of time. A court finally addressed this issue, concluding that the economic and time restraints combined with the unavailability of information, would make most criminal defendants unable to meet the *Swain* test.[11] Despite this criticism, the *Swain* test for proving purposeful discrimination in the use of peremptory challenges remained in effect until 1986, when the Court decided *Batson v. Kentucky*.[12]

The defendant in *Batson*, an African-American male, was indicted for second-degree burglary and receipt of stolen goods.[13] During jury selection, the prosecutor used peremptory challenges to remove all the African-American individuals on the panel.[14] The defendant argued that the prosecution's dismissal of all African-Americans violated his Sixth Amendment right to a jury comprised of a cross-section of the community.[15] The defendant further argued that his Fourteenth Amendment right to equal protection of the laws was violated by the prosecutor's discriminatory use of peremptory challenges.[16] The Court began its opinion by asserting that purposeful discrimination against African-Americans in the jury selection process did in fact violate the equal protection clause of the Fourteenth Amendment.[17] However, the majority rejected the defendant's challenge to the jury panel.[18] The Court stated that criminal defendants do not have a right to be tried by a jury consisting of individuals of their own race.[19] The Court also rejected the evidentiary standard of *Swain*[20] and created a new standard where a criminal defendant could establish a prima facie case of purposeful discrimination based on evidence of the prosecutor's discriminatory use of peremptory challenges during his own trial.[21]

Batson sets forth a three part test where: (1) "the trial court must determine whether the defendant has made a prima facie showing that the prosecutor exercised a peremptory challenge on the basis of race;" (2) "if the showing is made,

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9. *Swain*, 380 U.S.
10. *Id.* at 224.
11. United States v. Pearson, 448 F.2d 1207, 1217 (5th Cir.1971).
12. 476 U.S. 79 (1986).
13. *Id.* at 82.
14. *Id.* at 83.
15. *Id.*
16. *Id.*
17. *Batson*, 476 U.S. at 84.
18. *Id.*
19. *Id.* at 85.
20. *Id.* at 92-93.
21. *Id.* at 95.

the burden shifts to the prosecutor to present a race-neutral explanation;" and (3) "the court must then determine whether the defendant has carried his burden of proving purposeful discrimination."[22]

The Supreme Court has on several occasions expanded the scope of *Batson*. For example, in *Powers v. Ohio*,[23] the Court extended *Batson* protection to white criminal defendants. And in *Georgia v. McCollum*,[24] the Court held that *Batson* challenges may be used by the prosecution in response to alleged discriminatory use of peremptory challenges by the defense. Also, in *Edmundon v. Leesville Concrete Company*,[25] the Court extended the protection of *Batson* to civil litigants. And in *J.E.B. v. Alabama ex. rel. T.B.*,[26] the Court extended *Batson* to gender classifications, which meant that peremptory strikes based on gender were subject to the same three part test as strikes based upon race.

Rice v. Collins is an interesting case because not only does it call into question the usefulness of the three-step test set forth in *Batson*, but it asks another question too, whether the peremptory challenge system does in fact provide a tool to selecting an impartial jury or should it be abolished because it permits litigants to silently discriminate against potential jurors or strike a juror for arbitrary reasons.

II. FACTS

In the trial court of California, Collins was convicted of possessing cocaine with the intent to distribute. During the trial, Collins objected when the prosecutor used two peremptory challenges to strike two African-Americans from the jury; specifically Juror 16, who was a young female.[27] Upon the objection, the trial judge used the three part *Batson* test to determine whether the prosecutor had in fact exercised his peremptory challenges incorrectly.

When asked, the prosecutor provided a race-neutral explanation for striking Juror 16, stating that the juror "had rolled her eyes in response to a question from the court;" the prosecutor also stated that she was "young and might be too tolerant of a drug crime;" and that she "was single and lacked ties to the community."[28] The trial court was satisfied with the prosecutor's explanation and rejected Collins' challenge.[29] Collins appealed, and the California Court of Appeal affirmed his conviction.[30] Next, Collins filed a federal habeas petition,

22. *Rice*, 126 S. Ct. at 973-74.
23. 499 U.S. 400 (1991).
24. 505 U.S. 42 (1992).
25. 500 U.S. 614 (1991).
26. 114 S. Ct. 1419 (1994).
27. *Rice*, 126 S. Ct. at 972.
28. *Id.* at 973.
29. *Id.*
30. *Id.*

which was denied by the district court.[31] A divided panel for the Court of Appeals for the Ninth Circuit reversed, "Noting that . . . [AEDPA] governed Collins' petition, the panel majority concluded that it was an unreasonable factual determination to credit the prosecutor's race-neutral reasons for striking Juror 16."[32]

