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The Future of New Zealand's Accident Compensation Scheme

by Richard S. Miller

The Future of New Zealand's Accident Compensation Scheme

by Richard S. Miller*

Whenever I walk in a Wellington Street
I'm ever so careful to watch my feet;
For the broken glass that's scattered around
The fruits of labourers high off the ground.
And I squint my eyes as dust flies fast
From another grave of a building past.
I daren't slow down, or come to a halt,
Or I might get hit by a flying bolt.
If a worker's shed on a platform high,
Should happen to catch my wary eye,
I cross the road to miss the terror,
As it crashes down—human error!
I move on fast to avoid the trouble
That's parcelled up in construction rubble,
And masonry pieces that rocket down
From the tower blocks that litter the town.
And as I walk, my head's held high,
searching for workers against the sky,
Who watch from above and growl, "He's mine,
As soon as he's silly and comes into line."
So whenever I walk in a Wellington Street,
I'm ever so careful to watch my feet.

From Editorial, *A A Milne's Wellington?*[1]

In late 1986 and in 1987 there was in New Zealand a public furor over sharp increases in levies imposed on employers to support New Zealand's unique total non-fault accident compensation system—a furor which rivaled in intensity and media coverage[2] the tort and liability insurance "crisis" in the

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[1] Dominion (Wellington, N.Z.), Oct. 24, 1987, at 8, col. 1.

[2] *See infra* notes 124-37 and accompanying text.

United States. It is the purpose of this article to examine the problems which led to the New Zealand controversy and their causes, and to discuss some solutions proposed by the New Zealand Law Commission, by me, and by others as well as possible implications of the New Zealand experience for reform elsewhere.

I. INTRODUCTION

The New Zealand Accident Compensation Act[3] establishes a comprehensive no-fault scheme (Compo) for compensating accident victims. In exchange for substantial benefits including virtually complete medical and rehabilitation expenses, substantial wage replacement for earners whether they are injured on or off the job, and payment of some noneconomic losses, accident victims in New Zealand have largely given up their common law right to sue in tort for damages for personal injuries.[4]

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[3] Originally Accident Compensation Act, 1972, 1 N.Z. Stat. 521 (1972), as amended. This act was consolidated and amended by Accident Compensation Act, 1982, 3 N.Z. Stat. 1552 (1982), and its subsequent amendments.

There has, of course, been considerable interest in and discussion about the Act by academics and practitioners both inside and outside New Zealand. *See, e.g.*, A. BLAIR, ACCIDENT COMPENSATION IN NEW ZEALAND (1978);T. ISON, ACCIDENT COMPENSATION: A COMMENTARY ON THE NEW ZEALAND SCHEME (1980) [hereinafter T. ISON]; G. PALMER, ACCIDENT COMPENSATION: A STUDY OF LAW AND SOCIAL CHANGE IN NEW ZEALAND AND AUSTRALIA (1979) [hereinafter G. PALMER, ACCIDENT COMPENSATION]; J. STAPLETON, DISEASE AND THE COMPENSATION DEBATE (1986) [hereinafter J. STAPLETON]; Henderson, *The New Zealand Accident Compensation Reform*, 48 U. CHI. L. REV. 781 (1981) [hereinafter Henderson]; Blair, *The "Accident" of a Heart Attack*, 1982 N.Z.L.J. 199; Brown, *Deterrence in Tort and No-Fault: The New Zealand Experience*, 73 CALIF. L. REV. 976 (1985) [hereinafter Brown]; Fleming, *Is There a Future for Tort?*, 58 AUSTL. L.J. 131 (1984); Gaskins, *Tort Reform in the Welfare State*, 18 OSGOODE HALL L.J. 238 (1980); Gellhorn, *Medical Malpractice Litigation (U.S.)—Medical Mishap Compensation (N.Z.)*, 73 CORNELL L. REV. 170 (1988) [hereinafter Gellhorn]; Klar, *New Zealand's Accident Compensation Scheme: A Tort Lawyer's Perspective*, 33 U. TORONTO L.J. 80 (1983) [hereinafter Klar]; Love, *Actions for Non-physical Harm: The Relationship Between the Tort System and No-Fault Compensation (With an Emphasis on Workers' Compensation)*, 73 CALIF. L. REV. 857, 876-77 (1985) [hereinafter Love]; Miller, *The Accident Compensation Act and Damages Claims*, 1987 N.Z.L.J 159, 184; Palmer, *Dangerous Products and the Consumer in New Zealand*, 1975 N.Z.L.J. 366; Pedrick, *Palmer's Compensation for Incapacity: The New Zealand and Australian "No Fault" Story*, 1981 UTAH L. REV. 115; Vennell, *Informed Consent or Reasonable Disclosure of Risks: The Relevance of an Informed Patient in the Light of the New Zealand Accident Compensation Scheme*, 13 N.Z.R.L. 160 (1987) [hereinafter Vennell, *Informed Consent*]; Vennell, *Problems of New Zealand's No-Fault Accident Compensation Scheme*, 22 LAW SOC. J. 44 (1984); Vennell, *Unlocking the Turntable*, 1975 N.Z.L.J. 277; Vennell, *Some Kiwi Kite-Flying*, 1975 N.Z.L.J. 254.

[4] Accident victims retain their rights to sue for punitive damages, *see infra* note 205 and accompanying text, and there may remain a residual right of some medical malpractice victims who are found not to have suffered "injury by accident" or "medical misadventure" to bring a

There can be no doubt that Compo achieves significant compensation goals which are clearly not well served by the common law tort liability system: virtually all accident victims are covered; all reasonable medical and rehabilitation needs are provided; wage replacement for injured earners is substantial—amounting to eighty percent of the earnings loss for most earners, continuing if necessary until retirement; and compensation for most victims is promptly paid when and as needed.[5]

On the other hand, other goals—deterrence of accidents[6] and justice and fairness in the settlement of disputes arising from accidents—as well as other significant but less well recognized benefits of the common law system, are poorly served by Compo or not served at all.

The reasons for these differences are, of course, that on the one hand the common law tort liability system, particularly insofar as it is based on negligence, does not purport to be a compensation system, except conditionally and incidentally,[7] and, on the other hand, that Compo is intended to serve primarily as a compensation system. Indeed, Compo does not purport to serve justice goals at all nor does it serve accident prevention goals (except in the most attenuated and insignificant way) though it pretends to do so.[8]

Nevertheless, if the common law system, as some have alleged, serves deterrence goals poorly or not at all, then arguably it would also follow that because of its heavy costs it should be replaced by a system like Compo,[9] notwithstanding the extent to which the common law might serve justice or other goals in some instances. In that event the game (tort liability) would probably still not be worth the candle. Conversely, however, it would be even greater folly to adopt Compo and concurrently scrap the common law system, as New Zealand has done, until either the ineffectiveness of the tort system as a deterrent to

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common law action. *See* Vennell, *Informed Consent*, *supra* note 3.

[5] *See infra* text accompanying notes 16-66.

[6] *See infra* notes 189-246 and accompanying text.

[7] G. PALMER, ACCIDENT COMPENSATION, *supra* note 3, at 35; Miller, *The Scope of Liability for Negligent Infliction of Emotional Distress: Making "The Punishment Fit the Crime"*, 1 U. HAW. L. REV. 1, 23 (1979). *Cf.* Owen, *Deterrence and Desert in Tort: A Comment*, 73 CALIF. L. REV. 665, 674 (1985). *See* Gordon v. Parker, 83 F. Supp. 40, 42 (D. Mass. 1949) ("Tort law, like its younger brother criminal law, was sired by a policy of regulating the social order and substituting legal process for self-help. To be sure, tort law also always has a compensatory element. But that is of secondary consequence . . . .") (Wyzanski, D.J.) (citation omitted).

[8] *See infra* text accompanying notes 188-203.

[9] *See* Sugarman, *Doing Away With Tort Law*, 73 CALIF. L. REV. 555 (1985) [hereinafter Sugarman]. *See generally Symposium: Alternative Compensation Schemes and Tort Theory*, 73 CALIF. L. REV. 548 (1985). *Cf.* Zuckerman, *Tort Reform*, U.S. NEWS & WORLD REP., Sept. 7, 1987, at 68 (recommending adoption in the United States of a no-fault accident compensation scheme like New Zealand's).

accidents has been demonstrated[10] or until a reasonably well-tested accident prevention alternative is in place.

Ideally, since Compo has been in operation in New Zealand since 1974, we should have had the data necessary to assess whether elimination of the common law tort system has in fact had any impact on accident rates. Unfortunately, however, the data is not available.[11] The only study to date[12] seems inconclusive at best and there are reasons to question even its tentative conclusions.[13]

It is my principal thesis that the almost complete abolition of tort liability for personal injury in New Zealand has led to a serious failure of deterrence, to an increase in accidents and accident rates which has probably contributed significantly to a sharp increase in the costs of Compo, and to the attendant public crisis. Based upon this thesis, I have proposed that the tort system be reintroduced in New Zealand to supplement Compo. This proposal, contained in a submission in 1987 to the New Zealand Law Commission,[14] is described and discussed below along with the Law Commission's own recent proposals for reform of Compo. Finally, the New Zealand experience will be discussed in

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[10] There is reason to believe that the tort system as it existed in New Zealand prior to the adoption of Compo was in fact fairly ineffectual as a deterrent to accidents. Thus, for example, in 1967 only nine million dollars was spent by owners of motor vehicles in New Zealand for compulsory third-party insurance. THE ROYAL COMMISSION OF INQUIRY, COMPENSATION FOR PERSONAL INJURY IN NEW ZEALAND 229 app. (1967) [hereinafter WOODHOUSE REPORT]. And in 1970 compulsory third-party auto insurance for a private motor vehicle was only $7.90 per year. G. PALMER, ACCIDENT COMPENSATION, *supra* note 3, at 83. This may have been the result of a system where there is no contingent fee allowed in personal injury cases, where the losing party is chargeable with costs, including legal fees of the winning party, and where there is therefore significant financial hazard to pursuing a personal injury action and little risk in being inadequately insured. Under such a system there may be little direct deterrence by way of individual concern for the consequence of liability and little by way of general deterrence to raise the cost of driving. If this is correct, then the advent of Compo and the elimination of the personal injury tort action would not have had an important impact on deterrence, of which there was very little even before Compo.

Indeed, while commenting during a faculty seminar led by the author at Victoria University on his perception that Wellington was an unusually unsafe and hazardous place and suggesting that the absence of a tort action may have reduced or eliminated the motivation for safety, a senior staff member of the Law Commission remarked that New Zealand had always been that way, even before Compo.

[11] G. PALMER, ACCIDENT COMPENSATION, *supra* note 3, at 378-80; Brown, *supra* note 3, at 980.

[12] Brown, *supra* note 3, at 960.

[13] *See infra* note 325.

[14] Submission by R. Miller to the Director, New Zealand Law Commission, on the New Zealand accident compensation scheme, (May 15, 1987) [hereinafter Submission to Law Commission] (available in Faculty of Law Library, Victoria University of Wellington). *See also* Miller, *Plugging the ACC's Biggest Leak*, Nat'l Bus. Rev., July 24, 1987, at 17, col. 1.

relation to the ongoing debate on tort reform in the United States.

II. A DESCRIPTION OF THE ACCIDENT COMPENSATION SCHEME

While the details of Compo have been well-described elsewhere,[15] a summary of its basic features and its policy objectives, particularly as compared with the common law tort/liability insurance system, will prove useful here.

A. Major Features

In general, Compo provides compensation, without regard to fault, to New Zealanders and to others present in New Zealand who suffer personal injury or death as a result of "injury by accident."[16] The Act, however, prohibits common law tort actions to recover compensatory damages for personal injury or death covered by Compo; that is, caused by "injury by accident."[17] What constitutes an accident, for purposes of the Act, is determined from the victim's point of view. Thus, injuries caused by intentional torts as well as injuries caused by negligence, medical misadventure (including most medical malpractice), product defect, and pure accident are covered along with certain industrial diseases and industrial deafness.[18] In consequence, Compos' coverage for non-illness caused injuries and disablement is almost universal, excluding only some self-inflicted injuries, some injuries caused in the commission of a crime, and, possibly, some adverse consequences of medical treatment and of failure by a medical professional to diagnose illness or to secure an informed consent.[19] The corollary is that the abolition of tort actions to recover damages for personal injuries is, likewise, virtually complete.

1. Benefits

Benefits under the scheme fall into five categories: earnings-related compensation (ERC), medical expenses, rehabilitation expenses, noneconomic losses, and other miscellaneous costs of accidents.

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[15] *See, e.g.*, G. PALMER, ACCIDENT COMPENSATION, *supra* note 3; Henderson, *supra* note 3.

[16] Accident Compensation Act, 1982, § 26.

[17] *Id.* § 27.

[18] *See generally* G. PALMER, ACCIDENT COMPENSATION, *supra* note 3, at 249-62; T. ISON, *supra* note 3, at 18-39.

[19] Vennell, *Informed Consent*, *supra* note 3.

a. Earnings-Related Compensation[20]

In general, the Act provides for payment of eighty percent of lost wages or earnings after the first week of incapacity for earners (including the self-employed) whether they are injured on or off the job. Where the injury is work-related the employer must pay the first week's ERC. There is a ceiling on the total amount of wages eligible for ERC, which translates into a weekly maximum of ERC payments. As of June, 1987, the maximum payment was $976[21] per week.

ERC may continue as long as needed until retirement age.[22] Of particular interest is a provision, designed to insure that the receipt of ERC in lieu of wages does not discourage rehabilitation, *which prohibits a reduction in ERC, even though the victim's earning capacity increases*, once a assessment is made by the Accident Compensation Corporation (ACC)[23] that an earner is permanently disabled.[24] Once an earner has been deemed permanently incapacitated, he or she may be entitled to periodic percentage increases in weekly ERC payments, ordinarily based upon increases in the cost of living.[25] While such increases have not necessarily kept pace with the cost of living, they have been fairly generous.[26]

While New Zealand earners are thus entitled to rather fulsome benefits to compensate for their lost earnings, others who suffer injury by accident either do not receive ERC or may receive benefits which fall well below their actual earning capacity. These include visitors to New Zealand[27] and those, such as housewives, children, the elderly, and the long-time unemployed who, notwithstanding their *earning capacity*, either do not have earnings or have only meager

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[20] *See* Accident Compensation Act, 1982, §§ 52-71, as amended.

[21] ACCIDENT COMPENSATION CORPORATION, UNINTENTIONAL INJURY: NEW ZEALAND'S ACCIDENT COMPENSATION SCHEME 32 (1987) [hereinafter UNINTENTIONAL INJURY]. Except where otherwise indicated, dollar amounts are in New Zealand dollars. At the times referred to in this article the exchange rate was about N.Z.$1.00 = U.S.$0.58 or 0.59.

[22] Accident Compensation Act, 1982, § 66. The date of termination of ERC benefits may vary according to the age of the earner at the time of the accident and the earner's retirement age. New Zealand provides significant retirement benefits (superannuation) for New Zealand workers.

[23] The Accident Compensation Corporation is a governmental entity which administers the Accident Compensation Act. *Id.* §§ 4-10.

[24] *Id.* § 60(5). Note that increases in weekly compensation are permitted where it is determined that the capacity of a person deemed permanently incapacitated has deteriorated. *Id.* § 60(4).

[25] *Id.* § 60(7). These increases are effected through Orders in Council issued by the Governor-General on the recommendation of the Government.

[26] *See, e.g.*, Order in Council 1986/130 (June 30, 1986) (11.25 percent); *id.*, 1987 (May 15, 1987) (9.4 percent).

[27] Accident Compensation Act, 1982, § 52(2)(j).

earnings at the time of their injuries.[28]

b. *Medical, Hospital, and Other Related Expenses*

Virtually all medical and surgical treatment, hospital care, and pharmaceuticals required as a result of an injury by accident will be provided or reimbursed either under the general social security system of New Zealand, by the ACC, or by both.[29] The public health system generally provides very low fees to physicians (about $14.25 per visit)[30] and its hospital system has been subject to considerable complaint.[31] Compo covers the amounts of medical costs in excess of those paid by the Social Security system up to a total which the ACC determines are "reasonable by New Zealand standards."[32]

While the medical benefits paid through Compo are generally more complete and allow wider options than the public health system, including private hospitalization and private surgeons,[33] the availability and utilization of public health benefits for accident victims makes its virtually impossible to tally the health care costs attributable to accidents. That is, medical costs of accidents may be covered by the social security system and never identified as accident costs.[34]

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[28] Special provision is made for calculating the payment of ERC to employees or apprentices who suffer accident while under the age of 20 and who would have earned greater amounts after age 20, *id.* § 62, and to those who suffer "any loss of potential earning capacity," *id.* § 63. The latter provision, however, only applies to those who, at the time of the accident, are under the age of 16 or to those who were or had been actively engaged in studying or training for an occupation, career, or profession and were about to embark upon it. *Id.* § 63(1)(c). It then sets the earnings of such persons at a prescribed amount (subject to a discretionary fifty percent increase for a particular individual) which may provide a considerably lower ERC than might be earned if the victim's actual potential earning capacity were realized. *Id.* §§ 63(2), (5).

[29] UNINTENTIONAL INJURY, *supra* note 21, at 46-47.

[30] *See* LAW COMMISSION, REPORT NO. 4: PERSONAL INJURY: PREVENTION AND RECOVERY, REPORT ON THE ACCIDENT COMPENSATION SCHEME para. 174 (1988) [hereinafter SECOND WOODHOUSE REPORT]. The usual fees are about $22 per visit. *Id.*

[31] *See, e.g.*, Busby, *Bed crisis looms—Hospital room 'appalling'*, Dominion (Wellington, N.Z.), May 8, 1987, at 10, col. 6.

[32] Accident Compensation Act, 1982, § 75(1)(b); UNINTENTIONAL INJURY, *supra* note 21, at 46.

[33] Requests for admission to private hospitals have to be specially made to the ACC and approved. The ACC takes the following position: "The Corporation . . . is of the opinion that the public system copes well with urgent surgery. It believes that admission of ACC clients to private hospitals should only be for non-urgent surgery, and even then only when adequate arrangements cannot be made for surgery in the public system." UNINTENTIONAL INJURY, *supra* note 21, at 47.

[34] *See* ACCIDENT COMPENSATION CORPORATION, COMPENSATED ACCIDENTS FOR THE YEAR ENDED 31 MARCH 1988 1 (1988) (excluding from the accident statistics for 1988 accidents resulting only in medical treatment for which the physician is reimbursed directly by the social security system).

Conversely, the system of accounting and paying medical care providers for medical costs of accidents is not tightly controlled; physicians generally determine for themselves whether particular patients are being treated for injury by accident and bulk-bill the ACC for such treatment.[35] It is highly probable, therefore, that some medical costs which are reported and paid by the ACC as arising from accidents may in fact have arisen from causes, such as illness, which are not covered by Compo.

Other medically-related accident expenses which are paid by ACC for accident victims include dental treatment,[36] travel expenses to secure medical treatment,[37] and damage to artificial limbs, glasses, or clothing.[38]

c. Rehabilitation Expenses

The ACC is given broad responsibility for promoting the complete rehabilitation of accident victims.[39] Its function in practice is best stated in its own words:

> In broad terms the total rehabilitation process may encompass medical and paramedical, vocational, social, financial security and family requirements. It is a total process that unfolds over time and involves input from many sources. The rehabilitation services provided by the Corporation is but a segment of this process. A primary role of the Corporation is to make the connections between the injured person and the existing resources and services and, in so doing, provide the basis for informed choice.
>
> ACC's rehabilitation coordinators help injured persons to assess their needs and examine the possible options so that a personal choice can be made. The ideal is to achieve independent living on the part of the injured person. Once the needs have been assessed, the coordinators ensure that those needs are met to the fullest extent possible. Where necessary the ACC may become a direct provider of resources through financial assistance for housing alterations, motor vehicle adaptions, restraining programmes and the provision of aids for daily living.[40]

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[35] *Cf.* Accident Compensation Act, 1982, §§ 75(5) and (6) which, in the cases of certified medical practitioners and qualified radiologists, physical therapists, and providers of other paramedical services, authorizes the ACC to pay for their services "without further inquiry as to whether or not the services were required as a result of personal injury by accident" where the practitioner who has provided or authorized the other providers to furnish services has certified "that he considers that the services were required as a result of personal injury by accident . . . ." *Id.*

[36] *Id.* § 76.

[37] *Id.* §§ 72-74.

[38] *Id.* § 77.

[39] *Id.* §§ 36, 37.

[40] UNINTENTIONAL INJURY, *supra* note 21, at 65, 66.

d. *Noneconomic Losses*

Because Compo surrendered potentially large awards under the common law damage action in exchange for adequate and certain, but less bonanza-like, compensation, there has from the beginning been a demand from labor unions to retain and indeed to increase lump sum awards for noneconomic losses to replace some of the tort damages which have been given up.[41] From the beginning, therefore, the Act has allowed payment of lump sums, in addition to other compensation for actual economic losses, for "permanent loss or impairment of any bodily function (including the loss of any part of the body)"[42], and for pain and suffering, loss of amenities, disfigurement, and loss of capacity for enjoying life.[43] For non-earners, these noneconomic losses may constitute the principal compensation, other than medical expenses, paid for disabling accidents.

Currently, the permanent loss or impairment of a bodily function is compensated on the basis of a schedule appended to the Accident Compensation Act.[44] The maximum payable here is $17,000.[45] Assessment of the amount of payment for pain and suffering, disfigurement and loss of enjoyment or amenities of life is "a subjective and discretionary matter."[46] The maximum award for this category is $10,000.[47] Payments may be made from both categories to a single victim, $27,000 being the maximum award. However, no payments under these categories for noneconomic loss may be made unless the victim survives the accident by twenty-eight days. Moreover, entitlement to such payments do not survive the death of the victim.[48]

e. *Miscellaneous Benefits*

Other benefits payable by Compo include:

(1) ERC to the surviving dependent family members of an earner[49] who dies

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[41] G. PALMER, ACCIDENT COMPENSATION, *supra* note 3, at 129. Prior to Compo, workers were entitled to bring common law actions against their employers and also to seek workers' compensation. *Id.* at 26.

[42] Accident Compensation Act, 1982, § 78.

[43] *Id.* § 79.

[44] *Id.* at 140 (first schedule).

[45] *Id.* § 78.

[46] UNINTENTIONAL INJURY, *supra* note 21, at 58.

[47] Accident Compensation Act, 1982, § 79(1).

[48] *Id.* § 78(9) (impairment); *id.* § 79(6) (pain and suffering, etc.).

[49] A person who, not being married to the earner, "cohabited [with him or her] immediately preceding the date of the deceased person, and, in the opinion of the Corporation, . . . entered into a relationship in the nature of marriage" with the deceased person is included within the definition of "spouse." *Id.* § 65(1).

as a result of injury by accident.[50] The surviving spouse is entitled to receive up to three-fifths of the deceased earner's ERC, payable until the earner's entitlement to ERC would have ended or upon the death or remarriage of the dependent spouse.[51] Dependent children are each entitled to receive up to one-fifth of the deceased parent's ERC if one parent remains alive[52] or two-fifths if both have died.[53] Dependents of the deceased earner other than the spouse or surviving children may also be entitled to receive ERC in amounts similar to those available to a surviving spouse or child.[54]

(2) Compensation, in such amounts as the ACC "thinks fit for actual and reasonable expenses and proved losses necessarily and directly resulting from the [accident victim's] injury or death . . . ."[55] There are a number of specific exclusions applicable to this provision, such as property damage,[56] the opportunity to make a profit,[57] and losses arising from inability to perform a contract,[58] but it is not clear what is included.

(3) Compensation to members of the accident victim's household for substitute household or domestic services to replace those previously provided by the victim.[59]

(4) Compensation for losses or expenses incurred by a person in rendering help to the accident victim or "in taking any necessary action following and consequential upon the death of the injured person."[60]

(5) Compensation for "constant personal attention" for the victim where such attendant care is necessary.[61]

(6) Compensation for loss of pension or annuity rights upon which the claim-

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[50] *Id.* § 65.

[51] *Id.* § 65(2)(a). When a dependent widow or widower remarries, he or she is entitled, if under 63 years of age, to receive a lump sum equal to two year's of the ERC payments that would have been payable to him or her had there been no remarriage. *Id.* § 70.

[52] *Id.* § 65(2)(b).

[53] *Id.* § 65(4).

[54] *Id.* § 65(2)(c).

[55] *Id.* § 80(1).

[56] *Id.* § 80(1)(a).

[57] *Id.* § 80(1)(d).

[58] *Id.* § 80(1)(e).

[59] *Id.* § 80(2)(a).

[60] *Id.* § 80(2)(b). "This provision has been interpreted as covering the cost, inter alia, of hospital visits to give help to the injured person, or of home help to the person in convalescence. But the emphasis . . . is on giving help to the injured person, and unless it can be said, for example in the case of hospital visits, that they had a definite therapeutic purpose in giving 'help', the expenses cannot be claimed." UNINTENTIONAL INJURY, *supra* note 21, at 52.

[61] *Id.* at (3). "It has been held (*Accident Compensation Appeal Authority: Decision 595*) that such compensation is limited to cases where the incapacity is so grave that the person is incapable of care for himself/herself and requires, as a matter of necessity, constant personal attention." UNINTENTIONAL INJURY, *supra* note 21, at 52.

ant was dependent, caused by the death of the accident victim.[62]

(7) Compensation for funeral expenses for accident victims.[63]

(8) Lump sum payments. In the event of death as a result of personal injury by accident, the surviving spouse, if totally dependent on the deceased, receives a lump sum of $4,000; partially dependent spouses may receive lesser sums.[64] Surviving dependent children likewise receive up to $2,000 each.[65] These payments are completely independent of any other benefits which may be payable on account of the victim's death.[66]

2. *Funding Sources*

Compo is funded from three different sources: Levies upon employers and self-employeds based upon size of payroll (earners account),[67] levies upon automobile owners (motor vehicle account),[68] and general revenues (supplementary account).

The largest source, paying approximately sixty-six percent of the total cost of Compo,[69] and the source which has been most responsible for the creation of the outcry and potential crisis for Compo has been the earners account. All payments of compensation to earners who suffer accidents, *on or off the job*,[70] except for motor vehicle accidents, come exclusively from the earners account. And all income to the earners account comes from levies upon employers based upon the size of their payrolls.[71] These levies, in turn, are composed of three elements: variable levies related to the costs of on-the-job injuries of workers in each of 103 separate industrial activity classes; flat rate levies related to non-work injuries of all earners in all industrial classes; and a flat rate to fund the Industrial Safety, Health and Welfare programme of the Department of Labour.

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[62] Accident Compensation Act, 1982, § 80(4).

[63] *Id.* § 81. The expenses covered must be "reasonable by New Zealand standards." *Id.*

[64] *Id.* § 82(a).

[65] *Id.* § 82(b).

[66] UNINTENTIONAL INJURY, *supra* note 21, at 55.

[67] Accident Compensation Act, 1982, §§ 38-46.

[68] *Id.* §§ 47, 48.

[69] REPORT OF THE ACCIDENT COMPENSATION CORPORATION FOR THE YEAR ENDED 31 MARCH 1987, 9 (1987) [hereinafter 1987 ACC ANNUAL REPORT].

[70] For each of the five years from 1982 through 1987, work accidents accounted for approximately 56 percent and non-work accidents for about 44 percent of costs of accidents to earners (not considering accidents involving motor vehicles). *Id.*

[71] Only leviable earnings are considered. That is, since the maximum earnings which any earner can consider for purposes of earnings related compensation was, in 1987, $64,458 per year, earnings of an earner in excess of that amount were not considered in computing the amount of payroll subject to levy. *Id.* at 22.

For 1988-89, levy rates were set from a low of $1.30 to a high of $27.25 per hundred dollars of payroll.[72] While self-employed persons had been paying a flat rate levy which, in June, 1987, amounted to $3.75 per one hundred dollars of earnings,[73] they, too, are now being assessed according to the class of industrial activity in which their work falls.[74]

It is particularly important to note, for the purposes of this article, that levies for the earners account, *which becomes the sole source of Compo benefits for all earners who suffer accidents* (other than those involving a motor vehicle,) are paid by employers based upon the size of their payrolls. While levies for work-based accidents are related to the accident cost experience of each of the 103 classes of industrial activity, there is no necessary relationship between the amount of the levy paid or the levy rate, on the one hand, and the accident-causing propensities of the particular employer, either with respect to his own employees or to third persons, on the other. A particularly stark example is the levy paid by physicians, which in the 1988-89 levy structure was set at $1.45 per one hundred dollars of payroll.[75] This is the same rate as that paid by employers of teachers.[76] Obviously, there is no attempt to charge physicians—or anyone else—with the costs of injuries, through negligence or otherwise, *that they may cause to those who are not their employees.*

The second largest source of funding, covering about twenty-one percent of the total costs of Compo,[77] is the motor vehicle account. This account covers injuries to victims of all accidents involving motor vehicles, whether work-connected or not. Each motor vehicle owner is required to pay a levy as part of the annual vehicle registration fee. As of November, 1987, the levies were either $25.30 for small motorcycles, tractors, and vintage motor cars, for example, or $100 for automobiles, busses and other larger vehicles.[78] While the Accident Compensation Act authorizes levies on motor vehicle drivers,[79] that authority has so far not been used.[80]

The supplementary account covers injury costs from accidents, other than those involving motor vehicles, suffered by non-earners. This account also covers costs of accidents to visitors to New Zealand.[81] These costs are paid by the

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[72] *See* ACCIDENT COMPENSATION CORPORATION, A GUIDE TO THE 1988/89 ACC LEVY STRUCTURE 15-17 (1988) [hereinafter GUIDE TO ACC LEVY STRUCTURE].

[73] *Id.* at 23.

[74] *Id.* at 13.

[75] *Id.* at 33.

[76] *Id.* at 25.

[77] 1987 ACC ANNUAL REPORT, *supra* note 69, at 9.

[78] UNINTENTIONAL INJURY, *supra* note 21, at 24, 25.

[79] Accident Compensation Act, 1982, § 49.

[80] SECOND WOODHOUSE REPORT, *supra* note 30, para. 239.

[81] Visitors are not entitled to recover ERC. UNINTENTIONAL INJURY, *supra* note 21, at 26.

government from general tax revenues.[82]

B. *Goals and Policies of Compo*

Rt. Hon. Sir Owen Woodhouse, the distinguished New Zealand judge who may rightly be called the father of Compo, insists that Compo is not an insurance scheme, but a program of social insurance.[83] In order to assess the success or failure of the system, or to compare it with other systems, it is necessary to identify and to discuss in more detail the specific goals sought to be achieved. These goals or objectives have been admirably set forth from the beginning of Compo.[84] They continue to receive support from those in governmental power.[85] They are:

1. *Community Responsibility*. This principle involves a recognition that it is in the national interest to recognize an obligation in the entire society to protect all citizens "from the burden of sudden individual losses when their ability to contribute to the general welfare by their work has been interrupted by physical incapacity."[86]

It is evident that this obligation, as it has been described, does not end with compensation to those whose ability to contribute has been interrupted by injury by accident; it extends equally to those who cannot contribute because of incapacity caused by illness, as well. In its current form, however, as described above, Compo only covers some industrial diseases.[87] The decision to concentrate on accidental injuries was evidently a pragmatic one. While recognizing that the scheme ought to benefit those incapacitated by illness, and hoping that it would one day be so extended, the framers of Compo considered economic factors—including the costs of covering all incapacity and the belief that the costs of the former tort/liability insurance system could go a long way to finance Compo for accident victims[88]—in their decision to limit coverage principally to accidents.[89] However, as time passes since the coming into force of the

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[82] *Id.* at 25, 26.

[83] SECOND WOODHOUSE REPORT, *supra* note 30, para. 44.

[84] *See* WOODHOUSE REPORT, *supra* note 10, paras. 55-63.

[85] *See, e.g.*, the Terms of Reference for the Law Commission's most recent report, SECOND WOODHOUSE REPORT, *supra* note 30, at viii. *See also* J. CHAPMAN, J. GOURLEY, P. JONES, J. MARTIN, V. MOREL & D. SMITH, 1 REVIEW BY OFFICIALS COMMITTEE OF THE ACCIDENT COMPENSATION SCHEME, 2-3 (1986) [hereinafter REVIEW BY OFFICIALS COMMITTEE] (Introductory Letter of Submission).

[86] WOODHOUSE REPORT, *supra* note 10, para. 55.

[87] Accident Compensation Act, 1982, §§ 27-29.

[88] *See* WOODHOUSE REPORT, *supra* note 10, paras. 461-465.

[89] *See id.* at 113-14.

original Act[90] and the memory of the fault system and the underlying tradeoff fades, the anomaly of providing generous benefits for accident victims and only minimal subsistence benefits for illness victims becomes more apparent and creates more pressure for modifying Compo to accommodate all incapacitated victims of accident and illness.[91] No one has put it better than Geoffrey Palmer:

> Is it possible or desirable to restrict earnings-related benefits to accidental injury alone? If the injury being compensated were work-related injury only, the distinction might be easier to make. But twenty-four hour cover for all injury brings up starkly the distinction with sickness and disease. How can the man with cancer be treated less generously than the man who was hurt in a motor accident? It is hard to find a persuasive argument against the proposition that people with similar incapacities should be treated the same way whether the origin of their trouble was accident or disease, including congenital incapacity.[92]

2. *Comprehensive Entitlement.* This principle refers to the goal of providing compensation to all injured persons "on the same uniform method of assessment, regardless of the causes which gave rise to their injuries."[93] The intent here was to reject basing the right to compensation on proof of fault or upon other compensation systems, such as workers' compensation, which distinguished among the causes for incapacity.[94] Again, this goal, as well as goal 1, above, might have embraced incapacity by illness as well as by accidental injury.

3. *Complete Rehabilitation.* This principle requires going beyond mere restoration of economic losses of incapacity "to encourage every injured worker to recover the maximum degree of bodily health and vocational utility in a minimum of time."[95] The adoption of this goal also reflected a criticism of the dynamics and delays of the fault system, which had been alleged to encourage

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[90] The original Act came into force in 1974. It was enacted in 1972. SECOND WOODHOUSE REPORT, *supra* note 30, para. 1.

[91] *Cf.* SECOND WOODHOUSE REPORT, *supra* note 30, paras. 6, 7.

[92] G. PALMER, ACCIDENT COMPENSATION, *supra* note 3, at 327. Questions might also be raised as to whether capable persons who are unable to find work, through the "accident" of adverse economic conditions or plant closings, are not equally deserving of compensation under this principle. *See also id.* at 328; J. STAPLETON, *supra* note 3, at 180-83; and Hide & Ackroyd, *Liability and the Control of Hazardous Technology*, 1988 N.Z.L.J. 277, 278 ("[I]f the community is to be responsible for those who are incapacitated, that responsibility should arguably be placed directly with all taxpayers; and if the aim is comprehensive entitlement, that cover should arguably be extended to include all incapacity, whether it is the result of accident or illness. *The logical policy for community provision of comprehensive cover for incapacity is a taxpayer funded minimum wage.*") (emphasis added).

[93] WOODHOUSE REPORT, *supra* note 10, para. 55.

[94] *Id.* para. 42.

[95] *Id.* para. 58.

malingering and to discourage rehabilitation.[96]

One particularly interesting manifestation of this principle is the provision in the current Act,[97] which mandates that once the ACC has assessed a person as permanently disabled, his or her ERC cannot thereafter be reduced "by reason of any increase in his earning capacity."[98]

4. *Real Compensation.* This principle mainly requires that the level of compensation be based on the goal of income maintenance—actual earnings—rather than on the social welfare approach of minimum subsistence. It also encompasses "recognition of the plain fact that any permanent bodily impairment is a loss in itself *regardless of its effect on earning capacity.*"[99] The latter point provides support for the very expensive proposition that compensation for noneconomic losses is justified in addition to ERC.[100]

5. *Administrative Efficiency.* The adoption of this goal also reflected dissatisfaction with the fault system. "It looks to evenness and method in every aspect of assessment, adjudication, and administration. The collection of funds and their distribution as benefits should be handled speedily, consistently, economically, and without contention."[101] In practice, however, the beneficial effect of providing benefits promptly and without "hassle" seems to have been accompanied by a loss of control over what in fact is being paid for. Thus, for example, relying upon physicians to determine whether their patients' conditions are produced by accident or illness for purposes of determining whether to pay medical expenses largely removes that important question from the ACC's control.[102] It may also have contributed to the failure to collect reliable data on accidents.[103]

6. *Accident Prevention.* Although not included among the five guiding principles of Compo, promotion of safety is made a matter of "prime importance" in the Accident Compensation Act[104] as well as in the report of the Royal Commission, the Woodhouse Report,[105] which led to the Act's adoption in the first place. Indeed, as between prevention, rehabilitation, and compensation, the Woodhouse Report stated that prevention was "[t]he most important"[106] and that "[a]ny modern compensation scheme must have a branch concerned solely with safety. Effective education, adequate inspection, and firm enforcement

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[96] *See id.* paras. 124, 170-171, 399-404.

[97] *See supra* text accompanying note 24.

[98] Accident Compensation Act, 1982, § 60(5).

[99] WOODHOUSE REPORT, *supra* note 10, para. 55 (emphasis added).

[100] *See* SECOND WOODHOUSE REPORT, *supra* note 30, paras. 188-194.

[101] WOODHOUSE REPORT, *supra* note 10, para. 62.

[102] *See* SECOND WOODHOUSE REPORT, *supra* note 30, para. 179 (recognizing that maintaining a the distinction between injury and illness was "one incentive for abuse").

[103] *See infra* text accompanying notes 233-34.

[104] Accident Compensation Act, 1982, § 35.

[105] WOODHOUSE REPORT, *supra* note 10, para. 2.

[106] *Id.*

must all be backed up by the allocation of funds and the stimulus of central direction."[107] The role of the ACC in promoting safety is therefore explicitly provided for in the Act.[108] Unfortunately, the ACC has not succeeded in fulfilling its role as a promoter of safety.[109]

C. The Goals and Policies of the Tort Liability System

The goals and policies of the common law system for dealing with personal injury accidents have, until recently,[110] rarely been clearly articulated or agreed-upon by the common law judges who participated in the creation and evolution of the system. Instead, such goals and policies have more often been discovered after the fact by scholars[111] and great judges[112] who have reviewed the past in a search for likely rationales. By now, however, many policies which the tort system actually serve or ought to serve have been identified and debated.[113]

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[107] *Id.* para. 3.

[108] The ACC Compensation Act states that, "[i]t shall be a matter of prime importance for the Corporation to take an active and co-ordinating role in the promotion of safety in all the different areas where accidents can occur in New Zealand." Accident Compensation Act, 1982, § 35(1). Additionally, subsection 4 provides:

> The functions of the Corporation in relation to the promotion of safety shall include—
> (a) Stimulating and maintaining interest in safety and the prevention of personal injury by accident:
> (b) Publishing and disseminating safety literature and information:
> (c) Sponsoring, assisting, and conducting safety campaigns, exhibitions, and courses:
> (d) Sponsoring, supporting, and fostering organisations and groups concerned with safety and the prevention of personal injury by accident:
> (e) Researching into causes, incidence, costs, and methods of prevention of personal injury by accident:
> (f) Determining the requirements in respect of, and providing or arranging for provision to be made for, the adequate recording of statistical information concerning personal injury by accident:
> (g) Seeking continuously for new ways to reduce the number and severity of accidents and personal injuries in all fields.

Id. § 35 (4).

Section 40 of the Act provides for safety incentives by way of bonuses and penalties on levies payable by employers and self-employed persons.

[109] *See infra* text accompanying notes 188-246. Other goals and sub-goals of the scheme will be mentioned in the text where relevant.

[110] *See, e.g.*, Escola v. Coca Cola Bottling Co., 24 Cal. 2d 453, 462, 150 P.2d 436, 440 (1944) (Traynor, J., concurring).

[111] *See, e.g.*, W. KEETON, D. DOBBS, R. KEETON & D. OWEN, PROSSER AND KEETON ON THE LAW OF TORTS, ch. 1 (5th ed. 1984).

[112] *See, e.g.*, O.W. HOLMES, THE COMMON LAW 77-110 (1881).

[113] Most of these have been discussed in THE SPECIAL COMMITTEE ON THE TORT LIABILITY SYSTEM, TOWARDS A JURISPRUDENCE OF INJURY: THE CONTINUING CREATION OF A SYSTEM OF

In this article the focus is mainly upon the policies of accident prevention and deterrence, since these are the objectives I assert are seriously overlooked in New Zealand under Compo. It is of course widely understood that accidents and their costs cannot be *eliminated* without interfering unreasonably with the beneficial aspects of society. Instead, the appropriate goal is to *optimize* accident costs—to achieve the most "efficient" level of accident costs.[114] Tort law arguably achieves prevention either by direct or general deterrence. Under direct or specific deterrence, the fear of sanctions—large tort damage awards, increases in the price of liability insurance, or both—lead actors to make cost-efficient decisions conducive to safety. Under general deterrence placing the costs of inefficient accidents on the activities that caused them will cause the price of those activities to rise to reflect their accident costs. The consequence is (or is believed to be) that in a free market, the rate of consumption of activities will be significantly effected by price, with the consumption of unsafe activities reduced in relation to the consumption of safer activities. Conversely, removing the accident costs from the price of an activity—"externalizing" accident costs—will bring about an inefficiently high level of participation in that activity.[115]

Another form of deterrence, other than through economic incentives, has been well described by Professor Nesson: "Society attempts, through the judgments of its courts, to project a behavioral message that will influence individual's conduct."[116] This influence operates not only by bringing home to the actor the consequences of his conduct but, more importantly, by sending messages about what conduct the law disapproves the law "serves a moralizing, educative function . . . ." which results in an assimilation of preferred behavioral norms.[117]

SUBSTANTIVE JUSTICE IN AMERICAN TORT LAW—REPORT TO THE AMERICAN BAR ASSOCIATION 4-1 to -157 (1984). They include reduction of the occurrence and severity, of injury-causing events; optimizing of the level of risky activity; protecting entitlements; compensation; responsiveness to the dynamic nature of an increasingly technological society; dealing with disputes arising out of a system of mass production and distribution; spreading of risk and of loss; a response to the ability of actors to control the activities and lives of others; providing relatively clear standards of conduct; serving justice, fairness, and morality; and punishment and retribution. *Id.*

[114] G. CALABRESI, THE COSTS OF ACCIDENTS (1970). With respect to the New Zealand scheme, Calabresi's thesis is discussed in G. PALMER, ACCIDENT COMPENSATION, *supra* note 3, at 362-63, 366, and Palmer, *Dangerous Products and the Consumer in New Zealand*, 1975 N.Z.L.J. 366, 375-77. *See also* Swan, *The Economics of Law: Economic Imperialism in Negligence Law, No-Fault Insurance, Occupational Licensing and Criminology?*, AUSTL. ECON. REV., 3rd Qtr., 1984, at 92.

[115] *See* sources cited *supra* note 114. *See also* R. POSNER, ECONOMIC ANALYSIS OF LAW §§ 4.2-4.15 (1973).

[116] Nesson, *The Evidence or the Event? On Judicial Proof and the Acceptability of Verdicts*, 98 HARV. L. REV. 1357, 1359 (1985).

[117] *Id.* at 1359-60. *See also* Galanter, *Beyond the Litigation Panic*, 37 PROC. ACAD. POL. SCI. 18, 29 (1988) ("[I]n addition to its direct provision of compensation [the tort system] supports a

Since Compo has largely externalized accident costs[118] and currently proposed legislation purports to move to even greater externalization,[119] the issue of deterrence seems to be the most immediate and relevant policy issue to discuss in appraising differences between the two systems. Only if it appears that there is no significant difference in deterrence or accident prevention outcomes under the two systems would it become worthwhile to evaluate the worthiness of the other policies of tort law.

Of course, if the systems are to be compared on the basis of accident prevention and deterrence, the costs of accidents must not be ignored. If as a result of Compo's deletion of tort liability the rate and severity of accidents have increased over what they otherwise would have been, then the increased costs of accidents should either be charged to Compo or subtracted from the costs of the tort liability system.[120]

Perhaps there is another facet of tort law which though seldom identified as a policy of the law is nevertheless an important feature of it, particularly with regard to the issues discussed here. *The system of tort law is self-invoking and application of safety norms is largely effected through private negotiations in which the coercive elements of governmental power serve mainly as an incentive to private resolution.* Victims under the system are given a strong motivation to have their accidents evaluated and, if determined by a lawyer probably to have been caused by a tort, to proceed with their claims.[121] Thus, individuals and entities,

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vast system of bargaining in which almost all disputes are resolved by negotiation and . . . stimulates a host of preventive activities by threatening and educating those engaged in the various activities that underlie injuries and disputes."). *But cf.* Sugarman, *supra* note 9, at 611-13 (asserting that arguments for the moralizing or educating function of tort law are unconvincing).

As to the beneficial deterrent effect of tort law in the health care context, *See* Bennett, *The Advantage of Malpractice Suits*, TRIAL, Sept. 1988, at 20, (reprinted from the N.Y. TIMES MAGAZINE, July 24, 1988) ("[T]he malpractice system almost certainly costs less, by deterring negligent care, than it saves." *Id.* at 72, col. 3) (Bennett is the editor of the Harvard Medical School Health Letter); Halberstam, *The Doctor's New Dilemma—"Will I Be Sued?"*, N.Y. TIMES MAGAZINE, Feb. 14, 1971, at 8, ("The abuses of the present system [of tort liability] are great, but on the whole it probably has done more good than harm, for court action remains one of the few ways of enforcing discipline and improving the standards of careless doctors.").

[118] *See infra* text accompanying notes 182-84.

[119] *See infra* text accompanying notes 311-50.

[120] *See* R. POSNER, *supra* note 115. As noted by Richard Posner:

> If compensation is the only purpose of the negligence system, it is a poor system, being both costly and incomplete. Its economic function, however, is not compensation, but deterrence of noncost-justified accidents. If the system yields substantial savings in accident costs, the heavy administrative costs of the system, which relate primarily to the determination of liability—the determination whether the accident was uneconomical—may well be justified.

Id. at 84.

[121] *See* Galanter, *supra* note 117.

through their self-interest—rather than an army of paid regulators and inspectors—act to achieve the deterrence goals of tort law.[122] In comparing Compo with tort law, therefore, the relative costs of enforcement also need to be included in the calculus. If a reduction in accidents under a pure no-fault system like Compo can only be achieved by establishing comprehensive regulatory and administrative structures, then the costs of these structures should be charged to Compo in determining the relative costs of the two systems.[123]

Since it is my view that the abolition of the personal injury action has led to a serious failure of accident prevention, it is appropriate now to examine the "crisis" of 1986-87 and its causes.

III. THE "CRISIS" AND ITS CAUSES

A. *Increases in Levies*

On December 19, 1986 an Order in Council[124] which rivalled Scrooge in its meanness announced very substantial increases in the levies employers would have to pay to the ACC for the forthcoming year to fund the earners account.[125] Individual increases, according to the class of industrial activity into which the employer fell, ranged from 120 percent to 537 percent. For employers, the average increase was 192 percent; for the self-employed, 265 percent.[126] In addition, the government added an additional eight cents per hundred dollars of payroll in order to fund the Industrial Safety, Health and Welfare Pro-

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The motivation would seem to be much greater in a jurisdiction where the contingent fee system is permitted and widely used and where the winning party's attorney's fees are not routinely charged to the loser, like the United States, than in one in which neither is the case, like New Zealand and Great Britain. Indeed, as has already been suggested, *see supra* note 10, the absence of these features in New Zealand may be the reason why doing away with the tort system may not have had any profound effect on the rate of accidents there.

[122] Less calculable from an economic standpoint, but perhaps equally important from the viewpoint of human dignity, is, first, the likely increase in bribery as a device for avoiding detection if the principle mode of accident prevention becomes one of administrative inspection and regulation. Second, even more threatening are the potential problems of civil liberties which may arise if accident prevention outside of the arena of industrial safety is achieved by use of inspectors or public interest groups who must necessarily intrude into areas, such as rented homes and public areas of private businesses, where potential safety problems may arise in order to gather information for invoking regulatory prescriptions.

[123] Of course, the converse is also true: Since the tort system only compensates tort victims, and even then only to the extent that their tortfeasors are insured or are able to pay, the cost of more complete compensation must be considered before a fair comparison can be made with Compo.

[124] Order in Council, 1986/380 (Dec. 19, 1986).

[125] *See supra* text accompanying notes 69-76.

[126] 1987 ACC ANNUAL REPORT, *supra* note 69, at 9.

gramme of the Department of Labour.[127] The new levies ran from a low of $1.20 per $100 of payroll to $27.85. These increases in the levies for the earners account followed on the heels of a new rate, announced in July 1, 1986, for the motor vehicle account—$43.10 per vehicle—which was roughly twice the rate for the prior year.[128]

As a result of these increases employers and employer groups complained vociferously and organized to resist paying the new and higher levies.[129] In response, labor leaders threatened retaliation with "industrial action"[130] if em-

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[127] *Id.* To make matters worse, all levies are subject to a ten percent Goods and Services Tax (GST). GUIDE TO ACC LEVY STRUCTURE, *supra* note 72, at 12.

[128] Order in Council, 1986/93 (May 19, 1986). If Compo were available in the United States this levy would in effect substitute for the need to purchase liability insurance for bodily injury, personal injury protection in a system which has adopted no-fault, medical payments coverage, and uninsured motorist coverage. It would not eliminate the need for property damage liability, collision insurance, and comprehensive coverage.

The motor vehicle levy more than doubled again in November, 1987, rising to $100 per motor vehicle. UNINTENTIONAL INJURY, *supra* note 21, at 24-25. This compares with the author's six month automobile insurance premium to Government Employers Insurance Company of $249.40 for Bodily Injury Liability ($300,000 limits), $70.60 for Basic Personal Injury Protection of $15,000 (no-fault), and $14 for Uninsured Motorist Coverage, for a total of U.S.$668 for the year commencing December 6, 1988, more than one year after the quoted levy.

[129] Dominion (Wellington, N.Z.), June 13, 1987, at 6, col. 5 (letter from small business owner complaining of 300 per cent increase in levies); *id.* June 4, 1987, at 7, col. 4 ("Compo hailed as model for world"; article says ACC will start legal proceedings against employers who refuse to pay levies; mentions meat industry association as one of the groups of employers threatening to boycott the levy increase); *id.* June 2, 1987, at 2, col. 7 ("Compo 'cheapest in world'; article discusses response of officer of ACC who is also national secretary of the Harbour Workers Union to plans of some employers to boycott the payment of levies); *id.* May 28, 1987, at 1, col. 1 ("Levy boycott predicted"); *id.* May 26, 1987, at 10, col. 1 (Editorial: "Breaking the Law"; comments on the proposed defiance of the Meat Industry Association to pay higher levies); *id.* May 22, 1987; McCulloch, *Levy stand risks compo—Rodger*, *id.* at 3, col. 7 (report of assertion by government minister in charge of Compo that payments of accident compensation may be at risk if other employers follow the lead of the meat industry in refusing to pay increases in levies); *id.* May 20, 1987, at 8, col. 1 (report that president of the Institute of Directors "has expressed concern that many businesses may not be able to afford an increase in . . . levies."); *id.* May 12, 1987, at 2, col. 4 ("The Manufacturers Federation has called for an urgent overhaul of the [ACC]"); Otago Daily Times, Mar. 25, 1987, at 16, col. 7 (reports comments by member of parliament to the effect that employers' complaints about large increases in levies are justified); Keenan, *Shearing levy rise opposed*, Dominion (Wellington, N.Z.), Mar. 13, 1987, at 16, col. 4 (reports that sheep shearing contractors will refuse to pay increases in ACC levies which were announced in December, 1986).

[130] Dominion (Wellington, N.Z.), May 30, 1987, at 3, col. 2 ("Four days left for employers to pay levy"; reports: "The Federation of Labour has already told employers that any attempt to sabotage the accident compensation system would be met with an industrial response."); Managh, *Warning by FOL on Compo Sabotage*, *id.* May 27, 1987, at 3, col. 1 ("The Federation of Labour told employers yesterday any attempts to sabotage the accident compensation system would be met with industrial muscle."); McCulloch, *Unions criticise boycott of levy*, *id.* May 26, 1987, at 7,

ployers failed to pay the new levies. Labor was concerned because an employers' boycott could produce an inability on the part of the ACC to pay compensation to accident victims;[131] the ACC's reserve funds had been exhausted[132] and it had no clear right[133] or ability to borrow the funds that might be necessary.

Viewed in comparison to costs in other countries, however, the new rates were not terribly high. Levies for the earners account are paid in lieu of both workers' compensation and liability insurance for personal injury. If the rates were to be averaged for all industrial activities,[134] the average cost would have been only about $3.00 per $100 of payroll. This, as the Law Commission has noted, was not far out of line with workers' compensation premiums elsewhere.[135]

What upset the New Zealand employers, however, were the sudden and unexpected increases in the December, 1986 levies. As we have discovered in the United States, the best way to incur the wrath of insureds is to impose huge and unexpected increases in premiums.[136] That is what happened in New Zealand. The big difference there, however, was that unhappy levy payers could not blame the increases on lawyers and the tort system. Instead, they blamed it mainly on cheating by employees and on the fact that their levies were "unfairly" supporting off-work accidents, such as those incurred in the punishing game of rugby, as well as work-related accidents.[137]

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col. 1.

[131] McCulloch, *Levy stand risks compo—Rodger*, Dominion (Wellington, N.Z.), May 22, 1987, at 3, col. 7 (reports Stan Rodger, the minister responsible for Compo, as saying "there was no golden pool of money and if employers generally took the [Meat Industry] association's approach, [refusing to pay levy increases,] compensation payments were at risk.").

[132] *$95 million loan to stay afloat*, Dominion (Wellington, N.Z.), May 27, 1987, at 3, col. 1 (reports comments of ACC finance general manager that the ACC had borrowed $95 million to meet day-to-day expenditures and that its financial reserves were near zero).

[133] *See* Accident Compensation Act, 1982, § 9(6) (ACC can only borrow money and mortgage its property with the prior consent of the Minister of Finance.).

[134] Averaging is what is recommended in SECOND WOODHOUSE REPORT, *supra* note 30, paras. 250-266.

[135] *Id.* para. 248. Comparisons were drawn with rates in four Australian states.

[136] *Cf. The Manufactured Crisis*, 51 CONSUMER REP. 544, 544 (1986) ("The current liability-insurance crisis began . . . with skyrocketing premiums and cancellations of policies.").

[137] *Compo scheme attacked*, Dominion (Wellington, N.Z.), May 12, 1987, at 2, col. 4 (Reports that the Manufacturers Federation urged that "embarrassing and burdensome" lump sum payments be scrapped; that beneficiaries be made to pay minimum costs before making claims on Compo; that the cost of non-work accidents be spread "more evenly" through the community; and cost controls should be made more effective "by rigid criteria and minimum claim levels."); Hellaby, *Freezing workers 'abusing compo'*, *id.* Mar. 6, 1987, at 1, col. 2.

B. Articulated Causes of Increases

The immediate causes of the December, 1986 increases in levies were generally agreed to be a change in the method of funding Compo coupled with increases in its costs.

1. Changes in Funding Methods

Initially, Compo was intended to be fully funded by current levies. That is, each year levies were imposed sufficient to fund the benefits for all accidents arising the prior year for so long as the benefits had to be paid. Thus, for example, if a thirty-year old employee earning $2,000 per month were permanently and totally incapacitated in 1986, sufficient levies would have to be imposed on the next levy date to raise funds sufficient, when invested, to cover all Compo benefits—including $1,600 per month (80 percent of his earnings) plus periodic cost of living increases—for that employee until retirement. Such funding necessarily involved complex actuarial predictions. It also produced enormous reserves which were invested in order to produce the growth necessary to pay benefits each year as they became payable to prior years' victims.

In 1982 the system of funding was changed from full funding to current-cost financing, called—perhaps deceptively—"pay as you go."[138] Under current-cost financing only enough income need be produced each year to cover actual Compo costs for the following year with reserves sufficient to pay several extra months' expenditure.[139] While the reasons for the change may have been sound—reducing the costs and perhaps the unreliability of long-range actuarial predictions of the full cost of current accidents[140]—the manner in which the change was undertaken, plus substantial increases in Compo's costs, created a crisis of solvency and a consequent need for sharp increases in levies. Evidently, the 1982 decision to change to current-cost financing was accompanied by a parallel decision to use up the then large reserve produced by the fully-funded system by keeping levies very low or reducing them.[141] Unfortunately, heavy increases in the costs of Compo rapidly diminished the huge reserves and threatened to exhaust the system's funds. The response of the ACC was the

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[138] 1987 ACC ANNUAL REPORT, *supra* note 69, at 10, 11; UNINTENTIONAL INJURY, *supra* note 21, at 26.

[139] The ACC has determined that reserves equivalent to seven months expenditures are appropriate. GUIDE TO ACC LEVY STRUCTURE, *supra* note 72, at 9.

[140] *See* Address by Professor T.G. Ison, Accident Compensation in New Zealand—Future Options, Nov. 28, 1985, at 21, 22 (available in Faculty of Law Library, Victoria University of Wellington) [hereinafter Future Options].

[141] *Cf.* 1987 ACC ANNUAL REPORT, *supra* note 69, at 4.

Order in Council of December, 1986 that triggered the outcry.[142]

2. *Increases in Costs*

If it is assumed, as Professor Ison had suggested,[143] that the move from a fully-funded to a current-cost financed system was justified, then allowing the existing reserves—paid for by past levies—to run down and keeping levies artificially low until the reserves were exhausted, thus precipitating the need for a sharp increases, might have constituted poor strategy and bad politics but did not necessarily reflect a serious problem with Compo itself. However, the swiftness with which the reserves were used up suggested that Compo's costs were increasing at an alarming rate.

That there was a serious problem of escalating costs was the perception which led in early 1986 to the convening of a committee of officials by three government ministers[144] to conduct a review of the accident compensation scheme. According to the officials who drafted the report, "[t]his particular review was prompted by inequities in treatment of illness and accident disabled and concern about escalating costs of the present accident compensation scheme."[145]

In August, 1986 the Officials Committee submitted a lengthy report which warned:

> [T]he financial viability of the current scheme is open to question given the massive cost blow-out in compensation which has occurred. This has caused a much more rapid run-down of reserves than was originally forecast. To maintain the

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[142] The ACC claims:

> [I]f the part of the scheme funded by levies on employers had been on a pay-as-you-go basis with adequate reserves, the average rate of levy over recent years would have been as follows:
>
> Average Employer Levy per $100 of Payroll

Year	*Pay-as-you-go*	*Actual*
1984/85	0.97	0.74
1985/86	1.17	0.74
1986/87	1.54	0.77
1987/88	1.69*	2.25

*estimated

Id. at 11.

[143] Future Options, *supra* note 140, at 21, 22.

[144] Deputy Prime Minister G.W.R. Palmer, the Minister of Labour S.J. Rodger, and the Associate Minister of Finance D. Caygill. Geoffrey Palmer, the Deputy Prime Minister and now Minister of Justice, is a former law professor who has taught in the United States; he was involved in research which led to the adoption of Compo. *See* G. PALMER, ACCIDENT COMPENSATION, *supra* note 3, at 112.

[145] 1 REVIEW BY OFFICIALS COMMITTEE, *supra* note 85, at 1.

> current scheme at current levels will require substantial increases in levies each year. . . . The Committee is firmly of the opinion that the scheme cannot continue in its present form.[146]

The evidence of a "massive cost blow-out" was taken from the ACC's financial statements for the year ended March 31, 1986.[147] The data in these statements, illustrated in tables 1 through 5,[148] paint a dramatic picture of a system whose costs seem to have gone out of control. They show continuing large percentage increases each year since 1981 in compensation paid by ACC both for accidents occurring in prior years and for accidents occurring in the reporting year.

Table 1

COMPENSATION PAID BY YEAR IN MILLIONS
ANNUAL PERCENTAGE INCREASES IN
COMPENSATION PAID[149]

Total compensation (all accounts):

Prior Years' Claim	*Current Year's Claims*	*All Claims*
1988 Not Available	Not Available	$620 - 17%
1987 Not Available	Not Available	$531 - 28%
1986 $186 - 17.7%	$230 - 49.4%	$416 - 34%
1985 $158 - 29.6%	$154 - 20.3%	$312 - 20%
1984 $131 - 18.0%	$128 - 10.3%	$259 - 14%
1983 $111 - 32.0%	$116 - 39.8%	$227 - 36%
1982 $ 84 - not avail.	$ 83 - not avail.	$167 - 32%
Avg. % incr. - 24.3%	30.1%	25.9%

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[146] *Id.* at 3.

[147] ACCIDENT COMPENSATION CORPORATION, FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 1986 (1986) [hereinafter 1986 FINANCIAL STATEMENTS].

[148] *See infra*, pp. 47-51.

[149] 1986 FINANCIAL STATEMENTS, *supra* note 147, at 3; ACCIDENT COMPENSATION CORPORATION, ANNUAL REVIEW 33 (1988) [hereinafter 1988 ANNUAL REVIEW, The author requested financial statements for years after 1986 from ACC and received the 1988 ANNUAL REVIEW. Although that (very attractive and glossy) pamphlet contained financial statements, it did not categorize compensation payments by account nor separately report the costs of current year's accidents and past years' accidents in the manner of the document which contained financial statements for the year ended March 31, 1986. *Cf.* 1986 FINANCIAL STATEMENTS, *supra* note 147.

Table 2

COMPENSATION PAID BY YEAR IN MILLIONS
ANNUAL PERCENTAGE INCREASES IN COMPENSATION PAID[150]

Earners Account:

	Prior Years' Claim	*Current Year's Claims*	*All Claims*
1986	$120 - 23.7%	$150 - 45.7%	$273 - 36%
1985	$ 97 - 18.3%	$105 - 23.5%	$202 - 21%
1984	$ 82 - 5.1%	$ 85 - 2.4%	$167 - 4%
1983	$ 78 - 34.4%	$ 83 - 38.3%	$161 - 36%
1982	$ 58 - not avail.	$ 60 - not avail.	$118 - 30%
Avg. % incr. -	20.4%	27.5%	25.4%

Table 3

COMPENSATION PAID BY YEAR IN MILLIONS
ANNUAL PERCENTAGE INCREASES IN COMPENSATION PAID[151]

Motor Vehicle Account:

	Prior Years' Claim	*Current Year's Claims*	*All Claims*
1986	$ 50 - 4.2%	$ 37 - 68.2%	$ 87 - 25%
1985	$ 48 - 20.0%	$ 22 - 15.8%	$ 70 - 19%
1984	$ 40 - 66.7%	$ 19 - 58.3%	$ 58 - 64%
1983	$ 24 - 26.3%	$ 12 - 33.3%	$ 36 - 29%
1982	$ 19 - not avail.	$ 9 - not avail.	$ 28 - 33%
Avg. % incr. -	29.3%	43.9%	34%

Table 4

COMPENSATION PAID BY YEAR IN MILLIONS
ANNUAL PERCENTAGE INCREASES IN COMPENSATION PAID[152]

Supplementary Account:

	Prior Years' Claim	*Current Year's Claims*	*All Claims*
1986	$ 15 - 15.4%	$ 40 - 48.1%	$ 55 - 38%
1985	$ 13 - 44.4%	$ 27 - 11.1%	$ 40 - 21%
1984	$ 9 - 0.0%	$ 24 - 14.3%	$ 33 - 10%

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[150] 1986 FINANCIAL STATEMENTS, *supra* note 147, at 3.

[151] *Id.*

[152] 1986 FINANCIAL STATEMENTS, *supra* note 147, at 3.

1983	$ 9 - 28.6%	$ 21 - 50.0%	$ 30 - 43%
1982	$ 7 - not avail.	$ 14 - not avail.	$ 21 - 40%
Avg. % incr.	- 22.1%	30.9%	34.4%

C. Possible Causes of the Annual Increases in Costs

As Table 5 indicates, the annual increases in costs generally exceed by significant degree the increases in inflation rates in New Zealand for the reported years.[153]

Table 5

REAL COMPENSATION PAID AND ANNUAL PERCENTAGE INCREASES IN REAL COMPENSATION IN 1981 DOLLARS (in millions)[154]

	Prior Years' Claim	*Current Year's Claims*	*All Claims*
1987	$153 - 14.2%	$106 - 00.0%	$259 - 7.9%
1986	$134 - 24.1%	$106 - 11.6%	$240 - 18.2%
1985	$108 - 11.3%	$ 95 - 00.0%	$203 - 5.7%
1984	$ 97 - 14.1%	$ 95 - 6.7%	$192 - 10.3%
1983	$ 85 - 16.4%	$ 89 - 23.6%	$174 - 20.0%
1982	$ 73 - 23.7%	$ 72 - 5.9%	$145 - 14.2%
1981	$ 59 - not avail.	$ 68 - not avail.	$127 - n.a.
Avg. Increase:	17.3%	8.0%	12.7%
% Increase from 1981 to 1987:	159.3%	55.9%	103.9%

Arguably, real increases of the dimension there reported cannot continually be sustained, regardless of the source of funding, in a small nation suffering New Zealand's economic problems.[155]

The annual increase in real costs, which has been labeled "cost creep," is expected by the ACC to account for about 12.8 percent of the added expenditure for 1989 over 1988.[156] The ACC and others who support Compo have

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[153] *See* SECOND WOODHOUSE REPORT *supra* note 30, para. 85 ("Over the 4 year period from 1978 to 1982 the expenditure remained fairly constant when inflation is taken into account. But the next 4 years saw a real increase of 49% or about 12% per year, and 40% over just the past 3 years with almost half of that occurring between 1985 and 1986. The rate of increase between 1987 and 1988 is 10%."). *See also* GUIDE TO ACC LEVY STRUCTURE, *supra* note 72, at 10; 1988 ANNUAL REVIEW, *supra* note 149, at 28.

[154] SECOND WOODHOUSE REPORT, *supra* note 30. para. 87.

[155] *See infra* note 353.

[156] 1988 ANNUAL REVIEW, *supra* note 149, at 28 ("A disturbing feature is the excess of expenditure over the normally expected rate of inflation.").

been hard-pressed to find a full explanation for cost creep. Possible causes which have been identified by ACC include increases in the public's awareness of the availability of payments for noneconomic loss and increases in the size of the payments being made; increasing health care costs paid for by the ACC rather than the public health system, including greater use of private hospital treatment; "hidden unemployment," wherein workers who are partially disabled and receiving Compo payments and who (by virtue of New Zealand's poor economic climate) cannot find suitable alternative work continue to receive full weekly ERC; and increasing abuse of Compo, both as to possibly fraudulent claims and the payment of excessive and unnecessary medical claims.[157]

Although conceding that "[m]ajor questions about costs still remain,"[158] the Law Commission's recent report mentioned other possible causes of cost creep. Increases in the compensation paid to those who claimed compensation in earlier years, it noted, were a necessary result of the maturing of the scheme: each year it is necessary to continue to pay both ERC and medical benefits for victims injured in prior years, some of whom will continue to receive Compo until retirement. The build up of the numbers of persons receiving compensation was expected to take up to twenty years, with the largest annual increases occurring during the first twelve years or so.[159] According to the Commission: "Exactly that is happening."[160]

The Commission, however, did express concern about the possibility that some victims are being paid compensation for too long a period.[161] It also pointed to a change in the Act that allowed injured workers fit for light duties to continue to receive ERC without reduction for the amounts they were capable of earning if they could not find such work.[162]

Very substantial annual increases in lump sums for noneconomic loss were attributed by the Law Commission to higher awards allowed under the Act[163]

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[157] GUIDE TO ACC LEVY STRUCTURE, *supra* note 72, at 10.

[158] SECOND WOODHOUSE REPORT, *supra* note 30, para. 100.

[159] *Id.* para. 89.

[160] *Id.*

[161] *Id.* paras. 90, 93.

> [O]ne survey of a district comparing 1984 and 1987 suggests a near doubling of the proportion of persons receiving earnings related compensation for 44 weeks (from 3.3% to 6.1%); and other calculations and projections suggest an increase in the average number of days on earnings related compensation from 23.9 in 1982/83 to 32.1 in 1986/87. The process of making medical assessment may be a significant factor.

Id. para. 93.

[162] *Id.* para. 94.

[163] *Id.* paras. 95, 96. Effective in 1983 the maximum amount for permanent loss or impairment of bodily function was increased by $10,000, to $17,000. Accident Compensation Act, 1982, § 78.

and in some cases mandated by judicial decision,[164] an increase in the number of claims,[165] and the clearing up of a backlog of claims.[166]

Increases in medical payments for private hospital costs were attributed to "an increase in the volume of the services so provided,"[167] perhaps reflecting a preference by physicians and their patients for private accommodations over those provided by the public sector.[168] The Commission hinted that other increases in medical payments might be the result of overutilization in situations where the victim is not personally surcharged for use of the service, as in the case of medical specialists.[169]

The important question remained unanswered, however. Were increases in costs attributable to any extent to increases in accidents or their severity?

In my 1987 submission to the Law Commission I suggested that a failure of deterrence might constitute a significant factor in the "massive cost blow-out" identified by the Officials Committee.[170] The Law Commission's final report, entitled "Personal Injury: *Prevention* and Recovery,"[171] however, did not directly confront that possibility. Instead, the report first cited the conclusions of Professor Brown's article to the effect that the removal of tort liability for personal injury has not been shown to have an adverse effect on automobile accident rates.[172] After conceding that comparable statistics for other unintentional injuries are unavailable,[173] it then cited an OECD report of annual day's work lost due to ill health and rates of fatal injuries in industry[174] which, though evidently seriously underreporting the numbers of injuries,[175] nevertheless indicated no significant changes in the annual average of lost workdays in New Zealand between 1973 and 1983 and only small changes in the rates of fatal

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[164] SECOND WOODHOUSE REPORT, *supra* note 30, para. 96. *See, e.g., In re* Appleby, 5 N.Z.L.R. 99 (1985); Jones v. Accident Compensation Comm'n, 2 N.Z.L.R. 379 (1980) (lump sum awards for loss of amenities of life, for pain and suffering, and for disfigurement should not be scaled as a percentage of the total amount allowed (which has not increased with inflation) but awards should be based on the amount the court thinks is deserving and, if that amount exceeds the maximum, the maximum should be granted).

[165] SECOND WOODHOUSE REPORT, *supra* note 30, para. 95.

[166] *Id.*

[167] *Id.* para. 98.

[168] *Cf. supra* note 33 and accompanying text.

[169] As compared with using general practitioners, where the claimant was required to pay for a part of the service. SECOND WOODHOUSE REPORT, *supra* note 30, para. 97.

[170] *See supra* text accompanying note 146.

[171] SECOND WOODHOUSE REPORT, *supra* note 30 (emphasis in title added).

[172] Brown, *supra* note 3.

[173] SECOND WOODHOUSE REPORT, *supra* note 30, para. 80.

[174] *Id.* (citing OECD, MEASURING HEALTH CARE 1960-1983, EXPENDITURE, COSTS AND PERFORMANCE tables F.3, F.5(b) (1985)).

[175] SECOND WOODHOUSE REPORT, *supra* note 30, para. 80.

injuries among workers there during the last twenty years.[176] On this flimsy evidence the Commission then offered its opinion that it did not "see the alleged deterrent role of tort liability for such injuries as a significant factor."[177]

Moreover, after examining the costs data, the Commission expressed doubt that there had been a "massive cost blow-out," stating that to so suggest was, in its opinion, misleading.[178] Instead, the report noted that Compo was relatively inexpensive, amounting in 1987-88 to only 1.2 percent of gross domestic product while furnishing twenty-four hour protection at a cost of only sixty cents per person for protection from every kind of accident.[179]

Finally, the Commission's report made much of the fact that most of the annual increases, in real dollars, are attributable to continuing claims made for accidents which occurred in prior years. "There is very little real change in the amounts paid in each year for *new* claims—as there would be if the cost blow-out description were justified."[180]

It would appear, however, that the Law Commission did not really face up to the implications of the cited data. In the first place, the annual *real* increases in compensation for *new accidents* seem far from inconsequential. An average increase, after inflation, of eight percent per year, or an increase of almost fifty-six percent over a six year period—occurring more than ten years after the system was begun—cannot be attributed just to greater awareness of the existence of the system. Something else is obviously afoot and whatever it is—whether abuse of the system, an increase in accidents or their severity, or a combination of these—should not be so lightly dismissed. That an increase in real compensation for new accidents did not occur in two years of the six may be puzzling, but it emphasizes the size of the increases in the other four years. And certainly a more than doubling of the real costs of the entire system over a six year period qualifies for the epithet "massive cost blow-out."

Further, it is by no means clear that increases in the cost of compensation for prior years' accidents do not reflect a worsening accident experience. As the Commission itself notes, part of the increasing costs of prior years' accidents is attributable to "large increases in the numbers of people who are still receiving payments after three years."[181] Such increases may, of course, be attributable to

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[176] *Id.*

[177] *Id.* para. 81.

[178] *Id.* para. 16.

[179] *Id.* The report also noted that the New Zealand system accounts for a lower percentage of New Zealand's gross domestic product (1.2%) than the costs of the less comprehensive combination of third party motor vehicle insurance plus employer's liability insurance account for in relation to Australia's gross domestic product (1.7%). *Id.*

[180] *Id.* paras. 16, 87.

[181] *Id.* para. 90. The Report also noted a "relative increase in recent years of motor vehicle injuries (with their higher average cost)" but expressed doubt as to what weight to give to that

malingering (possibly produced by a shortage of jobs), but the more plausible cause is an increase in the seriousness of injuries, requiring a greater average period for recuperation and rehabilitation.

Compensation for prior years' accidents may also reflect increases in accidents or their severity if Compo payments for seriously injured persons are significantly delayed before regular payments are made or if they occur toward the end of the reporting year. Assume, for example, that an accident causing permanent and total incapacity occurs two months before the end of the ACC's reporting year and that payment of ERC, in the amount of $3,000 per month, does not begin until the beginning of the last month of the period. In such case, the statistics for the year of the accident would reflect, at most, payment for two months ($6,000) but the next year would include, under compensation paid for accidents in earlier years, a full year's compensation—$36,000.

Moreover, although Compo purports to be a comprehensive accident compensation system, its allegedly low costs do not fully reflect New Zealand's accidents. For persons who are killed outright but who leave no dependents nothing but funeral expenses are paid. Housewives and the elderly and visitors to New Zealand who are injured receive no ERC and children may never receive what their potential earning capacity might have provided had they not been injured. Earners whose incomes exceed the leviable amounts receive no ERC to compensate for lost earnings in excess of those amounts, and ACC pays no ERC for the first week of accidents. Further, a significant degree of externalization of accident costs occurs in the area of medical expenses, since a significant amount of medical treatment for accidents is provided through the social security system and not charged to the accident scheme at all.[182] Indeed, the Law Commission itself estimated that accident costs *equal to about half the amount paid by ACC are not borne by the accident compensation scheme.*[183] Its estimate of externalized costs, however, only included some of the earnings losses borne by employers and employees[184] and medical costs paid out of Health Vote, such as accident care in public hospitals, but not medical care privately paid for. Furthermore, the estimate does not include uncompensated losses of earning capacity of in-

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information. *Id.* This information could cast doubt on Professor Brown's findings that the advent of Compo has not produced an increase in automobile accidents. *Cf.* Brown, *supra* note 3, at 984-94. Professor Brown's figures ran only through 1980.

[182] Many New Zealanders carry private first party hospital and medical insurance because of the perceived inadequacies of the medical care provided through the Social Security System. It is not known to what extent such private insurance is used to cover the medical costs of accidents without any insurer's subrogation rights being exercised.

[183] SECOND WOODHOUSE REPORT, *supra* note 30, para. 226. *See also* 1 REVIEW BY OFFICIALS COMMITTEE, *supra* note 85, at 83 (cited by the Law Commission).

[184] Included were the first week of compensation and twenty percent of earners' salaries not paid as ERC; excluded was the amount of earnings of earners in excess of the maximum leviable amount. 1 REVIEW BY OFFICIALS COMMITTEE, *supra* note 85, at 83.

jured non-earners and injured visitors.

The relevance of the degree of externalization just described is this: If Compo were comprehensive in covering all accident costs, then the costs of the system would truly reflect the costs of New Zealand accidents including the rate of increases in accidents and in their severity. If that were the case, a per capita cost of sixty cents per person per day for all accidents would arguably reflect a reasonable level of accidents.[185] And in that event it would also be appropriate to focus, as the Law Commission has done, on the costs of Compo rather than on the actual rate and severity of accidents, since the former would accurately reflect the latter. To the extent that accident costs are not charged to Compo, however, the cost of Compo loses its relevance as a guide to the accident situation in New Zealand and to the relative safety of the society.

While accident statistics, such as they are, will be analyzed below, it is interesting to note here that in recent years annual claims have been increasing, as indicated in table 6, below, notwithstanding a levelling off or even a possible decline in the population.[186]

Table 6

ACC CLAIMS RECEIVED BY ACCOUNT (IN THOUSANDS) AND ANNUAL PERCENTAGE INCREASES[187]

Year	Total Claims		Earners Acc.		Motor Vehicle Acc.		Supp. Acc.	
1987	151	0.0%	n.a.	n.a.	n.a.	n.a	n.a.	n.a.
1986	151	-4.4%	115	0.9%	17	0.0%	17	-29.6%
1985	158	3.9%	114	4.6%	17	6.3%	27	- 3.6%
1984	153	6.3%	109	1.9%	16	33.3%	28	12.0%
1983	144	9.9%	107	9.2%	12	0.0%	25	19.0%
1982	131	1.6%	98	1.0%	12	0.0%	21	5.0%
Avge % incr:		2.8%		3.5%		7.9%		0.6%
Total % incr:		15.3%		17.3%		41.7%		-9.5%

It seems a fair conclusion, therefore, that not only does the cost data *not* foreclose the possibility of serious increases in accident rates and in severity of acci-

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[185] However, it is still not as inexpensive as it first appears. Sixty cents per day is, after all, $219 per year. For a family of four this amounts to $876 per year to cover only accidental injuries.

[186] Population of New Zealand grew from 3,113,000 in 1980 to 3,314,000 in 1987, reflecting an annual average growth rate of .9 percent. U.S. BUREAU OF THE CENSUS, STATISTICAL ABSTRACT OF THE UNITED STATES: 1988, table 1378 (108th ed. 1987). When the author was in New Zealand, during the first half of 1987, he recalls seeing newspapers reports of annual declines in the population of 20,000 and 12,000 for the period 1985-87.

[187] 1986 FINANCIAL STATEMENTS, *supra* note 147, at 1; SECOND WOODHOUSE REPORT,, *supra* note 30, para. 84.

dents, but on the contrary the data gives warning that such increases may be a significant factor in the otherwise unexplained cost creep. The question remains whether there is any direct and convincing evidence of a failure of deterrence.

IV. Deterrence of Accidents

A. *Position of the Act and the ACC*

Both the Accident Compensation Act and the Woodhouse Report which preceded it placed the highest priority on accident prevention, with rehabilitation second and compensation last.[188] As Professor Gellhorn has recently pointed out, however, "[t]he emphasis has been reversed in administrative reality."[189] While the Act authorizes the ACC to provide financial incentives, both penalties and bonuses, to employers or self-employeds with particularly bad or good safety records[190] and to impose penalty rates on drivers or classes of drivers with "significantly worse than average accident records,"[191] the ACC recently gave up its former very limited use of such financial incentives on employers[192] and has never surcharged bad drivers.[193] Notwithstanding the ACC's broad responsibilities and authority in the area of accident prevention,[194] the ACC only spent 1.2 percent, 1.1 percent, and .7 percent of its total annual expenditures on accident prevention during the years 1984 through 1986, the highest amount being $3,681,000 in 1985.[195] Aside from the safety bonuses in 1984 and 1985, the money was spent on financial grants to other organizations and other accident prevention services.[196] As noted in the *Review by Officials Committee*, "In the last few years, expenditure by A.C.C. on accident prevention has

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[188] Accident Compensation Act, 1982, § 26(1); Woodhouse Report, *supra* note 10, para. 2.

[189] Gellhorn, *supra* note 3, at 197.

[190] Accident Compensation Act, 1982, § 40. This section authorizes penalties not exceeding 100 percent and bonuses not exceeding 50 percent of annual levies.

[191] *Id.* § 49(e).

[192] $1,204,000 and $1,269,000 per year were awarded as safety incentive bonuses in the years ending March 31, 1984 and 1985, respectively. No penalties were assessed in those years and no bonuses were awarded in the year ending March 31, 1986. 1 Review by Officials Committee, *supra* note 85, at 115.

[193] Second Woodhouse Report, *supra* note 30, para. 140.

[194] Accident Compensation Act, 1982, § 35. *See supra* note 108 (listing the safety promotion functions of the ACC).

[195] 1 Review of Officials Committee, *supra* note 85, at 115. If safety bonuses are excluded, the percentages spent in the years ending March 31, 1984 and 1985 were 0.8 and 0.7, respectively. *Id.* These amounts and percentages, however, may not include about $3 million per annum to support a 40 person staff in the ACC Accident Prevention Branch. *Cf.* Second Woodhouse Report, *supra* note 30, para. 108.

[196] 1 Review by Officials Committee, *supra* note 85, at 115.

been declining both in real terms (total amounts in constant dollars) and as a percentage of total expenditure."[197] In general, the accident prevention activities of ACC seem to be focused mainly on supporting prevention activities of other groups; developing and running safety education campaigns, programs and courses; attempting to influence others to discover and to ameliorate hazardous conditions; cooperating with other national organizations and with local organizations, both public and private; and, in general, "[g]etting people to place a higher relative value on 'safety' in the continuum of factors that motivate their behavior."[198]

The only other source of deterrence in Compo is the levy structure itself. For the earners account, the rate for each industrial activity is, in part, based directly upon the past three year's payments of accident compensation by ACC to all the workers employed and injured in each such activity. This results in those companies engaged in industrial activities which have experienced the highest worker injury costs for on-the-job accidents paying the highest rates.[199] Unlike experience rating of individual firms under a workers' compensation system, in which each company's accident record may directly affect its insurance costs, an individual employer or self-employed under Compo can only reduce or increase its levy by influencing the accident record *of all employers engaged in the same industrial activity*. Thus, for example, a particularly careful employer engaged in aerial work operations will pay the same levy—$27.25 per $100 of payroll for 1988-89—as a particularly unsafe employer engaged in the same activity. Further, each employer pays the same flat-rate levy—$1.05 per $100 of payroll for 1988-89—to cover non-work-related accidents of all workers eligible for Compo in New Zealand.[200] Finally, there is no attempt whatsoever to relate levies to accidents caused by levy payers to third persons, such as one's customers, one's patients, one's lessees, or the consumers of one's products, who are not employees of the levy payer. Notwithstanding the elaboration of 103 levy classes of industrial activities, therefore, there is very little financial incentive for safety built into the current levy structure of the earners account.[201]

Similarly, there are virtually no safety incentives built into the levies for the motor vehicle account, since there are only two levy rates, one for small vehicles and one for large,[202] and accident costs of non-earners paid from the supple-

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[197] *Id.*

[198] UNINTENTIONAL INJURY, *supra* note 21, at 68-69.

[199] *Id.* "The corporation tries to make each class of industrial activity self-supporting in relation to funding for work injuries." *Id.*

[200] GUIDE TO ACC LEVY STRUCTURE, *supra* note 72, at 17.

[201] The Law Commission seems to agree. SECOND WOODHOUSE REPORT, *supra* note 30, paras. 137-139.

[202] As of November, 1987 the two rates were $25.30 and $100 per annum. Ordinary automobiles, motorcycles exceeding 60 c.c., buses, service coaches, "goods-service" vehicles, self-pro-

mentary account are entirely externalized since they are paid out of general tax revenues.[203]

While personal injury accident costs have thus been externalized, the common law system still flourishes in other areas. For example, actions at law for intentionally or negligently causing property damage may still be brought; and other actions, such as for malicious prosecution or conspiracy, also remain available so long as plaintiff seeks recovery for damages other than those produced by "injury by accident."[204] Moreover, common law actions for punitive damages may be brought to punish outrageous conduct, though the award must not be so large as to create an impression that plaintiff is being compensated for his injuries.[205] In addition, there may remain residual areas of medical malpractice liability, such as failure to diagnose illness and performance of surgical procedures without informed consent, which do not fall within the Act's definition of medical misadventure or injury by accident and in which a common law negligence action for resulting physical injuries may still be allowed.[206]

It follows, therefore, that whatever specific or general deterrents to accidents exists in New Zealand must come either from the availability of these residuary law actions or from other systems, such as the criminal law, administrative inspection and regulation, and disciplinary boards, which are not a part of Compo and which, from all that appears, are generally no more effective, and in some case considerably less effective, than similar systems, such as OSHA, professional disciplinary systems, safety commissions, and the like in the United States.[207]

The consequence of this is that those who can cause personal injury to others, whether they be firms or individuals and regardless of whether they are required

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pelled vans, and mobile cranes all paid the $100 rate. UNINTENTIONAL INJURY, *supra* note 21, at 24-25.

[203] *Id.* at 25.

[204] *Cf.* New Zealand Forest Prods. Ltd. v. Attorney General, 1 N.Z.L.R. 14 (1986) (action to recover economic losses for negligently cutting electric cable allowed). "The law of negligence has undergone a renaissance of recent years . . . ." *Id.* at 15; Auckland City Council v. Blundell, 1 N.Z.L.R. 732 (1986) (malicious prosecution and conspiracy). *See also* Love, *supra* note 3, at 976-77 and authorities there cited.

[205] Auckland City Council v. Blundell, 1 N.Z.L.R. 732 (1986); Donselaar v. Donselaar, 1 N.Z.L.R. 97 (1982).

[206] *See* Gellhorn, *supra* note 3, at 189-90; Vennell, *Informed Consent*, *supra* note 3. It is also not clear whether and to what extent non-industrial man-made diseases, negligently caused, are covered by Compo or might instead still be suable under the common law system. *See* J. STAPLETON, *supra* note 3, at 145 (asserting that under Compo "victims of man-made hazards such as environmental pollutants and non-medicinal products such as food, cosmetics, and other chemicals go uncompensated under the scheme. . . . [and] are relegated to what is usually the illusory remedy provided by tort").

[207] *See infra* notes 351-55 and accompanying text.

to pay levies, do not fear individually having to bear in any significant degree the increased costs of accidents they cause—whether through increased levies, judgments for damages for personal injuries, or increases in their liability insurance rates—or even losing liability insurance protection. Thus, as I noted in my submission to the Law Commission:[208]

> I suggest that the absence of liability for personal injuries in the case of product manufacturers and sellers, land owners and occupiers, health care providers, building contractors, public entities, and other actors may, as the awareness that there is no responsibility for personal injuries sinks home, lead to far greater hazards to the entire population. There is likely to be a temptation for the small-time landlord or business to put off costs of repairing unsafe conditions or disposing of hazardous materials or wastes. For the slumlord, there may be an irresistible temptation to capitalize on savings achieved by short-cutting safety. A similar problem may also exist with regard to that small percentage of every profession as to which a sense of personal responsibility coupled with professional discipline does not provide adequate deterrence. . . .
>
> Surely it seems excessively naive to argue that safety and accident prevention practices "are driven as much by a sense of responsibility to employees and the community at large, the protection of the organization's public image and a recognition of financial costs unrelated to accident compensation levies and penalties" as by financial incentives and penalties (i.e. loss of production, affect on employee morale, ability to attract suitable staff, cost of pay settlements, etc.).[209]

B. Personal Observation

Personal observations during New Zealand's summer, fall, and winter of 1987 established, at least to my satisfaction,[210] that disgracefully hazardous

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[208] Submission to Law Commission, *supra* note 14, at 5.

[209] 1 REVIEW BY OFFICIALS COMMITTEE, *supra* note 85, at 117.

[210] For a different perspective from a distinguished scholar whose stay in New Zealand coincided in part with the author's, see Gellhorn, *supra* note 3, at 197 (asserting that efforts to educate the public about safety hazards "have often been notably successful" and that "a visitor is struck by the extent to which workers, householders, athletes, and children have become accustomed to using protective devices such as headgear, breathing filters in dusty and fume-laden environments, and 'ear muffs' to reduce the impact of noise."). In addition to the inconsistent observations noted in the text, the author and his wife became particularly interested in rugby, a fast-moving physical contact sport accounting, in the year ended March 31, 1988, for 26 percent of New Zealand's 20,289 sports accidents (32.2 percent if Rugby League is included), 1988 ANNUAL REVIEW, *supra* note 149, fig. 8 (1988), and in which nothing resembling protective gear was anywhere in sight. Unlike American football, rugby players wear only shorts and jerseys and do not wear helmets or padding.

conditions[211] had become endemic to that beautiful nation. One needed only to walk around the City of Wellington for an hour or two to see many obvious conditions which seriously threatened both workers and passersby. These included widespread failures of construction workers to wear hard hats even in extremely dangerous situations; unfenced and unguarded hazards in busy downtown sidewalks, such as large and deep holes, pieces of equipment and dangerous items, including wire fencing and other construction debris, lying directly in the path of pedestrians; debris from demolished buildings heaped on unfenced construction sites and spilling onto adjacent sidewalks while children climbed on the rubble and adults searched for salvageable items; cranes lifting heavy objects directly over the heads of pedestrians and above moving automobile traffic; and a worker firing a "ramset" gun into a concrete walk within a few feet of passersby on the sidewalk.[212]

Further, large parts of the road system, particularly on the spectacular South Island, present dangerous challenges to the ordinary driver and especially to the visitor unaccustomed to such conditions.[213] The roads are narrow, often becoming single lane, clinging precariously to the sides of steep mountains with blind curves, with no guard rails, and often unsealed (unpaved) with new metal (freshly graveled) surfaces.

Admittedly, however, some of the hazards noted were not without offsetting and beneficial effects. Thus, for example, a used car salesman from whom I had purchased a car allowed me to use another car *without charge*—and without any corresponding benefit to the used car dealer—while my car was hors de combat in a repair garage unaffiliated with the car dealer. The first car so loaned was in dreadfully dangerous condition, with doors which flew open while driving around a rotary and water leaks which caused it to overheat and stall while driving up a steep hill. When I called the salesman to tell him about the problems he cheerfully invited me to return the first car and pick up another in better condition. In a more entrepreneurial vein, a farmer on magnificent Otago Peninsula, for a few dollars, allowed visitors to travel about ten kilometers over his farm—on a dangerous curvy and unpaved road—to view penguins and seals in their natural habitat. No warnings were given and no signs were posted alerting drivers to the formidable hazards which faced them on the road.

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[211] As compared to conditions in Japan, where the author had just completed a four and one-half month stay, and in Honolulu.

[212] The author submitted twenty-two photographs of hazards, taken during one or two short walks around the City of Wellington, to the Law Commission along with his submission. Slides made from the negatives are in the possession of the author.

[213] *See, e.g.*, *Thrills and spills for Asian travellers*, Dominion (Wellington, N.Z.), June 1, 1987, at 6, col. 7 (reporting a high rate of automobile accidents for Asian tourists and a call by a travel industry representative to improve road conditions and signposting of dangerous road conditions; the conditions were characterized as "nothing short of a national disgrace").

It is doubtful whether hazards such as these would be allowed to exist for long in a liability insurance-conscious nation like the United States. Their continued though not unremarked[214] existence in New Zealand does suggest that accident deterrence has failed there, probably because there is no meaningful sanction should the hazards actually produce the accidents they threaten. As suggested above, however, effective deterrence may on occasion eliminate some beneficial aspects of dangerous conduct which the absence of fear of liability might encourage.[215]

C. *Newspaper Reports*

While these personal observations of unsafe conditions are admittedly anecdotal, they are buttressed convincingly by contemporaneous newspaper reports. The editorial verse in the style of A.A. Milne quoted at the beginning of this article,[216] for example, seems to confirm rather forcefully my perception of the seriousness of hazards created by construction in Wellington. In addition, newspaper articles culled on a fairly regular basis reveal serious problems of safety in many other areas as well. In addition to construction hazards[217] these include

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[214] *See infra* notes 216-28.

[215] Perhaps similar outcomes could be produced in the United States by broadening the defense of implied assumption of risk. Whether such hazards, though beneficial in other respects, should be tolerated is another question. These cases do illustrate the point that the tort liability system may in some circumstances deter useful activities. *See generally* Olson, *Overdeterrence and the Problem of Comparative Risk*, 37 PROC. ACAD. POL. SCI. 42 (1988). For a view that Americans have an obsession that life should be risk-free and that the obsession "is one of the most debilitating influences in America today," see Fairlie, *Fear of Living—America's Morbid Aversion to Risk*, NEW REPUBLIC, Jan. 23, 1989, at 14. *But see* Correspondence, *id.* Mar. 13, 1989, at 6, 42. *See also* P. HUBER, LIABILITY: THE LEGAL REVOLUTION AND ITS CONSEQUENCES (1988) (an articulate polemic charging recent developments in tort law with inhibiting valuable advancements in science and technology and calling for greater return to contractual arrangements). *But cf.* Galanter, *Beyond the Litigation Panic*, 37 PROC. ACAD. POL. SCI. 18 (1988).

To the extent that overdeterrence occurs, its costs should be considered a cost of the tort liability system when that system is compared with other systems.

[216] *See supra* text accompanying note 1.

[217] Cross, *Walkers dodge falling debris*, Dominion (Wellington, N.Z.), Sept. 30, 1987, at 6, col. 2 ("Falling debris from Wellington building sites continues to pose hazards to pedestrians. . . . Inspectors were doing their best, but regulations and supervision could not stop accidents."); Menzies, Letter to the Editor, *id.* July 16, 1987, col. 3 (describing observed work situation where two workers on planks working about eight stories above the street were unprotected by scaffolding or safety rails, and "where the slightest loss of balance would have sent either of the two men to the pavement and certain death," and stating "[t]his incident was the worse of several I have observed around the city lately. Not only workers but also members of the public are being put at risk unnecessarily."); Victoria University of Wellington, News VUW, May 22, 1987, at 24 ("[C]rane topples in early May to block Culliford Drive.", the road adjacent to the University, with picture); *Inspector considers sites unsafe*, Dominion (Wellington, N.Z.),

problems of highway and driver safety,[218] fire and other hazards in high-rise buildings,[219] unsafe drugs administered to children,[220] excessive electrical acci-

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May 13, 1987, at 6, col. 6 (report of Labour Department official's statement: "A shortage of construction safety inspectors, combined with construction company pressure on workers to get buildings up quickly, meant many labourers worked in hazardous conditions . . . ."); *id.* May 8, 1987, at 7, col. 4 ("The Labour Department will send a "very stiff" warning to an Auckland building company after a wall collapsed and injured a carpenter.").

[218] Bishop, *Drivers do well in alcohol blitz*, Dominion (Wellington, N.Z.), July 20, 1987, at 3, col. 1 ("Few drivers mixed alcohol with driving . . . but 'alarming' figures were reported for the South Island."); *Death rate on roads not so gloomy, id.* June 26, 1987, at 3, col. 8 (original report that New Zealand's road accident death rate was the worst of eight nations surveyed was wrong; correct death rate for every 10 million kilometers traveled was 26 deaths rather than 37, thus putting New Zealand behind Germany (34) but ahead of Australia and Japan (24 each), Canada (23), the United Kingdom (21), Sweden (17), and the United States (15)); *Licensing revamp set for August, id.* June 11, 1987, at 3, col. 7 (announcement of plans for a "tough new licensing system for young drivers" designed to reduce the accident rate among drivers aged 15 to 24); *id.* at 16, col. 4 ("The attitudes of New Zealand drivers have deteriorated," according to retiring Ministry of Transport senior sergeant.); *Thrills and Spills for Asian Travellers, id.* June 1, 1987, at 6, col. 7.

[219] *Fire study begun*, Dominion (Wellington, N.Z.), July 18, 1987, at 3, col. 5 (report of Internal Affairs Minister asking the Building Industry Commission to examine need for fire sprinklers in high rise buildings); *Doubts cast on highrise safety, id.* July 12, 1987, at 1, col. 1 ("Many of the highrise towers being built in New Zealand could have structural faults serious enough to cast doubts on their safety, two senior Ministry of Works and Development staff say."); Vasil, *Sprinkler review likely—Tapsell, id.* July 11, 1987, at 3 (report that Internal Affairs Minister was likely to seek a review of existing sprinkler requirements); Vasil, *Insurers firm on sprinklers, id.* July 10, 1987, at 3, col. 7; *Law tougher abroad, id.* col. 8 ("New Zealand's requirement for sprinkler systems only in buildings higher than 14 stories is less stringent than in other Western countries."); Moran, *Backing for sprinkler bylaw urged, id.* July 8, 1987, at 3, col. 7; Editorial, *Waiting for a tragedy, id.* July 7, 1987, at 10, col. 1; Vasil, *Tourists' call for sprinklers heeded, id.* July 7, 1987, at 3, col. 1 ("Refusal by some overseas tourists and employees of large international companies to stay in hotels without sprinkler systems has prompted one Wellington chain to install them."); *High fire risk areas extended, id.* ("The Fire Service Commission has included hospitals and the chemical industry as high fire risk areas where sprinklers systems should be mandatory."); Vasil, *Hotel chief defends fire safety, id.* July 6, 1987, at 3, col. 7 (includes report that the Dominion revealed that most of Wellington's leading hotels were "unprotected throughout" by sprinkler systems, and that the chief executive of the Hotel Association asserted that the standard of fire safety in New Zealand hotels was nevertheless adequate); *Use of sprinklers supported, id.* col. 3 (owner of Wellington's second largest hotel agrees that all hotels should be required to have sprinklers systems).

[220] Editorial, *Uncertainty on vaccines*, Dominion (Wellington, N.Z.), July 15, 1987, at 10, col. 1 (Editorial asks: "Are New Zealand children being used as guinea pigs?" after noting conflicting reports on whether the meningitis vaccine administered to children after an outbreak of the disease was adequately tested.); Vasil, *Illnesses unrelated to vaccine, id.* at 1, col. 5 (report that Health Department investigators found no evidence that "minor side effects such as vomiting, fainting and a sensation of rubbery legs" were caused by vaccine rather than by the immunization process and that the Health Department "was not unduly worried about the immunisation programme and would continue with it unless long-term side-effects were proven"); *50 calls report*

dents,[221] risks from hazardous substances,[222] excessive recreational accidents,[223] excessive back injuries,[224] high rates of fatalities among bush (forest) workers,[225] problems of incompetent hospital treatment or other malpractice,[226] in-

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vaccine ills, *id.* July 14, 1987, at 3, col. 3 (reports of 50 calls to South Auckland Health Department of side effects of meningitis vaccine including vomiting and "having trouble walking"); *Vaccine to stay but inquiry planned*, *id.* July 13, 1987, at 6, col. 5; *Injection reactions kept from parents*, *id.* July 6, 1987, at 1, col. 5 ("The Health Department says it did not publicise the adverse reactions of 25 children to meningitis vaccination injections . . . because it did not want to threaten the campaign.").

[221] Dominion (Wellington, N.Z.), July 21, 1987, at 3, col. 1 ("Auckland Electric Power Board has called for a special report on fatal accidents involving its linesmen, three of whom have died this year."); Raea, *Electrical accidents kill nine people*, *id.* June 13, 1987, at 7, col. 1.

[222] Managh, *Transport firms act to reduce accidents*, Dominion (Wellington, N.Z.), June 8, 1987, at 3, col. 1 (report on efforts by the transport industry to reduce accidents from hazardous substances carried by road).

[223] *Ski field safety defended*, Dominion (Wellington, N.Z.), July 20, 1987, at 3, col. 3 (report of Turoa ski field public relations officials answering complaints in two letters to newspaper about safety measures taken at ski field); *Concern at rate of water deaths*, *id.* July 6, 1987, at 6, col. 8 ("New Zealand has one of the worst drowning records in the Western world," according to the Internal Affairs Minister. "Whatever excuses are advanced for reluctance to fence home swimming pools, there can be no argument with statistics that prove that such pools are attractive—and deadly dangerous—to toddlers."); *Most cycle accidents unreported*, *id.* June 11, 1987, at 3, col. 8 ("A 1984 survey showed the chance of a cyclist dying on the road was three times higher in New Zealand than it was in Britain."); *Rugby's ACC use defended*, *id.* ("World Cup rugby organisers are annoyed at an inference that the [ACC] may be footing a heavy bill for injuries to players involved in the tournament."); *Third accident at show injures youth*, *id.* May 12, 1987, at 6, col. 3.

[224] *Bad backs 'a worry'*, Dominion (Wellington, N.Z.), June 26, 1987, at 6, col. 5; *Back injury tops safety concern list*, *id.* May 4, 1987, at 3, col. 6 ("A survey by Wellington's trade union health and safety centre has identified back injuries as the number one workplace helth [sic] hazard . . . .").

[225] Managh, *Statistics highlight bush work dangers*, Dominion (Wellington, N.Z.), Apr. 30, 1987, at 3, col. 3 ("Bush workers have been killed in site accidents at a rate averaging almost one a month for the past 18 years, Labour Department figures show.").

[226] *Surgeon on suspension*, Dominion (Wellington, N.Z.), July 16, 1987, at 3, col. 1 (report relating to charges that orthopedic services at Whakatane Hospital had been causing unnecessary medical problems, including the death of a patient); *Doctors' discipline procedures for review*, *id.* July 13, 1987, at 1, col. 7 (report that "mounting pressure for change within and without the profession" has led the Medical Council to consider revising disciplinary procedures to make them "responsive, accessible and free of financial burden for taxpayers and complainants"); Letter to the Editor, *id.* June 21, 1987, at 10, col. 6 (writer complains that as a "medical victim" she has no recourse against her physician but is "ironically seen in the statistics as an 'accident victim' "); *100 complaints about treatment*, *id.* May 8, 1987, at 1, col. 7 ("Almost 100 people have complained . . . about the care they received at Whakatane Hospital."); *Month's wait for full orthopedic inquiry*, *id.*, May 1, 1987, at 9, col. 1 (solicitor for family whose son allegedly died as a result of malpractice after he entered hospital with fracture, "has compiled a list of between 40 and 50 people who claim to have had bad experiences at the hospital's orthopedic department.")

dustrial safety problems,[227] and, of major national concern, the possibility that physicians who diagnosed symptoms of cervical cancer in women had experimentally denied them treatment.[228]

It is of course not possible to present a clear correlation between the absence of tort liability and the reported incidence of accidents. Nevertheless, many of these situations—such as New Zealand's alleged high rate of water deaths produced in part by the failure of homeowners with swimming pools to fence in their pools[229] or an excessively relaxed attitude by physicians to certain kinds of evidence of cervical cancer,[230] for example—lend themselves rather plausibly to the explanation that the absence of any perceived tort sanction, whether of personal liability for damages, an increase in insurance premiums, or even being subjected to an action for civil liability, has created an "I don't give a damn" attitude toward risk of harm to others.

While essentially anecdotal like my personal observations, this evidence is also buttressed by statistics furnished by the ACC.

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[227] Meares, *Industrial hazards under scrutiny*, Dominion (Wellington, N.Z.), July 2, 1987, at 12, col. 7 (report includes assertion that, because workers fear losing their jobs, far more industrial accidents occur than ever get reported).

[228] *See* Committee of Inquiry into Allegations Concerning Treatment of Cervical Cancer at National Women's Hospital and Other Related Matters, *Public notice*, N.Z. Herald (Auckland), July 25, 1987, at 4, col. 1; Meares & McQuade, *Cancer inquiry fears*, Dominion (Wellington, N.Z.), July 20, 1987, at 1, col. 1 (report on problems of reaching women in a public investigation of charges that many women diagnosed with signs of cervical cancer were deliberately not treated during a twenty year "experiment"); *Doctor guilty of misconduct*, *id.* June 26, 1987, at 3, col. 7 ("A doctor who failed to diagnose cervical cancer in a patient has been found guilty of professional misconduct."); *Hospital inquiry fund set up*, *id.* June 14, 1987, at 3, col. 3 (fund established to help women who want to testify); Main, *Report on cancer treatment awaited*, *id.* June 5, 1987, at 3, col. 1 ("The government may begin an independent inquiry into the treatment of cervical cancer patients at the National Women's Hospital in Auckland."); *Cancer allegations disputed*, *id.* June 8, 1987, at 3, col. 8 (Cancer society medical director reported to admit that some physicians at National Women's Hospital "questioned the value of cervical screening" but that "as far as he was aware" the problem was limited to that hospital).

Women who believe they were victimized by the failure to treat their cervical cancers are seeking to bring law actions for damage. However, they must await the determination of the ACC as to whether their rights lie under Compo or in law actions for damages. Letter from John Miller, Senior Lecturer, Faculty of Law, Victoria University of Wellington, to Richard S. Miller (Nov. 25, 1988).

[229] *See supra* note 223.

[230] *See supra* note 228.

D. Accident Statistics

1. Deficiencies of Statistics

As part of the total scheme of Compo the ACC, and before it the Accident Compensation Commission, was charged, in furtherance of its accident prevention function, to engage in research "into causes, incidence, costs, and methods of prevention of personal injury by accident."[231] Unfortunately, notwithstanding high hopes expressed in the Woodhouse Report that the accident compensation scheme would overcome prior deficiencies in accident statistics and lead to the development of "a statistical picture unlikely to exist in the same detail in any other country,"[232] the effectiveness of accident intelligence-gathering has been a major disappointment.[233] Evidently, the gathering of statistics has taken a back seat to the receiving of claims and prompt paying of compensation.[234]

2. The Statistics

Nevertheless, the ACC has published accident statistics and those statistics, though they may be of questionable accuracy and completeness,[235] do seem to

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[231] Accident Compensation Act, 1982, § 35(4)(e).

[232] WOODHOUSE REPORT, *supra* note 10, paras. 319-322.

[233] *See* SECOND WOODHOUSE REPORT, *supra* note 30, paras. 99, 125-126, 281-282 ("To apply the words used 20 years ago by the Royal Commission, the statistical record for injuries is still incomplete and even misleading." *Id.* para. 281; 1 REVIEW BY OFFICIALS COMMITTEE, *supra* note 85, at 120 ("In our review of the accident compensation scheme, there was frequently some difficulty in obtaining appropriate statistical data to support or disprove various comments and opinions. This is of particular concern in the safety and accident prevention area . . . . Not all accidents are reported . . . . Even accidents reported lack full information in a significant number of cases."); G. PALMER, ACCIDENT COMPENSATION, *supra* note 3, at 392-93.

[234] SECOND WOODHOUSE REPORT, *supra* note 30, §§ 5, 126. This may represent a misguided application of the general principle of administrative efficiency, wherein claims are paid without hassle upon a general certification by a physician that they arose from accident without monitoring the accuracy of the certificates as to coverage and as to correctness of the physician's diagnosis or prognosis.

[235] The ACC stated:

> Data on injuries are compiled from certificates given by medical practitioners at the time each claim is made. Therefore, diagnoses must strictly be regarded as preliminary ones—although, obviously, most will not be expected to change. . . . The system of bulk-billing by medical practitioners means that most medical fees paid by the Corporation do not involve the registration of a claim.

ACCIDENT COMPENSATION CORPORATION, 2 ACC STATISTICS, NO. 1, 30 (1983) [hereinafter 2 ACC STATISTICS].

See also ACCIDENT COMPENSATION CORPORATION, 4 ACC STATISTICS, 36 (1985) [hereinafter 4 ACC STATISTICS]. As to the statistics for 1988, the ACC states:

> The statistics largely exclude those accidents resulting only in (1) incapacity during the

support the anecdotal evidence that the incidence and severity of accidents has been increasing significantly. Thus, for example, between 1981 and 1983, head injuries were reported to increase from 18,762 to 22,954, or by 22.3 percent; fractures increased from 10,315 to 12,522, or by 21.3 percent, and perhaps most frightening of all from the perspective of accident costs to ACC and human tragedy, spine fractures with cord lesion increased from 15 to 74, or by 393.3 percent.[236]

Unfortunately, accident statistics furnished to me for the year ended March 31, 1988[237] do not appear to be directly comparable to the statistics for 1981 and 1983 earlier published. Nor are they as detailed. Nevertheless, some rough comparisons are possible: A total of 22,954 compensated head accidents of all kinds was reported for 1983;[238] for 1988 the total of head accidents reported was 28,081,[239] a 22.4 percent increase. A total of 1,259 compensated eye or eye orbit accidents was reported for 1983;[240] for 1988 a total of 1,217,[241] representing a decrease of 3.3 percent, although it is not clear whether eye injuries reported for 1988 also include injuries to the orbit, as they did in 1983. The total of neck injuries reported in 1983 was 2,001[242] as compared to 2,574 in 1988,[243] an 18.6 percent increase. In 1983, a total of 14,973 compensated back or spine injuries were reported;[244] the total for 1988 was 18,864,[245] repre-

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first week (for which the Corporation is not liable) or (ii) medical treatment (for which the doctor is normally reimbursed direct [sic]). However, they do include those cases where compensation has been paid for dental treatment—which must be claimed for by the patient.

In addition, they also exclude accidents (even fatal ones) to non-earners unless compensation has been paid . . . . This applies to children and elderly people in particular.

It is estimated that about half of all lost-time work accidents may be excluded by the above provisions; how many non-work accidents are so excluded cannot be reliably estimated.

The circumstances of each accident are as reported by the claimant. Injuries are as diagnosed by medical practitioners at the time the claims were made, and some diagnoses may therefore not be final.

ACCIDENT COMPENSATION CORPORATION, COMPENSATED ACCIDENTS FOR THE YEAR ENDED 31 MARCH 1988 1 (1988) (unpublished) [hereinafter COMPENSATED ACCIDENTS FOR 1988].

[236] *Compare* 2 ACC STATISTICS, *supra* note 235, 30-31, *with* 4 ACC STATISTICS, *supra* note 235 at 36-37.

[237] COMPENSATED ACCIDENTS FOR 1988, *supra* note 235.

[238] 4 ACC STATISTICS, *supra* note 235, at 36.

[239] COMPENSATED ACCIDENTS FOR 1988, *supra* note 235, table 8.

[240] 4 ACC STATISTICS, *supra* note 235, at 37.

[241] COMPENSATED ACCIDENTS FOR 1988, *supra* note 235, table 8.

[242] 4 ACC STATISTICS, *supra* note 235, at 37.

[243] COMPENSATED ACCIDENTS FOR 1988, *supra* note 235, table 8.

[244] 4 ACC STATISTICS, *supra* note 235, at 37.

[245] COMPENSATED ACCIDENTS FOR 1988, *supra* note 235, table 8.

senting an increase of 26 percent.[246]

There do not seem to have been any sharp increases in population, employment, in the hazards of employment, or in recreational activities in New Zealand during the reporting period which could account for such sharp increases in serious injuries. The only remaining explanations for the increases are (1) that the figures supplied to the ACC by physicians, or the figures as published, are inaccurate or not comparable from one reporting period to the next, (2) that although the data may be accurate, more citizens have become aware of the availability of Compo and a higher percentage of accidents are resulting in claims and more fraudulent claims are being filed, (3) that a significantly more dangerous environment has indeed produced a shocking increase in serious accidents, or (4) a mix of the above.

E. Conclusions Regarding Deterrence

When the implications of the cost data—especially the otherwise unexplained "cost creep"—are considered in connection with the anecdotal evidence gathered by personal observation, the many newspaper reports—including some explicit reports of New Zealand's high accident rate in relation to other nations—and the available statistics provided by ACC, it is hard to avoid concluding that Compo's "cost creep" or its "cost blow-out" has been caused mainly by an "accident blow-out." When to this evidence is added the intuition as well as the theory that removing direct financial incentives on individuals and firms to avoid accidents and removing the costs of accidents from the activities which cause them will result in an inefficient level of accidents, then the conclusion that the absence of deterrence such as that produced by the tort system has indeed resulted in an unacceptably high and inefficient level of accidents seems proved by at least a preponderance of the evidence. If I am correct in this, then the Accident Compensation Scheme, notwithstanding its humane values and its success at providing compensation, is tragically flawed.

V. REFORMING THE SYSTEM

A. Problems Perceived

It was not specifically the problem of accidents or failure of deterrence but rather escalating costs, as described above, coupled with a continuing desire to

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[246] In 1983, 13,048, or 87.1 percent, of the 14,973 reported back or spine injuries were sprains or strains. 2 ACC STATISTICS, *supra* note 235, at 37. Comparable statistics were not available to the author for 1988. *See* COMPENSATED ACCIDENTS FOR 1988, *supra* note 235, table 8.

reduce the disparity of treatment between those disabled by accident and those disabled by other causes that generated reconsideration of the Accident Compensation Scheme by three impressive governmental bodies—the Officials Committee,[247] The Royal Commission on Social Policy,[248] and the Law Commission.[249] Since the Law Commission has produced a draft bill—the Safety, Rehabilitation and Compensation Act[250]—which would entirely replace the Accident Compensation Act of 1982, and since there is a fair chance that the Law Commission's report will become the starting place for discussions leading to a new compensation act for New Zealand,[251] the principal focus of discussion here will be the Law Commission's final report and the manner in which it deals with the problem of accidents.

Owen Woodhouse, the distinguished jurist responsible for the original report which eventually gave rise to Compo, served as the President of the Law Commission during the recent study which led to the current recommendations for a new Act.[252] Well before the final report emerged, in May, 1988, he had signalled his intention of dealing with the immediate problem of increasing costs and levies by eliminating differential rates for the 103 categories of industrial activity and moving toward a uniform flat rate for all employers.[253] It was therefore no surprise when the final report included a recommendation for a flat rate levy for employers and self-employed persons.[254]

The problem for the Law Commission, however, was not just to deal with employer complaints of excessively high levies, although that was obviously a promising way of cooling the political heat that had generated most of the governmental concern about the Scheme. The broader issue was how, in the

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[247] *See* 1 REVIEW BY OFFICIALS COMMITTEE, *supra* note 85; *see also* 2 REVIEW BY OFFICIALS COMMITTEE, *supra* note 85 (Introductory Letter of Submission).

[248] See references to the work of the Royal Commission on Social Policy, including six working papers, in SECOND WOODHOUSE REPORT, *supra* note 30, §§ 7, 14, 37, 57, 60, 63, 64, 163, 184, 186, 273.

[249] SECOND WOODHOUSE REPORT, *supra* note 30. Since Sir Owen Woodhouse, the author of the original Woodhouse Report, is President of the Law Commission, this report has been referred to here as the Second Woodhouse Report.

[250] *Id.* at 104-95.

[251] *See* letter from John Miller, *supra* note 228.

[252] In an interview given to the National Business Review (New Zealand), Sir Owen himself questioned whether it was "sensible" to place him in charge of assessing the scheme of which he was the architect. *See* Herbert, *Compo payments relief on the way*, Nat'l Bus. Rev., June 26, 1987, at 1, col. 2.

[253] *Id.* In Sir Owen's view, the levies, while in the form of a payroll tax, are "indirectly a sales tax as the cost is passed on to the general public in prices." *Id.* at 5, col. 5. Further, he holds the view that the preferred approach would be to finance the system out of general taxation. *Id.* This is of course consistent with the view that Compo is a social insurance scheme. *See* SECOND WOODHOUSE REPORT, *supra* note 30, paras. 2, 44-46.

[254] *See* SECOND WOODHOUSE REPORT, *supra* note 30, para. 21.

face of escalating costs, including the unexplained "cost creep" described above,[255] to maintain the original guiding principles of the Scheme which included relatively rich levels of compensation—"real compensation"—and in addition to broaden coverage to eliminate the anomalous difference in treatment between accident victims and other disableds—comprehensive entitlement—, while not complicating the administration of the Scheme—administrative efficiency—and while dealing appropriately with the supposed highest priority of all, accident prevention.[256]

B. *Options Available to the Law Commission*

If these objectives were to be met, a combination of some of the following options would have to be adopted:

1. *Reduce amount of benefits paid.* Total benefits could be reduced by (a) eliminating lump sum payments for noneconomic loss, which had recently experienced a meteoric increase;[257] (b) reducing weekly benefit levels of ERC by reducing the percentage (now eighty percent)[258] of weekly earnings paid or reducing the maximum amount of annual income on which ERC would be paid ($63,458);[259] (c) extending the length of the period of non-coverage for ERC beyond the current one week waiting period;[260] (d) shifting entirely or partly from income maintenance[261] to minimum subsistence; (e) reducing dependent's benefits[262] and some of the miscellaneous benefits;[263] (f) reducing false and fraudulent claims for ERC by workers; (g) monitoring physicians effectively to insure the correctness of determinations that patients' conditions were caused by accident rather than by non-covered conditions and that private hospital stays were necessary: and (g), most importantly, by reducing the number and severity of accidents.

2. *Increase income.* Possibilities included (a) extending levies beyond motor vehicle owners, employers, and self-employeds and imposing them on groups and individuals currently exempt, such as athletes and athletic groups, motor

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[255] *See supra* text accompanying notes 157-80.

[256] *See supra* note 189.

[257] Noneconomic loss paid increased from $56.9 million in 1985 to $88 million in 1986, a 55 percent increase. The payment in 1986 for noneconomic loss constituted 21.1 percent of the total of $416 million paid as compensation by the ACC in 1986. 1986 FINANCIAL STATEMENTS, *supra* note 147, at 3, 5.

[258] Accident Compensation Act, 1982, §§ 59(1), 60(1)(e).

[259] UNINTENTIONAL INJURY, *supra* note 21, at 22 (as of June, 1987).

[260] Accident Compensation Act, 1982, § 57.

[261] *See, e.g.*, Accident Compensation Act, 1982, §§ 59(1), 60(1).

[262] *Id.* § 65.

[263] *See, e.g., id.* §§ 72, 73, 77, 80.

vehicle drivers, workers, owners and occupiers of real property; (b) requiring beneficiaries or potential beneficiaries to contribute to the scheme, as by imposing monthly charges on workers, requiring patient contributions to medical and drug expenses, or levying a Compo tax on visitors to New Zealand; (c) imposing general or specific (as on gasoline) tax increases to support greater contributions from general tax revenues (d) experience rating—surcharging existing levy payers and assessing and imposing levies on others based upon the extent to which they cause accidents to others, as with drivers, occupiers of property, products manufacturers, and health care providers; (e) raising money through fines or penalties imposed on activities found to be violating safety standards; and (f), the most controversial proposal, reinstating the tort action in whole or part and allowing the ACC to recover the value of ACC payments from tortfeasors whose acts or omissions caused the accidents which led to such payments.

3. *Improve accident prevention.* Here the possibilities include (a) improving safety education and safety programs; (b) expanding specific deterrence through increased direct regulation of accident-causing activities coupled with fines, penalties, and imprisonment in appropriate situations; (c) expanding use of financial incentives such as bonuses for good safety records and penalties for poor safety records, and, for victims, longer waiting periods for commencement of benefits and requiring self insurance; and (d) improving general deterrence by requiring internalization of accident costs—through experience rating, by imposing a part or greater part of the costs of accidents on accident causers, such as employers in the case of work-related accidents and victims where there is contributory fault, or the reimposition of tort liability in whole or part. It should be noted that the last three possibilities for increasing income, (d) - (f) in paragraph 2, above, generally coincide with the last three possibilities for improving accident prevention, (b) through (d), in this paragraph.

C. Recommendations of the Law Commission

Here, however, in broad brush strokes, are the principal changes which the Law Commission has actually recommended:

1. Benefits

a. *Waiting period extended.* The waiting period for Compo benefits should be extended from one week to two.[264] However, the obligation to pay ERC which now falls on the employer for the first week of incapacity in cases of

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[264] SECOND WOODHOUSE REPORT, *supra* note 30, para. 28(3).

work-related injury would be extended to the full two weeks.[265] The earner injured on the job would thus suffer no loss of benefits, but employees injured off the job would have to carry themselves for the second week if the employer did not provide sick pay for that week.[266] While the Law Commission makes fairly expansive claims for the degree of self-incentive on both employees and employers and the degree of individual responsibility this change will produce,[267] the actuarially estimated savings—about $26,000,000 per year[268]—seems minuscule in relation to the likely problems of costs. The Law Commission evidently rejected the recommendation of the Royal Commission on Social Policy that the waiting period be extended to four weeks.[269]

b. *Earnings Related Compensation for Permanent Disability.* The Law Commission rejected a proposal of the Royal Commission on Social Policy to drop periodic payments of earnings related compensation at their current high level after the second year of disability and then to begin to pay a reduced flat rate somewhat more generous than the current social welfare payment for those disabled by illness.[270] Instead the Law Commission recommends that if and when a cut is necessary in ERC payments, a uniform percentage, such as five percent, be adopted.[271] In the meantime, there would be no change in the commitment to pay generous ERC to disabled workers until retirement if necessary. Indeed, the draft act sets the new maximum monthly salary on which ERC payments (of eighty percent) are based at $2,000 per week.[272]

A dramatic change, however, is recommended for the treatment of disabled non-earners who will for the first time become entitled to periodic payments based upon New Zealand's average weekly earnings, as described in the next section.

c. *Lump Sum Payment for Noneconomic Loss.* Noting that lump sum payments for permanent disability and for loss of the amenities of life and for pain and suffering could not be justified if the scheme were to move in the direction of covering sickness as well as accident,[273] the Law Commission has proposed that, generally, lump sum awards for noneconomic loss be abolished.[274] However, in recognition of the fact that those who suffer serious disability "will often meet

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[265] *Id.*

[266] *Id.* paras. 183-185.

[267] *Id.* paras. 183-184.

[268] *Id.* para. 184.

[269] *Id.* (citing ROYAL COMMISSION ON SOCIAL POLICY, WORKING PAPERS ON INCOME MAINTENANCE AND TAXATION (Mar. 1988)).

[270] *Id.*

[271] *Id.* (would reduce ERC payments to 75 percent of weekly earnings).

[272] *Id.* at iii (erratum), 127.

[273] *Id.* para. 193.

[274] *Id.* paras. 188-194. The proposal would also eliminate lump sum awards to a spouse and children upon the death of a worker. *Id.* para. 42.

greater costs in various areas than the able,"[275] the Commission recommends permanent periodic payments for loss of capacity if the loss exceeds five percent.[276] The percentage of incapacity is to be determined by an authoritative schedule of the American Medical Association.[277] The percentage is to be applied to eighty percent of the "average weekly wage" which, the Commission states, is a base figure which is different from the individual's own historic earnings which constitutes the base figure for ERC and is based instead upon "a general figure which we have taken as the average wage,"[278] presumably for all of New Zealand. In an appropriate case these benefits may be computed to a lump sum.[279]

The proposed draft Act, borrowed in part from legislation introduced into the Australian Parliament in 1977,[280] purports to be less complicated than the existing legislation.[281] Unfortunately, however, it is unclear on the important question whether an earner who suffers incapacity will receive ERC and, *in addition*, a percentage, based on the AMA schedule, of average weekly earnings "for 'all sectors, all persons' " in New Zealand in lieu of current lump sums for noneconomic loss.[282] The implication is that *both* kinds of payments will be available to earners.[283]

This proposal constitutes the most significant improvement in benefits for

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[275] *Id.* para. 190.

[276] *Id.* para. 195.

[277] *Id.* (citing AMERICAN MEDICAL ASSOCIATION, GUIDES TO THE EVALUATION OF PERMANENT IMPAIRMENT (2d ed. 1984)).

[278] *Id.* para. 203. There is a provision for adjustment in the event of exceptional cases. *Id. See also* Draft Act, §§ 25(2), 48, *id.* at 119, 130, respectively.

[279] *Id.* §§ 131-132 (§ 52).

[280] *Id.* at 94 (appendix B) ("The model was the National Rehabilitation and Compensation Bill presented and read a first time in the House of Representatives of the Australian Parliament on 24 February 1977. . . adapted . . . to New Zealand circumstances.")

[281] *Id.* para. 23.

[282] *Id.* para. 29.

[283] *Cf. id.* paras. 29, 194, 201-203. *But cf. id.* at 99: "Clause 42 attributes to a person who has no earnings a national income. This is set at the amount of average weekly earnings (all sectors, all persons). *The provision applies to all those who are not employed or self-employed.* They will be entitled to a periodical benefit for total incapacity or permanent partial incapacity." (emphasis added). This last provision as well as the draft act seems to limit such benefits to non-earners. On the other hand, one of the examples given is of a worker who shatters his leg in a motorcycle accident and then receives periodic payments of $190 per week, based on permanent incapacity of 60 percent, which may last thirty-four years. This amount is then compared in the example with the $10,000 lump sum for noneconomic loss the worker would currently receive. Since an injured earner may currently receive a lump sum payment in addition to ERC, the implication is that earners *will* receive periodic benefits in addition to ERC. *Id.* para. 199. However, if the proposal actually contemplates removing lump sum payments for noneconomic losses for earners without replacing those benefits, there may be serious resistance from the labor movement.

nonearners who, under the current scheme, fare very poorly if they suffer long term serious disability, being entitled only to a lump sum up to a total of $27,000 plus medical expenses. While giving up the right to lump sum payments for noneconomic loss, they would now be entitled to received periodic payments based on a percentage impairment determined by a physician using the AMA schedule of impairments, the percentage to be applied against the all-New Zealand average weekly earnings. Such payments could continue until retirement age.

Actuaries have estimated that the allowance of such periodic payments in lieu of current lump sums would eventually—when the new scheme reaches its full maturity—cost about $403 million per year in 1987-88 dollars, as compared with $145.5 million which would be paid in lump sums under the current Act.[284]

d. *Extension of Coverage to Illness-Based Disability.* The Law Commission recommends that, in furtherance of the objective of comprehensiveness, the scheme be extended to cover, as included within the definition of personal injury, congenital diseases.[285] The proposal, however, was not included within the draft act on the ground that "the change is a major one with significant consequences for other areas of policy and administration" and because its costs have not been determined.[286]

e. *Medical Expenses.* The Commission recommends that medical treatment for accident victims and victims of illness and disease be treated equally.[287] This would be accomplished *by removing the obligation to cover such expenses from the Compo scheme* and turning the public responsibility over to the social welfare system by reference to the Social Security Act 1964.[288] However, to insure that

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[284] *Id.* para. 204. The report mentions the figure given but the actuaries who computed the costs, in their report, estimate 1987-88 payments of lump sums for noneconomic loss at $175 million. *Id.* para. 211.

These estimates may also include the cost of a provision designed specifically to permit sexual assault victims and others who suffer serious emotional harm or permanent disfigurement to receive periodic payments for disability by directing the physician who determines the percentage of disability to take into account the extent to which the condition "has permanently lessened that person's ability to lead a normal life." *Id.* para. 120 (Draft Bill § 27). There is also a provision which would permit periodic payments, such as these, to be commuted to a lump sum "where it is particularly advantageous and just to the beneficiary that the benefit be paid by way of lump-sum payment." *Id.* paras. 131-132 (Draft Bill § 52).

[285] *Id.* para. 172 (the proposal would be similar to that contained in the bill introduced in the Australian Parliament in 1977: A congenital disease was there defined as "a physical or mental defect, including a disease, in a person existing at or shortly before birth, being a defect or disease that becomes evident before that person attains the age of 3 years.").

[286] *Id.*

[287] *Id.* paras. 7, 176-179.

[288] *Id.* para. 176.

accident victims continue to receive appropriate health care the specific elements of "personal attention" to which such victims are entitled are spelled out in the draft Act.[289] The Law Commission also recommends that in order to create appropriate "incentives" and to further "individual responsibility" victims should ordinarily cover one-third of their own medical costs.[290] However, because of international labor conventions to which New Zealand is evidently bound, the employer would be required to pay the amount of medical expenses not covered by Compo for its employee if the accident or disease was work-related.[291] In addition, special provision for payment would be made to impose a ceiling on the amounts an individual would have to pay and for further assistance in the event the victim was unable to pay the residual amount.[292]

Although some incentives to avoid or prevent accidents are built in to the medical expense proposal—to the extent that individuals and employers have to bear medical expenses—it must be recognized that *the remaining costs of medical and surgical care and all other health costs would be externalized by this proposal*; they would be paid for under the social security system from general revenues. For 1987 these expenses accounted for about twenty percent of all ACC compensation costs.[293]

f. *Coverage*. The Law Commission recommends moving away from exclusive reference to a broad and general definition of what conditions are covered, such as the current "personal injury by accident" and "medical misadventure," to a schedule of specific covered outcomes which is capable of being changed as necessary. The recommended schedule, *Causes of Personal Injury*, is based in part on the International Classification of Diseases of the World Health Organization.[294] It omits reference to "accident" because of the intention to expand coverage to injuries or conditions not necessarily caused by accident.[295]

One of the major proposed effects of the change to a schedule would be that a limitation which the courts had placed on the term "medical misadventure," to the effect that a "recognized risk" of a particular therapy was not covered,

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[289] *Id.* para. 177 (Draft Act § 53).

[290] *Id.* para. 176. It is not clear whether the one-third victim's share includes hospital and surgical expenses as well as expenses of physician's individual medical treatment. The illustration used to justify this figure was taken from the experience with ACC payments for individual practitioner visits, which had evidently been about one-third less than usual fees. *Id.* para. 174. Evidently this practice of setting payments lower than usual fees has recently been struck down in the courts, which have required ACC to pay the full fee to the extent it is "reasonable by New Zealand standards."

[291] *Id.* para. 178.

[292] *Id.*

[293] *Id.* para. 175.

[294] *Id.* paras. 165-166. The "First Schedule" (so denominated to distinguish it from the table of Motor Vehicle Levy Rates, which is the Second Schedule) may be found *id.* paras. 166-194.

[295] *Id.* para. 166.

would be eliminated.[296] Further, getting or failing to get informed consent would "no longer be relevant," since if the particular outcome were included in the schedule the victim would be covered regardless of whether the patient had been informed of its possibility and had consented.[297]

Other changes recommended include omitting a limitations period (currently within one year from the date of the accident or the death)[298] and giving cover, not available under the current scheme, to incapacity manifesting itself after 1974 although caused before that date.[299] By way of example, this would furnish coverage for asbestos-related occupational disease caused by exposure prior to 1974,[300] for injuries which manifested themselves after 1974 but which were caused by pre-1974 accidents,[301] and for sexual abuse of a child which occurred prior to 1974 but for which the emotional harm appears thereafter.[302]

2. *Funding*

The Law Commission recommends changes in the manner in which Compo is funded by eliminating different rates of annual levy for employers and self-employeds engaged in different industrial activities and instead adopting a flat rate, estimated to be about $2.64 per $100 of payroll.[303] Experience rating of employers, self-employeds or of motor vehicle owners or drivers would *not* be attempted and provisions in the Act allowing bonuses and penalties would be removed.[304] Levies upon owners of motor vehicles would instead be based upon the current two-rate structure, $100 or $35.30, which is based largely on size of vehicle, and the levies would be adjusted in the future according to changes in

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[296] *Id.* para. 165.

[297] *Id.*

[298] Accident Compensation Act, 1982, § 98.

[299] SECOND WOODHOUSE REPORT, supra note 30 paras. 167-171.

[300] This provision would only extend the current coverage of occupational diseases. *See* Accident Compensation Act, 1982, § 28. The Law Commission did not recommend the extension of coverage of Compo generally to man-made non-occupational diseases, *See generally* SECOND WOODHOUSE REPORT, *supra* note 30, First Schedule at 166-95, although a few environmental hazards seem to be included. *See id.* at 172-74 (accidental poisoning by other solid and liquid substances, gases, and vapours), *id.* at 189 (exposures to radiation), *id.* 190 (exposure to Noise (pollution, sound waves, and supersonic waves). The failure adequately to cover man-made diseases has been criticized as a serious failure of both the tort system and New Zealand's Compo. *See* J. STAPLETON, *supra* note 3, at 145-50.

[301] The example given is of spinal accidents. SECOND WOODHOUSE REPORT, *supra* note 30, para. 167.

[302] *Id.*

[303] *Id.* para. 250.

[304] *Id.* paras. 140-148.

the consumer price index.[305] In addition, a portion of the excise duty paid on motor vehicle fuel and ordinarily not used for the road system would be used to support the compensation scheme.[306]

From the perspective of general deterrence, perhaps the most significant elements of the Law Commission recommendations regarding funding are those that assert that the various levies are not premiums to fund an insurance system but taxes to fund a social welfare program.[307] In accordance with that view, the Commission has recommended that henceforth the strict separation of the existing three accounts—earners, motor vehicle, and supplementary—be weakened and that moneys received from all sources be intermingled in a single fund to provide for Compo benefits and ACC administrative expenses without regard to the source of the accident.[308] To sever the relationship between accident causers and accident costs even further, the Commission has recommended that "as with other taxes Parliament should directly exercise its constitutional function of determining from time to time the rate of the particular levies."[309] This would provide the government with "the general opportunity each year to make an overall assessment, against the Corporation's estimate of its needs, of the amount to be gathered from the three or four sources and the balance that should be struck between them."[310]

Under such a system it would seem to follow that in the future shortfalls produced by excessive or unexpected accident costs would not have to be financed by sharp increases in employer or driver levies. Instead, the government would have the responsibility of providing the needed funds and could, if it so desired, simply draw them from general tax revenues, thus blunting the kind of outcry from levy payers that generated the 1986-87 crisis.

3. *Accident Prevention*

Although it reaffirmed the view of the Woodhouse Report and the Accident Compensation Act that the most important way to deal with personal injury accidents was through prevention,[311] the Law Commission's report ultimately rejected any significant role by way of deterrence or prevention for the compen-

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[305] *Id.* para. 241.

[306] *Id.* para. 240. The Commission's justification for applying a portion of the fuel tax is that, "[g]iven that this particular tax is directed at road users and in particular had some regard to the extent of their use and their exposure to the risk of accidents, it does appear to us to be an equitable and efficient means of providing funds for the accident scheme." *Id.*

[307] *Id.* para. 243.

[308] *Id.* paras. 242-249.

[309] *Id.* para. 244.

[310] *Id.*

[311] *Id.* paras. 105-106.

sation scheme. After acknowledging "the widely held opinion that [the promotion of safety is] not adequately handled in our system of government,"[312] the Commission's principal response was to propose that a Minister of Safety be appointed and placed in charge of the entire field of safety.[313]

To arrive at its relatively relaxed and non-urgent response to the problem of accident prevention, the Commission first found it necessary to confront the problem of increasing costs[314] and to deal once again with the question whether elimination of tort liability for personal injuries might also have eliminated effective deterrence.

Curiously, although the possibility was brought to its attention,[315] the Commission in its report never explicitly mentioned that an increase in the rate or severity of accidents might have accounted for some of the mysterious cost creep. Rather, it relied on a study conducted by actuaries at the Commission's request[316] which itself never suggested such possibility. In the study the authors identified an "unexplained expenditure growth" from 1975-76 to 1984-85 of about fifty percent or more.[317] They downplayed the importance of the increase, however, by stating that the annual growth rate—about 4.6 percent per year—"is similar to or lower than the average rates of unexplained cost increases observed by many Australian workers compensation and compulsory third party schemes in the same period."[318] In response to the question whether it is possible to isolate any causes for the unexplained increases, the actuaries responded by suggesting several possibilities other than a worsening accident problem.[319]

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[312] *Id.* para. 104.

[313] *Id.* para. 128.

[314] *See supra* text accompanying notes 172-80.

[315] *See, e.g.*, Submission to Law Commission, *supra* note 14; Miller, *Plugging the ACC's Biggest Leak*, Nat'l Bus. Rev., July 24, 1987, at 17, col. 1. Evidently, other than the Author's, none of the many submissions to the Law Commission showed any interest in a return to the tort system. Letter from Jeffrey O'Connell to Richard S. Miller (August 16, 1988) (reporting on communication from the Law Commission). Since then, however, an article in a New Zealand journal has proposed the reinstatement of the tort action as a supplement to regulation controlling hazardous technology. Hide & Ackroyd, *Liability and the Control of Hazardous Technology*, 1988 N.Z.L.J. 277. *See also* text *infra* accompanying notes 397-404.

[316] Cumpston & Madden, *Report on the Costs of the Accident Compensation Scheme*, in SECOND WOODHOUSE REPORT, *supra* note 30, at 196 app. C.

But see Hide & Ackroyd, *Liability and the Control of Hazardous Technology*, 1988 N.Z.L.J. 277 (describing statutes regulating hazardous technology and characterizing them as providing "considerable scope for comprehensive control" but nevertheless proposing reinstitution of a civil action for personal injury).

[317] They also explained that if, over the nine year period, lump sum payments and ERC payments had not kept pace with inflation, as was probably the case, then the unexplained increase "would probably be higher than the 50% estimated . . . ." *Id.* at 205.

[318] *Id.*

[319] These were: (1) as to increases in weekly benefits, from increased unemployment, especially

As to the possibility of reintroducing the tort system, the Commission in effect reaffirmed the views of the Woodhouse Report, upon which Compo was originally based, that tort liability fails both as a deterrent to accidents and as a compensation system.[320] In arriving at this conclusion, the Commission noted that "much recent American writing addresses the 'torts crisis,' 'the failure of tort law' and the related 'insurance crisis,' "[321] but drew its main support from "the prevailing view of leading commentators on civil liability for personal injury[,]" particularly Professor Andre Tunc,[322] as buttressed by Professor Craig Brown's study of automobile accidents and fatality rates in New Zealand.[323]

Apart from the fact that not all leading commentators on civil liability necessarily share Professor Tunc's view of the failure of tort law as a deterrent,[324] the validity of Professor Brown's study as general support for that view beyond the motoring context, as he himself was careful to note,[325] is not established. In-

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in rural areas, and from a change in § 59(2) of the 1982 Act whereby those earners who suffer temporary partial disability but who cannot find work do not have their ERC reduced by the amount of earnings they might have had if they could have found work; (2) as to increases in lump sum payments for noneconomic loss for permanent loss or impairment of bodily functions, from an increase in the maximum from $7,000 to $17,000 which commenced in April, 1983; (3) as to increases in the lump sum payments for pain and suffering or loss of amenities of life, from "the increased tendency to award maximum or near maximum amounts for relatively minor impairments;" (4) as to increases in medical payments, from increasing costs of various medical and paramedical services plus "some continuing tendency to charge the Corporation for non-accident related treatment"; and (5) as to increases in hospital payments, partly from general medical cost increases and partly from greater use of private hospital facilities. *Id.* at 208-09. Neither an increase in accidents or their severity nor an increase of fraudulent or false claims (except, perhaps, for the charges for non-accident related treatment) was mentioned. Professor Gellhorn suggests, however, that "means can and should be developed" effectively to control professionals and others to whom the state has given licenses and to encourage greater care in other areas, such as driving and construction, as well. Letter from Walter Gellhorn to Richard S. Miller, Aug. 15, 1988.

[320] WOODHOUSE REPORT, *supra* note 10, paras. 78-113.

[321] SECOND WOODHOUSE REPORT, *supra* note 30, para. 79.

[322] Identified in the report as a scholar who, in the 11 INTERNATIONAL ENCYCLOPEDIA OF COMPARATIVE LAW ch. 14 (1983 & Supp. 1986), flatly rejected fault as the basis for determining compensation. *Id.*

[323] Brown, *supra* note 3.

[324] *See, e.g.*, Galanter, *Beyond the Litigation Panic*, 37 PROC. ACAD. POL. SCI. 18, 29 (1988); Henderson, *supra* note 3; Posner, *Can Lawyers Solve the Problems of the Tort System?*, 73 CALIF. L. REV. 747, 749-51 (1985).

[325] Professor Brown in his article clearly articulated the reasons why the negligence system is not a major factor in deterrence in the automobile accident context as compared with other areas. Brown, *supra* note 3, at 978.

In his study of road accidents, Professor Brown did not mention one factor which, in the motoring context, may have more than substituted in New Zealand for any general deterrence or internalization of costs produced by liability insurance premiums: the highly and artificially inflated prices of automobiles in New Zealand. Probably because of customs duties, car prices there

deed, to the contrary, he has stated: "Despite the protection provided by liability insurance, the deterrent effect of negligence law remains strong outside the context of motoring."[326] And both Professor Brown and the Law Commission agreed that the absence of comparable statistics with regard to unintentional injuries outside of the driving context made it impossible to present evidence of the effect of eliminating tort liability on accidents in areas other than automobile accidents.[327]

Nevertheless, the Law Commission rejected any return to tort liability for personal injury and, having done that, proceeded also to reject most other financial safety incentives, both existing and proposed,[328] and including the current distinctions based on employee injuries among 103 industrial activities.[329]

As to the safety incentives which might be lost by giving up bonuses and penalties and by rejecting experience rating, the Law Commission argued that on the one hand these so-called incentives are not effective and on the other

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are many times higher than they are in the United States, whether the differences in the values of the two currencies (the New Zealand dollar was worth between $0.56 and 0.59 U.S. at the time) are taken into account or not. Thus, for example, the advertised prices for used autos in the Dominion Sunday Times of July 19, 1987, at 40, included the following: 1986 Mazda RX7, $73,000; 1983 VW Scirocco GT, $23,990; 1986 Honda Civic, $23,990; 1984 Honda Accord 3-dr., $23,500; 1984 Mazda 626, $22,990; 1986 Chevrolet Camaro, $84,990. While the demand for automobile transportation may be highly inelastic, these awesome prices arguably could not have helped but reduce the overall driving activity in New Zealand over what it might have been if only market forces dictated prices. On the other hand, it is also possible that the fantastic prices of new and nearly new automobiles has led to excessive driving of older and hence less safe vehicles. (For example, the author, in February of 1987, paid about $7,000 for a 1974 Triumph Saloon; at home in Honolulu the author's oldest car in 1987 was a 1981 Subaru.)

If the prices of automobiles were about as high in relation to the cost of living in New Zealand before 1974, when Compo came into force, as they were after that date, then this factor would not affect Professor Brown's conclusion, based mainly on comparisons of injuries *per mile driven*, that the advent of Compo did not cause an increase in motor vehicle accidents. However, the high price of automobiles in New Zealand would affect the accuracy of comparisons with road accident rates in other countries (and in New Zealand if auto prices were relatively lower before 1974) in two ways: First, high auto prices would arguably chase younger drivers—who often account for a disproportionately high percentage of accidents—out of the car-buying market. Second, the high cost of automobiles might significantly reduce the total number of miles driven in New Zealand as compared with nations with lower prices. The first factor would improve New Zealand's rate of injuries per mile driven and the second would improve its per capita rate of injuries. Thus, comparisons of motor vehicle injury rates between New Zealand and nations that retain tort liability which indicate similar rates of accidents per mile driven or per capita may not accurately reflect an adverse effect on accidents produced by elimination of the tort action in New Zealand.

[326] Brown, *supra* note 3, at 978.

[327] *See* Brown, *supra* note 3, at 980; SECOND WOODHOUSE REPORT, *supra* note 30, para. 80.

[328] *See supra* text accompanying note 305.

[329] *See* SECOND WOODHOUSE REPORT, *supra* note 30, paras. 250-269.

hand there are other more effective safety motivations and strategies either in place or available for adoption. Some elaboration of both of these arguments seems warranted here.

a. Inadequacy of Incentives

As to the ability of variable levies—adjusted according to the accident costs of work-related accidents of employees in each class of industrial activity—to produce deterrence, the Law Commission argued, quite convincingly, that unless a particular employer enjoys a monopoly, its ability to lower the levy for its industrial class is very much in doubt; levies could only be decreased if the overall worker accident cost for all firms engaged in the same activity were lowered. Thus, the hope of reducing such levy by reducing a company's own accident costs is unrealistic.[330]

As the Commission itself noted,[331] however, variable levies by industry are different from bonuses and penalties on individual companies and from experience rating of individual companies. But these, too, the Commission found to be seriously flawed. The problems discussed included (a) difficulties of scale—most New Zealand companies employ 100 or fewer workers, while the minimum base of employees necessary for accurate merit rating is in the thousands; it is unfair to penalize some small firms and to give others bonuses based on safety records which are based on too few incidents to determine with accuracy the relative safety of such enterprises; (b) difficulties of time lag, whereby penalties or bonuses or new ratings may be imposed long after the situation which engendered them may have changed, for the better or worse; (c) difficulties of prediction, contributed to by the time lag, since employers will not be able to measure or predict the effects of their safety decisions on bonuses, penalties, or ratings; prediction will be particularly difficult and potentially unfair if accident costs, rather than frequency, are used as the base (as they now are in setting levies) since the costs of particular accidents may be fortuitous and since some accident costs, such as those dealt with only by the public hospital system, are not included in the base; (d) difficulties of under-reporting, as where employers discourage the reporting of accidents in order to avoid penalties or to keep their ratings low; and (e) difficulties in creating incentives where, as in past practice, the bonuses or penalties tend to be small.[332]

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[330] *Id.* paras. 137-138.

[331] *Id.* paras. 138, 140.

[332] *Id.* paras. 140-149. In reaching these judgments the Law Commission relied on a recent report of the Economic Council of Canada, Chelius & Smith, *The Impact of Experience Rating on Employer Behavior: The Case of Washington State*, in SEVENTH ANNUAL SEMINAR ON ECONOMIC ISSUES IN WORKERS' COMPENSATION (1987), sponsored by the National Council on Compensation

b. Other Safety Incentives

In view of these problems with bonuses, penalties, and experience rating, the Law Commission expressed a strong preference for imposing penalties "by reference to observed conditions[;]"[333] that is, by using inspectors who have the power to assess penalties, in the manner of the Occupational Safety and Health Act (OSHA)[334] in the United States. The Commission, however, did not make any specific recommendation as to whether the power should reside in the ACC since the government had yet to decide whether to create a separate "one Act - one Authority" occupational safety program like OSHA for New Zealand.[335]

What is particularly interesting is the Commission's views as to where, absence tort liability and the specific prevention strategies it rejected, it believes incentives for safety emerge under the amended regime it is recommending. In its report the Commission summarized its views in a section entitled "Safety incentives in general."[336]

First, the Commission asserted that the safety incentives of workers and employers will be increased by adding one week to the current one week delay after injury before Compo benefits become payable.[337] This incentive may well discourage false claims by workers who might otherwise be tempted to use Compo to finance a two-week hunting trip, or other vacation, by feigning an off-work injury and may also serve as an inducement to workers to exercise greater care off the job, since only earners who suffer on-the-job accidents must under the proposed amendments be paid earnings for their second week by their employers. With respect to work-related accidents to their own employees, therefore, the principal new incentive of having to bear an additional week of wages will be on employers, who will thus have an increased incentive to prevent worker accidents.

Second, the report refers to self-interest of individuals, in the varying contexts where they may suffer accidents, and especially of employers, who may "as a result of accident . . . lose the services of a skilled experienced employee"[338] or suffer other direct costs such as property damage, interruption of production,

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Insurance at the Wharton School, University of Pennsylvania, and on 1 REVIEW BY OFFICIALS COMMITTEE, *supra* note 85, at 56 (reporting that the safety incentive bonus program ceased "partly because of data deficiencies, partly because of the difficulty of determining better performance, and primarily because no link could be found between bonuses and improved prevention performance").

[333] SECOND WOODHOUSE REPORT, *supra* note 30, para. 148.

[334] The Occupational Safety and Health Act of 1970, 29 U.S.C. §§ 651-678 (1970).

[335] *See* SECOND WOODHOUSE REPORT, *supra* note 30, para. 148.

[336] *Id.* paras. 131-149.

[337] *Id.* para. 132.

[338] *Id.* para. 133.

loss of profits, or other consequential damage. At this point the report recognizes that for the employer many of these losses will be covered by loss insurance. Rather than asserting that the existence of the ability to spread a risk through insurance weakens deterrence, as is the position consistently taken with regard to liability insurance, the Commission states:

> (The total of fire and accident premiums in New Zealand is considerably in excess of Accident Compensation levies.) Accordingly, such incentives as an insurance policy may provide through experience rating, accident prevention (by increasing premiums if safety measures are not taken), no claims bonuses, and the like are already relevant to many accidents that may also cause personal injury.[339]

It is reasonable to ask why the Commission believes these financial incentives produced in the case of accidental injury to property should be any more effective than the Commission has asserted they are when applied to accidental injury to person.

Third, the Commission asserts that the prospects of accident costs to their business property or profits has led some businesses to adopt sophisticated safety programs which not only enhance safety but produce better relations with employees and improve production and generally lower costs.[340]

Fourth, there is a "growing acceptance of the need for methods for the promotion of workplace safety involving cooperation between all involved."[341] This has led to legislation which provides for the development of voluntary safety codes.[342] It is also "part of a world-wide movement towards greater worker participation in occupational health and safety."[343]

The fifth incentive merits direct quotation: "Unsafe methods of work or products which cause damage to property outside the work place *can be the subject of civil actions in the courts by those damaged.* Again[,] *insurance may have a role.*"[344]

Here, the inconsistency between the Law Commission's deprecatory view of the efficacy of the civil action for personal injury damage cum liability insurance as safety incentive and its positive view of the safety incentives engendered by law suits to recover for property damage seems inexplicable.

Sixth, there are incentives for safety for professionals and others in disciplinary processes which "will be significant in some situations."[345] In such situa-

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[339] *Id.*
[340] *Id.* para. 134.
[341] *Id.* para. 135.
[342] *Id.*
[343] *Id.*
[344] *Id.* para. 136 (emphasis added).
[345] *Id.*

tions, unlike those which give rise to law suits, there will be no insurance available to weaken the incentive to safety.[346]

Seventh, "much safety legislation imposes standards and rules which can be supervised and enforced through inspection, courts and commissions of inquiry, and prosecution in the criminal courts."[347]

Eighth, in some situations those who cause injuries to others may be prosecuted for a crime such as manslaughter in the criminal courts.[348]

D. The Effect of the Law Commission's Recommendations

Viewing the specific changes the Law Commission has recommended, it can be concluded:

First, that the Law Commission has, in practical effect, rejected any serious role in accident prevention for the ACC and the Compo scheme. Any deterrence that may be added by transferring responsibility for the second week of disability to the employer or, for non work-related accidents, to the employee, is minuscule, especially when compared with the externalization effects of (1) turning all medical expenses of accidents over to Social Security; (2) extensively disassociating the sources of funding and the accounts from which benefits are paid from any correlation with the costs of accidents; (3) adopting a flat-rate system for employer levies; (4) rejecting bonuses, penalties, and experience rating for employers and auto owners and rejecting any levies on drivers; and (5) generally recommending that levies be considered to be taxes and that government, rather than the ACC, be given the responsibility for raising them not only from existing sources but from motor vehicle fuel taxes and from general revenues, as well. Indeed, the Commission has suggested the placement of safety responsibility elsewhere (in a new Safety Minister and staff), has eschewed any desire to impose the costs of accidents on those persons and activities who cause them,[349] and has conveyed the view that Compo is, or should become, a pure social welfare program funded by general taxation.[350]

Second, that the Law Commission's recommendations with regard to benefits will significantly increase the overall costs of the scheme, notwithstanding the elimination of existing lump-sum payments for noneconomic losses, by extending very expensive periodic payments based on degree of disability and New Zealand's average weekly wage to non-earners who are not now entitled to such payments; by equalizing medical benefits for illness victims with those

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[346] *Id.*

[347] *Id.*

[348] *Id.*

[349] *Id.* paras. 256-257.

[350] *See, e.g., id.* para. 44.

provided under Compo for accident victims; by extending Compo to cover victims of occupational and other injury-causing events that occurred prior to 1974, the manifestations of which did not occur until after 1974; and, possibly, by also extending coverage to victims of congenital diseases. It is clear, however, that by removing the payment of health-related costs from ACC's responsibility and shifting it to Social Security, costs of the Compo scheme will, to that significant extent, *appear* to be reduced.

Third, that while costs will increase significantly, the political outcry that might otherwise ensue from levy payers under the current scheme will be muffled initially by adopting a single flat rate for employers[351] and ultimately by shifting most of the increased costs onto general taxation.

Thus, the expansion of Compo as envisioned by the Law Commission may from its perspective seem humane and consistent with its underlying principles.[352] Unfortunately, the problems not resolved and probably exacerbated by the report's recommendations include a worsening accident situation and the not unrelated cost creep. The latter, in view of New Zealand's difficult economic situation,[353] will probably make it impossible over the long run to adhere to the principle of real compensation and will surely prevent the achievement of comprehensive coverage of all disability.

It has been suggested that to criticize Compo because it does not provide comprehensive coverage for disability caused by illness as well as accident or to resist wider coverage, as recommended by the Law Commission, on the same grounds, is to make the best the enemy of the good.[354] The fact is, however, that when the larger economics of New Zealand are considered,[355] costs of the accident scheme as expanded according to the Law Commission's recommendations and as increased by uncontrolled accidents could become the enemy of Compo itself and not just of efforts to expand the protection of those with

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[351] However, those employers who previously paid less than the new flat rate may very well oppose the change. Indeed, the proposal for a flat-rate levy evidently drew significant opposition from employers in industrial activities which were paying less than the $2.50 rate earlier recommended by the Commission. *See id.* para. 253. Their opposition may be muted by the fact that no such levy payer would end up paying more than twice its prior levy. The changes that gave rise to the uproar in the first place, however, were as high as 500 percent.

[352] Indeed, the recommendations in some respects simply reassert ideas, such as flat rate levies and periodic payments for disabled non-earners, originally put forth in the Woodhouse Report but never implemented. *See* WOODHOUSE REPORT, *supra* note 10, paras. 441, 467-468.

[353] *See, e.g.*, Hayward & Sherwell, *Markets Descend into Gloom Following Douglas's Departure*, Financial Times, Dec. 15, 1988, at 6, col. 1; McGurn, *New Zealand's Painful Economic Cure*, Wall St. J., Oct. 11, 1988, at 22, col. 3; Richardson, *Economies: Freedom to Fail*, Far East Econ. Rev., Aug. 25, 1988, at 56, col. 1; Sullivan, *OECD suggests cuts in welfare*, Dominion (Wellington, N.Z.), June 2, 1987, at 1, col. 1.

[354] SECOND WOODHOUSE REPORT, *supra* note 30, para. 61.

[355] *See supra* note 353.

illness-based disability.[356]

It seems to follow that much greater attention needs to be given to cost—and accident—containment than has been given by the Law Commission. Indeed, purely humane considerations seem to require considerably more attention to deterrence of accidents than the "let George do it" approach of the Law Commission.

VI. TORT LIABILITY AS A BACK-UP FOR COMPO

Not only is general deterrence of accidents in New Zealand virtually non-existent, but specific deterrence—direct regulation of safety—is weak and ineffectual.[357] For example, there exists no comprehensive occupational safety and

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[356] As to the latter, it has been estimated that in Great Britain, for example, the incidence of incapacity by disease and other causes not attributable to accidents exceeds accident-produced incapacity by about ten times. *See* J. STAPLETON, *supra* note 3, at 5-6. It has also been estimated by the Officials Committee that extending the scheme to those seriously disabled other than by accident would add about 21,500 persons eligible for the invalids' benefit plus an unknown but potentially large number who are currently disqualified because of their spouse's income or who may be eligible for invalid benefits but have not applied. *See* 1 REVIEW BY OFFICIALS COMMITTEE, *supra* note 85, at 14. The Law Commission itself stated that Compo only covers "a small proportion of the disabled," and cites a recent estimate that the ACC is only concerned with about one quarter of 416,000 persons disabled for a month or more. SECOND WOODHOUSE REPORT, *supra* note 30, para. 153. The costs of extending ERC or, if they are not earners, periodic payments for permanent incapacity along with medical benefits approaching those now available to accident victims to these disabled persons would likely be monumental. It is understandable, therefore, why the Royal Commission on Social Policy, being concerned about overall welfare requirements in New Zealand, recommended extending the waiting period for Compo benefits to four weeks and replacing ERC after two years with a modest flat-rate payment. *See id.* para. 14.

[357] *See* T. ISON, *supra* note 3, at 159-77. *Cf.* SECOND WOODHOUSE REPORT, *supra* note 30, paras. 105-149; McBride, *Safer Cars Forced on Motor Industry*, NAT'L. BUS. REV., July 2, 1987, at 1 (proposal by transport undersecretary to require auto assemblers in New Zealand to comply with certain overseas regulations on design; "New Zealand is alone among western democracies in not having minimum standards." *Id*; *cf.* Dominion (Wellington, N.Z.), July 20, 1987, at 2, col. 5 (report that the Government is granting $100,000 to the Ministry of Consumer Affairs "to carry out its product safety work. . . . for staffing, standard setting and the investigation and testing of allegedly unsafe products. . . . [plus] $50,000 for the development and revision of standards").

The Fair Trading Act 1986 does permit actions for penalties against product manufacturers and sellers who sell products in violation of the Act. The maximum penalties, however, of $30,000 for individuals and $100,000 for corporations, *id.* § 40, fall far short of possible tort damages for injuries caused by defective products. These provisions were not adopted until 1986 notwithstanding the recommendation of Geoffrey Palmer, in 1975, to create a product safety commission to fill the gap in deterrence created by the externalization of accident costs which attended the adoption of the Accident Compensation Act of 1972. Palmer, *Dangerous Products and the Consumer in New Zealand*, 1975 N.Z.L.J. 366, 377-80.

health program under a single act[358] and disciplinary procedures for health professionals, which the Law Commission cites as an important safety incentive because actors are not insulated by insurance,[359] is weak and seldom used.[360]

Agencies which might afford effective specific deterrence, however, require significant investments of public funds and large cadres of skilled employees, inspectors, and administrative staffs and are rarely financially self-supporting—even though they may have authority to impose fines and penalties. Further, in order to reach the myriad sources of accident-causing behavior both within and beyond the occupational safety and health arena, such agencies would have to become both intrusive and coercive to a degree which is probably unacceptable to most New Zealanders. Therefore, the only system which has a chance of restoring effective deterrence and providing a significant new source of income to reduce the costs of Compo is the tort liability system *if tailored for use as a supplement to the accident compensation scheme*. In my submission of May, 1987 to the Law Commission, drawing on the outlines of a suggestion previously offered by Professor Jeffrey O'Connell in connection with proposals for no-fault in the United States,[361] I recommended such a plan. Although the Law Commission in its final report in effect rejected any return to what it believed to be the discredited tort system,[362] my proposal, as well as the joint response of Professors Brown, O'Connell, and Vennell to that proposal, remain relevant for the future both for New Zealand and for any other nation or state enticed to contemplate a comprehensive accident compensation scheme like Compo.

A. The Author's Proposal

Following are the essential features of my recommendation[363] for reintroduction of the tort action for personal injuries as a supplement to Compo:

1. The present accident compensation scheme, as it might be amended in

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[358] SECOND WOODHOUSE REPORT, *supra* note 30, para. 152.

[359] *See supra* text accompanying notes 340, 341.

[360] *See* Gellhorn, *supra* note 3, at 196-202.

[361] O'Connell, *Transferring Injured Victims' Tort Rights to No-Fault Insurers: New 'Sole Remedy' Approaches to Cure Liability Insurance Ills*, 1977 U. ILL. L.R. 749. *See also* Klar, *supra* note 3, at 89, 102.

[362] *See supra* text accompanying notes 315-18.

[363] These have been modified slightly from the author's original proposal in his submission to the Law Commission. Essentially, however, the proposal remains the same. *See* Submission to Law Commission, *supra* note 14. Much of the detail included in the submission, including examples of how the system would work in practice, *id.* at 11-15, and how certain problems, such as how to allocate the right to settle a claim between the victim and the ACC, *id.* at 14-15, are omitted here in order not unduly to extend the length of this article.

response to recommendations currently before the New Zealand government, would remain *the primary source* of compensation for accident victims.

2. The common law right to bring proceedings at law for damages for injury or death arising from an accident would be restored except in the case of actions by employees against their employers for work-connected accidents.[364]

3. Every person eligible to receive benefits from the ACC would be deemed to have assigned to the ACC any tort claim he or she might have against any third person for personal injury or death damages, *but only to the extent of the total value of the benefits he or she is entitled to receive both from the ACC and from other governmental sources*, plus certain legal costs.

Legislation giving effect to this assignment would be similar to the design of provisions found in some workers' compensation acts in which an employer is subrogated to the employee's tort claim against third parties to the extent of workers' compensation benefits paid by the employer or its insurer to the injured worker.[365] Preferably, the primary right to bring suit would be given to the ACC, with a right of the victim to intervene in the action. Regardless of who prosecuted the action, however, the ACC's assigned right would be primary and against the entire judgment; *the victim would receive nothing from the tort recovery until the ACC's right to full reimbursement was satisfied.*[366]

4. The existing right to prosecute actions for punitive damages in personal injury cases and *to retain the damages* would be transferred to the ACC.[367]

5. The right to receive lump sum payments for noneconomic loss *under the Act* would be abolished but could be replaced with periodic payments based on

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[364] Not reviving employees' common law rights against their employers for work-related injuries seems to be justified by the very special and continuing relationship between them and by the difficulties that are likely to arise in actions between them. However, either lump sum payments for noneconomic loss, *cf.* HAW. REV. STAT. § 386-12 (1985) (up to $15,000 allowed in cases of disfigurement), or, preferably, additional periodic payments to compensate for the non-earnings losses caused by disability, *see supra* text accompanying notes 270-74, would be allowed as a tradeoff—as the payment of noneconomic losses now is—for the relinquishment of workers' common law rights against their employers.

The right of action by employees against third parties would be revived, however, and the ACC would be assigned the employee's tort rights in that situation.

[365] *See, e.g.*, HAW. REV. STAT. § 386-8 (1985).

[366] As a condition of receiving Compo benefits, a beneficiary should be required to agree to cooperate with the ACC in the prosecution of its claim against the tortfeasor, much as an insured under a liability policy is required to cooperate with the insurer in defense of a claim adverse to the insured. However, the right to recover damages in addition to Compo benefits, after the ACC's rights are satisfied, might constitute a more effective incentive.

[367] Amounts received by the ACC by way of punitive damages would not be considered as reimbursement of ACC benefits paid or payable to the victim. Where the ACC fails to prosecute a claim for punitive damages within a certain period of time after the accident, however, the victim should be given that right and also be permitted to retain the proceeds in that event.

degree of disability for all claimants.[368]

6. If there is concern about problems allegedly created by the common law system of tort liability, such as affordability and availability of liability insurance, delay in payment, high transaction costs, excessively high judgments, overdeterrence, overburdening of the courts, unfair allocation of liability among joint and several tortfeasors, and the like, New Zealand is in an excellent position to adopt specific measures designed to eliminate or mitigate them.[369] These might include:

a. *Eliminate jury trials.* Under the New Zealand Judicature Act of 1908, jury trial in civil actions may lightly be dispensed with by the judge in certain cases;[370] it would not be a major step to do away with it entirely in cases of injury by accident.

b. *Adopt alternative modes of dispute resolution.* Mandatory arbitration, creation of special administrative tribunals, or creation of dispute resolution centers, as in Japan,[371] may be established either as substitutes or pre-conditions for

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[368] Workers have generally considered the lump sum payments for noneconomic loss as part of the tradeoff for giving up their common law right to recover for pain in suffering in favor of Compo. *See* G. PALMER, ACCIDENT COMPENSATION, *supra* note 3, at 223. Thus, any attempt to remove such payments without providing an equivalent, such as the periodic payments for percentage of loss of physical capacity, *in addition to ERC*, will predictably encounter stiff resistance from the labor movement.

[369] *See infra* note 413 and accompanying text.

In the author's view, the urgency of the need in New Zealand to restore the deterrence provided by reintroduction of the common law action, whether in a much-modified or limited form or not, seems to outweigh the harm that might be caused by the possibility that some or all of these concerns have not been and cannot be sufficiently validated.

[370] Judicature Act of 1908, § (5), as amended. The court may order that a civil action be tried without a jury where the court determines that the trial "or any issue therein will involve mainly the consideration of difficult questions of law", *id.* at (a), or that the trial or any issue may involve "prolonged examination of documents or accounts" or "difficult questions in relation to scientific, technical, business, or professional matters . . . being an examination or investigation which cannot conveniently be made by a jury." *Id.* at (b).

[371] *See* Miller, *Apples vs. Persimmons - Let's Stop Drawing Inappropriate Comparisons Between the Legal Professions in Japan and the United States*, 17 VICT. U. WELLINGTON L. REV. 201, 211-12 (1987).

An interesting experiment with mandatory non-binding arbitration of all personal injury actions where the amount claimed is less than $150,000 is underway in Hawaii. Of particular interest is the attempt, evidently successful, to limit discovery costs. *See* Barkai & Kassebaum, *The Impact of Discovery on Cost, Satisfaction, and Pace in Court-Annexed Arbitration*, 11 U. HAW. L. REV. ____ (1989).

Costs of public administration and the judiciary could be saved if the decision-making apparatus were made self-supporting. For example, the traffic accident dispute settlement centers in Japan are financed by the liability insurance companies. Another possibility is to have the ACC fund the costs of administrative tribunals from recoveries received pursuant to the assignment of victims' tort claims.

common law trials. These should be made self-supporting, thus avoiding increased costs of public administration and of the judiciary.

c. *Modify liability and damage rules.* Since the primary role of the liability system would be deterrence, and since Compo would remain the primary source of accident compensation, appellate courts deciding upon appropriate rules for a reinstated liability system might feel free to ignore or downgrade risk-spreading, admirably handled by Compo, as a policy reason for expanding liability.[372] Damages in cases where liability is not necessarily based upon fault, as in actions to impose strict liability for defective products, might be limited to economic losses suffered by the victim.[373] Damages in actions to recover only for negligent infliction of emotional distress or for loss of consortium might also be limited to economic losses occasioned by the distress.[374] Damages might be

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[372] *Compare* Escola v. Coca Cola Bottling Co., 24 Cal. 2d 453, 462, 150 P.2d 436, 440 (1944) (Traynor, J., concurring) (In this seminal opinion urging the adoption of strict liability for defective products, Justice Traynor said: "The cost of an injury and the loss of time or health may be an overwhelming misfortune to the person injured, and a needless one, for the risk of injury can be insured by the manufacturer and distributed among the public as a cost of doing business."). According to one thoughtful commentator, a significant cause of the crisis in insurance availability and affordability in the United States has been the use of tort liability for insurance—risk spreading—purposes. *See* Priest, *Understanding the Liability Crisis*, 37 PROC. ACAD. POL. SCI. 196 (1988); Priest, *The Current Insurance Crisis and Modern Tort Law*, 96 YALE L. J. 1521 (1987); Priest, *The Liability Crisis*, YALE L. REP. 2 (Fall 1987). *But see* Letter from Michael J. Sacks, *Letters to the Editor*, YALE L. REP. at 14 (Fall 1988).

[373] *Cf.* Traynor, *The Ways and Meanings of Defective Products and Strict Liability*, 32 TENN. L. REV. 363, 376 (1965). Traynor states that:

> Any system of enterprise liability or social insurance designed to replace existing tort law as the means for compensating injured parties should provide adequate but not undue compensation. . . . [O]nce adequate compensation for economic loss is assured, consideration might well be given to establishing curbs on such potentially inflationary damages as those for pain and suffering. Otherwise, the price of assured compensation could become prohibitive.

Id. (citation omitted).

While not directly apposite, Traynor's position would seem to support the argument that in actions based on strict liability, which is a form of "enterprise liability," where adequate non-fault compensation is available damages should be limited to economic losses.

Other more severe modifications might include eliminating strict liability altogether and, in actions for negligence, insisting on proof of subjective fault or blameworthiness before awarding noneconomic losses. *Cf.* U.S. ATTY. GEN'S TORT POLICY WORKING GROUP, REPORT OF THE TORT POLICY WORKING GROUP ON THE CAUSES, EXTENT AND POLICY IMPLICATIONS OF THE CURRENT CRISIS IN INSURANCE AVAILABILITY AND AFFORDABILITY 30-33, 61-62 (1986). For other possible modifications of the common law system, *see* REPORT OF THE ACTION COMMISSION TO IMPROVE THE TORT LIABILITY SYSTEM (1987).

[374] *See* Diamond, *Dillon v. Legg Revisited: Toward a Unified Theory of Compensating Bystanders and Relatives for Intangible Injuries*, 35 HASTINGS L.J. 477 (1984); Miller, *The Scope of Liability for Negligent Infliction of Emotional Distress: Making "The Punishment Fit the Crime,"* 1 U. HAW. L. REV. 1 (1979). *See also* Ingber, *Rethinking Intangible Injuries: A Focus on Remedy*, 73 CALIF. L.

discounted for doubt; that is, explicitly reduced by the degree or percentage of doubt entertained by the fact finder as to whether the victim has proved his or her case.[375] The rule of joint and several liability applicable to multiple tortfeasors might be modified in situations where particular classes of defendants are found, after carefully study, to suffer a disproportionate share of the liability to which their actionable acts or omissions contributed.[376] The rule should also be modified in cases in which the joint tortfeasor is immune from liability, as in the case of employers with regard to work-connected injuries to their workers.[377]

d. *Enlarge the defense of assumption of risk.* The defense of implied assumption of risk, which in many jurisdictions in the United States has been eliminated,[378] or has been swallowed up by the defense of comparative fault, could be reinstated. Recovery would be barred if it were proved that plaintiff was fully apprised of the risk and made a truly voluntary choice to encounter it *in order to receive a benefit provided by the defendant.*

7. Liability insurance. Because Compo eliminates only personal injury actions, many enterprises already purchase property damage liability insurance. If a tort

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REV. 772 (1985).

[375] This would resemble the manner in which under comparative fault damages are reduced by the degree or percentage of the claimant's contributory fault. This reduction, however, could be separately applied to the plaintiff's case and to the defendant's affirmative defenses. *Cf.* Nesson, *The Evidence or the Event? On Judicial Proof and the Acceptability of Verdicts*, 98 HARV. L. REV. 1357, 1382-90 (1985)(explained but not necessarily approved by the author). It would be similar to, but not the same as, cases which allow ill plaintiffs who suffer injury from negligent failure to diagnose their illness to recover for the value of the chance that if the diagnosis had been correct they would have recovered. *Cf.* McKellips v. Saint Francis Hosp., Inc. 741 P.2d 467 (Okla. 1987). *See generally* King, *Causation, Valuation, and Chance in Personal Injury Torts Involving Preexisting Conditions and Future Consequences*, 90 YALE L.J. 1353 (1981). As to similar issues in cases of man-made disease, see Rosenberg, *The Causal Connection in Mass Exposure Cases: A "Public Law" Vision of the Tort System*, 97 HARV. L. REV. 849 (1984).

[376] I am thinking particularly of public entities and public utilities, for example. They are often the "deep pocket" defendants in motor vehicle accident cases and, when found slightly at fault in comparison with the driver, all too often end up paying most of the damages because the driver has inadequate liability insurance and other assessable resources. In the individual case this may not be a problem since, in theory and in fact, the negligence of each defendant is a cause in fact or substantial factor in producing the loss and each should be responsible for the entire loss. When this situation occurs in case after case, however, the deep pocket defendant who is a popular target may end up paying a grossly disproportionate share of the losses.

[377] *See, e.g.*, Kamali v. Hawaiian Elec. Co., 54 Haw. 153, 158, 504 P.2d 861, 864 (1972) (noting that the majority rule allowing limited contribution by a third party defendant against an employer is based on "the proposition that it is unfair for one joint tortfeasor to bear the entire loss merely because the other joint tortfeasor is an employer"). *See generally* LARSEN, THE LAW OF WORKMEN'S COMPENSATION § 76.22, at 238 (1970).

[378] *See, e.g.*, Blackburn v. Dorta, 348 So. 2d 287 (Fla. Sup. Ct. 1977) (court abolished the doctrine of secondary implied assumption of risk).

supplement to Compo were adopted, these enterprises would need to expand their coverage to include liability for personal injuries. In addition, many other actors, such as individual homeowners, landlords of rental property, and health professionals, who may not now be purchasing any general property liability insurance other than for their motor vehicles, will have to reenter that market in order to protect themselves against such liability for personal injury. It will therefore become essential to keep premium rates reasonably low.[379] While the changes to the common law system suggested above might produce significant savings, close regulation of rates, investments, reserves, and other insurance practices in order to avoid wide cyclical swings experienced in the United States,[380] should be considered. On the other hand, the existence of a powerful State run insurance company, the State Insurance Office, which has acquired a significant part of the New Zealand general insurance market by virtue of its competitive premium rates and policy provisions,[381] may serve to keep the rates for all competing insurers reasonably low without having to resort to further regulation.

8. Experience rating. In order to enhance deterrence, determination of negligence or other fault in tort actions and determinations of wrongdoing in traffic accident cases should be required to be taken into account in determining liability insurance premiums.[382]

Possible criticisms. It will surely be argued that a return to tort recovery, even as a supplement, will violate the principle of "complete rehabilitation" since claimants with tort claims will have reasons to maintain their disability until the tort action is resolved. Indeed, it will be pointed out that the problem of "litigation anxiety neurosis" was one of the Royal Commission's stronger arguments for doing away with the personal injury action and adopting Compo in the first place.[383] It is doubtful, however, that a tort action could be a greater

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[379] In the Woodhouse Report, the plan was to use premiums formerly paid for workers' compensation by industry and the premiums paid by motor vehicle owners for liability insurance under compulsory third party insurance to help finance the accident compensation scheme. *See* WOODHOUSE REPORT, *supra* note 10, para. 312. With the tort system as a supplement, employers and motor vehicle owners paying levies will have to purchase bodily injury liability insurance, as well, in order to protect themselves against financial calamity.

[380] *See The Manufactured Crisis*, CONSUMER REP., Aug. 1986, at 544.

[381] *See* A. TARR, INSURANCE LAW IN NEW ZEALAND 34-36 (1985). Tarr notes that the State Insurance Office has about 20 percent of the total fire and general insurance market, *id.* at 34, and between 40-50 percent of the householders and motor vehicle insurance market, *id.* at 36. The State Insurance Office is governed by the State Insurance Act 1963.

[382] The Law Commission has evidently conceded that "such incentives as an insurance policy may provide through experience rating, accident prevention (by increasing premiums if safety measures are not taken), no claims bonuses, and the like " may constitute significant safety incentives. *See* SECOND WOODHOUSE REPORT, *supra* note 30, para. 133.

[383] WOODHOUSE REPORT, *supra* note 10, paras. 166, 118, 123-124.

incentive to maintain (and perhaps to falsify) disability than the prospects of an *irreducible* commitment to pay a permanently disabled victim up to 80 percent of his or her salary until retirement age.[384] But like determinations of permanent incapacity, tort determinations are also not re-examinable once a final judgment is entered or release signed. If streamlined modes of dispute resolution speed up the determination of fault, revival of the tort remedy would add little to the existing incentive to malinger and forestall rehabilitation.

Next, it may be argued that restoration of the complex machinery and issues of personal injury litigation would violate the principle of "administrative efficiency." In regard to Compo, however, claims and payment procedures need not be different from what they are today. Thus, with regard to the heart of the no-fault scheme, victims would experience no change in the promptness of payment as a result of the tort system. If enforcement of assigned tort rights were to be handled by an entirely separate, self-supporting division of the ACC, no administrative costs would be added to Compo.

While reinstitution of the tort remedy should not adversely affect the basic Compo scheme at all, it will be argued that the tort system would raise the cost of liability insurance to such levels that the combined costs of the two systems, operating in tandem, would impose an excessive burden on those compelled to contribute to levies and also to buy compulsory third-party insurance. There are several possible answers to this concern. First is the intent, mentioned above[385], to keep premiums reasonably low by close regulation or by virtue of the existence of a State-run insurance company. Second, tort judgments would be used to reduce Compo's costs and these reductions would be passed on to those paying levies.[386] Third, both a principal purpose and planned effect of the tort

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[384] *Cf.* G. PALMER, ACCIDENT COMPENSATION, *supra* note 3, at 230 ("Another important problem with the pattern adopted in New Zealand lies in the serious consequences upon rehabilitation. A person has an incentive not to go back to work in order to try and demonstrate that he has suffered a loss in his capacity to earn."). Under both the existing Act and the proposed Act, once a determination of permanent incapacity it made, the determination may not be altered. Accident Compensation Act, 1982, § 60(5); SECOND WOODHOUSE REPORT, *supra* note 30, § 51(93), at 131.

[385] *See supra* text accompanying notes 381-82.

[386] In some cases of severe and permanent disability the tortfeasor might agree to take over the ACC's responsibility to the victim entirely, by establishing an annuity or irrevocable trust. In additions, various arrangements between the ACC and liability insurers, as suggested by Professors Brown, O'Connell, and Vennell, wherein agreements to gain immunity from certain kinds of suits in exchange for substantial contributions each year to the ACC, might be also be tailored under this proposal. *See* J. O'Connell, C. Brown & M. Vennell, Reforming New Zealand's Reform: Accident Compensation Revisited 12-14 (Aug. 15, 1988) (unpublished manuscript) [hereinafter Reforming New Zealand's Reform]. Admittedly, such agreements might become more difficult to work out if victims retained their rights to sue for tort damages not compensated by Compo.

backup is to reduce the number and severity of accidents; this reduction will result directly in reduced levies or, to the extent that Compo costs are paid from general revenues, in reduced taxes. Fourth, there are currently many accident causers, including health care professionals, land owners and occupiers, motor vehicle drivers, building contractors, product manufacturers, retail sellers, public entities and their various sub-units, organizations conducting athletic activities, among many others, *who are contributing nothing except as general taxpayers to the disabilities and misfortunes they are causing to others beyond themselves and their own employees.* By spreading liability insurance premiums more equitably among all the groups who contribute to New Zealand's accident problem, the cost to each actor ought not to be excessive, except perhaps where a particular actor is appropriately surcharged for causing too many accidents. Further, it might be possible to achieve a reform sought by the Law Commission first by relieving all employers of levies to cover off-the-job worker accidents and then gradually moving to full funding of Compo, as with other social insurance programs, from general revenues,[387] or a combination of general revenues and user-pay fees. With that sort of change, employers would not view themselves as double-charged for Compo and for liability insurance. Finally, modifications of the tort system tailored to supplement a comprehensive compensation scheme, such as those mentioned above, could significantly limit the costs of litigation, the expenditure of attorneys' fees, and the percentage of the premium dollar expended for administrative expense.

Benefits. The principal benefits of a tort supplement to Compo would be, first, to rekindle the motivation to take concrete steps for the safety of others—whether through fear of a law suit, a desire to avoid an increase in liability insurance premiums, or through widespread reassimilation of the norms of tort law—which has fled the consciousness of New Zealanders under Compo and, second, to reduce the incidence of unsafe activities through general deterrence produced by directing accident costs toward the activities which caused them. That the tort system may not perfectly allocate costs or that it may be relatively inefficient in doing so is not a governing consideration when faced with a situation, like New Zealand's, where little more than the forlorn hope of universal altruism and enlightened self-interest is left to motivate decisions, even of product manufacturers in other nations as well as local actors, to avoid accidents.

Further, existence of a tort action may call attention to serious and festering dangers—as exemplified by recent controversies surrounding alleged failures in New Zealand to treat cervical cancer or to provide safe care at an orthopedic hospital—which in the absence of an incentive to sue may remain for long

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[387] *Cf.* SECOND WOODHOUSE REPORT, *supra* note 30, para. 228 ("[I]deally," supporting the scheme by general taxation, "is the right answer.").

periods of time unnoted.[388]

Moreover, the public sense of justice will be enhanced if intentional, reckless, and grossly negligent accident causers are compelled to compensate their victims. Although actions for punitive damages may still be available in some of these situations,[389] it may not be economically feasible in most cases to sue for punitive damages as they are currently limited by New Zealand law.[390]

In addition, those people such as: non-earners, housewives, young people, and visitors who under current law receive little or no compensation for loss of earning capacity; victims whose injuries cause greater pain and suffering, disfigurement, and loss of amenities of life than can be compensated with a $27,000 limit on noneconomic loss; and earners whose annual earnings exceed $63,458, the maximum amount on which ERC is paid, will be restored a remedy in the situation in which it is most fair to do so:[391] when the injury is produced by another's legally established fault.[392]

Another benefit of having the common law action assigned to the ACC is that if the ACC should create an enforcement arm composed of salaried lawyers, this will not only reduce the costs of litigation but could also serve to provide victims with legal representation for the portion of the cause of action not assigned to the ACC.[393]

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[388] *Cf.* J. STAPLETON, DISEASE AND THE COMPENSATION DEBATE 120 (1986). Dr. Stapleton recognizes that personal injury litigation may have a role in providing publicity, but argues that its role "based on the deterrent potential of publicity seems ultimately unconvincing." *Id.* at 120-21.

It is interesting to note that victims of the alleged failure to treat cervical cancer have now brought tort actions against the physicians involved but are awaiting a ruling by the ACC, which has the exclusive jurisdiction to determine coverage, Accident Compensation Act, 1982, § 27(3), as to whether they may proceed with their actions or must accept Compo benefits. Letter from John Miller to Richard S. Miller (Nov. 25, 1986). It is not clear whether publicity about the problem would have surfaced earlier if there had been a clear right to bring an action for medical malpractice.

[389] *See supra* text accompanying note 205.

[390] *Id*; *cf.* Love, *Actions for Nonphysical Harm: The Relationship Between the Tort System and No-Fault Compensation (With an Emphasis on Workers' Compensation*, 73 CALIF. L. REV. 857 (1985) (urging cumulative remedies for non-physical harm to augment no-fault compensation).

[391] *See* Klar, *New Zealand's Accident Compensation Scheme: A Tort Lawyer's Perspective*, 33 U. TORONTO L.J. 80, 88 (1983).

[392] It should be noted, however, that should the current proposals by the Law Commission for periodic payments for loss of capacity, *see supra* text accompanying notes 275-84, be adopted and be made available to earners as well as non-earners, then many of these serious inequities will probably be reduced or eliminated.

[393] New Zealand courts do not ordinarily permit contingent fee arrangements. Accident victims could thus ride the coattails of the ACC in situations where they could not otherwise afford to hire a lawyer to represent them in the action.

There are obviously problems which will arise if the cause of action is split between the victim and the ACC. These include problems of settlement, problems of control of the litigation, and

Finally, a most important benefit will be to provide a significant source of funds to reduce the costs of Compo. These funds would come from successful enforcement of tort rights and consequent recapture of funds paid out and to be paid out by the ACC. They would likely amount to millions of dollars, quite possibly hundreds of millions of dollars, each year and thus could be Compo's salvation.

Reintroducing tort liability as a supplement is by no means a retrograde step if it is seen as a necessary device to improve accident prevention and to preserve and perhaps to extend an effective and compassionate compensation scheme of which New Zealand can be very proud.

B. A Response

While my recommendation to the Law Commission, as just described, was not accepted, it evoked a somewhat more positive response from Professor Jeffrey O'Connell and from Professor Craig Brown and Ms. Margaret Vennell, both New Zealanders.[394]

First, these commentators expressed serious reservations about allowing tort actions for the full measure of damages along with a right to compensation, asserting concern that the assignment—the same as granting a right of subrogation to a social agency—"raises prospects of waste and duplication of very large proportion . . . ."[395] They next express a preference for a no-fault system which replaces tort liability, since they believe that granting no-fault benefits to victims who then retain the right to sue third persons for damages, as in the case of workers' compensation in the United States, subsidizes the tort action and leads to increases both in payouts—since the victim has little incentive to accept an early and relatively modest settlement—and in the number of third party actions.[396] They inveigh against such "double dipping" and complain that my proposal does not set a threshold below which Compo recipients cannot

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attendant conflicts of interest. *See* Submission to Law Commission, *supra* note 14, at 14-15. These may raise issues and call for solutions similar to those which may arise between workers and their employers in third party actions brought to recover damages also compensated by workers' compensation benefits and in actions brought to recover for personal injury and property damage where an insurer has paid to the insured the value of some or all of the damaged property.

[394] Reforming New Zealand's Reform, *supra* note 386. Professor Brown currently teaches at the University of Western Ontario; Margaret Vennell is a Senior Lecturer in Law at the University of Auckland.

[395] *Id.* at 6 (citing Blum & Kalven, *Public Law Perspectives on a Private Law Problem*, 31 U. CHI. L. REV. 641 (1964)).

[396] *Id.* at 7.

bring their tort claim.[397] They express fear that even without a contingency fee system in New Zealand my proposal might lead to a meteoric growth of tort claims in New Zealand, just as they have grown in other parts of the Western world, such as Canada, which do not permit the contingent fee.[398] Further, they even express doubt about the wisdom of providing the ACC with a right of subrogation while denying any separate right to pursue a claim to the victim who receives Compo benefits.[399]

It is suggested, however, that the problems predicted are not likely to be as serious as the commentators suggest where Compo benefits are substantial in relation to a victim's earnings and cover most of the victim's medical expenses, since under my proposal the victim could only sue for those damages *not* compensated for by Compo; the right to sue for compensated benefits would be exclusively the ACC's. Further, since the ACC's right to reimbursement from the tortfeasor is primary, in cases where liability is questionable or the tortfeasor has insufficient assets or insurance fully to satisfy a judgment, most or all of a negotiated settlement or of the amount received on execution of the judgment would go to the ACC and the victim would have to be satisfied with Compo benefits. To put it another way, one of the great advantages of Compo is that it tends to be very generous, at least to earners; the motivation to pursue an action to recover the difference between common law damages and the value of Compo benefits might not be nearly as great as it is under workers' compensation or automobile no-fault, where compensation is far less generous than Compo.

Where Compo is inadequate, however, as it is today with regard to non-earners, or where the potential tort award for noneconomic loss caused by the accident is great in relation to the payment expected from the ACC,[400] there is every reason to allow the victims to pursue their common law claim, and they will arguably have a strong incentive to do so. While a victim might indeed receive compensation both from Compo and from the tortfeasor, there will be no double-dipping in the sense of duplication or overlap of benefits.[401]

The purpose of implementing a supplemental tort system, after all, is to restore the deterrence provided by the common law system. Keeping recoveries and actions within limits may be achieved, if necessary, by adopting some of the modifications of the system suggested above.

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[397] *Id.* at 7-8.

[398] *Id.* at 8-9.

[399] *Id.* at 9-10.

[400] Either a lump sum under the current scheme or periodic payments based on percentage of disability under the proposed scheme.

[401] Indeed, to the extent the victim has received benefits from her employer to cover the losses of earnings or other expenses not compensated by Compo, she may have to reimburse her employer if she is successful in her tort claim.

In any event, having expressed their criticisms of my proposal, the commentators then proceed to suggest an ingenious twist which, in effect, restores the tort action in its full glory *unless the tortfeasor agrees within ninety days after the accident to reimburse the ACC for the cost of Compo benefits.*[402] Initially, the ACC would be subrogated to the common law rights of the victim to the extent of the value of benefits paid and to be paid by the ACC to the accident victim. If the alleged tortfeasor refused to reimburse the ACC for those benefits, however, both the ACC *and the victim* would be permitted to pursue their tort claims.[403]

Essentially, the principal difference between our proposals is that under the commentators' the tortfeasor can bar an action by both the victim and the ACC by paying the ACC the cost of its commitment to pay Compo benefits (or presumably by settling with the ACC) within ninety days of the accident. Under my proposal the victim could chose to pursue her action for damages in excess of her ACC benefits even if the tortfeasor settled with the ACC. Thus, the commentators' proposal creates a powerful incentive for a tortfeasor to settle with ACC which, admittedly, mine does not. In addition to enhancing fairness[404] and increasing deterrence by allowing the victim to sue for unreimbursed losses, however, I believe that restoring a right in the victim to sue for noneconomic as well as other uncompensated losses, would likely be a necessary condition to labor's giving up its right to lump sums for noneconomic loss under Compo.[405] If, however, the Law Commission's current recommendations for adding periodic payments for incapacity is provided for non-earners and visitors *and added to ERC for earners*, then there should be less objection to removing the victim's right to sue if the ACC settled its claim with the tortfeasor.

One further wrinkle, suggested by the commentators, is to allow victims to reject ACC benefits and instead to bring the common law tort action.[406] Under

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[402] This proposal is adapted, in turn, from one made by Professor O'Connell for adoption in the United States in cases of injuries by products, health care, and other activities. Reforming New Zealand's Reform, *supra* note 386, at 10 (citing O'Connell, *Balanced Proposals for Product Liability Reform*, 48 OHIO ST. L.J. 317, 328 (1987)).

[403] *Id.* at 11.

[404] *See* Klar, *supra* note 3, at 88 (asserting that the elimination of the common law action has resulted in "grave injustice" for some victims, such as those injured by intentional or reckless conduct).

[405] *See* G. PALMER, ACCIDENT COMPENSATION, *supra* note 3, at 228 ("[S]ection 120 has been the biggest source of contention under the Act during the first four years. It has provided the Commission with perhaps its most serious administrative headache. Now that lump sums are in the legislation it will not be easy to displace them. Their existence makes extension of the scheme to sickness problematic.")

[406] Reforming New Zealand's Reform, *supra* note 386, at 11 n.27. Variations to the tort action were also suggested, such as only allowing recovery where the claimant proves defendant guilty of "gross or wanton conduct," requiring a heightened burden of proof, and making plain-

the current Act this right seems justified because of the woefully inadequate benefits provided to non-earners and visitors, who are effectively deprived of their rights to reasonable compensation for their tort-based injuries by virtue of the level of benefits provided. If the Law Commission's new recommendations are accepted, however, the level of compensation for this group should improve considerably and the reason to provide such election should correspondingly diminish.