A trial court's findings are reviewed for clear error when on direct appeal in federal court.[33] The Court noted that, "Under AEDPA, however, a federal habeas court must find the state court conclusion 'an unreasonable determination of the facts in light of the evidence presented in the State court proceeding.'"[34] The Court also noted that a state court's factual findings are presumed correct and the petitioner must rebut that presumption by "clear and convincing evidence."[35] The problem was that the Ninth Circuit believed that the trial court erred when they applied the third step of the *Batson* analysis, "holding that it was unreasonable to accept the prosecutor's explanation that Juror 16 was excused on account of her youth and her demeanor."[36] The Ninth Circuit based its conclusion on the fact that the trial court had not witnessed the eye rolling and that, "no reasonable factfinder could have accepted the prosecutor's rendition of the alleged incident because the prosecutor's conduct completely undermined her credibility."[37] The Ninth Circuit was referring to the alleged conduct of Juror 16, which included: (1) the prosecutor's reference to another juror who was struck from the panel as "young," even though she was in fact a grandmother; (2) the possibility, as revealed in the record, that the prosecutor struck Juror 16 because of her gender; and (3) the prosecutor's statement that she believed Juror 16 might be "too tolerant of the crime," which it viewed as a excuse since Juror 16 "disclaimed any other reason she could not be impartial."[38]

The Court noted that the Ninth Circuit's reasoning at best, "suggest[s] only that the trial court had reason to question the prosecutor's credibility regarding Juror 16's alleged improper demeanor."[39] The Court believed however that this alone did not compel "the conclusion that the trial court had no permissible alternative but to reject the prosecutor's race-neutral justifications and conclude Collins had properly shown a *Batson* violation."[40] The Court stated: "[R]easonable minds reviewing the record might disagree about the prosecu-

31. *Rice*, 126 S.Ct. at 973.
32. *Id.*
33. *Id.* at 974
34. *Id.* (quoting 28 U.S.C. § 2254(d)(2) (2006)).
35. *Id.* (quoting 28 U.S.C. § 2254(e)(1) (2006)).
36. *Rice*, 126 S.Ct. at 974.
37. *Id.*
38. *Id.* at 975.
39. *Id.*
40. *Id.* at 975-76.

tor's credibility, but on habeas review that does not suffice to supersede the trial court's credibility determination."[41]

III. ASSESSING THE USEFULNESS OF *BATSON*

In the concurrence for *Rice v. Collins*, Justices Breyer and Souter wrote that this decision, "helps to illustrate *Batson*'s fundamental failings," which they note were pointed out by Justice Thurgood Marshall over twenty years ago in his concurrence in *Batson*.[42] The justices wrote that the prosecutor's inability to provide a clear explanation of why she removed Juror 16 "may well reflect the more general fact that the exercise of a peremptory challenge can rest upon instinct not reason."[43] Finally, Justices Breyer and Souter state, "ordinary mechanisms of judicial review cannot assure *Batson*'s effectiveness."[44] Years earlier, Marshall concluded that the only way to eliminate discrimination in jury selection was to do away with peremptory challenges altogether.[45] Marshall suggested several potential problems with the *Batson* test. One issue is that a challenge can only be triggered when the use of the peremptory challenge was "flagrant" enough that a prima facie case of purposeful discrimination could be established.[46] Another issue is that a prosecutor can easily assert "facially neutral reasons for striking a juror" that would satisfy step two and defeat a *Batson* challenge.[47] In *Miller-El v. Dretke*,[48] Justice Breyer's concurrence echoed Justice Marshall's concerns by expressing similar reservations about the peremptory challenge system. Justice Breyer wrote that "[t]he complexity of this process reflects the difficulty of finding a legal test that will objectively measure the inherently subjective reasons that underlie use of a peremptory challenge."[49] This is the same sentiment that Breyer echoed in *Rice*.

CONCLUSION

The confusion created by *Batson* challenges makes predicting the future of the peremptory challenge system difficult. However, taking into account Justice Breyer's and Justice Souter's concurrence, it is possible to consider possible directions for the peremptory challenge system. First, the Court may continue the status quo and continue to rule that race and gender based peremptory challenges are unconstitutional. Under this approach, the Court eventually

41. *Rice*, 126 S.Ct. at 976.
42. *Id.*
43. *Id.*
44. *Id.*
45. *Batson*, 476 U.S. 79 at 103.
46. *Id.* at 105.
47. *Id.* at 106.
48. 125 S. Ct. 2317 (2005).
49. *Id.* at 2340.

might extend the *Batson* holding to include other traditionally excluded groups based on religion, age, and disability. This would mean that the Court will have to continually review *Batson* claims on a case by case basis. Another option is that the Court could abolish the peremptory challenge altogether. This is controversial because the peremptory challenge system has been such a tradition in the judicial process. Lawyers rely on peremptory challenges as a trial technique. This could make the jury selection process more time consuming, as lawyers would likely want to have more time to question potential jurors in order to make a case to dismiss them based on cause. Finally, the Court could also go back to the way it was before *Batson* and reinstate peremptory challenges that cannot be questioned and do not need to be explained. This option is also controversial as it could allow for potential abuse by lawyers and leave the aggrieved party without recourse.

Rice v. Collins illustrates that the debate about peremptory challenges is far from over. It seems that cases dealing with peremptory challenges will keep coming before the Court until it can either articulate a more workable test or decide to take action and revamp the entire peremptory challenge system.

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