Finally, while the commentators agree with my proposal that tort actions by workers against their employers should not be reinstated, they go further than I by expressing a preference not to reinstitute tort actions for automobile accidents.[407] They suggest that requiring motor vehicle owners to pay liability insurance premiums in addition to Compo levies would be politically unacceptable[408] and they suggest that adequate deterrence might be achieved by "more individualized experience rating based on cooperation with the Ministry of Transport in shared data about the risk creating experience of individual motorists . . . ."[409] Unfortunately, as a result of life-time licensing,[410] levies which might be adjusted to reflect driving infractions cannot practically be imposed on drivers. Furthermore, motor vehicle owner levies are at a flat rate and also do not take account of the record of drivers of the automobile. In the face of these barriers to experience rating, I continue to believe that reinstitution of the tort action as a supplement to Compo is necessary to help deterrence to work in the increasingly dangerous driving context.

While the differences in our proposals discussed above do not seem to be very great and are certainly not insurmountable, what emerges from the debate, at bottom, is that I and the commentators, who include so thoughtful and dedicated a critic of the tort system as Jeffrey O'Connell, have joined in suggesting a modified reinstitution of that system in order to avoid the tragic consequences of virtually total externalization of accident costs produced by the advent of Compo and the failure to develop an adequate system of specific deterrence to replace the tort action.

VII. Extrapolating the New Zealand Experience to Other Nations

Because of its governmental structure as well as other conditions unique to the nation, its history, and politics, New Zealand's leaders found it relatively easy, in the early seventies, to adopt and implement a radical no-fault accident

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tiff and his lawyer jointly liable for defendant's attorney's fees. *Id.*

[407] *Id.* at 14-15.

[408] *Id.* at 14.

[409] *Id.* at 14-15.

[410] *See* Second Woodhouse Report, *supra* note 30, para. 239.

compensation scheme and to abolish the personal injury action.[411] New Zealand is a young democracy, a member of the British Commonwealth. Its parliamentary system, originally modeled on England's, however, has been modified by eliminating the upper house. There is no Bill of Rights or other external written constitutional document which might inhibit development of a radically new scheme of dealing with accident costs. Thus, there exists a unicameral legislature, the English tradition of party loyalty, and a powerful Prime Minister elected by the members of Parliament of the party in power.[412] This system evidently produces something close to "unbridled power,"[413] enabling that party to enact its desired programs quickly with little or no modification. If there are significant checks and balances in the process of legislation, they must come from within the party. Yet there is recent evidence that the system enabled the ministers in power, members of the Labour Party,[414] to inaugurate conservative economic reforms such as "corporatization" of the government-owned post office and post office bank and government-owned property, closing the coal mines, and selling off of publicly-owned industries and businesses, including the Bank of New Zealand and Air New Zealand.[415]

The significance of such freewheeling power for the present inquiry is that the New Zealand government has the apparent ability, almost at will, both to legislate new safety systems to replace deterrence lost by doing away with tort actions and to tinker with Compo in order to achieve greater efficiency and to reduce abuses. In few Western nations is there likely to be a greater ability to establish and then to adjust the accident compensation and prevention systems

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[411] *See generally* G. PALMER, ACCIDENT COMPENSATION, *supra* note 3, 63-130. Even so, it took almost four years to get the Bill passed. *Id.* at 143.

[412] *Id.* at 63.

[413] *See* G. PALMER, UNBRIDLED POWER 139 (2d ed. 1987) ("[I]n no United States legislature, and there are fifty-one of them, is it so easy to pass statutes as in New Zealand."); *Id.* at 219-20.

> We lack the checks on those powers which are found in other countries—we have no written Constitution and no upper house. Instead, Parliament's law-making powers are exercised by a single House and by the Governor-General. The Executive almost invariably controls the House and the Governor-General is obliged by convention—except in the most extraordinary circumstances—to assent to Bills presented to him by the Executive. Thus, the Executive, through Parliament, has very wide powers to take away our most precious rights and freedoms.

Id.

[414] It is the Labour Party which has required ships entering New Zealand harbors to declare whether they are carrying nuclear materials.

[415] The program, known popularly as "Rogernomics" after the Finance Minister, Roger Douglas, was based largely on the same economic theories as "Thatchernomics" in Great Britain and "Reaganomics" in the United States. Recently, as the drastic and painful reforms seemed not to be producing the hoped-for economic improvement, Minister Douglas was dismissed from the Cabinet by Prime Minister Lange. *See* Hayward & Sherwell, *Markets Descend into Gloom Following Douglas's Departure*, Fin. Times, Dec. 15, 1988, at 6.

in order to make them both work efficiently. If, then, New Zealand's Compo system has increased the cost of accidents to unacceptable levels—as I believe this paper demonstrates—and if the government has proved itself incapable or unwilling to adopt effective accident prevention mechanisms to substitute for the deterrence of the tort system—even though prevention has been explicitly assigned the very highest priority over rehabilitation and compensation—a pall is cast over the prospect that a more unruly democracy, such as the United States or any of its states, can ever *substitute* a reasonably generous no-fault accident compensation plan plus an effective accident prevention scheme for the current tort system along the lines being suggested by radical reformers in the United States.[416]

IX. For The Future

Viewed from the broadest perspective, in developed Western societies the problems of accident prevention and compensation are inextricably bound up with the larger problems of public health, poverty, and justice. A limitless variety of governmental and private instrumentalities and schemes, ranging from private charity at one extreme to the criminal justice system at the other, have evolved to deal with one or more facets of these interrelated problems. Usually, they operate interdependently, so that no one scheme can ever be identified as dealing only with a particular problem to the exclusion of all others. Often, since resources are limited, strong support for one scheme may undermine the effectiveness of others; each separate strategy is to that extent the enemy of other strategies. On the other hand, the combination of the various systems is synergistic; their combined effect is arguably greater than the sum of their individual effects. In the developed common law nations the law of negligence and, more recently, the law of products liability, have been among the more prominent instrumentalities in the mix of those that purport to deal with prevention and compensation. When New Zealand chose to scrap tort liability for personal

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[416] *See, e.g.*, Sugarman, *supra* note 9. Of course, the ability of New Zealand, a nation of slightly more than 3,000,000 people, to adopt effective prevention mechanisms is significantly influenced by limitations on its resources; by contrast, the United States already has many powerful safety and illness prevention strategies in place both at the federal and state level. Nevertheless, the New Zealand experience casts doubt on the prospects in the United States both for adopting no-fault compensation plans as substitutes for the tort system and adding the additional expensive strategies necessary to achieve effective prevention. The problem would be particularly difficult if some states desired to adopt a Compo-like program but others did not, thus weakening the possibility of uniform federal support.

In any event, building a no-fault system that concentrates on accident victims to the exclusion of equally deserving victims of man-made disease and illness may be a mistake. *See* J. Stapleton, *supra* note 3.

injuries in favor of a system of pure compensation, without at the same time inventing and imposing other injury prevention systems of equal efficacy, it may have weakened the synergy and thus unleashed an unacceptably large increase in accidents and their costs on the society. That is what the evidence presented in this paper suggests.

Thus, Compo has evidently had the effect, gradually as its workings have become more clearly understood since its inauguration in 1974, of removing for everyone the inhibiting knowledge or understanding, as imperfect as it may have been at the time in New Zealand,[417] that, to put it in lay terms, *my carelessness which threatens injury to others is likely to have unpleasant financial consequences for me and, even if it doesn't, it is against the law and not engaged in by good citizens.* Arguably, the long term existence of tort liability and the concomitant need to protect one's self by purchasing liability insurance builds a perspective for safety into each individual's subconscious mind without much regard to how effectively the system functions in fact to impose the costs of carelessness on the careless.

If that is correct then the map for the future of Compo drawn by the Law Commission in its most recent report—expanding the benefits while further externalizing the costs—seems to urge movement very much in the wrong direction. Instead, the greater need is to reintroduce the inhibiting influence of the tort system, as I and others have recommended. Indeed, reintroduction of that system could significantly reduce the costs of Compo, both by reducing accident costs and by removing costs of fault-caused accidents from the ACC, thus helping to finance greater coverage for Compo in the future.

For nations, such as the United States, which have tort liability systems in place, the message of New Zealand's experience has a negative and a positive aspect: First, it is naive to believe that it will be possible both to eliminate the tort system in favor of a compensation scheme and to re-create an adequate level of prevention by adopting effective administrative arrangements. Second, it may be possible at reasonable per capita cost to develop, through private insurers, or even through government,[418] a scheme of accident compensation which

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[417] For example, that compulsory liability insurance premiums for motor vehicles in 1970 were only $7.90 per year, *see* G. PALMER, ACCIDENT COMPENSATION, *supra* note 3, at 83, suggests that risk of being held liable for substantial sums because of driver negligence must have been very low.

[418] The costs of administering Compo, a government plan, have been very low: "For each dollar spent the following proportions were paid to or on the direct behalf of injured persons:

1983/84	89%
1984/85	90%
1985/86	91%
1986/87	93%

ACCIDENT COMPENSATION CORPORATION, REPORT OF THE ACCIDENT COMPENSATION CORPORATION FOR THE YEAR ENDED 31 MARCH 1987, 11 (1987).

covers, at least, a substantial part of lost earnings and other economic losses for persons suffering injury by accident, and to finance a part of the scheme by assigning tort rights of victims to the private or public provider. Adoption of such a scheme would solve the compensation problems often improperly attributed to the tort system. Agreements between the provider and the covered individual, whereby, (unless the victim rejected no-fault compensation,) the accident causer would be released from tort liability if the latter agreed, within a certain period after the accident, to reimburse the provider for value of the benefits it is required to pay to the victim, along the lines urged by O'Connell, Brown, and Vennell, would further reduce the costs of maintaining the deterrent aspects of the tort system.

Perhaps it is time, in one or more of the laboratories we call states, to give such a plan a try.

Because of its low cost and because it was feared that turning the administration of Compo over to private insurers could increase total annual costs by 32 to 69 percent (an estimate extrapolated from prior costs of workers' compensation insurance and third party automobile insurance), ACCIDENT COMPENSATION CORPORATION, PRELIMINARY PAPER NO. 2, THE ACCIDENT COMPENSATION SCHEME, A DISCUSSION PAPER 26, para. 126 (1987), the Law Commission did not recommend turning Compo over to private insurers. *See* SECOND WOODHOUSE REPORT, *supra* note 30, paras. 46, 47.

The Law Commission, however, did not consider the extent to which the low costs of administration under Compo were due to failures to prevent abuses of the system such as fraudulent claims or claims for illness parading as accidents. Private insurers would arguably have a strong motive to prevent such abuses. Furthermore, it was not appropriate to draw comparisons between the ACC and private insurers administering systems in which liability was based upon fault or upon the need to find a connection between the injury and the claimant's work.

The Impact of Discovery Limitations on Cost, Satisfaction, and Pace in Court-Annexed Arbitration*

by John Barkai** and Gene Kassebaum***

I. INTRODUCTION

During the past few years, virtually all state and federal jurisdictions have considered various alternative dispute resolution methods to treat major problems with their court systems.[1] Concern over the delay and high costs in the courts has led to the development of many procedural rule changes[2] and

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[1] *See generally* THE CENTER FOR PUBLIC RESOURCES LEGAL PROGRAM, ADR AND THE COURTS (1987) [hereinafter ADR]. In 1985, under the direction of Hawaii's Chief Justice Herman T.F. Lum, the Hawaii Judiciary, with partial support monies from the National Institute for Dispute Resolution, established a Program on Alternative Dispute Resolution. Peter S. Adler, formerly executive director of the Neighborhood Justice Center of Honolulu, was appointed as the Program's director. The Program has three general objectives: (1) to gather and disseminate up-to-date information on alternative dispute resolution methods; (2) to explore, test and evaluate new uses for mediation and arbitration; and (3) to help institutionalize these uses both in the courts and in the community-at-large. THE JUDICIARY, STATE OF HAWAII, 1984-1985 ANNUAL REPORT (1985).

[2] In 1983 the Federal Rules of Civil Procedure were amended to explicitly allow the judge to facilitate settlement discussions at the pretrial conference. FED. R. CIV. P. 16(A)(5). For an exam-

innovative programs.[3]

Court-annexed arbitration is one of the most popular innovations.[4] Although the arbitration programs vary considerably in their form, they typically provide for mandatory, yet non-binding arbitration on cases that seek only money damages.[5] The right to jury trial is preserved because either party may appeal the arbitration award to a trial de novo, but in some programs, sanctions may be imposed if the trial verdict does not improve on the arbitration award.

Court-annexed arbitration programs generally have been designed to ease court congestion and reduce delay.[6] These programs, however, also offer the possibility of cost savings in the private litigation costs of plaintiffs and defendants, and in the public costs of operating the courts.

Whether court-annexed arbitration indeed does reduce delay and cost must be the subject of careful evaluation. The potential for improvements appears promising, but actual results will depend upon the arbitration procedures and the behavior of lawyers. For example, arbitration could save time and increase the pace of case processing either because the lawyers negotiate a settlement prior to the arbitration or because the arbitration hearing occurs earlier in the life of a case than a trial would occur. Time savings will not be realized, however, if parties do not reach an early settlement because they prefer to wait for an arbitration award rather than negotiate an earlier settlement or if a significant number of awards are appealed to a trial de novo after the arbitration hearing.

Because arbitration programs can reduce the amount of time that judges must spend on pretrial hearings, and the trial itself, the courts may save a considerable amount of judge and staff time, thereby reducing public costs.[7] The impact on private litigation costs of the parties, however, is less clear. Pri-

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ple of a state rule specifically concerning settlement conferences, see HAW. CIR. CT. R. 12.1.

[3] *See* Planet, *Reducing Case Delay and the Costs of Civil Litigation: The Kentucky Economical Litigation Project*, 37 RUTGERS L. REV. 279 (1985); Lambros, *The Summary Jury Trial -An Alternative Method of Resolving Disputes*, 69 JUDICATURE 286 (1986); Levine, *Early Neutral Evaluation: A Follow-Up Report*, 70 JUDICATURE 236 (1987).

[4] *See* P. EBENER & D. BETANCOURT, COURT-ANNEXED ARBITRATION: THE NATIONAL PICTURE (Rand Institute for Civil Justice 1985); NATIONAL CENTER OF STATE COURTS AND THE CONFERENCE OF STATE COURT ADMINISTRATORS, 1987 SURVEY OF STATE COURT ADMINISTRATORS (July 17, 1987) [hereinafter NATIONAL CENTER].

[5] Levin, *Court-Annexed Arbitration*, 16 J. LAW REFORM 537, 537 (1983).

[6] E. ROLPH, INTRODUCING COURT-ANNEXED ARBITRATION: A POLICYMAKER'S GUIDE 6 (Rand Institute for Civil Justice 1984). This volume also presents an excellent overview of the considerations involved in designing an arbitration program. *See also* Hensler, *Court-Annexed Arbitration*, in ADR, *supra* note 1, at 34-37.

[7] For a discussion on calculating public cost savings, see E. ROLPH, *supra* note 6, at 33. For a discussion about the public financing of private litigation, see Alschuler, *Mediation with A Mugger: The Shortage of Adjudicative Services and the Need for a Two-Tier System in Civil Cases*, 99 HARV. L. REV. 1808, 1811-17 (1986).

vate cost savings would appear to correlate with the length of time a case remains open and to be inextricably linked to the amount of pretrial discovery.[8] Recent research, however, indicates that case processing time is not correlated with costs.[9] Therefore, if arbitration does not also reduce discovery and the amount of lawyer time, litigants are unlikely to save much in costs.[10] In fact, costs will increase for those cases that are appealed after the arbitration award, since such cases will then incur the normal costs of litigation. However, the increased costs for the few cases that actually go to trial might be more than offset by the reduction in costs for cases that terminate in arbitration. Because the discovery question is so difficult, most programs do not attempt to limit discovery,[11] but at most restrict the time for,[12] but not the activity of, discovery.[13]

Since February 15, 1986, Hawaii has been experimenting with a court-annexed arbitration program for some types of civil cases. Hawaii's Court-Annexed Arbitration Program (CAAP) is limited to tort cases,[14] but has several unique features that should be of interest to people across the country who are concerned with court management and alternative dispute resolution.

A. Reasons for National Interest in the Hawaii Program

The reasons for national interest in the Hawaii CAAP are found both in the central characteristics of the program and in the priority of program goals. The

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[8] *See* Hensler, *supra* note 6, at 39.

[9] Trubek, Sarat, Felstiner, Kritzer & Grossman, *The Costs of Ordinary Litigation*, 31 UCLA L. REV. 72, 104 (1983) [hereinafter *Costs of Litigation*].

[10] *See id.*

[11] Alschuler, *supra* note 7, at 1845.

Only three states, Pennsylvania, Arizona, and Hawaii, appear to have arbitration programs that limit discovery. The Pennsylvania program is for small cases. In Pittsburgh, no discovery is allowed in cases valued at less than $3,000. Developments, *Compulsory Automobile Arbitration: New Jersey's Road to Reducing Court Congestion, Delay, and Costs*, 37 RUTGERS L. REV. 401, 415 (1985). *See* ARIZ. UNIF. ARB. R. 3 ("The arbitrator . . . shall limit discovery whenever appropriate to insure that the purpose of compulsory arbitration is complied with.")

In the Hawaii program, discovery reduction is the key feature of the arbitration program. "Once a case is submitted or ordered to the program, the extent to which discovery is allowed, if at all, is at the sole discretion of the arbitrator." HAW. ARB. R. 14.

[12] Snow & Abramson, *Alternative to Litigation: Court-Annexed Arbitration*, 20 CAL. W.L. REV. 43, 58 (1983).

[13] Some states are beginning to restrict discovery in regular litigation. Planet, *supra* note 3, at 279.

[14] In Hawaii, tort cases account for approximately twenty-five percent of all Circuit Court cases, which are courts of general jurisdiction. For fiscal year 1986-87, of 5987 civil filings, 1,785, or 29.8 percent were personal injury cases. THE JUDICIARY, STATE OF HAWAII, 1986-1987 ANNUAL REPORT, STATISTICAL SUPPLEMENT, table 7 (1987).

program has the highest dollar ceiling ($150,000) of any mandatory state arbitration program in the country and is the only state-wide program, it urges the arbitrator to limit discovery as a way of reducing litigant costs, it intervenes earlier in the case than other programs, and it uses volunteer arbitrators. Other important features include a "gatekeeping" procedure that presumes all cases are eligible for arbitration, a procedure that allows attorneys to seek exemption from the program when they think their case exceeds the $150,000 ceiling, a required pre-hearing conference thirty days after an arbitrator has been assigned, and an option for litigants to select and pay for their own arbitrator.

The Hawaii CAAP differs from similar programs in other states because its primary purpose is to decrease litigant costs by reducing discovery activity. The program accomplishes this goal by prohibiting any discovery unless the arbitrator first authorizes the discovery. Most other arbitration programs would list their goals in the following order: (1) reduction of delay, (2) decrease in cost to litigants and (3) maintenance or improvement of litigant satisfaction. The Hawaii CAAP, however, has significantly reordered these priorities. The CAAP has made the decrease in costs to litigants the highest priority and therefore expects arbitrators to limit discovery in order to achieve the cost reduction goal.

This article first reviews court-annexed arbitration programs across the country. It then discusses pretrial delay and the high cost of litigation, which are the two most worrisome problems in the United States' judicial system. The article's discussion of delay and cost emphasizes how pretrial discovery and lawyers' fees contribute to these problems. The article then describes the Hawaii CAAP in detail with emphasis on the method used to limit pretrial discovery to reduce litigant costs.

The article then presents and interprets data taken from court records and lawyer surveys. Further evaluation shows that the Hawaii CAAP reduces litigation costs, that it may affect the incomes of lawyers, that it changes the level of lawyer satisfaction, and that defense lawyers see fewer benefits in the program than do plaintiff's lawyers.

II. COURT-ANNEXED ARBITRATION ACROSS THE NATION

Because of the rapid spread of arbitration programs nationally, it is difficult to say exactly how many jurisdictions currently use court-annexed arbitration programs. It is clear, however, that these programs have become very popular. Programs are currently operating in at least twenty-two states,[15] the District of

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[15] CONFERENCE OF STATE COURT ADMINISTRATORS ALTERNATIVE DISPUTE RESOLUTION SURVEY: SURVEY OVERVIEW 6 (July 17, 1987); 1 Alternative Dispute Resolution Rep. (BNA) No. 16, at 313 (Nov. 26, 1987) [hereinafter SURVEY OVERVIEW].

Columbia, and at least eleven United States Federal District Courts.[16] In three other states, arbitration programs are authorized but not yet operational.[17]

It is also difficult to give precise national statistics about arbitration program characteristics because the programs are often described as experimental and frequently undergo significant changes.[18] In addition, jurisdictional thresholds may change[19] or the programs may operate only in certain counties of the states that have adopted court-annexed arbitration.[20] Typically, the programs are limited to certain types of civil cases where the plaintiff seeks only money damages.[21] Personal injury, contract, and debt cases are the typical cases that are arbitrated in these programs.[22] Most of the programs are mandatory;[23] any case within the jurisdictional limit must go into arbitration. All programs, however, are non-binding.[24] Either party who is dissatisfied with the arbitration award can appeal and go on to a trial de novo. Many programs apply costs or sanctions to the appeal in an attempt to reduce the number of appeals.

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[16] As of January 1985 11 federal district courts had authorized court-annexed arbitration and at least 17 federal districts had applied for funds to operate new programs to start in 1985. P. EBENER & D. BETANCOURT, *supra* note 4, at 2, 6. The federal districts are the Eastern District of Pennsylvania, the Northern District of California, Connecticut, the Middle District of Florida, the Western District of Michigan, the District of New Jersey, the Southern District of New York, the Middle District of North Carolina, the Western District of Oklahoma, the Western District of Texas, and the Western District of Missouri. Lind & Foster, *Alternative Dispute Resolution in the Federal Courts: Public and Private Options*, 33 FED. BAR NEWS & J. 127 (1986).

[17] Alaska, Illinois, and New Mexico have authorized arbitration. NATIONAL CENTER, *supra* note 4.

[18] For example, Hawaii's arbitration program was described as a two-year experiment when it first began under the authorization of a state supreme court rule in February, 1986. Less than six months later, the state legislature created a new three-year experimental program. Letter from Janice Wolf, Administrative Director of the Courts, and Peter S. Adler, Director, Program on ADR, to the President and Members of the Senate, and the Speaker and Members of the House of Representatives of the Thirteenth State Legislature of the State of Hawaii (Dec. 30, 1986) (available in the office of The Study of Arbitration and Litigation, University of Hawaii at Manoa).

[19] The state legislature increased the jurisdictional ceiling of Hawaii's arbitration program from $50,000 to $150,000 when the program was less than six months old. HAW. REV. STAT. § 601-20 (Supp. 1986).

[20] Usually the programs operate in major metropolitan districts. P. EBENER & D. BETANCOURT, *supra* note 4, at 5-6. To our knowledge, Hawaii is the only state in which the arbitration program operates in every county.

[21] *Id.* at 9-10.

[22] *Id.* at 7.

[23] Hawaii's initial Phase I program was voluntary. Lawyers had to request that their cases be placed into the arbitration program. HAW. ARB. R. 8 (repealed 1987).

[24] P. EBENER & D. BETANCOURT, *supra* note 4, at 4.

A. Case Size

Court-annexed arbitration programs in state courts are generally limited to "smaller" cases, although federal courts usually have high jurisdictional limits, usually $50,000 to $150,000. The maximum dollar limit for cases in the state programs typically ranges from $15,000 to $50,000,[25] although state programs range from a $2000 ceiling to no limit at all. Hawaii has the second highest jurisdictional limit for a mandatory program in the nation and has the highest jurisdictional limit among those states that provide full arbitration hearings and take testimony from witnesses. Although the Michigan Mediation Program, which has no dollar limit, takes higher valued cases than CAAP, the Michigan program is really a case evaluation program.[26] The Michigan program does not hear testimony from witnesses, but hears only brief, summary presentations from lawyers. Therefore, Hawaii has the only state program that conducts arbitration hearings where parties can make personal presentations to a fact finder in cases valued at over $50,000.

B. Compensation

Almost every jurisdiction compensates their arbitrators.[27] Most are either paid by the day[28] or by the case.[29] The unit of compensation however may not be a clear guide to the program's cost. In some programs arbitrators may work on a case for many days; while in other programs, the arbitrator can hear several cases in one day.[30]

C. Delay and Costs, Discovery and Fees

Despite the fact that Rule 1 of the Federal Rules of Civil Procedure concludes with, "[these rules of civil procedure] shall be construed to secure the just, speedy, and inexpensive determination of every action,"[31] virtually no one would seriously assert that the civil justice system in the United States is either

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[25] P. EBENER & D. BETANCOURT, *supra* note 4.

[26] Shuart, Smith & Planet, *Settling Cases in Detroit: An Examination of Wayne County's "Mediation" Program*, 8 JUST. SYS. J. 307 (1983) [hereinafter *Settling Cases in Detroit*].

[27] It appears that only Hawaii and New Hampshire do not compensate their arbitrators. P. EBENER & D. BETANCOURT, *supra* note 4, at 9-10.

[28] Daily compensation ranges from $50 to $250 per day. *E.g.*, ARIZ. UNIF. ARB. R. 6.

[29] Compensation by the case ranges from $35 to $250 per case. P. EBENER & D. BETANCOURT, *supra* note 4, at 9-10. *E.g.*, CUYAHOGA COUNTY CT. C.P.R. 29(V).

[30] Some programs pay by the day or by the case, whatever is greater. CAL. CIV. P. CODE § 1141.18(b) (West Supp. 1985).

[31] FED. R. CIV. P. 1.

speedy or inexpensive.[32] Delay and high costs,[33] often resulting from congested dockets and excessive discovery, are considered the major problems of the American litigation system.[34]

The statistics about delay seem significant; the criticism[35] appears sound.[36] The number of lawsuits filed each year has increased dramatically,[37] but the number of judgeships has not risen at a rate in any way comparable to the increase in filings.[38] Although increased filings are attributable to population growth, other factors are also responsible. For example, state and federal legislatures have created new claims.[39] Moreover, court case loads have increased considerably faster than the population.[40] Furthermore, Americans may be becom-

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[32] For a critique of the problems with the civil justice system, see J. MARKS, E. JOHNSON & P. SZANTON, DISPUTE RESOLUTION IN AMERICA 9-10, (National Institute for Dispute Resolution 1984); and Yamamoto, *Case Management and the Hawaii Courts: The Evolving Role of the Managerial Judge in Civil Litigation*, 9 U. HAW. L. REV. 395, 396 (1987).

[33] Delay and high costs are usually discussed together. "Excessive cost and delay in the disposition of civil cases devalue judgments, cause the memories of witnesses and parties to fade, cause litigants to accept less than full value for their claims, prolong and exacerbate differences between people or entities, and make pursuing legal remedies prohibitively expensive for many people." ABA'S LAWYERS CONFERENCE TASK FORCE ON REDUCTION OF LITIGATION COST AND DELAY, DEFEATING DELAY xiii (1986). *See also* ABA ACTION COMM'N TO REDUCE COURT COSTS AND DELAY, ATTACKING LITIGATION COSTS AND DELAY: FINAL REPORT (1984). Planet, *supra* note 3 ("Of the issues facing courts today, perhaps none is more urgent or visible than that of long delays and high costs to litigants associated with the pace of civil litigation.").

[34] The problems are not limited to the United States. *See* Falt, *Congestion and Delay in Asia's Courts*, 4 UCLA PAC. BASIN L.J. 90 (1985).

[35] J. ADLER, W. FELSTINER, D. HENSLER & M. PETERSON, THE PACE OF LITIGATION iii (Rand Institute for Civil Justice 1982) [hereinafter PACE OF LITIGATION] ("Of all the criticisms of the civil justice system, the charge of unjustifiable delay is probably the most frequently levelled and the most deeply felt.").

[36] Although there are some court statistics about court backlogs and many anecdotal stories, there simply is not as much empirical evidence on delay. *Id.* at vi.

[37] According to the former Chief Justice of the United States Supreme Court, "[t]he caseloads in both federal and state courts experienced a fantastic growth during the past sixteen years." Burger, *Introduction, Symposium: Reducing The Costs of Civil Litigation*, 37 RUTGERS L. REV. 217, 217 (1985).

[38] Former United States Supreme Court Chief Justice Warren E. Burger said "In the federal system alone, for example, the number of new filings in District Courts have nearly tripled from 112,606 when I took office in 1969 to 307,582 in 1985; the number of judges has increased only about 50%. In short, 300% more cases are to be handled by 50% more judges." ABA LAWYERS CONFERENCE TASK FORCE ON REDUCTION OF LITIGATION COST AND DELAY, DEFEATING DELAY vii (1986).

[39] S. GOLDBERG, E. GREEN & F. SANDER, DISPUTE RESOLUTION 4 (1985); Yamamoto, *supra* note 32, at 400-01.

[40] In California the number of civil cases increased by 75% between 1969 and 1979, D. HENSLER, A. LIPSON & E. ROLPH, JUDICIAL ARBITRATION IN CALIFORNIA, 4-7 (Rand Institute for Civil Justice 1981). Between 1977 and 1981, the number of civil lawsuits in state courts grew

ing even more litigious.[41] For whatever the reason, "you'll be hearing from my lawyer" remains the battle cry.[42]

Despite the application of managerial judging techniques for the purpose of controlling the growing case dockets,[43] the assigned trial date may be several years after the date a case is filed in a major metropolitan area.[44] Despite some contrary evidence,[45] it is generally assumed that delay is harmful to litigants' cases and results in higher costs of litigation.[46] It is less clear however when, why, and where delay occurs.[47] Delay in the courts results, it is claimed, from congested court dockets that do not allow for trial dates until sometimes years after the filing of a complaint. Yet, a closer look shows that trial dates are not the true problem. The real problem is simply that cases are not resolved quickly enough because most cases never reach trial.[48] In theory, trial dates should not be significant. The trial date focus is important only because many cases do not get resolved until shortly before trial.[49]

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four times faster than the population of the United States, TIME, Mar. 24, 1986, at 20. However, while total filings have increased, not all types of litigation have increased at these dramatic rates. For example, between 1978 and 1984 the number of new tort cases increased 9% in 17 states, but the population in those states only rose 8%. *The Manufactured Crisis*, MED. ECONS., Nov. 10, 1986, at 69 (cited in D. HENSLER, M. VAIANA, J. KAKALIK & M. PETERSON, TRENDS IN TORT LITIGATION 2 (Rand Institute for Civil Justice 1987)).

[41] *See, e.g.*, Barton, *Behind the Legal Explosion*, 27 STAN. L. REV. 567 (1975); Manning, *Hyperlexis: Our National Disease*, 71 NW. U.L. REV. 767 (1977). For a contrary view suggesting that hyperlexis is a myth, see Galanter, *Reading the Landscape of Disputes: What We Know and Don't Know (And Think We Know) About Our Allegedly Contentious and Litigious Society*, 31 UCLA L. REV. 4 (1983). For the best explanation of these apparently contrary findings, see Hensler, *Trends in Tort Litigation: Findings from the Institute for Civil Justice's Research*, 48 OHIO ST. L.J. 479, 492 (1987).

[42] "Sue the Bastards" is a bumper sticker that is popular with more than just lawyers.

[43] A survey of state court administrators found that 48 states have recently adopted or were considering changes in civil procedure intended to reduce pretrial delay, P. EBENER, COURT EFFORTS TO REDUCE PRETRIAL DELAY (Rand Institute for Civil Justice 1981).

[44] It takes forty months to get to trial in Los Angles, and three years in other parts of California. It takes three years to get to trial in the large urban areas of Pennsylvania. Snow & Abramson, *supra* note 12, at 44.

[45] *Costs of Litigation*, *supra* note 9, at 104.

[46] A few observers, however, argue the delay may be a benefit. PACE OF LITIGATION, *supra* note 35, at x.

[47] *Id.* at vi.

[48] Of course not all cases that are not tried are settled. One of the few studies to examine the terminations of the vast number of cases that are not tried found that only 63 percent settled. Thirty percent of the cases were terminated by means other than trial or settlement. Kritzer, *Adjudication to Settlement: Shading in the Gray*, 70 JUDICATURE 161, 163 (1986).

[49] In a study of case dispositions, Professor Gerald Williams reported, "In Phoenix, for example, we found that over 70% of all cases were settled within 30 days of the trial date." G. WILLIAMS, LEGAL NEGOTIATION AND SETTLEMENT 78, n.23 (1983).

Since most cases are resolved in a negotiated agreement without a trial, it appears that lawyers and clients could actively reduce the delay by settling their cases earlier. It is unclear why they do not settle earlier. Many cases go through extensive pretrial discovery, which is expensive for the clients and income producing for the hourly-fee lawyers. Determining damages is another probable source of delay for both sides. Plaintiff lawyers may be waiting for their clients' injuries to stabilize,[50] while the defense may be expecting to see some rehabilitation that will reduce the damages. Some commentators contend that defendants want to hold on to their money and invest it as long as possible.[51] Perhaps the adversary system creates so much animosity between the parties that neither side is willing to extend a hand in compromise even if it might lead to a settlement. Finally, lawyers might not give serious attention to a case until it gets close to the "doomsday" event of trial.[52]

Despite the variety of attempts made to control delay, such as different types of case calendaring, docket control methods, and settlement conferences, pretrial delay remains as a serious and potentially crippling problem for court administrators and others concerned with optimizing justice in United States courts. Although delay has been treated, but certainly not cured, costs have been generally untouched by procedural reforms.

D. Cost

Although discovery is an essential[53] cornerstone of litigation, the costs of pretrial discovery are transforming our legal system into a system that is so costly that someday only corporations[54] and wealthy individuals will be able to afford to use it.[55] In cases where lawyers work for an hourly fee, the high cost of

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[50] Comment by speaker, Masters of the Game Seminar, Hawaii Institute for Continuing Legal Education (Apr. 30, 1988).

[51] PACE OF LITIGATION, *supra* note 35, at vi; Pepe, *Professional Responsibility in Pretrial Discovery—A Tale of Two Cities*, 64 MICH. BAR J. 300 (1985); Alschuler, *supra* note 7, at 1845 ("[P]reserving the status quo favors the defendant in almost every lawsuit.").

[52] E. LIND & J. SHAPARD, EVALUATION OF COURT-ANNEXED ARBITRATION IN THREE FEDERAL DISTRICT COURTS 79 (Federal Judicial Center 1983).

[53] As noted in Hickman v. Taylor, 329 U.S. 495 (1947), "mutual knowledge of all the relevant facts gathered by both parties is essential to proper litigation." *Id.* at 507.

[54] "The former chairman of one of America's largest corporations recently quipped that 'My lawyers have an unlimited budget, and every year they exceed it.' " J. KAKALIK & A. ROBYN, COSTS OF THE CIVIL JUSTICE SYSTEM iii (Rand Institute for Civil Justice 1982).

[55] A popular cartoon that sums up the problem shows a lawyer asking a prospective client, "Now, just how much justice can you afford?"

For a detailed examination of the problem see the articles in "Symposium: Reducing the Costs of Civil Litigation", 37 RUTGERS L. REV. 217 (1985), especially Levin & Colliers, *Containing the Cost of Litigation*, 37 RUTGERS L. REV. 219 (1985); Peckham, *A Judicial Response to the Costs of*

bringing suits may deter ordinary people from pressing their legitimate legal claims.[56]

A growing criticism argues that civil cases are over-discovered.[57] A vast amount of material has been written about discovery abuse and the assumed, parallel rise in the litigation costs because of this discovery.[58] In fact, the word "abuse" appears in the titles of many publications about discovery.[59] Criticism

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Litigation: Case Management, Two-Stage Discovery Planning, and Alternative Dispute Resolution, 37 RUTGERS L. REV. 253 (1985); Planet, *supra* note 3; Franaszek, *Justice and the Reduction of Litigation Cost: A Different Perspective* 37 RUTGERS L. REV. 339 (1985).

[56] The cost of discovery probably would not deter either side in litigating a tort lawsuit. Because plaintiff lawyers take personal injury cases on a contingent fee, presumably injured plaintiffs will always be able to find a lawyer. Even poor plaintiffs can file lawsuits because their discovery costs are advanced by plaintiff lawyers, who deduct the discovery costs from the plaintiff's recovery. These plaintiffs, however, might still not find a lawyer to represent them if the lawyer thinks the case is uneconomical (damages are low, or liability is very questionable) or the lawyer might not be able to advance large sums of money to conduct discovery. Defendants, of course, will defend virtually all tort lawsuits because insurance companies are involved in most of these suits. Insurance companies have the financial resources to litigate in all cases where it is appropriate.

[57] As observed by one commentator, "[s]ome over discovery results from compulsive, perfectionist attorneys worried about professional criticism for lack of thoroughness, and fearing failure at trial or settlement without near-perfect knowledge. The more common problem comes from fixed law firm routines, aided by form books and word processors." Pepe, *supra* note 51, at 302.

[58] Depositions are the costliest of discovery devices. Schmidt, *The Efficient Use of Discovery*, FOR THE DEFENSE, Jun. 1984, at 25, 27.

[59] C. ELLINGTON, A STUDY OF SANCTIONS FOR DISCOVERY ABUSE 17 (U.S. Dep't of Justice 1979); ABA SECTION OF LITIGATION, SPECIAL COMM'N FOR THE STUDY OF DISCOVERY ABUSE, FIRST REPORT (1977), *reprinted in* 92 F.R.D. 149 (1982); ABA SECTION OF LITIGATION, SECOND REPORT OF THE SPECIAL COMMITTEE FOR THE STUDY OF DISCOVERY ABUSE (1980), *reprinted in* 92 F.R.D. 137 (1980); Becker, *Modern Discovery: Promoting Efficient Use and Preventing Abuse of Discovery in the Roscoe Pound Tradition*, 78 F.R.D. 267, 274-75 (1978); Brazil, *Views from the Front Lines: Observations by Chicago Lawyers About the System of Civil Discovery*, 1980 A.B.F. RES. J. 217, 230-35; Brazil, *Civil Discovery: Lawyers' Views of Its Effectiveness, Its Principal Problems and Abuses*, 1980 A.B.F. RES. J. 789; Comment, *Preventing Discovery Abuses in the Federal Courts*, 30 CATH. U.L. REV. 273, 284-305 (1981); *District of Columbia Survey: Hinkle v. Sam Blanken & Co.: Dismissal for Discovery Abuse — Toward a New Standard in the District of Columbia*, 36 CATH. U.L. REV. 761 (1987); Note, *Discovery Abuse Under the Federal Rules: Causes and Cures*, 92 YALE L.J. 352 (1982); Note, *Rule 37 Sanctions: Deterrents to Discovery Abuses*, 46 MONT. L. REV. 95 (1985); Flegal, *Discovery Abuse: Causes, Effects, and Reform*, 3 REV. LITIGATION 1 (1982); Lundquist & Flegal, *Discovery Abuse — Some New Views About an Old Problem*, 2 REV. LITIGATION 1 (1981); Note, *The Emerging Deterrence Orientation in the Imposition of Discovery Sanctions*, 91 HARV. L. REV. 1033 (1978); Flegal & Umin, *Curbing Discovery Abuse in Civil Litigation: We're Not There Yet*, 1981 B.Y.U. L. REV. 597 (1981); Pollack, *Discovery — Its Abuse and Correction*, 80 F.R.D. 219 (1978); Rosenberg, *Discovery Abuse*, 7 LITIGATION at 8, 9-10 (Spr. 1981); Rosenberg & King, *Curbing Discovery Abuse in Civil Litigation: Enough is Enough*, 1981 B.Y.U. L. REV. 579; Sherwood, *Curbing Discovery Abuse: Sanctions Under the Federal Rules of Civil Procedure and the California Code of Civil Procedure*, 21 SANTA CLARA L. REV. 567 (1981);

of discovery includes excessive use of discovery, sometimes in a "fishing expedition,"[60] the unjustified resistance of legitimate discovery,[61] opportunities to delay the resolution of valid legal claims,[62] and attempts to intimidate the other party with the cost of discovery. Although discovery procedures are, in theory, designed to improve the exchange of information between the parties, discovery is frequently put to a more adversarial use by delaying and making the pursuit of a legal claim much more costly.[63] At least for the hourly-fee lawyers, discovery activity generally means an opportunity to bill more legal fees to the client.[64]

Although discovery apparently is the prime villain in the criticisms about delay and costs, it is only a part of the total cost of litigation. Lawyers' fees are actually the larger,[65] although lesser discussed, aspect of costs.[66] The combined fees and expenses of plaintiff and defense lawyers in tort litigation range from 45 to 63 percent of the total amount expended in this litigation, including the amount received by the injured plaintiffs.[67] After deducting lawyers' fees, dis-

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Sofaer, *Sanctioning Attorneys for Discovery Abuse Under the New Federal Rules: On the Limited Utility of Punishment*, 57 ST. JOHN'S L. REV. 680 (1983); Note, *Rule 37 Sanctions: Deterrents to Discovery Abuses*, 46 MONT. L. REV. 95 (1985); Levine, *Abuse of Discovery: or Hard Work Makes Good Law*, 67 A.B.A. J. 565 (May 1981); Batista, *New Discipline in Old Game—Sanctions for Discovery Abuse*, N.Y.L.J., Aug. 16, 1982, at 1, col. 2; Dombroff, *Objective Procedures Could Curb Discovery Abuse*, Legal Times, Sept. 6, 1982, at 15, col. 1; Huffman, *Protracted Litigation, Abuses of Discovery Targeted by Judge*, Legal Times, July 26, 1982, at 1, col. 1, at 32; Tell, *Legal Fee Axed for Litton Case Discovery Abuse*, NAT'L L.J., Oct. 12, 1981, at 2, col. 4.

[60] A "fishing expedition . . . undertaken in the hope that some cause of action might be uncovered." United Presbyterian Church in the U.S.A. v. Reagan, 738 F.2d 1375, 1383 (D.C. Cir. 1984).

[61] Thames, *Discovery Strategy*, FOR THE DEFENSE, Jan. 1986, at 12-13. For a list of lawyering skills of evasion and incomplete responses, see Pepe, *supra* note 51, at 301.

[62] R. HAYDOCK, D. HERR & J. STEMPEL, FUNDAMENTALS OF PRETRIAL LITIGATION 121 (1985) ("Discovery for other lawyers seems to be the best way to avoid or delay going to trial, and that attitude, too, accounts for its share of the abuse of discovery procedures.").

[63] *See* Brazil, *The Adversary Character of Civil Discovery: A Critique and Proposals for Change*, 31 VAND. L. REV. 1295 (1978); Shapiro, *Some Problems of Discovery in an Adversary System*, 63 MINN. L. REV. 1055 (1979).

[64] One lawyer said, "Discovery is good for our business but has nothing to do with justice." Brazil, *Views from the Front Lines: Observations by Chicago Lawyers About the System of Civil Discovery*, 1980 A.B.F. RES. J. 217, 250 n.53; Brazil, *Civil Discovery: Lawyers' Views of Its Effectiveness, Its Principal Problems and Abuses*, 1980 A.B.F. RES. J. 787.

[65] ABA ACTION COMM. TO REDUCE COURT COSTS AND DELAY, ATTACKING LITIGATION COSTS AND DELAY 60 (1984) [hereinafter COSTS AND DELAY].

[66] Lawyers' fees are part of litigation "transactions costs," which are "the sum of plaintiffs' costs, defense costs, and public costs. They are the 'overhead' costs of the system in the sense that the services purchased are not desired for themselves." S. CARROLL & N. PACE, ASSESSING THE EFFECTS OF TORT REFORMS 22 (Rand Institute for Civil Justice 1987).

[67] In auto torts, the defense legal fees are 19 percent, plaintiff legal fees are 26 percent, and

covery costs, and other costs of litigation, plaintiffs receive only about 50 percent[68] of the money paid out in trial verdicts or money paid to settle claims in regular tort cases.[69]

Lawyers' fees are partially related to discovery, although the precise relationship is dependant on how fees are calculated. Defense lawyers are almost always[70] paid on an hourly basis. In most tort litigation, the defense lawyers are paid by insurance companies. A large part of the hours defense lawyers bill for tort litigation are hours spent conducting discovery. It is obvious that reducing discovery will reduce the defense costs. Of course any program that reduces the amount of discovery will have a corresponding effect on the income of the hourly-fee defense lawyers, court reporters and paralegals.[71]

Plaintiffs' lawyers, on the other hand, are paid on a contingent fee basis. These lawyers receive no fee unless the plaintiff recovers. Typically, plaintiffs' lawyers take a 33½ to 40 percent contingent fee, although the rates vary depending on the jurisdiction, the type of case, and the personal reputation of the lawyer.[72] Because plaintiffs' lawyers are not paid on an hourly basis, reducing discovery will not automatically reduce the lawyer's fee.[73] In fact, studies of fee

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the net compensation to the plaintiff is 52 percent. In non-auto torts, the defense legal fees are 30 percent, plaintiff legal fees are 24 percent, and the net compensation to the plaintiff is 43 percent. In asbestos cases, the defense legal fees are 37 percent, plaintiff legal fees are 26 percent, and the net compensation to the plaintiff is only 37 percent. D. HENSLER, M. VAIANA, J. KAKALIK & M. PETERSON, TRENDS IN TORT LITIGATION 29 (Rand Institute for Civil Justice 1987).

[68] Plaintiffs in automobile accident cases net about 52 percent of the total expenditures. In non-auto torts they only receive about 37 percent of the transaction costs. Hensler, *Trends in Tort Litigation: Findings from the Institute for Civil Justice's Research*, 48 OHIO ST. L.J. 479, 492 (1987).

[69] Costs are extremely high in asbestos cases. The average payout to plaintiffs in asbestos litigation is only thirty-seven cents of every dollar paid by the insurance companies. J. KAKALIK, COSTS OF ASBESTOS LITIGATION (Rand Institute for Civil Justice 1983).

[70] In arbitration cases some lawyers are being paid to handle the case on a flat fee basis through the arbitration hearing. If there is an appeal of the arbitration award, a new fee arrangement is instituted in anticipation of trial de novo.

[71] Insurance companies are aware the discovery reductions which save expenses for the company will reduce defense fees. In Hawaii, these companies are trying to avoid problems with their defense lawyers by promising that every time that a defense lawyer settles a case in arbitration, another new case will be given to the defense lawyer to replace the one that has settled.

[72] In Hawaii, the fee is generally 33½ percent in automobile accident tort cases, and 40 percent for all other torts. At the time of recovery, the lawyer receives the agreed upon percentage of the recovery. The costs of discovery are deducted from the plaintiff's share of the recovery, and the plaintiff's lawyer is reimbursed for the advance of the discovery costs. Finally, the plaintiff receives the net sum remaining. If there is a defense verdict at trial, the plaintiff still owes the plaintiff lawyer for the costs of discovery, but in actuality the plaintiffs seldom pay back those advanced discovery costs, and plaintiffs' lawyers seldom pursue their claim against the plaintiff for the advanced discovery costs. Interview with a plaintiff's lawyer (April 20, 1988).

[73] H. HENSLER, A. LIPSON & E. ROLPH, JUDICIAL ARBITRATION IN CALIFORNIA: THE FIRST YEAR

structures have shown that programs saving the time of a plaintiff's lawyer did not result in a fee reduction for the client.[74] It is therefore possible that a reform that reduces discovery will not reduce the income of plaintiffs' lawyers, but will actually allow these lawyers to make the same amount of money in less time.

The contingent fee system is a major subject of controversy,[75] especially in the age of "tort reform" and the concerns about medical malpractice litigation. Those in favor of the contingent fee say that it is "the poor man's key to the courthouse."[76] Opponents, however, retort "that greedy attorneys, hungry for fat contingency fees, generate suits that would not otherwise be brought."[77] In striking a balance between these two views, some jurisdictions have placed limits on the amount of fees that a plaintiff's lawyer can receive, at least in medical malpractice cases.[78]

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82 (Rand Institute for Civil Justice 1981). Developments, *Compulsory Automobile Arbitration: New Jersey's Road to Reducing Court Congestion, Delay, and Costs*, 37 RUTGERS L. REV. 401, 430-31 (1985).

[74] In contingent fee cases, with procedures that save attorney time, "lawyers are benefiting, but clients are not." COSTS AND DELAY, *supra* note 65, at 66. Chapper & Hanson, *Attorney Time Savings/Litigant Cost-Savings Hypothesis: Does Time Equal Money?*, 8 JUST. SYS. J. 258 (1983).

[75] In concluding, we emphasize again our firm conviction that to the maximum degree possible litigants themselves should be the beneficiaries of reductions in the cost of litigation. At the same time, we are acutely aware that overall costs to litigants are in the main a reflection of how attorney's fees are structured in the United States and the various methods of calculating such fees. Whether those fees are fair to counsel and client and whether they can or should be changed substantially in amount or method of calculation pose fundamental issues of fairness and political feasibility that our mission and our resources could not encompass. We feel strongly, however, that the organized bar, at both the national and state levels, has an inescapable and immediate duty to address this overriding issue of how attorneys' fees affect litigant cost and access to justice.

COSTS AND DELAY, *supra* note 65, at 67. *See also*, Clermont & Currivan, *Improving on the Contingent Fee*, 63 CORNELL L. REV. 530 (1978); Kriendler, *The Contingent Fee: Whose Interests are Actually Being Served?*, 14 FORUM 406 (1979).

[76] Comment, *Medical Malpractice in Florida: Prescription For Change*, 10 FLA. ST. U.L. REV. 593, 609 (1983) (citing the Florida Academy of Trial Lawyers, SELF-PRESERVATION OF A PRIVILEGED CLASS 11 (1982)).

[77] Comment, *Recent Medical Malpractice Legislation — A First Checkup*, 50 TUL. L. REV. 655, 670 (1976).

[78] COSTS AND DELAY, *supra* note 65. Klein, *Caps in the Hat: Legislative Lids on Runaway Verdicts*, FOR THE DEFENSE, Jul. 1986, at 19, 22.

Section 6146 of California's Medical Injury Compensation Reform Act of 1975 (MICRA) limits contingency fees in actions against a health care provider based upon alleged professional negligence to: (1) 40% of the first $50,000 recovered; (2) 33½% of the next $50,000; (3) 25% of the next $100,000; and (4) 10% of any amount on which the plaintiff's recovery exceeds $200,000.

See also DEL. CODE ANN., tit. 18, § 6865 (Supp. 1988) (medical malpractice); TENN. CODE ANN. § 29-26-120 (Supp. 1988) (medical malpractice).

See Roa v. Lodi Medical Group, 37 Cal. 3d 920, 695 P.2d 164, 211 Cal. Rptr. 77, *appeal*

III. HAWAII'S COURT-ANNEXED ARBITRATION PROGRAM

A. Program Goals

The intent of Hawaii's arbitration program "is to provide a simplified procedure for obtaining a prompt and equitable resolution of certain civil matters."[79] It is generally agreed that the major goals of the program are: (1) to reduce litigant costs, (2) to increase the pace of disposing of tort cases, and (3) to improve or at least maintain the level of satisfaction for litigants and attorneys.[80] Although the arbitration program currently handles only tort cases,[81] the arbitration rules provide that parties may agree to submit other types of civil cases to the program.[82]

B. Program History

The Hawaii CAAP has operated in two different forms. When the program first began in 1986, it was designed under the Hawaii Supreme Court's rule-making power as a two-year experiment and was authorized in the Circuit Court Rules for the First Circuit.[83] Initially, the program was voluntary. Any party could request that a tort case at or below a "probable jury award of $50,000" be placed into the arbitration program. This first $50,000 program is now referred to as Phase I.

Less than six months after the start of what was to have been a two-year experiment, the Hawaii legislature changed the arbitration program. During a special legislative session, it passed Act 2 of 1986,[84] as part of "Tort Reform" legislation.[85] The most significant program change required by this new law was a major increase in the jurisdictional ceiling for arbitration cases. Beginning on May 1, 1987, the program was changed to require the arbitration of tort cases

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dismissed, 474 U.S. 990 (1985) (upholding the limit on contingent fees paid to plaintiff's lawyer).

[79] HAW. ARB. R. 2(A).

[80] Letter from Janice Wolf, Administrative Director of the Courts and Peter S. Adler, Director, Program on ADR, to the President and Members of the Senate, and the Speaker and Member of the House of Representatives of the Thirteenth State Legislature of the State of Hawaii (Dec. 30, 1986) (available in the office of The Study of Arbitration and Litigation, University of Hawaii at Manoa).

[81] HAW. ARB. R. 6(A).

[82] Admission to the program also requires the consent of the Arbitration Judge. *Id.* R. 6(B). To date, no non-tort cases have been accepted into the program.

[83] HAW. CIR. CT. R. 34.

[84] HAW. ARB. R. 6(A).

[85] For a list of state tort reform laws passed in 1986, see S. CARROLL & N. PACE, ASSESSING THE EFFECTS OF TORT REFORMS 47-72 (Rand Institute for Civil Justice 1987).

with "a probable jury award value, not reduced by the issue of liability, exclusive of interest and costs, of $150,000 or less."[86]

C. *Discovery Limitations*

The design of the Hawaii program makes it clear that reducing litigant costs is the prime goal of the program, and limiting discovery is the central mechanism. Although most arbitration programs schedule arbitration hearings after formal discovery has been completed, Hawaii's program does not allow *any* discovery without the consent of the arbitrator. Arbitrators are given certain guidelines for reducing or eliminating discovery.[87] Informal, less costly methods of discovery are encouraged.

D. *Jurisdictional Amount*

The Hawaii Court-Annexed Arbitration Program has, at $150,000, the highest jurisdictional amount of any mandatory, full arbitration program in a state court.[88] Even in the Phase I ($50,000) program, Hawaii's jurisdictional amount was as high as any state full-arbitration program in the country.[89] In the Phase II ($150,000) program, Hawaii's jurisdictional amount is three times higher than any other state arbitration program.[90] Only a few federal courts

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[86] HAW. ARB. R. 6(A).

[87] The training materials for arbitrators suggest that the following considerations be given to any discovery request:

a. Balance the benefit of discovery requested against the expense and necessity.
b. Nature and complexity of the case.
c. The amount in controversy.
d. Possibility of unfair surprises which may result if discovery is restricted.

PACIFIC L. INST., HAWAII ARBITRATION SOURCEBOOK, 2-14 (1987).

[88] Michigan has a mandatory program which has no jurisdictional limit. This program, however, does not contemplate full arbitration hearings with testimony presented by witnesses. Each case is allocated approximately 30 minutes before a panel of three mediators (a plaintiff lawyer, and defense lawyer, and a neutral lawyer) who make an arbitration award. The award is more of a case evaluation based upon the short presentation by the opposing lawyers and answers to questions posed by the panel rather than an adjudicative result after hearing witnesses. Although it is called the Michigan "Mediation" Program, the panel of lawyers perform the service of arbitrators who propose a non-binding result and not the service of mediators who assist the parties to reach their own decision. Interview with Robert W. Schweikart, Mediation Tribunal Clerk, Mediation Tribunal Association for the Third Judicial Circuit Court of Michigan (Jan. 1987). *See also Settling Cases in Detroit*, *supra* note 26.

[89] *But see* the Michigan Mediation program where mediators decide many cases per day. Shuart, Smith & Planet, *supra* note 88.

[90] California, Colorado, and Minnesota all have jurisdictional limits of $50,000. Keilitz, Gallas & Hanson, *State Adoption of Alternative Dispute Resolution*, ST. CT. J., Spr. 1988, at 4.

have jurisdictional amounts as high as Hawaii's.[91]

E. *Compensation for Arbitrators*

Most arbitration programs compensate the arbitrators or at least provide an honorarium.[92] Hawaii, however, is asking its arbitrators to volunteer their time, providing essentially "pro bono" service.[93] Arbitrators have averaged 6 hours of work on cases that settled and 16 hours of work on cases in which an award was rendered.

F. *Changes from Phase I to Phase II*

When the state legislature mandated that the Hawaii arbitration program include cases valued up to $150,000, the Judicial Arbitration Commission,[94] which designed and oversaw the rules, reviewed the arbitration procedures and revised some of these procedures in order to accommodate the new jurisdictional amount. The Commission took this opportunity to make several other program changes.

A significant change occurred in the gatekeeping function. In Phase I, all tort cases valued at $50,000 or less were supposed to enter the program. These cases, however, entered the program only if the plaintiff requested or the defendant demanded arbitration. In essence, cases were invited into the program; it was a voluntary program. As might be expected, many cases did not enter the program for reasons of ignorance, caution, suspicion, or tactics.[95] In Phase II, the gatekeeping function was changed significantly. Now, all tort cases automatically enter the program when they are filed in Circuit Court and attorneys who do not think that their cases belong in the program must make a special request to be exempted from the program.

To better control the flow of cases through the CAAP, Phase II rules require arbitrators to schedule a pre-hearing conference within thirty days of the date a case is assigned.[96] In addition, the arbitration selection process was changed.

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[91] *See* P. EBENER & D. BETANCOURT, *supra* note 4 (The jurisdictional limit for the Middle District of North Carolina is $150,000.); *see also* SURVEY OVERVIEW, *supra* note 15.

[92] P. EBENER & D. BETANCOURT, *supra* note 4, at 8-10.

[93] There has been an on-going discussion whether CAAP should at least pay the arbitrators an honorarium. Any payment to arbitrators will, of course, increase the cost of the program.

[94] The Commission is a body of representatives of plaintiff and defense lawyers as well as one representative from the insurance industry. It has the responsibility to "develop, monitor, maintain, supervise and evaluate the program." HAW. ARB. R. 4(A).

[95] The noted rationales were gleaned from interviews with lawyers, available on file in the office of The Study of Arbitration and Litigation, University of Hawaii at Manoa.

[96] HAW. ARB. R. 15(D).

Under Phase I rules, one arbitrator was initially assigned to a case, and if either party objected to the arbitrator, a list of five potential arbitrators was proposed to the parties. Each party was allowed to strike two names. The arbitrator who remained after both parties struck two potential arbitrators, or one of the remaining arbitrators if only one party struck names, was appointed.[97] Under Phase II rules, five potential arbitrators are initially proposed.[98]

During the summer of 1987, CAAP was expanded to all circuit courts in the state.[99] Expansion to the neighbor islands offers new challenges to the program, most notably, ensuring a sufficient supply of arbitrators on each of the neighbor islands.[100]

G. Hawaii's Program Description

The Hawaii CAAP is a mandatory, non-binding arbitration procedure for tort cases with a probable jury award of less than $150,000. For purposes of this program, all tort cases are presumed to be valued at $150,000 or less.[101] In other words, all tort cases are initially assigned to the arbitration program, and then attorneys are required to submit a request to have their case exempted from the program if they believe the value of the case exceeds $150,000.[102]

After the last defendant's answer is filed, a volunteer arbitrator[103] is assigned to the case. The arbitrator must schedule a pre-hearing conference within thirty days from the date the case is assigned,[104] and must determine what pretrial discovery the arbitrator will permit. Discovery is permitted only with the consent of the arbitrator.[105] The arbitrator can assist in settling the case if all par-

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[97] HAW. ARB. R. 9 (repealed 1987).

[98] HAW. ARB. R. 9.

[99] *Id.* 27.

[100] Twenty-three percent of Hawaii's population lives on the neighbor islands, but only six percent of the state's lawyers live on the neighbor islands. HAW. BAR NEWS, July 1988, at 20. Observers agree that most potential arbitrators on the neighbor islands are plaintiff's attorneys. The neighbor island arbitrator pool has raised issues regarding the balance of the pool.

[101] Under the Phase II program, all cases are presumed into the program. HAW. ARB. R. 8(A). Under the earlier Phase I program, either the plaintiff or the defendant could request arbitration for cases valued at $50,000 or less. HAW. ARB. R. 8 (repealed 1987).

[102] HAW. ARB. R. 8(A). The Arbitration Administrator automatically exempts wrongful death cases.

[103] Currently all arbitrators are lawyers. The attorneys "shall have substantial experience in civil litigation, and shall have been licensed to practice law in the State of Hawaii for a period of five (5) years, or can provide the Judicial Arbitration Commission with proof of equivalent qualifying experience." *Id.* 10(B).

[104] *Id.* 15(D).

[105] HAW. ARB. R. 14(A) ("Once a case is submitted to the Program, the extent to which discovery is allowed, if at all, is at the sole discretion of the arbitrator.").

ties consent in writing.[106] If the case proceeds to an arbitration hearing, the attorneys must file a pre-hearing statement[107] within thirty days prior to the date of the hearing.[108]

At the arbitration hearing, the rules of evidence are relaxed[109] and no transcription or recording is permitted.[110] Although findings of fact and conclusions of law are not required, arbitration awards must be in writing.[111] Awards are not limited to the jurisdictional amount of $150,000.[112] Awards must be filed within seven days of the conclusion of the arbitration hearing or within thirty days after the receipt of the final authorized memoranda of counsel.[113] The award becomes the final judgment if neither party files a written Notice of Appeal and Request for Trial De Novo within twenty days after the award is served upon the parties.[114] If such Notice and Request is timely filed, the case is scheduled for trial de novo. The case is then treated as if arbitration did not occur and full discovery is permitted under the rules of civil procedure. No testimony made during the course of the arbitration hearing is admissible in the trial de novo.[115]

There are disincentives attached to the appeal process in the form of sanctions for failure to prevail in the trial de novo. When parties appeal, they must receive an award that is at least fifteen percent greater at the trial de novo than they received at the arbitration award.[116] If the party fails, the party is subject to sanctions of attorney fees up to $5000, costs of jurors, and other reasonable costs actually incurred since the appeal of the arbitration award.[117]

H. Program Evaluation—Research Project Design

Researchers from the University of Hawaii have been studying and evaluating the arbitration program through a project called The Study of Arbitration and Litigation (SAL).[118] The evaluation is conducted in a randomized[119] exper-

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[106] *Id.* 11(A)(10).

[107] The arbitration rules dictate the contents of the pre-hearing statement, which includes material similar to what would be included in a pre-trial settlement conference with a judge. *Id.* 16.

[108] *Id.*

[109] *Id.* 11(A)(2).

[110] *Id.* 17.

[111] *Id.* 19.

[112] *Id.* 19(B).

[113] *Id.* 20(A).

[114] *Id.* 21.

[115] *Id.* 23(C).

[116] *Id.* 25.

[117] *Id.* 26.

[118] The Study of Arbitration and Litigation (SAL) is located at Department of Sociology,

imental design with two groups of cases; one-half of the cases are assigned to the arbitration program and the remaining one-half of the cases are designated as a "comparison group" and are assigned to regular litigation.[120] Initially, all tort cases are presumed eligible for arbitration and are assigned to the arbitration program when they are filed in the clerk's office. Eligible cases are then assigned either to arbitration or to regular litigation by random numbers.

A comparison group of cases is necessary to measure the effects of arbitration against cases in regular litigation. A comparison group is also necessary to develop an adequate database on cases in regular litigation. Current court records are only partially useful in this regard because they are geared to tracking cases, but not to evaluating alternatives.

The focus of the evaluation is on: (1) cost, (2) pace, and (3) satisfaction, which are factors reflecting the goals of CAAP. "Cost" includes discovery costs, time spent on cases by plaintiffs' lawyers, and hourly fees of defense lawyers. "Pace" measures the time necessary to resolve a case once it enters the arbitration program. "Satisfaction" is measured by questions asking lawyers how satisfied they and their clients were with the program. The essence of the program evaluation is to determine whether disposing of a case in the arbitration program can decrease cost and increase pace, while maintaining satisfaction.

Aside from whether or not the case was in CAAP, several major factors are expected to influence cost, pace, and satisfaction. Maximum exposure, case complexity, experience of and confidence in the arbitrator, and whether the case progressed to an award or was settled, may be significant factors. On an even more basic level, lawyers may have different views of arbitration because arbitration impacts plaintiff and defense lawyers differently, especially in the area of lawyers' fees. Because the arbitration program seeks to reduce discovery, the effect of arbitration on contingent-fee plaintiffs' lawyers, who do not get paid for the time they expend on discovery may be different from the effect on the

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Porteus Hall 237, University of Hawaii at Manoa, Honolulu, Hawaii, 96822. This project is currently funded by a three-year contract from the Hawaii Judiciary and in-kind contributions from the Program for Conflict Resolution, The Sociology Department, and the William S. Richardson School of Law, all of the University of Hawaii at Manoa.

[119] The randomized experiment has been referred to as "the most powerful of research designs." Lind & Foster, *supra* note 16, at 128. For more about random samples, *see* D. Vinson & P. Anthony, Social Science Research Methods for Litigation 142-44 (1985).

[120] This proportion of regular litigation cases to arbitration cases has changed because of program needs. Formerly, one-third of the cases were randomly assigned to the comparison group. Originally one-third was decided upon as the random comparison sample by the Arbitration Commission, the Arbitration Administrator, and the evaluation team. It was later increased to one-half at the behest of CAAP to decrease the number of arbitrators needed. Some plaintiff lawyers whose cases fell randomly in the comparison sample have complained that they want their comparison case placed into the arbitration program. These comments suggest that the arbitration program is satisfactory to plaintiff's lawyers.

hourly-fee defense lawyers who derive the major portion of their fees from conducting discovery. Perhaps other factors that have not yet been isolated will also have a substantial effect.

Data collected for the evaluation are kept in the strictest confidence. Only aggregated information is released. Evaluation data is collected from: (1) court and arbitration records, (2) surveys sent to lawyers and arbitrators for cases both in arbitration and regular litigation, and (3) inquiries to insurance companies, discussions with judiciary employees, and interviews with lawyers.

The evaluation was begun by using a survey questionnaire for lawyers and arbitrators and the case record files maintained by the court and the arbitration program. During the late fall of 1986 and the early spring of 1987, telephone interviews were conducted with forty-six lawyers who argued cases in CAAP during the first six months of Phase I. These interviews helped to shape the questions that were asked in later parts of the evaluation. The interviews indicated that a large majority of lawyers viewed the program as helpful. A smaller group had their cases terminated with minimal or no involvement of the arbitrators. A still smaller group was dissatisfied with the program. This pattern of opinions appears consistent with the recent survey of Phase I cases.

I. The Survey of Closed Cases From Phase I

It must be strongly emphasized that this is only a report on the findings of the first surveys of arbitration cases in Phase I of the program ($50,000 ceiling).[121] Phase II ($150,000 ceiling) began in May 1987 and too few cases have been terminated and surveyed yet to provide meaningful and accurate data on Phase II. The data on Phase II may be similar to or different from the data reported here.[122] This report also does not report information from the randomized comparison sample, which has not yet been fully collected.

When cases terminated from CAAP, surveys were sent to the arbitrator and the lawyers of all award cases and one out of four cases reaching settlement. A total of 334 surveys were sent to lawyers and arbitrators involved in 118 cases in Phase I. Of these, 268 surveys were returned, representing 80% of plaintiffs' lawyers surveyed, 74% of defense lawyers and 88% of arbitrators. Occasionally,

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[121] Phase I cases are those filed between February 15, 1986, and April 30, 1987.

[122] Note, however, that because Phase I cases (under $50,000) are a subset of the Phase II cases (under $150,000) and because the lawyers who handle Phase I cases are also the same lawyers who handle Phase II cases, it is expected that there will be some correspondence between the Phase I and the Phase II evaluations. When the program was being designed, unofficial Hawaii statistics indicated that 85 percent of all tort cases settled at values of $150,000 or below and that 60 percent of all tort cases settled at values of $50,000 or below. The other major difference between Phase I and Phase II is that Phase I was a voluntary program and Phase II is a mandatory program.

however, only one party involved in the arbitration returned the survey. Consequently, plaintiff views are lacking for some cases and defense views for other cases. Initially, data analysis was conducted upon only 49 cases where usable surveys were returned from both plaintiff and defense, and where there was only one plaintiff's and one defense lawyer involved. Interestingly, when data from all the cases were compared to the data from cases where both plaintiff and defense responded, no significant differences were found. Therefore, the data presented in this article comes from the larger set of all 268 responses.

J. Discovery and Cost Reduction

A major goal for the Hawaii arbitration program is to reduce expenses for litigants by reducing discovery. Survey results indicate that discovery was reduced, and it was reduced without affecting the outcome of the case for the most part. (See Table 1.) In cases that settled, 74% of arbitrators, 85% of plaintiffs' lawyers and 76% of defense lawyers thought discovery was reduced. In cases resulting in awards, 95% of arbitrators, 86% of plaintiffs' lawyers and 78% of defense lawyers thought discovery was reduced. It is important to note that 78% of plaintiffs' lawyers and 72% of defense lawyers whose cases went to an award reported that discovery reduction did not affect the outcome of the case, while 22% were sure that it had and 28% were uncertain.

Discovery can be reduced either because lawyers voluntarily agree to limit discovery or because the arbitrator denies requests for discovery. Since arbitrators reported that they denied discovery requests in only 10% of cases reaching settlement and 30% in cases reaching award, the statistics suggest that discovery is being reduced primarily through voluntary discovery reductions by the lawyers. On the issue of discovery denials, defense lawyers perceived more denials of discovery requests than did plaintiffs' lawyers. Nearly 39% of defense lawyers, but only 20% of plaintiffs' lawyers, whose cases went to an award thought discovery requests had been denied. In addition, 28% of defense lawyers, but only 17% of plaintiffs' lawyers, whose cases were settled thought discovery requests had been denied.

Discovery costs also were examined in the evaluation. (See Table 2.) Plaintiffs' lawyers reported lower discovery costs than defense lawyers. Plaintiffs' lawyers reported discovery was less than $400 in 57% of settlements and 27% of awards. Defense lawyers reported discovery was less than $400 in 42% of settlements and 34% of awards. Discovery costs were between $400 and $1000 for plaintiffs in 34% of settlements and 38% of awards, and above $1000 in 9% of settlements and 35% of awards. Discovery costs were between $400 and $1000 for defense lawyers in 32% of both settlements and awards, and above $1000 in 26% of settlements and 34% of awards. The average discovery costs for the plaintiffs were $445 for settlements and $761 for awards. For defense lawyers,

the discovery costs were $750 for settlements and $962 for awards. Until the comparison group data is available, the savings in discovery costs attributable to the program cannot be estimated.

Discovery costs for regular litigation cannot be accurately estimated until the evaluation of comparison cases is completed. In the survey however plaintiffs' lawyers more often saw CAAP as saving cost than did defense lawyers. Plaintiffs' lawyers, 80% who settled and 86% who proceeded to the award stage reported that the case would have cost more if it had not been in CAAP. For defense lawyers, 58% who settled and 52% who went to award reported that the case would have cost more if it had not been in CAAP.

K. Pace of Disposition

The majority of lawyers agreed that if their case had not been in CAAP it would have taken longer to terminate. (See Table 3.) Again, however, the views of the plaintiffs' and defense lawyers differed. Of cases that settled, 87% of plaintiffs' lawyers and 71% of defense attorneys thought the case would have taken longer if it was not in the arbitration program. In award cases, 88% of plaintiffs' lawyers and 63% of defense attorneys thought the case would have taken longer if it was not in the arbitration program.

L. Lawyer Satisfaction

Overall, lawyers were satisfied with the way their cases were handled in the program, but lawyers who reported a voluntary settlement were more often satisfied than were the lawyers whose cases continued to the award stage. (See Table 4.) Furthermore, there was more criticism and dissatisfaction from defense lawyers than from plaintiff lawyers. Satisfaction differed depending on whether the case settled or went to award. The survey revealed that 98% of plaintiffs' lawyers and 86% of defense lawyers whose cases settled were satisfied; 75% of plaintiffs' lawyers and 49% of defense lawyers whose cases went to an award were satisfied.

There is a high correlation between lawyer satisfaction and the lawyer's perception of whether the award was similar to what the lawyer thought the verdict would have been at trial. Remember, however, that the assumption that the case would have gone to trial is quite hypothetical. Trials are infrequent. Less than three percent of tort cases are tried in Hawaii,[123] which is even lower than the national average for trials.[124]

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[123] THE JUDICIARY, STATE OF HAWAII, 1986-1987 ANNUAL REPORT, STATISTICAL SUPPLEMENT (1987). Annual reports for prior years also show a low trial rate.

[124] *See* ANNUAL REPORT OF THE DIRECTOR OF THE ADMINISTRATIVE OFFICE OF THE UNITED

When cases did proceed to the award stage, more plaintiffs' lawyers (64%) than defense lawyers (47%) thought the awards were similar to the expected trial verdict. More defense than plaintiffs' lawyers believed that awards were worse than they would have expected at trial. Seventy-eight percent of plaintiffs' lawyers who saw the awards as similar to verdicts were satisfied with the arbitration program. Sixty-two percent of defense lawyers who saw the awards as similar to verdicts were satisfied with the arbitration program.

Not unexpectedly, lawyers who saw the arbitration award as different from the trial verdict were much less satisfied on both sides of the case. Only 50% of the plaintiffs' lawyers who saw the awards as different from trial were satisfied, and only 13% of the defense lawyers who saw the awards as different from trial were satisfied.

Both plaintiffs' and defense lawyers indicated that they were satisfied with the arbitration program, although they were more satisfied with cases that settled in the program than with cases that went to arbitration awards.[125] Of cases that settled, 98% of plaintiffs' lawyers and 86% of defense lawyers reported that they were satisfied. In award cases, 74% of plaintiffs' lawyers and 49% of defense lawyers reported that they were satisfied.

M. Terminations and Arbitrator Involvement

In Phase I, 278 cases entered the program between February 15, 1986 and April 31, 1987. As of June 30, 1988, 270 cases had terminated:[126] 183 were settled, 65 went to awards, 16 were dismissed, 6 were classified as "other," and 8 were pending.[127] Of the cases that were terminated, settlements accounted for 68% and awards accounted for 24% of the cases.[128] The ratio of settlements to

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STATES COURTS (1987); THE BUSINESS OF STATE TRIAL COURTS 43 (National Center for State Courts 1983).

[125] Although in this phase of the evaluation clients were not surveyed to determine their satisfaction with the arbitration program, the lawyers were asked to give estimates of their clients' satisfaction. Both plaintiff and defense lawyers thought that their clients were satisfied with the arbitration program. Interestingly, defense lawyers estimated that their clients were more satisfied than they, the lawyers, were, and plaintiffs' lawyers estimated that their clients were equally or less satisfied than they, their lawyers, were. Of cases that settled, both 92% of plaintiffs' lawyers and 92% of defense lawyers estimated that their clients were satisfied. In award cases, 74% of plaintiffs' lawyers and 57% of defense lawyers estimated that their clients were satisfied.

[126] Termination statistics have been provided by Ed Aoki, Arbitration Administrator.

[127] Phase II will have a larger number of cases both because of the higher ceiling and largely because the program is mandatory in Phase II. As of June 30, 1988, 974 cases have entered the Phase II program and 447 have terminated. Of the cases that entered Phase II, 211 were settled, 66 went to awards, 96 were dismissed, 53 were exempted, 17 were classified as "other," and 531 are pending in this on-going program.

[128] In Phase II, settlements have accounted for 55% and awards have accounted for 16% of

awards was approximately three to one (183 to 65).

Some cases settled before the arbitrator was appointed, others settled after the appointment of the arbitrator, but before the arbitrator did any work on the case. Some cases settled with the arbitrator's assistance. Other cases, of course, went to an award. Survey results indicated that arbitrators were actively involved in approximately half the cases. Twenty-eight percent of the cases settled with the arbitrator's assistance.[129] Twenty-four percent of the cases studied received an arbitrator's award. Of the remaining cases, there was either no arbitrator appointed or very little arbitrator activity. The mean number of hours that arbitrators spent on cases was 5.1 hours on settled cases and 15.4 hours on award cases.[130]

N. Appeals to a Trial De Novo

After an arbitration award, a case can be appealed to a trial de novo. So far, 65 awards have been issued, 26 appeals have been filed, and 16 cases have settled before the trial de novo. All other appeals were still pending. At a later date, the evaluation project will collect data on these appeal cases. In Phase I 40% of the awards have been appealed.[131] Arbitration programs across the country find that a much higher percentage of cases appeal than ultimately go to the trial de novo.[132] In other arbitration programs, most appeals settle before trial.[133]

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the terminations. As in Phase I, Phase II has experienced a ratio of three settlements (394) to each award (131).

[129] The arbitrator has the authority "to attempt, with the consent of all parties in writing, to aid in the settlement of the case." HAW. ARB. R. 11(A)(10). However, cases may settle while the arbitrator is working on the case, but without the direct assistance of the arbitrator. In one case reported to the Arbitration Administrator, the lawyers settled the case while waiting in the lobby of the arbitrator just before the first meeting with the arbitrator. This example shows the importance of using court-annexed arbitration to bring the opposing lawyers together to talk about the case earlier than they would normally meet in regular litigation.

[130] Early returns on Phase II surveys show that mean hours for arbitrators are down slightly in Phase II. The mean number of hours that arbitrators spent on cases was 3.5 hours on settled cases and 13.8 hours on award cases.

[131] In Phase II, 51%, or 38 of the 75 awards have been appealed.

[132] For example, one study of three federal district courts found that appeals were filed in 60% of cases that went to awards. However, the actual number of trials held was less than the numbers of trials before the arbitration programs began. Lind & Foster, *supra* note 16, at 128.

[133] D. HENSLER, COURT-ANNEXED ARBITRATION IN THE STATE TRIAL COURTS SYSTEM 8 (Rand Institute for Civil Justice 1984).

O. *Arbitrator Quality and Supply*

The issues of arbitrator quality and supply are very important to the program. The viability of the arbitration program depends upon the ability of volunteer arbitrators, drawn from the ranks of partisan practicing lawyers, to credibly assume the role of high-quality, neutral experts. Two items in the case closing survey are germane to these concerns about perceived arbitrator quality. The vast majority (90%) of both plaintiffs' and defense lawyers agree that arbitrators have the requisite experience to decide the cases before them fairly, and nearly as many, 89% of plaintiffs' and 80% of defense lawyers, believe that the arbitrator was neutral and impartial.

Of course, the arbitration program must have a sufficient supply of qualified arbitrators to meet the case demands. Because the program assigns an arbitrator to a case at a very early stage, each case needs an arbitrator. Initially, 241 arbitrators were in the arbitrator pool for the Phase I program.[134] The size of the arbitrator pool has been increased to 416 in the Phase II program, but arbitrator supply remains a critical issue for the program. If the Hawaii program was not placing half of the arbitration-eligible cases into a "control group" and re-assigning them back to the regular litigation track, CAAP would not be able to assign arbitrators to every case in the program.

P. *Complex Litigation*

Although many people have suggested that arbitration may be inappropriate for complex cases,[135] most lawyers reported that these Phase I cases were not complex. In 1986, the research team conducted a telephone survey of lawyers with cases in or eligible for the $50,000 Phase I program. One focus of that survey was to determine what types of cases might be inappropriate for CAAP. Several lawyers questioned the appropriateness of arbitration for complex cases. Very few of the lawyers in this recent survey thought that their cases were complex. Only 12% of plaintiff lawyers and 4% of defense lawyers reported that their cases were complex.

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[134] Arbitrators volunteered for the program by agreeing to serve after receiving a letter from the Chief Justice of the Hawaii Supreme Court.

[135] Results of telephone interviews with lawyers, November-December 1986 (on file in the office of The Study of Arbitration and Litigation, University of Hawaii at Manoa). The arbitrators must have substantial experience in civil litigation and have been licensed to practice in the state for five years. HAW. ARB. R. 10.

Q. *Amounts of Settlements and Awards*

The 24 surveyed cases that settled averaged $20,803.63. Arbitration awards were somewhat higher. If the zero awards are excluded from the survey results, the mean value of awards was $28,662.92. If the 3 zero awards are included, the average was $25,223.37.

Plaintiffs' lawyers reported that settlements averaged $21,899 and that awards averaged $27,875. Defense lawyers reported slightly lower averages, $20,060 for settlements and $25,105 for awards (excluding zero awards).

The survey also asked lawyers to report what they initially thought their case was worth. Defense lawyers, on the average, valued the amount at issue lower than the plaintiffs' lawyers did. Plaintiffs' lawyers' estimates of the worth for cases that went to settlement averaged $29,407 and for awards $30,488. For defense, estimates of the worth for cases that settled averaged $19,408 and awards averaged $12,795.

R. *Insurance Companies*

Because insurance companies initially provided part of $200,000 in private funding to begin Phase I of CAAP, it can be assumed that these companies thought the program would save defense costs. So far, however, there has been no direct critique from insurance companies concerning the arbitration program. If the program does in fact save defense costs, an interesting economic factor may arise on the defense side. Reduced discovery should be viewed as a positive factor by the insurance companies because their costs will decrease. Reduced discovery, however, will mean that the defense lawyers will then find that their incomes have decreased. The ramifications of this clash of interests on the defense side are open to speculation.

IV. Conclusions

The initial findings of the evaluation of Hawaii's Court-Annexed Arbitration Program indicate that the program is meeting its goals. Costs to litigants have decreased, the pace of disposition has increased, and the satisfaction of the lawyers has been maintained. Most importantly from a national perspective is the indication that in a carefully controlled arbitration program, discovery (and correspondingly costs to litigants) can be reduced without impairing the fairness of the dispute resolution process. Court-Annexed Arbitration, particularly in the Hawaii form, appears to offer great promise in reducing the long standing problems of delay and costs in the United States' legal system.

Participating lawyers differ somewhat in their view of CAAP. Lawyers were

satisfied with the program, although more plaintiffs' lawyers were satisfied than were defense lawyers. As might be expected, more lawyers were satisfied with their voluntary settlements than with the awards rendered by the arbitrators.

Most plaintiffs' lawyers, defense lawyers and arbitrators reported that the program reduced discovery and that discovery reduction did not affect case outcome. Most plaintiffs' lawyers believed that if their case had not been in CAAP it would have cost more to terminate the case. Only about half of the defense lawyers believed that the arbitration program was less costly than ordinary litigation. Similarly, most plaintiffs' lawyers believed that if their case had not been in the arbitration program it would have taken longer to terminate the case. Only about half of the defense lawyers believed that the arbitration program was faster than ordinary litigation. Later evaluation efforts will explore the reasons for the consistent differences in views of plaintiffs' and defense lawyers. It is possible, however, that CAAP has in some way changed the practice of law, especially for defense lawyers, and this change, rather than economic factors, accounts for the less favorable opinion about CAAP by defense lawyers.

TABLE 1

DISCOVERY REDUCTION

(SHOWN IN PERCENTAGES)

	PLAINTIFF		DEFENSE	
	SETTLEMENT	AWARD	SETTLEMENT	AWARD
DISCOVERY REDUCED	85	86	76	78
NOT REDUCED	15	14	24	22
	n=40	n=43	n=37	n=51
DISCOVERY REDUCTION AFFECTED OUTCOME				
NO	86	78	71	72
YES OR MAYBE	14	22	29	28
	n=36	n=41	n=32	n=49
ARBITRATOR DENIED DISCOVERY REQUEST				
NO	83	80	72	61
YES	17	20	28	39
	n=35	n=41	n=29	n=46

TABLE 2
COSTS

COSTS IF NOT IN ARBITRATION				
LESS	-	2	5	11
SAME	20	12	37	37
GREATER	80	86	58	52
	n=40	n=42	n=38	n=46
DISCOVERY COST				
≤$400	57	27	42	34
401-999	34	38	32	32
1000 and over	9	35	26	34
Average Cost	$445	$761	$750	$962
	n=35	n=37	n=31	n=35

TABLE 3
PACE: ARBITRATION COMPARED TO LITIGATION

IF CASE WAS NOT IN CAAP, IT WOULD HAVE CLOSED				
SOONER	-	5	-	13
IN SAME TIME	13	7	29	24
LATER	87	88	71	61
	n=39	n=42	n=38	n=46

TABLE 4
LAWYER SATISFACTION

SATISFACTION				
LAWYER				
SATISFIED	98	75	86	49
DISSATISFIED OR AMBIVALENT	2	25	14	51
	n=39	n=43	n=36	n=49

AWARD COMPARED WITH ESTIMATED TRIAL VERDICT		
SIMILAR	64	47
DIFFERENT	36	53
	n=42	n=45
AWARD COMPARED WITH EXPECTATION FOR AWARD		
BETTER	14	-
SAME	43	43
WORSE	43	57

TABLE 5
RATINGS OF ARBITRATORS

	PLAINTIFF		DEFENSE	
	SETTLE	AWARD	SETTLE	AWARD
ARBITRATOR EXPERIENCE				
NOT ENOUGH		19	3	15
YES, ENOUGH	100	81	97	85
	n=32	n=36	n=33	n=46
ARBITRATOR FAIRNESS				
IMPARTIAL	91	88	82	79
PARTIAL BUT NO EFFECT	9	2	12	6
PARTIAL AND EFFECT	-	10	6	15
	n=32	n=40	n=33	n=48

TABLE 6
AVERAGE SETTLEMENT AND AWARD AMOUNTS

	PLAINTIFF		DEFENSE	
	SETTLE	AWARD	SETTLE	AWARD
MEAN AMOUNTS, EXCLUDING ZERO AMOUNTS	$21,899	$27,875	$20,060	$25,105
	n=41	n=37	n=38	n=40
MEAN AMOUNTS, INCLUDING ZERO AWARDS		$23,985		$19,690
		n=43		n=51
ESTIMATES OF WORTH	$29,407	$30,488	$19,408	$12,795
	n=38	n=43	n=30	n=44

New Players in the Public Borrowing Game: Tax and Sovereignty Considerations as Freely Associated States and Indian Tribes Approach Wall Street

by Carl Ullman*

I. INTRODUCTION

In recent years public borrowing in the United States has grown dramatically as authorities at all levels find themselves in greater need of significant capital accumulations in order to meet the needs of constituencies that have been either assigned to them or secured to them by the electoral process. This fiscal activity, encouraged by favorable tax treatment for a broad spectrum of such borrowers, is part of an enormous and dynamic industry involved in marketing and trading public debt.[1] By its nature this industry balances risk against return and

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[1] For example, the amount of new issue municipal bonds generated in recent years is, in millions of U.S. dollars:

1985 228,653
1986 172,219
1987 121,039
1988 (through Nov. 21) 122,454

"Yankee" bonds issued in the U.S. by foreign entities providing public services such as electric power or telecommunications total, in millions of U.S. dollars:

1985 4,215
1986 6,492
1987 5,752
1988 (through Dec. 7) 8,956

Telephone conference with Walter J. Laskey, Vice President, Honolulu Office, Merrill Lynch Consumer Markets (Dec. 12, 1988).

This is a substantial and vigorous market despite the decline in the municipal bond market as a result of the Tax Reform Act of 1986, which narrowed the class of such bonds whose interest income is exempt to holders. *Id.* For a discussion on the Tax Reform Act of 1986, see *infra* text accompanying notes 94-96.

pays paramount attention to analyzing the risk/return balance as it affects lenders and particular borrowers.

In the political arena, as pressure for institutional change has exceeded the support for institutional maintenance[2] existing governing bodies and newly recognized entities[3] have both emerged as public authorities newly burdened by the same responsibilities and constituents' demands that fuel the public finance industry. This article considers two types of such entities as potential borrowers in the public finance industry, and examines two discrete factors in the risk/return equation.

The borrowers selected are (1) the Freely Associated States of the Micronesian (Freely Associated States)[4] region as they emerge from forty years of United States administration, by the Interior Department's Trust Territory of the Pacific Islands, under a United Nations trusteeship,[5] and (2) the governments of long-established Indian tribes in the United States as they take on a broader range of the burdens of governmental responsibility for public utility infrastructure and economic development.[6] The "risk" factors examined are the borrowers' potential invocation of sovereign immunity and related legal doctrines as defenses to lenders' debt collection efforts. The "return" factors examined include the potentially exempt status under United States tax law of lenders' interest income from loans to these borrowers.[7]

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[2] Political change and the emergence and disappearance of governing structures are analyzed from a global perspective by Reisman & Suzuki, *Recognition and Social Change in International Law: A Prologue for Decisionmaking*, in INTERNATIONAL LAW ESSAYS 493 (1981).

[3] For example, three new governments discussed herein have emerged from the United Nations Trust Territory of the Pacific Islands to take on the resonsibilities of self-government, *see infra* note 69, including the full range of capital intensive governmental responsibilities like roads, airports, hospitals, sewer and water infrastructure and power generation.

[4] The term "Micronesia" is used here to refer to the islands of the Northern Marianas, Eastern and Western Carolines, and Marshalls. This usage makes the term coextensive with the territory governed by the Trust Territory of the Pacific Islands. It does not include Guam (a United States possession since it was severed from Spain after the Spanish-American war) or the Line Islands, Gilbert Islands, or Nauru, all of which are geographically a part of Micronesia but were not part of the trusteeship and are not now in free association with the United States. The Freely Associated States of the region include the Federated States of Micronesia (in the Carolines), the Republic of the Marshall Islands, and, potentially, the Republic of Palau (also in the Carolines).

[5] *See* Compact of Free Association Act of 1985, Pub. L. No. 99-239, 99 Stat. 1800 (1986) [hereinafter Compact] (establishing the freely associated status of the Federated States of Micronesia and the Republic of the Marshall Islands, and laying part of the foundation for the same status for the Republic of Palau).

[6] *See, e.g.*, The Indian Tribal Government Tax Status Act of 1982, Pub. L. No. 97-473, 96 Stat. 2607 (1983) (codified at 26 U.S.C. § 7871 (1982 & Supp. IV 1986); King, *Hodel Urging Shift in Indian Programs*, N.Y. Times, Oct. 27, 1987, at A18, col. 4; King, *Navajos Plan Luxury Tourist Resort on Reservation*, N.Y. Times, Oct. 28, 1987, at A20, col. 4.

[7] The selection of these types of borrowers and risk factors is not intended to imply similarities among the governments other than as expressly discussed herein.

This article assumes that the governments discussed have decided that the interests of their constituencies are furthered by public borrowing or at least that the feasibility of such borrowing is worthy of close study.[8] The paper takes an overview of borrower/lender relations and assumes the participants seek to reduce the borrowing cost by minimizing lender risk.[9] The article analyzes applicable judicial doctrine but does not draft or review specific language for loan instruments or recommend specific dedications of capital.[10] Finally, the article assumes that American marketing mechanisms will be initially relied on, though it is also expected that foreign lenders may participate in various phases.[11]

II. FREELY ASSOCIATED STATES OF MICRONESIA

A. *Political History and Status*

1. *United Nations trusteeship*

Before the end of World War II the Allied powers agreed that there was a need for a new mechanism to replace the mandate system for governing what were described as dependent territories.[12] Moreover, the United States wanted

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[8] The decision to incur public debt can involve consideration of a wide range of political, social, and economic factors, some of which may be unique to the particular projects being contemplated. These can include, for example, the size of the constituency to be served, the perceived need for the project, projections of income to service debts, reliability of such projections, availability of alternative funding sources or alternative service providers, campaign promises, proximity of elections and the like.

[9] In any public debt transaction the borrowing government will seek to minimize its costs, usually by minimizing the interest that must be paid on borrowed funds. Interest is in part a function of the risk perceived by lenders. Indeed, analysis of such risk has itself spawned an industry that studies borrowers and assigns their bond offerings ratings to reflect the credit-worthiness of the borrower and the security of the bond. *See* PUBLIC SECURITIES ASSOCIATION, FUNDAMENTALS OF MUNICIPAL BONDS (rev. ed. 1982).

[10] The factors in a decision about a particular public project and associated borrowing are too many and unique to allow generalized recommendations here. *See supra* note 8.

[11] The American bond marketing industry is among the largest and most aggressive in the world. For the historic reasons discussed herein, the American bond industry will be the most familiar with the legal status and the political leadership of both and Freely Associated States and American Indian governments. Geographic proximity also suggests that American Indian governments can be expected to look first to domestic underwriters.

[12] 1 M. WHITEMAN, DIGEST OF INTERNATIONAL LAW 735 (1963). Territories that were not self-governing under the League of Nations system were "mandated" to metropolitan powers for administrative purposes. The islands that now comprise the Freely Associated States, for example, were mandated to Japan. The mandate required, among other things, that Japan not militarize the islands. For the Allies during World War II, the inability to enforce this requirement was a

to replace Japan as the administrative authority in Micronesia.[13]

At the Yalta Conference the United States obtained Allied agreement that the new trusteeship system would apply, in part, to "territory to be detached from the enemy as a result of this war[.]"[14] Enactment of specific rules for governing territories was postponed until development of the United Nations Charter.[15] Ultimately, the United Nations granted to the United States administrative responsibility for Micronesia.[16] Consistent with the idea that trusteeship would be a temporary status, both the Charter[17] and the Trusteeship Agreement[18] required the United States, as administering authority, to assist the inhabitants of the territory toward "self-government or independence."[19]

Despite the Charter's considerable detail about trust territories, the political character of the trusts was unclear.[20] It is clear, however, that sovereignty is *not* vested in the administering authority. The United States, for example, specifically disclaimed sovereignty over the Micronesian islands. Australia and the

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contributing factor to the war and demonstrated the need for a new mechanism for administering nonself-governing areas.

[13] Report to the President from the Chairman of the United States Delegation, San Francisco Conference, Secretary of State, 126-32 (June 26, 1945), *quoted in* 1 M. WHITEMAN, DIGEST OF INTERNATIONAL LAW 735 (1963). Japan lost the Micronesian islands, which it held under the League of Nations mandate, to the Allied forces in some of the bloodiest fighting of World War II.

[14] *Id.* at 736.

[15] *Id.* The United Nations Charter was drafted containing specific provisions for trust territories. Articles 75 through 85 establish the machinery for trust creation and administration while the details of each trust are left for negotiation between the United Nations and the administering authority. U.N. CHARTER arts. 75-85. Two types of trusts, strategic and nonstrategic, are provided for in the Charter. *Id.* art. 82. The primary distinction is that nonstrategic trusts are administered by the Trusteeship Council and strategic trusts by the Security Council. Of the eleven trusts created Micronesia became the only one designated strategic.

[16] The arrangement was titled the Trusteeship Agreement for the Former Japanese Mandated Islands. July, 18, 1947, 61 Stat. 3301, T.I.A.S. No. 1665, 8 U.N.T.S. 189 [hereinafter Trusteeship Agreement]. Japan formally relinquished control and "renounc[ed] all right, title and claim in connection with the League of Nations Mandate System, and accept[ed] the action of the United Nations Security Council . . . extending the trusteeship system to the Pacific Islands formerly under mandate to Japan." Treaty of Peace with Japan, Sept. 8, 1951, T.I.A.S. No. 2491.

[17] U.N. CHARTER art. 76(b).

[18] Trusteeship Agreement, *supra* note 16, art. 6.

[19] *Id.*; U.N. CHARTER art. 76(b).

[20] Ambassador Sayre, an early United States representative to the Trusteeship Council, wrote that the trusteeship provisions "offer some of the most complex legal problems in the entire Charter". Sayre, *Legal Problems Arising from the United Nations Trusteeship System*, 42 AM. J. INT'L L. 262, 268 (1948). Trusteeship issues include questions of the meaning of the ultimate goal of "independence or self-government," the lack of specified Charter processes for terminating a trust, and the question of where sovereignty over a trust territory is vested. *See id.*

United Kingdom issued similar disclaimers of sovereignty over their respective trusteeships.[21]

Despite these disclaimers the administering states were still required to govern their particular trust territories. Article 3 of the Trusteeship Agreement gave the United States "full powers of administration, legislation, and jurisdiction over the territory[.]"[22] After an initial period of administration by the Navy, the United States Congress vested full administrative authority over the Trust Territory in the President,[23] who in turn delegated this authority to the Secretary of the Interior.[24] The Secretary further delegated executive powers to a High Commissioner and vested judicial review in a High Court.[25] A Congress of Micronesia comprised of citizens of the territory was eventually established and vested with partial legislative power while the High Commissioner retained complete veto power over legislation.[26] Through these mechanisms the United States exercised complete administrative power though sovereignty was still disclaimed.[27] Thus, the trusteeship system left unsettled the precise political identity of the entities it had created.

2. *Government under the Trust Territory of the Pacific Islands*

Whatever the exact nature of the governing apparatus of the Trust Territory of the Pacific Islands (Trust Territory), it was adequate to meet the United States' responsibilities under the United Nations Charter. While the Soviet Union occasionally objected to United States administrative activity, no formal attempts were made to alter the nature or execution of the trusteeship.

Difficult problems, however, confronted United States federal courts in deciding whether the Trust Territory was a "foreign country," a "territory," or an "agency" of the United States.[28] Analysis of these cases indicates that the Freely

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[21] *Id.* at 271. The trust territories administered by Australia were Nauru (administered by Australia on behalf of Australia, New Zealand and the United Kingdom) and New Guinea. Those administered by the United Kingdom were Tanganyika and parts of Togoland and Cameroon.

[22] Trusteeship Agreement, *supra* note 16, art. 3.

[23] 48 U.S.C. § 1681 (1982 & Supp. 1986).

[24] Exec. Order No. 11021, 3 C.F.R § 600 (1959-1963).

[25] *See, e.g.*, Order No. 2918 of the Secretary of the Interior, as amended March 24, 1976.

[26] *Id.* pt. 3, § 13.

[27] Under United States administration, the trust islands had no ability to conduct foreign affairs or even to implement domestic policy by legislation free from United States review. American disclaimers of sovereignty were based not on a lack of immediate power but, rather, on the international source of that power and the obligations imposed by the United Nations on the administering state. *See supra* text accompanying notes 20-21.

[28] *See, e.g.*, People of Saipan v. Department of the Interior, 502 F.2d 90 (9th Cir. 1974), *cert. denied*, 420 U.S. 1003 (1975); McComish v. Commissioner, 580 F.2d 1323 (9th Cir. 1978);

Associated States have taken a step away from United States control, with the effect of clarifying their status for tax and sovereignty purposes.

In *People of Saipan v. Department of the Interior*,[29] the United States Court of Appeals for the Ninth Circuit addressed Micronesian claims that the Administrative Procedure Act (APA)[30] applied to actions of the Trust Territory.[31] The plaintiffs contended that the Trust Territory was an "agency" and not a "territory or possession" exempted from the APA's application.[32] By focusing on whether the Trust Territory government was subject to the exemption for territories, the court assumed that the Trust Territory's origins in United States law included it as a United States "authority."[33] Thus the inquiry became whether the territorial exception applied. First, the court noted that the Trust Territory was not a territory or possession.[34] It then discussed conflicting cases dealing with agency status, but dismissed those cases because they did not consider agency status for APA purposes.[35] Ultimately the court held without citation that the Trust Territory was sufficiently like a territory that Congress must have intended the exemption to include the Trust Territory.[36] The court reasoned that since the Trust Territory's activities occur so far from the United States, Congress could not have intended United States federal courts to provide judicial review of the Trust Territory's activities.[37]

The difficult issue in this case involved the uncertainty of Trust Territory

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Gale v. Andrus, 643 F.2d 826 (D.C. Cir. 1980); Thompson v. Kleppe, 424 F. Supp. 1263 (D. Haw. 1976); Temingil v. Trust Territory of the Pac. Islands, 33 Fair Empl. Prac. Cas. 1029 (D.N.M.I. 1985); Callas v. United States, 253 F.2d 838 (2d Cir. 1958); Adranas v. Hogan, 155 F. Supp. 546 (D. Haw. 1957); Bowoon Sangsa Co. v. Micronesian Indus. Corp., 720 F.2d 595 (9th Cir. 1983).

[29] 502 F.2d 90 (9th Cir. 1974), *cert. denied*, 420 U.S. 1003 (1975).

[30] 5 U.S.C. §§ 701-706 (1982 & Supp. IV 1986).

[31] At issue was the applicability of the APA provisions allowing judicial review of agency action. 502 F.2d at 93.

[32] The United States Code states, "For purposes of this chapter . . . 'agency' means each authority of the Government of the United States whether or not it is within or subject to review by another agency, but does not include . . . the governments of the territories or possessions of the United States." 5 U.S.C. § 701(b)(1)(C) (1982).

[33] The court did not discuss whether the absence of United States sovereignty meant that the Trust Territory was not an "authority" of the United States. Rather, it compared the Trust Territory to the governments of territories and possessions and concluded that Congress intended to exclude "all governments of this general type created pursuant to the authority of Congress." 502 F.2d at 95.

[34] *Id.* at 95.

[35] The court reasoned that conflicting cases dealing with agency status were limited to the applicability of the Federal Tort Claims Act and of federal taxation, citing Callas v. United States, 253 F.2d 838 (2d Cir.), *cert. denied*, 357 U.S. 936 (1958); Brunell v. United States, 77 F. Supp. 68 (S.D.N.Y. 1948); and Richard W. Benfer, 45 T.C. 277 (1965).

[36] 502 F.2d at 95.

[37] *Id.* at 95-96.

sovereignty. An ambiguity arose out of constraints on United States control imposed by the Trusteeship Agreement.[38] The court believed an anomaly existed whereby the more directly controlled territories and possessions under United States sovereignty were exempt from application of the APA while the more independent Trust Territory was included within it. To cure the anomaly the court created the territorial similarity theory which treated both entities the same for APA purposes.

In 1978, in *McComish v. Commissioner*,[39] the United States Court of Appeals for the Ninth Circuit addressed the issue of the Trust Territory's status relating to section 911 of the Internal Revenue Code.[40] Earlier cases had used a "control" test to determine whether United States activity in a particular area was direct enough to warrant application of the tax statute.[41] The *McComish* court, relying on the attenuated nature of United States control inherent in the trusteeship held that section 911 did not apply.[42] To achieve this result, the court interpreted *People of Saipan* as holding that the Trust Territory is not an agency of the United States.[43] This analysis, however, is misleading since *People of Saipan* assumed that the Trust Territory was included in the definition of agency, and ruled instead on the availability of the territorial exemption.[44]

In *Gale v. Andrus*,[45] the court, construing language in the Freedom of Information Act (FOIA) identical to that of the APA, held first that the Trust Territory was not an agency[46] and, alternatively, that the territorial similarity theory would bring it within the FOIA's exemption for territories and possessions.[47] Accordingly:

> It would thus be highly inconsistent for this Court to hold that territories and possessions are exempt, but the Trust Territory is not, when the latter is more removed from substantial control by the United States than most territories and possessions, and is on the road to self-government. Therefore, we find that the

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[38] Trusteeship Agreement, *supra* note 16.

[39] 580 F.2d 1323 (9th Cir. 1978).

[40] I.R.C. § 911 (1978).

[41] *See* Kalinski v. Commissioner, 528 F.2d 969 (1st Cir. 1976) (United States "control" is present when Air Force sets up a Child Guidance Center because the Air Force monitors the program and controls budget and price lists); Morse v. United States, 443 F.2d 1185, 195 Ct. Cl. 1 (1971), *cert. denied.*, 405 U.S. 989 (1972) (United States Employees Association is "controlled" by the United States because the government is able to initiate or terminate the Association to meet government purposes).

[42] 580 F.2d at 1328.

[43] *Id.* at 1330.

[44] *See supra* discussion at notes 33-37.

[45] 643 F.2d 826 (D.C. Cir. 1980).

[46] *Id.* at 832.

[47] *Id.* at 833.

> Trust Territory is "like" territories and possessions of the United States and is exempt from coverage under § 551(1)(C) of the Freedom of Information Act.[48]

Given this precedent, it is arguable that the territorial similarity theory includes the Trust Territory as a territory for purposes of section 103 of the Internal Revenue Code,[49] thus permitting the Trust Territory and the Freely Associated States to issue tax-exempt bonds. The matter, however, is not so easily resolved. First, there are cases that militate against this approach. Some federal courts resolved status ambiguities by pushing the Trust Territory away from the United States on the sovereignty spectrum. Both *Callas v. United States*[50] and *Adranas v. Hogan*[51] have treated the Trust Territory as a foreign nation.[52] And, in *Thompson v. Kleppe*,[53] the Federal District Court of Hawaii held that the Trust Territory is not a territory or state for purposes of federal statutory civil rights.[54]

Second, territorial similarity for some purposes does not mean similarity exists for all purposes. A careful analysis requires looking to the purposes of the statutes at bar prior to applying the territorial similarity theory. A proper analysis for purposes of Internal Revenue Code section 103 requires consideration of the intent of the tax exemption and whether it is served by extending it to the Trust Territory or the Freely Associated States. On one hand the United States'

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[48] *Id.*

[49] I.R.C. § 103 (1988). Section 103(a) exempts from gross income a bondholder's interest on certain government bonds, allowing the affected government to enjoy a lower interest rate when using such bonds as a borrowing device.

[50] 253 F.2d 838 (2d Cir. 1958) (exemption in Federal Tort Claims Act for events taking place in a foreign country applies).

[51] 155 F. Supp. 546 (D. Haw. 1957) (return to Hawaii from Marshall Islands is re-entry into United States for purposes of Immigration and Nationality Act); Immigration and Nationality Act, 8 U.S.C. § 1101 (1982).

[52] *Cf.* Bowoon Sangsa Co. v. Micronesian Indus. Corp., 720 F.2d 595, 602 (9th Cir. 1983) (as long as the High Court of the Trust Territory of the Pacific Islands holds review power over the decisions of Palauan courts, Palau cannot be said to be foreign).

[53] 424 F. Supp. 1263 (D. Haw. 1976).

[54] *Id.* at 1265. The text of the statute provides:

> Every person who, under color of any statute, ordinance, regulation, custom or usage of any State or Territory, subjects or causes to be subjected, any citizen of the United States or other person within the jurisdiction thereof to the deprivation of any rights, privileges, or immunities secured by the Constitution and laws, shall be liable to the party injured in an action at law, suit in equity, or other proper proceeding for redress.

42 U.S.C. § 1983 (1982).

While a thorough analysis led another District Court to the opposite conclusion largely on the territorial similarity theory, Temingil v. Trust Territory of the Pac. Islands, 33 Fair Empl. Prac. Cas. 1029 (D.C.N.M.I. 1985), *Kleppe* at least suggests that the theory is not universally embraced.

obligation to promote the welfare of the inhabitants of the Trust Territory[55] favors allowing bonds to be issued for infrastructure projects and therefore benefit from the cost savings of the section 103 tax exemption. On the other hand, the United States is also obligated to move the islands toward self-government or independence. Either status reduces the United States' obligations to Micronesia thereby reducing the motivation to subsidize Micronesian development at the expense of United States revenues. This expectation of attenuated ties between the Trust Territory and the United States suggests an additional strain on the territorial similarity theory as material changes occur in the political relationships that justify the tax exemption. Therefore, it is not surprising that a court (or the Internal Revenue Service) might feel compelled to resolve ambiguities in status by applying a territorial *dis*similarity analysis,[56] which would lead to the conclusion that the Trust Territory is not a territory for purposes of section 103.

Recent developments in Micronesia, however, serve to clarify heretofore uncertain political status questions.

3. Emergence of the Freely Associated States

a. Negotiation of the Compacts of Free Association

Micronesian demands for a greater voice in their own affairs and an American desire to move in directions suggested by the Trusteeship Agreement both led the Interior Department to begin transferring control of the apparatus governing Micronesia.[57] In 1964 the Congress of Micronesia was established. The Congress represented all the Districts of the Trust Territory.[58] Composed exclusively of citizens of the Trust Territory who were elected to the bicameral body, the Congress held a law-suggesting power. Bills passed by the Congress could be vetoed by the High Commissioner.[59]

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[55] *See supra* text accompanying notes 17-19.

[56] A dissimilarity analysis reasons that termination of the trusteeship obligations in Micronesia removes the reasons for subsidizing development through tax exemptions at the United States' expense. This distinguishes the Trust Territory from other permanent territories where those reasons continue to exist.

[57] For a history of events encouraging the transfer of political power to citizens of the Trust Territory see, D. MCHENRY, MICRONESIA: TRUST BETRAYED (1975); N. MELLER, THE CONGRESS OF MICRONESIA (1969), and S. DESMITH, OPTIONS FOR MICRONESIA: A POTENTIAL CRISIS FOR AMERICA'S PACIFIC TRUST TERRITORY (1969).

[58] Micronesia had been divided into seven administrative regions called Districts. They were the Northern Marianas, the Marshalls, Yap, Palau, Truk, Pohnpei and Kosrae.

[59] *See, e.g.*, Department of the Interior Secretarial Order 2918; and *supra* text accompanying notes 24-26.

In 1966, leaders of the Congress of Micronesia initiated their first formal move toward self-government by petitioning President Lyndon B. Johnson to establish a Micronesian status commission.[60] While the Johnson administration studied the request, the Congress of Micronesia appointed its own commission to study the alternatives open to Micronesia.[61] Ultimately the Micronesian Commission recommended negotiations with the United States leading to free association with the United States or, alternatively, independence.[62] In October 1969, negotiations between the United States and Micronesia formally opened in Washington.[63]

The United States initially proposed commonwealth status for the entire Territory.[64] The proposal received a mixed reception. Most Districts rejected the proposal because it was inconsistent with the desire for self-government. The Mariana Islands, however, saw the proposal as a path to a long-sought closer association with the United States.[65] The proposal brought into focus fundamental differences in the aspirations of various island groups, leading eventually to separate negotiations between the United States and the Mariana Islands.[66] Later negotiations saw the remaining Districts dividing along lines reflecting culture, geography, and the presence or absence of American military activity.[67]

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[60] D. MCHENRY, *supra* note 57, at 88. The petition asked the President "to establish a commission to consult the people of Micronesia to ascertain their wishes and views, and to study and critically assess the political alternatives open to Micronesia." S. DESMITH, *supra* note 57, at 4.

[61] The body was called the Future Political Status Commission. It was chaired by Representative Lazarus Salii of Palau and began its meetings in November, 1967, and met again in January and April, 1968. Members visited the United Nations, Puerto Rico and the United States Virgin Islands later in 1968. The Commission produced its first Interim Report in June, 1968. S. DESMITH, *supra* note 57, at 5.

[62] D. MCHENRY, *supra* note 57, at 89.

[63] Meanwhile, the United States Congress did not make known any formal views on the status question. No enabling legislation was passed to authorize negotiations and even President Johnson's proposal for a study commission failed passage. *Id.* at 94.

[64] Commonwealth status would bring the entire territory permanently under United States' control. This was the alternative studied by the Micronesian Future Political Status Commission in Puerto Rico and the Virgin Islands, but not included in the Commission's formal recommendations. S. DESMITH, *supra* note 57, at 5, 14-19.

[65] D. MCHENRY, *supra* note 57, at 130.

[66] These negotiations had the announced intent of reaching agreement on a commonwealth relationship. *Id.*

[67] In the Marshall Islands the United States sought continued control of the Kwajalein Missile Range on Kwajalein Atoll. Also, the plight of radiation victims from nuclear weapons testing at Bikini and Eineweţok posed unique complications in the Marshallese negotiations with the United States.

In Palau the United States sought use of about one-third of the largest island as a military training site. Palauan constitutional restrictions on the presence of nuclear devices added a further complicating factor.

The remaining Districts formed the Federated States of Micronesia. Here the United States

The goal of greater self-government, however, remained. The differences resulted in one set of "commonwealth" negotiations leading to a Covenant with the Marianas,[68] and another set of three "free association" negotiations leading to Compacts with new freely associated states: the Republic of the Marshall Islands, the Republic of Palau, and the Federated States of Micronesia (FSM).[69]

Following concentrated political education campaigns, plebiscites were conducted under United Nations auspices and the new political relationships were approved by the island citizenry.[70] In 1986, declarations were exchanged between the United States and the new entities putting into effect the Compacts and Covenant[71] for all entities except Palau.[72]

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sought no immediate physical military presence, settling instead for "denial rights" that would allow the United States to forbid entry to the these Districts by a third nation's forces.

[68] Negotiations were substantially completed in 1975. Under the Covenant of Commonwealth the Northern Marianas are a "self-governing commonwealth" that is "in political union with and under the sovereignty of" the United States. Covenant to Establish a Commonwealth of the Northern Mariana Islands in Political Union with the United States, Feb. 15, 1975, H.R.J. Res. 549, 94th Cong., 1st Sess. (1975); S.J. Res. 107, 94th Cong., 1st Sess. (1975); Pub. L. No. 94-241, 90 Stat. 263, 48 U.S.C. § 1681 (1976). *See* Note, *Self-Determination and Security in the Pacific: Study of the Covenant Between the United States and the Northern Mariana Islands*, 9 N.Y.U. J. INT'L LAW & POL. 277 (1976); Note, *The Marianas, The United States and the United Nations: The Uncertain Status of the New American Commonwealth*, 6 CAL. W. INT'L L.J. 382 (1976); Clark, *Self-Determination and Free Association—Should the United Nations Terminate the Pacific Islands Trust?*, 21 HARV. INT'L L.J. 1 (1980).

[69] Substantial completion of negotiations was reached with the Marshalls in 1980 and with the FSM and Palau in 1982. Under the Compacts of Free Association the new states "acting through the Governments established under their respective Constitutions, are self-governing." Compact, *supra* note 5, tit. 1, art. 1, § 111. The Compact of Free Association Act of 1985 implemented the Compacts as to the Marshalls and FSM. In several plebiscites the voters of Palau rejected certain Compact-related proposals relating to nuclear weapons so that Compact has not been implemented.

[70] The resulting documents were studied by the United States and the Freely Associated States' legislatures for more than a year. The United States Congress had avoided commitment to the negotiation process and felt itself free to impose unilateral changes in the Compact. Those changes required further study and response in Micronesia. For a discussion of changes to the tax and tariff provisions, see *infra* text accompanying notes 88-91.

After the division of Micronesia into four entities, each new entity pursued a path different from that of its brethren. The history presented here is a generalized summary of those events. Particularly in the case of Palau, where the trusteeship is still operative, where voters repeatedly rejected proposed Compact requirements, and where political violence is not unknown, the outcome of these events is still unclear.

[71] *See, e.g.*, Presidential Declaration of November 3, 1986. The effect of commonwealth status is beyond the scope of the remainder of this article, but it bears mention that the Commonwealth of the Northern Mariana Islands issued housing bonds whose access to tax-exempt treatment was unchallenged by the IRS.

[72] The United States and the Freely Associated States contend that implementation of the Compact satisfactorily discharges the United States' obligations under the United Nations Trus-

b. Precursor cases

No United States court has yet construed the Compacts. During the transition from trusteeship to free association, however, questions about the new political status under the Compacts were discussed in several cases treating Micronesia no longer as governed solely by the Trust Territory Government.[73] These cases suggest that the territorial similarity doctrine is no longer applicable to Freely Associated States.

In *Bowoon Sangsa Co., Ltd. v. Micronesian Industrial Corp.*[74] the United States Court of Appeals for the Ninth Circuit analyzed the Palau judiciary's relationship to the United States. The case turned in part on whether the Palau courts were bound to follow a limitation of liability order from the American federal admiralty court in Guam.[75] As part of the transition from trusteeship to free association, Palau created, with the United States' consent, its own courts under its own Constitution.[76] The United States had retained final review by writ of certiorari in the Trust Territory High Court of all decisions of the Supreme Court of Palau.[77] This persuaded the Ninth Circuit that the Palauan judiciary would find itself bound by a Guam federal court's order.[78] Under free association the United States' judicial control, upon which this opinion was based, will disappear. Thus a court following the *Bowoon Sangsa* analysis will find a Freely Associated State no longer subject to United States control and therefore no longer like a territory.

The same result was reached in *United States v. Covington*.[79] An arrest in the Marshall Islands raised *Miranda*[80] issues and the court addressed whether police in the Marshalls were foreign authorities for purposes of United States law.[81]

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teeship. *See* Letter from the Permanent Representative of the United States of America to the Secretary General, United Nations, U.N. Doc. No. S/18424 (Oct. 23, 1986). Termination was approved by the Trusteeship Council, but no Security Council approval was sought or obtained. This leaves unclear the adequacy of the termination process under the United Nations Charter. *See, e.g.*, Clark, *supra* note 68.

[73] Bowoon Sangsa Co. v. Micronesian Indus. Corp., 720 F.2d 595 (9th Cir. 1983); United States v. Covington, 783 F.2d 1052 (9th Cir. 1985); Temingil v. Trust Territory of the Pac. Islands, 33 Fair Empl. Prac. Cas. 1027 (D.C.N.M.I. 1983).

[74] 720 F.2d 595 (9th Cir. 1983).

[75] 720 F.2d at 600-02.

[76] Department of the Interior Secretarial Order 3039, 44 Fed. Reg. 28116 (May 14, 1979).

[77] *Id.* § 5(b).

[78] 720 F.2d at 602. The analysis underestimated the independence of the Palau judiciary during the transition. High Court activity was shrinking and High Court staff was being cut back as the new entities' constitutional courts came on line. The High Court granted no writs of certiorari after 1985.

[79] 783 F.2d 1052 (9th Cir. 1985).

[80] Miranda v. Arizona, 384 U.S. 436 (1966).

[81] Failure to give the warnings required in *Miranda* would not necessarily result in suppression

The Ninth Circuit noted that one result of free association is an absence of United States sovereignty, so the confession was treated as having been taken in a foreign country.[82] *Covington* strongly suggested that under free association a court will view the absence of United States sovereignty as fatal to a territorial similarity analysis.

In *Temingil v. Trust Territory of the Pacific Islands*,[83] the federal court for the District of the Northern Mariana Islands analyzed the political status of the Northern Marianas under the Covenant of Commonwealth. The court contrasted the status of free association into which the other Districts were emerging,[84] observing that free association was a "more autonomous status . . . which does not involve political union with the United States."[85] This treatment again suggests that courts will not view Freely Associated States as being similar to territories because they are not as closely linked to the United States.

In sum, on the spectrum of political independence termination of the trusteeship is a shift of the Freely Associated States away from the United States. As a result, for purposes of Internal Revenue Code section 103 the territorial similarity doctrine is no longer valid.

B. Internal Revenue Code Section 103

1. Incorporation in the Compacts of Free Association

Compact negotiations involved discussion of the application of United States tax and tariff laws to the Freely Associated States and to American taxpayers deriving income there. Under agreements reached in the negotiations the Freely Associated States were assigned a special tax status under which tax benefits available to United States possessions were available. Section 255 of the Compacts provided:

> Where not otherwise manifestly inconsistent with the intent of this Compact, provisions in the United States Internal Revenue Code that are applicable to possessions of the United States as of January 1, 1980 shall be treated as applying to the Marshall Islands and the Federated States of Micronesia.[86]

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of the defendant's statements if the investigators were "foreign" officers. 783 F.2d at 1056.

[82] *Id.* at 1055. The court was ahead of events as free association was still more than a year away and, in fact, the confession had been taken in 1979.

[83] 33 Fair Empl. Prac. Cas. 1027 (D.C.N.M.I. 1985).

[84] *See supra* text accompanying notes 66-68.

[85] 33 Fair Empl. Prac. Cas., at 1031 n.12, 1033 n.25.

[86] Freely Associated States were also protected in Compact section 255 against loss of the benefit of these Code provisions in the event that the United States changed the Internal Revenue Code. Section 255 provides:

Section 103 has been a part of the Internal Revenue Code since 1954[87] and the issuance of tax-free bonds is not manifestly inconsistent with the purposes of the Compact.[88] Therefore, under section 255, as originally drafted,[89] the Freely Associated States would be eligible to finance public projects with bonds marketed to American taxpayers using section 103 incentives.

Section 255 of the Compact, however, did not survive review in the United States Congress.[90] The final version of the Compact of Free Association Act[91] treated the Freely Associated States as possessions only for purposes of section 936 of the Internal Revenue Code.[92] Congress thus eliminated treatment of the Freely Associated States as possessions of the United States for purposes of issuing tax-free bonds under section 103 of the Internal Revenue Code.[93]

> If such provisions of the Internal Revenue Code are amended, modified or repealed after that date, such provisions shall continue in effect as to Palau, the Marshall Islands and the Federated States of Micronesia for a period of two years during which time the Government of the United States and the Governments of Palau, the Marshall Islands and the Federated States of Micronesia shall negotiate an agreement which shall provide benefits substantively equivalent to those which obtained under such provisions.

Compact, *supra* note 5, § 255.

[87] Pub. L. No. 591, 68A Stat. 29 (1954).

[88] For a discussion of Compact purposes and trusteeship obligations, see *supra* text accompanying notes 17-19.

[89] See *supra* note 86 for text of section 255.

[90] Congress viewed the provision as a tax loophole and wanted to do away with it entirely. The Administration contended that the length and sensitivity of the Compact negotiations resulted in a document of such delicacy that no provision could be eliminated without jeopardizing Micronesian willingness to implement the Compact. The Administration, however, acquiesced in changes to the Compact that it believed did not alter its overall value to Micronesia. The result was substitution of specified provisions of the Internal Revenue Code for the general application contemplated by Section 255 and addition of an Investment Development Fund to compensate for the removal of tax incentives. *See* Pub. L. No. 99-239, 99 Stat. 1799 § 111(b) (1986).

[91] Compact, *supra* note 5.

[92] Pub. L. 99-239, 99 Stat. 1800, § 404(a) (1986). Internal Revenue Code section 936 provides that, subject to specified conditions, United States corporations shall be allowed as a credit against the tax imposed by this chapter an amount equal to the portion of the tax which is attributable to certain income derived from trade and investment in United States possessions. I.R.C. § 936 (1988).

[93] The Freely Associated States acquiesced in this congressional alteration of the Compact. The concern in Micronesia was that such alterations not result in a closer relationship with the United States than the Freely Associated States had contemplated. The change in section 255 was palatable because it moved the Freely Associated States away from United States control and it was fiscally compensated for by the addition of the Investment Development Fund. *See* Compact, *supra* note 5, § 111(b).

2. *The 1986 tax legislation*

In the Tax Reform Act of 1986,[94] section 103 was changed in a subtle way without explanation. Prior to the Tax Reform Act, section 103 exempted from gross income the interest on bonds issued by "a state, a Territory or a possession of the United States." In the 1986 Act, only State bonds were mentioned and "State" was defined to include "any possession of the United States."[95] The word "territory" was dropped.

Unfortunately, the legislative history of this change is not helpful. The Conference Report makes no reference at all to the wording.[96] After introductory observations that the exemption was traditionally available for obligations of "States, territories or possessions of the United States" both the House and Senate reports then indicate in footnotes that "[g]overnments of the States, U.S. possessions and the District of Columbia, and their political subdivisions, are hereinafter referred to collectively as qualified governmental units."[97] No separate discussion of territories is found and no reasons for dropping the word "territory" from section 103 are offered. But whatever the unspoken motivations, the result points again toward an inability of bonds issued by the Freely Associated States to offer tax-exempt treatment to their purchasers.

C. *The Foreign Sovereign Immunities Act*

In view of the political identity of the Freely Associated States,[98] the Freely Associated States can raise the defense of sovereign immunity in American courts if actions are brought in the United States to force payment of a Freely Associated State's public debt. The possibility and plausibility of such a claim should be evaluated in light of the Foreign Sovereign Immunities Act of 1976 (FSIA).[99] Four issues are raised for purposes of the FSIA: (1) Are the Freely

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[94] Pub. L. No. 99-514, 100 Stat. 2085 (1986).

[95] I.R.C. § 103(c) (1987).

[96] H.R. CONF. REP. NO. 841, 99th Cong., 2d Sess., *reprinted in* 1986 U.S. CODE CONG. & ADMIN. NEWS 4075.

[97] H.R. REP. NO. 426, 99th Cong., 2d Sess., 492 (1985); S. REP. NO. 313, 99th Cong., 2d Sess., 809 (1986).

[98] *See supra* text accompanying notes 66-68.

[99] 28 U.S.C. §§ 1602-1611 (1982). The FSIA eliminates the sovereign immunity of foreign states in United States courts in specified circumstances including where the foreign state has waived immunity or where "the action is based upon a commercial activity carried on in the United States by the foreign state, or upon an act performed in the United States in connection with a commercial activity of the foreign state elsewhere". *Id.* §§ 1605(a)(1), (2). "Commercial Activity" is defined to mean "either a regular course of commercial conduct or a particular commercial transaction or act. The commercial character of an activity shall be determined by reference to the nature of the course of conduct or particular transaction or act, rather than by refer-

Associated States foreign states? (2) Are the Compacts international agreements affecting application of the FSIA? (3) Is the borrowing the type of commercial activity covered by the FSIA? (4) Has immunity to suit been waived?

1. Freely Associated States as "foreign states"

The FSIA was intended to eliminate the defense of sovereign immunity in cases involving commercial activities of foreign entities. It codified the sovereign/commercial distinction that had been emerging in case law and State Department practice.[100] Under that distinction, the defense could be overcome in commercial cases on the theory that the need for sovereign immunity to protect from judicial scrutiny certain sovereign acts by foreign states was outweighed by the need to provide a vigorous and fair marketplace once a foreign state entered the purely commercial arena.[101]

FSIA section 1605 operates to defeat the immunity of a foreign state but does it define the term "foreign state?" The United States Supreme Court has cautioned that the term has no inherent specific content. "The term 'foreign country' is not a technical or artificial one, and the sense in which it is used in a statute must be determined by reference to the purpose of the legislation."[102]

In determining whether Freely Associated States are foreign states for FSIA purposes, it is significant that the Compacts explicitly recognize the authority of the Freely Associated States to conduct their own foreign affairs.[103] Resident representatives of ambassadorial status are exchanged between the governments.[104] Thus, the external affairs of the Freely Associated States are no longer controlled by Washington, but are controlled by the Freely Associated States.

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ence to its purpose." *Id.* § 1603(d).

[100] See the State Department's "Tate Letter", 26 DEP'T OF STATE BULL. 984, *reprinted in* Alfred Dunhill of London, Inc. v. Cuba, 425 U.S. 682, 711-15 (1976); and discussion of the FSIA in H.R. REP. NO. 1487, 94th Cong., 2d Sess., *reprinted in* 1976 U.S. CODE CONG. & ADMIN. NEWS 6604.

[101] H.R. REP. NO. 1487, 94th Cong., 2d Sess., *reprinted in* 1976 U.S. CODE CONG. & ADMIN. NEWS 6604.

[102] Burnet v. Chicago Portrait Co., 285 U.S. 1, 5-6 (1932).

[103] Compact Title I, art. II, § 121(a) provides that "[t]he Governments of Palau, the Marshall Islands and the Federated States of Micronesia have the capacity to conduct foreign affairs and shall do so in their own name and right, except as otherwise provided in this Compact." Compact, *supra* note 5, § 121(a).

In the Compact of Free Association Act of 1985, the Compact itself, as originally negotiated, is Title 2 of the Act. Sections of the Compact are cited herein by their designation within that Title, that is, their designation within the Compact itself.

[104] Compact, *supra* note 5, tit. 1, art. 5, § 151. While the representatives were not initially termed "ambassadors", it appears that arrangements are being made for that title to be used. WASHINGTON PACIFIC REPORT 3 (Dec. 3, 1987).

Relations between the United States and the Freely Associated States are subject to all the vicissitudes of relations of nations *inter se*. The United States, however, desires good relations with the Freely Associated States on a par with United States relations with other friendly states.[105] The Compacts thus describe a relationship between the United States and the Freely Associated States whereby the sovereign immunity doctrine is intended to protect the United States from embarrassment by judicial interference in the conduct of this diplomatic relationship. This is buttressed by a specific immunity provision written directly into the Compacts.[106]

The FSIA itself provides some guidance in defining "foreign state." A "foreign state" is defined in the Act by its contrast with the term "United States."[107] The latter term is defined as including "all territory and waters, continental or insular, subject to the jurisdiction of the United States."[108] In this regard, *Sablan Construction v. Trust Territory of the Pacific Islands*[109] relied on the jurisdictional grant to the United States in the Trusteeship Agreement to hold that the Trust Territory is not a foreign state. The Trusteeship Agreement no longer applies after termination of the trusteeship. Therefore, the Freely Associated States are not part of the United States since the United States no longer exercises jurisdiction over them.[110]

Thus the Freely Associated States should be deemed foreign states for purposes of the FSIA. This was the result reached in *Morgan Guaranty Trust v.*

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[105] *See, e.g.*, Compact, *supra* note 5, preamble.

[106] The Compact provides, "[t]he Governments of Palau, the Marshall Islands and the Federated States of Micronesia shall be immune from the jurisdiction of the courts of the United States, and the Government of the United States shall be immune from the jurisdiction of the courts of Palau, the Marshall Islands and the Federated States of Micronesia." Compact, *supra* note 5, tit. 1, art. 7, § 174(a).

[107] With respect to the definition of a "foreign state," the FSIA provides:

> For purposes of this chapter—
>
> (a) A "foreign state", except as used in section 1608 of this title, includes a political subdivision of a foreign state or an agency or instrumentality of a foreign state as defined in subsection (b).
>
> (b) An "agency or instrumentality of a foreign state" means any entity—
>
> (1) which is a separate legal person corporate or otherwise, and
>
> (2) which is an organ of a foreign state or political subdivision thereof, or a majority of whose shares or other ownership interest is owned by a foreign state or political subdivision thereof, and
>
> (3) which is neither a citizen of a State of the United States as defined in section 1332(c) and (d) of this title, nor created under the laws of any third country.

28 U.S.C. § 1603 (1982).

[108] *Id.* § 1603(c).

[109] 526 F. Supp. 135 (D.N.M.I. 1981).

[110] There is residual United States authority in a narrow class of defense matters. *See* Compact, *supra* note 5, tit. 3 (Security and Defense Relations).

Republic of Palau[111] where the court held that even in the absence of termination of the trusteeship Palau had exercised a degree of independence that established a *de facto* foreign statehood.[112]

2. *The Compact's effect on application of the FSIA*

The Compacts track closely the theories that led to the FSIA. Sovereign immunity is accorded its full general effect. As provided in the Compact:

> The Governments of [the Freely Associated States] shall be immune from the jurisdiction of the courts of the United States, and the Government of the United States shall be immune from the jurisdiction of the courts of [the Freely Associated States].[113]

And the commercial activity exception is spelled out textually:

> The Governments of [the Freely Associated States] shall not be immune from the jurisdiction of the courts of the United States, and the Government of the United States shall not be immune from the jurisdiction of the courts of [the Freely Associated States] in any case in which the action is based on a commercial activity of the defendant Government where the action is brought, or in a case in which damages are sought for personal injury or death or damage to or loss of property occurring where the action is brought.[114]

The purpose of both enactments is the same and there is no reason to define commercial activity differently under the Compacts than under the FSIA. The critical question in either case is whether public borrowing is a commercial activity triggering the exception to the sovereign immunity doctrine.

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[111] 639 F. Supp. 706 (S.D.N.Y. 1986).

[112] *Id.* at 713-14.

[113] Compact, *supra* note 5, tit. 1, art. 7, § 174(a).

[114] *Id.* § 174(d). Though their theoretical foundations seem to be the same as those of the FSIA, the Compacts may allow for a narrower exception to immunity than does the FSIA because the commercial exception of the FSIA defeats immunity in a technically broader class of cases including those

> in which the action is based upon a commercial activity carried on in the United States by a foreign state; or upon an act performed in the United States in connection with a commercial activity of the foreign state elsewhere; or upon an act outside the territory of the United States in connection with a commercial activity of the foreign state elsewhere and that act causes a direct effect in the United States.

28 U.S.C. § 1605(a)(2) (1982). This elimination of immunity for actions having effects in the United States is broader than that of the Compacts which eliminate immunity only when the commercial activity itself is in the United States.

3. *Freely Associated State borrowing as commercial activity*

The commercial activity exception to the sovereign immunity doctrine stems from the theory that a vigorous marketplace is desirable and is best promoted by offering remedies to those who are injured by the acts of their trading partners, including sovereigns.[115] Accordingly, in a commercial setting the sovereign is seen as neither deserving nor requiring immunity since intergovernmental relations are not in jeopardy.[116] The leading judicial test for determining whether particular activity is commercial and therefore undeserving of protective immunity is "if the activity is one in which a private person could engage."[117]

While that test has an appealing simplicity, it is difficult to apply since the result depends on the analytical precision with which the court is willing to examine the transaction in question. For example, a Freely Associated State's issuance of a bond might be classified commercial since bond *issuance* is something that private entities engage in regularly.[118] Alternatively, a closer analysis might reveal that the bond *payments* are to be made through a pledge of monies paid to the Freely Associated State by the United States under the Compacts.[119] Such a pledge could only be made by a Freely Associated State government, not by a private person,[120] leading to a noncommercial characterization.[121]

Section 1603(d) of title 28 attempts to resolve the dilemma in favor of lim-

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[115] *See supra* text accompanying note 97.

[116] *See supra* text accompanying note 98.

[117] Texas Trading v. Federal Republic of Nigeria, 647 F.2d 300, 309 (2d Cir. 1981). Nigeria severely overbought cement and sought to repudiate its purchase contracts. The court held that the FSIA defeated Nigeria's sovereign immunity. *Id.* at 312.

[118] This was the posture struck by the court in Resource Dynamics Int'l, Ltd. v. General Peoples Comm. for Communications & Maritime Transp. in Socialist Peoples Libyan Arab Jamahiriya, 593 F. Supp. 572 (N.D. Ga. 1984).

[119] For example, the Freely Associated State might pledge its Grant Assistance under section 211 of the Compact. These funds are intended "to assist the Governments of Palau, the Marshall Islands, and the Federated States of Micronesia in their efforts to advance the economic self-sufficiency of their peoples and in recognition of the special relationship that exists between them and the United States." Compact, *supra* note 5, tit. 1, art. 2, § 211.

[120] The Compacts embody government-to-government relationships and funds provided thereunder are transferred to the Freely Associated State governments, not to individual citizens. *See generally*, Compact, *supra* note 5, tit. 1 (Government Relations).

[121] This closer look at the obligations undertaken was employed in preserving immunity in Practical Concepts, Inc. v. Republic of Bolivia, 613 F. Supp. 863 (D.D.C. 1985), where contractual promises of expedient treatment in administrative matters such as customs, visas and taxation were part of the consideration and could only have been provided by the Bolivian government. *See also* MOL, Inc. v. Peoples Republic of Bangladesh, 736 F.2d 1326 (9th Cir. 1984) (holding that, although signing a contract for commerce in monkeys is by its nature commercial, since the activity is at base regulation of a national resource it is in fact a sovereign activity).

ited sovereign immunity by instructing courts that the "commercial character of an activity shall be determined by reference to the nature of the course of conduct or particular transaction or act, rather than by reference to its purpose."[122] Perhaps the most graphic example of this instruction's application occurred when the Mexican government tried to stabilize domestic price supports by entering the soybean market.[123] The public purpose of the Mexican government was termed "wholly collateral and irrelevant" to the question of commerciality since the nature of the activity—buying, selling and transporting commodities—was one which could be undertaken by private persons.[124]

The availability of immunity regarding public borrowing was mentioned in the pre-FSIA case of *Victory Transport v. Comisaria General de Abastecimientos y Transportes*.[125] The court listed specific activities that deserved immunity due to their international political sensitivity. The activities included "(1) internal administrative acts, such as expulsion of an alien; (2) legislative acts such as nationalization; (3) acts concerning the armed forces; (4) acts concerning diplomatic activity; (5) *public loans*."[126]

That dictum, however, has been severely undermined by the legislative history of the FSIA. Congress recognized that the phrase "commercial activity" was not specifically defined and was left for courts to construe. But by way of illustration it stated that "[a]ctivities such as a foreign government's sale of a service or product, its leasing of property, [or] *its borrowing of money*, . . . would be among those included within the definition."[127] Moreover, it was said that "both a sale of bonds to the public and a direct loan from a [United States] commercial bank to a foreign government are activities which are of a commercial nature."[128]

Relying on this congressional language at least one court held that bonds issued by a foreign government in order to raise capital constitute a commercial activity for FSIA purposes.[129] Another court merely examined the statutory def-

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[122] 28 U.S.C. § 1603(d) (1982).

[123] Bankers Trust Co. v. Worldwide Transp. Servs., 537 F. Supp. 1101 (E.D. Ark. 1982). In 1977 a Mexican governmental agency purchased substantial amounts of soybean meal and soybean oil from American companies and engaged Worldwide to coordinate movement of the commodities within the United States.

[124] *Id.* at 1107.

[125] 336 F.2d 354 (2d Cir. 1964).

[126] *Id.* at 360 (emphasis added).

[127] H.R. REP. NO. 1487, 94th Cong., 2d Sess., 16, *reprinted in* 1976 U.S. CODE CONG. & ADMIN. NEWS 6604, 6615.

[128] *Id.* at 6609. *See also* Morgan Guaranty Trust Co. v. Republic of Palau, 657 F. Supp. 1475 (S.D.N.Y. 1987) (borrowing by Palau to finance a power plant is commercial activity).

[129] Schmidt v. Polish Peoples Republic, 579 F. Supp. 23 (S.D.N.Y. 1984). The FSIA was found to defeat immunity where a 1929 bond was issued, for purchase by American investors, to finance the construction of railway cars because it was an activity "in which a private, profit-

inition itself, holding that any bond sales activity constitutes commercial activity even where the sale occurred before enactment of the FSIA.[130]

Given these judicial constructions of the statute, holders or trustees of Freely Associated State bonds should be able to obtain federal jurisdiction over a Freely Associated State in a suit to enforce bond payment provisions.[131] There may, however, be exceptions to this conclusion. If, for example, the borrowing is structured to involve direct concessions by the issuing sovereign, a court might be persuaded that the transaction would have been quite different if performed by private parties, leading to the conclusion that it is noncommercial.[132] Similarly, if fundamental FAS economic stabilization efforts are jeopardized a court might be persuaded that serious international concerns are involved such that sovereign immunity should be recognized.[133] If the bond market perceives that sovereign immunity will be accorded to bond sales, allowing an effective default by the sovereign, the interest rate on Freely Associated State bonds will reflect that risk of default. The Freely Associated States should, therefore, eliminate this perception of risk by including specific waivers of sovereign immunity in the structure of the borrowing itself.[134]

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making corporation might well engage." *Id.* at 26.

[130] Jackson v. Peoples Republic of China, 550 F. Supp. 869 (N.D. Ala. 1982). Holders of bonds issued by China in 1911 to construct a railway from Beijing to Canton used the FSIA to overcome sovereign immunity.

[131] An additional jurisdictional basis might be available in 12 U.S.C. § 632 (1982), which vests federal district courts with subject matter jurisdiction over cases arising out of transactions "involving international or foreign banking" in which at least one party is a corporation organized under the laws of the United States. The United States Supreme Court has, however, recently ruled that the FSIA is "the sole basis for obtaining jurisdiction over a foreign state in federal court." Argentine Republic v. Amerada Hess Shipping Corp., 57 U.S.L.W. 4121 (U.S. Jan. 23, 1989) (No. 87-1372).

[132] For example, in Practical Concepts, Inc. v. Republic of Bolivia, 613 F. Supp. 863 (D.D.C. 1985), Bolivia had contracted with a United States corporation for development planning services. The court found several contract provisions performable by Bolivia only in its sovereign capacity. These included tax and duty exemptions for the corporation and its staff, and assurances of prompt customs treatment of the staff's personal effects. *Id.* at 869-70.

[133] *See, e.g.*, De Sanchez v. Banco Central de Nicaragua, 515 F. Supp. 900 (E.D. La. 1981). For a discussion of the Act of State doctrine, see *infra* text accompanying notes 147-68.

[134] Waiver provisions will vary from borrower to borrower depending on constitutional divisions of authority among the various branches of government. For example, if national treasury authorities negotiate the borrowing, their ability to waive sovereign immunity will depend on the scope of executive power under the relevant constitution. Even legislative ability to waive immunity may be limited if a constitution requires public consent. For a discussion of a Palauan waiver that produced serious misunderstanding, see Morgan Guaranty Trust Corp. v. Republic of Palau, 657 F. Supp. 1475, 1477 (S.D.N.Y. 1987).

4. Waivers of sovereign immunity

The FSIA provides an exception to the immunity of a foreign state "in any case . . . in which the foreign state has waived its immunity either explicitly or by implication[.]"[135] The waiver exception is in addition to the commercial activity exception,[136] and is within the control of the parties to a Freely Associated State borrowing.[137] The waiver exception is advantageous to the parties because it eliminates possible misunderstandings about the parties' intentions regarding loan repayment enforcement actions.[138]

The Supreme Court of the Federated States of Micronesia has discussed the status of sovereign immunity in that jurisdiction.[139] In *Panuelo v. State of Pohnpei*,[140] that court put a new twist on the doctrine. Instead of holding that sovereign immunity, as a function of sovereignty itself, existed until the government waived it, the court held that immunity is merely *available* to the government but has no effect until it is adopted and implemented by the legislature.[141]

Even before the *Panuelo* ruling, though, at least two Freely Associated States enacted waiver statutes.[142] For public borrowing, however, the waiver statutes are of limited use. While both codes' waivers allow actions on contractual obli-

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[135] 28 U.S.C. § 1605(a)(1) (1982).

[136] For a discussion of the commercial activity exception, see *supra* text accompanying notes 97-98.

[137] Particular waiver language can be negotiated by both the borrowing state and the lenders. It can be drafted in light of the borrower's constitutional requirements and requirements of United States case law interpreting the FSIA waiver provision. The language can then be incorporated into the lending instruments themselves or into the borrower's enabling legislation.

[138] For example, misunderstandings about whether a Freely Associated State has consented to be sued in a distant United States forum can be eliminated by using language that spells out which courts and which causes of action are contemplated by the waiver of sovereign immunity.

[139] No cases from the Marshall Islands or Palau are reported.

[140] 2 F.S.M. Interm. 150 (F.S.M. Sup. Ct. 1986).

[141] Compare the history and origins of sovereign immunity of Indian governments discussed *infra* at notes 178-81. The *Panuelo* reasoning suggests that waiver language is unnecessary in loan documents, at least for enforcement actions in the Freely Associated States' own courts. The FSM Supreme Court did not reach the question of sovereign immunity in courts foreign to the FSM.

[142] With respect to limited waiver of sovereign immunity, the Micronesian statutory law provides:

> Actions upon the following claims may be brought against the Federated States of Micronesia with original and exclusive jurisdiction residing in the Trial Division of the Supreme Court of the Federated States of Micronesia . . . .
>
> . . . .
>
> (3) Claims, whether liquidated or unliquidated, upon an expressed or implied contract with the Federated States of Micronesia.

6 FED. STATES OF MICRONESIA CODE § 702 (1982); *see also* 14 PALAU NAT'L CODE §§ 501-503 (1986).

gations, which probably includes enforcement of bond-related obligations,[143] the codes vest jurisdiction in Freely Associated State courts to the exclusion of all others.[144] Indeed, the Palau code eliminates from the waiver any claim arising outside of the Trust Territory.[145] Understandably these conditions are not acceptable to lenders who desire accessible forums.

A specific sovereignty waiver in the borrower's authorizing legislation would avoid a number of problems. Lenders' apprehensions would be reduced as the spectre of the immunity defense was clearly eliminated. Borrowers' legislation could specify which foreign courts, if any, have jurisdiction, thereby eliminating the possibility of litigation in numerous forums. The types and origins of claims could be specified, assuring the Freely Associated States that their borrowing in distant markets would not expose them to unrelated litigation to which they would otherwise be immune.[146] Moreover, legislative bodies would be forced to articulate their needs, desires, expectations and concessions, thereby minimizing subsequent legislative/executive misunderstanding of exactly what the borrowing government had promised and obtained.

5. *The act of state doctrine and nationalization*

Another defense potentially available to the Freely Associated States in the proper circumstances is the act of state doctrine. The doctrine's classic formulation was articulated in *Underhill v. Hernandez*,[147] which states:

> Every sovereign State is bound to respect the independence of every other sovereign State, and the courts of one country will not sit in judgment on the acts of the government of another done within its own territory. Redress of grievances by reason of such acts must be obtained through the means open to be availed of by sovereign powers as between themselves.[148]

Grounded in the same precept of international comity as the sovereign immunity doctrine,[149] the act of state doctrine must be considered in all cases in

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[143] 6 FED. STATES OF MICRONESIA CODE § 702(3) (1982); 14 PALAU NAT'L CODE § 501(a)(2) (1986).

[144] 6 FED. STATES OF MICRONESIA CODE § 702 (1982); 14 PALAU NAT'L CODE § 501(a) (1986).

[145] 14 PALAU NAT'L CODE § 502(f) (1986). *Cf.* Morgan Guaranty Trust Co. v. Republic of Palau, 657 F. Supp. 1475 (S.D.N.Y. 1987) (upholding federal jurisdiction of an action against Palau for repayment of a loan).

[146] For example, the waiver could specifically prohibit litigation of debt claims arising from procurement operations or damage claims from the activities of diplomats in the forum country.

[147] 168 U.S. 250 (1897).

[148] *Id.* at 252.

[149] For a discussion of sovereign immunity, see *supra* text accompanying notes 100-03.

which a foreign government's action is called into question, whether or not the foreign government itself is named as a party.[150] This doctrine is a substantive rule of federal law which must be addressed because a plaintiff might prevail on FSIA claims but be unable to overcome the act of state doctrine.[151]

Act of state defenses might arise in Freely Associated State public borrowing litigation if the borrowing state perceived that the investment of bond proceeds produced adverse results such that continued debt service undermined the government's liquidity and jeopardized its ability to meet the basic needs of its citizens. If default litigation ensued, the borrower would assert that the failure to pay principle and interest to the trustee for the bondholders was not a commercial default but a sovereign's effort to stabilize its economy, avoid a ruinous drain of cash reserves, and generally protect the public fisc. At the extreme, such a default could be portrayed as nationalizing or expropriating assets otherwise pledged for repayment of bond obligations.

It is unclear whether there is a "commercial activity" exception to the act of state doctrine. In *Alfred Dunhill, Inc. v. Republic of Cuba*,[152] the United States Supreme Court held that certain repudiations of commercial obligations were not acts of state because of the absence of indicia of state authority.[153] Interestingly, the opinion has been cited by lower courts[154] and Congress[155] as *establishing* a commercial exception. So while lenders might find heartening signs in the law, they cannot be sure that a commercial exception exists, and other courts have hinted against such a result even where the relevant transaction includes a clearly commercial component.[156] In recent years both the United

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[150] Indeed, a government may not be named as a party to the suit. "Perhaps the most typical act of state case involves the original owner or his assignee suing one not in association with the expropriating state who has had 'title' transferred to him." Banco Nacional de Cuba v. Sabbatino, 376 U.S. 398, 435 (1964). *See, e.g.*, American Banana Co. v. United Fruit Co., 213 U.S. 347 (1909) (action between private parties for treble damages under anti-monopoly statutes stemming from the defendant's alleged complicity in Costa Rican government interference with plaintiff's business).

[151] *See, e.g.*, Callejo v. Bancomer, S.A., 764 F.2d 1101 (5th Cir. 1985).

[152] 425 U.S. 682 (1976).

[153] The opinion drew a majority only on the point that the intervenors had not established their act of state defense because they did not show they were invested with sovereign authority to repudiate the relevant debts. Only three Justices accompanied Justice White into Part III of the opinion, which held in favor of a commercial activity exception to the act of state doctrine. Justice Stevens, who voted with the majority, did not explain his refusal to concur in Part III. *Id.* at 715.

[154] Hunt v. Mobil Oil Corp., 550 F.2d 68, 73 (2d Cir. 1976), *cert. denied*, 434 U.S. 954 (1977); American Int'l Group, Inc. v. Islamic Republic of Iran, 493 F. Supp. 522 (D.D.C. 1980), *vacated on other grounds*, 657 F.2d 430 (D.C. Cir 1981).

[155] H.R. REP. NO. 1487, 94th Cong., 2d Sess., *reprinted in* 1976 U.S. CODE CONG. & ADMIN. NEWS 6604.

[156] International Ass'n of Machinists & Aerospace Workers v. OPEC, 649 F.2d 1354, 1360

States Courts of Appeal for the Second and Fifth Circuits have avoided decision on the existence of the exception.[157] Thus, whether or not a commercial exception exists, it is important to examine recent case developments in the act of state doctrine to determine those activities that give rise to the defense and those elements of the doctrine that might be present or absent in the Freely Associated States situation.

The extent to which the court is willing to find sovereign activity is essential to determining whether the act of state doctrine applies. *Callejo v. Bancomer S.A.*[158] is typical of the current trend of financial cases.[159] In *Callejo*, the court decided against immunity in its FSIA analysis because the relevant transaction was defendant's act of selling certificates of deposit and failing to repay them at full value. The court characterized this act as commercial for FSIA purposes.[160] But, on the act of state question, the court went beyond the actions of the parties and examined the governmental activities behind them. The court found that the exchange controls imposed by the Mexican government indirectly caused the reduced payment. The exchange controls were unquestionably vested with the sovereign's authority since the controls were initiated by the Mexican executive and confirmed by the legislature. The controls, therefore, were paradigmatically sovereign in nature.[161] Judgment for the plaintiffs was therefore denied because such a judgment would have rendered nugatory the very purpose of the exchange controls, exactly the result to be avoided by the act of state doctrine.

Similar results have been reached in other cases regarding the Mexican ex-

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(9th Cir. 1981) (sale of oil).

[157] For cases suggesting an awareness that *Dunhill* did not resolve the issue, see Callejo v. Bancomer, S.A., 764 F.2d 1101, 1113 n.12 (5th Cir. 1985), and Braka v. Bancomer S.N.C., 762 F.2d 222, 225 (2d Cir. 1985).

[158] 764 F.2d 1101 (5th Cir. 1985) (Mexican currency exchange controls brought on by a decline in the price of oil require Mexican banks to pay U.S. dollar-denominated certificates of deposit in pesos at a fixed rate).

[159] Another line of cases dealing with oil resource nationalizations is also instructive. Viewing natural resource protection as a paradigmatically sovereign activity these cases support the view that oil nationalizations can be defended in United States courts on act of state grounds. *See* Hunt v. Mobil Oil Corp., 550 F.2d 68 (2d Cir. 1976), *cert. denied*, 434 U.S. 984 (1977); D'Angelo v. Petroleos Mexicanos, 422 F. Supp. 1280 (D. Del. 1976), *aff'd*, 564 F.2d 89 (3d Cir. 1977), *cert. denied*, 434 U.S. 1035 (1978); Hunt v. Coastal States Gas Producing Co., 570 S.W.2d 503 (Tex. Civ. App. 1978), *aff'd*, 583 S.W.2d 322 (Tex. 1979), *cert. denied*, 444 U.S. 992 (1979); Carey v. National Oil Corp., 453 F. Supp. 1097 (S.D.N.Y. 1978), *aff'd on other grounds*, 592 F.2d 673 (2d Cir 1979); Libyan Am. Oil Co. v. Socialist Peoples Libyan Arab Jamahiriya, 482 F. Supp. 1175 (D.D.C. 1980); International Ass'n of Machinists & Aerospace Workers v. OPEC, 649 F.2d 1354 (9th Cir. 1981).

[160] 764 F.2d at 1110.

[161] 764 F.2d at 1115, n.15.

change controls,[162] seizure of sugar[163] and spice[164] assets, and beef enterprises.[165] In each of these cases the *Underhill* formulation of the act of state doctrine has been reconfirmed.[166] So long as the action, whether seizure, nationalization, or expropriation, is that of the foreign government acting in its own territory, the United States courts will not act to negate it.

Two important points emerge from these cases. First, lenders to Freely Associated States face the risk that loan proceeds located in the borrowing state can be nationalized rendering enforcement actions in United States courts unavailing.[167]

Second, the effect of the act of state doctrine is avoidable by attention to the situs of the relevant assets. When the assets at issue are located in the United States the doctrine has been held inapplicable.[168]

This situation presents a policy decision for a Freely Associated State as borrower/sovereign. On one hand, in order to reduce interest rates required by lenders the spectre of the act of state defense must be minimized. This suggests that loans be negotiated and consummated in the United States, that the proceeds be invested there, and that debt service mechanisms be established there.

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[162] Braka v. Bancomer S.N.C., 762 F.2d 222 (2d Cir. 1985).

[163] Empresa Cubana Exprotadora de Azucar y sus Derivados v. Lamborn & Co., 652 F.2d 231, 234 (2d Cir. 1981) (takeover, by Cuban Minister of Labor, of American investor's offices and sugar operations pursuant to Cuban law allowing "intervention . . . of the work centers or enterprises at which the normal production rate is ostensibly altered").

[164] Ethiopian Spice Extraction Share Co. v. Kalamazoo Spice Extraction Co., 543 F. Supp. 1224 (W.D. Mich. 1982) (nationalization by provisional military government of American 80% share in Ethiopian corporation producing spices).

[165] Alberti v. Empresa Nicaraguense de la Carne, 705 F.2d 250 (7th Cir. 1983) (nationalization by Nicaragua of American 35% ownership in corporation engaged in slaughtering livestock and packaging beef).

[166] *But see* American Int'l Group, Inc. v. Islamic Republic of Iran, 493 F. Supp. 522 (D.D.C. 1980) (citing *Dunhill* for the commercial activity exception to the act of state doctrine), *vacated on other grounds*, 657 F.2d 430 (D.C. Cir. 1981).

[167] Still, loans to Freely Associated States are in this regard no more risky than loans to other sovereigns. As early as 1877 the British Master of the Rolls noted that bonds issued by foreign sovereigns "amount to nothing more than engagements of honor . . . not contracts enforceable before the ordinary tribunals of foreign governments, or even of the ordinary tribunals of the country which issued them without the consent of the government." Twycross v. Dreyfus, 5 Ch. D. 605, 616 (1877), *quoted in* Nichols, *Sovereign Debtors Under U.S. Immunity Law*, in SOVEREIGN LENDING: MANAGING LEGAL RISKS 81 (1984).

[168] In *Underhill* it was relevant that the sovereign's actions were "done in its own territory." Underhill v. Hernandez, 168 U.S. 250, 252 (1897). And in Allied Bank Int'l v. Banco Credito Agricola de Cartago, 757 F.2d 516 (2d Cir. 1985), the act of state doctrine was held inapplicable because the affected interests had a situs outside Costa Rica. Similarly, in Braka v. Bancomer S.N.C., 762 F.2d 222 (2d Cir. 1985), and Callejo v. Bancomer S.A., 764 F.2d 1101 (5th Cir. 1985), the courts strongly suggested that an American situs of the relevant deposits would have defeated the doctrine.

This creates an American situs for the debts that places them beyond the reach of nationalization by the borrower. The act of state defense is thereby unavailable.

On the other hand, retention of sovereign prerogatives suggests that the situs be the borrowing state so that the assets would remain under the sovereign control of the borrower.[169] Whether a borrowing state is forced to abandon these prerogatives in order to obtain workable interest rates depends on a variety of factors including relative interest rates, the strength of the borrower's commitment to the prerogatives, and the availability of lender assurances that could be built into a loan package.[170]

III. INDIAN TRIBAL GOVERNMENTS

A. *Tax status—The Indian Tribal Government Tax Status Act*

The unique political and legal status of Indian tribes in the United States[171] has denied tribal governments the favorable federal tax treatment enjoyed by States and municipalities. For example, in 1968 the Internal Revenue Service ruled against tax-exempt treatment of tribal government bonds. The Service found Internal Revenue Code section 103 unavailable because the tribes' authority is not derived from State sources.[172] Under this ruling tribal governments faced commercial, non-exempt interest rates when borrowing for infrastructure development. This exacerbated the lack of development in Indian country.[173]

In 1982 Congress alleviated the situation by passing the Indian Tribal Government Tax Status Act.[174] The Act provides that "[a]n Indian tribal government shall be treated as a State . . . for purposes of section 103 (relating to interest on certain governmental obligations)"[175] thereby allowing tribes to issue

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[169] Also, the borrower's economy would benefit from the investment of the loan proceeds in domestic financial institutions.

[170] For example, surety arrangements to protect lenders may be available at borrowers' expense. *See, e.g.*, Morgan Guaranty Trust Co. v. Republic of Palau, 657 F. Supp. 1475 (S.D.N.Y. 1987), an action brought by guarantors who, upon default by the borrowing government, paid off government debts incurred to construct a power plant.

[171] *See infra* discussion in text accompanying notes 178-81.

[172] Rev. Rul. 68-231, 1968-1 C.B. 48.

[173] Williams, *Small Steps on the Long Road to Self-Sufficiency for Indian Nations: The Indian Tribal Government Tax Status Act of 1982*, 22 HARV. J. ON LEGIS. 333 (1985); Barsh, *Issues in Federal, State and Tribal Taxation of Reservations Wealth: A Survey and Economic Critique*, 54 WASH. L. REV. 531 (1979).

[174] Pub. L. No. 97-473, 96 Stat. 2607 (codified as amended at 26 U.S.C. § 7871 (1982 & Supp. IV 1986)).

[175] I.R.C. § 7871(a)(4) (1983).

tax-exempt debt.

There are, however, certain exceptions imposed on tribes that are not imposed on States. Industrial development bonds[176] are denied tax-free treatment when used by Indian tribes.[177] Also, exemption is available to tribes only if "substantially all of the proceeds [of the bond] . . . are to be used in the exercise of any essential governmental function."[178] Under the regulations[179] and legislative history only projects traditionally viewed as public works or a "utility-type activity"[180] qualify for exempt treatment.

A further qualification applies when borrowing authority is delegated by a tribal government to a subdivision of the tribe.[181] In such cases the exemption is available only if the Secretary of the Treasury determines, after consultation with the Secretary of the Interior, "that such subdivision has been delegated the right to exercise one or more of the substantial governmental functions" of the delegating government.[182]

In sum, unlike Freely Associated States, Indian tribes are able to issue bonds whose interest is tax-exempt to lenders. But close attention must be paid to the disposition of the proceeds so that the essential government function test is met. And when a subdivision of tribal government issues the bonds, active federal consent appears to be a necessary prerequisite to tax-exempt treatment under section 103.

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[176] Industrial development bonds can be used by local governments to provide incentives for private businesses to locate within the government's jurisdiction. Such bonds have been used to provide, for example, factory or retail space for lease to private businesses.

[177] I.R.C. § 7871(c)(2) (1983). This restriction is continued in the Tax Reform Act of 1986 where it is translated into an elimination of the "qualified bond" exemption defined in section 141(d) of the Act. The new section 103 denies tax-free treatment to "any private activity bond which is not a qualified bond" of the State or local government. By contrast, Indian governments are denied tax-exempt treatment of "*any* private activity bond." *Id.* (emphasis added).

[178] *Id.* § 7872(c)(1). Treasury Regulations accompanying the Act incorporate the interpretation of "essential government services" used for Internal Revenue Code section 115. Temp. Treas. Reg. §§ 305.7871-1(d)(1)-(2) (1984).

[179] Temp. Treas. Reg. §§ 305.7871-(1)(d)(1)-(2) (1984).

[180] H.R. REP. NO. 984, 97th Cong., 2d Sess., 13-14, *reprinted in* 1982 U.S. CODE CONG. & ADMIN. NEWS 4580, 4591-92. The limitations imposed on tribal governmental activity are discussed in Williams, *supra* note 173, at 383-89.

[181] This includes, for example, delegation of power to a tribal housing authority to issue bonds for construction funding or delegation to a tribal natural resources agency to borrow for coal, oil or water development.

[182] I.R.C. § 7871(d) (1988). How "substantial" government functions compare to "essential" government functions discussed at section 103(c) is not explained in the legislative history or the Regulations.

B. *Tribal sovereign immunity*

1. *Origins and present status of the doctrine*

The doctrine of tribal sovereign immunity is a manifestation of a fact often ignored in legal analysis—that Indians occupied North America first. Felix Cohen writes:

> Perhaps the most basic principle of all Indian law, supported by a host of decisions . . . is the principle that those powers which are lawfully vested in an Indian tribe are not, in general, delegated powers granted by express acts of Congress, but rather inherent powers of a limited sovereignty which has never been extinguished. Each tribe begins its relationship with the Federal Government as a sovereign power, recognized as such in treaty and legislation. The powers of sovereignty have been limited from time to time by special treaties and laws . . . . What is not expressly limited remains within the domain of tribal sovereignty.[183]

The United States Supreme Court used that analysis in establishing the tribal sovereign immunity doctrine.[184] And in *Santa Clara Pueblo v. Martinez*,[185] the Court reaffirmed the doctrine, noting that any congressional waiver of tribal immunity must be unequivocally expressed.[186]

Despite these authorities, though, two lines of reasoning are advanced against tribal immunity.[187] First, it is argued that in matters involving non-Indians and not directly affecting intratribal affairs or tribal self-government the immunity doctrine is unjustifiable. The United States Court of Appeals for the Tenth Circuit used this reasoning to distinguish *Martinez* and allow an action for money damages against a tribe in *Dry Creek Lodge, Inc. v. Arapahoe & Shoshone*

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[183] F. COHEN, HANDBOOK OF FEDERAL INDIAN LAW, 122-23 (1971).

[184] United States v. United States Fidelity & Guar. Co., 309 U.S. 506, 512 (1940).

[185] 436 U.S. 49 (1978).

[186] 436 U.S. 49, 58 (1978). The plaintiff contended that the Indian Civil Rights Act, 25 U.S.C. §§ 1301-1303 (1982 & Supp. V 1987), waived tribal immunity. The Court found no plain congressional statement of waiver and, therefore, immunity was upheld.

[187] These arguments are encouraged by the fact that doctrines of immunity are sometimes broadly criticized. *See, e.g.*, Amar, *Of Sovereignty and Federalism*, 96 YALE L.J. 1425 (1987); McLish, *Tribal Sovereign Immunity: Searching for Sensible Limits*, 88 COLUM. L.R. 173 (1988). The FSIA and the Federal Tort Claims Act, 28 U.S.C. § 2674 (1982), are legislative limitations on sovereign immunity. And at least one Justice of the United States Supreme Court has expressed dissatisfaction with the tribal sovereign immunity doctrine. In Puyallup Tribe v. Department of Game, 433 U.S. 165 (1977), Justice Blackmun stated, "I entertain doubts . . . about the continuing vitality in this day of the doctrine of sovereign immunity as it was enunciated in *United States v. United States Fidelity & Guaranty*. I am of the view that the doctrine may well merit reexamination in an appropriate case." *Id.* at 178-79 (Blackmun, J., concurring) (citation omitted).

Tribes.[188]

Second, a complainant may have no remedy available through tribal systems. The absence of a tribal forum was relied on in *Dry Creek* to justify providing a federal forum, and the argument has been given weight by at least one other court.[189]

But the tribal sovereign immunity doctrine is well established and lenders in the bond markets will be understandably dissatisfied with these counterarguments. Tribal borrowers will realize the lowest available interest rate only if they remove this risk by providing an explicit waiver of immunity.

2. *Indian tribes and the Foreign Sovereign Immunities Act*

The FSIA is not a congressional waiver of tribal immunity. Tribal governments, while sovereign, are not sufficiently foreign to come within the scope of the FSIA. Early articulations of the status of tribal governments described them as "domestic dependent nations."[190] Their dependence and domesticity defeat a claim of international identity. They have no international political recognition[191] or ability to enter into treaties with foreign nations.[192] Thus, while the term "foreign state" in the FSIA is susceptible of broad interpretation,[193] the direct congressional control over tribes eliminates the diplomatic delicacy of foreign sovereignty[194] and renders the FSIA inapplicable.

Interestingly, there is no commercial activity exception to tribal immunity. Immunity is sustained where defendant tribes have been engaged in construction,[195] off-reservation fish processing,[196] maintenance of tourist attractions,[197] and liquor sales.[198] These results are supported by the United States Supreme

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[188] 623 F.2d 682 (10th Cir. 1980), *cert. denied*, 449 U.S. 1118 (1981). The distinction is tenuous because *Martinez* was broad and uncategorical, containing nothing to suggest that the Supreme Court sees such a limitation on tribal immunity. Interestingly, three Justices objected to the denial of certiorari.

[189] Kenai Oil & Gas, Inc. v. Department of the Interior, 522 F. Supp. 521 (D. Utah 1981) (dismissing in part for failure to exhaust tribal remedies).

[190] Cherokee Nation v. Georgia, 30 U.S. (5 Pet.) 1 (1831).

[191] D. GETCHES, D. ROSENFELT, & C. WILKINSON, FEDERAL INDIAN LAW 253 (1979).

[192] F. COHEN, *supra* note 183, at 123.

[193] *See supra* text accompanying notes 99-105.

[194] For discussion of foreign relations and sovereign immunity, see *supra* text accompanying notes 102-03.

[195] Maryland Casualty Co. v. Citizens Nat'l Bank, 361 F.2d 517, 521 (5th Cir. 1966).

[196] North Sea Prods., Ltd. v. Clipper Sea Foods Co., 92 Wash. 236, 595 P.2d 938 (1979).

[197] Haile v. Saunooke, 246 F.2d 293 (4th Cir.), *cert. denied*, 355 U.S. 893 (1957). The report of the case, however, leaves some doubt as to the tribe's involvement in commercial activity.

[198] Rehner v. Rice, 678 F.2d 1340 (9th Cir. 1982).

Court's rule that tribal immunity waivers cannot to be implied, but must be unequivocally expressed.[199]

3. *Waiver of tribal immunity—Who has authority to waive?*

Does authority to waive immunity lie with the tribes or exclusively with Congress? Tribes being sovereigns yet being in a trust or ward-guardian relationship[200] with the United States is a paradox.

It has been suggested that only Congress can waive tribal immunity. In *United States v. Fidelity & Guaranty Co.*,[201] the United States Supreme Court said the "Indian Nations are exempt from suit without Congressional authorization."[202] And the United States Court of Appeals for the Tenth Circuit upheld an immunity waiver by a tribe in part because the ordinance containing the waiver was approved by the Secretary of the Interior pursuant to federal legislation.[203] The Arizona Supreme Court held that *either* the tribe or Congress can waive tribal immunity.[204]

In contrast to these cases, several federal circuits upheld tribal immunity waivers in the absence of federal approval.[205] The United States Court of Appeals for the Eighth Circuit found a tribal waiver of immunity in a tribal entity's sue and be sued clause.[206] The United States Court of Appeals for the Ninth Circuit held that a tribe's voluntary intervention in a suit waives immunity and consents to having orders issued against the tribe that would otherwise be barred by sovereign immunity.[207] These two cases present the most persua-

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[199] Santa Clara Pueblo v. Martinez, 436 U.S. 49, 58-59 (1979).

[200] *See, e.g.*, Cherokee Nation v. Georgia, 30 U.S. (5 Pet.) 1 (1831); United States v. Mitchell, 463 U.S. 206 (1983).

[201] 309 U.S. 506 (1940).

[202] *Id.* at 512.

[203] Merrion v. Jicarilla Apache Tribe, 617 F.2d 537 (10th Cir. 1980), *aff'd on other grounds*, 455 U.S. 130 (1982). The waiver is a part of a tribal resource severance ordinance.

[204] Morgan v. Colorado River Indian Tribe, 103 Ariz. 425, 443 P.2d 421, 424 (1968) (holding that the defendant tribe "cannot be subjected to the jurisdiction of our courts without its consent or the consent of Congress").

[205] In addition to the cases discussed *infra*, see Merrion v. Jicarilla Apache Tribe, 617 F.2d 537, 540 (10th Cir. 1980) (en banc); Fontenelle v. Omaha Tribe, 430 F.2d 143, 147 (1970); Maryland Cas. Co. v. Citizens Nat'l Bank, 561 F.2d 517, 520-21 (5th Cir.), *cert. denied*, 385 U.S. 918 (1966).

[206] Namekagon Dev. Co. v. Bois Forte Reservation Hous. Auth., 517 F.2d 508 (8th Cir. 1975). The tribal housing authority was empowered by the tribal government to "sue and be sued in its corporate name, upon any contract, claim or obligation arising out of its activities under this ordinance and hereby authorizes the Authority to agree by contract to waive any immunity from suit which it might otherwise have . . . ." *Id.* at 509.

[207] United States v. Oregon, 657 F.2d 1009 (9th Cir. 1981).

sive theoretical and practical reasoning. First, they are the only cases that address the issue in the context of a unilateral tribal waiver. Second, they rest on the logically compelling argument that the ability to waive immunity is an inherent incident of the sovereignty which creates it. Third, as the Ninth Circuit observed, it contradicts federal policies encouraging tribal self-government not to allow a tribe to waive its immunity.[208]

In sum, tribal sovereign immunity is a factor that must be addressed in tribal government borrowing in order to minimize risk and thereby minimize interest rates. As with the Freely Associated States, a waiver of sovereign immunity by the borrowing government provides the surest way to handle the matter.[209]

IV. CONCLUSION

Freely Associated States cannot issue debt on which the interest is tax-exempt to lenders because the Freely Associated States do not come with section 103 of the Internal Revenue Code. Freely Associated State debt will therefore be treated as a taxable public borrowing.

The Freely Associated States enjoy sovereign immunity from suit and are entities to which the Foreign Sovereign Immunities Act and the act of state doctrine apply. While an argument can be made that United States courts will be reluctant to apply these doctrines to defeat lenders' collection efforts, the possibility of invocation of such defenses creates an undesirable risk for lenders, driving up the cost of borrowing. This cost is unnecessary and can be avoided by techniques available to the Freely Associated States in structuring their borrowing.

Tribal governments, while not foreign sovereigns for FSIA purposes, also can invoke the sovereign immunity defense, giving rise to the same increase in borrowing costs. Techniques similar to those available to the Freely Associated States can be used to address this matter. Unlike the Freely Associated States, though, Indian governments can issue tax-exempt debt for a limited class of public projects.

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[208] *Id.* at 1013-14. It is unlikely that a court will hold a tribe's clearly expressed, unequivocal waiver of immunity invalid for want of federal consent. None of the cases cited above compel that result and it would contradict both logic and federal policy. Any litigant asserting that a tribe should be able to renege on such a waiver would surely be left in a most unsympathetic position in the court's eyes.

[209] For a discussion of the advantages of such a waiver in the Freely Associated State context, see *supra* text accompanying note 142.

Two Growing Procedural Defenses in Common Law Wrongful Discharge Cases—Preemption and *Res Judicata*

I. INTRODUCTION

During the twentieth century, Congress and state legislatures passed a great number of statutes regulating the employment relationship.[1] The number of these statutes in existence increases every year. Recently, state courts began providing employees with common law claims against their employers. In many instances case law and statutory laws overlap. This overlap raises the question of whether or not a statute preempts a common law claim.

Where a discharged employee brings a state common law wrongful discharge action against the employee's former employer, and where the employer attempts to invoke a statute to either preempt or preclude the common law claim, the outcome will vary widely depending upon a multiplicity of factors. Among these are the applicable law, the nature of the employment, and the possible forums available.

II. BACKGROUND

This comment surveys some of the most common applications of preemption and preclusion to employment law. Section II discusses the background, while Section III discusses the non-legal context, and Section IV discusses in detail the legal process involved. Finally, this comment concludes, in Section VI, that in a situation where there are civil rights involved, preclusion and preemption generally are not successful defenses to state common law wrongful discharge. Preemption and preclusion, however, are successful defenses when certain other less important employee rights are implicated.

At-will employment is employment that both the employer or employee may terminate at any time, without notice and without cause. Traditionally, a hiring

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[1] Craver, *The 1986-87 Supreme Court Labor and Employment Law Term: The Expanding Focus on Individual Rights and Preemption*, 3 LAB. LAW. 755 (1987).

for an indefinite period (as opposed to a hiring for a specific term) is considered at-will employment. Recently, this American common-law rule has become the subject of increasing judicial intervention.[2] The trend toward seeking to provide employees with some protection from certain kinds of termination has gained a substantial judicial foothold. Many employee lawsuits attacking discharges from employment now frequently survive motions to dismiss or motions for summary judgment. This imposes on employers the cost of extensive litigation and the risk of a judgment for the employee on the merits.

The traditional American common law doctrine of "employment at-will" is that unless a definite period of services is specified in the contract, the hiring is at-will, and the employer has the right to discharge the employee without notice at any time, for any reason, and an employee may terminate the employment relationship on the same basis.[3] A general or indefinite hiring is *prima facie* evidence of a hiring at-will under the common law rule.[4] This employment at-will rule gained constitutional status in *Adair v. United States*.[5]

That status, however, proved to be short lived. United States Supreme Court decisions upholding the constitutionality of "new deal" legislation permitted the limitation, or significant alteration, of the common law employment at-will doctrine.[6] Today, many federal statutes limit at-will employment. Among these are the National Labor Relations Act,[7] the Fair Labor Standards Act,[8] the Oc-

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[2] J. BARBASH & J. KAUFF, UNJUST DISMISSAL 1983: LITIGATING, SETTLING, AND AVOIDING CLAIMS 17 (1983).

[3] *Id.* at 18; *see* Crawford v. Stewart, 25 Haw. 226 (1919). The American common law rule became known as Wood's rule. *See* H. WOOD, MASTER AND SERVANT § 134 (1st ed. 1877).

[4] J. BARBASH & J. KAUFF, *supra* note 2, at 18.

[5] 208 U.S. 161 (1908). The Supreme Court held unconstitutional federal and state statutes which barred enforcement of employment contracts requiring, as a pre-condition, that employees expressly agree not to join a union because in the Court's view such statutes violate the 14th amendment due process clause. The Court stated that "it is not within the functions of government [to] compel any person in the course of his business [to] retain the personal services of another." *See also* Coppage v. Kansas, 236 U.S. 1 (1915). *But see* Phelps Dodge Corp. v. NLRB, 313 U.S. 177, 187 (1941) (noting that ". . .decisions in this Court since [*Adair*] and [*Coppage*] have completely sapped those cases of their authority.")

[6] *See, e.g.*, NLRB v. Jones & Laughlin Steel Corp., 301 U.S. 1 (1937) (upholding constitutionality of the National Labor Relations Act). The N.L.R.A. prohibits discharges of employees for exercising their rights to organize and bargain collectively. *Jones & Laughlin* thus limited the employment at-will doctrine by prohibiting employers from discharging employees for exercising their rights under the National Labor Relations Act). *But see* Schechter Poultry Corp. v. United States, 295 U.S. 495 (1935) (holding that federal government could not regulate wages and hours of workers employed in intrastate commerce. *Schechter* held the National Industrial Recovery Act unconstitutional. This was the last statute to be struck down that imposed limitations upon the employment at-will doctrine. After *Schechter*, statutes that limited the doctrine were held constitutional.)

[7] 29 U.S.C. §§ 158(a)(1), (3), (4) (1982).

[8] *Id.* §§ 215(1), (3), 216(b).

cupational Safety and Health Act,[9] Title VII of the Civil Rights Act of 1964,[10] the Age Discrimination in Employment Act of 1967,[11] the Employee Retirement Income Security Act,[12] the Railway Labor Act,[13] and others.[14] State workers' compensation acts and other state statutes often limit the at-will doctrine as well.[15]

Since the 1970s, courts in a number of jurisdictions have recognized *judicially* created claims, which further limit the employment at-will doctrine.[16]

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[9] *Id.* §§ 2000e-2, 2000e-3(a).

[10] 2 U.S.C. §§ 2000e-2, 2000e-3(a) (1982).

[11] 29 U.S.C. §§ 623, 631, 633(a) (1982).

[12] *Id.* §§ 1140, 1141.

[13] 45 U.S.C. §§ 151-188 (1982).

[14] Civil Rights Acts of 1866 & 1871, 42 U.S.C. § 1981 (1982); Federal Employers' Liability Act, 45 U.S.C. § 60 (1982); Jurors' Employment Protection Act, 28 U.S.C. § 1875 (1982); Rehabilitation Act of 1973, 29 U.S.C. § 793(a) (1982); Vietnam Veterans Readjustment Act, 38 U.S.C. §§ 2021, 1024(a) (1982).

[15] Portillo v. G.T. Price Prods., Inc., 131 Cal. App. 3d 285, 182 Cal. Rptr. 291 (1982); Taylor v. St. Regis Paper Co., 560 F. Supp. 546 (C.D. Cal. 1983); Cornejo v. Polycon Indus., Inc., 109 Wis. 2d 649, 327 N.W.2d 183 (Ct. App. 1982).

[16] *See, e.g.*, McNulty v. Borden, Inc., 474 F. Supp. 1111 (E.D. Pa. 1979) (employee can have a cause of action under Pennsylvania law for wrongful discharge); O'Neill v. ARA Servs., Inc., 457 F. Supp. 182 (E.D. Pa. 1978) (terminable at-will is a rebuttable presumption); Petermann v. International Bhd. of Teamsters, 174 Cal. App. 2d 184, 344 P.2d 25 (1959) (public policy exception adopted); Hunter v. Hayes, 533 P.2d 952 (Colo. Ct. App. 1975) (not chosen for official publication) (promissory estoppel applied); Parnar v. Americana Hotels, Inc., 65 Haw. 370, 652 P.2d 625 (1982) (public policy exception adopted); McIntosh v. Murphy, 52 Haw. 29, 469 P.2d 177 (1970); Ravelo v. County of Hawaii, 66 Haw. 194, 658 P.2d 883 (1983); Kinoshita v. Canadian Pacific Airlines, Ltd., 68 Haw. 724 P.2d 110 (1986) (implied contract exception adopted); Kelsay v. Motorola, Inc., 74 Ill. 2d 172, 384 N.E.2d 353 (1978); Fortune v. National Cash Register Co., 373 Mass. 96, 364 N.E.2d 1251 (1977) (duty to terminate in good faith imposed); Grouse v. Group Health Plan, Inc., 306 N.W.2d 114 (Minn. 1981) (promissory estoppel applied); Monge v. Beebe Rubber Co., 114 N.H. 130, 316 A.2d 549 (1974) (duty to terminate in good faith imposed); Weiner v. McGraw-Hill, Inc., 57 N.Y.2d 458, 443 N.E.2d 441, 457 N.Y.S.2d 193 (1982) (additional consideration exception recognized). *See also* S. DIAMOND, CAN THEY JUST FIRE ME? (1984); J. BARBASH & J. KAUFF, *supra* note 1; A. HILL, "WRONGFUL DISCHARGE" AND THE DEROGATION OF THE AT-WILL EMPLOYMENT DOCTRINE (1987); Copeland, *The Revenge of the Fired*, NEWSWEEK, Feb. 16, 1987, at 46; Ichinose, *Hawaii's Supreme Court Recognizes Tort of Retaliatory Discharge of an At-Will Employee*, 17 HAW. B.J. 123 (1982); Jung & Harkness, *The Facts of Wrongful Discharge*, 4 LAB. LAW 257 (1988); Lopatka, *The Emerging Law of Wrongful Discharge - A Quadrennial Assessment of the Labor Law Issue of the 80's*, 40 BUS. LAW. 1 (1984); Machida, *Wrongful Discharge*, HAW. BUS., Jan. 1987, at 44; Recent Development, *Contract Law—Kinoshita v. Canadian Pacific Airlines, Ltd.: Judicial Exception to the "Employment-at-Will" Doctrine*, 9 U. HAW. L. REV. 783 (1987); Note, *Ravelo v. County of Hawaii: Promissory Estoppel and the Employment At-Will Doctrine*, 8 U. HAW. L. REV. 163 (1986); Kobayashi, *Fired Secretary Awarded $2 Million*, Honolulu Advertiser, Apr. 25, 1987; Gould, *Fired! Employers Paying Up in Wrongful Dismissal Suits*, Sunday Honolulu Star-Bull. & Advertiser, Feb. 10, 1985, at G-6; Lubin, *Legal Challenges Force*

These are known as "wrongful discharge" or "unjust dismissal" claims. They are grounded on both contract and tort theories. Plaintiffs in these "wrongful discharge" actions often seek punitive damages, which are unavailable under most statutorily created claims. Because of the number of statutory and common law claims affecting employment today, employment claims may often overlap. When this happens, one law may preempt or preclude another.

Thus, preemption and preclusion have now joined the procedural defenses that are important to employers in defending wrongful discharge actions.[17]

Preemption can be classified broadly into two types: (1) federal statute/state law (common law or statutory) and (2) state statute/state common law. Federal law displacing state law is the most common example of preemption.[18] This theory of preemption derives from the supremacy clause of the United States Constitution.[19] The supremacy clause permits Congress to preempt state regulation in three ways: (1) expressly; (2) by enacting a regulation that conflicts with state law; or (3) by enacting a comprehensive system of regulations that displaces all state law in the area (i.e., "occupying the field").[20] Federal statutes can preempt both state statutes[21] and state common law.[22] Federal preemption of state statutes is discussed in this comment mainly to develop the doctrine of preemption for later application to state common law wrongful discharge situations. State statutes may also preempt state common law wrongful discharge causes of action.[23]

Firms to Revamp Ways They Dismiss Workers, Wall St. J., Sept. 13, 1983 at 1, col. 6.

[17] *See* Brown, *Labor Law Issues Facing Multinational and Japanese Companies Operating in the United States and United States Companies Using Japanese-Style Labor Relations: Agenda Items Under the "New Labor Relations,"* 8 U. HAW. L. REV. 261, 331 (1986) ("One of the most rapidly growing defenses in wrongful discharge cases is that of pre-emption.").

[18] "Preemption" is defined as the "[d]octrine adopted by U.S. Supreme Court holding that certain matters are of such a national, as opposed to local, character that federal laws pre-empt or take precedence over state laws. As such, a state may not pass a law inconsistent with the federal law. Examples are federal laws governing interstate commerce." BLACK'S LAW DICTIONARY 1060 (5th ed. 1979).

[19] U.S. CONST. art. VI, cl. 2.

[20] *See* Pacific Gas & Elec. Co. v. State Energy Resources Conservation & Dev. Comm'n, 461 U.S. 190 (1983); G. STONE, L. SEIDMAN, C. SUNSTEIN & M. TUSHNET, CONSTITUTIONAL LAW 318 (1986).

[21] J. NOWAK, R. ROTUNDA & J. YOUNG, CONSTITUTIONAL LAW 267 (1978); *see* Garner v. Teamsters Local 776, 346 U.S. 485 (1953).

[22] Local 926, Int'l Union of Operating Eng'rs v. Jones, 460 U.S. 669 (1983); Viestenz v. Fleming Cos., 681 F.2d 699 (10th Cir. 1982).

[23] *See* Portillo v. G.T. Price Prods., Inc., 131 Cal. App. 3d 285, 182 Cal. Rptr. 291 (1982); Taylor v. St. Regis Paper Co., 560 F. Supp. 546 (C.D. Cal. 1983); Cornejo v. Polycon Indus., Inc., 109 Wis. App. 2d 649, 327 N.W. 2d 183 (1982); Strauss v. A.L. Randall Co., 144 Cal. App. 3d 514, 194 Cal. Rptr. 520 (1983); Wolk v. Saks Fifth Ave., Inc. 728 F.2d 221 (3d Cir. 1984).

The second procedural defense discussed in this comment is preclusion. Preclusion bars litigants from making a claim in one forum which previously was made in another forum.[24] This comment will focus on the general doctrines of preemption and preclusion and exceptions thereto. In addition, cases in which employers used preemption or preclusion as defenses against wrongful discharge actions will be examined.

III. NON-LEGAL CONTEXT

Certain policy arguments and conflicts arise in determining whether, and if so, when preemption or preclusion should apply. Among these policy concerns are local interests versus a uniform national policy, the possibility of duplicative remedies,[25] and the burdens and traps of defending in multiple forums.[26] These are discussed briefly in the above order.

First, there are often important local interests involved in settling a wrongful discharge claim.[27] There are, however, many benefits that flow from a uniform national policy.[28] For example, a uniform body of labor law is essential to guard rights granted under the National Labor Relations Act from erosion in state courts and legislatures.[29] Second, if a plaintiff's claim is not preempted or precluded, the plaintiff may have more than one forum in which to pursue the same remedies.[30] If, on the other hand, the employee's claim is preempted or

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[24] *See* Kremer v. Chemical Constr. Corp., 456 U.S. 461 (1982); University of Tennessee v. Elliott, 478 U.S. 788 (1986).

[25] If an employee is allowed to successfully pursue a remedy in more than one forum, he or she may receive duplicative remedies; that is, possibly double recovery for the same loss.

[26] An employee who files a claim in more than one forum forces the employer to defend itself twice on the same fact situation.

[27] *See, e.g.*, Linn v. United Plant Guard Workers, 383 U.S. 53, 62 (1966) (recognizing an overriding state interest in redressing citizens' injuries from malicious libel); Belknap, Inc. v. Hale, 463 U.S. 491 (1983) (state has substantial interest in protecting its citizens from misrepresentations). *See infra* text accompanying notes 49-69 regarding matters of overriding local concern and NLRA preemption.

[28] *See, e.g.*, San Diego Bldg. Trades Council v. Garmon, 359 U.S. 236, 245 (1959) ("[T]he States as well as the federal courts must defer to the exclusive competence of the National Labor Relations Board if the danger of state interference with national policy is to be averted."); Teamsters v. Lucas Flour Co., 369 U.S. 95, 104 (1962) ("The importance of the area which would be affected by separate systems of substantive law makes the need for a single body of federal law particularly compelling.")

[29] *See, e.g.*, Vandeventer v. Local 513, Int'l Union of Operating Eng'rs, 579 F.2d 1373 (8th Cir.), *cert. denied*, 439 U.S. 984 (1978).

[30] *See* Alexander v. Gardner-Denver Co., 415 U.S. 36, 53-54 (1974) ("[T]he arbitrator has authority to resolve only questions of contractual rights, and this authority remains regardless of whether certain contractual rights are similar to, or *duplicative* of, the substantive rights secured by Title VII.") (emphasis added).

precluded, the employee's remedy may be severely limited and the employer may not be discouraged from discharging employees wrongfully. Third, the burden of an employer to defend in more than one forum may be excessive if preemption or preclusion does not apply.[31] Last, the traps of multiple forums may make for a stronger argument that preclusion or preemption should apply.

IV. LEGAL PROCESS

A. Federal Statutes/State Law Preemption

1. The National Labor Relations Act[32]

a. Doctrine

Generally, the National Labor Relations Act (NLRA)[33] preempts state law wherever the two areas overlap.[34] One of the leading United States Supreme Court cases for this proposition is *San Diego Building Trades Council v. Garmon*.[35] *Garmon* involved a state court suit by an employer seeking damages arising from employee picketing. The Court held that picketing was within the scope of the NLRA and that the state court had no jurisdiction to award the employer damages for injuries caused by the picketing.[36] The Court found that it was Congress' intent to have close questions resolved by the National Labor

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[31] *See* Allen v. McCurry, 449 U.S. 90, 94 (1980) (giving preclusive effect encompasses both the parties' interest in avoiding the cost and vexation of repetitive litigation and the public's interest in conserving judicial resources); K. DAVIS, ADMINISTRATIVE LAW 78 (2d ed. 1983). *See also* Alexander v. Gardner-Denver Co., 346 F. Supp. 1012, 1019 (D.Colo. 1971), *aff'd*, 466 F.2d 1209 (10th Cir. 1972), *rev'd*, 415 U.S. 36 (1974) (the District Court described this situation as one which, "gives the employee two strings to his bow when the employer has only one.").

[32] *See generally* Gregory, *The Labor Preemption Doctrine: Hamiltonian Renaissance or Last Hurrah?*, 27 WM. & MARY L. REV. 507 (1986); Kosanovich, *Inching Through the Maze: Recent Developments in Preemption Under the NLRA and the Impact of Caterpillar, Hechler and Others*, 4 LAB. LAW. 225 (1988).

[33] 29 U.S.C. §§ 151-169 (1982).

[34] *See* Garner v. Teamsters Local 776, 346 U.S. 485 (1953); *see generally* Comment, *NLRA Preemption of State Wrongful Discharge Claims*, 34 HASTINGS L.J. 635 (1983); Comment, *State Actions for Wrongful Discharge: Overcoming Barriers Posed by Federal Labor Law Preemption*, 71 CALIF. L. REV. 942 (1983); Grossman, *NLRA Preemption of Wrongful Discharge Actions: A Perspective*, 1 LAB. LAW. 583 (1985); Kennedy, *Federal Labor Law Preemption and Hawaii's Work-Injury Discharge Law*, 16 HAW. B.J. 37 (1981); Wheeler & Browne, *Federal Preemption of State Wrongful Discharge Actions*, 8 INDUS. REL. L.J. 1 (1986).

[35] 359 U.S. 236 (1959).

[36] *Id.* at 246.

Relations Board.[37] If the conduct was arguably protected or prohibited, then, in the Court's view, state law was inapplicable.

Applying the doctrine of preemption, the United States Supreme Court concluded in *Garmon* that Congress intended the NLRB to oversee labor law regulation to ensure uniform application of the NLRA. The Supreme Court thus limited the power of a state to create rights affecting labor disputes, or to adjudicate controversies arising from such disputes.[38] The Court further noted that preemption by the NLRA is based on the rationale that the NLRA is a regulatory scheme intended to prohibit certain conduct, protect certain conduct, and leave other matters between management and labor to the regulated economic power struggle.[39] A state law that prohibits what the NLRA permits is invalid by virtue of the supremacy clause.[40]

The NLRA also seeks to allow freedom of action in some areas under its regulation.[41] Protected and prohibited conduct generally refers to the rights created by Section 7 and the unfair labor practices set out in Section 8 of the NLRA.[42] While these sections do not touch upon all possible areas of concern to employers and employees, state regulation is not necessarily permitted in these untouched areas. State regulation of actions that are neither prohibited nor protected might still impede the policy goals of the NLRA and are therefore also preempted.[43]

The doctrine of preemption was further developed in *Allis-Chalmers Corp. v. Lueck*.[44] The *Allis-Chalmers* preemption is distinct from the *Garmon* preemption because *Allis-Chalmers* involves section 301, and hence is commonly referred to as "301 preemption."[45] The United States Supreme Court in *Allis-*

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[37] *Id.* at 242.

[38] *See id.* at 245.

[39] *See id.* at 240.

[40] U.S. CONST. art. IV, § 2.

[41] Weber v. Anheuser-Busch, Inc., 348 U.S. 468, 480 (1955); R. GORMAN, LABOR LAW: UNIONIZATION AND COLLECTIVE BARGAINING 778 (1976).

[42] 29 U.S.C. §§ 157, 158 (1982).

[43] 359 U.S. 236, 242-45; Machinists v. Wisconsin Employment Relations Comm'n, 427 U.S. 132 (1976). The Court in *Machinists* expressly overruled Local 232 v. Wisconsin Employment Relations Bd. 336 U.S. 245 (1949), which held that states were not preempted from regulating conduct that was neither protected nor prohibited by federal labor laws.

[44] 471 U.S. 202 (1985).

[45] Section 301 of the Taft-Hartley Act, which governs actions for breach of collective bargaining agreements, reads as follows:

> Suits for violation of contracts between an employer and a labor organization representing employees in an industry affecting commerce as defined in this Act, or between any such labor organizations, may be brought in any district court of the United States having jurisdiction of the parties, without respect to the amount in controversy or without regard to the citizenship of the parties.

29 U.S.C. § 185(a) (1982).

Chalmers held that when the resolution of a state law claim is substantially dependent on interpretation of the terms of a collective bargaining agreement, the claim must either be treated as a section 301 claim, or dismissed as preempted by federal contract law. In addition, the Supreme Court noted that because the right asserted in *Allis-Chalmers* not only derived from the labor contract, but was defined by the contractual obligation of good faith, any attempt to assess liability inevitably would involve contract interpretation.[46] Thus, the Court held that the action should be dismissed for failure to use the contract grievance arbitration procedure, or be dismissed as preempted by section 301.[47]

b. Limitations/Exceptions

Although the scope of federal preemption of state law under the NLRA is very broad, there are exceptions where state law may apply. These exceptions may be divided into two categories: (1) those that are judicially created; and (2) those expressly created by the NLRA.[48]

(1) Judicially Created Exceptions

In this comment, judicial exceptions are further divided into those of overriding local concern and those of peripheral federal concern.

(a) Matters of Overriding Local Concern

One exception made by the United States Supreme Court to the preemption doctrine, permits state regulation of conduct that "touches interests deeply rooted in local feeling and responsibility."[49] Where the matter is of overriding local concern, the NLRA will not preempt state law. Examples of matters involving overriding local concern include violence,[50] defamation,[51] intentional infliction of emotional distress,[52] unemployment benefits,[53] and breach of contract

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[46] 471 U.S. at 208-21.

[47] *Id.* at 220-21.

[48] *See* R. GORMAN, *supra* note 41, at 786.

[49] Amalgamated Ass'n of Street, Elec. Ry. & Motor Coach Employees v. Lockridge, 403 U.S. 274 (1971).

[50] *See, e.g.*, UAW v. Russell, 356 U.S. 634 (1958).

[51] *See, e.g.*, Linn v. United Plant Guard Workers, 383 U.S. 53 (1966).

[52] *See, e.g.*, Farmer v. United Bhd. of Carpenters & Joiners Local 25, 430 U.S. 290 (1977).

[53] *See, e.g.*, Ohio Bureau of Employment Servs. v. Hodory, 431 U.S. 471 (1977).

regarding strike replacements.[54]

The violence exception has been applied to allow state courts to remedy acts of violence or threats thereof in labor disputes. State courts may grant injunctions to restrain violent acts or award damages against those who engage in violence.[55] State courts may address claims of violence although such conduct may also constitute an unfair labor practice under the NLRA. The rationale supporting this exception to the preemption doctrine is that states are the natural guardians of the public against acts of violence. Therefore, prevention of violent acts is a matter of genuine local concern.[56]

Another judicially created exception involving an overriding state interest is the prevention of defamation in labor disputes.[57] Local courts are permitted to award tort damages for defamation if it is malicious,[58] that is, if it is uttered with deliberate or reckless disregard for the truth.[59] State courts may not award damages based on any lower standard of malice because federal law sets the limit on free speech in labor disputes. Federal law, however, requires a showing of deliberate or reckless falsity.[60] While federal labor policy does not condone knowing falsehoods, the United States Supreme Court has found deeply rooted local concerns for creating a qualified privilege to defame.[61] Free speech is important in labor disputes to minimize the possibility that labor debate will be chilled.[62]

Intentional infliction of emotional distress is a third judicially created exception of overriding local concern. A state court action by an employee against a union for intentional infliction of emotional distress is not preempted by the

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[54] *See, e.g.*, Belknap, Inc. v. Hale, 463 U.S. 491 (1983).

[55] UAW v. Russell, 356 U.S. 634 (1958); UAW v. Wisconsin Employment Relations Bd., 351 U.S. 266 (1956); Construction Workers v. Laburnum Constr. Corp., 347 U.S. 656 (1954). *See also* Franchise Tax Bd. v. Construction Laborers Vacation Trust for S. California, 463 U.S. 1, 25 n.28 (1983) (noting in dictum that state battery suit arising out of a violent strike would not be preempted); Sears, Roebuck & Co. v. Carpenters, 436 U.S. 180 (1978) (state trespass action arising from picketing not subject to preemption).

[56] *Russell*, 356 U.S. 634.

[57] Linn v. United Plant Guard Workers, 383 U.S. 53, 63 (1966). *See also* Salzhandler v. Caputo, 316 F.2d 445 (2d Cir.), *cert. denied*, 375 U.S. 946 (1963). The definition of a labor dispute is found at 29 U.S.C. § 152(a) (1982).

[58] *Linn*, 383 U.S. at 64-65 (tort of libel is not preempted if plaintiff "can show that the defamatory statements were circulated with malice and caused him damage"; requirement that malice be shown will minimize the possibility that labor debate will be chilled by the threat of state libel suits). *See also* New York Times Co. v. Sullivan, 376 U.S. 254 (1964).

[59] *New York Times*, 376 U.S. 254.

[60] Old Dominion Branch No. 496, Nat'l Ass'n of Letter Carriers v. Austin, 418 U.S. 264 (1974).

[61] *Id.*

[62] *Linn*, 383 U.S. at 64-65.

NLRA.[63] This exemption, however, applies only when the conduct in question is unrelated to the alleged employment discrimination or involves abusive tactics of discrimination.[64]

Unemployment benefits are yet another judicial exception of overriding state concern. The United States Supreme Court has upheld state statutes both allowing[65] and disallowing[66] unemployment benefits to strikers.

Finally, breach of contract for strike replacements is still another exception to the preemption doctrine.[67] An employer who hires permanent replacements for striking employees and then later discharges them after the strike is over can be sued in state court for breach of contract.[68] Preventing the discharged employees from proceeding in state court would deny them a remedy. Allowing them to proceed supports a strong state interest.[69]

(b) Matters of Peripheral Federal Concern

The United States Supreme Court has held that the preemption doctrine does not apply where the matter is of only peripheral concern to federal labor policy.[70] As such, the NLRA will not preempt state law in such cases. One example of this is purely internal union management matters, which have no impact on the national labor policy. In *International Association of Machinists v. Gonzales*,[71] a union member sued for reinstatement and damages after expulsion from his union where the expulsion allegedly violated the union constitution and bylaws. The Supreme Court upheld the state's power to award damages, characterizing the case more as a breach of contract action than a matter of peripheral federal labor policy.[72]

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[63] Farmer v. United Bhd. of Carpenters & Joiners Local 25, 430 U.S. 290 (1977). *But see* Spielmann v. Anchor Motor Freight, Inc., 551 F. Supp. 817 (S.D.N.Y. 1982) (distinguishing *Farmer* where outrageous conduct was the arguably prohibited conduct under the NLRA).

[64] *Farmer*, 430 U.S. 290. *See* Viestenz v. Fleming Cos., 681 F.2d 699 (10th Cir.), *cert. denied*, 459 U.S. 972 (1982) (claims of intentionally inflicted emotional distress arising in the context of an unfair labor practice and the events surrounding the employee's discharge was held preempted by federal law).

[65] New York Tel. Co. v. New York State Dep't of Labor, 440 U.S. 519 (1979).

[66] Ohio Bureau of Employment Servs. v. Hodory, 431 U.S. 471 (1977).

[67] *See generally*, Stromire, *The National Labor Relations Act Does Not Preempt a Discharged Permanent Replacement Worker's State Cause of Action*, 37 VAND. L. REV. 1205 (1984).

[68] Belknap, Inc. v. Hale, 463 U.S. 491 (1983).

[69] Note, *Labor Law Preemption After Belknap, Inc. v. Hale: Has Preemption as Usual Been Permanently Replaced?*, 17 IND. L. REV. 491 (1984).

[70] San Diego Bldg. Trades Council v. Garmon, 359 U.S. 236 (1959).

[71] 356 U.S. 617 (1958).

[72] *Id.*

(2) Statutory Exceptions

In addition to the above-noted judicial exceptions to the preemption doctrine, the NLRA explicitly provides certain statutory exceptions. Damages for unlawful strikes or boycotts,[73] actions for breach of a collective bargaining agreement (section 301),[74] situations where the NLRB refuses jurisdiction,[75] and state limitations on union security agreements[76] all have been explicitly exempted by Congress from the general rule of NLRA preemption.

c. Wrongful Discharge

Having outlined the preemption doctrine of the NLRA and a number of its exceptions, the discussion now turns to applications of the NLRA preemption doctrine as a defense to state common law wrongful discharge actions.

Express employment contracts have been enforceable in state courts under state common law for several years.[77] The phrase "state common law wrongful discharge claim" is used frequently to refer to more recent judicial limitations to the employment at-will doctrine. Wrongful discharge in this context usually refers to implied contract theories of recovery or tort theories of recovery based on violation of public policy.

These cases arise where an employee was unsuccessful in gaining reinstatement under the grievance and arbitration procedures of the collective bargaining agreement.[78] An employee might also bypass the grievance procedure for a state court action in hopes of obtaining a better remedy such as the addition of punitive damages not available under the NLRA.[79] Allowable wrongful discharge claims vary from state to state.[80]

The United States Supreme Court has yet to directly address federal preemption of such state common law wrongful discharge actions. Federal courts are divided on the question of preemption where the terminated employee is a union member in a recognized collective bargaining unit. To illustrate the point, this comment will analyze two cases decided by the United States Court of Appeals for the Ninth Circuit.

The first case is *Olguin v. Inspiration Consolidated Copper Co.*.[81] In *Olguin*, the

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[73] Taft-Hartley Act, § 303, 29 U.S.C. § 187 (1982).

[74] Taft-Hartley Act, § 301, 29 U.S.C. § 185(a) (1982).

[75] Landrum-Griffin Act of 1959, § 14(c), 29 U.S.C. § 164(c) (1982).

[76] NLRA, § 14(b), 29 U.S.C. § 164(b) (1982).

[77] *See, e.g.*, Belknap v. Hale, 463 U.S. 491 (1983).

[78] *See, e.g.*, Olguin v. Inspiration Consolidated Copper Co., 740 F.2d 1468 (9th Cir. 1984).

[79] *See, e.g.*, Allis-Chalmers Corp. v. Lueck, 471 U.S. 202 (1985).

[80] *See generally* J. BARBASH & J. KAUFF, *supra* note 2.

[81] 740 F.2d 1468 (9th Cir. 1984). *Contra* Miller v. AT & T Network Systems, 850 F.2d

plaintiff employee, Olguin, was discharged by his employer because he misused and damaged a saw.[82] Plaintiff asserted claims for wrongful discharge, wrongful discharge in violation of public policy, intentional infliction of emotional distress, and breach of contract.[83] Because plaintiff was covered by a collective bargaining agreement,[84] his employer removed the action to federal court.[85] The federal district court subsequently dismissed the case, however, because the claims all arose under federal law, because federal law provided exclusive remedies, and because plaintiff failed to follow the procedures provided by the collective bargaining agreement.[86] The United States Court of Appeals for the Ninth Circuit affirmed the district court's dismissal,[87] holding that plaintiff's exclusive remedies lay under the collective bargaining agreement, since the agreement was governed by federal law. Plaintiff's state wrongful discharge claims were preempted by the NLRA.[88]

The second case is *Garibaldi v. Lucky Food Stores, Inc.*,[89] which was decided earlier in that year. In *Garibaldi*, a completely different panel of the United States Court of Appeals for the Ninth Circuit[90] held that a suit alleging wrongful discharge in violation of public policy was not preempted by the NLRA.[91] Garibaldi, the plaintiff employee, alleged that he was discharged for notifying the state health department about a shipment of spoiled milk that his employer ordered him to deliver.[92] *Garibaldi* is distinguishable from *Olguin* in that the *Garibaldi* court found that Garibaldi alleged a discharge in violation of state public policy, whereas, the *Olguin* court found that Olguin acted without benefit of either state law or policy to support his actions.

It appears then, at least in the Ninth Circuit, that in a state wrongful discharge claim, where the discharged employee acted in accordance with a state public policy and the employer violated that policy, the employee's state common law claim will not be preempted by the NLRA. If, however, the court finds that the employer's actions did not violate a state law or policy, the employee's claim will be preempted by the NLRA.

A recent decision of the United States Supreme Court involving section 301

543, 549 (9th Cir. 1988) (opinion by a different 9th Circuit judge said *Olguin* was no longer binding precedent).

[82] 740 F.2d at 1470 n.2.

[83] *Id.* at 1471.

[84] *Id.* at 1470.

[85] *Id.* at 1471.

[86] *Id.*

[87] *Id.* at 1470.

[88] *Id.* at 1476.

[89] 726 F.2d 1367 (9th Cir. 1984), *cert. denied*, 471 U.S. 1099 (1985).

[90] *See id.* at 1368; *see also* 740 F.2d at 1470.

[91] 726 F.2d at 1369.

[92] *Id.* at 1368.

preemption in a wrongful discharge suit was *Lingle v. Norge Division of Magic Chef, Inc.*[93] In that case, plaintiff, a former employee, was discharged for filing an allegedly false worker's compensation claim.[94] Plaintiff was covered by a collective bargaining agreement that protected employees from discharge except for just cause.[95] During the arbitration of the dispute, plaintiff sued Magic Chef for wrongful discharge.[96] The Supreme Court held that plaintiff's state wrongful discharge remedy was not preempted by section 301.[97] Justice Stevens, speaking for the majority, reasoned that as long as a state law claim can be resolved without interpreting the collective bargaining agreement, the claim is independent of the agreement for section 301 preemption purposes.[98]

2. *Title VII, Civil Rights Act of 1964*

The Civil Rights Act of 1964 (Title VII),[99] unlike the NLRA, will not preempt the application of state law that is consistent with or expands upon rights granted thereunder.[100] State law, of course, cannot substantively or procedurally frustrate rights granted by Title VII.[101]

The United States Supreme Court held, in *California Federal Savings & Loan Association v. Guerra*,[102] that Title VII did not preempt a California statute which required employers to grant pregnant employees up to four months of unpaid pregnancy leave. Male employees were not allowed similar leaves, thus the state statute allegedly violated Title VII by discriminating on the basis of sex. The employer argued that Title VII preempted the state law. The Supreme Court, however, upheld the state statute.

While the federal civil rights statute, as applied in *Guerra*, does not require employers to grant pregnancy leave, it does not preclude states from granting

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[93] 108 S. Ct. 1877 (1988).

[94] *Id.* at 1879.

[95] *Id.*

[96] *Id.*

[97] *Id.* at 1883.

[98] *Id.* at 1884.

[99] Civil Rights Act of 1964, 42 U.S.C. § 2000e 1 - 17 (1982).

[100] M. PLAYER, EMPLOYMENT DISCRIMINATION LAW, § 5.04 (1988).

[101] *Id.* Section 708 of Title VII specifically states:

> Nothing in this subchapter shall be deemed to exempt or relieve any person from any liability, duty, penalty, or punishment provided by any present or future law of any State or political subdivision of a State, other than any such law which purports to require or permit the doing of any act which would be unlawful employment practice under this subchapter.

42 U.S.C. § 2000e-7 (1982).

[102] 479 U.S. 272 (1987).

more protection to employees.[103] Thus, Title VII permits states to grant benefits to pregnant women that are *not* accorded to men.[104] Although employers are not *required* to, they may grant similar leaves to men.[105] As such, the employer in *Guerra* was not being compelled by the state statute to violate Title VII. The Court held that the state statute was therefore compatible with Title VII.[106]

In *Lucas v. Brown & Root, Inc.*,[107] the United States Court of Appeal for the Eighth Circuit held a state law contract claim was not preempted by Title VII. Lucas brought an action against her former employer alleging sex discrimination under Title VII.[108] The district court held the Title VII claim untimely[109] and the Eighth Circuit agreed. Lucas, however, had also brought a state common law contract claim. This claim, the Eighth Circuit held, was *not* preempted by Title VII.[110] The Eighth Circuit's rationale was the language of Title VII itself,[111] which stated that nothing in the Act shall relieve any person from liability under state law.[112]

Prior to *Lucas*, a federal district court, in *Brudnicki v. General Electric Co.*,[113] held that Title VII, along with a state statute, provided the "exclusive remedies for the enforcement of their terms and the corresponding vindication of the public policies involved."[114] The district court further stated that if the plaintiff were permitted to maintain the common law action that "the remedies provided by state and federal law would have no meaning."[115] That court, however, failed to mention section 708 of Title VII.[116] Indeed, the court should have dealt with section 708 because of that section's specific language providing that Title VII does not "exempt *any* person from *any* liability . . . provided by *any* present or future law of *any* State."[117]

Because of this clause it seems unlikely that Title VII preempts any state law except that which frustrates the rights granted by Title VII.[118] Therefore, Title

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[103] *Id.* at 290-92.

[104] *Id.* at 291.

[105] *Id.*

[106] *Id.* at 292.

[107] 736 F.2d 1202 (8th Cir. 1984).

[108] *Id.* at 1203.

[109] *Id.*

[110] *Id.* at 1206.

[111] *Id.*

[112] *See supra* note 101.

[113] 535 F. Supp. 84 (N.D. Ill. 1982).

[114] *Id.* at 89.

[115] *Id.*

[116] *See id.* at 86-90.

[117] 42 U.S.C. § 2000e-7 (1982) (emphasis added).

[118] *But see* Lapinad v. Pacific Oldsmobile-GMC, Inc., 679 F. Supp. 991 (D. Haw. 1988) (employee could not bring state common law wrongful discharge claim on public policy exception

VII preemption is generally an unsuccessful defense for employers against state common law wrongful discharge claims.

3. *Age Discrimination in Employment Act*

The Age Discrimination in Employment Act of 1967, as amended, (ADEA),[119] much like Title VII, normally does not preempt state laws. The ADEA will not preempt the award of tort damages on pendent state claims.[120] In *Kelly v. American Standard, Inc.*,[121] the Ninth Circuit specifically upheld emotional distress damages under a state age discrimination statute. Likewise, in *Cancellier v. Federated Department Stores*,[122] the United States Court of Appeals for the Ninth Circuit held that the ADEA did not preempt state law. In *Cancellier*, the court noted that punitive and emotional distress damages are unavailable under the ADEA and that these state law damage claims did not duplicate the ADEA's compensation for back pay, lost benefits, and liquidated damages.[123]

State laws may provide broader protection than the ADEA. Examples of broader protection are state laws with weaker defenses or no age limits.[124] The United States Court of Appeals for the Eighth Circuit has also held that state claims may be joined with an ADEA claim.[125] Federal courts may exercise pendent jurisdiction and provide state remedies.[126]

However, at least one court has "that the ADEA provides the exclusive judicial remedy for claims of age discrimination."[127] Yet, the ADEA itself in Section 14(a) discusses the federal-state relationship, stating that nothing in the Act will affect the jurisdiction of any State agency performing similar functions with regard to discriminatory employment practices as it affects age, except that upon commencement of an action under the Act such action would supersede any State action.[128] ADEA preemption is not an effective defense for employers

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to at-will doctrine because policy allegedly violated by employer was covered by Title VII which already provided a remedy).

[119] 29 U.S.C. §§ 621-634 (1982).

[120] *See, e.g.*, Kelly v. American Standard, Inc., 640 F.2d 974, 983 (9th Cir. 1981).

[121] *Id.*

[122] 672 F.2d 1312 (9th Cir.), *cert. denied*, 459 U.S. 859 (1982).

[123] *Id.* at 1318.

[124] M. PLAYER, *supra* note 100, at § 6.03.

[125] *See* Ridenour v. Montgomery Ward & Co., 786 F.2d 867 (8th Cir. 1986).

[126] *Id.*; M. PLAYER, *supra* note 100 at § 6.03.

[127] Platt v. Burroughs Corp., 424 F. Supp. 1329, 1340 (E.D. Pa. 1976).

[128] 29 U.S.C. § 633(a) (1982) (§ 14(a)) *See also Ridenour*, 786 F.2d 867 ("Nothing in this Act shall affect the jurisdiction of any agency of any State performing like functions with regard to discriminatory employment practices on account of age except that upon commencement of action under this Act such action shall supersede any State action"); M. Player, *supra* note 100, at

in wrongful discharge actions.

4. Employee Retirement Income Security Act

The Employee Retirement Income Security Act of 1974 (ERISA)[129] states in Section 1144(a) that its provisions supersede any and all state laws that "relate to" any employee benefit plan described by the Act.[130] The United States Supreme Court has recognized that this preemptive clause has a very broad reach.[131] ERISA has been held to preempt state statutes.[132] ERISA also has been held to preempt state common law wrongful discharge claims.[133]

5. Railway Labor Act

a. Doctrine

Preemption under the Railway Labor Act (RLA)[134] seems much broader in scope than that under the NLRA.[135] Lower courts have found that the scope of this preemption is broader because the RLA is structured differently from the NLRA. There has been a lack of detailed authority from the United States Supreme Court to verify that the lower courts have correctly stated RLA preemption is broader than NLRA preemption.[136]

The RLA establishes a system of compulsory arbitration for collective bargaining disputes and employee grievances. Employers are statutorily mandated to arbitrate, irrespective of any contractual obligation to arbitrate.[137] The RLA covers only railroad and airline employees.[138] Such an employee may success-

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§ 6.03.

[129] 29 U.S.C. §§ 1001-1461 (1982).

[130] *Id.* at § 1144(a).

[131] *See* Alessi v. Raybestos Manhattan, Inc., 451 U.S. 504 (1981).

[132] *See, e.g.* Standard Oil Co. of California v. Agsalud, 633 F.2d 760 (9th Cir. 1980), *aff'd*, 454 U.S. 801 (1981) declaring Hawaii's prepaid health act preempted by ERISA).

[133] Dependahl v. Falstaff Brewing Corp., 653 F.2d 1208 (8th Cir.), *cert. denied*, 454 U.S. 968 (1981); Maxfield v. Central States Health, Welfare & Pension Funds, 559 F. Supp. 158 (N.D. Ill. 1982); Gordon v. Matthew Bender & Co., 562 F. Supp. 1286 (N.D. Ill. 1983); Johnson v. Trans World Airlines, Inc., 149 Cal. App. 3d 518, 196 Cal. Rptr. 896 (1983); Witkowski v. St. Anne's Hosp. of Chicago, Inc., 113 Ill. App. 3d 745, 447 N.E.2d 1016 (1983).

[134] 45 U.S.C. §§ 151-163, 181-88 (1982).

[135] H. HOLLOWAY & M. LEECH, EMPLOYMENT TERMINATION RIGHTS AND REMEDIES 142 (1985) [hereinafter HOLLOWAY & LEECH].

[136] *Id.* at 143.

[137] 45 U.S.C. § 153 (1982).

[138] §§ 1,201, *Id.*, §§ 151, 181.

fully bring suit if his or her union's failure to process a grievance was a breach of the duty of fair representation and if the union and employer acted in concert.[139] The result of such an action brought by an employee against his or her employer is reached as a matter of strict statutory construction.[140] The statutory adjustment board, however, has jurisdiction only over situations in which the employee or union has a dispute with an employer. The board does not have jurisdiction in an employee's dispute with the employee's union.[141] The RLA mandates submission of disputes to the appropriate adjustment board after completion of contractual procedures.[142]

The RLA purports to cover all employee grievances.[143] The United States Court of Appeals for the Seventh Circuit, in *Jackson v. Consolidated Rail Corp.*,[144] held that only federal statutory claims and outrageous conduct unrelated to the collective bargaining relationship could escape RLA preemption. The RLA has been held to preempt state actions arising out of discipline or discharge asserting claims of defamation,[145] fraud,[146] false imprisonment,[147] and intentional infliction of emotional distress.[148] The general rule, then, is that the RLA preempts state law.

b. Exceptions/Limitations

There are at least two exceptions to the general rule that state law claims will not lie where the RLA applies. The United States Supreme Court, in *Colorado Anti-Discrimination Commission v. Continental Air Lines, Inc.*,[149] held state laws prohibiting racial discrimination in hiring are not preempted by the RLA.[150] This is the result of the RLA's policy of not addressing the issue of discrimina-

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[139] HOLLOWAY & LEECH, *supra* note 135, at 143.

[140] *Id.*

[141] Glover v. St. Louis-San Francisco Ry., 393 U.S. 324 (1969); Riddle v. Trans World Airlines, Inc., 512 F. Supp. 75 (W.D. Mo. 1981); 45 U.S.C. § 153 (1982).

[142] 45 U.S.C. § 153 First (1982).

[143] HOLLOWAY & LEECH, *supra* note 135, at 144.

[144] 717 F.2d 1045 (7th Cir. 1983), *cert. denied*, 465 U.S. 1007 (1984).

[145] Majors v. U.S. Air, Inc., 525 F. Supp. 853 (D. Md. 1981); Carson v. Southern Ry., 494 F. Supp. 1104 (D.S.C. 1979); Louisville & Nashville R.R. v. Marshall, 586 S.W.2d 274 (Ky. Ct. App. 1979).

[146] Magnuson v. Burlington N., Inc., 576 F.2d 1367 (9th Cir.), *cert. denied*, 439 U.S. 930 (1978).

[147] Majors v. U.S. Air, Inc., 525 F. Supp. 853 (D. Md. 1981).

[148] Choate v. Louisville & Nashville R.R., 715 F.2d 369 (7th Cir. 1983); Beers v. Southern Pacific Transp. Co., 703 F.2d 425 (9th Cir. 1983); *Magnuson*, 576 F.2d 1367.

[149] 372 U.S. 714 (1963).

[150] Although Title VII was not adopted at the time of this case, the federal policy of encouraging state resolution of claims makes this holding still relevant.

tion in hiring.[151] A second exception to RLA preemption may exist for work injury discharges covered by a state statute.[152]

c. Wrongful Discharge

Wrongful discharge claims follow the general doctrine and are preempted where the employees are covered by the RLA. In *Andrews v. Louisville & Nashville Railroad Co.*,[153] the United States Supreme Court held that a terminated employee could not successfully pursue an action in court because he had accepted the severance of the employment relationship and sought damages for breach of contract. The basis for the decision was the employee's need to rely on the collective bargaining agreement. The case involved an employee who was not allowed to return to work after an auto accident. Andrews claimed that this constituted a wrongful discharge. The Supreme Court, finding the claim contractually based, stated:

> [T]he very concept of 'wrongful discharge' implies some sort of statutory or contractual standard that modifies the traditional common law rule that a contract of employment is terminable by either party at will. Here it is conceded by all that the only source of the petitioner's right not to be discharged, and therefore to treat an alleged discharge as a 'wrongful' one that entitles him to damages, is the collective bargaining agreement between the employer and the union.[154]

Although *Andrews* probably would apply to state law contract claims and the RLA would thus preempt those claims, courts have held both ways in state retaliatory discharge tort claims. For example, in *Jackson v. Consolidated Rail Corp.*,[155] the United States Court of Appeals for the Seventh Circuit focused on the need to construe the collective bargaining agreement as the critical issue of the case.[156] The employer's defense in *Jackson* was that the termination was pursuant to the terms of the collective bargaining agreement. The *Jackson* court held that the claim was preempted, however, based on the Ninth Circuit Court of Appeals' opinion in *Magnuson v. Burlington Northern, Inc.*[157]. In *Magnuson*, the Ninth Circuit construed *Andrews* to apply to *any* action arising out of dis-

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[151] 372 U.S. 714 (1963).

[152] Puchert v. Agsalud, 67 Haw. 25, 677 P.2d 449 (1984), *appeal dismissed sub nom.*, Pan American World Airways, Inc. v. Puchert, 472 U.S. 1001 (1985).

[153] 406 U.S. 320 (1972).

[154] *Id.* at 324.

[155] 717 F.2d 1045 (7th Cir. 1983), *cert. denied*, 465 U.S. 1007 (1984).

[156] *Id.*

[157] 576 F.2d 1367 (9th Cir.), *cert. denied*, 439 U.S. 930 (1978).

charge from employment.[158] *Magnuson* noted that if the gravamen of the suit is a wrongful discharge, it is preempted by the RLA.

Two state appellate courts have held the other way. In *Wiley v. Missouri Pacific Railroad Co.*,[159] the court held that a statutory retaliatory discharge claim was *not* preempted by the RLA.[160] In *Trombetta v. Detroit, Toledo, & Ironton Railroad Co.*,[161] the Michigan Court of Appeals held that RLA preemption applies only where the plaintiff is covered under a collective bargaining agreement and asserts a violation of the agreement.[162] Trombetta alleged that he was discharged for refusing to falsify pollution control reports to a state agency. Trombetta, who was not covered by a collective bargaining agreement, alleged violation of public policy and the court held preemption did not apply.[163]

RLA preemption is generally a viable defense for employers in wrongful discharge actions, provided the employers are covered by the RLA. Nevertheless, a minority of state courts have held that a retaliatory discharge claim is not preempted by the RLA.

6. *Atomic Energy Act*

a. Doctrine

The United States Supreme Court, in *Pacific Gas & Electric Co. v. Energy Resources & Development Commission*[164] held that nuclear safety is an area of regulation occupied entirely by the federal government.[165] The Supreme Court further noted that "[w]hen the Federal Government completely occupies a given field or an identifiable portion of it, as it has done [in the area of nuclear safety], the test of preemption is whether the matter on which the state asserts the right to act is in any way regulated by the Federal Act."[166]

b. Exceptions/Limitations

The United States Supreme Court has, however, upheld a ten million dollar punitive damage award as not preempted by the Atomic Energy Act in

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158 *Id.*

159 430 So. 2d 1016 (La. App. 1982), *cert. denied*, 431 So. 2d 1055 (La. 1983).

160 *Id.* at 1022-23.

161 81 Mich. App. 489, 265 N.W.2d 385 (1978).

162 *Id.* at ____, 265 N.W.2d at 387-88.

163 *Id.* at ____, 265 N.W.2d at 388.

164 461 U.S. 190 (1983).

165 *Id.* at 212-13.

166 *Id.*

Silkwood v. Kerr-McGee Corp.[167]

c. Wrongful Discharge

The specific portion of the Atomic Energy Act that applies to employment discharge situations is § 5851 of the Energy Reorganization Act (ERA).[168] Generally, that section prohibits discharge of an employee for assisting with a Nuclear Regulatory Commission investigation.[169]

In *Snow v. Bechtel Construction Inc.*,[170] an employee of a contractor to a nuclear power plant under a license issued by the Nuclear Regulatory Commission brought an action for wrongful termination. The federal district court held that to the extent the employee claimed that he was wrongfully terminated because he complained about safety violations, his action was preempted by the ERA. The court then granted summary judgment for the defendant employer, Bechtel.

The Kansas Supreme Court has also addressed the issue in *Chrisman v. Philips Industries, Inc.*[171] The *Chrisman* court, like the court in *Snow*, held the state claim preempted by the ERA. *English v. General Electric*,[172] has also held a similar state claim preempted under similar facts.

Other courts, however, have held to the contrary. In *Stokes v. Bechtel North American Power Corporation*,[173] a nuclear engineer filed an action in state court for wrongful discharge. The federal district court held that the engineer's complaint was not preempted by federal nuclear regulatory law. The engineer was allegedly terminated in retaliation for his refusal to suppress information concerning quality assurance problems and design miscalculations at a nuclear power plant. The court relied primarily on California's clearly announced policy of ensuring continued employment and job security for its citizens and advancing the state's economic productivity through promotion of the nuclear industry. The court declined to rely on a state policy representing nuclear safety.

The Illinois Supreme Court has also held that a similar action was not preempted in *Wheeler v. Caterpillar Tractor Co.*[174]

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[167] 464 U.S. 238 (1984); *see generally Federal Preemption of the State Regulation of Nuclear Power: State Law Strikes Back*, 60 CHI.-KENT L. REV. 989 (1984).

[168] 42 U.S.C. § 5851 (1982).

[169] *Id.*

[170] 647 F. Supp. 1514 (C.D. Cal. 1986).

[171] 242 Kan. 772, 751 P.2d 140 (1988).

[172] No. 87-31-CIU-7 (E.D.N.C. Feb. 10, 1988) (LEXIS, Genfed Library, Dist. file).

[173] 614 F. Supp. 732 (N.D. Cal. 1985).

[174] 108 Ill. 2d 502, 485 N.E.2d 372 (1985), *cert. denied*, 475 U.S. 1122 (1986).

B. State Statute/State Common Law Preemption

1. Workers' Compensation Acts

a. Doctrine

When an employee's injury is covered by a workers' compensation act, courts uniformly hold that statutory compensation is the sole remedy, and any recovery against the employer at common law is barred.[175] This remedy is a compromise in which the worker accepts limited compensation, usually less than a jury might award, in return for extended liability of the employer and an assurance that the employee will be paid.[176] Even though a worker's damages may go partially uncompensated under the Act, the worker has no actionable claim based on the employer's negligence.[177] Hence, state workers' compensation statutes preempt state common law claims. While the specific language of these statutes may vary, the statutes of the different states are generally uniform.[178]

For the workers' compensation statute preemption to apply, the injury must take place in the course of employment. In *Hernandez v. Home Education Livelihood Program, Inc.*,[179] an employee claimed that a discharge announced by way of an after-hours phone call led to a mental breakdown. The court held that the discharge was not within the course of employment because it occurred away from the workplace. Another court, in *Gates v. Trans Video Corp.*[180] held that an employee was covered under the workers' compensation act even though he had been discharged from employment earlier. In one of two incidents in which he was involved, Gates, the employee, was dropping off his keys, tools and uniforms, and picking up his personal belongings. An incident occurred which allegedly caused him emotional distress.[181] The *Gates* court held that the employee's common law claim for intentional infliction of emotional distress was barred and preempted by the workers' compensation statute.[182] By contrast, in *Jamison v. Storer Broadcasting Co.*,[183] where the injury and emotional impact

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[175] *See*, W. KEETON, D. DOBBS, R. KEETON & D. OWEN, PROSSER & KEETON ON TORTS 574 (5th ed. 1984).

[176] *Id.*

[177] *Id.*

[178] *See* HOLLOWAY & LEECH, *supra* note 135, at 147.

[179] 98 N.M. 125, 645 P.2d 1381 (Ct. App.), *cert. denied*, 98 N.M. 336, 648 P.2d 794 (1982).

[180] 93 Cal. App. 3d 196, 155 Cal. Rptr. 486 (1979).

[181] *Id.* at 199-200, 155 Cal. Rptr. at 488-89.

[182] *Id.* at 206, 155 Cal. Rptr. at 492. *But see* Lapinad v. Pacific Oldsmobile-GMC, Inc., 679 F. Supp. 991 (D. Haw. 1988) (exclusivity provision of Hawaii's worker's compensation law did not preclude action by employee for intentional infliction of emotional distress).

[183] 511 F. Supp. 1286 (E.D. Mich. 1981).

took place after the employment was over, the court held that the workers' compensation statute did not bar a claim that the discharge had triggered the employee's subsequent suicide.[184]

California courts have held that their workers' compensation act[185] preempts emotional distress claims when the emotional distress is accompanied by physical injury and disability.[186] Other courts disagree. In *Lapinad v. Pacific Oldsmobile-GMC, Inc.*,[187] it was noted that there may be an exception to the workers' compensation exclusivity provisions for claims alleging intentional infliction of emotional distress where the alleged injury is not physical. Additionally, the federal district court, in *Cohen v. Lion Products Co.*,[188] appeared to hold an action for mental distress preempted without even a threat of physical harm.[189]

b. Exceptions/Limitations

There are, however, exceptions to the general preemption of emotional distress claims by workers' compensation statutes. Statutes often have an intentional tort exception to their general exclusivity.[190] Actions for non-physical injury based on torts such as invasion of privacy, fraud, and defamation are not barred because these torts do come within the basic coverage formula.[191] When an otherwise viable action includes a claim for damages within the exclusivity bar, the usual course taken is the excising of the preempted portion of the action.[192]

c. Wrongful Discharge

Wrongful discharge actions are among the exceptions to workers' compensa-

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[184] *Id.* at 1298.

[185] CAL. LAB. CODE §§ 3200-4386 (West 1971).

[186] *See, e.g.*, Ankeny v. Lockheed Missiles & Space Co., 88 Cal. App. 3d 531, 151 Cal. Rptr. 828 (1979); Magliulo v. Superior Court, 47 Cal. App. 3d 760, 121 Cal. Rptr. 621 (1975).

[187] 679 F. Supp. 991 (D. Haw. 1988).

[188] 177 F. Supp. 486 (D. Mass. 1959).

[189] *Id.*

[190] *See* Maggio v. St. Francis Medical Center, Inc., 391 So. 2d 948 (La. Ct. App. 1980), *cert. denied*, 396 So. 2d 1351 (La. 1981); Magliulo v. Superior Court, 47 Cal. App. 3d 760, 121 Cal. Rptr. 621 (1975). *But see* Lui v. Intercontinental Hotels Corp., 634 F. Supp. 684 (D.Haw. 1986) (workers' compensation statute held to be exclusive remedy for employee's sexual assault or battery at hands of supervisor during working hours).

[191] *See* 2A A. LARSON, WORKMAN'S COMPENSATION LAW, § 68.30 (1987).

[192] *See, e.g.*, Stimson v. Michigan Bell Tel. Co., 77 Mich. App. 361, 258 N.W.2d 227 (1977); Milton v. County of Oakland, 50 Mich. App. 279, 213 N.W.2d 250 (1973); *but see* Braman v. Walthall, 215 Ark. 582, 225 S.W.2d 342 (1949).

tion statute preemption. Both breach of contract[193] and retaliatory discharge[194] theories of recovery generally are not barred.

One of the best known cases standing for the proposition that a workers' compensation statute does not preempt a state common law wrongful discharge claim is *Kelsay v. Motorola, Inc.*[195] In *Kelsay* an employee-at-will was terminated after filing a claim for workers' compensation. The Illinois Supreme Court upheld the plaintiff's state tort claim for retaliatory discharge.[196] The court reasoned that such discharges undermined the public policy behind the workers' compensation act.[197] It then awarded punitive damages because the act's remedies were insufficient to provide a deterrent to future abuse.[198]

In *Brown v. Transcon Lines*,[199] the Oregon Supreme Court also held that a wrongful discharge claim was not preempted by a state workers' compensation act. In *Brown* the court held that because the common law action existed prior to the adoption of a statutory provision making discharge from employment for filing a claim an unlawful employment practice, the wrongful discharge claim was not preempted.[200]

Preemption by a workers' compensation act will not always be a successful defense for employers in wrongful discharge actions. In at least two states, however, courts have held that the remedy created by the statute was exclusive.[201] Consequently, where the statute expressly intends to abrogate or supersede any common law action, the employer may successfully rely upon preemption as a

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[193] *See, e.g.*, Hernandez v. Home Educ. Livelihood Program, Inc., 98 N.M. 125, 645 P.2d 1381 (Ct. App.), *cert. denied*, 98 N.M. 336, 648 P.2d 794 (1982).

[194] *See, e.g.*, Kelsay v. Motorola, Inc., 74 Ill. 2d 172, 384 N.E.2d 353 (1978); Brown v. Transcon Lines, 284 Or. 597, 588 P.2d 1087 (1978). *See* Meyer v. Byron Jackson, Inc., 120 Cal. App. 3d 59, 174 Cal. Rptr. 428 (1981).

[195] 74 Ill. 2d 172, 384 N.E.2d 353 (1978). *See also* Brooks, *Preemption of Federal Labor Law by the Employment-at-Will Doctrine*, 38 LAB. L.J. 335, 340 (1987); Comment, *Midgett v. Sackett in the Aftermath of Allis-Chambers: The Impact of Federal Labor Law on Retaliatory Discharge Claims*, 1986 N. ILL. U.L. REV. 347, 347-48.

[196] 74 Ill. 2d at ——, 384 N.E.2d at 357.

[197] *Id.*

[198] Violation of the act is a petty offense. ILL. REV. STAT. ch. 48, § 138.26 (1983).

[199] 284 Or. 597, 588 P.2d 1087 (1978).

[200] *Id.* at 1096.

[201] Portillo v. G.T. Price Prods., Inc., 131 Cal. App. 3d 285, 182 Cal. Rptr. 291 (1982) (California retaliation statute held to be exclusive; cases from other jurisdictions allowing common-law action held distinguishable because specific language of Labor Code section 132a giving the appeals board "full power, authority, and jurisdiction to try and determine finally all the matters specified in this section"). Taylor v. St. Regis Paper Co., 560 F. Supp. 546 (C.D. Cal. 1983) (Follows *Portillo*); Cornejo v. Polycon Indus., Inc., 109 Wis. App. 2d 649, 327 N.W.2d 183 (1982) (court held statutory remedy for worker's compensation retaliation claim was employee's exclusive remedy where employer allegedly refused to rehire employee after he recovered from work-related injury.).

defense.

2. *State EEO Statutes*

The California Court of Appeals found, in *Strauss v. A.L. Randall Co.*[202], that a state statute provides the exclusive remedy for age discrimination. The *Strauss* court held a wrongful discharge action preempted by the state statute.[203] The United States Court of Appeals for the Third Circuit has similarly held that a Pennsylvania state statute preempted a wrongful discharge claim where sexual harassment was alleged.[204] Similarly, in two United States District Court opinions, the Hawaii Employment Discrimination statute[205] has been held to preclude additional common law remedies based on the same public policies set forth in the statute.[206]

C. *Res Judicata*

Along with the various claims that a discharged employee may pursue in federal court, there are a substantial number of remedies available outside the federal judicial system.[207] Among these are:

(1) Unemployment compensation claims (typically before a state "employment security" department or commission);[208]
(2) Workers' compensation proceedings (usually before the "industrial" commission);[209]
(3) Collective bargaining grievance arbitration;[210]
(4) Unfair labor practice proceedings (heard by state or federal labor relations boards);[211]
(5) Employee compensation complaints (presented to state or federal labor departments);[212]
(6) Race, sex, age, religion, national origin, handicap, or marital status discrimi-

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[202] 144 Cal. App. 3d 514, 194 Cal. Rptr. 520 (1983).

[203] *Id.* at 519-21, 194 Cal. Rptr. at 523-24.

[204] Wolk v. Saks Fifth Ave., Inc., 728 F.2d 221 (3d Cir. 1984).

[205] HAW. REV. STAT. § 378-2 (1988).

[206] Lapinad v. Pacific Oldsmobile-GMC, Inc., 679 F. Supp. 991, 993 (D. Haw. 1988); Lui v. Intercontinental Hotels Corp., 634 F. Supp. 684 (D. Haw. 1986).

[207] HOLLOWAY & LEECH, *supra* note 135, at 156.

[208] *Id.*

[209] *Id.*

[210] *See, e.g.*, Alexander v. Gardner-Denver Co., 415 U.S. 36 (1974); Barrentine v. Arkansas-Best Freight & System, Inc., 450 U.S. 728 (1981); HOLLOWAY & LEECH, *supra* note 135, at 156.

[211] HOLLOWAY & LEECH, *supra* note 135, at 156.

[212] *Id.*

nation proceedings (before municipal or state human rights or fair employment practices commissions or the federal Equal Employment Opportunity Commission or Office of Federal Contract Compliance Programs);[213]
(7) Civil service, personnel, or tenure hearings (presided over by federal, state, county, school, or municipal governing bodies or personnel boards); and[214]
(8) Litigation in state courts.[215]

When a terminated employee pursues one or more of the aforementioned remedies, issues may be raised that advance, limit, or bar the employee's court case or any of the other options that are open to the employee. The effect of a resolution of a court case or other option chosen is governed by the doctrines of *res judicata*: merger and bar, and collateral estoppel.[216]

To understand when employers can effectively use *res judicata* as a defense to wrongful discharge actions, it is necessary to explore different applications of *res judicata*. Proceedings other than those in federal court can be grouped into three categories, which are discussed in detail below. These categories include arbitrators' decisions, administrative proceedings, and state court judgments.

1. *Arbitrators' Decisions*

The central issue involving *res judicata* and arbitrators' decisions is the effect, if any, that a prior arbitration of an employment dispute has on the employee's right to a trial *de novo*. The leading United States Supreme Court case in this area is *Alexander v. Gardner-Denver Co.*[217] In that case, Alexander, a black employee, was discharged by the Gardner-Denver Company.[218] Alexander filed a grievance under an existing collective bargaining agreement,[219] that contained an arbitration clause.[220] He claimed that his discharge resulted from racial discrimination,[221] and, when the company rejected his claim, an arbitration hearing was held.[222] Prior to the hearing, Alexander filed a race discrimination complaint with the Colorado Civil Rights Commission, which claim was subsequently referred to the Equal Employment Opportunity Commission

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[213] *Id.*; *see, e.g.*, Alexander v. Gardner-Denver Co., 415 U.S. 36 (1974).

[214] HOLLOWAY & LEECH, *supra* note 135, at 156-57. *See, e.g.*, University of Tennessee v. Elliott, 478 U.S. 788 (1986).

[215] *See, e.g.*, Kremer v. Chemical Constr. Corp., 456 U.S. 461 (1982).

[216] *Id.* at 157.

[217] 415 U.S. 36 (1974).

[218] *Id.* at 38.

[219] *Id.* at 39.

[220] *Id.* at 40.

[221] *Id.* at 42.

[222] *Id.*

(EEOC). The arbitrator ruled the discharge was for cause.[223] The EEOC subsequently determined that there was no reasonable ground to believe that Title VII had been violated.[224] Alexander then sued in a federal district court,[225] alleging that racial discrimination was the basis for his discharge.[226] The federal district court granted the employer's motion for summary judgment, holding that Alexander was bound by the prior arbitral decision. The United States Court of Appeals for the Tenth Circuit affirmed.[227]

The issue before the United States Supreme Court was whether a discharged employee's statutory right to a trial *de novo* was foreclosed by prior submission of his claim to final binding arbitration under the non-discrimination clause of a collective-bargaining agreement.[228] The Supreme Court held that it was not.[229] The Court noted, however, that an arbitral decision could be admitted as evidence and accorded such weight as the trial court deemed appropriate.[230] Title VII, according to the Court, was designed to supplement, rather than supplant, existing laws and institutions relating to employment discrimination.[231] The *Alexander* court further found that Congress intended that an individual not only be able to pursue rights under Title VII, but also be free to seek a remedy under other state and federal statutes.[232]

In a claim based on the Fair Labor Standards Act (FLSA),[233] where there was a prior arbitration, the analysis of the *res judicata* issue is similar. *Barrentine v. Arkansas-Best Freight System, Inc.*[234] is a leading case in point. In *Barrentine*, truck drivers were not being paid for the time they spent conducting required pre-trip safety inspections and for all the time they spent transporting to the repair facility trucks which had failed the inspections.[235] The union representing the drivers submitted a wage claim to a joint grievance committee pursuant to a collective bargaining agreement.[236] The committee rejected the claim,[237] and

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[223] *Id.*

[224] *Id.* at 43.

[225] *Id.*

[226] *Id.*

[227] *Id.*

[228] *Id.* at 59-60.

[229] *Id.* at 60.

[230] This last statement has allowed courts to accord arbitral decisions differing amounts of weight. *See* Comment, *Disarray in the Circuits After Alexander v. Gardner-Denver Co.*, 9 U. HAW. L. REV. 605 (1987).

[231] 415 U.S. at 48-50.

[232] *Id.* at 48 n.9.

[233] 29 U.S.C. §§ 201-219 (1982).

[234] 450 U.S. 728 (1981).

[235] *Id.* at 730.

[236] *Id.* at 730-31.

[237] *Id.* at 731.

the drivers then filed a claim in federal district court for damages under the FLSA.[238] The district court did not address the FLSA claim, and the court of appeals held the district court was incorrect in failing to address that claim.[239] The United States Court of Appeals for the Eighth Circuit concluded that the submission of the grievances to arbitration barred the union from bringing the statutory claims in court.[240]

The issue before the United States Supreme Court in *Barrentine* was whether an employee could bring an action in federal district court, alleging a FLSA violation after unsuccessfully submitting a wage claim to a joint grievance committee pursuant to a collective-bargaining agreement.[241] The Supreme Court held the wage claims under the FLSA were not barred and reversed the Eighth Circuit.[242] The Court's rationale was that the employees' rights under the FLSA were independent of the collective-bargaining process.[243]

Based on these two United States Supreme Court cases, it appears that employers may not be able to successfully raise *res judicata* successfully as a defense, at least where rights under Title VII or the FLSA are involved. This is true even when the claims are decided in prior arbitrations under collective-bargaining agreements. Otherwise, state common law wrongful discharge claims, brought in court, would be barred where a collective bargaining agreement exists and where the claims have not first been submitted to a prior arbitration.[244] The rationale for permitting courts to hear such claims, in spite of prior arbitral decisions, is the public policy that encourages arbitration as the preferred method of settling labor disputes under traditional American labor law.[245] If arbitration had a preclusive effect, it would become a less attractive means of dispute resolution.

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[238] *Id.* at 731-33.

[239] *Id.* at 733-34.

[240] *Id.* at 734.

[241] *Id.* at 729-30.

[242] *Id.* at 745.

[243] *Id.*

[244] *See* Bertrand v. Quincy Mkt. Cold Storage & Warehouse Co., 728 F.2d 568 (1st Cir. 1984); Lamb v. Briggs Mfg., Div. of Celotex Corp., 700 F.2d 1092 (7th Cir. 1983) (an employee who has a duty to arbitrate must arbitrate first before filing a lawsuit against the employer).

[245] *See* "Steelworkers Trilogy:" United Steelworkers of Am. v. American Mfg. Co., 363 U.S. 564 (1960); United Steel Workers of Am. v. Warrior & Gulf Navigation Co., 363 U.S. 574 (1960); United Steelworkers of Am. v. Enterprise Wheel & Car Corp., 363 U.S. 593 (1960); Labor Management Relations Act, § 203(d), 29 U.S.C. § 173(d) (1982) ("[f]inal adjustment by a method agreed upon by the parties is hereby declared to be the desirable method for settlement of grievance disputes arising over the application or interpretation of an existing collective-bargaining agreement").

2. Administrative Proceedings

Prior administrative proceedings may or may not have an effect on subsequent judicial action where the claim is based on a federal statute.[246] The United States Supreme Court case of *University of Tennessee v. Elliott*,[247] illustrates both of these possibilities.

In *Elliott*, the University of Tennessee discharged Elliott, a black employee.[248] Elliott then requested an administrative hearing,[249] and also filed suit in federal district court alleging that his discharge was racially motivated. He sought relief under Title VII and the Reconstruction Civil Rights Statutes,[250] including section 1983.[251] The court allowed the administrative hearing to proceed, and a ruling that the discharge was not racially motivated followed.[252] Elliott did not seek state court review of the proceedings, but continued to pursue his case in federal court.[253] The federal district court held the administrative ruling was preclusive.[254] However, the United States Court of Appeals for the Sixth Circuit reversed, holding that state administrative fact finding is never entitled to preclusive effect in Title VII or section 1983 actions.[255]

The United States Supreme Court held that Congress did not intend unreviewed state administrative proceedings to have a preclusive effect on Title VII claims.[256] As to section 1983 claims, however, the Supreme Court held "that when a state agency 'acting in a judicial capacity . . . resolves disputed issues of fact properly before it which the parties have had an adequate opportunity to litigate,' federal courts must give the agency's fact finding the same preclusive effect to which it would be entitled in the State's courts."[257] The Supreme Court's rationale was based upon its determination of Congressional intent.[258] When an administrative proceeding has taken place, *res judicata*, then, may be

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[246] *See generally*, Note, *The Collateral Estoppel Effect of Administrative Agency Actions in Federal Civil Litigation*, 46 GEO. WASH. L. REV. 65 (1977); Perschbacher, *Rethinking Collateral Estoppel: Limiting the Preclusive Effect of Administrative Determinations in Judicial Proceeding*, 35 U. FLA. L. REV. 422 (1983).

[247] 478 U.S. 788 (1986).

[248] *Id.* at 790.

[249] *Id.*

[250] *Id.*

[251] 42 U.S.C. § 1983 (1982).

[252] 478 U.S. at 791.

[253] *Id.* at 792.

[254] *Id.*

[255] *Id.*

[256] *Id.* at 796.

[257] *Id.* at 799 (quoting United States v. Utah Constr. & Mining Co., 384 U.S. 394, 422 (1966)).

[258] *Id.* at 797.

effective as a defense for employers in Section 1983 actions.[259] In Title VII actions, however, it is not an effective defense.

3. *State Court Judgments*

The preclusive effect of state court judgments in federal court was the issue in *Kremer v. Chemical Construction Corp.*[260] The United States Supreme Court held that federal courts must give preclusive effect to state court judgments[261] and stated that the "merits of a legal claim once decided in a court of competent jurisdiction are not subject to redetermination in another forum."[262] The Court based its decision on the Full Faith and Credit Statute.[263]

V. ANALYSIS AND DISCUSSION

The preemption doctrine as it applies to bar state common law wrongful discharge claims involving NLRA, RLA and ERISA[264] issues generally prevents duplicative remedies while promoting uniform national labor policy. The burden of defending in more than one forum and the traps of multiple forum litigation are also eliminated where state common law wrongful discharge claims are preempted by federal law.[265] One trade-off of preemption, then, is that under federal law local interests are less likely to be promoted.[266] Another is that employees may be limited to reinstatement or compensatory damages or both.[267] Because these remedies do not include exemplary or punitive damages, which generally are available under state law wrongful discharge claims, employers may not be discouraged from discharging employees wrongfully.[268]

The rule that federal discrimination statutes do not preempt state common law wrongful discharge claims[269] allows local interests to be promoted. Employers may be less likely to terminate employees unjustly because of the risks of

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[259] *See generally* Comment, *Gaining Access to a Federal Forum: The Preclusive Effect of Unreviewed Administrative Determinations in Section 1983 Actions*, 9 U. HAW. L. REV. 643 (1987).

[260] 456 U.S. 461 (1982).

[261] *Id.* at 485.

[262] *Id.*

[263] 28 U.S.C. § 1738 (1982).

[264] *See supra* text accompanying notes 77-98, 129-33, and 153-63.

[265] *Id.*

[266] *See supra* text accompanying note 25.

[267] *See* Parnar v. Americana Hotels, Inc., 65 Haw. 370, 652 P.2d 625 (1982); Ichinose, *Hawaii's Supreme Court Recognizes Tort of Retaliatory Discharge of an At-Will Employee*, 17 HAW. B.J. 123 (1982).

[268] *Id.*

[269] *See supra* text accompanying notes 99-128.

exposure to punitive damages. Employees are better protected because of the availability of these punitive damages. The problems are that claims may be duplicative, and that employers may have to defend in multiple forums and may be exposed to the traps of multiple forum litigation.

Where the Atomic Energy Act applies it is still unclear whether state common law wrongful discharge actions will be preempted.[270]

State statute preemption of state wrongful discharge actions,[271] although varying from state to state, leaves the determination of the remedy under the control of the legislative branch rather than the judiciary. Employers and employees have the opportunity to lobby state legislatures or to elect the representatives that promote their views. Therefore, the will of the people may be better expressed through action by the legislative branch. Because many state workers' compensation schemes do not preempt common law wrongful discharge claims,[272] employers will be less likely to discharge workers who file claims. Again, employees are benefited by the possibility of punitive damage awards. The trade-offs are similar, though the possibility of duplicative claims, and the traps and burdens of defending in more than one forum, exist where state statutes do not preempt employee wrongful discharge actions.

The acts of deferral and giving preclusive effect to arbitration awards promote the national labor policy of arbitration as the favored dispute resolution mechanism when the NLRA or the RLA applies.[273] Again, the problems of duplicative claims and multiple forums are avoided. States, however, may feel that the local interests are not promoted.

One might also contend that a national policy that requires statutory interpretation be ultimately discerned by courts is promoted when possible Title VII or FLSA claims are not precluded by prior arbitration[274] or administrative proceedings.[275] The United States Supreme Court has interpreted the rights protected by these statutes to be of such importance that employees are entitled to a trial *de novo*.[276] However, with this right comes the burden of litigation in, and traps of, multiple forums and the possibility of duplicative remedies.

Preclusion of section 1983 administrative proceedings[277] and all state court judgments[278] minimizes litigation in multiple forums, but allows employees only one opportunity to pursue remedies that some might feel are better de-

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[270] *See supra* text accompanying notes 164-74.
[271] *See supra* text accompanying notes 193-204.
[272] *See supra* text accompanying notes 193-201.
[273] *See supra* text accompanying notes 244-45.
[274] *See supra* text accompanying notes 217-45.
[275] *See supra* text accompanying notes 246-59.
[276] *See supra* text accompanying notes 217-59.
[277] *See supra* text accompanying notes 246-50.
[278] *See supra* text accompanying notes 260-63.

cided by federal courts.

VI. CONCLUSION

When federal statutes such as the NLRA, RLA, and ERISA apply, the general rule is that they will preempt state common law wrongful discharge actions.[279] This seems especially true under the NLRA when a collective bargaining agreement exists with an arbitration clause and a just cause dismissal provision.[280] An exception exists for discharged permanent strike replacements.[281] Another exception may exist where the discharged employee acted in behalf of a state public policy, and, therefore, has a state tort claim.[282] Section 301 preemption will not be effective where the claim can be decided on the basis of state law that is independent of the collective bargaining agreement.[283] If the discharge does not fit into one of these exceptions, employers may successfully raise preemption as a defense.

Where Title VII or the ADEA apply in discrimination cases, the federal statute generally will not preempt a state common law wrongful discharge action.[284] Employers may not successfully raise federal preemption in these situations as an effective defense.

Where a state workers' compensation statute applies, although the outcome varies from state to state, the availability of a worker's compensation remedy generally will not preempt a state common law wrongful discharge claim.[285] At least in some states, though, a state EEO statute may preempt a state common law claim.[286] Unlike a state EEO statute, which, at least in some states, is an effective defense, preemption by a state workers' compensation statute is probably not an effective employer defense to wrongful discharge.

State common law wrongful discharge claims are most likely precluded where a collective bargaining agreement exists and the claims have been previously submitted to arbitration.[287] Two exceptions may exist where the claims are based either on Title VII[288] or FLSA[289] rights. Where Title VII or FLSA rights are not involved, employers may successfully preclude litigation in the courts

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[279] *See supra* text accompanying notes 77-98, 129-33 and 153-63.
[280] *See supra* text accompanying notes 81-88.
[281] *See supra* text accompanying notes 67-69.
[282] *See supra* text accompanying notes 89-92.
[283] *See supra* text accompanying notes 93-98.
[284] *See supra* text accompanying notes 99-128.
[285] *See supra* text accompanying notes 193-201.
[286] *See supra* text accompanying notes 202-04.
[287] *See supra* text accompanying notes 244-45.
[288] *See supra* text accompanying notes 217-32.
[289] *See supra* text accompanying notes 233-43.

when the discharged employee has failed to exhaust the employee's duty to arbitrate under a contract or by statute.

When administrative proceedings have taken place, preclusion is a successful defense for employers in section 1983 actions,[290] but not Title VII actions.[291] State court judgments are entitled to preclusive effect in the federal courts.[292]

In conclusion, where a discharged employee brings a state common law wrongful discharge action against the employee's former employer, and, where the employer attempts to have the action either preempted or precluded under the applicable statutes, the outcome varies widely depending upon a multiplicity of factors. Among these are: the facts, the applicable law, the right that is being protected, and the possible forums available.

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[290] *See supra* text accompanying notes 246-59.

[291] *Id.*

[292] *See supra* text accompanying notes 260-63.

Johnson v. Raybestos-Manhattan, Inc.: The Death of State of the Art Evidence in Strict Products Liability Actions Involving Inherently Dangerous Products

I. INTRODUCTION

In *Johnson v. Raybestos-Manhattan, Inc.*,[1] the Hawaii Supreme Court did not permit state of the art evidence[2] to be introduced in a strict products liability action for injuries resulting from exposure to asbestos.[3] The Hawaii Supreme Court held that in strict products liability actions, state of the art evidence is not admissible for the purpose of establishing whether the seller knew or reasonably should have known of the dangerousness of the seller's product.[4]

Part II of this note states the facts of the case. Part III examines the historical development and reasons for strict products liability. Part IV presents an analysis of the Hawaii Supreme Court's opinion in *Johnson*. Part V considers the impact of this decision on future strict products liability litigation in Hawaii law.

II. FACTS

Ray Johnson died of asbestosis and lung cancer resulting from his exposure to asbestos products while working at the Pearl Harbor Naval Shipyard from 1941 to 1944.[5] Plaintiff, Johnson's widow, brought suit in Hawaii federal dis-

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[1] 69 Haw. ____, 740 P.2d 548 (1987).

[2] State of the art evidence refers to the scientific and technological knowledge available to a manufacturer at the time of manufacture of a product. This may refer to the feasibility of producing a safer product as in design defect cases, or it may refer to the knowability of a risk associated with a product as in failure to warn cases. Note, *The State of the Art Defense and Time Rule in Design and Warning Defect Strict Liability Cases*, 38 RUTGERS L. REV. 505, 506-07 (1985).

[3] 69 Haw. at ____, 740 P.2d at 549.

[4] *Id.*

[5] Johnson v. Raybestos-Manhattan, Inc., 829 F.2d 907, 908 (9th Cir. 1987). The case came before the Hawaii Supreme Court when the United States Court of Appeals, Ninth Circuit,

trict court on August 22, 1980. She alleged negligence and strict liability against Raybestos-Manhattan for failure to warn of the dangerousness of asbestos.[6] The district court denied plaintiff's motion to exclude all state of the art evidence. The district court held that previous Hawaii decisions refused to interpret strict liability as absolute liability.[7] The jury returned a verdict for Raybestos on both the negligence and strict liability theories.[8] On appeal to the United States Court of Appeals for the Ninth Circuit, plaintiff challenged the introduction of state of the art evidence in a strict liability case.[9]

Because the admissibility of state of the art evidence in a strict products liability case was undecided in Hawaii, the Ninth Circuit certified the following question[10] to the Hawaii Supreme Court:

> In a strict products liability case for injuries caused by an inherently unsafe product, is the manufacturer conclusively presumed to know the dangers inherent in his product, or is state of the art evidence admissible to establish whether the manufacturer knew or through the exercise of reasonable human foresight should have known of the danger?[11]

On July 22, 1987, the Hawaii Supreme Court held that state of the art evidence was not admissible in strict products liability actions to show whether the seller knew or reasonably should have known of the dangerousness of the seller's product.[12]

III. HISTORY

A. *The Development of Strict Products Liability*

Strict products liability is a relatively new addition to the law of torts. The rationale for strict products liability was first articulated by Justice Traynor in

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certified a question to the Hawaii Supreme Court for resolution of an issue which had not been decided in Hawaii. The opinion of the Hawaii Supreme Court does not set out the facts of the case; therefore, the facts have been stated from the opinion of the Court of Appeals.

[6] *Id.*

[7] *Id.*

[8] *Id.* at 909.

[9] *Id.*

[10] A certified question is the procedure by which a federal court abstains from deciding a state law question until the highest court of the state has had an opportunity to rule on the question so certified by the federal court. In Hawaii, Rule 13 of Hawaii Rules of Appellate Procedure allows the Hawaii Supreme Court to receive certified questions from federal courts and to rule on the question in a written opinion.

[11] 69 Haw. at ——, 740 P.2d at 549.

[12] *Id.*

his concurring opinion in *Escola v. Coca-Cola Bottling Co.*[13] Justice Traynor noted that negligence should not be the basis of a plaintiff's right to recover in cases where: (1) a manufacturer places a defective product on the market; (2) the product causes injury; and (3) the manufacturer knew that the product would be used without inspection.[14] Justice Traynor reasoned that responsibility should be fixed wherever it will most effectively reduce the hazards to life and health inherent in defective products. He noted that the injured person could suffer catastrophic harm, whereas the manufacturer could protect itself by procuring insurance and distributing the expense to the public as a cost of doing business.[15]

Justice Traynor further suggested that limiting a plaintiff's claims to negligence theories placed an inordinate burden on the plaintiff. The inference of the manufacturer's negligence could be simply "dispelled by an affirmative showing of proper care."[16] Justice Traynor believed that public policy demands that a manufacturer be held responsible for harm caused by its product, regardless of negligence. Therefore, that responsibility should be clearly fixed.[17]

The main advantage of strict products liability for plaintiffs is the elimination of the requirement of proving fault. Even under the doctrine of res ipsa loquitur[18] the manufacturer could easily overcome the inference of negligence by showing due care in the manufacture of the product and in the adoption of quality control measures.[19] Strict products liability, therefore, increases the plaintiff's chances of recovery.

The seminal case adopting strict products liability is *Greenman v. Yuba Power Products, Inc.*[20] In *Greenman*, plaintiff was injured while using a power tool

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[13] 24 Cal. 2d 453, 150 P.2d 436 (1944) (Traynor, J., concurring). In *Escola*, a waitress whose hand was severely injured by an exploding Coca-Cola bottle was unable to prove any specific acts of negligence on the part of the manufacturer. The waitress relied completely on the doctrine of res ipsa loquitur to prove her claim of negligence. The court, after an analysis of the testing of bottles for defects by the bottle manufacturer, found that all the elements of the doctrine of res ipsa loquitur were present, and the waitress prevailed. *Id.* at 457-61, 150 P.2d at 438-40.

[14] *Id.* at 461, 150 P.2d at 440.

[15] *Id.* at 462, 150 P.2d at 441.

[16] *Id.*

[17] *Id.* at 463, 150 P.2d at 441.

[18] Res ipsa loquitur is a "[r]ebuttable presumption or inference that defendant was negligent, which arises upon proof that [the] instrumentality causing injury was in defendant's exclusive control, and that the accident was one which ordinarily does not happen in [the] absence of negligence." BLACK'S LAW DICTIONARY 1173 (5th ed. 1979).

[19] Birnbaum, *Unmasking the Test for Design Defect: From Negligence [to Warranty] to Strict Liability to Negligence*, 33 VAND. L. REV. 593, 595 (1980). While the doctrine of res ipsa loquitur aided some plaintiffs, the "manufacturer could dispel the inference of negligence by advancing sufficient evidence to show that he exercised due care in the manufacture of the product and in the adoption of quality control measures." *Id.*

[20] 59 Cal. 2d 57, 377 P.2d 897, 27 Cal. Rptr. 697 (1962).

when a piece of wood on which he was working flew out of the machine and struck him.[21] Justice Traynor, writing for a unanimous California Supreme Court, held that a manufacturer was strictly liable when an article he placed on the market, knowing it would be used without inspection for defects, proved to have a defect which caused injury.[22] Rejecting product warranties as a basis of liability,[23] the court reasoned that strict liability is appropriate because it insures that the cost of injuries caused by defective products is borne by manufacturers rather than injured persons who are powerless to protect themselves from such defects.[24]

In *Greenman*, the court held that the plaintiff need only show that he was injured while using the manufacturer's product the way "it was intended to be used, [and was injured] as a result of a defect in design and manufacture of which plaintiff was not aware."[25] The court did not differentiate between a design defect and a manufacturing defect.[26] Following *Greenman*, courts have discussed various product defects and the corresponding tests for each.[27] An excellent example of cases defining both the types and legal tests for product defects is *Barker v. Lull Engineering Co.*[28] In *Barker*, the plaintiff was injured by lumber which fell from a high lift loader that plaintiff was operating.[29] The court defined three types of product defects, which have been widely recognized by courts and commentators.[30]

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[21] *Id.* at 59, 377 P.2d at 898, 27 Cal. Rptr. at 698.

[22] *Id.* at 62, 377 P.2d at 900, 27 Cal. Rptr. at 700.

[23] The court noted that section 1769 of the Civil Code provided that:

> In the absence of express or implied agreement of the parties, acceptance of the goods by the buyer shall not discharge the seller from liability in damages or other legal remedy for breach of any promise or warranty in the contract to sell or the sale. But, if after acceptance of the goods, the buyer fails to give notice to the seller of the breach of any promise or warranty within a reasonable time after the buyer knows, or ought to know of such breach, the seller shall not be liable.

Id. at 60, 377 P.2d at 899, 27 Cal. Rptr. at 699.

The court then rejected this notice requirement:

> The notice requirement of section 1769, however, is not an appropriate one for the court to adopt in actions by injured consumers against manufacturers with whom they have not dealt . . . . Moreover, to impose strict liability on the manufacturer under the circumstances of this case, it was not necessary for plaintiff to establish an express warranty . . . .

Id. at 61, 377 P.2d at 900, 27 Cal. Rptr. at 700.

[24] *Id.* at 63, 377 P.2d at 901, 27 Cal. Rptr. at 701.

[25] *Id.*

[26] The distinction was made later between these two types of defects. *See infra* notes 31-37 and accompanying text.

[27] The tests are the legal tests for determining the type of defect in a given case. *See infra* notes 32-37 and accompanying text.

[28] 20 Cal. 3d 413, 573 P.2d 443, 143 Cal. Rptr. 225 (1978).

[29] *Id.* at 419, 573 P.2d at 447, 143 Cal. Rptr. at 229.

[30] *See, e.g.*, Cepeda v. Cumberland Eng'g Co., 76 N.J. 152, 386 A.2d 816 (1978); Caterpillar

The first is a manufacturing defect.[31] The relevant test is whether the product in question "differs from the manufacturer's intended result or from other ostensibly identical units of the same product line."[32]

The second is a design defect. The defect in *Barker* is an example.[33] There are two tests for design defect in *Barker*. The first test requires the plaintiff to show that the product failed to perform as safely as an ordinary consumer would expect when the product is used in an intended or reasonably foreseeable manner. The second test requires the plaintiff to show that the product's design proximately caused the injury. Upon such a showing, the burden of proof shifts to the manufacturer to show that, on balance, the benefits of the design outweigh the risk of danger inherent in the design.[34]

The third type of defect, failure to warn, exists in those products which are inherently dangerous.[35] Asbestos is included in this inherently dangerous group.[36] The test for defect in inherently dangerous products is whether the

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Tractor Co. v. Beck, 593 P.2d 871 (Alaska 1979).

[31] *Escola* is a classic example. *See supra* note 13.

[32] 20 Cal. 3d at 429, 573 P.2d at 454, 143 Cal. Rptr. at 236. For example, if the soft drink bottle is adequately designed for safe use under pressure, but in the manufacturing process a bottle is produced with a flaw in it such that it will explode under pressure, this defect would be a manufacturing defect.

[33] In *Barker*, the high lift loader in question was not equipped with outriggers. Outriggers are mechanical arms that extend out from the sides of the machine. These devices give the unit more stability. Evidence was introduced which revealed that cranes and some high lift loaders are equipped with outriggers or offer them as optional equipment. The lack of these outriggers probably caused the accident. Further, the loader was defective in that it was not equipped with seat belts or roll bars. These defects are not flaws resulting from the manufacturing process. Indeed, the loader may have been made exactly as designed. The defect here is in the design of the loader.

[34] 20 Cal. 3d at 432, 573 P.2d at 455-56, 143 Cal. Rptr. at 237-38. This is the risk-benefit analysis.

[35] These are products which cannot be made safer, but are useful in spite of their dangers. RESTATEMENT (SECOND) OF TORTS § 402A comment k (1977).

[36] Terminology varies in the cases and the authorities. The Hawaii Supreme Court employs the words "inherently dangerous" to describe the same condition which the Restatement (Second) of Torts § 402A, comment k defines as "unavoidably unsafe." The question certified to the Hawaii Supreme Court from the United States Court of Appeals for the Ninth Circuit, in the *Johnson* case used the words "inherently unsafe." There would be an obvious benefit to consistency in the use of terminology by the courts and commentators. To achieve some degree of consistency, this casenote uses the language of the Hawaii Supreme Court in *Johnson*.

According to the Restatement:

> Unavoidably unsafe products. There are some products which, in the present state of human knowledge, are quite incapable of being made safe for their intended and ordinary use. These are especially common in the field of drugs. An outstanding example is the vaccine for the Pasteur treatment of rabies, which not uncommonly leads to very serious and damaging consequences when it is injected. Since the disease itself invariably leads to a dreadful death, both the marketing and the use of the vaccine are fully justified, not-

manufacturer warned, or adequately warned, the consumer of the inherent dangers.[37]

B. Strict Products Liability in Hawaii

1. The adoption of strict products liability in Hawaii

In 1970, the Hawaii Supreme Court adopted strict products liability in *Stewart v. Budget Rent-A-Car Corp.*[38] In *Stewart*, plaintiff was injured when her rental car went off the side of the road after control of the steering wheel failed and the car jerked to the left. The court noted that it is "the modern trend and the better reasoned view that strict liability in tort is a sound legal basis for recovery in products liability cases."[39] The court relied on the leading arguments for a rule of strict products liability:

> The leading arguments for the adoption of a rule of strict products liability have been that the public interest in human life and safety requires the maximum possible protection that the law can muster against dangerous defects in products; that by placing the goods on the market the maker and those in the chain of distribution represent to the public that the products are suitable and safe for use; and that the burden of accidental injuries caused by defective chattels should be placed upon those in the chain of distribution as a cost of doing business and as an incentive to guard against such defects.[40]

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withstanding the unavoidable high degree of risk which they involve. Such a product, properly prepared, and accompanied by proper directions and warning, is not defective, nor is it *unreasonably* dangerous. The same is true of many other drugs, vaccines, and the like, many of which for this very reason cannot legally be sold except to physicians, or under the prescription of a physician. It is also true in particular of many new or experimental drugs as to which, because of lack of time and opportunity for sufficient medical experience, there can be no assurance of safety, or perhaps even of purity of ingredients, but such experience as there is justifies the marketing and use of the drug notwithstanding a medically recognizable risk. The seller of such products, again with the qualification that they are properly prepared and marketed, and proper warning is given, where the situation calls for it, is not to be held to strict liability for unfortunate consequences attending their use, merely because he has undertaken to supply the public with an apparently useful and desirable product, attended with a known but apparently reasonable risk.

RESTATEMENT (SECOND) OF TORTS § 402A comment k (1977) (emphasis in original).

[37] RESTATEMENT (SECOND) OF TORTS § 402A comment k (1977). Comment k is followed in two major manufacturing states: California (*see, e.g.*, Brown v. Abbott Laboratories, 44 Cal. 3d 1049, 751 P.2d 470, 245 Cal. Rptr. 412 (1988)) and New Jersey (*see, e.g.*, Feldman v. Lederle Laboratories, 97 N.J. 429, 479 A.2d 374 (1984)).

[38] 52 Haw. 71, 470 P.2d 240 (1970).

[39] *Id.* at 74, 470 P.2d at 243.

[40] *Id.*

Based on these policy interests, the court adopted strict liability in tort in products liability cases in Hawaii and stated the elements of such an action:

> [W]e adopt the rule that one who sells or leases a defective product which is dangerous to the user or consumer or to his property is subject to liability for physical harm caused by the defective product to the ultimate user or consumer, or to his property, if (a) the seller or lessor is engaged in the business of selling or leasing such product, and (b) the product is expected to and does reach the user or consumer without substantial change in its condition after it is sold or leased.[41]

The court noted that this formulation was essentially the rule adopted in the Restatement (Second) of Torts section 402A.[42] The Hawaii formulation, however, omitted the word "unreasonably" from section 402A. In Hawaii, therefore, the product need only be *dangerous* to the user or consumer or to his property. The court did not comment on the omission, however, and eventually, this silence created the need for the court to clarify its formulation. This opportunity arose in *Brown v. Clark Equipment Co.*[43]

2. *Distinguishing strict products liability from negligence*

Brown involved actions in negligence and strict products liability for wrongful death caused by the impact of a front-end loader.[44] The defendant argued that a jury instruction, which departed from the definition of strict liability in tort found in the Restatement (Second) of Torts, incorrectly stated the law in Hawaii.[45]

The Hawaii Supreme Court discussed the omission of the term "unreasonably" from the *Stewart* formulation, citing cases that criticized the standard adopted by section 402A as injecting a negligence concept into the theory of strict liability.[46] The court held that the trial court had correctly applied the

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[41] *Id.*

[42] *Id.* According to the Restatement:

> (1) One who sells any product in a defective condition unreasonably dangerous to the user or consumer or to his property is subject to liability for physical harm thereby caused to the ultimate user or consumer, or to his property, if
>
> (a) the seller is engaged in the business of selling such a product, and
>
> (b) it is expected to and does reach the user or consumer without substantial change in the condition in which it is sold.

RESTATEMENT (SECOND) OF TORTS § 402A (1977).

[43] 62 Haw. 530, 618 P.2d 267 (1980).

[44] *Id.* at 531, 618 P.2d at 269.

[45] *Id.* at 541, 618 P.2d at 274. The defendant asserted that the phrase "unreasonably dangerous" was endorsed by the court in Stewart. *Id.*

[46] *Id.* at 543, 618 P.2d at 274-75. Cases cited by the court include Cronin v. J.B.E. Olson

Stewart test for design defects, omitting the words "unreasonably dangerous" from the jury instruction and in defining a defective condition pursuant to the Restatement.[47]

The following year, in *Boudreau v. General Electric Co.*,[48] the Hawaii Intermediate Court of Appeals (ICA) clarified the concept of strict products liability. In *Boudreau*, plaintiff sued the defendant manufacturer for damages resulting from an explosion of methane gas which accumulated in plaintiff's washer/dryer unit.[49] Defendant did not install safety glass in the door of the unit. The explosion blew the glass out of the door and cut the plaintiff.[50] Interestingly, the jury found that the washer/dryer unit was not defective, but that defendant was negligent in designing, manufacturing and selling the product.[51] This result is anomalous because a finding of negligence on the part of the manufacturer in designing, manufacturing and selling the product should lead to a conclusion that the product is defective. The anomaly is understandable because the court instructed the jury that reasonableness and foreseeability were the touchstones of both negligence and strict liability.[52] The ICA reversed and held that negligence concepts such as reasonableness and foreseeability are not relevant to strict products liability.[53]

The ICA, therefore, effectively separated strict products liability from negligence. Although strict products liability was adopted in *Stewart* and then dis-

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Corp., 8 Cal. 3d 121, 501 P.2d 1153, 104 Cal. Rptr. 433 (1972); Glass v. Ford Motor Co., 123 N.J. Super. 599, 304 A.2d 562 (1973); and Clary v. Fifth Ave. Chrysler Center, 454 P.2d 244 (Alaska 1969). The court discussed with approval the *Cronin* case, which adopted the rule that a manufacturer is liable for "all injuries proximately caused by any of its products which are adjudged 'defective' [in design]." *Cronin*, 8 Cal. 3d at 133-34, 501 P.2d at 1162, 104 Cal. Rptr. at 442. While the Hawaii Supreme Court found the *Cronin* rule attractive, the court did not adopt the rule. 62 Haw. at 543, 618 P.2d at 275.

[47] *Id.* The Restatement defines unreasonably dangerous as follows: "The article sold must be dangerous to an extent beyond that which would be contemplated by the ordinary consumer who purchases it, with the ordinary knowledge common to the community as to its characteristics." RESTATEMENT (SECOND) OF TORTS § 402A comment i (1977). The trial court used this language to define the term "defective condition." It did not include the term "unreasonably dangerous" in its analysis. The court did not address the issue of tests for defects.

[48] 2 Haw. App. 10, 625 P.2d 384 (1981).

[49] *Id.* at 11-12, 625 P.2d at 386.

[50] *Id.*

[51] *Id.* at 12, 625 P.2d at 388.

[52] The objectionable instruction stated that a product is not defective unless it is reasonably foreseeable that it may, as a result of normal use, cause an accident of the general kind or type involved in this case. *Id.* at 15, 625 P.2d at 389. The instruction converted the doctrine of strict products liability into one of negligence.

[53] The court noted the "jury's finding General Electric to be negligent but the product not defective . . . points clearly to the danger of importing the reasonability or foreseeability test with respect to danger into strict liability instructions." *Id.* at 16, 625 P.2d at 389.

tinguished from negligence in *Brown*, Hawaii courts still had not defined tests for the various types of product defects. Two years later, the Hawaii Supreme Court was given the opportunity to do so.

3. *Adoption of a test for product defects*

In *Ontai v. Straub Clinic & Hospital*,[54] plaintiff was injured when the footrest of an X-ray machine gave way, causing plaintiff to fall to the floor. The court adopted a two-part test for product defects:

> First, a product may be found defective in design if the plaintiff establishes that the product failed to perform as safely as an ordinary consumer would expect when used in an intended or reasonably foreseeable manner. Second, a product may alternatively be found defective in design if the plaintiff demonstrates that the product's design proximately caused his injury and the defendant fails to establish, in light of the relevant factors, that, on balance, the benefits of the challenged design outweigh the risk of danger inherent in such design.[55]

The court, however, noted that under either test, the plaintiff must show that the product was dangerously defective and the defect proximately caused the injury.[56] The court also held that there is a duty to warn of known dangers which a user would not normally discover. This duty includes adequate instructions for safe use and warnings of any dangers inherent in improper use.[57]

C. *State of the Art Evidence as a Defense to Strict Products Liability*

1. *State of the art evidence generally*

In the 1956 case of *Day v. Barber-Colman Co.*,[58] plaintiff was injured by an overhead door that fell on him. In rejecting plaintiff's claim that the manufacturer negligently designed the door, the court reasoned that the design was safe according to industry standards, and that the "state of the art at the time and the prior history of the use of the product would not have indicated or required

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[54] 66 Haw. 237, 659 P.2d 734 (1983).

[55] *Id.* at 242, 659 P.2d at 739-40. The *Cronin* court held that a plaintiff seeking recovery on a theory of strict liability in tort need not prove that the defect made the product unreasonably dangerous to the consumer. The court applied this rule to both design and manufacturing defects. 8 Cal. 3d at 135-36, 501 P.2d at 1155, 104 Cal. Rptr. at 443.

[56] 66 Haw. at 243, 659 P.2d at 740.

[57] *Id.* at 248, 659 P.2d at 743.

[58] 10 Ill. App. 2d 494, 135 N.E.2d 231 (1956).

any material change in the design, or manufacture."[59] Unfortunately, the *Day* court did not define the phrase "state of the art."

Subsequent case law has provided various definitions of "state of the art" depending upon the context in which the term is used.[60] In "design defect" cases, the term refers to the technical feasibility of designing a safer product at the time the product is manufactured.[61] In "failure to warn" cases, the term refers to scientific knowledge of a risk associated with the product at the time the product is manufactured.[62] However, courts do not agree on a standard definition, and application of the term has not been uniform.[63]

Since state of the art evidence is presented to show whether or not a product is defective, its application differs depending upon the type of defect alleged. In manufacturing defect cases, state of the art evidence is inadmissible to determine liability because it is irrelevant.[64] Similarly, state of the art evidence is inadmissible in "failure to warn" cases.[65]

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[59] *Id.* at 507, 135 N.E.2d at 237.

[60] Some courts define state of the art in terms of the pertinent scientific and technical knowledge existing at the time of design and manufacture of the product. *See, e.g.*, Bruce v. Martin-Marietta Corp., 544 F.2d 442 (10th Cir. 1976) (ordinary consumer could not expect an aircraft made in 1952 to have the safety features of an aircraft made in 1970); Olson v. Arctic Enters., 349 F. Supp. 761 (D.N.D. 1972) (court "must view the alleged defect in light of the engineering standards in 1966"); Balido v. Improved Mach., Inc., 29 Cal. App. 3d 633, 105 Cal. Rptr. 890 (1973) (defective design only when determined from the state of the art at the time).

Other courts confuse state of the art evidence with then-existing industry standards. *See, e.g.*, Sturm, Ruger & Co. v. Day, 594 P.2d 38 (Alaska 1979) (" 'state of the art' refers to customary practice in the industry"); Suter v. San Angelo Foundry & Mach. Co., 81 N.J. 150, 406 A.2d 140 (1979) ("state of the art refers not only to the common practice and standards in the industry . . . ."); Olson v. A.W. Chesterton Co., 256 N.W.2d 530 (N.D. 1977) (state of the art defined in terms of products similar to the defendant's or of the same nature to show different features used by other manufacturers).

[61] Birnbaum & Wrubel, *"State of the Art" and Strict Products Liability*, 21 TORT & INS. L.J. 30, 31 (1985).

[62] *Id.*

[63] Courts defining state of the art in terms of available scientific or technical knowledge at the time of design and manufacture are applying a different standard than courts defining state of the art in terms of industry standards. *See supra* note 60.

[64] Robb, *A Practical Approach to Use of State of the Art Evidence in Strict Products Liability Cases*, 77 NW. U.L. REV. 1, 11 (1982). A manufacturing defect occurs when the product differs from the manufacturer's intended result or from other ostensibly identical units of the same product. State of the art evidence has no application in this situation as liability is based upon a defect in construction.

[65] *See, e.g.*, Oakes v. Geigy Agricultural Chemicals, 272 Cal. App. 2d 645, 77 Cal. Rptr. 709 (1969) (to find liability for unknown dangers is to recast the manufacturer as an insurer); Woodill v. Parke Davis & Co., 79 Ill. 2d 26, 402 N.E.2d 194 (1980) (knowledge of danger is a proper limitation to manufacturer's strict liability for failure to warn). There is little controversy over admissibility of state of the art evidence in failure to warn cases because the Restatement (Second) of Torts § 402A comment j requires the seller to warn of a danger of which it has

The major dispute over admitting state of the art evidence is in design defect cases. The argument for excluding state of the art evidence rests on the separation of strict products liability and negligence,[66] because such evidence addresses the issue of reasonable care on the part of the manufacturer.[67] Such evidence, therefore, should be excluded as irrelevant because liability is imposed only on the basis of a product defect. The focus is on the product, not on the reasonableness of the manufacturer's care.[68] The difficulty with this argument is its tendency to extend strict liability to absolute liability.[69] Thus, under the foregoing argument, the manufacturer is liable regardless of whether a safer design was feasible. The manufacturer is thereby transformed into the insurer of its product. Moreover, those opposed to admitting state of the art evidence fail to consider the fact that such evidence queries whether the product was defective *at the time of manufacture*. If a safer design was feasible at the time of manufacture, then the product was defective, but if a safer design was *not feasible* at the time of manufacture, the product should not be deemed defective.[70]

Moreover, state of the art evidence helps to determine reasonable consumer expectations,[71] and the risk benefit analysis of *Barker*[72] considers the feasibility of a safer design.[73] Significantly, state of the art evidence relates directly to this determination.

2. *State of the art evidence in design defects cases*

In design defect cases, the jurisdictions are split on the admissibility of state

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knowledge or "by the application of reasonable, developed human skill and foresight should have knowledge." Robb, *supra* note 64, at 13. Thus, the test in a failure to warn case is whether the manufacturer adequately warned consumers of the dangers of the manufacturer's product.

[66] Robb, *supra* note 64, at 14.

[67] This occurs by focusing on whether the manufacturer could determine the safety of the manufacturer's product in light of knowledge available at the time of manufacture. Such evidence, therefore, introduces a negligence concept in the form of reasonableness of the manufacturer's conduct into strict products liability.

[68] Robb, *supra* note 64 at 11. Strict products liability eliminates plaintiff's need to prove the absence of due care by defendant. *See supra* notes 18-19 and accompanying text.

[69] *See, e.g.*, Robb, *supra* note 64, at 1; Birnbaum & Wrubel, *supra* note 61, at 30.

[70] Birnbaum & Wrubel, *supra* note 61, at 33. State of the art evidence addresses product defect and not manufacturer conduct. Thus, in a failure to warn case, "a product cannot be made safer by the addition of a warning if science and technology do not suggest to the manufacturer that there is any hazard or risk to warn about." *Id.*

[71] Robb, *supra* note 64, at 33. The consumers base their expectation of the safety of a product by considering the state of the art at the time of manufacture. This factor enters into the determination of liability under the *Barker* test. *See supra* notes 33-34 and accompanying text.

[72] *See supra* notes 33-34 and accompanying text.

[73] 20 Cal. 3d at 431, 573 P.2d at 455, 143 Cal. Rptr. at 237.

of the art evidence.[74] The jurisdictions excluding state of the art evidence hold that such evidence is irrelevant because it relates to the reasonableness of the design selected for manufacture, and the manufacturer's standard of care is not an issue in strict products liability. For example, in *Flatt v. Johns-Manville Sales Corp.*,[75] plaintiff brought a products liability action against the manufacturer of cement pipes which contained asbestos, alleging that exposure to the pipes caused the death of plaintiff's decedent. The court stated that evidence relating to the state of the art at the time of manufacture was relevant only to the issue of due care in the manufacturing process—a negligence concept not at issue in a strict liability action.[76] Moreover, in *Cunningham v. MacNeal Memorial Hospital*,[77] plaintiff allegedly contracted serum hepatitis from defective blood used by defendant in treating plaintiff.[78] Defendant argued that the current state of medical science was incapable of determining the existence of the serum hepatitis virus in whole blood.[79] The Supreme Court of Illinois held that state of the art evidence was inadmissible and held defendant liable:

> To allow a defense to strict liability on the ground that there is no way, either practical or theoretical, for a defendant to ascertain the existence of impurities in his product would be to emasculate the doctrine and in a very real sense would signal a return to a negligence theory.[80]

In jurisdictions admitting state of the art evidence in design defect cases, the courts hold that such evidence serves as a measure of reasonable consumer ex-

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[74] For cases excluding state of the art evidence, *see* Ruggeri v. Minnesota Mining & Mfg. Co., 63 Ill. App. 3d 525, 380 N.E.2d 445 (1978); Gelsumino v. E.W. Bliss, 10 Ill. App. 3d 604, 295 N.E.2d 110 (1973) (state of the art evidence irrelevant to strict liability). For cases admitting state of the art evidence, *see* Bruce v. Martin-Marietta Corp., 544 F.2d 442 (10th Cir. 1976) ("state of the art evidence helps to determine the expectation of the ordinary consumer"); Olson v. Arctic Enters., 349 F. Supp. 761 (D.N.D. 1972) (state of the art evidence relevant to manufacturer's design choice).

[75] 488 F. Supp. 836 (E.D. Tex. 1980).

[76] *Id.* at 841.

[77] 47 Ill. 2d 443, 266 N.E.2d 897 (1970).

[78] The product in this case was the blood which was marketed to consumers needing blood transfusions. The product was "designed defectively" in that no provision existed for insuring the blood was free of serum hepatitis virus. This was an early case and reflects the difficulty the court had with classifying blood as a product.

[79] 47 Ill. 2d at 453, 266 N.E.2d at 902.

[80] *Id.* Many decisions which have excluded state of the art evidence are from Illinois. *See, e.g.*, Ruggeri v. Minnesota Mining & Mfg. Co., 63 Ill. App. 3d 525, 529, 380 N.E.2d 445, 448 (1978); Stanfield v. Medalist Indus., 34 Ill. App. 3d 635, 640-41, 340 N.E.2d 276, 280 (1975); Matthews v. Stewart Warner Corp., 20 Ill. App. 3d 470, 482, 314 N.E.2d 683, 692 (1974); Gelsumino v. E.W. Bliss Co., 10 Ill. App. 3d 604, 608, 295 N.E.2d 110, 112-13 (1973) (state of the art evidence irrelevant to strict liability). Thus, the rule for exclusion of state of the art evidence is sometimes referred to as the Illinois rule.

pectations.[81] In *Bruce v. Martin-Marietta Corp.*,[82] plaintiffs brought products liability and negligence actions against the manufacturer of an aircraft to recover for injuries sustained as a result of the alleged uncrashworthiness of the aircraft. The court expressly rejected the Illinois rule,[83] and noted plaintiffs' failure to show that the ordinary consumer would expect a plane manufactured in 1952 to have the safety features of a plane manufactured in 1970. Having recognized that consumer expectations change as new safety features are developed, the court noted that "state of the art evidence helps to determine the expectation of the ordinary consumer."[84]

Under the risk benefit analysis,[85] the feasibility of a safer design is a factor in determining whether the design is defective. State of the art evidence is related directly to this determination. In *Boatland of Houston, Inc. v. Bailey*,[86] plaintiffs' decedent was killed when the motorboat he had purchased from defendant struck a submerged stump and threw decedent into the water. The boat's motor did not have an automatic "turn-off" switch. The boat struck decedent and killed him.[87] Plaintiffs offered state of the art evidence relating to a "kill switch" that automatically turns the motor off if the boat operator is thrown into the water. Evidence showed that these devices had been in use on racing boats for ten years preceding decedent's death. Defendant offered evidence that the device was not feasible at the time decedent's boat was manufactured.[88] In finding for the defendant, the court stated that defendant's "[e]vidence . . . is important in determining whether a safer design was feasible. The limitations imposed by the state of the art at the time of manufacture may affect the feasibility of a safer design."[89]

In sum, there is a jurisdictional split as to the admissibility of state of the art evidence in design defect cases. Some jurisdictions exclude state of the art evidence as irrelevant because it introduces negligence concepts into strict liability

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[81] This is the first prong of the *Barker* test. *See supra* notes 33-34 and accompanying text.

[82] 544 F.2d 442 (10th Cir. 1976).

[83] *See supra* note 80.

[84] The court relied on the language of the Restatement (Second) of Torts § 402A: "defective condition" and "unreasonably dangerous." 544 F.2d at 447. *See also* Cantu v. John Deere Co., 24 Wash. App. 701, 705, 603 P.2d 839, 841 (1979) (state of the art evidence relevant to consumer's expectation of safety of the plane).

[85] This is the *Barker* test. *See supra* notes 33-34 and accompanying text.

[86] 609 S.W.2d 743 (Tex. 1980).

[87] *Id.* at 745.

[88] *Id.* at 748.

[89] *Id. See also*, Wilson v. Piper Aircraft Corp., 282 Or. 61, 577 P.2d 1322 (1978) (in the absence of evidence of availability or practicality of alternative designs, plaintiffs' evidence of deficiency of the aircraft was not sufficient to permit a jury finding that the airplane was dangerously defective).

actions.[90] Other jurisdictions admit the evidence as relevant to either reasonable consumer expectations or the feasibility of a safer design.[91]

3. State of the art evidence in failure to warn cases

A failure to warn case is one in which the manufacturer provides no warning or inadequate warnings of the dangers of a product. In such cases, the relevant question is how can a manufacturer warn of a danger of which he is unaware? Courts have resolved this question in one of two ways. Some courts have held that the plaintiff must prove that the manufacturer knew or should have known of the dangers of the product.[92] An alternative position simply imputes knowledge of the danger to the manufacturer.[93] Therefore, plaintiff need only prove that the manufacturer failed to warn adequately of the danger and that the defective product caused the resulting injury.

Another alternative, at least in failure to warn cases involving inherently dangerous products, holds that the plaintiff must show that the manufacturer knew or should have known of the dangerousness of the product.[94] In *Oakes v. Geigy Agricultural Chemicals*,[95] plaintiff sued on a strict liability theory for damages resulting from an allergic reaction allegedly caused by the use of the defendant's weed-killing chemical products. The appellate court held for defendant. It reasoned that the Restatement (Second) of Torts[96] requires a warning only when the manufacturer knows or should know there is a special danger. The court refused "[t]o exact an obligation to warn the user of unknown and unknowable allergies, sensitivities and idiosyncracies [because such a holding would] recast the manufacturer in the role of an insurer."[97] Similarly, in *Woodill v. Parke Davis & Co.*,[98] the Supreme Court of Illinois held that "the imposition of a

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[90] *See supra* notes 74-80 and accompanying text.

[91] *See supra* notes 82-89 and accompanying text.

[92] Other jurisdictions reject this approach specifically because it introduces negligence principles into strict liability. *See infra* notes 95-99 and accompanying text.

[93] *See infra* notes 101-05 and accompanying text.

[94] *See infra* notes 98-99 and accompanying text. Such holdings may reflect the language of the Restatement, which requires the seller of a product to warn of a danger of which the seller has knowledge or "by the application of reasonable, developed human skill and foresight should have knowledge." RESTATEMENT (SECOND) OF TORTS § 402A comment j (1977). Thus, those courts which follow the Restatement do not impute such knowledge to the manufacturer of an inherently dangerous product.

[95] 272 Cal. App. 2d 645, 77 Cal. Rptr. 709 (1969).

[96] RESTATEMENT (SECOND) OF TORTS § 402A comment j (1977).

[97] 272 Cal. App. 2d at 651, 77 Cal. Rptr. at 713.

[98] 79 Ill. 2d 26, 402 N.E.2d 194 (1980). *Woodill* involved a strict products liability action for damages for injuries allegedly suffered by a child in the fetal stage when the defendant's drug was administered to the mother during delivery of the child.

knowledge requirement is a proper limitation to place on a manufacturer's strict liability in tort predicated upon a failure to warn of a danger inherent in a product."[99]

Other jurisdictions hold, however, that the manufacturer's knowledge is irrelevant because liability in warning cases is not based upon negligence, and, therefore, evidence of technical knowledge at the time of manufacture is irrelevant.[100] This view was adopted in *Beshada v. Johns-Manville Products Corp.*[101]

In *Beshada*, an action for wrongful death and personal injury, plaintiffs claimed to have developed asbestos-related diseases due to exposure to asbestos products during their employment. Plaintiffs claimed that defendant manufacturers were strictly liable because they failed to warn of the hazards of asbestos. Defendants asserted the state of the art defense, alleging that they could not have known that the hazards existed based on available scientific evidence at the time of marketing the products.[102]

The Supreme Court of New Jersey was not persuaded. It held that "in strict liability cases, culpability is irrelevant. The product was unsafe. That it was unsafe because of the state of technology does not change the fact that it was unsafe. Strict liability focuses on the product, not the fault of the manufacturer."[103] Finally, the court decided that imposing liability for failing to warn of unknowable dangers furthered the goals and policies of the strict liability doctrine,[104] thus barring the state of the art defense.[105]

Just two years later, however, the New Jersey Supreme Court retreated from this position. In *Feldman v. Lederle Laboratories*,[106] plaintiff suffered tooth discoloration as a result of taking a tetracycline drug as an infant and premised her strict liability claim on defendant's failure to warn of such discoloration as a possible side effect. Defendant asserted that this side effect was not known at the time the drug was marketed.[107]

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[99] *Id.* at 33, 402 N.E.2d at 198.

[100] *See supra* notes 66-67 and accompanying text.

[101] 90 N.J. 191, 447 A.2d 539 (1982).

[102] Defendants attempted to distinguish Fruend v. Cellofilm Properties, Inc., 87 N.J. 229, 432 A.2d 925 (1981), an earlier New Jersey case holding that in strict products liability, knowledge of the product's danger is imputed to the manufacturer. Defendants argued that *Freund* should be interpreted narrowly so that only knowledge of the product's dangerousness existing at the time of marketing should be imputed. 90 N.J. at 203, 447 A.2d at 546.

[103] *Id.* at 204, 447 A.2d at 546.

[104] *Id.* at 205, 447 A.2d at 547.

[105] *Id.* at 207, 447 A.2d at 549.

[106] 97 N.J. 429, 479 A.2d 374 (1984).

[107] *Id.* at 435, 479 A.2d at 377. The jury found for the defendant and the Appellate Division affirmed the decision of the lower court. The Supreme Court remanded the case to the Appellate Division to reconsider in light of *Beshada*, which had been decided after the Appellate Division's decision. The Appellate Division subsequently reaffirmed its decision.

The court's retreat from *Beshada* began with a blurring of the lines between strict liability and negligence:

> The question in strict liability design-defect and warning cases is whether, assuming that the manufacturer knew of the defect in the product, he acted in a reasonably prudent manner in marketing the product or in providing the warnings given. Thus, once the defendant's knowledge of the defect is imputed, strict liability analysis becomes almost identical to negligence analysis in its focus on the reasonableness of the defendant's conduct.[108]

Turning to the question of what a reasonably prudent manufacturer should know, the court noted that the manufacturer would be "deemed to know of reliable information generally available or reasonably obtainable in the industry or in the particular field involved."[109] The court reasoned that there was no conflict between this test and imputed knowledge in strict liability cases as long as "the knowledge that is assumed is reasonably knowable in the sense of actual or constructive knowledge."[110] Thus, in contrast to *Beshada*, which required *all knowledge* of dangers of a product be imputed to the manufacturer, *Feldman* requires that only *reasonably knowable* dangers be imputed.[111] In New Jersey, therefore, state of the art evidence in failure to warn cases is generally admissible only if the manufacturer knew or reasonably should have known that the product was dangerous.

IV. ANALYSIS

A. *The Hawaii Supreme Court's Reasoning in* Johnson v. Raybestos-Manhattan, Inc.

In *Johnson*, the Hawaii Supreme Court defined state of the art as "the ability or inability to discover the danger posed by the product at the time the product is marketed in light of the state of scientific knowledge or technology at the

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[108] *Id.* at 451, 479 A.2d at 385.

[109] *Id.* at 453, 479 A.2d at 387.

[110] *Id.*

[111] *Id.* at 454, 479 A.2d at 387-88. Indeed, the court went even farther in its retreat from *Beshada* and specifically limited the holding of *Beshada* to its facts:

> If *Beshada* were deemed to hold generally or in all cases, particularly with respect to a situation like the present one involving drugs vital to health, that in a warning context knowledge of the unknowable is irrelevant in determining the applicability of strict liability, we would not agree . . . . The rationale of *Beshada* is not applicable to this case. We do not overrule *Beshada*, but restrict *Beshada* to the circumstances giving rise to its holding.

Id.

time."[112] The court explained that the definition applied only in the context of strict liability actions based on the inherent dangerousness of the product. Neither manufacturing defects nor design defects were addressed.[113]

The Hawaii Supreme Court agreed with those jurisdictions that refuse to admit state of the art evidence, because the issue of whether the seller knew or should have known of the dangers inherent in the seller's product is irrelevant to the issue of liability.[114] Our court made it clear that strict products liability and negligence are completely distinct theories. The Hawaii Supreme Court began its analysis restating the definition of strict products liability articulated in *Ontai*.[115] The plaintiff must show (1) that the seller was engaged in the business of selling the product, (2) that the product contained a defect dangerous to the user or consumer, and (3) that the defect was the cause of the injury.[116] A dangerously defective product is, therefore, a product that does not meet the reasonable safety expectations of the ordinary consumer or user.[117]

The court then indicated that a seller's knowledge of the danger inherent in the seller's product is irrelevant in a strict products liability action. The court specifically held that state of the art evidence is inadmissible to establish whether the seller knew or should have known of the dangerousness of its product.[118] Next the court rejected defendant's contention that such a rule renders defendants de facto insurers, absolutely liable for all harm caused by their products.[119] The court reasoned that defendants are only liable for any harm caused by their products when the plaintiff shows that the product is dangerously defective, and that the product does not meet the reasonable safety expectations of the ordinary consumer.[120]

Finally, the court reasoned that because its analysis made defendant's knowl-

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[112] *Id.* at ____ n.1, 740 P.2d at 549 n.1.

[113] *Id.* at ____ n.2, 740 P.2d at 549 n.2. It is possible that the reason the court declined to address these issues is that it was limited to the certified question, and perhaps it preferred to reserve these issues for a later day.

[114] *Id.* *See supra* notes 66-67 and accompanying text.

[115] 66 Haw. at 241, 659 P.2d at 739.

[116] 69 Haw. at ____, 740 P.2d at 549.

[117] *Id.* This definition is used by most other jurisdictions.

[118] 69 Haw. at ____, 740 P.2d at 549. The court's concern here was based on the preservation of the separation of negligence concepts and strict products liability doctrine which it achieved in *Brown* and in *Boudreau*. *See supra* notes 43-53 and accompanying text. Indeed, the key distinction between strict products liability and negligence is the elimination of a "fault" requirement in the former action. The court was concerned that admitting state of the art evidence in strict products liability cases would reinsert the element of fault and blur the line between strict products liability and negligence.

[119] *Id.* at ____, 740 P.2d at 550.

[120] *Id.* This appears to be an attempt by the court to fend off any argument that the *Johnson* decision has taken products liability law in Hawaii to the brink of absolute liability.

edge of the dangers of its product irrelevant in a strict liability action, there was "no need to adopt the fiction that the defendant is presumed to know of the dangers inherent in his product."[121] The court, therefore, reiterated its desire to completely separate negligence and strict products liability theories.[122]

B. Did the Court Answer the Question Certified to It by the Ninth Circuit Court of Appeals?

The question certified to the *Johnson* court was whether, in a strict products liability case for injuries caused by an inherently unsafe product, (1) the manufacturer was presumed to know of the dangers inherent in the product, or (2)

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[121] *Id.*

[122] In this last section of its opinion, the court cited *Beshada*. The court, however, failed to note that *Beshada* has been limited by *Feldman*, 97 N.J. 429, 479 A.2d 374 (1984). Decided two years apart, both cases came from the New Jersey Supreme Court. Traditionally, New Jersey has been a liberal state with regard to strict products liability, but, perhaps in recognition of the problems of subjecting a manufacturer to absolute liability in failure to warn cases, the *Feldman* case represents a retreat from the strong stand of *Beshada*.

Beshada demonstrated clearly how elimination of "foreseeability" precluded the state of the art defense in a failure to warn case. This holding extends the doctrine of strict products liability, as applied to the manufacturer of an inherently dangerous product, to nearly absolute liability.

Beshada has been expressly limited to its facts by *Feldman*. *See supra* note 111. The result in *Feldman* was the development of one test applicable to either failure to warn cases or design defect cases. The court stated that the question in either case was "whether, assuming the manufacturer knew of the defect in the product, he acted in a reasonably prudent manner in marketing the product or in providing the warnings given." *Id.* at 451, 479 A.2d at 385. Thus, in a failure to warn case, state of the art evidence would be relevant in determining the reasonableness of the defendant's conduct by showing what was or should have been known of the dangers of the product at the time the product was manufactured.

Feldman has resulted in confusion on the part of other courts applying New Jersey law. *See* Herber v. Johns-Manville, No. 82-2081 (D.N.J. Nov. 30, 1984) (Barry, J.). *See also* Kreider v. Keene Corp., No. 81-2794 (D.N.J. Oct. 17, 1984). In both cases, federal district judges agree with the defendants' contentions that in view of *Feldman*, *Beshada* no longer precludes state of the art evidence. *But see In re* Asbestos Litigation Venued in Middlesex County, No. L-2740-81 (N.J. Super. Ct. Sept. 21, 1984) (Keefe, J.). In this case, the court ruled to the contrary on a similar contention, stating that *Beshada* still precluded state of the art evidence. *Feldman* did not overrule *Beshada*, but the New Jersey Supreme Court issued an order stating that *Beshada* would continue to apply to all pending asbestos cases. *In re* Asbestos Litigation Venued in Middlesex County, Nos. M-338/339/340/341/ (N.J. Super. Ct. Dec. 4, 1984) (Clifford, J.), *reh'g denied*, No. 23,265 (Dec. 19, 1984).

In light of this order, it is unclear what the effect of *Feldman* will be on future asbestos cases, and perhaps the real effect of *Feldman* was to overrule *Beshada* de facto. Already limited to its facts by *Feldman*, and further restricted by the New Jersey Supreme Court order, it is possible that *Beshada* may have been so limited that, in the words of one commentator, "*Beshada* will likely be remembered only as a vestigial remnant of the court's abandoned flirtation with notions of absolute liability." Birnbaum & Wrubel, *supra* note 61, at 43.

whether state of the art evidence would be admissible to show whether the manufacturer knew or should have known of the danger.

The court ruled that state of the art evidence was inadmissible because whether the manufacturer knew or should have known of dangers of its product had no bearing on the elements of a strict liability action.[123] By admitting neither of the two propositions, the court provided no solution to the problem.

Thus, in a case involving an inherently dangerous product in Hawaii, the plaintiff need only show that the product does not meet the reasonable safety expectations of the ordinary consumer.[124] The manufacturer may not introduce state of the art evidence to show whether it could have known the product was inherently dangerous at the time it was marketed.

As such, *Johnson* implies that state of the art evidence will be excluded in *all* situations regarding product defect.[125] If so, *Johnson* falls neatly in line with Hawaii cases on products liability since *Stewart*,[126] because such decisions have always interpreted strict products liability in a plaintiff-oriented manner.[127]

C. *An Unclear Use of the Test for Inherently Dangerous Products*

A major shortcoming in the *Johnson* analysis is the lack of clarity in discussing product defects.[128] Indeed, the *Johnson* requirement that the plaintiff must prove that the product did not meet the reasonable expectations of the ordinary consumer,[129] appears to misapply the first prong of the *Barker* test.[130] The *Johnson* court applied the test for design defect, as articulated in *Barker*, to a

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[123] 69 Haw. at ____, 740 P.2d at 549.

[124] *Id.* at ____, 740 P.2d at 550.

[125] Therefore, in view of the New Jersey court's retreat from *Beshada* in *Feldman*, one can only question Hawaii's position in this area. The Hawaii court's alignment with *Beshada* and its failure to mention *Feldman* in its opinion seem to imply that Hawaii will not limit its decision on state of the art evidence to asbestos cases as has New Jersey.

[126] *See supra* notes 38-43 and accompanying text.

[127] *Stewart*, *see supra* notes 38-42 and accompanying text, (adoption of strict products liability in Hawaii); *Brown*, *see supra* notes 43-47 and accompanying text, (refusal to use "unreasonably dangerous" in the jury instruction); *Boudreau*, *see supra* notes 48-53 and accompanying text, (refusal to insert concepts of reasonability and foreseeability in strict products liability); *Ontai*, *see supra* notes 54-57 and accompanying text, (adoption of the *Barker* test for design defect).

[128] Inherently dangerous products, such as asbestos, are treated in the Restatement. RESTATEMENT (SECOND) OF TORTS § 402A comment k (1977). *See supra* note 36. The test for defect in these products is whether the manufacturer warned, or adequately warned, the consumer of the inherent danger or dangers of the product. Although comment k has been followed in two major manufacturing states, *see supra* note 37, the *Johnson* court made no reference to it. Such a reference would have greatly clarified its holding, by emphasizing that the discussion was limited to unavoidably unsafe products, and that the issue was "failure to warn."

[129] 69 Haw. at ____, 740 P.2d at 549.

[130] *See supra* notes 33-34 and accompanying text.

case involving an unavoidably unsafe or inherently dangerous product. The *Johnson* application, therefore, provides an unclear test concerning such products.[131]

The use of the first prong of *Barker* in cases of inherently dangerous products appears to be an extension of *Ontai*.[132] Although the court specifically noted that its discussion was limited to inherently dangerous products, "not involving a manufacturing defect nor a design defect,"[133] the use of the *Barker* test in *Johnson* implies that state of the art evidence is not admissible even in design defect cases for purposes of establishing whether the manufacturer knew or should have known of the dangers of its product.

D. Consumer Expectations and State of the Art

Although under *Johnson* state of the art evidence is not admissible to establish whether a seller knew or should have known of the dangerousness of the seller's product, the court did not address the use of state of the art evidence when consumers are forming their expectations of product safety.

In determining what the ordinary consumer expects in terms of product safety, it is necessary to examine what an ordinary consumer knows about the product. Clearly, a consumer's expectation that an inherently dangerous product could not cause harm is not a "reasonable" expectation. It therefore seems self-evident that the consumer will consider the state of the art of the product at the time of purchase, at least insofar as that information is available to the consumer.[134]

Two possible problems arise when a consumer is injured by the product and seeks compensation at a later point in time. First, the consumer's expectations formed at the time of purchase reflect, at least to some degree, the state of the art knowledge concerning that product.[135] Thus, through the testimony of the consumer, state of the art evidence relating to whether the manufacturer knew

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[131] In *Ontai*, the Hawaii Supreme Court adopted the *Barker* tests for design defects. *See supra* notes 54-57 and accompanying text. The court added that the plaintiff must also show that the product was dangerously defective and that the defect proximately caused the injury. Thus, the *Ontai* court expanded the *Barker* tests.

[132] The Hawaii Supreme Court did not state whether, in ruling in a design defect case, it was applying either or both of the *Barker* tests for design defect. It also did not specify whether these tests will be extended to manufacturing defect actions and inherently dangerous product actions. Note, *Ontai v. Straub Clinic & Hospital: Who Carries the Burden of Proving Design Defects?* 6 U. HAW. L. REV. 635 (1984).

[133] 69 Haw. at ____ n.1, 740 P.2d at 549 n.1.

[134] Consumers may glean this information from package inserts, product labelling, consumer reports, or product literature.

[135] It is obvious that consumers will base their expectations of a product on what they believe is technologically possible at the time.

or should have known of the dangers of the product may be admitted inadvertently.[136]

Second, at trial, consumers, backed by any state of the art knowledge concerning the safety of the product gleaned since the accident, may consciously or unconsciously use such knowledge in describing their expectations. Thus, there exists the possibility of admission, again inadvertently, of state of the art evidence relating to whether the manufacturer knew or should have known of the dangerousness of the product.

These possibilities are significant because *Johnson* precluded *any* state of the art evidence which would help establish whether the manufacturer knew or should have known of the dangers of its product. Unfortunately, the court gave no guidance on how to prevent the admission of such evidence indirectly by plaintiffs, when plaintiffs attempt to prove that the product did not meet the reasonable expectations of the ordinary consumer.

V. IMPACT

Historically, Hawaii's courts have shown great generosity to plaintiffs in products liability actions.[137] *Johnson* is consistent with this approach.

The ramifications of *Johnson* are both immediate and far reaching. In the most obvious sense, precluding state of the art evidence as a defense for inherently dangerous products increases a plaintiff's chances of recovering damages because a manufacturer's mere compliance with state of the art does not excuse liability.

On the other hand, manufacturers, retailers and consumers are harmed by the *Johnson* analysis. Because the court rejected state of the art evidence, manufacturers of inherently dangerous products are treated as insurers of their products. Therefore, manufacturing and insurance costs will necessarily rise and, through the filtering down process, such costs will be borne by consumers.[138] There is also the threat that because of rising insurance costs, important goods and services will be removed from the market.[139] This would result in recovery by a small number of injured persons, at a significantly increased cost to the majority of the population.

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[136] Because the consumer/plaintiff will be testifying as to what he or she expected of the product, evidence of state of the art could be admitted to show consumer expectation rather than to show a manufacturer's knowledge. Thus, the evidence will still be admitted.

[137] *See supra* notes 38-57 and accompanying text.

[138] Address by the Honorable Edwin Meese III before the National Legal Center for the Public Interest, *reprinted in* 23 IDAHO L. REV. 343, 345-46 (1987) [hereinafter Meese Address]. The "filtering down" process is one in which costs incurred at a production level are gradually, by increasing prices at each link in the chain of production, passed down to the consumer.

[139] Sugarman, *Taking Advantage of the Torts Crisis*, 48 OHIO ST. L.J. 329, 334 (1987).

The potentially enormous cost-shifting to consumers undermines the policy considerations that gave birth to the concept of strict liability.[140] Those policy considerations placed the risk of loss on those who were best equipped to bear that loss, namely, upon the manufacturer who best knew the product. The same concerns were voiced in *Stewart*, where the court recognized that "the public interest in human life and safety requires the maximum possible protection that the law can muster . . . ."[141]

Now, however, the balance has tipped against the manufacturer, and perhaps now it is the individual who is better able to bear a loss by purchasing some form of personal insurance.[142] Because manufacturers cannot bear the entire burden of skyrocketing insurance costs, it is the consumer who pays the higher price for goods or who is forced to forego certain goods.

Several commentators have suggested that a current crisis exists in the liability insurance field due to the expansion of tort liability.[143] For example, some companies are subject to liability for claims not resulting from probabilistic causes.[144] This increases insurance costs because certain risk pools are immense and many companies are vulnerable to damage claims for a long period of time.[145]

If this is the current state of the insurance and the manufacturing fields, then cases such as *Johnson*, which disallow one of the last defenses available to manufacturers, serve only to exacerbate the problem.

Permitting a state of the art defense would help manufacturers by decreasing their exposure to liability which should in turn reduce insurance costs. Moreover, a wide selection of individual health and disability coverage is presently available to facilitate self insurance.[146] The widespread availability of personal

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[140] *See supra* notes 13-19 and accompanying text.

[141] 52 Haw. at 74, 470 P.2d at 243.

[142] Stewart, *Crisis in Tort Law? The Institutional Perspective*, 54 U. CHI. L. REV. 184, 188 (1987). It is unknown whether the cost to individuals of self insuring would ultimately be less than the costs of risk and loss spreading to manufacturers, sellers and consumers. Overall, however, it is the poor that suffer, because they do not generally buy insurance, but they do purchase products. If they were required to self insure, they would lose, but if risk spreading raised the cost of goods, they would also lose.

[143] Priest, *The Current Insurance Crisis and Modern Tort Law*, 96 YALE L.J. 1521 (1987); Sugarman, *supra* note 140; Freeman, Jr., *Tort Law Reform Superfund/RCRA Liability as a Major Cause of the Insurance Crisis*, 21 TORT & INS. L.J. 517 (1986); Meese Address, *supra* note 139.

[144] Priest, *supra* note 144 at 1582. Examples of this inability to insure are day care centers insuring against injury suffered by sex abuse, liquor establishments insuring against injury by drunken behavior, and publishers insuring against injury by defamation. A probabilistic cause is one in which a claim for damages is due to the occurrence of a loss which is probable.

[145] *Id.* at 1583. Examples of this are the liability of asbestos manufacturers, pharmaceutical and chemical manufacturers and members of the medical profession, especially obstetricians and anesthesiologists.

[146] *Id.* at 1586.

insurance undercuts the policy argument that society is better able to absorb a loss than is the individual plaintiff.

Indeed, some state legislatures have enacted statutes which provide for the admissibility of state of the art evidence in strict products liability cases.[147] They have done so to readjust the balance between manufacturers and retailers on the one hand and individual plaintiffs on the other.

The Hawaii courts should, therefore, reexamine the original policies underlying strict products liability claims and recognize that the current treatment of products liability no longer furthers those goals. In the context of ever increasing costs to consumers and skyrocketing insurance costs to manufacturers, and in view of legislative tort reform, the retreat by the New Jersey Supreme Court[148] may well prove prophetic. Hawaii should follow New Jersey so that a liability system which is both equitable and reasonable may be preserved.

VI. CONCLUSION

In *Johnson v. Raybestos-Manhattan, Inc.*, the Hawaii Supreme Court continued its plaintiff-oriented approach in strict products liability actions by precluding the admission of state of the art evidence to establish whether the seller knew or should have known of the dangerousness of the seller's product.

The court's ruling has arguably created absolute liability for manufacturers, a result which will have a significant impact on the future of Hawaii's consumer economy and liability insurance rates. The Hawaii state legislature has taken some groping steps toward a more equitable tort system. In the absence of judicial action, the legislature, through statutory enactment, may well provide for the admissibility of state of the art evidence in products liability cases in Hawaii.

Rexford M. Reynolds
Michele Sunahara

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[147] ARIZ. REV. STAT. ANN. § 12-683 (Supp. 1980); COLO. REV. STAT. § 13-21-403(1)(a) (Supp. 1980); IND. CODE ANN. § 34-4-20A-4(4) (Burns Supp. 1981); KY. REV. STAT. § 411.310(2) (Supp. 1978); NEB. REV. STAT. § 25-21, 182 (Supp. 1979); N.H. REV. STAT. ANN. § 507-D:4 (Supp. 1979); TENN. CODE ANN. § 29-28-105(b) (1980).

[148] *See supra* notes 106-11 and accompanying text.

Kapiolani Park Preservation Society v. City and County of Honolulu: The Lease of Public Park Land as a Breach of a Charitable Trust

I. INTRODUCTION

In *Kapiolani Park Preservation Society v. City & County of Honolulu*,[1] the Hawaii Supreme Court held that the City and County of Honolulu (City) was a trustee over Kapiolani Park and as such was bound by the terms of the trust.[2] The court, therefore, prohibited the City from leasing or selling Kapiolani Park lands, since such action would exceed the City's powers as trustee and breach the terms of the Kapiolani Park trust.[3]

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[1] 69 Haw. ____, 751 P.2d 1022 (1988).

[2] Kapiolani Park was established as a public charitable trust in 1896 by the Kapiolani Park Association, William G. Irwin, and the Republic of Hawaii. *See infra* notes 6-10 and accompanying text. The Honolulu Park Commission was named trustee and the terms of the trust were set forth in Act 53 passed that same year. Act approved June 6, 1896, No. 53, 1896 Haw. Sess. Laws 162-66. Section 6 of Act 53 specifically provides: "The said [Honolulu Park] Commission shall not have authority to lease or sell the land comprising the said park or any part thereof . . . ." *Id.* at 165.

In 1913, the territorial legislature passed Act 163 relating to Kapiolani Park. Act approved April 30, 1913, No. 163, 1913 Haw. Sess. Laws 288-89. Act 163 transferred trusteeship of Kapiolani Park to the City. *See infra* note 18. Act 163 also, however, contained a blanket repeal of Act 53, including the restriction against lease or sale of Kapiolani Park lands. *See infra* notes 18-19.

In the instant case, the Hawaii Supreme Court addressed this apparent repeal of Act 53, which contains the terms of the Kapiolani Park trust. The court found that the 1913 legislature only intended to transfer trusteeship of Kapiolani Park to the City, to be held in conformance with the terms of the trust, and did not intend to repeal the express prohibition against the lease or sale of Kapiolani Park lands, as such a construction would unconstitutionally impair the obligations of the contract under which the trust was created. 69 Haw. at ____, 751 P.2d at 1027-28. Thus, the terms of the trust, as contained in Act 53, including the restriction against the lease or sale of Kapiolani Park lands, remain in effect.

[3] The underlying dispute in this case involved a proposed agreement between the City and Pentagram Corporation, under which the City would rent to Pentagram a portion of Kapiolani Park lands for fifteen years. *See infra* notes 22-23 and accompanying text. The court held that this agreement was a lease, *see infra* note 5, that the City had no power to enter into. 69 Haw. at

This note begins in Part II with a review of the history of the Kapiolani Park trust and the facts of *Kapiolani Park*. Part III provides a historical overview of charitable trusts and also examines the protection of charitable trust terms under the United States Constitution, the effect of prohibiting alienation in charitable trusts, and standing to enforce charitable trusts. Part IV analyzes, first, the Hawaii Supreme Court's holding on the breach of trust issue, and second, the court's ruling that the plaintiff, Kapiolani Park Preservation Society (Preservation Society),[4] had standing to bring suit.[5] This note concludes in Part V with a discussion of the impact of the *Kapiolani Park* decision.

II. FACTS

A. *History of the Kapiolani Park Trust*

In 1896, Kapiolani Park Association (Association),[6] William G. Irwin (Ir-

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____, 751 P.2d at 1029.

[4] The Preservation Society is a Hawaii non-profit corporation whose members include persons who live adjacent to, and make frequent use of Kapiolani Park. 69 Haw. at ____, 751 P.2d at 1024.

[5] The Hawaii Supreme Court raised and promptly disposed of the issues of jurisdiction and whether the proposed agreement (*see infra* notes 22-23 and accompanying text) was a lease or a license.

The court dismissed any doubt as to its proper jurisdiction of this case with cites to American Jurisprudence 2d and Corpus Juris Secundum. 69 Haw. at ____, 751 P.2d at 1024. These sources indicate that the court, sitting in equity, has jurisdiction over charitable trust disputes. "Courts of equity in this country exercise an original inherent jurisdiction over charitable trusts . . . ." 15 AM. JUR. 2D *Charities* § 135 (1976). This broad jurisdiction arises from the statute of Elizabeth, 43 Elizabeth 1, c. 4 (1601), from which much of our present law in the area of charitable trusts stems. "It is to this statute that the very extensive jurisdiction at present exercised by the Court of Chancery over subjects of this nature [i.e., the law of charities] is generally, if not exclusively, to be referred." The Trustees of Dartmouth College v. Woodward, 17 U.S. (4 Wheat.) 518, app. at 5 (1819).

The court rejected the City's assertion that the proposed agreement was a concession rather than a lease. Noting that the agreement involved possession of a definite parcel of real estate for a fixed fifteen year term and that this interest was assignable and mortgageable, along with other terms so indicating, the court held that an interest in land was to be transferred and the agreement clearly was a lease. 69 Haw. at ____, 751 P.2d at 1028-29.

Another issue briefly noted by Justice Nakamura in his concurring opinion was the role of the court in reviewing discretionary decisions of trustees. Justice Nakamura stated his understanding that the opinion did not alter the general rule that the court is not to invalidate discretionary decisions made by trustees unless there has been an abuse of discretion. 69 Haw. at ____, 751 P.2d at 1029. In this case, the decision by the City to lease the land was not discretionary due to the explicit restriction against leasing in the trust.

[6] The Association was a chartered corporation of the Hawaiian Islands. Act 53, *supra* note 2, at 162.

win), and the Republic of Hawaii (Republic) agreed to establish a permanent public park and recreation ground.[7] The park had its genesis when the Association and Irwin exchanged interests in land with the Republic.[8] Some of the lands received from the Association and Irwin were conveyed by the Republic to the Honolulu Park Commission (Commission)[9] in trust for the maintenance of a free public park, named Kapiolani Park.[10]

The exchange agreement is embodied in Act 53 of the 1896 Hawaii Session Laws.[11] The Act provides for the selection and tenure of the commissioners and enumerates the Commission's powers.[12] Significantly, the commissioners were expressly prohibited from leasing or selling Kapiolani Park lands.[13]

In 1913, the territorial legislature, concerned about the poor management of

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[7] *Id.* at 162-64.

[8] The Association conveyed its fee simple title to 9.01 acres and leasehold title to 150 acres of land from the Republic of Hawaii and 26 acres of land from Allen Herbert to the Republic. *Id.* at 162-63; Appellant's Opening Brief at 1-2, Kapiolani Park Preservation Soc'y v. City & County of Honolulu, 69 Haw. ____, 751 P.2d 1022 (1988) (No. 12323).

Irwin obtained fee simple title to the 26 acres of land leased to the Association by Allen Herbert. He conveyed his fee simple interest in 25.65 acres of these lands to the Republic. Act 53, *supra* note 2, at 163-64.

The Republic granted Irwin fee simple title to thirty-seven lots, covering 10.02 acres, that he leased and subleased from the Association, and surrendered the lease on the remaining .35 acre of Irwin's fee simple land that he obtained from Herbert. *Id.*

[9] The Commission was comprised of six individuals selected as provided in Section 2 of Act 53. Act 53, *supra* note 2, at 164-65.

[10] *Id.* at 164. The park is named after Queen Kapiolani (1834-1899), wife of King David Kalakaua. M. PUKUI, S. ELBERT & E. MOOKINI, PLACE NAMES OF HAWAII 88 (2d ed. 1974).

[11] Act 53, *supra* note 2, at 162-66. Part of the agreement is also contained in Act 74 passed that same year. Act approved June 13, 1896, No. 74, 1896 Haw. Sess. Laws 263. Act 53 erroneously did not provide for the conveyance of the thirty-seven lots to Irwin. *See supra* note 8. Act 74 merely corrects this omission.

The conveyances occurred on July 1, 1896. The conveyance documents contained implicit references to Act 53 and Act 74. The deed from the Association to the Republic referenced Act 53, stating in the habendum clause: "[F]orever upon trust for the purpose declared in said Legislative Enactments." Irwin's deed to the Republic contained the same reference and habendum. The Republic's deed to the Commission also provided: "[U]pon the trust to use and maintain the same as a public park and recreation ground, in compliance with the terms and provisions of and subject to the limitations and conditions imposed by Legislative Enactments." 69 Haw. at ____, 751 P.2d at 1025. The deeds, therefore, implicitly incorporated the provisions of Act 53, including the prohibition against the lease or sale of Kapiolani Park lands.

The habendum clause "defines the extent of the ownership in the thing granted to be held and enjoyed by the grantee." BLACK'S LAW DICTIONARY 639 (5th ed. 1979). It usually begins with the words "To have and to hold" and follows the granting part of a deed. *Id.*

[12] Act 53, *supra* note 2, at 164-65.

[13] Section 6 of Act 53 provides: "The said Commission shall not have authority to lease or sell the land comprising the said park or any part thereof . . . ." *Id.* at 165.

Kapiolani Park, enacted Act 163[14] and transferred management and control of the park from the Commission to the Board of Supervisors of the City and County of Honolulu.[15] Act 163 directed the Commission to convey Kapiolani

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[14] Act 163, *supra* note 2.

[15] Act 163 was introduced on April 25, 1913 as House Bill No. 314 entitled, "An Act to Transfer the Control and Management of Kapiolani Park from the Honolulu Park Commission to the City and County of Honolulu, and to Repeal Certain Laws Relating to said Park." 1913 HOUSE J. 1012. The bill was not referred to a House committee. *See id.* at 1012, 1021, 1025, 1052. After the bill passed third reading in the House and crossed over to the Senate, it was referred to the Select Committee of Oahu Senators. 1913 SENATE J. 1396.

The Select Committee of Oahu Senators had previously considered House Joint Resolution No. 5, which was introduced in the House on April 19, 1913 and requested the Honolulu Park Commission to transfer the management, control, and administration of Kapiolani Park to the Board of Supervisors of the City and County of Honolulu. 1913 HOUSE J. 886-87. The committee recommended passage of the joint resolution and it passed second reading, but further Senate action on the joint resolution was deferred when the Senate learned that House Bill No. 314 had been introduced. 1913 SENATE J. 1214, 1268-69, 1306.

When the Select Committee of Oahu Senators reported on House Bill No. 314, it recommended that the earlier resolution be tabled and that House Bill No. 314 be passed, noting that its opinion on the bill was the same as when it previously recommended passage of the resolution. *Id.* at 1407. The committee report refers to "Concurrent Resolution No. 17," but it appears the committee meant to refer to House Joint Resolution No. 5. *See id.* The language of House Joint Resolution No. 5 and the committee report of the Select Committee of Oahu Senators on the joint resolution are enlightening. House Joint Resolution No. 5 provided, in part:

> Whereas, for some time past the Board of Supervisors of the City and County of Honolulu has from time to time appropriated such funds as were necessary for the support and maintenance of said Kapiolani Park; and
>
> Whereas, it is highly advisable that all public parks in the Territory should be controlled, supported, maintained and managed by the governing bodies of each of the political subdivisions of the Territory; Now Therefore Be It
>
> Resolved by the Legislature of the Territory of Hawaii that the Honolulu Park Commission be and it is hereby requested to transfer the management, control and administration of Kapiolani Park to the Board of Supervisors of the City and County of Honolulu.

H.R.J. Res. 5, 7th Terr. Leg., Reg. Sess., *reprinted in* 1913 HOUSE J. 886-87. The Board of Supervisors is now known as the City Council. The committee report stated:

> The Board of Supervisors have [sic] furnished the money necessary to carry on the Park, and the management and control has been with the Park Commissioners. It is understood that the Board of Supervisors have [sic] declined to advance any further money to the Park Commissioners, for the reason that they [sic] have [sic] had nothing to say or do with regard to its management and control. The Park's management can certainly be improved, and this Committee is of the opinion that by placing the whole administration of its affairs with the Board of Supervisors that it will be an improvement upon what has been done heretofore. The management and control cannot be any worse than it has been in the past, and your Committee deem [sic] that a change to the Board of Supervisors will be a benefit, and that under their [sic] control and supervision, the Park will be placed and put into a far better condition than it ever has been before, and instead of being a disgrace to the City and County, will, under their [sic] management, be an ornament.

S. SELECT COMM. REP. NO. 43, 7th Terr. Leg., Reg. Sess., *reprinted in* 1913 SENATE J. 1269.

Park to the Territory of Hawaii in trust forever as a public park and recreation ground[16] and authorized the governor to set aside the park to the City.[17] Act 163,[18] however, also contained a blanket repeal of Act 53.[19]

The legislature intended to improve Kapiolani Park by transferring management and control of the park to the Board of Supervisors.[20] When the legislature repealed Act 53, however, it also repealed the provision prohibiting the lease and sale of Kapiolani Park lands.[21]

As of 1913, therefore, the City was the trustee of Kapiolani Park, and under a literal interpretation of Act 163, there was no express prohibition against alienation of Kapiolani Park lands. The dispute in *Kapiolani Park* arose from the interpretation of Act 163, specifically regarding the power to lease park lands.

B. *Facts of* Kapiolani Park

Kapiolani Park involved a proposed concession agreement between the City and Pentagram Corporation (Pentagram), under which the City would rent to

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[16] *See infra* note 18.

[17] This was accomplished by Exec. Order No. 22 dated July 1, 1913. Appellant's Opening Brief at 3, Kapiolani Park Preservation Soc'y v. City & County of Honolulu, 69 Haw. ____, 751 P.2d 1022 (1988) (No. 12323).

[18] Act 163 provides, in pertinent part:

> WHEREAS, by various statutes passed by the Legislature of the Territory, the care, custody, maintenance and control of all public parks in the Territory of Hawaii, except the said Kapiolani Park and the Makiki Park or Reservation, have been transferred to and placed in charge of the Boards of Supervisors of the several political subdivisions of the Territory; NOW, THEREFORE,
>
> Be it Enacted by the Legislature of the Territory of Hawaii:
>
> Section 1. The Honolulu Park Commission is hereby directed forthwith to convey to the Territory of Hawaii all of the real and personal property, comprising the Kapiolani Park, in trust, to maintain the same forever as a public park and recreation ground.
>
> Section 2. The Governor is hereby authorized and empowered to set aside, by executive order, to the City and County of Honolulu, the real and personal property comprising Kapiolani Park aforesaid, subject to the trusts and for the purposes aforesaid.
>
> Section 3. Sections 765 to 770 inclusive of the Revised Laws, and Act 12 of the Laws of 1911, are hereby repealed.

Act 163, *supra* note 2 at 288-89.

[19] Act 53 was incorporated into the Revised Laws of Hawaii 1905 as sections 765-70. HAW. REV. LAWS §§ 765-70 (1905). Under Act 12 of 1911, the Territory of Hawaii accepted a gift of additional lands from Irwin to be added to Kapiolani Park and placed under the control and management of the Honolulu Park Commission. Act approved Mar. 8, 1911, No. 12, 1911 Haw. Sess. Laws 10.

[20] *See supra* note 15.

[21] *See supra* note 13.

Pentagram 10,000 square feet in Kapiolani Park[22] for fifteen years.[23]

The Preservation Society sought declaratory relief[24] to stop this agreement.[25] The Preservation Society contended that Kapiolani Park was the subject of a charitable trust and that the terms of the trust, as set forth in Act 53,[26] prohibited the leasing of park lands. According to the Preservation Society, the proposed concession agreement was a lease of park lands and it would be a breach of trust for the trustee City to enter into such a lease.[27]

The City and Pentagram maintained that the restriction against alienation in Act 53 was not a covenant running with the land, but merely a limitation on the authority of the Commission.[28] They asserted that the City, as successor trustee, was not restricted by this provision. They further contended that Act 163 repealed Act 53, specifically section 6 of Act 53, which prohibited the leasing of Kapiolani Park lands. The City, therefore, had the power to lease the property to Pentagram under section 171-11 of the Hawaii Revised Statutes,[29] which governs the management of public lands set aside by the government.[30]

Thus, the issue before the trial court was whether there was still a restriction on leasing Kapiolani Park lands. The trial court resolved this question in favor of the City and Pentagram by granting the City's motion for summary judgment,[31] and dismissing the Preservation Society's complaint.[32] The Preservation

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[22] This land was adjacent to the Honolulu Zoo.

[23] 69 Haw. at ____, 751 P.2d at 1024. Pentagram would spend at least $1.5 million erecting and operating a restaurant on the property. Pentagram would also have the right to assign or mortgage the agreement, with the consent of the City. *Id.*

[24] Suit was filed in the First Circuit Court of the State of Hawaii. *See* First Amended Complaint for Declaratory Relief, Kapiolani Park Preservation Soc'y v. City & County of Honolulu, 69 Haw. ____, 751 P.2d 1022 (1988) (Civ. No. 87-0634).

[25] *See id.*

[26] Act 53, *supra* note 2.

[27] 69 Haw. at ____, 751 P.2d at 1024.

[28] Defendant-Appellee City's Answering Brief at 29, Kapiolani Park Preservation Soc'y v. City & County of Honolulu, 69 Haw. ____, 751 P.2d 1022 (1988) (No. 12323); Defendant-Appellee Pentagram's Answering Brief at 16, Kapiolani Park Preservation Soc'y v. City & County of Honolulu, 69 Haw. ____, 751 P.2d 1022 (1988) (No. 12323).

[29] HAW. REV. STAT. § 171-11 (1985).

[30] 69 Haw. at ____, 751 P.2d at 1026. Section 171-11 provides that the City:

> in managing such lands shall be authorized to exercise all of the powers vested in the board [board of land and natural resources] in regard to the issuance of leases, easements, licenses, revocable permits, concessions, or rights of entry covering such lands for such use as may be consistent with the purposes for which the lands were set aside . . . .

HAW. REV. STAT. § 171-11 (1985).

The City also asserted that the proposed agreement was a license rather than a lease. The Hawaii Supreme Court held the proposed agreement was a lease and this issue is not discussed in this note. *See supra* note 5.

[31] Pentagram joined in this motion. *See* Joinder in Motion for Summary Judgment, Kapiolani Park Preservation Soc'y v. City & County of Honolulu, 69 Haw. ____, 751 P.2d 1022 (1988)

Society appealed to the Hawaii Supreme Court.

III. HISTORY

A. *Historical Overview of Charitable Trusts*

A charitable trust is a trust for the benefit of an indefinite class of persons constituting some portion or class of the public, or a trust limiting property to some public use.[33] The law of charities was derived principally from the statute of Elizabeth,[34] known as the "Statute of Charitable Uses."[35] The statute recognized and enumerated some of the more important charitable uses in its preamble.[36] The common element of all charitable trusts is that they benefit the community.[37]

The Statute of Charitable Uses also provided for the protection and enforcement of charities by the Court of Chancery.[38] Some states consider this statute part of the common law.[39] Other states have adopted statutes specifically declaring the enforceability of charitable trusts.[40] Most states, however, including Ha-

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(Civ. No. 87-0634).

[33] The trial court also dismissed the complaint as to the defendant State of Hawaii. *See* Order Granting Motions for Summary Judgment and Dismissal and Judgment, Kapiolani Park Preservation Soc'y v. City & County of Honolulu, 69 Haw. ____, 751 P.2d 1022 (1988) (Civ. No. 87-0634). The trial court did not issue findings of fact or conclusions of law.

[33] 15 AM. JUR. 2D *Charities* § 6 (1976). No wholly satisfactory definition of a charitable trust exists, but the touchstone is the purpose for which the property or funds are given and dedicated by the donor. *Id.*

[34] 43 Elizabeth 1, c. 4 (1601).

[35] The Trustees of Dartmouth College v. Woodward, 17 U.S. (4 Wheat.) 518, app. at 5 (1819).

[36] *Id.* at 5-6. Some of the charitable uses listed were gifts and devises "for the relief of aged, impotent, and poor people; for maintenance of sick and maimed soldiers and mariners; for schools of learning, free schools, and scholars of universities; for repairs of bridges, ports, havens, causeways, churches, sea-banks and highways . . . for marriages of poor maids; for supportation, aid and help of young tradesmen, handicraftsmen and persons decayed; for relief or redemption of prisoners or captives . . . ." *Id.* This list is not exclusive. A charitable trust "includes everything that is within the letter and spirit of the Statute of Elizabeth, considering such spirit to be broad enough to include whatever will promote, in a legitimate way, the comfort, happiness, and improvement of an indefinite number of persons." G.T. BOGERT, TRUSTS, § 54 (6th ed. 1987) (quoting Harrington v. Pier, 105 Wis. 485, 520, 82 N.W. 345, 357 (1900)).

[37] RESTATEMENT (SECOND) OF TRUSTS § 368 comment a (1959). *See also* 15 AM. JUR. 2D *Charities* § 7 (1976).

[38] *Dartmouth College*, 17 U.S. (4 Wheat.) 518, app. at 7.

[39] G.T. BOGERT, *supra* note 36, § 56, at 214. The Hawaii Supreme Court has stated that although the statute is not the law in Hawaii, Hawaii courts may adopt any reasonable provisions of the statute. Estate of Boardman, 5 Haw. 146, 147 (1884).

[40] *See e.g.* CONN. GEN. STAT. §§ 45.79, 45.80 (1981); GA. CODE ANN. §§ 53-12-70 to 53-12-

waii,[41] enforce charitable trusts through the court's general equity jurisdiction.[42]

B. The Protection of Charitable Trust Terms Under the United States Constitution

Although the legislature may enact general laws respecting the regulation of charitable trusts, its authority to pass special laws regarding particular charitable trusts is limited.[43] The duty of the trustee to carry out the trust in accordance with the terms of the trust instrument is a contractual relationship protected from state impairment under article I, section 10, clause 1 of the United States Constitution, the contract clause.[44]

The contract clause provides that "[n]o State shall . . . pass any . . . Law impairing the Obligation of Contracts . . . ."[45] The principal concern of the drafters of the Constitution in adopting the contract clause was to prevent the states from enacting debtor relief laws to combat the economic depression occurring at that time.[46] The contract clause sought to promote financial stability by assuring banks and financiers that their credit arrangements would not be abrogated by state legislatures.[47]

Although the framers of the Constitution apparently intended the contract clause to have this limited application, it was soon used to protect private property interests arising out of contractual arrangements from unwarranted state intervention in other areas.[48] The contract clause also prohibits the state from impairing contractual obligations of the state itself.[49] This principle was clearly

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77 (1982); *see also* G.T. BOGERT, *supra* note 36, § 56, at 216.

[41] *See* Bishop v. Pittman, 33 Haw. 647, 653 (1935) ("Equity has jurisdiction over all matters relating to trust property and in the execution and administration of the trust . . . ."). Hawaii Revised Statutes, section 603-21.7, which was enacted in 1972, provides that, "[t]he . . . circuit courts shall have jurisdiction, without the intervention of a jury . . . [o]f actions or proceedings . . . [f]or enforcing and regulating the execution of trusts . . . ." HAW. REV. STAT. § 603-21.7 (1985). *See also* HAW. REV. STAT. § 560:7-201 (1985) (Uniform Probate Code).

[42] G.T. BOGERT, *supra* note 36, § 56.

[43] G.G. BOGERT & G.T. BOGERT, THE LAW OF TRUSTS AND TRUSTEES, § 395 (2d rev. ed. 1977) [hereinafter TRUSTS AND TRUSTEES].

[44] *Id.*

[45] U.S. CONST. art I, § 10, cl. 1.

[46] L. TRIBE, AMERICAN CONSTITUTIONAL LAW 466 (1978).

[47] J. NOWAK, R. ROTUNDA & J. YOUNG, HANDBOOK ON CONSTITUTIONAL LAW 420 (1978).

[48] *See, e.g.*, Vanhorne's Lessee v. Dorrance, 2 U.S. (2 Dall.) 304 (1795). In *Vanhorne's Lessee*, the district court of Pennsylvania declared a Pennsylvania law altering title of disputed land unconstitutional as a violation of the contract clause. The United States Supreme Court subsequently held that the contract clause prevented the Georgia legislature from annulling land titles previously granted to good faith purchasers by the original grantees. Fletcher v. Peck, 10 U.S. (6 Cranch) 87 (1810).

[49] 16a C.J.S. *Constitutional Law* § 287 (1984).

stated in *Trustees of Dartmouth College v. Woodward*,[50] perhaps the most famous decision construing the contract clause.

Dartmouth College involved a private charitable corporation founded by the Reverend Eleazer Wheelock in 1769. Reverend Wheelock sought to establish a college for the general education of Indian and English youth. He solicited contributions, appointed trustees, and selected a site for the college on lands located in the present state of New Hampshire. King George III granted the trustees a charter of incorporation.[51]

In 1816, the New Hampshire legislature enacted legislation altering the charter of incorporation by increasing the number of trustees and establishing a state-controlled board of overseers to inspect and control the acts of the trustees.[52] The trustees resisted the legislation, which would have transferred administration and control of the college from the trustees to the state of New Hampshire and transformed the college into a public institution.

The United States Supreme Court held that the college's charter of incorporation was a contract protected under the contract clause and, thus, could not be impaired by the legislature.[53] The Supreme Court acknowledged that the change might be to the advantage of the college, but stressed that such a change was, nevertheless, "not according to the will of the donors, and [was] subversive of that contract, on the faith of which their property was given."[54] The state, therefore, could not impair this contract between the donors, the Crown, and the trustees by legislating contrary to the donors' intent.[55]

The Supreme Judicial Court of Massachusetts reached the same conclusion in *In re Opinion of the Justices*.[56] In response to a request by the Massachusetts senate for an advisory opinion on the constitutionality of several pending bills, the court stated:

> Several of the bills seemingly purport to authorize changes in the terms upon which property devoted to charitable uses is to be held and enjoyed . . . .
>
> . . . .
>
> Gifts to trustees or to eleemosynary corporations, accepted by them to be held upon trusts expressed in writing or necessarily implied from the nature of the

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[50] 17 U.S. (4 Wheat.) 518 (1819).

[51] *Id.* at 631-32.

[52] *Id.* at 652.

[53] *Id.* at 650.

[54] *Id.* at 653.

[55] The *Dartmouth College* doctrine was followed by a New York court in a similar situation. *See* Goldstein v. Trustees of the Sailor's Snug Harbor, 277 A.D. 269, 98 N.Y.S.2d 544 (1950) (where a charitable trust was created by will with a fixed number of trustees, the legislature has no power to enact a statute authorizing the appointment of additional trustees, in variance with the testator's will).

[56] 237 Mass. 613, 131 N.E. 31 (1921).

> transaction, constitute obligations which ought to be enforced and held sacred under the Constitution. It is not within the power of the Legislature to terminate a charitable trust, to change its administration on grounds of expediency, or to seek to control its disposition under the doctrine of cy pres.[57]

The Massachusetts court, thus, affirmed that the terms in the instrument creating a charitable trust should be constitutionally protected from alteration by the legislature. The court more specifically held in subsequent decisions that grants subject to charitable trusts constitute contractual obligations that are protected under the contract clause from legislative impairment.[58]

In *City of Reno v. Goldwater*,[59] the Nevada Supreme Court recognized and honored the contractual obligations that arose when a private donor granted lands to the city of Reno for the charitable purpose of establishing a public park. In *City of Reno*, the city had traded part of the park lands for privately owned land it needed for an approach to a bridge and to widen a street. The city contended that it was authorized to alienate the property under a charter provision similar to section 171-11 of the Hawaii Revised Statutes.[60]

The Nevada Supreme Court held that the trust instruments had created a charitable trust and that the trading of trust property to private persons for a nonpublic use was a breach of the trust.[61] The court reasoned that "[w]hen the

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[57] *Id.* at 617, 131 N.E. at 32. Under the doctrine of cy pres:

> If property is given in trust to be applied to a particular charitable purpose, and it is or becomes impossible or impracticable or illegal to carry out the particular purpose, and if the settlor manifested a more general intention to devote the property to charitable purposes, the trust will not fail but the court will direct the application of the property to some charitable purpose which falls within the general charitable intention of the settlor.

RESTATEMENT (SECOND) OF TRUSTS § 399 (1959).

[58] Dunphy v. Commonwealth, 368 Mass. 376, 331 N.E.2d 883 (1975) (where land was devised to a town for a public park, a statute authorizing the town to convey it to the Commonwealth as a site for an artificial skating rink was a violation of the trust terms, impairing the town's contractual obligation to use the land solely for trust purposes); Opinion of the Justices to the Senate, 369 Mass. 979, 338 N.E.2d 806 (1975) (where land was deeded to the city as part of a public park and playground, legislature could not authorize the city to use the park as a public school site); Salem v. Attorney General, 344 Mass. 626, 183 N.E.2d 859 (1962) (construction of a public school building, pursuant to legislative enactment, on lands devised to the city for purposes of a public park, would impair the original contract); Adams v. Plunkett, 274 Mass. 453, 175 N.E. 60 (1931) (the legislature's changing of the method of selecting managers of the trust, as specified and agreed between the donor and trustee, would impair the original contractual obligations).

[59] 92 Nev. 698, 558 P.2d 532 (1976).

[60] *See supra* note 30 for the pertinent text of Hawaii Revised Statutes section 171-11 (1985). The Nevada city charter provided that: "[t]he city council shall have the power to hold, improve, manage and use and dispose of all public grounds, parks, recreation centers . . . ." 92 Nev. at 701, 558 P.2d at 534.

[61] 92 Nev. at 701, 558 P.2d at 533.

City accepted the gift of land . . . a contract was created obligating the City to hold such property in trust for the people of Reno to enjoy as a park and playground. That obligation could not later be impaired by legislative enactment."[62] Accordingly, the charter provision empowering the city to dispose of all public property was inapplicable.[63]

C. *The Effect of Prohibiting Alienation in Charitable Trusts*

Indefinite suspension of the power of alienation in grants to a private trust or corporation generally violates public policy and is void.[64] In the case of charitable trusts, however, a provision against alienation in a grant to a charitable trust or corporation is usually held to be either an exception to the rule against restraints on alienation, or a perpetuity permitted by law in this specific instance.[65]

Even in the case of charitable trusts, however, there is a limitation on the donor's power to restrain alienation. Courts of equity may order a sale of charitable trust property notwithstanding an express restraint on alienation where it is necessary and desirable to carry out the purposes of the trust, or where conditions have changed such that a sale of trust property is reasonably required.[66]

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[62] *Id.* at 702, 558 P.2d at 534. The Nevada Supreme Court then cited to U.S. CONST. art. I, § 10, NEV. CONST. art. I, § 15, and cases.

[63] *Id.*

[64] 15 AM. JUR. 2D *Charities* § 24 (1976).

[65] *See, e.g.*, Perin v. Carey, 65 U.S. 465 (1861) (devise of real and personal estate in trust for the purpose of building and maintaining two colleges with restraints against alienation of real estate is a perpetuity allowed by law and equity in cases of charitable trusts). *See generally* 15 AM. JUR. 2D *Charities* § 24 (1976); Annotation, *Validity and Effect of Provision or Condition Against Alienation in Gift for Charitable Trust or to Charitable Corporation*, 100 A.L.R.2d 1208 (1965).

The rationale for this exception is that since a donor may grant property for a charitable purpose in perpetuity (*see* G.T. BOGERT, *supra* note 36, § 69), he should be able to place restraints against alienation on the property to ensure that the property remains in the hands of the trustee and that the donor's primary purpose is effectuated. 15 AM. JUR. 2D *Charities* § 24 (1976); Annotation, *Validity and Effect of Provision or Condition Against Alienation in Gift for Charitable Trust or to Charitable Corporation*, 100 A.L.R.2d 1208 (1965). In addition, it is in the public's interest to encourage the creation and continuation of charitable trusts. Ohio Society v. McElroy, 175 Ohio St. 49, 191 N.E.2d 543 (1963).

[66] 15 AM. JUR. 2D *Charities* § 24 (1976); Annotation, *Validity and Effect of Provision or Condition Against Alienation in Gift for Charitable Trust or to Charitable Corporation*, 100 A.L.R.2d 1208, 1209-14 (1965); *see, e.g.*, Wachovia Bank & Trust Co. v. John Thomasson Co., 275 N.C. 399, 168 S.E.2d 358 (1969) (notwithstanding terms in the trust instrument restricting alienation, where conditions had changed such that a sale of the trust property was necessary to preserve the trust and accomplish its ultimate purpose (the once thriving dairy farm deeded to the trustee for the benefit of a children's institution became economically unproductive, the trust was operating at a deficit, and the land was not suitable for leasing, but if the land were sold for

Courts may similarly authorize a lease or mortgage of such property.[67]

The Hawaii Supreme Court, in two cases involving private testamentary trusts, has recognized that Hawaii courts may authorize a sale of trust property contrary to the trust terms established by a testator when changed conditions render it necessary to preserve the trust and carry out the intention of the settlor.[68] In addition, the power of the Hawaii courts to order a sale or lease of trust property under restraint was codified in 1957.[69]

The trial court's authority to approve the alienation of real property in such circumstances is derived from the court's general power to direct or permit the trustee of a charitable trust to do acts which are not authorized or are forbidden by the trust terms when, due to changed and unanticipated circumstances, compliance would defeat or substantially impair the purposes of the trust.[70] Hawaii

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residential purposes and the proceeds held in trust and invested, substantial income would be produced for the institution), the court, in the exercise of its equitable jurisdiction, could authorize and direct a sale of trust property).

[67] TRUSTS AND TRUSTEES, *supra* note 43, § 394 at 260-61. *See, e.g., Ohio Society*, 175 Ohio St. 49, 191 N.E.2d 543 (charitable corporation must abide by testator's instructions not to lease or sell the charitable trust property unless and until a court of equity in appropriate proceedings gives authority to do otherwise).

[68] *See* Hawaiian Trust Co. v. Breault, 42 Haw. 268, 271-72 (1958) (despite terms of a will instructing that a residence be kept intact for the use of two beneficiaries during their respective lives, the trial court could authorize sale of the residence, with the beneficiaries' consent, where the residence had deteriorated and there were no funds to make needed improvements, the beneficiaries were not occupying the house, and there were no trust funds to make monthly annuity payments to the beneficiaries in accordance with the will); Hawaiian Trust Co. v. Gonser, 40 Haw. 245, 251-52 (1951) (the trial court could not authorize the sale of real estate when there was no danger of the trust becoming insolvent without the sale of the real estate, the real estate was not a drain on the trust, but rather generated income, and all appearing beneficiaries opposed the sale).

[69] The statute states in pertinent part:

> Notwithstanding any limitation in any instrument creating any . . . trust, whether or not eleemosynary or incorporated . . . which forbids or restrains the sale of real property of such . . . trust or which limits the terms of lease of such property to periods less than fifty-five years, the trustees or officers of the . . . trust, with the approval of the court, may sell the real property of the . . . trust or may lease the same for periods up to fifty-five years . . . .

HAW. REV. STAT. § 517-1 (1985). This statute does not, however, contain language requiring exigent circumstances to justify authorizing the sale or lease of property under restraint.

Another statute, although not referring to property under restraint, provides:

> Any circuit court having jurisdiction over a trust, on application of . . . the trustees . . . may, if it appears to be for the benefit of the trust estate, authorize or direct the . . . trustees to lease . . . the real property for such periods as may be deemed advantageous to the estate . . . .

HAW. REV. STAT. § 554-3 (1985).

[70] RESTATEMENT SECOND OF TRUSTS § 381, comments d, e (1959). This is commonly referred to as the power of the court to sanction deviation from the terms of the trust. TRUSTS AND

statutory law refers to this power in the Uniform Trustees' Powers Act.[71] Courts have justified this power to deviate from trust terms by asserting that they are merely carrying out the donor's intent or primary objectives in light of changed conditions.[72]

In the limited number of jurisdictions that have considered the issue, most hold that the legislature may also authorize the sale of charitable trust property held under trust terms prohibiting the sale or alienation of the trust property, where there is a practical necessity for the sale and the proceeds are devoted to carrying on the trust purposes.[73] By inference, the legislature may also authorize the lease of trust property in these circumstances.

D. Standing to Enforce Charitable Trusts

1. Standing Generally

The requirement of "standing" is a judicially created rule used to limit the types of issues which may be brought before the court.[74] Standing decisions are rather unpredictable; indeed, Justice Douglas remarked that "[g]eneralizations

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TRUSTEES, *supra* note 43, § 394.

[71] The statute provides in pertinent part:

> Power of court to permit deviation . . . (a) This chapter does not affect the power of a court of competent jurisdiction for cause shown and upon petition of the trustee . . . to relieve a trustee from any restrictions on the trustee's power that would otherwise be placed upon the trustee by the trust . . . .

HAW. REV. STAT. § 554A-5 (1985).

[72] TRUSTS AND TRUSTEES, *supra* note 43, § 561, at 231-32.

[73] *See, e.g.*, Trustees of New Castle Common v. Gordy, 33 Del. Ch. 334, 93 A.2d 509 (1952) (where, due to changing conditions, the legislature could authorize trustees under a charitable trust to sell trust realty to promote the purposes of the trust, notwithstanding the donor's original restriction thereof, and such legislation is not unconstitutional under article I, section 10 of the Constitution). *See also* Annotation, *Constitutionality, Construction, and Effect of Legislation Authorizing Sale of Charitable Trust Property*, 40 A.L.R.2d 556 (1955); Stanley v. Colt, 72 U.S. (5 Wall.) 119 (1866); Delaware Land & Dev. Co. v. First & Cent. Presbyterian Church, 16 Del. Ch. 410, 147 A. 165 (1929). *Contra*, Bridgeport Public Library & Reading Room v. Burroughs Home, 85 Conn. 309, 82 A. 582 (1912) (legislative acts authorizing the sale of charitable trust property without submitting the matter to the court are invalid as an attempt by the legislature to exercise judicial power belonging solely to the courts).

The Hawaii Supreme Court has, in dicta, noted that "[i]f a deviation from any trust provision is necessary in the interest of the trust, the power to authorize the deviation rests solely with the court." Midkiff v. Kobayashi, 54 Haw. 299, 336, 507 P.2d 724, 745 (1973).

The validity of general legislation in many states that sanctions the sale of charitable trust property pursuant to court order has been upheld. Annotation, *Constitutionality, Construction, and Effect of Legislation Authorizing Sale of Charitable Trust Property*, 40 A.L.R.2d 556 (1955).

[74] J. FRIEDENTHAL, M. KANE & A. MILLER, CIVIL PROCEDURE § 6.3 at 326 (1985) [hereinafter CIVIL PROCEDURE].

about standing . . . are largely worthless as such."[75] This unpredictability arises because standing was designed as an instrument of self restraint, and thus, its application depends somewhat on the court's desire to be restrained.[76]

Standing is a subcategory of justiciability,[77] which in turn "is a term of art employed to give expression to [the] dual limitation placed upon federal courts by the case-and-controversy doctrine."[78] This dual limitation is that courts are restricted to addressing questions (1) which are presented in an adversary context and (2) which do not require them to overstep their position in government as one of three separate powers.[79] Standing focuses on the first of these two limitations—the preservation of the adversary process.[80]

In *Allen v. Wright*,[81] the United States Supreme Court undertook a broad examination of the standing doctrine and adopted a three-part test to determine whether a plaintiff had standing to sue: 1) a plaintiff must allege personal injury; 2) that is fairly traceable to the defendant's allegedly unlawful conduct; and 3) that is likely to be redressed by the requested relief.[82]

The prudential component of the standing doctrine involves policy considerations[83] closely associated with the article III requirements.[84] Examples of prudential limitations on standing are: (1) plaintiffs may not bring suits to protect the rights of third parties; (2) plaintiffs may not bring abstract claims with widely shared injuries, i.e., "generalized grievances;" and (3) plaintiffs' claimed

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[75] Association of Data Processing Orgs. v. Camp, 397 U.S. 150, 151 (1970).

[76] K. RIPPLE, CONSTITUTIONAL LITIGATION 100 (1984).

[77] *Id.* at 88. Justiciability of a controversy refers to the issue of whether a matter is suitable for judicial review. It encompasses the doctrines of mootness, ripeness, and political question in addition to standing. The Hawaii Supreme Court has referred to justiciability as the need for courts to "carefully weigh the wisdom, efficacy, and timeliness of an exercise of their power before acting, especially where there may be an intrusion into areas committed to other branches of government." Life of the Land v. Land Use Comm'n, 63 Haw. 166, 172, 623 P.2d 431, 438 (1981).

[78] Flast v. Cohen, 392 U.S. 83, 95 (1968).

[79] K. RIPPLE, *supra* note 76, at 88.

[80] *Id.* at 93.

[81] 468 U.S. 737 (1984).

[82] *Id.* at 751. In *Allen*, the United States Supreme Court denied standing to parents of black school children suing to require the Internal Revenue Service to fulfill its obligation to deny tax exempt status to racially discriminatory private schools. The Court identified two components of the standing doctrine: the constitutional component and the prudential component. The constitutional component stems from article III of the United States Constitution which limits the federal courts to adjudicating "cases" and "controversies." *Id.* at 750. By limiting the power of the courts, the cases and controversies requirement defines the role of the judicial branch of the federal government with respect to the separation of powers between the three branches. *Id.*

[83] CIVIL PROCEDURE, *supra* note 74, § 6.3 at 327.

[84] Valley Forge Christian College v. Americans United for Separation of Church & State, 454 U.S. 464, 475 (1982).

injuries must fall within the zone of interests meant to be protected by the statute or constitutional guarantee upon which they are based.[85] Prudential concerns are not as essential to a standing analysis as the core requirements.[86] Moreover, the prudential considerations tend to be restrictions on the scope of "personal injury," the first of the three-part constitutional standing analysis.[87]

The Hawaii Supreme Court is not constrained by the United States Constitution's cases and controversies restriction because article III applies only to federal courts,[88] and the Constitution of the State of Hawaii has no similar provision. The Hawaii Supreme Court, however, has stated that "we nevertheless believe judicial power to resolve public disputes in a system of government where there is a separation of powers should be limited to those questions capable of judicial resolution and presented in an adversary context."[89] The Hawaii Supreme Court has described standing as:

> that aspect of justiciability focusing on the party seeking a forum rather than on the issues he wants adjudicated. And the crucial inquiry in its determination is "whether the plaintiff has 'alleged such a personal stake in the outcome of the controversy' as to warrant *his* invocation of . . . [the court's] jurisdiction and to justify exercise of the court's remedial powers on his behalf."[90]

"The question of standing is essentially one that resolves itself into the elementary proposition that one who is injured by the act of another may legally challenge the propriety of the action."[91] Thus, the Hawaii Supreme Court has asserted the importance of adhering to standing requirements, particularly the core constitutional requirements: injury, causation, and redressibility.[92]

In *Akau v. Olohana Corp.*,[93] a public nuisance action, the Hawaii Supreme Court surveyed the standing doctrine as it existed in Hawaii. The plaintiffs in *Akau* were several persons who lived or fished in Kawaihae. They brought a class action suit to enforce public rights of way over land in Kawaihae owned by the defendants. The court began its standing analysis by noting "a trend in the law . . . away from focusing on whether the injury [was] shared by the

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[85] *Id.* at 474-75.

[86] The article III requirement "states a limitation on judicial power, not merely a factor to be balanced in the weighing of so-called 'prudential' considerations." *Id.* at 475.

[87] *See supra* note 82 and accompanying text.

[88] *Life of the Land*, 63 Haw. at 171, 623 P.2d at 438.

[89] *Id.* at 171-72, 623 P.2d at 438.

[90] *Id.* at 172, 623 P.2d at 438 (quoting Warth v. Seldin, 422 U.S. 490, 498-99 (1975) (original emphasis)).

[91] *In re* Application of Hawaiian Elec. Co., 56 Haw. 260, 263, 535 P.2d 1102, 1105 (1975).

[92] *See supra* note 82 and accompanying text.

[93] 65 Haw. 383, 652 P.2d 1130 (1982).

public, to whether the plaintiff was in fact injured."[94] The court further noted that it "ha[d] been in step with the trend away from the special injury rule towards the view that a plaintiff, if injured, ha[d] standing."[95] The court then held that:

> a member of the public has standing to sue to enforce the rights of the public even though his injury [was] not different in kind from the public's generally, if he [could] show that he ha[d] suffered an injury in fact, and that the concerns of a multiplicity of suits [were] satisfied by any means . . . .[96]

Akau, therefore, effectively eliminated the prudential standing analysis considerations in public rights cases. The Hawaii Supreme Court believed the ability of the public to redress wrongs outweighed most prudential concerns: "[W]hile every challenge to government action has not been sanctioned, our basic position has been that standing requirements should not be barriers to justice."[97]

The expansive standing analysis articulated in *Akau* reaffirmed that of *In re Application of Hawaiian Electric Co.*[98] There, appellant, an environmental organization, challenged the decision of the Public Utilities Commission (PUC) of the State of Hawaii to allow an increase in electricity rates. Once the PUC had allowed the rate increase, the staff of the PUC, mandated by law to protect the interests of consumers, chose not to challenge the decision in court. The Hawaii Supreme Court acknowledged that the environmental organization had standing, noting that "[t]he practical effect of denying the appellants standing here would be to silence the voice of all those who would speak in the public interest, a duty that normally resides with the PUC staff."[99] Thus, in *Hawaiian Electric*, the court held that when a genuine issue is not brought to court by the office responsible for protecting the interest of the public in that particular area of law, the public itself may have standing to bring the suit.[100]

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[94] *Id.* at 386, 652 P.2d at 1133.

[95] *Id.* at 388, 652 P.2d at 1134. The "special injury rule" is one that combines the injury in fact requirement of a *personal* injury and the further prudential limitations prohibiting generalized grievances and suits solely for the interest of third parties. It requires that a plaintiff have suffered a special, as opposed to a generalized, injury.

[96] *Id.* at 388-89, 652 P.2d at 1134. Though the court included satisfaction of the prudential concern of a multiplicity of suits in its standing analysis in *Akau*, this element of the test was not emphasized. The plaintiffs' bringing a class action suit was sufficient to overcome this burden.

[97] *Life of the Land*, 63 Haw. at 173-74, 623 P.2d at 439.

[98] 56 Haw. 260, 535 P.2d 1102 (1975).

[99] *Id.* at 265, 535 P.2d at 1106.

[100] *Id.*

2. *Application of Standing Doctrine to Charitable Trusts*

The extensive equitable jurisdiction over charitable trusts resulting from the statute of Elizabeth led early to a liberal application of law by the courts in order to carry out the expressed intentions of donors.[101] Charitable donations that were invalid in law were upheld in equity in a variety of circumstances.[102] This liberal construction carried over into the areas of trust administration and standing of parties to bring suit.[103] Judges supervised court-appointed trustees and assumed the role of trustee when none had been appointed.[104] In addition, either the attorney general or an interested private party had standing to sue to enforce a charitable trust.[105]

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[101] *Dartmouth College*, 17 U.S. (4 Wheat.) 518, app. at 9-16.

[102] *Id.* For instance, words in a will were given very different construction when applied to a charity rather than an individual. *Id.* Also, if a charitable bequest was for a purpose which was against public policy, the court could execute the bequest for some other charity which was not unlawful. *Id.* If a bequest was unlawfully vague, the court could apply it to charity as it saw fit to try to carry out the charitable intentions of the donor. *Id.* The English court also corrected defects in faulty conveyances for charitable purposes. *Id.*

[103] *Id.*, app. at 19-20.

[104] *Id.*, app. at 19.

[105] *Id.*, app. at 20. The reason for making the attorney general a party in charitable trust suits has a historical basis.

> It is laid down in the books of authority, that the king, as *parens patriae*, has the general superintendence of all charities not regulated by charter, which he exercises by the keeper of his conscience, the chancellor; and, therefore, the Attorney-General, at the relation of some informant, when it is necessary, files *ex officio* an information in the Court of Chancery to have the charity properly established and applied.

Id., app. at 19. The king was *parens patriae*, or the "parent of the country," and, as such, was responsible for keeping watch over charitable trusts. The Attorney-General, being the legal arm of the king, would file suit if there appeared to be problems in the execution of a trust, and the Court of Chancery would then pass judgment. This arrangement remained in the law of the United States even after the colonies gained independence from Britain. The king has now been replaced by the people or their representatives, and the Court of Chancery is now the court sitting in equity. The office of attorney general has remained the legal arm of the government. The attorney general retains the responsibility of looking after charitable trusts and filing suit when problems arise. Hite v. Queen's Hospital, 36 Haw. 250, 262 (1942) (citing ZOLLMANN, AMERICAN LAW OF CHARITIES § 613, at 427 (1924)).

The attorney general's role historically was as an officer of the crown calling the court's attention to the trustee's failure to perform a public duty, not as one complaining of a personal injury. TRUSTS AND TRUSTEES, *supra* note 43, § 411. The pleading was thus called a bill of information rather than a bill of complaint, and the attorney general was an informant rather than a complainant. *Id.* The attorney general could also sue at the relation (a relation is "information given"—BLACK'S LAW DICTIONARY 1453 (4th ed. 1968)) of others who were then called relators, and the proceeding then was called an information *ex relatione*. *Id.* Persons did not need to have a beneficial interest in the trust to act as relators. *Id.* Relators were often included in charitable trust suits so that there would be a party to bear the costs if it turned out that the information was

Presently, the general rule of standing in the area of charitable trusts is set out in section 391 of the Restatement (Second) of Trusts:

> A suit can be maintained for the enforcement of a charitable trust by the Attorney General or other public officer, or by a co-trustee, or by a person who has a special interest in the enforcement of the charitable trust, but not by persons who have no special interest or by the settlor or his heirs, personal representatives or next of kin.[106]

The attorney general is primarily responsible for bringing charitable trust suits.[107] Although jurisdictions are split concerning cases where the attorney general refuses to bring suit, the predominant rule is that the attorney general need only be made a party to the suit, if not as a plaintiff, then as a defendant.[108]

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improperly filed since the crown was never required to pay costs. *Id.*

The vesting of exclusive power to sue in a public official such as the attorney general occurred so that trustees of charitable trusts would not be subjected to "unreasonable and vexatious litigation," and courts would not have their calendars clogged unnecessarily. *Id.* This fear of clogged court calendars and vexatious litigation was due to the fact that charitable trusts generally have a large and shifting group of persons whom they affect. *Id.*

[106] RESTATEMENT (SECOND) OF TRUSTS § 391 (1959).

[107] TRUSTS AND TRUSTEES, *supra* note 43, § 411.

[108] 15 AM. JUR. 2D *Charities* § 145 (1976). *See* Bible Readers' Aid Soc'y v. Katzenbach, 97 N.J. Eq. 416, 128 A. 628 (1925), where a bill was brought by the Bible Readers' Aid Society of Trenton, N.J. (BRAS), and the Young Women's Christian Association of Trenton, N.J. (YWCA), for a decree to discharge the BRAS from its duties as trustee of a charitable trust and to appoint the YWCA in its stead. The BRAS was incorporated under a legislative enactment in 1875, and its members donated or contributed property in trust to the group for the purpose of furthering its goals of reading the Bible to the poor and teaching the poor to help themselves. The BRAS sought to shift the trusteeship to the YWCA since BRAS membership had dwindled to just a few elderly persons. The court, in addressing the standing issue, held that:

> [in charitable trust suits,] [t]he general practice has been for the Attorney General to file the bill either of his own motion or on the relation of some party interested, but where the interested parties present the bill and make the Attorney General a defendant, the proper parties are before the court and it is immaterial that the Attorney General is defendant instead of complainant.

Id. at 417-18, 128 A. at 628.

But see Ames v. Attorney General, 332 Mass. 246, 124 N.E.2d 511 (1955), where the court held that the duty to take action to enforce the proper application of charitable trusts was the attorney general's alone, both by state statute and by common law, and, therefore, the lack of consent of that office is fatal to a claim of breach of a charitable trust:

> We are not convinced that the petitioners, who have no interest other than that of the general public, have any legal right to demand a decision of the court in advance before action is brought, and when an action may never be brought, in a matter ultimately resting in the executive discretion of the Attorney General, and when the court in the last analysis can only advise and not command.

Unlike the attorney general,[109] members of the general public usually do not have standing to bring a charitable trust suit.[110] However, the courts have some discretion with regard to the general public since a court may apply either a broad or a narrow interpretation to the phrase "a person who has a special interest in the enforcement of the charitable trust."[111] The recent trend has been for courts to broaden the definition of what constitutes a "special interest" in a charitable trust.[112]

For example, in *Young Men's Christian Association of City of Washington v. Covington*,[113] members of the Bowman branch of the Young Men's Christian Association (YMCA) sued the YMCA after it closed the dilapidated, historic building in which the branch was housed. The plaintiffs asserted that, by allowing the building to deteriorate and then closing it down, the YMCA had breached an implied or constructive trust to maintain the property that was given in trust to the YMCA seventy years earlier.[114]

Because the plaintiffs were all members of the Bowman branch, the court found that the plaintiffs had standing.[115] The court noted that while the entire public benefited from the existence of YMCA facilities, the individual plaintiffs received a *particular benefit* from the operation of the Bowman branch.[116]

Similarly, the standing of a citizen group to challenge a municipal action that violated the terms of a trust was addressed in *City of Reno*.[117] There, the Nevada Supreme Court held that the plaintiffs, who lived near a park that was given in trust for park purposes, had standing to sue for breach of the trust.[118] The court stated: "The plaintiffs . . . are taxpayers and residents of the City of Reno who live in close proximity to Newlands Park and enjoy its beauty. Their standing to compel the City to honor its trust is beyond question."[119]

Id. at 252, 124 N.E.2d at 515.

[109] 15 AM. JUR. 2D *Charities* § 144 (1976).

[110] The Restatement (Second) of Trusts states that:

> [a] suit for the enforcement of a charitable trust cannot be maintained by persons who have no special interest in the enforcement of the trust. *The mere fact that as members of the public they benefit from the enforcement of the trust is not a sufficient ground to entitle them to sue*, since a suit on their behalf can be maintained by the Attorney General.

RESTATEMENT (SECOND) OF TRUSTS § 391 comment d (1959) (emphasis added); *See also* 15 AM. JUR. 2D *Charities* § 143 (1976).

[111] RESTATEMENT (SECOND) OF TRUSTS § 391 (1959).

[112] J. DUKEMINIER AND S. JOHANSON, WILLS, TRUSTS, AND ESTATES 610 (3d ed. 1984).

[113] 484 A.2d 589 (D.C. App. 1984).

[114] *Id.* at 591.

[115] *Id.* at 591-92.

[116] *Id.* at 592.

[117] 92 Nev. 698, 558 P.2d 532.

[118] *Id.* at 700, 558 P.2d at 533.

[119] *Id.* Such holdings generally are based on the fact that persons owning land near public parks are persons with special interests for standing purposes. *See also* Appeal of Leech, 170 Pa.

Courts in other jurisdictions, however, have dispensed with the "special interest" requirement and have granted standing to members of the general public. In *Hiland v. Ives*,[120] for example, land was conveyed to the city for use as a public park. The plaintiffs brought suit when the state highway commissioner tried to take some of the park lands so that a highway could be relocated.[121] The court held that since the plaintiffs were residents of the city and park users they had standing to sue to enjoin the action of the highway commissioner, even though this holding violated general standing rules because the complaint was a generalized grievance.[122] The court reasoned that standing rules should not be used to prevent plaintiffs from seeking redress from their injuries solely because the injuries are ones suffered by other members of the public as well.[123]

In *Paepcke v. Public Building Commission*,[124] the Supreme Court of Illinois reached a similar result, holding that members of the public have standing to sue to enforce a public trust. In *Paepcke*, the Public Building Commission of Chicago wanted to build a school on the grounds of a public park. The park was acquired pursuant to an 1869 statute " 'for the recreation, health and benefit of the public, and free to all persons forever.' "[125] As to standing, the court noted that:

> [i]f the "public trust" doctrine is to have any meaning or vitality at all, members of the public, at least taxpayers who are beneficiaries of that trust, must have the right and standing to enforce it. To tell them that they must wait upon governmental action is often an effectual denial of the right for all time.[126]

Super. 130, 84 A.2d 787 (1951), *rev'd on other grounds*, 371 Pa. 84, 89 A.2d 351 (1952) (owners of real estate near a tract of land which had been dedicated to the public for park purposes had standing to bring suit when the municipality sought to sell the land since they were persons aggrieved); Hoffman v. Pittsburgh, 365 Pa. 386, 75 A.2d 649 (1950) (owners of lots fronting a public square had standing to bring suit as parties with a special interest when the city passed an ordinance authorizing the sale of the square).

[120] 28 Conn. Supp. 243, 257 A.2d 822 (1966).

[121] *Id.* at 244, 257 A.2d at 823.

[122] *Id.* at 246-47, 257 A.2d at 824-25.

[123] *Id.* at 247, 257 A.2d at 825. The *Hiland* court justified its holding by noting that the rule against generalized grievances was formulated for judicial convenience to ensure that the courts were not overrun by public interest suits. The court noted that the rule was predicated on the assumption that the appropriate public authorities would adequately protect the interests of the public in such situations. The court stated that where the attorney general has considered the matter and declined to bring suit, this assumption was a "trompe-l'oiel", i.e., an illusion or a sham, and that under circumstances such as in *Hiland*, where it appeared very unlikely that the attorney general or any other appropriate public official would in fact bring suit on the public's behalf, members of the public should have standing.

[124] 46 Ill. 2d 330, 263 N.E.2d 11 (1970).

[125] *Id.* at 332, 263 N.E.2d at 13.

[126] *Id.* at 341, 263 N.E.2d at 18.

Thus, the Illinois Supreme Court also held that members of the public have standing to enforce public or charitable trusts when the authority vested with the responsibility of protecting the public's interest does not bring suit.[127]

IV. ANALYSIS

The Hawaii Supreme Court reviewed the origin of Kapiolani Park[128] and concluded that Kapiolani Park was a public charitable trust[129] established by the deeds of July 1, 1896[130] with the Honolulu Park Commissioners as trustees.[131]

A. Breach of Trust

The Hawaii Supreme Court first determined that the terms of the trust instrument creating the trust dictated whether the trustees had the power to lease the trust property.[132] By the terms of the trust, the initial trustees (the Honolulu Park Commissioners) had no authority to lease Kapiolani Park lands. The court held that the trustees were expressly forbidden by Act 53, and, therefore, by the deeds of July 1, 1896, to lease or sell any part of Kapiolani Park.[133]

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[127] *Id.*; *See also* Parsons v. Walker, 28 Ill. App. 3d 517, 328 N.E.2d 920 (1975) (holding that the injury suffered in a breach of trust claim involving land held in public or charitable trust was contractual rather than environmental and granting members of the general public standing based on the breach of contract claim).

[128] *See supra* notes 6-21 and accompanying text.

[129] The Restatement (Second) of Trusts defines a charitable trust as a "fiduciary relationship with respect to property arising as a result of a manifestation of an intention to create it, and subjecting the person by whom the property is held to equitable duties to deal with the property for a charitable purpose." RESTATEMENT (SECOND) OF TRUSTS § 348 (1959). The maintenance of a public park is a charitable purpose. *Id.* at § 373.

[130] According to the Restatement, "A charitable trust may be created by . . . a transfer inter vivos by the owner of property to another person to hold it upon a charitable trust . . . ." RESTATEMENT (SECOND) OF TRUSTS, § 349(b) (1959).

[131] 69 Haw. at ____, 751 P.2d at 1025-26. *See supra* notes 6-13 and accompanying text.

[132] 69 Haw. at ____, 751 P.2d at 1026 (quoting 14 C.J.S. *Charities* § 48 (1939)). *See* Campbell v. Kawananakoa, 31 Haw. 500 (1930) (whether trustees under will have power to lease trust lands depends on terms in the will).

[133] 69 Haw. ____, 751 P.2d at 1026. *See supra* note 13 for the full text of the clause in Act 53 prohibiting leasing. The implication is that the terms of Act 53, including the leasing prohibition, were incorporated in the deeds by reference.

The City and Pentagram argued that the leasing prohibition was merely a restriction on the powers of the Commission, rather than an essential term of the trust itself. Defendant-Appellee City's Answering Brief at 29, Kapiolani Park Preservation Soc'y v. City & County of Honolulu, 69 Haw. ____, 751 P.2d 1022 (1988) (No. 12323); Defendant-Appellee Pentagram's Answering Brief at 16, Kapiolani Park Preservation Soc'y v. City & County of Honolulu, 69 Haw.

The court then considered the effect of Act 163[134] on the prohibition against leasing. Although none of the parties cited the case in their briefs, the Hawaii Supreme Court applied the principles of *Dartmouth College*[135] to the instant case. The court held that granting the City, as the present trustee, power to lease or deed Kapiolani Park lands, in derogation of the express terms of the trust instruments, was an alteration of the trust terms similar to changing the trustees and management of the trust in *Dartmouth College*.[136] Moreover, giving the trustee such power would impair the obligations of the contract under which the trust was created and violate article I, section 10 of the United States Constitution.[137]

To support its holding, the Hawaii Supreme Court quoted from *In re Opinion of the Justices*,[138] but did not address any of the cases cited in the Preservation Society's brief.[139] Apparently, the court felt that *Dartmouth College* and *In re Opinion of the Justices* were controlling precedents and did not want to balance

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____, 751 P.2d 1022 (1988) (No. 12323). The Hawaii Supreme Court noted, however, that restriction of the power of alienation is one of the distinguishing characteristics of trust estates. 69 Haw. at ____ n.3, 751 P.2d at 1026 n.3.

Defendants also argued that as the underlying park land in question had always been government land, it was not affected by any restrictions on other park lands donated by the Association or Irwin. Defendant-Appellee Pentagram's Answering Brief at 20-21, Kapiolani Park Preservation Soc'y v. City & County of Honolulu, 69 Haw. ____, 751 P.2d 1022 (1988) (No. 12323).

[134] *See supra* note 18 for the pertinent text of Act 163. As noted, Act 163 contained a general repeal of the provisions of Act 53, as incorporated into the Revised Laws of 1911, necessarily including a repeal of the prohibition against lease or sale of Kapiolani Park lands.

[135] 17 U.S. (4 Wheat.) 518. *See supra* notes 49-55 and accompanying text.

[136] 69 Haw. at ____, 751 P.2d at 1027.

[137] *Id.* It was argued in *Dartmouth College* that the New Hampshire legislature had the power to alter the trust, especially since the states of New Hampshire and Vermont had added lands to the trust and, in addition, the changes were for the benefit of, and would result in the expansion of the trust. *Id.* In *Kapiolani Park*, the Republic had similarly donated lands to the park (*see supra* notes 7-10 and accompanying text), and it was also argued that the leasing of Kapiolani Park was for the benefit of the trust. Defendant-Appellee City's Answering Brief at 31, Kapiolani Park Preservation Soc'y v. City & County of Honolulu, 69 Haw. ____, 751 P.2d 1022 (1988) (No. 12323). Regardless of the method of acquisition of trust property and despite the beneficial nature of the changes in the trust, *Dartmouth College* and *Kapiolani Park* both held that the obligations of the contract creating the trust could not be impaired.

[138] 237 Mass. 613, 131 N.E. 31 (1921). *See supra* note 57 and accompanying text.

[139] The Preservation Society cited, among other cases: Opinion of the Justices to the Senate, 369 Mass. 979, 338 N.E.2d 806 (1975); Salem v. Attorney General, 344 Mass. 626, 183 N.E.2d 859 (1962); and City of Reno v. Goldwater, 92 Nev. 698, 558 P.2d 532 (1976). Appellant's Opening Brief at 19-21, Kapiolani Park Preservation Soc'y v. City & County of Honolulu, 69 Haw. ____, 751 P.2d 1022 (1988) (No. 12323). These cases concerned lands held under charitable trusts for public park purposes. While upholding the principle that the terms of trust instruments were constitutionally protected under the contract clause, these cases pertain to the trustee's use of trust property for impermissible park purposes such as erection of school buildings and an ice skating rink. *See supra* notes 58-63 and accompanying text.

the benefit of a restaurant as an appropriate and needed improvement to Kapiolani Park against the harm of a restaurant as an impermissible private profit-making venture. Instead, the court wanted to firmly uphold the intent of the donors, as expressed in the terms of the trust, and establish that commercial ventures such as the proposed restaurant will not be allowed in Kapiolani Park.

The Hawaii Supreme Court also held that granting the trustee power to alienate Kapiolani Park lands would violate the basic principles of equity.[140] In 1896, the Association, Irwin, and the Republic agreed to enter into conveyances and create a trust subject to certain restrictions, including a prohibition against leasing. Removing the restrictions to which the government expressly agreed [141] would be tantamount to defrauding the donors.[142]

In order to avoid holding Act 163 unconstitutional, unconscionable, or invalid,[143] however, the Hawaii Supreme Court found that the legislature's only intent in passing Act 163 was to transfer the management of the trust from the Commission to the City, as trustee, to be held in conformance with the terms of the trust.[144] Since the Commission agreed to the transfer of the trust property and trusteeship, there was no impairment of the trust terms.[145] The court found that the legislature did not intend to confer upon the City, as trustee, the authority to lease or deed away Kapiolani Park lands, powers that were expressly forbidden in the trust instruments.[146] Such a construction of Act 163 would have violated the contract clause of the United States Constitution[147] and

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[140] 69 Haw. at ____, 751 P.2d at 1027.

[141] Under Act 163, the present trustee *is* the government, the City and County of Honolulu. *See supra* note 18.

[142] 69 Haw. at ____, 751 P.2d at 1028.

[143] The Hawaii Supreme Court noted that legislative acts are not to be held unconstitutional, unconscionable, or invalid if such a construction can reasonably be avoided. *Id.* The court did not cite any cases, but this principle is embodied in the canon that statutes should be construed to avoid constitutional questions. United States v. Albertini, 472 U.S. 675 (1985); Heckler v. Mathews, 465 U.S. 728 (1984). The Hawaii Supreme Court is following the United States Supreme Court's lead in Aptheker v. Secretary of State, 378 U.S. 500 (1964), "[T]his Court will not consider the abstract question of whether Congress might have enacted a valid statute but instead must ask whether the statute that Congress did enact will permissibly bear a construction rendering it free from constitutional defects." *Id.* at 515.

[144] This is consistent with the legislative history of Act 163, *supra* note 15, and the preamble to Act 163, *supra* note 18.

[145] While it would seem that a transfer of all of the charitable trust property to another trustee is a breach of trust, many cases have approved such a transfer. TRUSTS AND TRUSTEES, *supra* note 43, § 393, n.89-90. In accordance with the courts' power to sanction deviation from trust terms, courts have authorized the transfer of charitable trust assets to a new trustee where necessary to preserve the trust. *Id.* § 394, n.29.

[146] 69 Haw. at ____, 751 P.2d at 1028.

[147] *See supra* notes 49-55 and text accompanying notes 134-37.

basic principles of equity.[148]

Had the Hawaii Supreme Court simply held Act 163 unconstitutional, it appears Act 53 alone would govern the Kapiolani Park trust. Such an interpretation would nullify the conveyance of Kapiolani Park from the Honolulu Park Commission to the Territory of Hawaii and the set aside order placing management and control of the park in the City. Kapiolani Park would then still be held in trust by the heirs and successors of the commissioners, pursuant to the provisions of Act 53.[149] The court correctly avoided this interpretation by finding that the legislature intended only to change the trustee, the Commission had agreed to such change, and, thus, Act 163 remained in force and there was no impairment of contract.[150]

The court could have queried whether the Commission had also consented to lifting the express prohibition against alienation. It is unlikely that such consent would be found, however, because nothing in the legislative history of Act 163 supports this inference.[151] Moreover, it is common to find such a restriction against alienation in charitable trusts.[152]

The Hawaii Supreme Court concluded that since the terms of the trust did not permit leasing of Kapiolani Park, section 171-11 of the Hawaii Revised Statutes[153] could not confer such power upon the City, as trustee.[154] After determining that the proposed concession agreement between the City and Pentagram was a lease,[155] the court held that the City would exceed its powers as trustee and breach the terms of the Kapiolani Park trust by leasing park lands under the proposed agreement.[156]

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[148] *See supra* notes 140-42 and accompanying text.

[149] Act 53, *supra* note 2.

[150] *See supra* note 143.

[151] *See supra* note 15 and the preamble to Act 163, *supra* note 18.

[152] *See supra* note 65 and accompanying text. Hawaii statutory law, however, contains the following provision disfavoring restraints on the alienation of land:

> Construction of wills and trusts instruments. Whenever any will or trust instrument contains any provision restraining the free alienation of land . . . and any such provision comes before the court for construction, all doubts shall be resolved against any such restraint or limitation, and doubts as to the existence of a power of sale or power to lease beyond the term of the trust shall be resolved in favor of the existence of such power.

HAW. REV. STAT. § 517-2 (1985).

[153] *See supra* note 30.

[154] 69 Haw. at ____, 751 P.2d at 1028.

[155] *See supra* note 5, ¶ 3.

[156] 69 Haw. at ____, 751 P.2d at 1029. The City filed a Motion for Reconsideration with the Hawaii Supreme Court asserting that the initial trustee, the Honolulu Park Commission, was a public corporation whose powers could be changed by the state legislature. The court denied this motion.

B. *Standing*

The second key issue addressed by the Hawaii Supreme Court was whether the Preservation Society had standing to bring suit.[157] The court held that the Preservation Society did have standing, but cited no authority for its holding.[158] Referring to the question of breach of a charitable trust, the court noted that:

> [o]rdinarily, such a question is raised when the trustee, or the attorney general acting in the capacity of parens patriae, files a petition seeking the instructions of the court or, in the cases where the trustees make periodic accounts of their stewardship to the court, such a question may be raised by a master appointed by the court to review the report.[159]

The Hawaii Supreme Court's justification for allowing suit was that the attorney general had abandoned its duty to act as the *parens patriae* by not bringing suit where the execution of a public charitable trust was being reasonably questioned.[160] Consequently, the beneficiaries of the trust, the members of the public, were without protection or remedy. The court held that in such circumstances "members of the public, as beneficiaries of the trust, have standing to bring the matter to the attention of the court."[161]

The Hawaii Supreme Court could have reached its holding in a number of different ways. First, it could have cited *Akau* since that case held that "a member of the public has standing to sue to enforce the rights of the public even though his injury is not different in kind from the public's generally . . . ."[162] *Akau* could have been applied to *Kapiolani Park* because in both cases the Hawaii Supreme Court considered the issue of standing in a public rights case regarding members of the public whose injury was not different from the public as a whole. In *Akau*, the plaintiffs sought to enjoin an owner of certain private property from blocking the public's access to two trails which traversed the owner's property.[163] The injury the plaintiffs suffered was loss of beach access. The defendant in *Akau* argued that the plaintiffs did not have standing since their injuries were not different from those of the general public. The court noted the broad trend in law away from the rule requiring plaintiffs

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[157] *See id.* at ____, 751 P.2d at 1024-25.

[158] *Id.* at ____, 751 P.2d at 1025.

[159] *Id.* at ____, 751 P.2d at 1024.

[160] *Id.* at ____, 751 P.2d at 1025. That there was a genuine controversy was evidenced by a 1969 letter opinion from the corporation counsel and a 1986 attorney general opinion, both questioning the propriety of a restaurant operating in Kapiolani Park on a term of years arrangement. *Id.*

[161] *Id.*

[162] 65 Haw. at 388, 652 P.2d at 1134. *See supra* notes 93-97 and accompanying text.

[163] 65 Haw. at 385, 652 P.2d at 1133.

to have a special injury, mentioning as examples the areas of administrative decisions, citing *Hawaiian Electric*,[164] and public trust property, citing *Paepcke*.[165] The court further noted its comfort with the trend away from a requirement of special injury, citing *Life of the Land v. Land Use Commission*.[166] The Hawaii Supreme Court, in *Kapiolani Park*, could have very neatly fit charitable trust standing into this set of cases by relying on *Akau*.

Akau set out a two part standing test, (1) the plaintiff must have suffered an injury in fact, and (2) the concerns of a multiplicity of suits must be satisfied,[167] that was not mentioned in *Kapiolani Park*. Because the "injury in fact" requirement was central to the *Akau* holding, some believe that its omission in *Kapiolani Park* suggests that the Hawaii Supreme Court has removed that requirement from its standing analysis in public rights cases. The omission can be interpreted to mean that members of the public can sue to enforce the rights of the public *whenever* such rights are being violated and the violation is not otherwise being redressed.[168]

A second valid authority the Hawaii Supreme Court could have used to bolster its standing analysis was *Hawaiian Electric*.[169] There, the court held that when the agent responsible for bringing a controversy before the court on behalf of the public fails to do so, other representatives of the public have standing to sue.[170] The facts in *Hawaiian Electric* are directly analogous to the facts in *Kapiolani Park*, except that in *Kapiolani Park* it was the office of the attorney general rather than the PUC that was charged with the responsibility of guarding the interests of the public. Thus, the *Kapiolani Park* court clearly should have addressed *Hawaiian Electric* in its standing analysis.

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[164] *Id.* at 387, 652 P.2d at 1133.

[165] *Id.* at 387, 652 P.2d at 1134.

[166] *Id.* at 388, 652 P.2d at 1134. *Life of the Land*, 63 Haw. 166, 623 P.2d 431, held that, because of valid aesthetic and environmental interests, an environmental organization had standing to bring a class action suit challenging reclassification of state lands since the interests of the organization and its members gave it a sufficient stake in the controversy.

[167] 65 Haw. at 388-89, 652 P.2d at 1134.

[168] Justice Nakamura's concurring opinion in *Kapiolani Park* restates the majority's holding on the issue of standing, and declares that he concurs with the majority "on this understanding of the scope of the opinion." 69 Haw. at ____, 751 P.2d at 1029. The fact that Justice Nakamura felt compelled to file the concurring opinion indicates an attempt to limit the scope of the majority's holding, further underscoring the contention that this case represents an expansion of the general public's right to sue where a public interest is involved.

The second part of the *Akau* test, addressing the multiplicity of suits problem, was satisfied in *Akau* because a class action suit was brought binding all interested parties. While the *Kapiolani Park* court did not address this factor either, such failure is not very significant due to the Hawaii Supreme Court's lesser emphasis of this prudential concern. *See supra* notes 93-97 and accompanying text.

[169] *See supra* notes 98-100 and accompanying text.

[170] 56 Haw. at 265, 535 P.2d at 1106.

Third, the Hawaii Supreme Court could have held that in *Kapiolani Park*, as in *City of Reno*,[171] the plaintiffs had standing to sue because they lived near the park and made use of it, and, therefore, had a special interest in the charitable trust. The court probably rejected the *City of Reno* approach because it wanted to provide an even broader standing analysis than *City of Reno* allowed.

Fourth, the Hawaii Supreme Court could have cited *Hiland* because the circumstances in *Hiland* were almost identical to those of *Kapiolani Park*.[172] In *Hiland*, the city held a park in trust pursuant to conveyances made by private parties at the turn of the century. When the city later proposed to convey part of the parklands, the attorney general did not bring suit. The *Hiland* court held that in such circumstances, members of the public had standing to sue. This case is directly in point, and it would have provided the Hawaii Supreme Court with support for its *Kapiolani Park* holding even though the decisions of a sister state are not binding in Hawaii. *Hiland*, however, imposed a limitation on the plaintiffs' right to sue not found in *Kapiolani Park*, i.e., a requirement that the plaintiffs have suffered an injury. *Kapiolani Park* made no reference to injury.

Indeed, the most intriguing part of the Hawaii Supreme Court's holding on the standing issue was its failure to examine whether the plaintiffs would have suffered an injury if the lease was allowed. The parties did not brief this issue since standing was not contested.[173] The court raised the standing issue *sua sponte*. Once the court raised the standing issue, it should have resolved it completely.

The issue of standing in trust suits is discussed in treatises and encyclopedias in terms of whether the plaintiff has the power to enforce the trust rather than whether the plaintiff has been injured.[174] This analysis likely results from the fact that the injury involved in a breach of trust is contractual, as noted in both *Dartmouth College*[175] and *Parsons v. Walker*,[176] and the injury resulting from not enforcing contracts is somewhat amorphous. Injury resulting from a breach of contract may not appear to be an injury to anyone other than the person to

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[171] *See supra* notes 117-19 and accompanying text.

[172] *See supra* notes 120-23 and accompanying text.

[173] The City did dispute the standing of the Preservation Society to bring a *counterclaim* asserting breach of trust regarding the City's leasing of park land to Royal Construction for storing equipment. But the City claimed only that standing did not attach because private individuals were not granted a claim pursuant to Hawaii Revised Statutes section 171-11, a point which the Hawaii Supreme Court did not find important enough to address.

[174] *See* 4 A. SCOTT, THE LAW ON TRUSTS § 391 (3d ed. 1967); TRUSTS AND TRUSTEES, *supra* note 43, ch. 21; 15 AM. JUR. 2D *Charities* § 143 (1976).

[175] 17 U.S. (4 Wheat.) at 627-28.

[176] 28 Ill. App. 3d at 525, 328 N.E.2d at 927 (Because of a possible contractual injury, plaintiffs were allowed standing to challenge plans to construct a reservoir on lands held in trust by a university).

whom the contractual duty is owed. Still, the contract should be enforced unless the duty owed would violate public policy. This reasoning is reinforced by the ability of persons to rule by the "dead hand," meaning that testators may attach conditions to wills or testamentary trusts which will be carried out despite the testator or settlor being dead and the beneficiary objecting to the condition.[177]

Thus, in *Parsons*, though the claim of a threatened injury due to possible flooding of a park held in trust by the University of Illinois (the flooding would occur if a proposed agreement between the University and the United States to build a reservoir were to materialize) was held to be not ripe, the plaintiffs were allowed standing since the proposed agreement threatened immediate injury in the form of alienation of the trust.[178] As alienation of the trust in *Kapiolani Park* was likewise threatened by the proposed lease of park land, the Hawaii Supreme Court's discussion of the breach of trust issue can be interpreted as judicial recognition of the existence of an injury.

Furthermore, the history of charitable trusts indicates that an injury is not necessarily required in these cases since charitable trusts formerly were brought simply on information of a genuine controversy, without a requirement that the informant have a legal interest in the trust. The existence of a genuine controversy guarantees the requisite adversity between the parties.

Also, it may be asserted that the decision of whether a breach of trust has occurred is made by the court in its capacity as supervisor of charitable trusts rather than as a decision between two claimants. This duty of the court might be considered administrative rather than discretionary, and thus, it might not require adverse parties. This is consistent with a "modern tendency . . . for courts . . . to enforce the duties of trustees even though not called upon by the beneficiaries to do so."[179]

The fact that the Hawaii Supreme Court raised the standing issue *sua sponte*[180] only to hold that the plaintiffs did indeed have standing is significant. The court's inclusion of a standing analysis of the plaintiff's main claim suggests either that the court felt it was important to pass judgment on the standing issue as to charitable trusts, or that it wanted to broaden the public's ability to bring suit to protect public rights.

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[177] *See, e.g.*, Shapira v. Union National Bank, 39 Ohio Misc. 28, 315 N.E.2d 825 (1974) (upholding a provision in a will which required a testator's son to marry a Jewish woman before he could qualify to take under his father's will).

[178] 28 Ill. App. 3d at 525-26, 328 N.E.2d at 926-27.

[179] A. SCOTT, *supra* note 174, § 200.4.

[180] *See supra* note 173.

V. IMPACT

The *Kapiolani Park* decision is important because there are many charitable trusts in Hawaii[181] and a dearth of local case law on the issues of breach of trust and standing.

By finding that the legislature only intended to transfer trusteeship and management of Kapiolani Park under Act 163, and that Act 163 did not remove the prohibition against alienation of park lands, the Hawaii Supreme Court avoided offending the legislature by declaring Act 163 unconstitutional and upheld the intent of the trust donors.[182] The Hawaii Supreme Court has previously stated that the goal of the court in construing a trust instrument is to ascertain and carry out the settlor's intent.[183] Changing trustees in light of unforeseen circumstances in order to more effectively manage and maintain Kapiolani Park is compatible with the donors' intent, while striking an express prohibition against leasing is not.

Hawaii courts have the power, notwithstanding trust terms prohibiting alienation of trust property, to authorize the trustee to sell, and impliedly lease, trust property when necessary to preserve the trust estate and accomplish the ultimate purpose of the settlor.[184] Case law suggests, however, that there must be changed conditions requiring the lease or sale of trust property in order to preserve the trust and carry out the intention of the settlor before such sale or lease can be made.[185] If exigent circumstances exist, therefore, the City could petition the appropriate court for authority to lease or sell part of Kapiolani Park.[186]

Since the City cannot lease Kapiolani Park lands, the park will likely remain free from large scale commercial ventures. In addition, the status of existing activities in Kapiolani Park, such as the golf driving range, snack bars, and the

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[181] Perhaps the most well known charitable trust in Hawaii is the Bernice P. Bishop Estate. *See also* ALU LIKE, INC., A GUIDE TO CHARITABLE TRUSTS AND FOUNDATIONS IN THE STATE OF HAWAII (1980).

[182] "One of the important functions of the court of equity is to assist in the enforcement and administration of trusts, and hence to make such orders and decrees as will secure the carrying out of the creators' expressed intent . . . ." TRUSTS AND TRUSTEES, *supra* note 43, § 561 at 226. Carrying out the donor's intent also accords with the justification for the court's power to allow deviation from trust terms. *See supra* notes 70-72 and accompanying text.

[183] *In re* Estate of Dowsett, 38 Haw. 407, 409 (1949) ("The aim of a court of equity, in construing a trust instrument is, and should be, to ascertain and carry out the settlor's intent.").

[184] *See supra* notes 68-69 and accompanying text.

[185] *See supra* note 68 and accompanying text.

[186] Recourse to the legislature, however, may not be proper in light of Midkiff v. Kobayashi, 54 Haw. 299, 507 P.2d 724 (1973), in which the Hawaii Supreme Court stated: "If a deviation from any trust provision is necessary in the interest of the trust, the power to authorize the deviation rests solely with the court." *Id.* at 336, 507 P.2d at 745. *But see supra* note 73 and accompanying text.

Kodak Hula Show, is open to question.[187]

The impact of the Hawaii Supreme Court's holding on the issue of standing stems from (1) its finding that members of the public have standing in charitable trust suits where the attorney general refuses to inform the court of a controversy, and (2) the absence of an examination of whether the plaintiff had an interest in the trust that was aggrieved by the trust's alleged breach, i.e., whether there was an injury in fact. The decision establishes the standing analysis applicable to charitable trust cases in Hawaii. Because the Hawaii Supreme Court's holding takes Hawaii beyond the majority position set out by the Restatement of Trusts in section 391,[188] the result of the court's holding is an easing of the public's ability to bring suit in controversies regarding public or charitable trusts.

The assertion that the absence of an injury in fact examination by the Hawaii Supreme Court indicates that it has dropped this as a requirement in all public rights cases is unwarranted. Such a holding would significantly alter standing analysis, and so the court would likely have explicitly set forth the change if that was its intention.[189] Since the express language of the decision restricts the holding to charitable trusts — the majority opinion carefully laid out the specific facts of the case before noting that standing was granted under these circumstances — Justice Nakamura's concurrence emphasizing this point seems overly cautious.

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[187] In addition, section 1 of Act 53 provides that Kapiolani Park be maintained as a "*free* public park." Act 53, *supra* note 2, at 164 (emphasis added). Section 1 of Act 163, however, deletes the word "free" and provides that the Territory of Hawaii hold and maintain Kapiolani Park as a "public park and recreation ground." Act 163, *supra* note 2, at 289. As the language of Act 53 is apparently still applicable, the propriety of existing activities in the park that charge fees may be questioned. Section 6 of Act 53 provides, however, that although the trustee may not "compel the payment of an entrance fee as a condition to the admission of any one to the grounds . . . the [trustee] may authorize the proprietors or managers of any special entertainment or exhibition which may be permitted within the Park limits, to charge and collect fees for admission to such entertainment or exhibition." Act 53, *supra* note 2, at 165-66.

[188] *See supra* note 106 and accompanying text.

[189] After the completion of this article, a case was decided by the Hawaii Supreme Court which confirmed this analysis. In Hawaii's Thousand Friends v. Anderson, No. 86-1810, slip op. (1989), a non-profit organization sued the mayor of Honolulu and several others alleging that, in the course of advertising and promoting a proposed housing project, the defendants had (1) fraudulently used public funds by advertising the project in order to promote the political candidacy of one of the defendants, (2) made misrepresentations in the advertisements, and (3) violated public bidding requirements. *Id.* at 3-4. The Hawaii Supreme Court held that, despite liberalized standing requirements, Hawaii's Thousand Friends (HTF) lacked standing because it failed to demonstrate that it had suffered an injury. *Id.* at 8-12. The court cited *Akau* as imposing the injury requirement. *Id.* at 8. Responding to HTF's claim to standing as a "private attorney general," the court stated that "[e]conomic injury gives standing and not the 'public interest' as HTF argues." *Id.* at 12.

On its face, *Kapiolani Park* does not represent any substantive change in Hawaii standing law. The Hawaii Supreme Court simply applied the standing analysis of previous Hawaii cases to the area of charitable trusts. Although it did not cite supporting cases, the Hawaii Supreme Court's holding was consistent with Hawaii case law on standing in the areas of private nuisance and administrative decisions, taking into account the unique nature of the law of charitable trusts.

VI. CONCLUSION

Kapiolani Park indicates that in Hawaii, the intentions of charitable trust donors, and other trust settlors, as expressed in the terms of the trust at the inception of the trust, are paramount and will be strictly enforced and protected from alteration by the legislature.

The prohibition against leasing of Kapiolani Park lands, contained in the trust instruments and agreed to by the donors at the inception of the trust, is still in effect. This holding will effectively preclude large scale commercial ventures in Kapiolani Park. Whether this decision will affect existing activities in the park is unknown.

The Hawaii Supreme Court's failure to include the issue of injury in fact in its standing analysis does not indicate that the court has dropped that requirement in all public rights cases. The decision does, however, establish Hawaii standing requirements for the public in cases of charitable trusts as one of the least restrictive in the country. The public has standing to enforce a charitable trust if the attorney general has neglected his *parens patriae* duty to bring a controversy regarding such a trust to the attention of the appropriate court and the public is not otherwise able to protect its interests.

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Knodle v. Waikiki Gateway Hotel, Inc.: Imposing a Duty to Protect Against Third Party Criminal Conduct on the Premises

I. INTRODUCTION

In *Knodle v. Waikiki Gateway Hotel, Inc.*,[1] the Hawaii Supreme Court, for the first time, imposed a duty on a hotel to protect its guests from the criminal conduct of unknown third persons.[2] In determining whether such a duty existed, the court focused exclusively on the relationship between the defendant hotel and the victim guest. The court concluded that this relationship was a "special relationship" between innkeeper and guest, recognized under the common law as one that imposed a duty on an innkeeper to protect its guests from third party criminal acts.[3]

Although Hawaii courts had previously acknowledged that special relationships may, under certain circumstances, impose a duty of care against third party criminal acts, they had been reluctant to impose such a duty on owners and occupiers of land. *Knodle* represents the first time the Hawaii Supreme Court has actually found the existence of a special relationship and the corresponding duty thereby expanding premises liability in Hawaii.

This note discusses the "special relationship" doctrine in general, and how the Hawaii Supreme Court applied it in the *Knodle* case. Section III outlines the rationale and historical basis of the doctrine. Section IV discusses and analyzes the Hawaii Supreme Court's rationale for finding the existence of a special innkeeper-guest relationship in *Knodle*, and the court's imposition of a duty on the hotel to protect its guests from the criminal acts of unknown third parties. Section V considers the implications of the *Knodle* decision and forecasts the likely effect *Knodle* will have on premises liability in Hawaii.

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[1] 69 Haw. ____, 742 P.2d 377 (1987).

[2] *Id.* at ____, ____, 742 P.2d at 384, 388.

[3] *Id.*

II. FACTS

The decedent, Linda Knodle, a Continental Airlines flight attendant, was en route to Chicago from Guam on an off-duty flight pass.[4] She stopped over in Honolulu at the Waikiki Gateway Hotel, which accommodated Continental flight crews while on "layovers."[5] Arriving at the hotel at about 5:00 a.m., she started to fill out a guest registration card at the front desk, but upon learning that there was space for her in one of the rooms already occupied by other flight attendants, she obtained a key to their room from the manager who knew her.[6] The manager tore up the registration card.[7] In the meantime, a stranger, George Murphy, entered the lobby and went into the elevator where Knodle had placed her luggage.[8] The manager called for Murphy to hold the elevator for her, and Murphy held the door open while Knodle boarded the elevator with her remaining luggage.[9] At about 6:30 a.m., Knodle's luggage was reported as being in the elevator, but the management decided not to disturb her.[10] At 7:00 a.m., a key to the tenth floor room, where Knodle was to stay, was found on the fourth floor. [11] Shortly after 9:00 a.m., Knodle's body was discovered in a fourth floor restroom.[12] She had been strangled to death by Murphy between the hours of 5:15 and 9:00 a.m.[13]

The plaintiff, Knodle's father, alleged that the defendants, the Waikiki Gateway Hotel, Inc., and the owners and operators of the hotel,[14] were negligent, acting with "wanton and reckless disregard" for the decedent's safety, and that they failed to provide "safe accommodations" and "adequate security" to protect her "from the unreasonable risk of physical harm."[15] The jury was instructed that they must find a duty, a breach of that duty and proximate causation in order to find the defendants negligent.[16] The jury found that the

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[4] *Id.* at ____, 742 P.2d at 381.

[5] *Id.*

[6] *Id.*

[7] *Id.*

[8] *Id.*

[9] *Id.*

[10] *Id.* at ____, 742 P.2d at 381-82.

[11] *Id.* at ____, 742 P.2d at 382.

[12] *Id.*

[13] *Id.*

[14] The plaintiff filed suit against Murphy, the Waikiki Gateway Hotel, Inc., Continental Airlines, and the owners and operators of the hotel: Waikiki Gateway Hotel Associates, Hyatt Corporation, Continental-Kalakaua Hotel Corp., and Northridge Industries, Inc. *Id.* at ____, 742 P.2d at 380. Default was entered against Murphy and summary judgment was granted to Continental Airlines. *Id.*

[15] *Id.* at ____, 742 P.2d at 383.

[16] *Id.* at ____, 742 P.2d at 387. The jury was also instructed on independent acts and superseding cause, and was informed that "[a]n act is reasonably foreseeable if it appears to have been

defendants had a duty to take reasonable measures to protect the decedent from foreseeable third party criminal acts, but that they had not breached that duty.[17] Subsequently, the plaintiff appealed to the Hawaii Supreme Court.[18]

III. HISTORY

A. *Premises Liability in General: The Common Law Status Distinctions*

At common law, the duty of care owed by a possessor of land to a person entering the premises varied, depending upon the legal status of the visitor.[19] In determining whether a duty of care existed, courts focused on the injured party's "status" in relation to the owner or occupier of land, rather than on the factors directly contributing to the injury. The standard of care required of the owner or occupier of land depended upon whether the person using the premises was characterized as a trespasser, licensee, or invitee.

English common law, with its traditional regard for the rights of private ownership of property, left no legal redress to trespassers[20] injured by the act or omission of a landowner.[21] The majority of jurisdictions in the United States modified the English common law to impose on the possessor of land a slight duty of care towards a trespasser. That duty now involves no more than that the possessor of land refrain from willful, wanton, or reckless disregard for the trespasser's safety.[22] Courts reasoned that those who entered the land without the possessor's consent have no right to demand protection from the landowner.[23]

Licensees[24], as mere "social guests," can only expect the landowner to use

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ordinary or usual under all circumstances then existing." *Id.*

[17] *Id.* at ____, 742 P.2d at 382. The Hawaii Supreme Court found that the trial court did not err by not admitting "evidence of all reported criminal activity at or near the hotel." *Id.* at ____, 742 P.2d at 381.

[18] *Id.* at ____, 742 P.2d at 381.

[19] W. KEETON, D. DOBBS, R. KEETON & D. OWEN, PROSSER & KEETON ON TORTS § 62, at 432 (5th ed. 1984) [hereinafter PROSSER & KEETON ON TORTS].

[20] A "trespasser" is defined as "a person who enters or remains upon the land in the possession of another without a privilege to do so created by the possessor's consent or otherwise." RESTATEMENT (SECOND) OF TORTS § 329, at 171 (1965).

[21] F. BOHLEN, STUDIES IN THE LAW OF TORTS 162-64 (1926); 5 F. HARPER, F. JAMES, & O. GRAY, THE LAW OF TORTS 131-32 (1986); Appalachian Power Co. v. LaForce, 214 Va. 438, 201 S.E.2d 768 (1974).

[22] J. PAGE, THE LAW OF PREMISES LIABILITY § 2.3, at 9 (2d ed. 1988).

[23] PROSSER & KEETON ON TORTS, *supra* note 19, § 58, at 393-94.

[24] A "licensee" is defined as "a person who is privileged to enter or remain on land only by virtue of the possessor's consent." RESTATEMENT (SECOND) OF TORTS § 330, at 172 (1965); *see also id.* § 342, at 210; *id.* § 342 comments (b)-(d), at 210-11. Licensees are those who enter "by permission, but for purposes of [their] own, rather than for business purposes or purposes for which the premises are held open to the public." J. PAGE, *supra* note 22, § 3.2, at 34-35.

ordinary care in warning about possible dangers not evident to a reasonable person of ordinary intelligence. Originally, a landowner owed no greater duty to a licensee than that which was owed to a mere trespasser. Licensees were viewed as having received use of the premises as a gift, and therefore, to have assumed the risk of whatever they encountered on the land.[25] Today, the rule in a large number of jurisdictions requires the possessor to warn a licensee of any unreasonably dangerous hidden conditions known to the possessor but unknown to the licensee, or to "exercise reasonable care not to injure a known licensee, or one who is reasonably to be anticipated, by active conduct."[26]

At common law, invitees,[27] or "business visitors,"[28] are entitled to a higher degree of care than that afforded either licensees or trespassers. Because the landowner derives some real or imagined economic benefit from the invitee's entry upon the land,[29] the invitee is given "an implied representation, assurance, or understanding that reasonable care has been used to prepare the premises, and make them safe for [the invitee's] reception."[30] Therefore, the possessor of land has an affirmative duty to exercise due care to make the premises reasonably safe for the invitee.[31] This duty obligates the landowner to use reasonable care to seek out and discover hidden dangers that create an unreasonable risk of harm to the invitee.[32]

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[25] PROSSER & KEETON ON TORTS, *supra* note 19, § 60, at 412.

[26] J. PAGE, *supra* note 22, § 3.7, at 41.

[27] A "public invitee" is defined as one "who is invited to enter or remain on land as a member of the public for a purpose for which the land is held open to the public." RESTATEMENT (SECOND) OF TORTS § 332(2), at 176 (1965).

[28] The Restatement (Second) of Torts defines a "business visitor" as one "who is invited to enter or remain on land for a purpose directly or indirectly connected with business dealings with the possessor of the land." *Id.* § 332(3), at 176.

[29] J. PAGE, *supra* note 22, § 4.2, at 66.

[30] RESTATEMENT (SECOND) OF TORTS § 332, comment (a), at 176 (1965); James, *Tort Liability of Occupiers of Land: Duties Owed to Licensees and Invitees*, 63 YALE L.J. 605, 612-13 (1954).

[31] RESTATEMENT (SECOND) OF TORTS § 343, comments (b), (d), at 216-17 (1965).

[32] The duty owed to an invitee is greater than the duty owed to a licensee in several respects. First, the possessor must exercise reasonable care to discover unreasonably dangerous conditions on the premises and take appropriate action to protect the invitee. RESTATEMENT (SECOND) OF TORTS § 343, at 215-16 (1965). Second, even if the invitee knows of a danger, the possessor may still be held to further protect the invitee, if the possessor anticipated or should have anticipated that the invitee might suffer harm regardless of the invitee's knowledge of the danger. *Id.* § 343A, at 218. Third, the possessor must carry on activities with reasonable care to avoid injuring an invitee on the premises, and even a warning sign may not suffice if the possessor does or should anticipate that the invitee will not protect himself or herself. *Id.* § 341A, at 209. Finally, since the invitee has entered the land in response to an invitation, the possessor's duty to exercise reasonable care will generally require the possessor to anticipate the invitee's presence to a much greater degree than a licensee or trespasser. J. PAGE, *supra* note 22, § 4.5, at 76.

B. *Status Categories No Longer Determinative in Situations Not Involving Third Party Criminal Acts*

The formal common law rules limiting the duty owed by owners and occupiers of land has been criticized for being harsh, mechanical, "unduly complex, and overly protective of property interests at the expense of human safety."[33] Increasing dissatisfaction with the "no duty" or "limited duty" rule associated with the common law status categories forced many courts to carve out exceptions to the common law rules.[34]

In 1957, the British Parliament, by statute[35], abolished the distinction between licensees and invitees as a basis for determining a landowner's duty of care to visitors and imposed upon the occupier a "common duty of care" toward all persons who lawfully enter the premises. In 1958, the United States Supreme Court, following the English lead, refused to apply the traditional licensee-invitee distinctions to admiralty law. The Court imposed upon a shipowner whose vessel was in navigable waters a duty to use due care under the circumstances for the benefit of all those on board.[36]

Nearly a decade later, the distinctions between trespassers, licensees and invitees were abolished by the Supreme Court of California in the seminal case of *Rowland v. Christian*.[37] The *Rowland* court refused to take the traditional approach of relying on the legal status of a visitor to determine the duty owed by a landowner to that visitor, and instead held that a duty of reasonable care is owed by the possessor of land to all entrants upon the premises, regardless of their status.[38] The *Rowland* court found that the reasons that had once supported the traditional approach were no longer valid. The court concluded that in determining whether or not the owner or occupier of land has a duty of care, "the plaintiff's status as a trespasser, licensee, or invitee may . . . have some bearing on the question of liability, [but] the status is not determinative."[39]

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[33] PROSSER & KEETON ON TORTS, *supra* note 19, § 62, at 432.

[34] J. PAGE, *supra* note 22, § 6.1, at 130.

[35] Occupiers' Liability Act, 1957, 5 & 6 Eliz. 2, ch. 31.

[36] Kermarec v. Compagnie Generale Transatlantique, 358 U.S. 625 (1959).

[37] 69 Cal. 2d 108, 443 P.2d 561, 70 Cal. Rptr. 97 (1968). In this case, the plaintiff, a social guest, injured his hand on a cracked faucet handle in his host's bathroom. There was evidence that the defendant had known for two weeks that the handle was cracked, but she did not inform the plaintiff of its condition. *Id.* at 110-11, 443 P.2d at 563, 70 Cal. Rptr. at 99.

[38] *Id.* at 119, 443 P.2d at 568, 70 Cal. Rptr. at 104.

[39] *Id.* The *Rowland* court reasoned:

> A man's life or limb does not become less worthy of protection by the law nor a loss less worthy of compensation under the law because he has come upon the land of another without permission or with permission but without a business purpose. Reasonable people do not ordinarily vary their conduct depending upon such matters, and to focus on the status of the injured party as a trespasser, licensee, or invitee in order to determine the

In 1969, the Hawaii Supreme Court adopted the *Rowland* approach and effectively eliminated all common law status distinctions between trespassers, licensees, and invitees. The court, in *Pickard v. City & County of Honolulu*,[40] articulated the rationale of *Rowland*:

> We believe that the common law distinctions between classes of persons have no logical relationship to the exercise of reasonable care for the safety of others. We therefore hold that an occupier of land has a duty to use reasonable care for the

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question whether the landowner has a duty of care, is contrary to our modern social mores and humanitarian values. The common law rules obscure rather than illuminate the proper considerations which should govern determination of the question of duty.

Id.

Other jurisdictions have followed *Rowland* in its entirety, by abolishing all three categories of entrants upon land: Pickard v. City & County of Honolulu, 51 Haw. 134, 452 P.2d 445 (1969); Smith v. Arbaugh's Restaurant, Inc., 469 F.2d 97 (D.C. Cir. 1972); Webb v. City & Borough of Sitka, 561 P.2d 731 (Alaska 1977); Basso v. Miller, 40 N.Y.2d 233, 352 N.E.2d 868, 386 N.Y.S.2d 564 (1976); Mariorenzi v. Joseph Diponte, Inc., 114 R.I. 294, 333 A.2d 127 (1975); Ouellette v. Blanchard, 116 N.H. 552, 364 A.2d 631 (1976); Cates v. Beauregard Elec. Coop., 328 So. 2d 367 (La. 1976).

Several states have abolished the distinctions between licensees and invitees: Antoniewicz v. Reszcynski, 70 Wis. 2d 836, 236 N.W.2d 1 (1975); Hudson v. Gaitan, 675 S.W.2d 699 (Tenn. 1984); O'Leary v. Coenen, 251 N.W.2d 746 (N.D. 1977); Peterson v. Balanch, 294 Minn. 161, 199 N.W.2d 639 (1972); Pulin v. Colby College, 402 A.2d 846 (Me. 1979); ILL. ANN. STAT. ch. 80, § 301 (Smith-Hurd Supp. 1986).

A few states have treated social guests and invitees equally: CONN. GEN. STAT. ANN. § 52-557(a) (West Supp. 1984); Wood v. Camp, 284 So. 2d 691 (Fla. 1973); Preston v. Sleziak, 16 Mich. App. 18, 167 N.W.2d 477 (1969).

While the 1970's reflected a movement away from the traditional status distinctions, the 1980's, however, have shown a shift back toward recognizing the categories. The Colorado legislature reinstated the common law categories in 1986. COLO. REV. STAT. § 13-21-115 (Cu. Supp. 1986). Massachusetts has applied a duty of due care under the circumstances for all entrants except adult trespassers, but more recently seems to have fallen away from this straight negligence approach. Since 1982, no jurisdiction has followed *Rowland* outright. A vast number of decisions have continued to apply the common law categories: Adams v. Fred's Dollar Store, 497 So. 2d 1097 (Miss. 1986); Britt v. Allen County Community Jr. College, 230 Kan. 502, 638 P.2d 914 (1982); Huyck v. Hecla Mining Co., 101 Idaho 299, 612 P.2d 142 (1980); Murphy v. Baltimore Gas & Elec. Co., 290 Md. 186, 428 A.2d 459 (1981); Nixon v. Mr. Property Management, 690 S.W.2d 546 (Tex. 1985); Yalowizer v. Husky Oil Co., 629 P.2d 465 (Wyo. 1981); Younce v. Ferguson, 106 Wash. 2d 658, 724 P.2d 991 (1986). PROSSER & KEETON ON TORTS, *supra* note 19, § 62, at 433 nn.5-7 (Supp. 1988); J. PAGE, *supra* note 22, § 6.4, at 133-34, § 6.8, at 140.

[40] 51 Haw. 134, 452 P.2d 445 (1969). The plaintiff in this case suffered injuries in a restroom that he had obtained permission to use. He unexpectedly fell through a hole in the floor and sought compensation from the defendant, for failure to use ordinary care in keeping the premises safe and failure to provide adequate warning of the hazard in the unlit restroom. The defendant contended that he owed no duty to the plaintiff, since the latter was a mere licensee. *Id.* at 134, 452 P.2d at 445.

safety of all persons reasonably anticipated to be upon the premises, regardless of the legal status of the individual.[41]

Subsequent Hawaii cases have continued to disregard the status of the injured party and have held that an occupier of land has a duty to use reasonable care for the safety of all persons reasonably anticipated to be on the premises. In *Farrior v. Payton*,[42] the plaintiffs, alleged trespassers on the defendants' property, sustained injuries in their attempt to escape the defendants' guard dog.[43] The Hawaii Supreme Court, applying the rationale of *Pickard*, reversed the trial court's grant of a directed verdict for the defendants.[44]

The legal status of the injured party has also been ignored in a hotel-guest context. In *Bidar v. Amfac, Inc.*,[45] a hotel guest was injured while using a bathroom towel rack to pull herself up from a sitting position.[46] The towel rack tore loose from the wall, causing her to fall.[47] The Hawaii Supreme Court, following *Pickard*, held that the hotel had a duty to exercise "reasonable care for the safety of all persons reasonably anticipated to be upon the premises."[48]

Generally, Hawaii courts have abolished the common law status distinctions in determining the duty or standard of care required of owners and occupiers of land to persons injured on the premises. However, in situations where the injury is caused by a third party criminal act, the status of the injured party remains a crucial factor in deciding whether or not a duty is owed to the injured party.[49]

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[41] *Id.* at 135, 452 P.2d at 446.

[42] 57 Haw. 620, 562 P.2d 779 (1977).

[43] *Id.* at 624-26, 562 P.2d at 783-84.

[44] *Id.* at 629, 638, 562 P.2d at 786, 790.

[45] 66 Haw. 547, 669 P.2d 154 (1983).

[46] *Id.* at 549, 669 P.2d at 157.

[47] *Id.*

[48] *Id.* at 552, 669 P.2d at 159 (quoting Pickard v. City & County of Honolulu, 51 Haw. at 135, 452 P.2d at 446).

[49] The California case of Totten v. More Oakland Residential Hous., Inc., 63 Cal. App. 3d 538, 134 Cal. Rptr. 29 (1977) explained how the status distinctions, which have been rejected in situations where a plaintiff's injuries are *not* caused by a third person, cannot be ignored when third party criminal acts do cause the injuries. In *Totten*, the plaintiff was injured while visiting a friend at his apartment. The California Court of Appeal held that the corporate owner of the apartment complex had no duty to protect the plaintiff from the criminal attack of two strangers in a laundry room on the premises. *Id.* at 541, 544, 134 Cal. Rptr. at 32, 33. While the plaintiff was in the laundry room, a fight erupted outside between the two strangers. One of them chased the other into the laundry room, firing a pistol, and hitting the plaintiff with a stray bullet. *Id.* at 540, 134 Cal. Rptr. at 32. The court considered the plaintiff a mere licensee, and not a business visitor or a public invitee. Although the plaintiff argued that the differences between the status categories had been abolished in California, the court applied the special relationship doctrine, and nevertheless found for the defendant. The court articulated this rationale:

> It is conceded that in *Rowland* the Supreme Court held that the proper test to be applied to the liability of the possessor of land is whether in the management of his

In those situations, Hawaii courts have relied on the common law "special relationship" doctrine.

C. Premises Liability for Third Party Criminal Acts: The Special Relationship Doctrine

Generally, at common law, there is no duty to protect another against the wrongful acts of a third party. Such a legal obligation may arise, when there exists a "special relationship" between either the defendant and the third party who causes the injury or the defendant and the person entitled to protection.[50] The common law recognizes as "special" certain relationships that are protective by nature, such as the relationships between landowner and invitee,[51] innkeeper and guest, common carrier and passenger, and custodian and ward.[52] This

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property he has acted as a reasonable man in view of the probability of injury to others. But while pointing out that the common law classifications are no longer determinative as to the liability of the possessor of land, the court clearly indicated that "the plaintiff's status as a trespasser, licensee, or invitee may in the light of the facts giving rise to such status have some bearing on the question of liability . . . ." Furthermore, it must be remembered that the court in *Rowland* was dealing with an injury allegedly caused by a defective condition of the defendant's property which the defendant had a duty to maintain and repair. The rules relating to the physical condition of the premises are not applicable to the situation where, as here, it is the conduct of third persons which directly causes the injury . . . .

Id. at 543, 134 Cal. Rptr. at 34 (citations omitted).

[50] As the Restatement articulates:

There is no duty so to control the conduct of a third person as to prevent him from causing physical harm to another unless (a) a special relation exists between the actor and the third person which imposes a duty upon the actor to control the third person's conduct, or (b) a special relation exists between the actor and the other which gives to the other a right to protection.

RESTATEMENT (SECOND) OF TORTS § 315, at 122 (1965).

[51] Traditionally, a landowner's duty to protect against third party criminal acts is limited to those classified as invitees, and does not include either licensees or trespassers. *Totten*, 63 Cal. App. 3d at 543, 134 Cal. Rptr. at 33.

[52] The Restatement view is as follows:

(1) A common carrier is under a duty to its passengers to take reasonable action (a) to protect them against unreasonable risk of physical harm, and (b) to give them first aid after it knows or has reason to know that they are ill or injured, and to care for them until they can be cared for by others. (2) An innkeeper is under a similar duty to his guests. (3) A possessor of land who holds it open to the public is under a similar duty to members of the public who enter in response to his invitation. (4) One who is required by law to take or who voluntarily takes the custody of another under circumstances such as to deprive the other of his normal opportunities for protection is under a similar duty to the other.

RESTATEMENT (SECOND) OF TORTS § 314A, at 118 (1965). These classifications are not necessarily exclusive. *See id.* "Caveat," at 119.

"special relationship" imposes a duty of care, which would otherwise be nonexistent, on the landowner, innkeeper, common carrier and custodian, to protect others from unreasonable risks of harm.[53] This duty extends to third party acts that are "innocent, negligent, intentional, or even criminal."[54]

Hawaii first recognized the special relationship doctrine in *Seibel v. City & County of Honolulu*.[55] In *Seibel*, a sex offender, while on conditional release from his criminal trial, murdered the plaintiff's decedent. The Hawaii Supreme Court held that because the offender was not under the control or custody of the City, no special relationship existed between the City and the offender; therefore, the City was under no duty to control his behavior.[56]

More recently, the Hawaii Supreme Court has refused to use the special relationship doctrine to impose a duty on the State as landowner. In *Wolsk v. State*,[57] the Hawaii Supreme Court refused to hold the state of Hawaii liable for injuries suffered by two state park campers who were criminally attacked by unknown third parties.[58] Although the State retained exclusive control of the park, the court concluded that "where the third persons who harmed [the plaintiffs] were unknown and were never alleged to be under [the] State's control, no special relationship duty existed . . . ."[59] The court, however, did not directly discuss the relationship between the State, "a possessor of land who holds it open to the public," and the victims, "members of the public who enter in response to his invitation," which is a relationship defined in the Restatement (Second) as a "special" one.[60] The *Wolsk* court did emphasize, however, that simply because the state park "*may* have had a tendency to attract dangerous persons [was] no reason to impose a duty on [the] State to warn or protect park users from those dangerous persons."[61]

Following the Hawaii Supreme Court's decision in *Wolsk*, the Hawaii Intermediate Court of Appeals (ICA), in *Kau v. City & County of Honolulu*,[62] re-

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[53] *Id.* § 314A(1)(a), at 118.

[54] *Id.* comment (d), at 119. The Restatement continues to state, however, that "[t]he duty in each case is only one to exercise reasonable care under the circumstances . . . . He is not required to take precautions against a sudden attack from a third person which he has no reason to anticipate . . . ." *Id.* comment (e), at 120.

[55] 61 Haw. 253, 602 P.2d 532 (1979).

[56] *Id.* at 257-61, 602 P.2d at 536-38.

[57] 68 Haw. ____, 711 P.2d 1300 (1986).

[58] *Id.* at ____, 711 P.2d at 1301, 1303.

[59] *Id.* at ____, 711 P.2d at 1303. *See supra* note 50 and accompanying text.

[60] *See supra* note 52 and accompanying text. *See also* Note, Wolsk v. State: *A Limitation of Governmental Premises Liability*, 9 U. HAW. L. REV. 306, 312 n.85 (1987) [hereinafter Note, *Governmental Premises Liability*].

[61] 68 Haw. at ____, 711 P.2d at 1303 (emphasis in original). Note, *Governmental Premises Liability*, *supra* note 60, at 312-13.

[62] 6 Haw. App. ____, 722 P.2d 1043 (1986).

fused to impose a special relationship duty on the City.[63] In finding that the City owed no duty of care to golfers injured and robbed while on the premises of a municipal golf course, the ICA, citing *Wolsk*, focused on the lack of control the City had over the third parties responsible for the criminal acts.[64] As in *Wolsk*, the court failed to address the relationship between the defendants and the injured parties, and concluded that "the City . . . [was] not liable for dangerous conditions not under its control."[65]

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[63] *Id.* at ____, 722 P.2d at 1047.

[64] *Id.* at ____, 722 P.2d at 1046-47.

[65] *Id.* at ____, 722 P.2d at 1047. Judge Burns, concurring in *Kau*, disagreed with the majority that there was no special relationship. In Burns' view, a special relationship existed between the City and the plaintiffs, for "[i]n Hawaii, the relation between a possessor of land and all persons reasonably anticipated to be on the premises is a special relation." *Id.* However, Burns agreed with the majority that no duty should be imposed on the defendants. Burns based his conclusion on the aspect of foreseeability of unreasonable risks of harm. According to Burns, four elements help to determine the existence of a duty:

1. Is defendant a possessor of the premises upon which the plaintiff was injured?
2. Is plaintiff a person reasonably anticipated to be on the premises?
3. Did defendant foresee or anticipate or should defendant have foreseen or anticipated in ample time to avert injury that there was an *unreasonable risk* of that kind of physical harm to the victim?
4. Is it in the public interest to impose a duty?

Id. (emphasis in original). In Burns' view, no duty arose in *Kau* or in *Wolsk* by reason of the third element above. Burns did not consider the criminal acts in either cases as being "unreasonable risks" of harm. *Id.* at ____, 722 P.2d at 1047-48.

Other courts hold a similar view of duty. "Notwithstanding the existence of a special relationship, the duty of a landowner to take affirmative action to control the wrongful acts of third persons arises only where he 'has reasonable cause to anticipate such acts and the probability of injury resulting therefrom and fails to take affirmative steps to control wrongful conduct.' " Morrison v. MGM Grand Hotel, 570 F. Supp. 1449, 1451 (D. Nev. 1983) (quoting Totten v. More Oakland Residential Hous., Inc., 63 Cal. App. 3d 538, 543, 134 Cal. Rptr. 29, 33 (1977)). *See supra* note 49. The *Totten* court held that the plaintiff failed to allege sufficient facts to indicate that the defendant could have anticipated or foreseen the criminal act in question. *Id.*

Looking to the *Rowland* decision, the *Totten* court articulated:

> The *Rowland* court instructs us that in determining whether the possessor land owes a duty to the injured victims we must balance a number of considerations. Among these are: the foreseeability of harm to the plaintiff; the closeness of the connection between the defendant's conduct and the injury suffered; the moral blame attached to the defendant's conduct and the injury suffered; the extent of the burden to the defendant and the consequences to the community of imposing a duty with resulting liability for breach; and the availability, cost, and prevalence of insurance for the risk involved. It has also been said that the *imposition of duty is ultimately a question of fairness* and the inquiry involves a weighing of the relationship of the parties, the nature of the risk, and the public interest in the proposed solution.

Id. at 545, 134 Cal. Rptr. at 34 (emphasis in original) (citations omitted). *See supra* notes 37-39 and accompanying text.

D. *The Innkeeper-Guest Special Relationship*

It is well-established under the common law that there is a special legal relationship between innkeepers and registered guests. Innkeepers have been held to operate under a rigorous liability standard, "approaching that of an insurer against all dangers save acts of God,"[66] which has underpinnings in feudal times.[67] Although the virtual strict liability of ancient times has not survived in this century, the common law continues to impose a duty on innkeepers to protect their guests against third party criminal acts.[68] The rationale for this duty is that an innkeeper implicitly or explicitly suggests that the customer will have a safe overnight stay.[69]

Many jurisdictions have relied on the special relationship doctrine to impose a duty of care on hotel owners and operators for the safety of their guests against third party criminal acts.[70] Further, courts have not limited the scope of

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[66] Kveragas v. Scottish Inns, Inc., 733 F.2d 409, 412 (1984).

[67] A historical background was provided by the Supreme Court of New York in Crapo v. Rockwell, 48 Misc. 1, 94 N.Y.S. 1122 (1905):

> In those days there was little safety outside of castles and fortified towns for the wayfaring traveler, who, exposed on his journey to the depredations of bandits and brigands, had little protection when he sought at night temporary refuge at the wayside inns, established and conducted for his entertainment and convenience. Exposed as he was to robbery and violence, he was compelled to repose confidence, when stopping on his pilgrimages over night, in landlords who were not exempt from temptation; and hence there grew up the salutary principles that a host owed to his guest the duty, not only of hospitality, but also of protection.

Id. at 2, 94 N.Y.S. at 1123.

[68] *Kveragas*, 733 F.2d at 412.

[69] Sharp, *Paying for the Crimes of Others? Landowner Liability for Crimes on the Premises*, 29 S. TEX. L. REV. 11, 26 n.60, 27 n.63 (1987) [hereinafter Sharp, *Landowner Liability*]. In some situations, a distinction has been drawn between the liability of a landowner and its business invitee and the liability of an innkeeper to its guest, where a higher standard of liability is imposed on the existence of the latter relationship:

> [I]n the case of the landowner or merchant nothing is paid by the invitee for the privilege of entering the premises, and he may as freely leave as he came and carry with him his belongings, but not so with the guest at the hotel, who has paid the price demanded for the very purpose of securing proper accommodations in the way of food or lodging, and for safety, comfort and repose.

Cumming v. Allied Hotel Corp., 144 S.W.2d 177, 181 (Mo. Ct. App. 1940). In *Cumming*, the plaintiff, a paying guest, was injured due to a defective condition in the hotel room. The court recognized the relationship between the plaintiff and the defendant as that of innkeeper and guest, rather than that of merchant and customer, and held that the hotel owed a duty of care to the plaintiff. *Id.* *See infra* note 71 and accompanying text. *See also* Burnison v. Souders, 35 S.W.2d 619 (Mo. Ct. App. 1931).

[70] Gurren v. Casperson, 147 Wash. 257, 265 P. 472 (1928) (innkeeper held liable for the assault of a guest by another guest after the victim had demanded protection); Fortney v. Hotel Rancroft, Inc., 5 Ill. App. 2d 327, 125 N.E.2d 544 (1955) (liability imposed for the attack on a

the innkeeper duty exclusively to registered guests of the hotel. Family members have been protected under the innkeeper-guest special relationship when an individual has registered for use of a room by the individual and the individual's family.[71] The duty has been extended to the guest of a registered guest,[72] to persons attending business conferences at the hotel,[73] and to restaurant patrons using hotel facilities.[74]

Prior to *Knodle*, the Hawaii courts had never explicitly imposed a duty of care on hotel owners and operators for the safety of their guests from the criminal acts of third parties. While Hawaii courts have recognized the innkeeper-guest relationship as special,[75] until *Knodle*, they had not actually applied the special relationship doctrine to the innkeeper-guest situation.

The innkeeper-guest relationship has been analogized to that of landlord and tenant.[76] However, Hawaii courts have not viewed the landlord-tenant relationship as a special one. Unlike the innkeeper-guest relationship, the relationship between a landlord and tenant has never been considered a relationship where duty unquestionably arises.[77] In *King v. Ilikai Properties, Inc.*,[78] where a tenant

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guest by an intruder who gained access to the room via a key; a guest who is sleeping or about to enter his or her room has a right to rely on the innkeeper to do whatever is in its power to prevent crime); and Jenness v. Sheraton-Cadillac Properties, Inc., 48 Mich. App. 723, 211 N.W.2d 106 (1973), (hotel held responsible for the attack on a guest by a stranger who was observed earlier as a suspicious-looking person loitering in the lobby, and who later allegedly propositioned the guest in his hotel room). Damages in such instances can be extensive. Singer and entertainer Connie Francis recovered $2.5 million in a suit against Howard Johnson's Motor Lodges, after she was raped in the motel where she was staying. Garzilli v. Howard Johnson's Motor Lodges, Inc., 419 F. Supp. 1210 (E.D.N.Y. 1976). *See infra* notes 71-74 and accompanying text.

[71] *Cumming*, 144 S.W.2d 177 (Mo. Ct. App. 1940). The court explained that a "guest" was a traveler who visited the hotel "for the purpose of availing himself of the entertainment offered, that is, to obtain refreshments or lodging." *Id.* at 181.

[72] Daniel v. Days Inn of America, Inc., 292 S.C. 291, 356 S.E.2d 129 (Ct. App. 1987).

[73] Walkoviak v. Hilton Hotels Corp., 580 S.W.2d 623 (Tex. Civ. App. 1979).

[74] Virginia D. v. Madesco Inv. Corp., 648 S.W.2d 881 (Mo. 1983) (en banc).

[75] *See, e.g.*, Bidar v. Amfac, Inc., 66 Haw. 547, 669 P.2d 154 (1983); Seibel v. City & County of Honolulu, 61 Haw. 253, 602 P.2d 532 (1979); Wolsk v. State, 68 Haw. ____, 711 P.2d 1300 (1986); Kau v. City & County of Honolulu, 6 Haw. App. ____, 722 P.2d 1043 (1986); King v. Ilikai Properties, Inc., 2 Haw. App. 359, 632 P.2d 657 (1981); Moody v. Cawdrey & Assocs., 6 Haw. App. ____, 721 P.2d 708, *rev'd per curiam*, 68 Haw. ____, 721 P.2d 707 (1986).

[76] Kline v. 1500 Mass. Ave. Apartment Corp., 439 F.2d 477, 485 (D.C. Cir. 1970). *See infra* note 77.

[77] Historically, the landlord-tenant relationship was not recognized as a "special" one that would impose a duty of reasonable care on the landlord to protect against third party criminal acts. Courts were reluctant to tamper with the traditional common law concept that recognized the transfer of the landlord's responsibilities to the tenant, once the tenant assumed the lease. In the agrarian setting of early common law, the tenant was in total control of the leased property

and her guest were attacked by unidentified third parties in a private condo-

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and was completely able to provide for self-protection. Therefore, traditionally, a landlord was not required to provide for a tenant's protection against third party criminal conduct absent a statute or contract that specifically imposed the duty. R. SCHOSHINSKI, AMERICAN LAW OF LANDLORD AND TENANT § 4:14, at 216 (1980). The modern landlord-tenant relationship in an urban setting far from resembles its ancient agrarian predecessor. Today, tenants usually lease only single units in multiunit dwellings, rather than large parcels of land, and expect their landlords to provide some basic necessities, such as heat, light, and maintenance, as part of the lease agreement. Note, *Landlord's Duty to Protect Tenants from Criminal Acts of Third Parties: The View from 1500 Massachusetts Avenue*, 59 GEO. L.J. 1153, 1156 (1971). Still, as a matter of public policy, the traditional rule has continued for a number of reasons:

> [j]udicial reluctance to tamper with the common law concept of the landlord-tenant relationship; the notion that the act of a third person in committing an intentional tort or crime is a superseding cause of harm to another . . . ; the oftentimes difficult problem of determining foreseeability of criminal acts; the vagueness of the standard which the landlord must meet; the economic consequences of the imposition of the duty; and conflict with the public policy allocating the duty of protecting citizens from criminal acts to the government rather than the private sector.

R. SCHOSHINSKI, § 4:14, at 217 (quoting *Kline*, 439 F.2d at 481).

The landmark case of Kline v. 1500 Mass. Ave. Apartment Corp., 439 F.2d 477 (D.C. Cir. 1970), departed from the common law non-duty approach. In this case, a tenant was criminally assaulted in the common hallway of her apartment complex. In imposing a duty of care on the landlord to protect the tenant from the criminal acts of third parties, the court focused on the increase in assaults and robberies suffered by the tenants, and on the substantial reduction in security provided in the building. *Id.* at 480, 483, 485. The *Kline* court adopted a standard of "reasonable care" to determine whether the landlord fulfilled the duty of protection, and held that where attacks were probable and predictable, a duty arose for the landlord to "take steps to protect tenants from foreseeable criminal acts committed by third parties." *Id.* at 484, 485.

The court analogized the relationship between the parties with an innkeeper-guest relationship:

> [I]f we reach back to seek the precedents of common law, on the question of whether there exists or does not exist a duty on the owner of the premises to provide protection against criminal acts by third parties, the most analogous relationship to that of the modern day urban apartment house dweller is not that of a landlord and tenant, but that of innkeeper and guest.

Id. at 485.

It has been argued, however, that the analogy is not very persuasive. "[T]he 'implicit feeling of security engendered by a hotel's image' contrasts sharply with the realistic expectations of tenants, especially in low-income housing." J. PAGE, *supra* note 22, § 11.14, at 309 (quoting M. SHAPO, THE DUTY TO ACT: TORT LAW, POWER, AND PUBLIC POLICY 49 (1977)). Also, "the innkeeper-guest analogy . . . would . . . produce the anomalous result of granting recovery to a tenant but not to the tenant's invitee or licensee also foreseeably attacked in an apartment common area." J. PAGE, *supra* note 22, at 309 n.90 (quoting Selvin, *Landlord Tort Liability for Criminal Attacks on Tenants: Developments Since Kline*, 9 REAL EST. L.J. 311, 314 (1981)).

Kline, however, did not impose on landlords a general duty to protect tenants from third party criminal acts; a duty arose only when there was reasonable foreseeability of harm to the tenants. Recent Development, *Francis T. v. Village Green Owners Association: Liability of Condominium Associations and Boards of Directors for Criminal Acts of Third Persons*, 19 PAC. L.J. 377, 381 (1988). *See also* Sharp, *Landowner Liability*, *supra* note 69, at 27 n.63.

minium unit located in a hotel tower, the plaintiff sued the hotel operator, the lessor of the condominium unit, and the association of apartment owners for failure to make the premises safe.[79] In refusing to impose a duty on the hotel operator, the Hawaii Intermediate Court of Appeals stressed that the plaintiffs were not "guests" of the hotel, and therefore, no special relationship existed.[80]

The *King* court also refused to recognize the landlord-tenant relationship between the defendant lessor and the plaintiff lessee as a special one, in keeping with the general "reluctan[ce] [of courts] to impose a duty on landlords to protect tenants from criminal acts of third parties."[81] The ICA distinguished *King* from *Kline v. 1500 Massachusetts Avenue Apartment Corp.*,[82] where a duty was imposed on a landlord to protect its tenants from third party criminal acts. Two factors that influenced the *Kline* decision—the decline in security in the apartment building between the time the plaintiff moved into the building and the time she was criminally attacked, and the fact that the landlord was aware of numerous assaults occurring since the decline in security—were absent in *King*.[83] Further, the ICA reasoned that if the landlord owed no duty to the tenant, then it was "axiomatic" that even less of a duty was owed to the tenant's guest.[84] Finally, the court stated that with respect to the association of apartment owners, "it [was] even further removed from the chain."[85] The court concluded that foreseeability, overall fairness, and public policy had to be considered in determining the question of duty.[86]

The special relationship issue was again addressed in *Moody v. Cawdrey & Associates, Inc.*[87] In *Moody*, a case factually similar to *King*, condominium owners and their guests sued the condominium owners association and its managing agent for injuries the guests sustained when criminally assaulted by third parties in the apartment unit.[88] The ICA held that the condominium owners association and its managing agent owed a duty to protect condominium owners and their guests from foreseeable third party criminal acts.[89] On appeal, however,

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[78] 2 Haw. App. 359, 632 P.2d 657 (1981).

[79] *Id.* at 360, 632 P.2d at 659-60.

[80] *Id.* at 362, 632 P.2d. at 661.

[81] *Id.* at 363, 632 P.2d at 661.

[82] 439 F.2d 477 (D.C. Cir. 1970).

[83] 2 Haw. App. at 363-64, 632 P.2d at 661. *See supra* note 77.

[84] *Id.* at 364, 632 P.2d at 662.

[85] *Id.* at 364, 632 P.2d at 662.

[86] *Id.* at 363, 632 P.2d at 661. This conclusion was influenced by the Supreme Court of New Jersey's view in Goldberg v. Housing Auth. of Newark, 38 N.J. 578, 583, 186 A.2d 291, 293 (1962).

[87] 6 Haw. App. ____, 721 P.2d 708, *rev'd per curiam*, 68 Haw. ____, 721 P.2d 707 (1986).

[88] 6 Haw. App. at ____, 721 P.2d at 710-11.

[89] *Id.* at ____, ____, 721 P.2d at 710, 713. In contrast to its decision in *King*, the ICA, in

the Hawaii Supreme Court, relying on *King*, reversed the ICA's decision.[90]

Until *Knodle v. Waikiki Gateway Hotel, Inc.*, Hawaii courts had never imposed a duty on an owner or occupier of land to protect against the criminal conduct of third parties.

IV. ANALYSIS

A. *Innkeeper-Guest Special Relationship Duty Found*

In *Knodle v. Waikiki Gateway Hotel, Inc.*, the Hawaii Supreme Court held that the trial court had committed reversible error in its instructions to the jury.[91] The court vacated the judgment of the lower court and remanded the case for a new trial.[92] The Hawaii Supreme Court emphasized that duty is a question of law, exclusively for the judge to determine, and therefore, the trial judge erred in submitting to the jury the question of whether the defendants had a duty to protect Knodle.[93] The *Knodle* court further found that the trial court's instructions on proximate causation and foreseeability were improper.[94]

Moody, found that a special relationship existed between the plaintiffs and the defendants. The ICA distinguished the two cases by holding that a special relationship based on "mutual dependence" existed in *Moody*, but not in *King*. *Id.* at ____, 721 P.2d at 714. Analogizing the relationship between a condominium owners association and a resident condominium owner to that of a landlord and tenant, the ICA concluded that the condominium owners association had "a similar duty as a landowner to protect resident condominium owners from foreseeable criminal acts of third parties." *Id.* at ____, 721 P.2d at 713. According to the court, this duty extended to guests of the condominium owner. *Id.* at ____, 721 P.2d at 713-14.

[90] 68 Haw. ____, 721 P.2d 707 (1986). The Hawaii Supreme Court did not elaborate on how it arrived at its decision beyond stating that "[o]n the basis of *King v. Ilikai Properties, Inc.*, . . . the decision of the Intermediate Court of Appeals is reversed, and the judgment of the trial court [summary judgment in favor of defendants] is accordingly affirmed." *Id.*

[91] 69 Haw. ____, ____, 742 P.2d 377, 381 (1987). *See infra* note 95.

[92] Id. at ____, 742 P.2d at 388.

[93] *Id.* at ____, ____, ____, 742 P.2d at 383, 384, 387.

[94] The Hawaii Supreme Court concluded that the trial judge erred in instructing the jury that " '[a]n act is reasonably foreseeable if it appears to have been ordinary or usual under all the circumstances.' " *Id.* at ____, 742 P.2d at 381. The high court "fail[ed] to see how murder can be 'ordinary or usual' under any circumstance," and stated that the proper test is whether " 'there is some probability of harm sufficiently serious that [a reasonable and prudent person] would take precautions to avoid it.' " *Id.* at ____, 742 P.2d at 388 (quoting Tullgren v. Amoskeag Mfg. Co., 82 N.H. 268, 276, 133 A. 4, 8 (1926)).

With respect to the instruction on "proximate cause," the *Knodle* court concluded that the lower court's definition of: "that cause which in direct, unbroken sequence, produces the injury, and without which the injury would not have occurred," was "clearly a misstatement of the law". The Hawaii Supreme Court stated, "We have moved beyond the strictures of 'direct, unbroken sequence' in the consideration of legal causation." *Id.* at ____, 742 P.2d at 387. The court also concluded that "to speak of legal cause as that 'without which the injury would not have oc-

In determining that the defendants had a duty of care to protect Knodle from the criminal acts of third persons, the court focused exclusively on the relationship between the hotel and Knodle. Although Knodle was not an officially registered guest of the defendant,[95] the court summarily dismissed any contention that Knodle was not a guest of the hotel[96] and concluded that the relationship between the defendant hotel and Knodle was a special one of innkeeper and guest.[97] Relying on the language of the Restatement (Second) of Torts and on Hawaii case law, the court elaborated on the scope of this duty.

Consistent with its recognition of the special relationship doctrine as defined in the Restatement (Second)[98] and its acknowledgment of the doctrine in *Bidar v. Amfac, Inc.*,[99] the court stated that a hotel operator's duty to protect its guests includes protection against unreasonable risks "arising out of [its] own conduct;" "the condition of [its] land or chattels;" or "the acts of third persons, whether they be innocent, negligent, intentional, or even criminal."[100] The court noted that while normally a defendant has no duty to control the acts of a third party, the existence of a special relationship between the defendant and either the third party who threatens harm or the potential victim of the harm "gives the [potential victim] a right to protection from unreasonable risks arising from the acts of the third person."[101] According to the court, the particular relationship of innkeeper and guest that existed between the hotel and Knodle imposed a legal duty of care on the hotel to provide for Knodle's protection.

B. Exclusive Focus on Defendant-Victim Relationship; Innkeeper-Guest Relationship Establishes Duty Without Question

Hawaii courts had previously acknowledged that, under certain circumstances, a special relationship may impose a duty of protection on the defendant. Prior to *Knodle*, however, Hawaii courts had found neither the existence of

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curred' " was in error, for in Hawaii, "substantial factor," rather than "proximate cause" is the norm for finding that a defendant's negligence legally caused a plaintiff's injuries. *Id.* (citing Mitchell v. Branch, 45 Haw. 128, 363 P.2d 969 (1961)).

[95] *See supra* notes 6, 7 and accompanying text.

[96] 69 Haw. at ____ n.11, 742 P.2d at 387 n.11. The Hawaii Supreme Court surmised that the trial court might have submitted the question of duty to the jury because "there might have been a dispute on the existence of a 'special relationship.' However, the supreme court was "convinced from a review of the whole evidence relating to the issue that no reasonable inference that Ms. Knodle was not a guest could be drawn therefrom." Therefore, her status was not a question for the jury to decide. *Id.*

[97] *Id.* at ____, ____, 742 P.2d at 384, 388.

[98] *See supra* notes 50, 52 and accompanying text.

[99] 66 Haw. 547, 669 P.2d 154 (1983).

[100] 69 Haw. at ____, 742 P.2d at 384.

[101] *Id.*

a special relationship nor a corresponding duty in situations involving premises liability for third party criminal acts. The *Knodle* court's conclusion that the relationship between the hotel and Knodle was a "special" one of innkeeper and guest, marked the first time a special relationship was found to exist so as to impose an affirmative duty of care on a defendant hotel to protect its guests from the criminal acts of unknown third parties. While it may seem surprising, considering the abundance of hotel rooms and relatively constant flow of visitors to the state, Hawaii courts previously have not had the opportunity to consider the special relationship doctrine for third party criminal acts in a clear hotel-guest context.[102] However, the innkeeper-guest special relationship duty for third party criminal acts has been imposed in other jurisdictions.[103] *Knodle* indicates the Hawaii Supreme Court's willingness to follow other jurisdictions in imposing the special relationship duty on hotel operators.

In concluding that an innkeeper-guest special relationship existed, the *Knodle* court departed from previous Hawaii decisions where the courts had refused to impose a duty of care through special relationships in situations involving third party criminal acts. Instead, the court relied on the language of the Restatement (Second) of Torts, which provides that an innkeeper is under a duty to protect its guests against unreasonable risks of physical harm.[104] In determining the existence of a special relationship, the *Knodle* court focused exclusively on the relationship that existed between the defendant hotel and the victim, Knodle. Contrary to the previous Hawaii decisions of *Seibel*[105], *Wolsk*,[106] and *Kau*,[107] where the courts, in holding that no special relationship existed, focused almost exclusively on the lack of control the defendant had over the third persons responsible for the harm, in *Knodle*, the defendant's lack of control over the third person was not even a factor in the court's analysis.

It would appear, under the *Wolsk* rationale, that the *Knodle* court could have held that no duty existed notwithstanding the existence of an innkeeper-guest

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[102] Although Bidar v. Amfac, Inc., 66 Haw. 547, 669 P.2d 154 (1983), involved a hotel-guest situation, the injuries suffered by the plaintiff were not at the hands of a third party. And, although the Intermediate Court of Appeals, in King v. Ilikai Properties, Inc., 2 Haw. App. 359, 632 P.2d 657 (1981), briefly discussed the innkeeper-guest relationship as being special, it was clear from the facts of the case that, as the court concluded, the plaintiff was a lessee of a condominium unit that happened to be situated in the hotel complex, and therefore, was not a guest of the hotel.

[103] *See supra* notes 70-74 and accompanying text.

[104] *See supra* note 52 and accompanying text.

[105] 61 Haw. 253, 602 P.2d. 532 (1979). *Seibel*, however, did not involve premises liability. *See supra* notes 55-56 and accompanying text.

[106] 68 Haw. ____, 711 P.2d 1300 (1986). *See supra* notes 57-61 and accompanying text.

[107] 6 Haw. App. ____, 722 P.2d 1043 (1986). *See supra* notes 62-65 and accompanying text.

special relationship as defined in the Restatement (Second) of Torts.[108] In *Wolsk*, despite the Restatement's specific definition of "special" as the relationship between "[a] possessor of land who holds it open to the public" and "members of the public who enter in response to his invitation,"[109] the basis of the court's failure to find a special relationship duty was that "the third persons who harmed [the victims] . . . were never alleged to be under [the] State's control . . . ."[110] Similarly, in *Knodle*, the third person who was responsible for the murder was never alleged to be under the hotel's control. In *Knodle*, however, the defendant's lack of control over the third person responsible for the murder was never a factor in the court's analysis. It appears that the very existence of an innkeeper guest relationship itself created the duty.

While the special relationship issue was raised in *Wolsk* and *Kau*, no special relationship was found and therefore no duty was imposed on the defendants. *Wolsk* and *Kau* involved municipal defendants, where a special relationship duty might easily have been established on the basis of a landowner and invitee relationship. The Hawaii courts, however, seemed to be using the special relationship doctrine to impose a duty only in a situation, as in *Knodle*, where liability was apparent, and, for policy reasons, appropriate. Although the *Wolsk* and *Kau* courts did not discuss policy concerns, such concerns probably explain their reluctance to find the existence of a special relationship. By limiting the government's liability, the courts appear to have concluded that the financial burden of maintaining security for public facilities such as parks and golf courses would be too severe. In contrast, the *Knodle* court, by imposing an innkeeper's duty, apparently has decided that the Hawaii hotel industry is able to shoulder the burden of protection against third party criminal acts.

The economic benefit a hotel receives from its guests, although not explicitly mentioned in the court's opinion, may have been a factor in the court's determination that the hotel owed a duty to protect Knodle. Unlike the cases involving municipal defendants, *Knodle* involved a private sector defendant who derived an economic benefit from its guest. Although Knodle herself was not an "official" guest, her employer, Continental Airlines, was a regular patron of the hotel. The hotel staff knew Knodle from her previous overnight flight "layovers" at the hotel. Hence, the Hawaii Supreme Court, in *Knodle*, infers that a hotel has a duty to protect its guests from criminal harm caused by third parties in situations where an economic benefit is derived from the existence of a special relationship between the defendant and the injured party.[111]

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[108] *See supra* note 50 and accompanying text.

[109] *See supra* note 52 and accompanying text.

[110] 68 Haw. at ____, 711 P.2d at 1303.

[111] The relationship between Knodle and the hotel was analogous to that of a landowner and invitee. The historical rationale at common law for requiring the highest standard of care for invitees would also apply to hotel guests today. In consideration for an economic benefit, the

It seems that the Hawaii courts have established different special relationship criteria depending upon whether the defendant is a public entity or a private entity. The courts have been more reluctant to impose liability for the criminal acts of unknown third persons where the defendant is a public entity. In cases involving public agencies, the courts have focused on the relationship between the defendant and the third party perpetrator and have found no special relationship to exist. By contrast, in cases involving private defendants, such as *Knodle*, *King*,[112] and *Moody*,[113] the court has focused on the relationship between the defendant and the injured party in deciding the special relationship issue. In *King* and *Moody*, the courts' refusal to impose a duty was due to their reluctance to consider a landlord-tenant relationship or a condominium owners association-condominium owner relationship as "special."

Until *Knodle*, no Hawaii decision had imposed liability on a defendant for third party criminal acts occurring on the premises, whether public or private. Imposing a duty on hotels to protect their guests from such third party conduct will undoubtedly influence future Hawaii court decisions regarding other types of premises liability.

V. IMPACT

The potential impact of the Hawaii Supreme Court's decision in *Knodle v. Waikiki Gateway Hotel, Inc.* is significant. For the first time, Hawaii has imposed a duty on a hotel to protect against third party criminal acts. After *Knodle*, parties, under certain circumstances, are no longer insulated from liability arising from injuries sustained from the criminal acts of third persons.

Although the *Knodle* court voiced no specific policy considerations in imposing a duty on the defendant hotel, the Hawaii Supreme Court apparently has decided that the Hawaii hotel industry should carry the burden of protecting its guests from third party criminal acts. However, notwithstanding the finding of a special relationship for innkeepers, it is not likely that the courts will impose a general duty on all owners or occupiers of land. *Knodle* seems only to apply to private sector defendants, excluding landlords and condominium owners associations, and not to municipal or other public sector defendants. It seems probable that the Hawaii courts will be more inclined to impose a duty on a defendant where the defendant derives an economic benefit from the relationship.

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landowner/hotel assumes the duty to keep the premises safe for the invitee/guest. *See supra* note 29 and accompanying text.

[112] 2 Haw. App. 359, 632 P.2d 657 (1981).

[113] 6 Haw. App. ____, 721 P.2d 708, *rev'd per curiam*, 68 Haw. ____, 721 P.2d 707 (1986).

By focusing on the relationship between the parties, it appears that *Knodle* has narrowed the scope of an innkeeper's duty to its guests. It is uncertain, however, as to whether the hotel's duty to protect others from criminal acts of third persons, after *Knodle*, extends only to persons characterized as "guests." The *Knodle* court did not define "guest" other than to deem the unregistered victim a guest by virtue of her employer, who regularly patronized the hotel. Although other jurisdictions have extended the definition of "guest" to beyond that of an officially registered guest,[114] it is uncertain whether Hawaii courts will expand an innkeeper's liability as broadly.

It may be that a hotel's liability would be limited, and no duty would be imposed on the hotel to protect "non-guests" from an identical criminal act. For example, would the hotel's duty to protect against the acts of this person extend to the visitor of a registered hotel guest? To a trespasser using the hotel pool? Under a strict application of special relationship doctrine, it would seem that the hotel's duty would not extend to such situations. Perhaps, in the interest of fairness, the Hawaii courts should adopt the Hawaii Intermediate Court of Appeals' approach in *King*, and consider foreseeability and the totality of the circumstances in determining whether liability attaches, rather than focusing exclusively on the relationship between the parties. It may then be possible for a duty to be imposed despite the absence of a special relationship.

It remains to be seen how Hawaii courts will respond in situations involving third party criminal acts in non-hotel-guest situations. Many variables affect whether a duty exists, such as the type of landowner, the type of visitor, and the type of relationship. Conservatively speaking, it appears that Hawaii courts will follow the general trend of the common law by being selective in imposing a duty on an owner or occupier of land for the criminal acts of third parties. It is now apparent that Hawaii courts are willing to find that a special relationship exists, and along with it, the corresponding duty.

VI. CONCLUSION

Knodle v. Waikiki Gateway Hotel, Inc. marked a noticeable departure from Hawaii's reluctance to impose on owners or occupiers of land a duty to protect against third party criminal acts. For the first time, the court held that a hotel operator has such a duty, due to the existence of the "special relationship" of innkeeper and guest.

Still undecided is whether *Knodle* extends beyond the hotel-guest context to other types of premises liability situations. By relying on the common law special relationship doctrine, the Hawaii Supreme Court may have limited the impact of its decision in *Knodle*. It may be that a duty to protect others from

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[114] *See supra* notes 71-74 and accompanying text.

the acts of unknown third parties will be imposed only in situations where a special relationship has been clearly established by previous case law or perhaps only in situations involving a hotel and its guests.

Regardless of the uncertainty as to the scope of the decision, the Hawaii Supreme Court has firmly established that, in certain circumstances, a special relationship duty does arise and will be imposed to protect against third party criminal conduct.

Virginia M. Chock
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State v. Kam: The Constitutional Status of Obscenity in Hawaii

I. INTRODUCTION

In *State v. Kam*,[1] the Hawaii Supreme Court extended the protection of article I, section 6 of the Hawaii Constitution,[2] which recognizes the right of privacy, to the purchase of obscene material for private use. This contradicted United States Supreme Court precedent which had held that the purchase of obscene material for private use was unprotected by the federal right of privacy. Obscenity is unprotected speech under the first amendment of the federal Constitution and article I, section 3 of the Hawaii Constitution.[3]

This note will initially examine the status of obscenity under the federal and state constitutions pursuant to first amendment and privacy analyses. Next, it will present an outline and critique of the *Kam* court's analysis. Finally, this note will examine the impact of the *Kam* decision on the state's ability to regulate obscenity, focusing on *Kam*'s immediate impact on the penal code and its future impact on child pornography, snuff films, bestiality, obtrusive public displays of pornography, the showing of obscenity to captive audiences, and the sale of pornography to minors.

II. FACTS

Defendants Brian Kam and Deborah Cohen were clerks in two adult bookstores.[4] Each sold an adult magazine to an undercover police officer and were subsequently arrested,[5] charged, and convicted for "promoting pornographic

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[1] ____ Haw. ____, 748 P.2d 372 (1988).

[2] Article I, section 6 reads: "The right of the people to privacy is recognized and shall not be infringed upon without the showing of a compelling state interest. The legislature shall take affirmative steps to implement this right." HAW. CONST. art. I, § 6.

[3] *See* State v. Manzo, 58 Haw. 440, 573 P.2d 945 (1977); Roth v. United States, 354 U.S. 476 (1957).

[4] *Kam*, ____ Haw. at ____, 748 P.2d at 374.

[5] *Id.* at ____, 748 P.2d at 374.

adult magazines"[6] under section 712-1214(1)(a) of the Hawaii Revised Statutes.[7] Defendants moved to dismiss the complaints on the grounds that the statute violated the right to privacy contained in article I, section 6 of the Hawaii Constitution and was overbroad and/or vague.[8] The trial court denied the defendants' motions.[9] Following trial, the court ruled that the magazines were pornographic, patently offensive, and violated prevailing community standards; that neither surveys nor expert testimony was necessary to decide the case; and convicted the defendants.[10] The defendants subsequently filed separate appeals to the Hawaii Supreme Court, which were later ordered consolidated.[11]

III. HISTORY

This section will discuss the development of the obscenity standard, the status of obscenity under the free speech provisions of the federal and state constitutions, and the development of the federal and state rights of privacy, focusing on their applicability to obscene material. This section will also discuss the standard of judicial scrutiny applied in reviewing legislation that burdens fundamental rights protected by the right of privacy.

A. *The Development of the Obscenity Standard and the Status of Obscenity Under the First Amendment of the United States Constitution*

In *Roth v. United States*,[12] the United States Supreme Court held that obscenity is not protected speech under the first amendment of the United States Constitution.[13] The *Roth* Court established the standard for judging obscenity

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[6] *Id.* at ____, 748 P.2d at 373.

[7] Section 712-1214(1)(a) reads: "A person commits the offense of promoting pornography if, knowing its content and character, he . . . [d]isseminates for monetary consideration any pornographic material . . . ." HAW. REV. STAT. § 712-1214 (1985). Section 712-1210 defines pornographic as:

> Any material or performance . . . [in which] all of the following coalesce: (a) The average person, applying contemporary community standards would find that, taken as a whole, it appeals to the prurient interest. (b) It depicts or describes sexual conduct in a patently offensive way. (c) Taken as a whole, it lacks serious literary, artistic, political, or scientific merit.

HAW. REV. STAT. § 712-1210 (1985).

[8] ____ Haw. at ____, 748 P.2d at 374.

[9] *Id.*

[10] *Id.*

[11] *Id.*

[12] 354 U.S. 476 (1957).

[13] *Id.* at 485. The Court reached this conclusion after examining the purpose of the first amendment. The first amendment was developed to facilitate the exchange of ideas for the pur-

as "whether to the average person, applying contemporary community standards, the dominant theme of the material taken as a whole appeals to the prurient interest."[14] From its inception, the *Roth* standard has been criticized. In his dissent, Justice Douglas expressed his concern that a standard which relies on community standards for its content would lead to a tyranny of the majority.[15]

Despite this criticism, the "community standards" portion of the test was retained when the test was refined in *Memoirs v. Massachusetts*,[16] which articulated a three-tiered standard for determining obscenity. First, the dominant theme of the material taken as a whole must appeal to a prurient interest in sex; second, the material must be patently offensive according to contemporary community standards; third, the material must be utterly without redeeming social value.[17] The *Memoirs* standard also had its critics. In his concurring opinion, Justice Douglas reiterated his belief that obscenity was protected by the first amendment.[18] Justice Harlan opined that suppression of obscene matter should be limited to "hard-core pornography."[19] A later Supreme Court criticized the standard as imposing too great a prosecutorial burden on the government.[20]

Miller v. California[21] addressed the problem of the prosecutorial burden by altering the third tier of the *Memoirs* test. Under *Miller*, material must be without serious literary, artistic, political, or scientific value.[22] The *Miller* standard stands as the current definition of obscenity.[23]

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pose of bringing about social and political change. Thus, all ideas which are of any social importance are protected. The Court found that obscenity is utterly without redeeming social importance and so not entitled to first amendment protection. For support, it noted that the original states had laws against libel, blasphemy, and profanity. Further, the Court found that the status of obscenity had remained unchanged in the years following the adoption of the first amendment (when *Roth* was decided all 48 of the states had obscenity laws and Congress had enacted 20 obscenity laws from 1842 to 1956). *Id.* at 484-85.

[14] *Roth*, 354 U.S. at 489.

[15] "This is community censorship in one of its worst forms. It creates a regime where in the battle between the literati and the Philistines, the Philistines are certain to win." 54 U.S. at 512 (Douglas, J., dissenting).

[16] 383 U.S. 413 (1966).

[17] *Id.* at 418.

[18] *Id.* at 412 (Douglas, J., concurring).

[19] *Id.* at 455, 457 (Harlan, J., dissenting).

[20] Under *Memoirs*, "the prosecution [must] prove a negative, i.e., that the material [is] '*utterly* without redeeming social value'—a burden virtually impossible to discharge under our criminal standards of proof." Miller v. California, 413 U.S. 15, 22 (1973).

[21] *Id.*

[22] *Id.* at 24. The *Miller* standard was clarified in Pope v. Illinois, 481 U.S. 497 (1987), which held that in order to determine whether a work is without serious value, a reasonable person standard should be used.

[23] *Miller* has not been without its critics. In his dissent, Justice Douglas adhered to his belief

The primary argument against holding that obscenity is unprotected speech under the first amendment is the difficulty in formulating a definition of obscenity specific enough that it (1) does not encroach on protected speech and (2) meets due process requirements of giving adequate notice to those who may be prosecuted under a particular regulatory scheme.[24]

Two basic alternatives to *Roth* have been proposed.[25] First, *Roth* may be overruled so that first amendment protection extends to obscene materials.[26] Second, the governmental regulation of obscenity may be limited to prohibiting distribution of obscene material to minors and protecting unwilling adults from exposure to obscene material.[27] This view was formulated by Justice Brennan in his dissent in *Paris Adult Theatre*.[28] Justice Brennan believed that legislation

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that obscenity is protected speech. 413 U.S. at 37 (Douglas, J., dissenting). In a retreat from his majority opinion in *Memoirs*, Justice Brennan now advocates regulation of obscenity only when it involves children or unwilling adults. Paris Adult Theatre I v. Slaton, 413 U.S. 49, 112-13 (Brennan, J., dissenting). Commentaries have criticized the requirement that the material have serious literary, artistic, political or scientific value as being too limiting a requirement. *See* Note, *Obscenity: 30 Years of Confusion and Still Counting—Pope v. Illinois*, 21 CREIGHTON L. REV. 379, 387-90 (1987-1988); Main, *The Neglected Prong of the Miller Test for Obscenity: Serious Literary, Artistic, Political or Scientific Value*, 11 S. ILL. U. L.J. 1159 (1987).

The United States Supreme Court has recently reaffirmed that the obscenity standards in *Miller* are not unconstitutionally vague. The Court held that the Indiana Racketeer Influenced and Corrupt Organization (RICO) statute is not unconstitutionally vague as applied to obscenity predicate offenses because obscenity law itself is not vague and the RICO statute encompasses obscenity law. Thus, for obscenity predicate offenses, the prosecutor may proceed under the RICO statute. Fort Wayne Books, Inc. v. Indiana, No. 87-470, No. 87-614 (U.S. Feb. 27, 1989) (LEXIS, Genfed Library, US file).

[24] *Paris Adult Theatre*, 413 U.S. at 89-93 (Brennan, J., dissenting).

[25] Justice Brennan's dissent in *Paris Adult Theatre* suggested several possible solutions to the problem of formulating a proper definition for obscenity. First, the Court could draw a new line between protected and unprotected speech, with all doubts in particular cases being resolved in favor of the state. Second, the Court could adhere to the *Miller* test. Third, the Court could grant extreme deference to juries or lower court decisions. Fourth, the Court could decide that the first amendment bars the suppression of any sexually oriented expression. Ultimately, Justice Brennan concluded that obscenity could not be defined in such a way as to avoid vagueness. However, the state interest in protecting children and unconsenting adults is strong enough to allow legislation against obscenity to protect those classes. 413 U.S. at 93-113 (Brennan, J., dissenting).

[26] *See Roth*, 354 U.S. 476 at 503 (Douglas & Black, JJ., dissenting); *Memoirs*, 383 U.S. at 424 (Douglas, J., dissenting); *Miller*, 413 U.S. at 37 (Douglas, J., dissenting); United States v. Thirty-Seven Photographs, 402 U.S. 363 (1971) (Black & Douglas, JJ., dissenting); United States v. 12 200-Ft. Reels of Super 8mm. Film, 413 U.S. 123, 130 (1973) (Douglas, J., dissenting).

[27] *Paris Adult Theatre*, 413 U.S. at 70 (Brennan, Stewart & Marshall, JJ., dissenting). *See also* Hamling v. United States, 418 U.S. 87, 141 (1974) (Brennan, Stewart & Marshall, JJ., dissenting); United States v. Orito, 413 U.S. 139, 147 (1973) (Brennan, Stewart & Marshall, JJ., dissenting); Pope v. Illinois, 481 U.S. 497, 506 (1987) (Brennan, J., dissenting).

[28] 413 U.S. at 112-13.

prohibiting the exposure of obscenity to consenting adults was based on morality and that the states' interest in regulating morality was not strong enough to justify interference with first amendment rights.[29] On the other hand, the states' interest in protecting children and unwilling adults from exposure to obscenity was strong enough to justify the prohibition of obscenity with respect to these two groups.[30]

B. *The Development of the Federal Right of Privacy*

The United States Constitution contains no express provision guaranteeing a person's right of privacy. However, the United States Supreme Court has found that a right of privacy does exist in the Constitution. This section will explore the development of the right in federal case law.

Although the common law has always protected the individual's person and property,[31] this protection was originally limited to "physical interference with life and property. . . . [L]iberty meant freedom from actual restraint[.]"[32] The law later expanded to include "a recognition of man's spiritual nature, of his feelings and intellect[,]"[33] and, by 1890, when Brandeis and White wrote their essay on the private law meaning of privacy, privacy had come to include "the right to enjoy life,—the right to be let alone; the right to . . . the exercise of extensive civil privileges[.]"[34]

The United States Supreme Court first addressed the issue of "whether individuals maintain certain privacy rights that fall within the contexts of the constitutionally protected liberty interests"[35] in *Olmstead v. United States*,[36] It first recognized a constitutional right of privacy in *Griswold v. Connecticut*.[37] Since

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[29] *Id.* at 112.

[30] *Id.* at 106, 112.

[31] Brandeis & White, *The Right to Privacy*, 4 HARV. L. REV. 193 (1890).

[32] *Id.* at 193.

[33] *Id.*

[34] *Id.*

[35] Note, *Bowers v. Hardwick: Is There a Right to Privacy*, 37 AM. U.L. REV. 487, 490 (1988).

[36] 277 U.S. 438 (1928). In his famous dissent, Justice Brandeis spoke eloquently of the right, conferred by the Constitution, to be let alone.

[37] 381 U.S. 479 (1965). *Griswold* dealt with the right of married people to use contraceptives. In it, the Court held that "specific guarantees of the Bill of Rights have penumbras, formed by emanations from these guarantees that help give them life and substance." *Id.* at 484. Specifically, the first amendment created a zone of privacy relating to the right of association; the third amendment's prohibition of non-consensual quartering of soldiers in homes during peacetime created another aspect of the right; the fourth amendment explicitly affirmed the right to be secure against unreasonable searches and seizures; the fifth amendment's self-incrimination clause created a zone of privacy around the individual; and the ninth amendment allowed for finding a right to privacy by providing that "the enumeration in the Constitution, of certain rights, shall

Griswold, in addition to the penumbras of the first, third, fourth, and fifth amendments, the Supreme Court has found the right of privacy in the fourteenth amendment, the privileges and immunities clauses of article IV and the fourteenth amendment, and implicit in the eighth amendment's prohibition against cruel and unusual punishments.[38] The Supreme Court has established that an activity must be deemed "fundamental" before it is considered protected by the right of privacy.[39] However, the right of privacy is not absolute. Should a court establish that an activity is fundamental, the activity may be regulated upon the showing of a *compelling* state interest by the government.[40]

In a unanimous decision in *Whalen v. Roe*,[41] the United States Supreme Court seemed to expand the scope of activities protected by the right of privacy, suggesting that the right to privacy "encompassed something beyond the least common denominator of the Court's prior decisions,"[42] and was in fact comprised of a general "individual interest in avoiding disclosure of personal matters"[43] and a separate "interest in independence in making certain kinds of important decisions."[44]

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not be construed to deny or disparage others retained by the people." *Id.* Finally, the fourth and fifth amendments protected against governmental invasions of "the sanctity of a man's home and the privacies of life." *Id.*

Griswold's penumbra theory is based on the idea that although the Constitution does not refer expressly to a right to privacy, "various provisions of the Constitution embody separate aspects of such a concept, and the composite of these protections should be accorded the status of a recognized constitutional right." Emerson, *Nine Justices in Search of a Doctrine*, 64 MICH. L. REV. 219, 228 (1965).

Prior to *Griswold*, "development of [a] constitutionally protected right of privacy [had] been in connection with limitations imposed on the authority of government to seize persons or property." McKay, *The Right of Privacy: Emanations and Intimations*, 64 MICH. L. REV. 259, 272 (1965).

[38] L. TRIBE, AMERICAN CONSTITUTIONAL LAW 893 (1976).

[39] The Court in Bowers v. Hardwick, 478 U.S. 186 (1986), defined as "fundamental" rights which are rooted in the nation's tradition and history or that are implicit in the concept of ordered liberty. *Id.* at 191-92. Among the activities which the Supreme Court has found to be fundamental are activities relating to contraception, Eisenstadt v. Baird, 405 U.S. 438 (1972), procreation, Skinner v. Oklahoma, 316 U.S. 535 (1942), family relationships, Prince v. Massachusetts, 321 U.S. 158 (1944), child rearing and education, Pierce v. Society of Sisters, 268 U.S. 510 (1925), and a woman's right to decide whether or not to terminate her pregnancy, Roe v. Wade, 410 U.S. 113 (1973).

[40] Roe v. Wade, 410 U.S. 113, 155-56 (1973).

[41] 429 U.S. 589 (1977).

[42] L. TRIBE, *supra* note 38, at 892.

[43] 429 U.S. at 599.

[44] 429 U.S. at 599-600 (citing Roe v. Wade, 410 U.S. 113 (1973); Doe v. Bolton, 410 U.S. 179 (1973); Loving v. Virginia, 388 U.S. 1 (1967); Griswold v. Connecticut, 381 U.S. 479 (1965); Pierce v. Society of Sisters, 268 U.S. 510 (1925); Meyer v. Nebraska, 262 U.S. 390 (1923); Allgeyer v. Louisiana, 165 U.S. 578 (1897)).

Recently, the United States Supreme Court retreated from its position in *Whalen*. In *Bowers v. Hardwick*,[45] the Supreme Court upheld a Georgia statute that criminalized sodomy, as it was enforced against homosexuals. Instead of recognizing a broad privacy right, the Supreme Court adhered to a "list approach," comparing homosexual sodomy to activities previously deemed fundamental. Because homosexual sodomy was not sufficiently similar to these activities, the Supreme Court found no fundamental right entitled to protection under a right of privacy.

An adherence to a comparative "list approach" may make it easier to predict which activities are protected by the right to privacy. Even with a list approach, however, courts decide what is fundamental and therefore protected by the right of privacy based on what value society places, at the time of its decision, on the activity involved.[46] As a result, courts' notions of what falls within the right of privacy changes over time.[47]

C. *Judicial Scrutiny of Legislation Burdening the Right of Privacy*

Legislation that burdens a fundamental right is subjected to strict scrutiny.[48]

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[45] 478 U.S. 186 (1986).

[46] L. TRIBE, *supra* note 38, at 892.

[47] Hence, when Warren and Brandeis argued in 1890 for an expansion of the existing right of privacy to protect the person and "[secure] to the individual . . . the right 'to be left alone,' " *Id.* at 195 (citing T. COOLEY, LAW ON TORTS, 29 (2d ed. 1888), they were concerned with technological and social changes which threaten the individual with "invasion either by the too enterprising press, the photographer, or the possessor of any other modern device for recording or reproducing sense or sounds." *Id.* at 206. They argued that the right of privacy, already existing in the common law, should be expanded by the courts to address invasions of privacy brought about by the greater ability of society to infringe upon it, thus expanding the law's conception of what the common law right of privacy included and protected. Brandeis & White, *The Right to Privacy*, 4 HARV. L. REV. 192 (1890).

Likewise, the recognition of a constitutional right of privacy in *Griswold* came at a time when protection of "the dignity and integrity of the individual—[had] become increasingly important as modern society . . . developed." Emerson, *Nine Justices in Search of a Doctrine*, 64 MICH. L. REV. 219, 229 (1965). As the forces of technology narrowed the area of privacy, "the capacity to maintain and support this enclave of private life" came to be viewed as the "difference between a democratic and totalitarian society." *Id.*

A further rationale for recognizing a privacy right is the protection of the minority from the majority. As society evolves, "[m]ajorities grow more complacent; factions rigidify. Locked into frozen configurations, legislators may either ignore sound opportunities for progress, or opt for novelty without adequate thought of consequences . . . . It is to resist such dangers that rights of personhood are elaborated, serving both as *reminders of values to be preserved and as hints of values not yet realized*." L. TRIBE, *supra* note 38, at 892 (emphasis added).

[48] *See* L. TRIBE, *supra* note 38, at 1000-05; Note, *Roe and Paris: Does Privacy Have a Principle?*, 26 STAN. L. REV. 1161, 1171-73 (1974).

In the absence of interference with a fundamental right, the Court subjects legislation to a

This test first requires that the goal of the legislation be a compelling interest, and second, that the means chosen are necessary to achieve this goal.[49] As privacy protection extends only to activities deemed fundamental,[50] these activities can be infringed upon only if the legislation passes the hurdle of strict scrutiny. In the area of privacy, only one state interest has been recognized as compelling: the state's interest in the health of a pregnant woman and in protecting potential life.[51] Thus, in practical terms, once the court determines that a decision or activity is fundamental and protected by a right of privacy, legislation burdening the right will likely be invalidated.[52]

D. The Status of Obscenity Under the Federal Right of Privacy

Obscenity, which in *Roth* had been denied first amendment protection, was first analyzed under the right of privacy in *Stanley v. Georgia*.[53] The United States Supreme Court in *Stanley* distinguished between regulating commercial

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"rational relation" test. *See* L. TRIBE, *supra* note 38, at 994-97; *Roe and Paris: Does Privacy Have a Principle?*, 26 STAN. L. REV. 1161, 1166-71 (1974); *Paris Adult Theatre I*, 413 U.S. 49 (1973). This test grants great deference to legislative pronouncements and has two requirements. First, the goal of the challenged legislation must be a legitimate goal. Second, the means employed must be rationally related to the goal. Perry, *Modern Equal Protection: A Conceptualization and Appraisal*, 79 COLUM. L. REV. 1023, 1068 (1979), *See, e.g.*, Williamson v. Lee Optical, Inc., 348 U.S. 483 (1955); United States R.R. Retirement Bd. v. Fritz, 449 U.S. 166 (1980); Lyng v. International Union, United Auto., Aerospace & Agric. Implement Workers, 485 U.S. ——, Doc. No. 86-1471 (1988).

[49] Note, *An Argument for the Application of Equal Protection Heightened Scrutiny to Classification Based on Homosexuality*, 57 S. CAL. L. REV., 797, 808-11 (1984).

This two-tiered approach to judicial scrutiny has been criticized as too inflexible. *See, e.g.*, Ravin v. State, 537 P.2d 494, 515 (Alaska 1975) (Boochever, J., concurring). As a practical matter, given the Court's great deference to the legislature, the rational relation test "is merely a rubber-stamp review." *Id.* at 808. Thus, under this test, the Court will always be able to find a rational relationship between the means and a legitimate goal. *See, e.g.*, United States R.R. Retirement Bd. v. Fritz, 449 U.S. 166 (1980). In contrast, under the compelling interest test, the state "has rarely prevailed." *Roe and Paris: Does Privacy Have a Principle?*, 26 STAN. L. REV. 1161, 1167 (1974).

[50] *See supra* note 39 and accompanying text.

[51] In Roe v. Wade, 410 U.S. 113, 154 (1973), the Court declared:

> [A] State may properly assert important interests in safeguarding health, in maintaining medical standards, and in protecting potential life. At some point in pregnancy, these respective interests become sufficiently compelling to sustain regulation of the factors that govern the abortion decision. The privacy right involved, therefore, cannot be said to be absolute.

Id. at 154.

[52] *See, e.g.*, Loving v. Virginia, 388 U.S. 1 (1967) (invalidating antimiscegenation statute that burdened the fundamental right to marry).

[53] 394 U.S. 557 (1969).

distribution of obscene material and regulating private possession of such material.[54] It held that within the privacy of the home, the "personal liberties guaranteed by the first and fourteenth amendments[,]" which include the right to read and observe what one pleases, overcame any state interference based on the mere categorization of material as obscene.[55]

The Supreme Court's decision in *Stanley* was based on two constitutionally protected rights. First, the first amendment right "to receive information and ideas, regardless of their social worth,"[56] and second, the right to be free from "unwanted governmental invasions into one's privacy."[57] Under the Supreme Court's reasoning, the first amendment right to receive information and ideas took on an "added dimension"[58] and became stronger when exercised in "the privacy of a person's own home."[59] Activity taking place within the home was also in itself protected by the right of privacy.[60] Because the first amendment right was stronger when exercised in the home, private use of obscenity within the home could not be regulated. Once obscenity left the home, the "extra layer" of constitutional protection disappeared and, pursuant to *Roth*, obscenity was unprotected speech under the first amendment and subject to regulation.

The United States Supreme Court in *Stanley* explicitly stated that the *Roth* holding remained unimpaired and that the states retained broad power to regulate obscenity.[61] It did not address the issue of whether there was a correlative right to purchase obscene material for use in the home. Cases following *Stanley* answered this question negatively, limiting *Stanley*'s holding strictly to the *possession* of obscene material *in the home*. The right to possess obscene material in the privacy of the home did not give rise to a correlative right to have someone sell or give it to others.[62] *Stanley* did not apply even when the importer of obscene material claimed that the material was for private, personal use and possession only.[63] No constitutionally protected zone of privacy followed obscene material once it was moved "outside the home area protected by *Stanley*."[64]

The United States Supreme Court's reasoning in the post-*Stanley* cases ap-

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[54] *Id.* at 563-64.

[55] *Id.* at 565. The Court described the right to privacy as a fundamental, constitutionally protected "right to be free, except in very limited circumstances, from unwanted governmental intrusions into one's privacy." *Id.* at 564.

[56] *Id.* at 564.

[57] *Id.*

[58] *Id.*

[59] *Id.*

[60] *Id.* at 565.

[61] *Id.* at 568.

[62] United States v. Thirty-Seven Photographs, 402 U.S. 363 (1971).

[63] United States v. 12 200-Ft. Reels of Super 8mm. Film, 413 U.S. 123 (1973).

[64] United States v. Orito, 413 U.S. 139, 141-42 (1973).

pears to rest on the view that *Stanley* was decided mainly on privacy, rather than first amendment, grounds.[65] Obscenity is protected within the home not because of its nature as speech, but because the activity of viewing obscenity takes place in the home, a place protected by the right of privacy. Hence, consistent with *Roth*, any purchase, transportation, or use of obscenity outside of the home is constitutionally unprotected and subject to regulation. Perhaps as an indication of its discomfort with this result, the Supreme Court has stated that Congress is free to create "an exemption for private use" of obscene material, "permit the transportation of obscene material under conditions ensuring privacy[,]"[66] or otherwise restructure obscenity laws.[67]

Concurring and dissenting opinions in the post-*Stanley* cases argued for a correlative right to acquire obscene material for use in the home. Under this reasoning, the inability to obtain obscene material prevents the exercise of a protected activity (viewing obscene material in the privacy of one's home) and therefore is unconstitutional.[68] Alternatively, some of the opinions ground their arguments in first amendment rights.[69]

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[65] In United States v. Reidel, 402 U.S. 351 (1971), the Court noted that:

> The focus of [*Stanley*] was on freedom of mind and thought and on the privacy of one's home. It does not require that we fashion or recognize a constitutional right in people like Reidel to distribute or sell obscene materials. The personal constitutional rights of those like Stanley to possess and read obscenity in their homes and their freedom of mind and thought do not depend on whether the materials are obscene or whether obscenity is constitutionally protected. Their rights to have and view that material in private are *independently* saved by the Constitution.

Id. at 356 (emphasis added).

"*Stanley* depended, not on any first amendment right to purchase or possess obscene materials, but on the right to privacy in the home." United States v. 12 200-Ft. Reels of Super 8mm. Film, 413 U.S. at 126.

"The Constitution extends special safeguards to the privacy of the home, just as it protects other special privacy rights." United States v. Orito, 413 U.S. at 142.

[66] *Orito*, 413 U.S. at 129.

[67] *Reidel*, 402 U.S. at 1413.

[68] Justice Stewart, concurring in *Thirty Seven Photographs*, stated that if "the Government may lawfully seize literary material intended for the purely private use of the importer . . . then I do not understand the meaning of *Stanley v. Georgia*." 402 U.S. at 379.

In his dissenting opinion in *12 200-Ft. Reels of Super 8mm. Film*, Justice Douglas argued for the ancillary right to carry obscene literature in one's briefcase or to bring it home from abroad, in order to realize the *Stanley* right. 413 U.S. at 137.

Justice Black, in his combined dissenting opinion to *Thirty Seven Photographs* and *Reidel*, stated that *Stanley* should be interpreted to include the right to receive obscene material voluntarily through the mail or to carry it privately in luggage when entering the country, for without that right, the right to view and read any material at home was "hollow indeed." 402 U.S. at 381.

[69] In United States v. Orito, 413 U.S. 139 (1973), Justice Douglas argued that *Stanley* was decided on first amendment grounds, therefore the right to read "obscene" books followed the

E. *Free Speech Guarantee in Hawaii Constitution Does Not Protect Obscenity*

The Hawaii legislature adopted the *Miller* standard in Hawaii Revised Statutes section 712-1210(6).[70] The Hawaii Supreme Court upheld the statute against challenges of overbroadness and vagueness in *State v. Manzo*.[71] It also held that, like the federal Constitution, Hawaii's free speech provision does not protect obscenity.[72] In reaching this conclusion, the Hawaii Supreme Court was influenced by the fact that Hawaii's free speech provision was "identical to that contained in the [first amendment of the] United States Constitution, which language was dealt with in *Roth*."[73] The court reasoned that because *Roth* represented the "definitive interpretation" of the borrowed language in 1959 when the Hawaii Constitution was adopted,[74] the intent of the framers of the Hawaii Constitution was that obscenity was subject to the same regulation prescribed in

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reader wherever he or she went. Thus, "he who carries an 'obscene' book in his pocket during a journey for his intended personal enjoyment" and "he who carries the book in his baggage or has a trucking company move his household effects to a new residence" would both be protected. *Id.* at 146.

Likewise, Justice Stevens, joined by Justice Marshall, stated in his dissenting opinion in Pope v. Illinois, 481 U.S. 497 (1987), that the Court's restrictive reading of *Stanley* (that it had "no implications to the criminalization of the sale or distribution of obscenity") offended the "overarching first amendment principles discussed in *Stanley*, almost as much as it insults the citizenry by declaring its right to read and possess material which it may not legally obtain." *Id.* at _____.

On a basic level, some of the opinions urge that *Roth* be overruled because there is no principled reason to exclude obscenity from protection under the first amendment, whether used inside or outside the home.

In *Orito*, Justice Brennan dissented, stating that, "Whatever the extent of the Federal Government's power to bar the distribution of allegedly obscene material to juveniles or the offensive exposure of such material to unconsenting adults, the statute before us is clearly overbroad and unconstitutional on its face." 413 U.S. at 147-48.

In *Thirty Seven Photographs*, Justice Black, dissenting, urged that the Court should "adhere to the literal command of the first amendment that 'Congress shall make no law . . . abridging the freedom of speech, or of the press." 402 U.S. at 380.

[70] *See supra* note 7.

[71] 58 Haw. 440, 573 P.2d 945 (1977). In *Manzo*, the court upheld Defendant's conviction under HAW. REV. STAT. § 1214(1)(a) (1985) for promotion of pornography, as defined in HAW. REV. STAT. § 712-1210(6) (1985).

[72] At the time *Manzo* was decided, the free speech provision was found in article I, section 3, which read: "No law shall be enacted . . . abridging the freedom of speech . . . ." HAW. CONST. art. I, § 3.

The Hawaii Constitution has since been amended. The free speech provision is now located in article I, section 4, which reads: "No law shall be enacted respecting an establishment of religion, or prohibiting the free exercise thereof, or abridging the freedom of speech or of the press or the right of the people peaceably to assemble and to petition the government for a redress of grievances." HAW. CONST. art. I, § 4.

[73] 58 Haw. at 452, 573 P.2d. at 953.

[74] *Id.* at 453, 573 P.2d. at 953-54.

Roth.[75] However, the court also stated that it was not necessary for its decision to decide whether the borrowed language "must be read as interpreted in *Roth*[,]" and that "[j]ust where the line between protected speech and obscenity should be drawn for the purposes of the Hawaii Constitution and whether it is located elsewhere than under the first amendment, may be left for determination when the occasion arises."[76] Thus, the court left open the possibility of a different interpretation of article I, section 4 with regard to obscenity.

F. The Right of Privacy in Hawaii

The right to privacy in Hawaii is explicitly stated in article I, sections 6 and 7 of the Hawaii Constitution.[77]

Prior to 1968, present article I, section 7, provided security against unreasonable searches and seizures in the same terms as the fourth amendment of the United States Constitution. In 1968, the Constitutional Convention of Hawaii amended section 7 to include a specific reference to security against invasion of privacy. The purpose was to "protect the individual's wishes for privacy as a legitimate social interest" and was "intended to include . . . undue government inquiry into and regulation of those areas of a person's life which is defined as necessary to insure 'man's individuality and human dignity.' "[78]

Following the amendment of article I, section 7, the Hawaii Supreme Court attempted to define the limits of the newly recognized right of privacy. In *State v. Roy*,[79] it suggested that section 7 had been amended solely to protect against extensive governmental use of electronic techniques.[80] In *State v. Baker*,[81] while

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[75] *Id.* at 453, 573 P.2d at 954.

[76] *Id.* at 454, 573 P.2d at 954.

[77] Article I, section 6 reads: "The right of the people to privacy is recognized and shall not be infringed upon without the showing of a compelling state interest. The legislature shall take affirmative steps to implement this right." HAW. CONST. art. I, § 6.

Article I, section 7 reads:

> The right of the people to be secure in their persons, houses, papers and effects against unreasonable searches, seizures and invasions of privacy shall not be violated; and no warrants shall issue but upon probable cause, supported by oath or affirmation, and particularly describing the place to be searched and the persons or things to be seized or the communications sought to be intercepted.

HAW. CONST. art. I, § 7.

[78] STAND. COMMITTEE REP. NO. 55, 1 PROCEEDINGS OF THE CONST. CONVENTION OF HAW. of 1968, at 233-34 (1973).

[79] 54 Haw. 513, 510 P.2d 1066 (1973) (involving a search and seizure issue in a charge of unlawful transfer of marijuana).

[80] *Id.* at 517, 510 P.2d at 1069. Justice Levinson, concurring, asserted that section 7 was not limited to protection against governmental electronic surveillance, but included protection against "undue governmental inquiry into and regulation of those areas of a person's life which is defined

the court acknowledged the right of privacy contained in the article I, section 7, it did "not find in that provision any intent to elevate the right of privacy to the equivalent of a first amendment right."[82] Based on that conclusion, and citing to *State v. Rocker*,[83] the Hawaii Supreme Court held that the right of privacy contained in section 7 was protected only against *unreasonable* governmental invasion.[84] Similarly, Justice Abe's dissent in *State v. Lee*[85] argued that article I, section 2 (present section 7) of the Hawaii Constitution specifically recognized the fundamental right to be let alone, but allowed that the right was subject to *reasonable* restriction under the police power.[86]

Partly in response to *State v. Roy*, the 1978 Constitutional Convention clarified the nature of Hawaii's privacy right by limiting section 7 to criminal cases and creating section 6 to apply to "privacy in the informational and personal autonomy sense."[87] In addition, the Convention clearly provided in the text of

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as necessary to insure 'man's individuality and human dignity.' " *Id.* at 518, 510 P.2d at 1069. In fact, the court had earlier, in Medeiros v. Kiyoshi, 52 Haw. 436, 478 P.2d 314 (1970) recognized that the specific right of privacy contained in section 7 included parents' educational decisions regarding their children.

[81] 56 Haw. 271, 535 P.2d 1394 (1975) (held that the trial court erred in reversing the presumption of constitutionality of a statute that proscribed marijuana as a harmful substance, even though there is conflicting scientific evidence as to the harmfulness of marijuana and that a statute proscribing the commercial distribution of harmful substances may, as an enforcement measure, proscribe the possession of the substance for personal use).

[82] *Id.* at 280, 535 P.2d at 1399.

[83] 52 Haw. 336, 475 P.2d 684 (1970). In this case, the Hawaii Supreme Court did not apply section 7 in reaching its decision. Instead, citing to *Griswold* and *Stanley*, it recognized "each individual's constitutional right of privacy and right to be let alone," *Id.* at 344, 475 P.2d at 690, but stated that the right was not exclusive and did "not entitle an individual to do as he pleases in violation of the rights of others." *Id.* The right to privacy did not automatically follow one about, but was dependent on whether one could reasonably expect to be free from government intrusion. Thus, defendants, who were charged and convicted of creating a common nuisance by sunbathing nude at a public beach, were not protected by a right to privacy, although the beach was away from view of a public road and adjoining beaches.

[84] 56 Haw. at 280, 535 P.2d at 1399. *See also* State v. Renfro, 56 Haw. 501, 542 P.2d 366 (1975). In State v. Kahalewai, 56 Haw. 481, 541 P.2d 1020 (1975), involving a statute prohibiting the inhalation of certain compounds for the purpose of intoxication, the court rejected Defendant's argument that consumption of harmless substances was protected by a right of privacy arising from the state and federal constitutions.

[85] 51 Haw. 516, 465 P.2d 573 (1970). Statute requiring motorcyclists to wear safety helmets sustained. Justice Abe believed that the statute in question unreasonably infringed on the right to decide what is in one's own best interest. Justice Abe, joined by Justice Kobayashi, made the same argument in dissent in State v. Cotton, 55 Haw. 138, 576 P.2d 709 (1973), involving a similar fact pattern.

[86] 51 Haw. at 526, 465 P.2d at 579.

[87] STAND. COMM. REP. NO. 69, 1 PROCEEDINGS OF THE CONST. CONVENTION OF HAW. of 1978, at 674 (1980). Included within this right of privacy are control over dissemination of private matters, control over the issuance of personal information, and control over highly personal

the constitution that the right of privacy contained in section 6 is fundamental and "shall not be infringed without the showing of a compelling state interest."[88]

The scope of the Hawaii right specifically includes the "right to control certain highly personal and intimate affairs of [one's] own life . . . . to dictate [one's] lifestyle, to be oneself[.]"[89] According to the Committee of the Whole Report, it is "similar to the privacy right discussed in cases such as *Griswold v. Connecticut* . . . , *Eisenstadt v. Baird* . . . , *Roe v. Wade* . . . , etc."[90] and is "a right that, though unstated in the Federal Constitution, emanates from the penumbra of several guarantees of the Bill of Rights."[91] The delegates left it to the courts' discretion to decide whether, in a particular case, an activity is protected by the right of privacy.[92]

The Hawaii Supreme Court had an opportunity to determine whether an activity is protected under the personal autonomy section of article I, section 6,[93] in *State v. Mueller*.[94] In *Mueller*, the defendant sought to have the decision to engage in sex for hire in the privacy of the home declared a fundamental right entitled to protection from governmental interference under the privacy right guaranteed by the state and federal constitutions.[95] The Supreme Court conceded that while there was room to argue that "the right [of freedom from intrusion] encompasses any decision to engage in sex at home with another willing adult[,]"[96] the defendant had failed to show that the decision to engage

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affairs of one's life.

[88] HAW. CONST. art. I, § 6. *See supra* note 77.

[89] STAND. COMM. REP. NO. 69, 1 PROCEEDINGS OF THE CONST. CONVENTION OF HAW. of 1978, at 674 (1980). This suggests that the state criteria for a fundamental right is "highly personal and intimate" activities and decisions, as compared to the federal formulation of "rooted in the nation's tradition and history" or "implicit in the concept of ordered liberty." *Bowers*, 478 U.S. at 191-92.

[90] COMM. OF THE WHOLE REP. NO. 15, 1 PROCEEDINGS OF THE CONST. CONVENTION OF HAW. of 1978, at 1024 (1980).

[91] *Id.*

[92] STAND. COMM. REP. NO. 69, 1 PROCEEDINGS OF THE CONST. CONVENTION OF HAW. of 1978, at 675 (1980).

[93] The court has decided two cases based on the informational privacy portion of section 6: Nakano v. Matayoshi, 68 Haw. 142, 706 P.2d 814 (1985), and Painting Indus. v. Alm, ___ Haw. ___, 746 P.2d 79 (1987).

[94] 66 Haw. 616, 671 P.2d 1351 (1983).

[95] *Id.* at 618-19, 671 P.2d at 1354.

[96] *Id.* at 626, 671 P.2d at 1358 (citing to Eisenstadt v. Baird, 405 U.S. 438 (1972) (right of privacy extends to sexual activity among unmarried adult couples), and Stanley v. Georgia, 394 U.S. 557 (1979) (right of privacy extends to autoeroticism in the home). The court also noted that the drafters of the Hawaii Penal Code found the usual reasons used to justify suppressing prostitution unconvincing. *Id.* at 626, 671 P.2d at 1358.

in prostitution had been recognized as a fundamental right.[97] Therefore, regulation was allowable on a showing of a rational basis for state interference.[98]

The court in *Mueller* specifically held that under Hawaii's Constitution, as under the federal Constitution, prostitution was not a fundamental right. According to the court, Hawaii did not have a broader right of privacy than the federal Constitution. Rather, "[w]hile the report that brought the proposal to the floor of the convention in 1978 may be read as envisioning a broader right to privacy, what was approved by the framers 'is similar to the privacy right discussed in cases such as *Griswold v. Connecticut* . . . , *Eisenstadt v. Baird* . . . , *Roe v. Wade* . . . , etc.' "[99] In the court's view, terms such as "the right to be let alone," "intimate decision," or "personal autonomy," or "personhood" were not intended by the framers to have a talismanic effect. An activity or decision had to be deemed fundamental before being afforded protection under the right of privacy.[100] Because prostitution was not a fundamental right, it was not protected by either the federal or the state right of privacy.[101]

IV. ANALYSIS

This section will begin with a narrative of the Hawaii Supreme Court's decision in *Kam*. It will then explore the validity of the *Kam* court's decision that the Hawaii privacy right is broader than the federal right and compare *Kam* with *Mueller* and similar cases from other states.

A. *Narrative*

In *Kam*, the Hawaii Supreme Court addressed three issues. First, whether Hawaii Revised Statutes section 712-1214(1)(a), which prohibited the promo-

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[97] In determining that prostitution was not a fundamental right, the Court was influenced by federal case law, stating that after reviewing relevant United States Supreme Court case law

> we perceive no inclination on the part of the [Supreme] Court to exalt sexual freedom per se or to promote an anomic society. And until we learn from the Court's pronouncements that we have been misinformed, we shall continue to assume there is a "social interest in order and morality.

Id. at 628, 671 P.2d at 1359.

[98] *Id.* The Court found the rational basis in the need for public order.

[99] *Id.* at 630, 671 P.2d at 1360 (quoting from COMM. OF THE WHOLE REP. NO. 15, 1 PROCEEDINGS OF THE CONST. CONVENTION OF HAW. of 1978, at 1024 (1980)).

[100] *Id.*

[101] In a footnote, the court limited its holding to the issue of whether the decision to engage in prostitution was protected and did not establish the outer boundaries of protection under section 6 in any other sense. *Id.*

tion of pornography, was unconstitutionally overbroad or vague;[102] second, whether defendants, as sellers of pornography, had standing to assert the privacy rights of their customers to purchase pornographic material; third, whether Hawaii Revised Statutes section 712-1214(1)(a) infringed on the right to privacy found in article I, section 6 of the Hawaii Constitution.

Hawaii Revised Statutes section 712-1214 tracks the language of *Miller v. California*,[103] and therefore is a valid statute under the United States Constitution. In *State v. Manzo*,[104] the Hawaii Supreme Court held that the definition embraced by the statute was neither overbroad nor vague and was valid under the Hawaii Constitution. In *Kam*, the court again held the statute constitutional under free speech analysis.[105] It then proceeded to analyze the statute under the right of privacy.[106]

The Hawaii Supreme Court first ruled that defendants, as sellers of pornographic items, had standing to assert the privacy rights of persons who wished to buy the items for use in the privacy of their homes. The court based its decision on two facts. First, enforcement of the statute "severely reduces the ability of persons to read or view pornographic material in the privacy of the home[,]"[107] thus having a detrimental effect on a protected right. Second, "buyers of pornography . . . are usually never charged with violating [the statute] so cannot generally raise the privacy issue[,]"[108] therefore allowing the defendants to assert the buyers' rights was necessary to protect the buyers' rights.

Turning to the merits of the privacy issue, the Hawaii Supreme Court began by analyzing United States Supreme Court case law which sets forth three basic propositions. First, obscenity is not protected speech, therefore states are free to regulate against it. Second, the possession of obscenity in the home is a fundamental right protected by the right to privacy. Third, the fundamental right to possess obscenity in the home does not give rise to a correlative right to have someone sell it to others.[109] The Hawaii Supreme Court then recognized the

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[102] *See supra* note 7.

[103] *See supra* notes 23-24 and accompanying text.

[104] *See supra* notes 70-76 and accompanying text.

[105] *Kam*, ___ Haw. at ___, 748 P.2d at 375.

[106] *Id.*

[107] *Id.* at ___, 748 P.2d at 376. The court analogized to Eisenstadt v. Baird, 405 U.S. 438 (1972), which held that a distributor of contraceptives had standing to assert the rights of his distributees because enforcement of the statute materially impaired a single person's ability to obtain contraceptives.

[108] ___ Haw. at ___, 748 P.2d at 376. The court analogized to Eisenstadt v. Baird, 405 U.S. 438 (1972), which held that a distributor of contraceptives could assert the rights of his distributees because single persons seeking contraceptives were not normally prosecuted so had no forum to challenge the law.

[109] ___ Haw. at ___, 748 P.2d at 376.

"paradoxical conflict"[110] in current federal case law that an individual has a right to possess what he cannot obtain and supported its ultimate holding by stating that the federal rulings and reasoning had "engendered substantial controversy and numerous dissents"[111] and that it was not bound by United States Supreme Court precedents because article I, section 6 of the Hawaii Constitution "affords much greater privacy rights than the federal right to privacy[.]"[112]

The Hawaii Supreme Court then discussed the history and scope of article I, section 6. It concluded that the government must have a compelling state interest before being allowed to intrude on "certain highly personal and intimate affairs of [a person's] life,"[113] and that the "personal decision . . . to read or view pornographic material in the privacy of one's own home" is a protected right under article I, section 6 of the Hawaii Constitution.[114] The court explicitly accepted *Stanley*'s reasoning so far as it established that possession of pornography in the home is protected by a right to privacy. It did not adopt *Stanley*'s holding that the right was strictly limited to the home.

Finally, the court applied article I, section 6, to the facts of the case and held that there is, correlative to the right to read or view pornographic material in the home, the right to "purchase such materials for . . . personal use[.]"[115] In support of its holding, the Hawaii Supreme Court cited *Carey v. Population Services International*,[116] where the United States Supreme Court "invalidated a state law which restricted the sale of contraceptives to licensed pharmacists and impermissibly infringed on an individual's privacy right to decide about family planning by making contraceptives less accessible to the public."[117] Because enforcement of the Hawaii statute had a similar detrimental effect on privacy rights, the state had to show a compelling governmental interest in order to prohibit the sale of pornographic material.[118] The state, having failed to show

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[110] *Id.*

[111] *Id.* at ____, 748 P.2d at 377 (citing dissenting opinions in Hamling v. United States, 418 U.S. 87, 141 (1974) (Brennan, Stewart & Marshall, JJ., dissenting), *reh'g denied*, 419 U.S. 885 (1974); United States v. Thirty Seven Photographs, 402 U.S. 363, 379 (1974) (Black, J., dissenting), *reh'g denied*, 403 U.S. 924 (1971); Smith v. United States, 431 U.S. 291 (1977) (Stevens, J., dissenting); and Pope v. Illinois, 481 U.S. 497 (1987) (Stevens, Marshall & Brennan, JJ., dissenting).

[112] *Id.* Interestingly, although the court goes on to discuss the legislative history of article I, section 6, it does not specify why it believes that the framers intended the Hawaii Constitution to afford "much greater privacy rights" than the federal right. See *infra*, notes 120-25 and accompanying text for further discussion of this point.

[113] *Id.* at ____, 748 P.2d at 378.

[114] *Id.* at ____, 748 P.2d at 378-79.

[115] *Id.* at ____, 748 P.2d at 380.

[116] 431 U.S. 678 (1977).

[117] ____ Haw. at ____, 748 P.2d at 379.

[118] *Id.*

such an interest, infringed on the individual's right to privacy, which includes the right to view pornographic material in the home and the correlative right to purchase pornographic material for personal use.[119]

B. *Did The Framers Intend The Hawaii Privacy Right To Be Broader Than The Federal Right?*

The *Kam* court determined that the Hawaii Constitution affords greater privacy rights than the federal Constitution. However, the court did not support its conclusion, and although section 6 specifically articulates a right to privacy, something the federal Constitution lacks, it is not clear whether section 6 was intended to afford a *greater* right to privacy than the federal Constitution.

As the "ultimate judicial tribunal" with "final, unreviewable authority to interpret and enforce the Hawaii Constitution,"[120] the Hawaii Supreme Court has the power to " 'extend the protections of the Hawaii Bill of Rights beyond those of textually parallel provisions of the federal Bill of Rights when logic and a sound regard for the purposes of those protections' so warrant."[121] At the same time, in interpreting the Hawaii Constitution, the Hawaii Supreme Court is bound to give effect to the intention of the people adopting it.[122]

In studying the legislative history of section 6, there is no reference to an intent to create a right broader than the federal right. There seems to be no difference in the general definition or scope of the right. Both require a fundamental right and a compelling state interest. The Committee of the Whole report explicitly states that the purpose of inserting section 6 was to alleviate confusion over the source and existence of the right, the absence of which had caused controversy in interpreting the federal Constitution.[123] In addition, the majority of the examples given by the Standing Committee and the Committee of the Whole are taken from federal case law, from which one could infer that the Hawaii and federal privacy rights share common characteristics regarding scope and application. This, in fact, was the court's conclusion in *Mueller.*

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[119] *Id.* at ____, 748 P.2d at 380. The Hawaii Supreme Court distinguished *Paris Adult Theatre I* and *Mueller* on the ground that both had been decided on rational basis, rather than compelling interest, analyses. *Id.* at ____, 748 P.2d at 379-380. The court applied the same reasoning to distinguish *Orito* and *12 200-Ft. Reels of Super 8mm. Film.*

[120] State v. Kim, ____ Haw ____, 711 P.2d 1291, 1293 (1985) (quoting State v. Wyatt, 67 Haw. 293, 304 n.9, 687 P.2d 544, 552 n.9 (1984)).

[121] Huihui v. Shimoda, 64 Haw. 527, 531, 644 P.2d 968, 971 (1982) (quoting State v. Miyasaki, 62 Haw. 269, 281, 614 P.2d 915, 922 (1980)); State v. Manzo, 58 Haw. 440, 452, 573 P.2d 945, 953 (1977); State v. Kaluna; 55 Haw. 361, 369, 520 P.2d 51, 58 (1974).

[122] *Id.*

[123] COMM. OF THE WHOLE REP. NO. 15, 1 PROCEEDINGS OF THE CONST. CONVENTION OF HAW. of 1978, at 1024 (1980).

The Hawaii Supreme Court's conclusion that Hawaii has a broader privacy right than that afforded at the federal level is supported by one of its earlier decisions. In *State v. Kaluna*,[124] the Hawaii Supreme Court interpreted Hawaii's search and seizure clause as affording greater privacy protection than the federal Constitution, although based on virtually the same language.[125]

C. *Is Kam Consistent with Mueller?*

The court in *Mueller* stated that the Hawaii right of privacy was not broader than the federal right. In *Kam*, it stated the opposite. While it first appears that *Kam* contradicts *Mueller*, on closer examination the two cases are reconcilable.

Mueller held that prostitution was not a fundamental right under either the federal or state constitution. For the purpose of determining what is or is not a fundamental right, the Hawaii Supreme Court relied on United States Supreme Court precedents and held that the Hawaii privacy right is no broader than the federal privacy right.

In *Kam*, the Hawaii Supreme Court again relied on United States Supreme Court precedent for holding that the right to view or use obscenity within the home was a fundamental right. It departed from federal case law on the issue of whether the right of privacy encompassed a correlative right to acquire obscene material for use in the home, which in itself was not a fundamental right. Thus, under *Kam*, the state right of privacy was interpreted more broadly than the federal right to protect a non-fundamental activity (the acquisition of obscene material) which affected one's ability to practice a fundamental activity (use of obscenity within the home).

Reading *Mueller* and *Kam* together, one could predict that in the future the Hawaii Supreme Court will use federal case law in determining what is a fundamental right but may go beyond federal case law in extending the right of privacy to protect non-fundamental activities which are necessary to the exercise of fundamental rights.

D. *Other State Court Decisions*

The Hawaii Supreme Court's decision in *Kam* differs in two ways from deci-

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[124] 55 Haw. 361, 520 P.2d 51 (1974).

[125] Although Hawaii's search and seizure provision contained a guarantee of the right to be free of unreasonable invasions of privacy, the Hawaii Supreme Court stated that it did not need to determine the exact meaning or scope of that provision because "*as a search and seizure*, the conduct of the police in this case was unreasonable," even though that conduct would have been accepted under interpretations of the fourth amendment of the United States Constitution. *Id.* at 369 n.6, 520 P.2d at 58 n.6.

sions made by other state appellate courts which have considered the same issue. First, states that have considered the issue of whether the purchase and/or sale of obscene material is protected under state constitutional provisions have followed the holdings of the post-*Stanley* rulings.[126] Second, these decisions have been based on the free speech clauses of the federal and state constitutions. Those states with privacy provisions have chosen not to address the issue in terms of the right to privacy.[127]

The Hawaii Supreme Court may have decided *Kam* based on privacy analysis because the state's explicit privacy clause has no federal counterpart, unlike Hawaii's free speech clause, which is very similar to the first amendment of the United States Constitution. This allowed the Hawaii Supreme Court to reach its desired result without contradicting federal case law. Arguably, because article I, section 6 has no "counterpart" in the federal Constitution, federal holdings on the same subject matter are less persuasive than they otherwise might be. The Hawaii Supreme Court may also have been unwilling to contradict its own ruling in *Manzo*, which adopted federal first amendment analysis in holding obscenity unprotected speech under the Hawaii Constitution's free speech provision.[128]

V. IMPACT

This section discusses the immediate impact of *Kam* and possible future implications with regard to certain types of obscenity, such as child pornography, bestiality, snuff films, and obtrusive public displays of pornography and sale of

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[126] *See* State v. Barrett, 278 S.C. 92, 292 S.E.2d 590 (1982) (obscene material not protected by first amendment or corresponding provision of South Carolina Constitution); Playhouse Corp. v. Washington State Liquor Control Bd., 35 Wash. App. 539, 667 P.2d 1136 (1983) (obscene and lewd *conduct* not protected by first amendment or by inferentially interchangeable provisions of state constitution); Commonwealth v. Croll, 331 Pa. Super. 107, 480 A.2d 266 (1984) (state's free speech clause provides no greater protection from prosecution for distribution of obscene material); People v. Seven Thirty-Five East Colfax, Inc., 697 P.2d 348 (Colo. 1985) (state's free speech section broader than federal protection, therefore statute banning sale of obscene material must satisfy both federal and state constitutional requirements; sale of obscenity still unprotected under state constitution); City of Portland v. Jacobsky, 496 A.2d 646 (Me. 1985) (any difference between Maine and United States Constitution doesn't justify reaching different result regarding obscenity as unprotected speech).

[127] *See* State v. Barrett, 278 S.C. 92, 292 S.E.2d 590 (1982), where the South Carolina Constitution's search and seizure clause contained a privacy provision similar to § 7 of the Hawaii Constitution; and Playhouse Corp. v. Washington State Liquor Control Bd., 35 Wash. App. 539, 667 P.2d 1136 (1983), in which the Washington Constitution contained a clause stating that "no person shall be disturbed in his private affairs, or his home invaded, without authority of law" that has been interpreted to apply to search and seizure issues.

[128] *See supra* notes 120-25 and accompanying text.

pornography to minors.

The *Kam* decision immediately invalidates Hawaii Revised Statutes section 712-1214(a), which prohibits the dissemination of pornographic material for monetary consideration. However, the remaining provisions of section 712-1214 remain intact. Hence, the state can still prohibit the production, presentation, or direction of pornographic performances for monetary consideration and the participation for monetary consideration in pornographic performances.

Moreover, *Kam* specifically declined to determine "whether a compelling government interest justifies the ban on certain types of obscenity such as child pornography, 'snuff films' (the depiction of actual killings), or bestiality."[129] Nor was it "presented with situations involving obtrusive public displays of pornography, the showing of obscenity to a captive audience, or the sale of pornography to minors."[130] Despite the court's silence on these issues, it is possible to speculate on whether a compelling interest in banning any of these activities could be found.[131]

The United States Supreme Court has rarely found a compelling interest sufficient to support legislation burdening a fundamental right.[132] In *Korematsu v. United States*,[133] a widely criticized case, the United States Supreme Court sustained federal legislation that called for the internment of Japanese Americans during World War II by finding a compelling interest in the prevention of sabotage and invasion.[134] In the area of privacy, the United States Supreme Court in *Roe*[135] held that the state's interest in the protection of maternal health and potential life was a compelling state interest.[136] In *New York v. Ferber*,[137] which involved child pornography, the United States Supreme Court held that the state's interest in " 'safeguarding the physical and psychological well-being

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[129] ____ Haw. at ____ n.2, 748 P.2d at 380 n.2.

[130] *Id.*

[131] The requirement of a compelling state interest in Hawaii is found within the text of its constitution. Haw. Const. art. I, § 6. Because the level of judicial scrutiny is dictated by the constitution, the Hawaii courts are prevented from adopting a more flexible standard such as the "sliding-scale test" used in Alaska. Under the sliding-scale test, the importance of the government interest is weighed against the importance of the right involved. As the right becomes more important, the state's burden in justifying the legislation increases. *See* Ravin v. State, 537 P.2d 494, 515 (Alaska 1975) (Boochever, J., concurring); State v. Erickson, 574 P.2d 1, 12 (Alaska 1978); Harrison v. State, 687 P.2d 332, 339-40 (Alaska 1984). There is also some federal support for the sliding-scale test. *See* San Antonio School Dist. v. Rodriguez, 411 U.S. 1, 70 (1973) (Marshall, J., dissenting); Plyer v. Doe, 457 U.S. 202 (1982).

[132] *See supra* note 51 and accompanying text.

[133] 323 U.S. 214 (1944).

[134] *Id.* at 219, 223.

[135] 410 U.S. 113 (1973).

[136] *Id.* at 162.

[137] 458 U.S. 747 (1982).

of a minor' is 'compelling'."[138] Finally, Justice Brennan has indicated his willingness to consider the protection of children and unwilling adults a compelling interest sufficient to support some regulation or prohibition of obscene materials.[139] Justice Brennan compared the involuntary exposure to erotic material to a physical assault.[140]

It is difficult to find a common thread running through this list of compelling interests. It appears, however, that a compelling interest may be discovered when physical harm, or something closely akin to physical harm, is threatened. Thus, in *Korematsu*, there was a compelling interest in protecting the nation against invasion; in *Roe*, there was a compelling interest in the prevention of harm to the pregnant woman or to the developing life. In *Paris*, Justice Brennan advocated protection of unwilling adults from exposure to obscenity because exposure would be comparable to a physical assault. According to *Ferber*, where children are involved, a compelling interest may be based on protection of either physical or psychological well-being.

Under *Mueller* and *Kam*, the Hawaii Supreme Court is likely to adhere to federal analysis regarding the scope of the right of privacy (i.e. what are fundamental rights, what are compelling state interests). The issue raised in *Kam* (i.e., whether non-fundamental rights, which allow one to exercise fundamental rights, are also protected) would not arise in these instances.

In the area of child pornography, the Hawaii Supreme Court is likely to find a compelling state interest that would allow regulation of both the dissemination and private possession of child pornography. Hawaii Revised Statutes section 707-751 already prohibits dissemination of material depicting children engaged in sexual conduct regardless of whether the material is obscene.[141] In holding the statute constitutional under first amendment analysis, the Hawaii

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[138] *Id.* at 756-57 (citing Globe Newspaper Co. v. Superior Court, 457 U.S. 596, 607 (1982)). The Court in *Ferber* further held that child pornography, even if not obscene, is unprotected speech under the first amendment. *Id.* It limited unprotected child pornography to material which involved "live performance or photographic or other visual reproduction of live performances." *Id.* at 765. "Distribution of descriptions or other depictions of sexual conduct, not otherwise obscene . . . retain[ed] first amendment protection." *Id.* at 764-65.

In Cinema I Video, Inc. v. Thornburg, 83 N.C. App. 544, 351 S.E.2d 305 (1986), the Court of Appeals of North Carolina interpreted this language to mean that a drawing or representation of sexual conduct involving children was unprotected child pornography. *Id.* at ____, 351 S.E.2d at 319.

[139] Paris Adult Theatre I v. Slaton, 413 U.S. 49, 107 (1973).

[140] *Id.* at 106-07.

[141] Hawaii Revised Statutes section 707-751 reads: "A person commits the offense of promoting child abuse in the second degree if, knowing or having reason to know its character and content, the person disseminates any pornographic material which employs, uses, or otherwise contains a minor engaging in or assisting others to engage in sexual conduct." HAW. REV. STAT. § 707-751 (1986).

Supreme Court adopted the compelling state interest in protecting the physical and psychological well being of children found in *Ferber*. In so doing, it stated that there was "no difference between the state and federal constitutions in this respect."[142]

Although the issue in *Ferber* was limited to the distribution of child pornography, the state is likely to follow the reasoning of the Ohio Supreme Court in *State v. Meadows*,[143] which held that private possession of child pornography can also be regulated.[144] This same compelling state interest could also be used to justify regulating the sale of obscenity to minors.

Using Justice Brennan's notion of the protection of unwilling adults from a kind of psychological assault as a compelling state interest, the state could also regulate obtrusive public displays of pornography, and the showing of obscenity to a captive audience.

A compelling state interest to regulate snuff films could easily be found in the protection of the lives of the murdered individuals. A compelling interest might also be found in discouraging physical violence.

The Hawaii Supreme Court's treatment of the regulation of bestiality is more difficult to predict. If it approaches the issue from the viewpoint that the fundamental right being protected is the right to use/view obscenity in the home, *Stanley* and *Kam* have already held that no compelling state interest has so far been presented to overcome that right. If the Hawaii Supreme Court believes strongly that bestiality should be regulated, it may take the position that the activity involved is the specific activity of viewing bestiality. It could then compare bestiality with those rights that the United States Supreme Court has found to be fundamental and conclude that viewing bestiality is not sufficiently similar to these rights to be considered fundamental. Regulation could then be based on a rational state interest, such as protection of animals or protecting the morals of society. This approach would be similar to the approach taken by the United States Supreme Court in *Bowers v. Hardwick*, which defined the right involved as the right to engage in homosexual sodomy, not the broader right to engage in consensual sexual activity.

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[142] State v. Shingaki, 65 Haw. 116, 118, 648 P.2d 190, 191 (1982).

[143] 28 Ohio St. 3d 43, 503 N.E.2d 697 (1986).

[144] There, the court stated that with respect to child pornography, the interests of the state in protecting the privacy, health, emotional welfare and well-rounded growth of its young citizens, together with its undeniable interest of safeguarding the future of society as a whole, comprise exactly the type of 'compelling reasons' justifying a 'very limited' first amendment intrusion envisioned by the *Stanley* court.

Id. at 50, 503 N.E.2d at 703. Hence, a criminal statute prohibiting "knowing possession or control" of material showing minors "participating in or engaging in sexual activity" was constitutional. *Id.* at 43, 503 N.E.2d at 697-98.

VI. CONCLUSION

State v. Kam is the Hawaii Supreme Court's resolution of a conflict between United States Supreme Court precedents that have held that although the right to view obscenity in the home is a protected right, there is no correlative right to acquire such material. In support of its departure from federal precedent, the Hawaii Supreme Court stated that Hawaii's Constitution provides a much broader privacy right than the federal right of privacy. In application, however, *Kam*'s expansive statement of a broader state right appears to be limited to the protection of a non-fundamental right which was necessary for the exercise of recognized fundamental right. It did not expand the scope of what is included within the category of fundamental rights. *Kam*'s impact on the area of regulation of obscenity also seems to be limited to this particular issue and is not likely to herald a further liberalization of obscenity laws in Hawaii.

Nevertheless, the Hawaii Supreme Court has cleared the way for future defendants to argue that Hawaii's privacy provision in fact expands the scope of what can be considered a fundamental right protected by the right of privacy. If so, the court may be hard pressed to find compelling state interests which would allow regulation of those rights.

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TORT LAW—*Bertelmann v. Taas Associates*: Limits on Dram Shop Liability; Barring Recovery of Bar Patrons, Their Estates and Survivors

I. INTRODUCTION

In *Bertelmann v. Taas Associates*[1] the Hawaii Supreme Court held that, absent either harm to an innocent third party or affirmative acts by an alcohol provider, merely serving liquor to an already intoxicated customer and allowing that customer to leave the premises does not constitute actionable negligence. The Hawaii Supreme Court thus declined to extend the availability of a common law dram shop action previously stated in *Ono v. Applegate*.[2]

Under *Ono*, an innocent third party injured by an intoxicated liquor consumer may sue the establishment that furnished the consumer with alcohol.[3] Such an action is based upon the alcohol provider's violation of a statutory duty to refrain from serving already intoxicated patrons.[4] *Bertelmann*, however,

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[1] 69 Haw. ____, 735 P.2d 930 (1987).

[2] 62 Haw. 131, 612 P.2d 533 (1980).

[3] *Id.* at 131, 612 P.2d at 534.

[4] Hawaii's liquor control statute reads, in relevant part:

(a) At no time under any circumstance shall any liquor:

. . . .

(2) Be sold or furnished by any licensee to:

. . . .

(B) Any person at the time under the influence of liquor,

. . . .

(b) At no time under any circumstance shall any licensee:

(1) Knowingly permit any person under the influence of liquor to be or remain in or on the licensed premises. . . .

HAW. REV. STAT. § 281-78 (1975).

The Hawaii Supreme Court found, in *Ono*, that these portions of the liquor control law (which were also at issue in *Bertelmann*) did establish a duty of due care on the part of the liquor provider. 62 Haw. at 138, 612 P.2d at 539.

Under Hawaii law, violation of a statute may be submitted to the finder of fact as evidence of negligence. *Id. See also* Michael v. Valdastri, Ltd., 59 Haw. 53, 55, 575 P.2d 1299, 1301

presented the Hawaii Supreme Court with a suit against an alcohol provider by the estate and survivors of a decedent whose intoxication caused his own death.

The *Bertelmann* court determined that bar patrons are not among the intended beneficiaries of Hawaii's liquor control statute.[5] Therefore, the court held that, absent affirmative acts by the alcohol provider,[6] a liquor consumer may not recover even where the alcohol provider violates the liquor control statute by serving an already intoxicated patron.[7] Furthermore, because the decedent in *Bertelmann* had no claim, the court also denied the derivative claims of his estate[8] and survivors.[9] The *Bertelmann* decision thus creates a bright line in dram shop liability actions: While injured third parties may sue the liquor provider, the actual consumer generally has no claim if he is later killed or injured.[10]

(1978); Sherry v. Asing, 56 Haw. 135, 149, 531 P.2d 648, 658 (1975); Young v. Honolulu Constr. & Draying Co., 34 Haw. 426, 435 (1938); Char v. Honolulu Rapid Transit Co., 31 Haw. 53, 58 (1929).

[5] 69 Haw. at ____, 735 P.2d at 933.

[6] *See infra* notes 64-69 and accompanying text.

[7] 69 Haw. at ____, 735 P.2d at 934.

[8] *Id.* Hawaii's survival statute reads:

> A cause of action arising out of a wrongful act, neglect, or default, except a cause of action for defamation or malicious prosecution, shall not be extinguished by reason of the death of the injured person. The cause of action shall survive in favor of the legal representative of the person and any damages recovered shall form part of the estate of the deceased.

HAW. REV. STAT. § 663-7 (1985).

As the court pointed out, under this statute "only those causes of action the decedent possessed survive for his or her estate." 69 Haw. at ____ n.5, 735 P.2d at 935 n.5.

[9] 69 Haw. at ____, 735 P.2d at 934-35. Plaintiffs maintained that the survivors could recover under an independent cause of action under section 663-3, even if Bertelmann, as administrator of Decedent's estate, was barred from recovery. Although Plaintiffs failed to raise this issue at trial, the court exercised its discretion to consider the point on appeal because "the existence of the Survivor's cause of action is of public importance and does not require additional facts. . . ." *Id.* at ____, 735 P.2d at 935.

Hawaii's wrongful death statute reads, in relevant part:

> When the death of a person is caused by the wrongful act, neglect, or default of any person, the deceased's legal representative, or any of the persons hereinafter enumerated, may maintain an action against the person causing the death or against the person responsible for the death. The action shall be maintained on behalf of the persons hereinafter enumerated, except that the legal representative may recover on behalf of the estate the reasonable expenses of the deceased's last illness and burial.
>
> In any action under this section, such damages may be given as under the circumstances shall be fair and just compensation with reference to the pecuniary injury and loss of love and affection . . . suffered as a result of the death of the person by the surviving spouse, children, father, mother, and by any person wholly dependent upon the deceased person.
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> . . . .

HAW REV. STAT. § 663-3 (1985).

[10] HAW. REV. STAT. §§ 281-78(a)(2)(A) and (a)(4) prohibit the selling or furnishing of liquor

This recent development begins with a brief description of the facts of the *Bertelmann* case in Part II. Part III analyzes the Hawaii Supreme Court's legal reasoning in *Bertelmann* by comparison to the court's reasoning in *Ono*. The analysis section also contains a discussion of various public policy rationales that are raised by the bright line rule imposed by the *Bertelmann* decision, but which were not fully addressed in the court's opinion. Part IV assesses the specific impact of *Bertelmann* on dram shop law in Hawaii, and also assesses the more general impact of *Bertelmann* in light of pertinent tort law principles. Finally, Part V reaches the conclusion that due to the *Bertelmann* court's unfortunate failure to conduct a complete public policy analysis, the Hawaii Supreme Court may have missed an opportunity to both enhance the credibility of its decision, and to establish a useful guidepost with which to assess future arguments for bright line limits to tort liability.

II. FACTS

On the evening of March 24, 1985, or the early morning of March 25, 1985, Solomon Boyd Keliikoa (Decedent) consumed alcoholic beverages at the Sheraton Royal Waikoloa Hotel[11] (Sheraton). Sometime after leaving the hotel, Decedent sustained fatal injuries when his car crashed on the Queen Kaahumanu Highway in North Kona.[12] No other persons or vehicles were involved in the accident.[13]

Decedent's estate and survivors (Plaintiffs)[14] filed suit on March 6, 1986 alleging that Sheraton employees negligently violated Hawaii's liquor control law by continuing to serve liquor to Decedent although they knew, or should have known, that he was intoxicated, and by allowing an intoxicated person to remain on the premises.[15] Plaintiffs contended that under Hawaii law, by virtue of the *Ono* decision, such negligent violations of the liquor control statute gave rise to a private right of action for dram shop liability which was applicable to

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to minors. The court did not decide whether a violation of these provisions of the statute would create a justiciable claim for the minor who is later killed or injured. 69 Haw. at ____ n.3, 735 P.2d at 934 n.3.

See infra note 55 for examples of the limited situations in which an alcohol consumer might still be permitted to recover from the establishment which provided him with intoxicants.

[11] 69 Haw. at ____, 735 P.2d at 931. The Sheraton Royal Waikaloa hotel is located on the island of Hawaii.

[12] *Id.*

[13] *Id.*

[14] The Plaintiffs-Appellants were Eric Kaleo Bertelmann as administrator of the estate of Solomon Boyd Keliikoa and the decedent's survivors, Mary Kapua Bertelmann Keliikoa as guardian ad litem for the unmarried minor Saulnette Kapua Palenapa, Eric Kaleo Haili Bertelmann, Mary Kapua Bertelmann Keliikoa, and Saul Cleghorn Keliikoa. *Id.*

[15] *Id.* See *supra* note 4 for the text of the statute.

the facts of this case.[16]

Sheraton moved for dismissal of the complaint for failure to state a claim upon which relief could be granted.[17] Reasoning that an actual liquor consumer should not be allowed to recover for his own wrongful act, Sheraton argued that, as a matter of public policy, dram shop liability should be limited to situations, such as in *Ono*, where an innocent third party is injured.[18]

The trial court granted Sheraton's motion to dismiss the complaint. On appeal, Plaintiffs argued that the existence and degree of negligence on the part of both the alcohol provider and the alcohol consumer were issues of fact for the jury to decide.[19] The Hawaii Supreme Court held, however, that as a matter of law, there could be no recovery for the death or injury of the decedent because Hawaii's liquor control laws "were created to protect the general public from drunk driving accidents, and not to reward intoxicated liquor consumers for the consequences of their voluntary inebriation."[20]

III. ANALYSIS

Under the traditional common law rule, any injury caused by an inebriated person, whether to himself or to third parties, was the sole responsibility of that person and under *no* circumstances could the alcohol provider be held liable.[21]

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[16] *Id.*

[17] 69 Haw. at ____, 735 P.2d at 932. *See* HAW. R. CIV. P. 12(b)(6).

[18] Defendant's Memorandum in Support of Motion to Dismiss Complaint at 15-24, Bertelmann v. Taas Assocs., 69 Haw. ____, 735 P.2d 930 (1987) (No. 86-195). Sheraton further supported this contention by citing cases from several jurisdictions barring recovery by liquor consumers as against liquor providers. Sheraton also noted that, in some jurisdictions which had allowed liquor consumers a dram shop action, the state legislatures promptly abrogated the case law.

[19] Plaintiffs-Appellants Opening Brief at 23, Bertelmann v. Taas Assocs., 69 Haw. ____, 735 P.2d 930 (1987) (No. 86-195). Plaintiffs also argued that even if decedent's estate was barred from recovery as a matter of law, the survivors' action could still be maintained. *Id.* Although this issue was not raised below the court did consider it. 69 Haw. at ____, 735 P.2d at 934.

In interpreting Hawaii's wrongful death statute the court held that if the decedent's recovery is barred, so are the survivors' wrongful death actions. *Id.*

[20] 69 Haw. at ____, 735 P.2d at 934. See Note, *Ono v. Applegate: Common Law Dram Shop Liability*, 3 U. HAW. L. REV. 149 (1981) noting that the *Ono* decision did not determine whether the plaintiff (the injured third party) was within the class of persons protected by Hawaii's liquor control law, but because a violation of that law would logically increase the chances of alcohol related injuries, "Hawaii's liquor control law is apparently designed to benefit all members of the public." *Id.* at 153.

[21] See, *e.g.*, Note, *The Liability of Providers of Alcohol: Dram Shop Acts?*, 12 PEPPERDINE L. REV. 177, 180, n.15 (1984) [hereinafter *Providers*] citing the following as examples of non-liability cases: Collier v. Stamatis, 63 Ariz. 285, 162 P.2d 125 (1945) (overruled in Ontiveros v. Borak, 36 Ariz. 500, 667 P.2d 200 (1983)); Carr v. Turner, 238 Ark. 889, 385 S.W.2d 656

Today, however, the majority of jurisdictions impose some sort of dram shop liability, either statutorily[22] or through common law actions.[23]

The Hawaii Supreme Court first upheld a common law dram shop action in *Ono v. Applegate*.[24] That court noted that only two elements of a dram shop negligence claim were at issue there: duty and proximate causation.[25] The *Ono* court had little difficulty finding that both crucial elements were established in that case. First, by referring to Hawaii's liquor control statute which prohibits alcohol dispensers from serving an already intoxicated person,[26] the *Ono* court held that a duty was owed to the plaintiff by the defendant tavern keeper.[27] Second, and despite the bar patron's voluntary consumption of alcohol, *Ono* further held that the tavern keeper's act of furnishing alcohol to an intoxicated bar patron was the proximate cause of injuries inflicted by that patron on a third person.[28]

Noting the "increasing frequency of accidents involving drunk drivers,"[29] the *Ono* court determined that the consequences of serving liquor to an already intoxicated patron were entirely foreseeable by the tavern owner.[30] Thus, *Ono* concluded, "[t]he consumption, resulting intoxication and the injurious conduct are therefore foreseeable intervening causes which will not relieve the tavern of liability."[31]

The principal question raised by a comparison of the *Ono* and *Bertelmann* decisions, then, is why the court had no difficulty finding the bar negligent in *Ono* where liquor was served to an intoxicated person, but found that service to

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(1965); Henry Grady Hotel Co. v. Sturgis, 70 Ga. App. 379, 28 S.E.2d 329 (1943).

[22] Nineteen states had such statutes as of 1984: Alabama, Alaska, California, Colorado, Connecticut, Georgia, Illinois, Iowa, Maine, Michigan, Minnesota, New York, North Carolina, North Dakota, Ohio, Rhode Island, Utah, Vermont, and Wyoming. *Note, Providers, supra* note 21, at 192 n.101.

[23] Seventeen cases from other states (excluding federal cases) were cited in *Ono*. 62 Haw. at 135-36, 612 P.2d at 538. Many of these jurisdictions impose liability, as Hawaii does, based upon violation of a liquor control statute. Other states, such as New Jersey, have imposed liability based simply on general principles of negligence. *See* Rapport v. Nichols, 31 N.J. 188, 156 A.2d 1 (1959).

[24] 62 Haw. 131, 612 P.2d 533 (1980).

[25] *Id.* at 137, 612 P.2d at 539.

[26] *See supra* note 4 for the text of the statute. *Ono* did not specifically address the question of which classes of persons constituted the intended beneficiaries of the statute. The distinction between intended and unintended beneficiaries of Hawaii's liquor control statute, however, became crucial in *Bertelmann*. *See infra* note 33 and accompanying text.

[27] 62 Haw. at 138, 612 P.2d at 539. The violation of the statute was held properly submitted to the jury as evidence of negligence.

[28] *Id.* at 141, 612 P.2d at 540.

[29] *Id.*

[30] *Id.*

[31] *Id.*

an intoxicated patron did not constitute actionable negligence in *Bertelmann*. Proximate causation is arguably no more difficult to establish under the *Bertelmann* facts than under the facts of *Ono* because, simply put, it is just as foreseeable that a drunken bar patron might injure himself as it is that he might injure others. The distinction between the two cases turns, therefore, on the Hawaii Supreme Court's interpretation of the extent of the duty imposed on the alcohol provider by the liquor control statute.

In *Bertelmann*, Sheraton argued that dram shop recovery should be limited, as a matter of policy, to innocent third parties. The court agreed, noting that "[d]runken persons who harm themselves are solely responsible for their voluntary intoxication and cannot prevail under a common law or statutory basis."[32] The court, however, did not seem to rest its holding on general public policy. Rather, the *Bertelmann* court emphasized, as the basis of its holding, its finding that liquor consumers are not the intended beneficiaries of the liquor control statute.[33] No legislative history or Hawaii precedent was cited in support of this construction of the statute.

The present liquor control statute is substantially the same as the original act, adopted with little comment in 1933.[34] The 1933 Territorial Legislature may

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[32] 69 Haw. at ____, 735 P.2d at 933. The court next cited with approval the case of Allen v. County of Westchester, 109 A.D.2d 475, 492 N.Y.S.2d 772 (1985). There the decedent suffered a fatal fall after becoming drunk at a community college bar. While the trial court denied the defendant county's motion to dismiss plaintiff's negligence claims, the Appellate Division reversed. The *Bertelmann* court quoted a passage from *Allen* which stated, in part, that "[t]o allow recovery in favor of one who has voluntarily procured a quantity of liquor . . . 'would savor too much of allowing [said] person to benefit by his or her own wrongful act.' " 69 Haw. at ____, 735 P.2d at 933. The Hawaii Supreme Court found this reasoning to be "highly persuasive." *Id.*

[33] 69 Haw. at ____, 735 P.2d at 934.

[34] Compare the present statute, *supra* note 4, with the relevant portions of the 1933 statute:

> 2. At no time nor under any circumstances shall any licensee:
>
> (a) Knowingly permit any person under the influence of liquor or any interdicted or disorderly person to be or remain in or on the licensed premises;
>
> . . . .
>
> (c) Fail immediately to suppress any violent, quarrelsome, disorderly, lewd, immoral or unlawful conduct of any person on the premises.

Act approved Jan. 11, 1934, No. 40, § 48, 1933 Haw. Spec. Sess. Laws 72.

Section (a) is virtually identical to the current law. Section (c) was added by the House as an amendment. *See* S. CONF. REP. NO. 4, 17th Terr. Leg., Spec. Sess., *reprinted in* 1933 SENATE J. 538-39. This addition probably indicates that disorderly conduct and the like were the major concerns of the legislature in enacting the statute. In fact, the only substantive comment on the bill by either house of the Territorial Legislature is the following:

> This Bill has for its purpose a scheme of regulating and controlling the manufacture and sale of intoxicating liquors. It makes intoxicating liquors readily available to those who desire to use the same and yet incorporates most of the regulatory features of the 1907 Act, which Act seemingly afforded a satisfactory scheme of regulation of the liquor traffic

have intended the statute to benefit only innocent third parties. It is equally plausible, however, that the Territorial Legislature, cognizant of the fact that intoxicated persons are not fully able to exercise reasonable care, and thus pose a risk of harm not only to "innocent" members of the general public but also to themselves, intended the liquor control law to protect both the temperate and intemperate public.[35]

Of course, it is also possible that in adopting the liquor control statute the 1933 Territorial Legislature was motivated by other rationales, and did not consider the issue of which persons were the intended beneficiaries of the statute.[36] But whichever rationale prompted the legislature's adoption of the liquor control statute, *Bertelmann*'s failure to cite any legislative history or precedent in support of its conclusion that liquor consumers are not among the intended beneficiaries of that statute, suggests that the conclusion is essentially a convenience.[37] Unfortunately, by basing its holding on the unsubstantiated intent of

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as it existed prior to the advent of prohibition.

H.R. REP. NO. 109, 17th Terr. Leg., Spec. Sess., *reprinted in* 1933 HOUSE J. 550.

[35] *See, e.g.*, Christiansen v. Campbell, 328 S.E.2d 351 (S.C. Ct. App. 1985) (South Carolina liquor control statutes designed to protect intoxicated persons from their own incompetence and helplessness; statute reflects legislative determination that intoxicated persons pose a menace to themselves).

One commentator has stated that:

> Although some courts have held that liquor control statutes are designed only to protect "innocent" members of the general public from the dangers posed by intoxicated persons, the more reasoned view of liquor liability in today's world is that such statutes demonstrate a legislative recognition of the commonly-known fact that intoxicated adults or minors are not fully able to exercise reasonable care.

Kelly, *Liquor Liability and Blame Shifting Defenses: Do They Mix?*, 69 MARQ. L. REV. 217, 232 (1984).

[36] The issue only becomes important once raised by the specter of dram shop liability based on a duty that is derived from the liquor control statute. Certainly the possibility that the liquor control statute would one day be used as a basis for finding an alcohol provider liable for an automobile accident must have seemed remote, if the Territorial Legislature even considered such a possibility.

Indeed, the 1933 Legislature was probably much more concerned with disorderly conduct than with automobile accidents. Section (c) of the 1933 liquor control statute, *see supra* note 32, which specifically addresses disorderly conduct, was the only amendment offered to the original legislation. *See* S. CONF. REP. NO. 4, 17th Terr. Leg., Spec. Sess., *reprinted in* 1933 SENATE J. 538-39.

[37] Prosser notes that "[i]n many cases the evident policy of the legislature is to protect only a limited class of individuals. If so, the plaintiff must bring himself within that class in order to maintain an action based on the statute." W. KEETON, D. DOBBS, R. KEETON & D. OWEN, PROSSER AND KEETON ON THE LAW OF TORTS 224 (5th ed. 1984) [hereinafter PROSSER AND KEETON ON TORTS]. In this case, however, there does not seem to be any discernable legislative intent to protect only a particular class of persons.

Similar to Prosser's version is the Restatement (Second) of Torts, which provides for the adoption by a court of a "reasonable" standard of conduct based upon a legislative enactment whose purpose is "to protect a class of person which includes the one whose interest is invaded." RE-

the 1933 Territorial Legislature rather than on present day policy considerations, the court failed to undertake a comprehensive examination of the major policy issues raised by the imposition of such a hard and fast rule.

The effect of a rule that absent affirmative acts by the alcohol provider no duty is owed by the tavern to the actual liquor consumer, is that recovery is denied to liquor consumers in virtually all dram shop actions. Such a barrier, based on the policy determination that drunken persons who injure themselves are "solely responsible" for their own conduct,[38] seems at first compelling. Indeed, given the current climate of intolerance of drunk driving in Hawaii,[39] the court's adoption of a bright line rule which holds drunk drivers "solely responsible" for their own injuries seems to support efforts to reduce drunk driving accidents.[40]

Moreover, such a rule finds support in certain prior Hawaii case law[41] and statutory law.[42] This consistency could have been used by the court to support a holding explicitly based on policy considerations rather than one based on unsubstantiated legislative intent.

There are, however, countervailing policy arguments that the *Bertelmann* court did not fully consider. First, the *Bertelmann* decision may not, in fact, advance the goal of preventing drunk driving accidents. This goal was implicit

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STATEMENT (SECOND) OF TORTS § 286 (1964). Comment "f" notes that a statute "may, because of its title, preamble, detailed provisions, history, or other reasons, be found to be intended for the protection of the interests of only a particular class of persons." *Id.* comment f. Again, however, the *Bertelmann* court made virtually no effort to justify its determination of legislative intent to limit the intended class of beneficiaries with anything which arguably could fit within one of these reasons.

[38] 69 Haw. at ____, 735 P.2d at 933.

[39] *See Beer Boost for Safety*, Honolulu Advertiser, August 8, 1988, at A8, col.1 (editorial applauding steps taken by the National Beer Wholesalers Association and by local sellers "to reduce the slaughter on our highways").

[40] As one court has noted:

> [T]he evil of intoxication, and the manifold disastrous consequences flowing from it, would not be likely to be lessened by according against a seller of intoxicating liquor a cause of action in favor of an intoxicated customer for injury to himself or his property resulting from his own intoxication. *To recompense in damages an injury to an intoxicated person or his property resulting from his own overindulgence in intoxicating liquor, might quite properly, be felt . . . to encourage, rather than discourage, such overindulgence.*

Nolan v. Morelli, 154 Conn. 432, 440, 226 A.2d 383, 387 (1967) (emphasis added).

[41] *See, e.g.*, Ikene v. Maruo, 54 Haw. 548, 511 P.2d 1087 (1973) (no duty to keep a highway in a reasonable safe condition for one driving in excess of the speed limit). *But see* Hao v. Owens-Illinois, Inc., 69 Haw. ____, 738 P.2d 416 (1987) (plaintiff in strict products liability case permitted to recover even where his negligence is greater than that of the manufacturer).

[42] *See, e.g.*, Hawaii's workers's compensation act, HAW. REV. STAT. § 386-3 (1985) ("No compensation shall be allowed for an injury incurred by an employee . . . by the employee's intoxication.").

in the Hawaii Supreme Court's decision in *Ono*.[43] The *Bertelmann* court itself noted *Ono*'s emphasis on the need to deter violations of the liquor control law since the reasonable and foreseeable consequence of such violations would be an increase in the incidence of alcohol related driving accidents.[44] As noted above, a rule holding drunken persons "solely responsible" for their own injuries appears to support deterrence of drunk driving accidents. The deterrent value of dram shop liability arguably would be enhanced, however, by holding *both* the drinker *and* the provider responsible for violations of the liquor control statute.[45]

The *Bertelmann* court might have reasoned, on the other hand, that an alcohol provider has no way of determining in advance whether an intoxicated person will injure innocent third parties or just himself. Therefore, a reasonable provider will not serve a patron who is already intoxicated.[46] This argument is not entirely satisfying however, because by limiting the class of persons protected under the liquor control statute, the *Bertelmann* decision has reduced the number of suits likely to be brought under a dram shop cause of action. This lower incidence of suits may, itself, somewhat limit the preventive aspects of imposing dram shop liability in spite of the provider's inability to predict when liability will arise.

Second, it can be argued that the alcohol provider really has the best chance to prevent serious bodily injury and loss of life. This is true because the commercial alcohol provider has both expertise in judging whether a person is intoxicated[47] and total control over the alcohol dispensed.[48] In addition, an ine-

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[43] 62 Haw. 141, 612 P.2d at 540.

[44] 69 Haw. at ____, 735 P.2d 933. Recently a record $1.5 million out-of-court settlement was reported paid by the insurance carrier of a bar to a 26 year old man, who was left partially paralyzed as a result of a hit-and-run accident. The driver had allegedly been drinking at the bar prior to the accident. Honolulu Advertiser, Nov. 5, 1987, at A3, col. 1. Such large settlements are not likely to go unnoticed by either the food and beverage trade or the insurance industry. This in turn will presumably produce greater compliance with the alcohol control statutes.

[45] *See* Comment, *Liability of Commercial Vendors, Employers, and Social Hosts for the Torts of the Intoxicated*, 19 WAKE FOREST L. REV. 1013, 1015 (1983) [hereinafter *Commercial Vendors*] (rationale for imposing liability on commercial vendors is to deter sale of alcohol to classes of persons—minors and the intoxicated—likely to injure themselves or third persons).

[46] Presumably prevention of injuries to innocent third parties was one of the underlying rationales motivating the court to impose dram shop liability on the server of alcohol in the *Ono* case. There, the court noted that injuries to third parties caused by drunken bar patrons turned loose behind the wheel were entirely foreseeable given the "universal use of automobiles, and the increasing frequency of accidents involving drunk drivers." 62 Haw. at 141, 612 P.2d at 540.

[47] Comment, *Commercial Vendors*, *supra* note 45 at 1015. *But see* Note, *Comparative Negligence and Dram Shop Laws: Does Buckley v. Pirolo Sound Last Call for Holding New Jersey Liquor Vendors Liable for the Torts of Intoxicated Person?*, 62 U. NOTRE DAME L. REV. 238, 252 ("Simply because commercial vendors can capably guard against injuries to innocent persons by intoxicated individuals does not mean that courts and legislatures should automatically thrust such

briated alcohol consumer by definition suffers under diminished capacity to evaluate the extent of his own intoxication and the concomitant threat he poses to himself and others.[49]

Third, it can be argued that extending the provider's potential liability to include alcohol consumers would not place an unfair burden on alcohol providers because the potential liability is part of the cost of doing business.[50] Moreover, the provider may insure himself, and spread the risk of liability through slightly higher prices.[51] Conversely, by holding that the liquor consumer has no claim under virtually any circumstance, the court effectively allocates the cost of the loss wholly upon the consumer, even where circumstances would tend to implicate the establishment which provided the intoxicants.[52]

While it might be argued that extending the liability of taverns to include claims by actual liquor consumers renders the alcohol providers virtual insurers of the consumers,[53] in a comparative negligence jurisdiction, such as Hawaii,

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liability on them.").

[48] One commentator has noted that:

> A commercial seller of alcohol has absolute control over the alcohol that is dispensed. Usually, the persons who are to consume the alcohol are visible to the provider, and sales are small enough to control by the exercise of the right of refusal of service. A commercial seller is experienced in selling alcohol, and in dealing with drinking persons. Furthermore, a commercial seller has voluntarily entered the business of making a profit through the provision of alcohol, and thus has a responsibility for the situation he has voluntarily created.

Providers supra note 21, at 202-04 (footnotes omitted).

[49] In *Ono*, the Hawaii Supreme Court quoted the following jury instruction, which it upheld as a valid definition of the term "under the influence of liquor" under Hawaii law:

> Under the influence of liquor means that the person considered has consumed intoxicating liquor sufficient to impair, at the particular time under inquiry, *his normal mental faculties or ability to take care of himself, and guard against casualty*, or sufficient to substantially impair at the time under inquiry that clearness of intellect and control of himself, which he would otherwise normally possess.

62 Haw. at 139, 612 P.2d at 540 (emphasis added).

[50] *See* Note, *Ono v. Applegate: Common Law Dram Shop Liability*, 3 U. HAW. L. REV. 149, 158 (1981) (many cases cited by Hawaii Supreme Court in *Ono* emphasized that liquor licensees, in return for privilege of operating their business, have a public responsibility not to serve drunk or underage persons).

[51] *See Providers, supra* note 21, at 202 (cost of insurance obtained by alcohol providers in order to cover possible dram shop liability will likely be borne by the alcohol consumers via higher drink prices); Comment, *Dramshop Liability: Should the Intoxicated Person Recover for His Own Injuries?*, 48 U. OHIO ST. L.J. 228, 243 (1987) (least cost avoider theory).

[52] It is entirely possible to conceive of fact patterns in which the tavern owner might be more at fault than the alcohol consumer. For example, in Ewing v. Cloverleaf Bowl, 20 Cal. 3d 389, 143 Cal. Rptr. 13, 572 P.2d 1155 (1978), a bar patron who had just turned twenty-one years old was served ten straight shots of 151-proof rum, a vodka collins, and two beer chasers in less than an hour and a half. The patron died of alcohol poisoning.

[53] *See* Defendant-Appellee's Answering Brief at 28, Bertelmann v. Taas Assocs., 69 Haw.

the drinker is not necessarily absolved of responsibility, even where the alcohol provider violates a legal duty to refrain from serving an already intoxicated patron. Instead, the negligence of the drinker is *compared* with that of the provider, with the jury making a final determination of the comparative fault and liability.

On the other hand, the fact that Hawaii is a comparative negligence jurisdiction might also provide a reason to oppose extending dram shop recovery to liquor consumers. Because the issue of the alcohol consumer's comparative negligence is an issue of fact, such cases would not be subject to summary disposition. Therefore, the rule enunciated in *Bertelmann* might be supported by the argument that, given Hawaii's modified comparative negligence law,[54] the incidence of cases in which the alcohol consumer might actually recover would be so few in number that they would not outweigh the considerable cost to the parties, and burden on judicial resources, which such litigation might entail.[55]

Finally, it can be argued that there is a certain logical inconsistency between the *Bertelmann* and *Ono* decisions. If alcohol providers are potentially liable for alcohol related injuries, why is recovery limited, as a matter of law, almost exclusively[56] to persons who are *not* their customers?[57] The answer that the court seems to provide is simply that "innocent" third parties are the intended beneficiaries of the liquor control statue, while actual liquor consumers are not. Hence, the alcohol vendor owes a duty to innocent third parties, but does not owe one to his or her actual customers in most cases. This response indicates the *Bertelmann* court's conclusion; it does not, however, explain the anomaly produced by that conclusion. Alcohol providers are held potentially liable for alcohol related injuries which are foreseeable, yet they are rarely even potentially

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——, 735 P.2d 930 (1987) (No. 86-195) ("Appellants urge this Court to essentially remove from the drunk driver the responsibility for his actions, and place that responsibility instead on the dramshop.").

[54] HAW. REV. STAT. § 663-31 (1985) allows recovery by a plaintiff only if his negligence is equal to or less than that of the defendant.

[55] *See* Wright v. Moffitt, 437 A.2d 554, 556 (Del. 1981). *See also* Sager v. McClendon, 296 Or. 33, 40, 672 P.2d 697, 701 (1983) and cases cited therein.

[56] Even after *Bertelmann* there are a few exceptional cases in which a bar patron might be able to recover from the alcohol provider in a dram shop action. For example, a drinker later injured by the negligence of an intoxicated drinking companion might still recover although this area of the law is not entirely clear at present. *See infra* note 74 and accompanying text. Another example of a situation in which the alcohol consumer might recover in a dram shop action occurs where, purely by coincidence, both the victim of an accident and the person who caused the accident happen to have been patrons of the same tavern prior to the accident. *See supra* note 44.

[57] As one court noted, "[i]t is illogical to hold that a defendant tavern has a duty not to serve an intoxicated patron, but it may escape liability by breaching that duty in serving the patron and then alleging that the plaintiff was negligent in rendering himself intoxicated." Rhyner v. Madden, 188 N.J. Super. 544, 549, 457 A.2d 1243, 1246 (1982).

liable for what is arguably the most foreseeable injury of all—that of their own patrons.

This anomaly can best be understood by examining the different focal points of the *Ono* and *Bertelmann* decisions. *Ono* focused both on duty and on proximate causation, but primarily on the latter. As *Ono* noted, the old common law rule barring recovery from a supplier of liquor for an injury suffered as a result of a tavern patron's intoxication, rested on the rationale that the consumption of alcohol and not its sale or service was the proximate cause of the injury.[58] In supplanting that rule with one which permitted innocent third parties injured by an intoxicated alcohol consumer to pursue a claim against alcohol providers, *Ono* stressed the foreseeability of alcohol related injuries following the provider's service to an already intoxicated patron.[59] Once the foreseeability of injury was established, duty was rather easily derived from the liquor control statute.[60]

Bertelmann, by contrast, focused on the fact that alcohol consumers should be responsible for their own injuries.[61] The rationale for the latter conclusion cannot be the lack of foreseeability; *Ono* foreclosed that avenue of thought.[62] Rather, *Bertelmann*'s conclusion that alcohol providers should not be held liable in most cases involving injury to alcohol consumers seems to be based upon a policy determination that, in spite of the foreseeability of injury following the alcohol provider's allegedly negligent act, the actual liquor consumer does not have a moral right to recover.[63]

Thus, in comparing *Bertelmann* to *Ono* one can see that while the alcohol server's liability is assessed in terms of the foreseeability of injury to innocent third parties, the alcohol consumer's ability to recover is assessed in terms of the morality of his actions. This helps to explain why virtually all alcohol consumers are barred from recovery although their injuries are foreseeable.

The moral argument that allowing a dram shop recovery to a consumer of alcohol would "reward intoxicated liquor consumers for the consequences of their voluntary inebriation,"[64] is a strong one. Indeed, this argument seems to

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[58] 62 Haw. at 134, 612 P.2d at 537.

[59] *Id.* at 141, 612 P.2d at 540.

[60] *Id.* at 138, 612 P.2d at 539.

[61] 69 Haw. at ____, 735 P.2d at 933.

[62] Although *Ono* "carefully limited its ruling to third parties," Defendant-Appellee's Answering Brief at 6, Bertelmann v. Taas Assocs., 69 Haw. ____, 735 P.2d 930 (1987) (No. 86-195), it is not difficult to see that once *Ono* determined that injury to a third party was the foreseeable result of serving an already intoxicated alcohol consumer it would be difficult to argue that injury to the actual imbiber was not at least as foreseeable.

[63] *See supra* notes 32-37 and accompanying text. Sheraton argued that the creation of a claim for dram shop liability on behalf of alcohol consumers was " 'morally indefensible.' " Defendant-Appellee's Answering Brief at 27, Bertelmann v. Taas Assocs., 69 Haw. ____, 735 P.2d 930 (1987) (No. 86-195).

[64] 69 Haw. at ____, 735 P.2d at 935.

be at the heart of the *Bertelmann* court's decision. Similar policy arguments can be found in many of the cases from other jurisdictions which have, like *Bertelmann*, refused to extend to liquor consumers the right to recover under a dram shop claim.[65] Nevertheless, the *Bertelmann* opinion did not test this argument by analyzing it in light of some of the countervailing policy arguments raised above. The court simply reached the conclusion that liquor consumers are not among the intended beneficiaries of Hawaii's liquor control statute.[66]

It is unfortunate that the Hawaii Supreme Court, by failing to address fully the policy arguments which can be made on both sides of this issue, did not avail itself of an opportunity to explain why it reached this conclusion. Undoubtedly the court did weigh some of the policy issues raised above. Without an explicit and thorough discussion of the policy issues, however, the court's opinion is subject to speculation as to which unstated rationales might have motivated its decision in *Bertelmann*. The decision is particularly subject to such speculation because the court's discussion of the intent of the liquor control statute is unsubstantiated, thus giving credence to the view that the *Bertelmann* decision resulted from the court's public policy concerns.

A more complete analysis may have led to a different result. More importantly, and even if the court would have reached the same result, by treating the *Bertelmann* decision as one requiring a careful and explicit policy analysis, the Hawaii Supreme Court would have enhanced the credibility of its decision, and would have left a useful guidepost with which to assess future arguments for bright line limits to tort liability.

IV. IMPACT

The rule of *Bertelmann* bars virtually all claims by alcohol consumers, as well as their estates and survivors, against the providers of alcohol. The principal advantage of such a bright line rule is that it is easy to interpret and apply. Nevertheless, several issues remain unresolved.

The Hawaii Supreme Court clearly stated in *Bertelmann* that alcohol providers must avoid "affirmative acts" which place an intoxicated consumer in "peril."[67] *Bertelmann* held, however, that, absent harm to an innocent third party, merely serving liquor to an already intoxicated customer falls short of actionable negligence.[68] This raises two questions. First, what sort of affirmative act would constitute actionable negligence absent harm to an "innocent" third

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[65] *See, e.g.*, Allen v. County of Westchester, 109 A.D.2d 475, 480, 492 N.Y.S.2d 772, 776 (1985); Wright v. Moffit, 437 A.2d 554, 557 (Del. 1981).

[66] 69 Haw. at ____, 735 P.2d at 934.

[67] *Id.*

[68] *Id.*

party? Second, when, if ever, may a drinking companion constitute an "innocent" third party?

Recently, in *Feliciano v. Kiku Hut*,[69] the Hawaii Supreme Court held that, as a matter of law, aggressive drink sales to an unsophisticated youth (who was of legal drinking age) did not constitute the sort of affirmative act that would lead to actionable negligence.[70] As an example of what would constitute such an affirmative act *Feliciano* cited the case of *Parvi v. City of Kingston*,[71] where police officers relocated two drunken persons to an abandoned golf course to "sleep it off." The city was held liable when the two later wandered onto a nearby freeway resulting in the death of one and serious injury to the other.[72] After *Feliciano* it appears that an alcohol provider would actually have to place the intoxicated customer in physical peril before being held liable for that consumer's injuries.

Still undecided, however, is the issue of a "complicity defense"[73] in dram shop actions. It is unclear whether the court, if presented with a case in which a drinker is later injured by the negligence of an intoxicated drinking companion, will decline to extend the dram shop action created under *Ono* to the drinking companion because he is not an "innocent" third party.[74] It is also unclear what, if any, effect the *Bertelmann* decision will have on other unresolved issues in the area of dram shop liability. For example, the decision does not seem to offer any reliable way to predict how the Hawaii Supreme Court might rule on a dram shop case involving a minor, or a case alleging social host liability.

The *Bertelmann* decision may, however, have an impact on Hawaii law which extends beyond the specific issues involved in dram shop liability.

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[69] 69 Haw. ____, 752 P.2d 1076 (1988).

[70] *Id.* at ____, 752 P.2d at 1079.

[71] 41 N.Y.2d 553, 394 N.Y.S.2d 161, 262 N.E.2d 960 (1977).

[72] *Id.*

[73] The complicity defense is essentially an assumption of risk argument which some courts have determined best fits under comparative negligence analysis. *See* Herrly v. Muzik, 355 N.W.2d 452 (Minn. Ct. App. 1984) (under comparative negligence drinking companion's negligence will be compared with that of the driver and alcohol provider in comparative fault analysis).

[74] For a case presenting such facts, see Umetsu v. Hingada, Civ. No. 86-0971 (Haw. 1st Cir., 1987). There, both plaintiff and defendant were drinking alcohol at the same bar. The two drinking companions left the bar in a van driven by the defendant. Shortly thereafter the van allegedly struck a concrete pillar and overturned throwing plaintiff out of the vehicle. Defendant impleaded both the bar and liquor distributor. These third party defendants unsuccessfully moved for summary judgment arguing that *Bertelmann* would apply since any recovery by the defendant from the bar would reduce the amount that the defendant would be obligated to pay to the plaintiff. Defendant Marriot Corporations's Motion for Summary Judgment, Umetsu v. Hingada, Civ. No. 86-0971 (Haw. 1st Cir., 1987). In this case at least, the court apparently reasoned that the drinking companion was more like an innocent third party (as in *Ono*) than like the plaintiff in *Bertelmann*.

Bertelmann denied recovery to the plaintiffs because the court found that the defendant tavern owed no duty to the deceased liquor consumer. This finding followed from the conclusion that alcohol consumers are not within the intended class of beneficiaries of the liquor control statute. Because this conclusion seems to rest not on legislative intent, but rather on a policy determination that drunken persons should not profit from their own wrongdoing, *Bertelmann*'s legal theory justifying a holding of non-liability could just as easily be labeled contributory negligence or assumption of risk.[75]

The essence of the court's holding was that the actual liquor consumer, as well as his estate and survivors, should not recover because the liquor consumer was part of a culpable class of persons. This is hardly distinguishable from finding that a particular plaintiff is culpable, and therefore denied recovery because he is contributorily negligent. Hawaii has rejected contributory negligence in favor of a comparative negligence system.[76] Yet the *Bertelmann* decision, which denies recovery based on a legal theory which could easily be labeled contributory negligence, arguably precludes the application of comparative negligence principles in virtually every dram shop case where the actual liquor consumer is injured.

A similar comparison can be made insofar as assumption of risk is concerned. Indeed, the Hawaii Supreme Court previously described assumption of risk as "a form of contributory negligence [which] acts to completely bar recovery."[77] Arguably assumption of risk was abolished in Hawaii following the adoption of comparative negligence.[78] Nevertheless, *Bertelmann*'s denial of claims to liquor

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[75] The role of the assumption of risk defense under a comparative negligence system has been puzzling to courts and commentators alike. *See* PROSSER AND KEETON ON TORTS, *supra* note 37, at 495-98.

[76] *See infra* notes 77-79 and accompanying text.

[77] Kaneko v. Hilo Coast Processing, 65 Haw. 463, 477, 654 P.2d 343, 353-54 (1982) (adopting comparative negligence principles in strict products liability in order to eliminate the harshness of the "all or nothing" bar which results from application of assumption of risk).

[78] Prosser cites Hawaii as one of the first states in the nation to abolish completely the defense of assumption of risk. *See* PROSSER AND KEETON ON TORTS, *supra* note 37, at 494 n.40 (citing Bultao v. Kauai Motors, Ltd., 49 Haw. 1, 406 P.2d 887 (1965)). In fact, though, the case only noted the closeness between assumption of risk and contributory negligence as defenses that will bar liability altogether. *Bultao* held that, there being no difference between the two defenses in that case, the defendant had to rely on one or the other.

On the other hand, Prosser also notes that "primary implied assumption of risk should also logically continue to be an absolute bar after the adoption of comparative fault . . . because assumption of risk in this form is really a principle of no duty." PROSSER AND KEETON ON TORTS, *supra* note 37, at 496.

See also Folda v. City of Bozeman, 177 Mont. 537, 582 P.2d 767 (1978) (seventeen year old girl's voluntary intoxication constituted contributory negligence barring wrongful death action against the bar that had illegally served her). *But see* Bissett v. DMI, 220 Mont. 153, 717 P.2d 545 (1986) (overruling *Folda* and holding that under a comparative negligence standard it is for

consumers because of the consumers' voluntary intoxication is akin to arguing that alcohol consumers should not recover because they have assumed the risk of alcohol related injuries. Bertelmann essentially denies recovery to liquor consumers because the whole class has assumed the risk of injury.

In this light, it can also be argued that the court, by creating special rules such as the one stated in *Bertelmann*, dilutes the effect of the legislatively enacted comparative negligence standard. In recommending adoption of comparative negligence[79] to the Hawaii Legislature, the Senate Judiciary Committee noted that the then existing contributory negligence standard barred recovery by injured parties if it was shown that they contributed to their own injuries in any way.[80] The Senate Judiciary Committee further noted that "[s]uch a rule seems to be unfair and in opposition to the average person's concept of justice."[81] Thus, the Hawaii Legislature adopted comparative negligence in order to abolish the harsh effect of contributory negligence.

The *Bertelmann* opinion did recognize that a substantial minority of jurisdictions permit a suit by an injured liquor consumer against those who provided him with the intoxicants.[82] *Bertelmann* further noted that in those jurisdictions the question of "causal connection between the defendants' unlawful failure to stop providing alcohol to an inebriated consumer and the consumer's later harm is a jury question,"[83] although defendants in such cases may "raise the affirmative defenses of contributory negligence or assumption of risk to reduce or negate fault."[84] Without any further explanation, however, the Hawaii Supreme Court simply announced its intention to "adhere to the majority view and restrict the applicability of *Ono*."[85] The court failed to explain why it reached this result. Perhaps the court felt less constrained to place limits on dram shop liability than on other aspects of Hawaii's tort law simply because dram shop liability in Hawaii is a common law creation, rather than a statutory one.

V. CONCLUSION

Bertelmann v. Taas Associates limits the extent of dram shop liability created in *Ono v. Applegate*. Under the bright line rule of *Bertelmann*, innocent third parties may bring claims against alcohol providers; barred are virtually all claims

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the jury to determine the relative negligence of the imbiber as against the providers of alcoholic beverages).

[79] *See* HAW. REV. STAT. § 663-31 (1985).

[80] S. REP. NO. 849, 5th Haw. Leg., Reg. Sess., *reprinted in* 1969 SENATE J. 1194.

[81] *Id.*

[82] 69 Haw. at ____, 735 P.2d at 934.

[83] *Id.*

[84] *Id.*

[85] *Id.*

against the providers by actual consumers of alcoholic beverages. The consumers' estates and survivors are also barred from bringing suit against the providers because the claims of the estates and survivors are largely derivative.

The *Bertelmann* decision is based upon a finding that Hawaii's liquor control statute does not impose a duty upon commercial alcohol providers to protect the actual consumers of alcoholic beverages. Although this decision appears to be one based on public policy concerns, the Hawaii Supreme Court's opinion rests on the court's unsubstantiated determination that alcohol consumers are not among the intended beneficiaries of Hawaii's liquor control statute.

It is unfortunate that the *Bertelmann* court did not undertake an explicit and comprehensive examination of the public policy issues raised by the facts of this case. Such an analysis, no matter what outcome it may have led to, would have both enhanced the credibility of the court's decision in this case, and left a guidepost with which to measure future cases which raise the possibility of establishing other bright line limits to tort liability.

The issue of what sort of affirmative action by the alcohol provider might permit an alcohol consumer to press a dram shop claim against the provider was left unresolved by *Bertelmann*. After the Hawaii Supreme Court's subsequent decision in *Feliciano v. Kiku Hut*,[86] however, it appears that nothing short of placing the intoxicated liquor consumer in actual physical peril will suffice.

Still unresolved is the issue of whether a drinking companion who is injured by an intoxicated bar patron is similarly barred from bringing suit because he is not an "innocent" third party. The decision also does not offer a way to predict how the Hawaii Supreme Court might rule on a dram shop case involving a minor, or a case alleging social host liability.

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[86] 69 Haw. ____, 752 P.2d 1076 (1988).

Review Essay: Impact Fees, Exactions and *Paying For Growth In Hawaii*

by David L. Callies*

I. INTRODUCTION

Of the many issues and problems confronting local governments in these times of scarce public resources and monumental public needs, few have received as much attention recently as paying for public infrastructure[1] and providing for low- and moderate-income housing.[2] This is particularly true in "growth" states in "sunbelt" regions, such as California, Florida—and Hawaii. It is thus both timely and useful for the Land Use Research Foundation of Hawaii to have sponsored and published a major study on these very issues: *Paying for Growth in Hawaii: An Analysis of Impact Fees and Housing Exaction Programs*. While the study is written from a particular point of view—that of the land developer—it is a useful and timely contribution to the national debate on the subject[3] which is critical to Hawaii's future. If we accept that local

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[1] Bosselman & Stroud, *Legal Aspects of Development Exactions*, in DEVELOPMENT EXACTIONS (1987) [hereinafter Bosselman & Stroud, *Legal Aspects*]; T. SNYDER & M. STEGMAN, PAYING FOR GROWTH: USING DEVELOPMENT FEES TO FINANCE INFRASTRUCTURE (1986); Bosselman & Stroud, *Pariah to Paragon: Developer Exactions in Florida 1975-85*, 14 STETSON L. REV. 527 (1985); Callies, *Property Rights: Are There Any Left?*, 20 URB. LAW. 597 (1988) [hereinafter Callies, *Property Rights*]; *Symposium: Development Impact Fees*, 54 J. AM. PLAN. A. 3-78 (1988); *Exactions: A Controversial New Source for Municipal Funds*, 50 LAW & CONTEMP. PROBS. 1-194 (1987); *Symposium: Linkage Fee Programs*, 54 J. AM. PLAN. A. 197-224 (1988); Taub, *Exactions, Linkages, and Regulatory Takings: The Developer's Perspective*, 20 URB. LAW. 515 (1988).

[2] Bosselman & Stroud, *Mandatory Tithes: The Legality of Land Development Linkages*, 9 NOVA L.J. 381 (1985) [hereinafter Bosselman & Stroud, *Land Development Linkages*]; Kayden & Pollard, *Linkage Ordinances and Traditional Exactions Analysis: The Connection Between Office Development and Housing*, 50 LAW & CONTEMP. PROBS. 127 (1987).

[3] Andrew & Merriam, *Defensible Linkage*, 54 J. AM. PLAN. A. 199 (1988); Kayden & Pollard, *supra* note 2; Nelson, *Downtown Office Development and Housing Linkage Fees*, 54 J. AM. PLAN. A.

government can no longer afford the costs of development associated with providing new roads, parks, schools, water and sewer lines, and so forth, how will these be provided? Although housing is not such a "public facility" it is an important public need in Hawaii and other parts of the country. Can government force its construction and development in the same fashion that it can force construction of public facilities by the development community? Why or why not?

Paying for Growth is the latest in a series of softback studies[4] dealing with the subject of impact fees and other exactions. Though clearly more regional than the others, its analyses—particularly the legal and economic—are general in nature, with national application. Its main strengths, however, are its well-written and incisive Conclusion and Commentary[5] and its illuminating, if somewhat rambling, interviews with key governmental officials[6] who will be charged with implementing impact fee and housing exaction programs in Hawaii.

This review essay comments upon *Paying for Growth* while exhaustively surveying the state of the law on impact fees and housing exaction programs. Although the chapters on planning, economics, and interviews are interesting, they do not address the legal issues raised by impact fees and housing exactions, and are therefore treated very lightly. It is the legal issues and their resolution that are critically important in states experiencing rapid growth through development, such as Hawaii.

II. Impact Fees, Housing Exactions and Paying for Growth

A. *Conclusion and Commentary: The Last Should be First*

Paying for Growth ends with a conclusion and summary section which should have introduced the whole report as an executive summary which is clearly needed, and for which the section is admirably suited. Aside from concisely summarizing each of the preceding chapters on planning, interviews, law and economics, the author[7] raises key points which it would have been well to consider before delving into the substantive chapters:

1. Will impact fees, as and when adopted by the four counties of Hawaii,

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197 (1988).

[4] Snyder & Stegman, *Paying for Growth*, Urb. Land. Inst. (1986); *see generally* Development Exactions (1987).

[5] Paying For Growth In Hawaii: An Analysis Of Impact Fees and Housing Exaction Programs 171-82 (D. Davidson ed. 1988) [hereinafter Paying For Growth].

[6] *Id.* at 13-86.

[7] Lawyer Dan Davidson, who is also principal editor and Director of the Land Use Research Foundation which supported the study.

take the place of the many ad hoc governmental requirements for land development,[8] many of which are unsubstantiated, randomly applied, and often illegal? As Davidson notes, most landowners would rather pay than fight, agreeing to all manner of requirements which are then often reduced to a unilateral agreement and recorded—a process meant presumably to establish rights against a reneging landowner, but which in all probability gives the community no legal leverage whatsoever.[9] Impact fees and other exactions set forth in ordinances and regulations should replace this ad hoc system with all possible deliberate speed.

2. Housing exactions programs are the achilles heel of an impact fee system from a legal perspective, and nearly indefensible from an economic perspective, in the long run.[10] Unless these conclusions are shown to be significantly in error, this does not bode well for the commitment at both county and state level in Hawaii to supplement the Governor's bellweather affordable housing production scheme[11] with the nation's most stringent affordable housing set-aside pro-

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[8] What types of exactions are encompassed by a unilateral? The following represents requirements that may be imposed depending upon the nature and the size of the development:

- *Water.* Satisfy Board of Water Supply's requirements for necessary water source, reservoir and distribution at developer's cost.
- *Sewerage.* Pay all fees, charges or assessments required for the expansion of off-site wastewater treatment facilities needed for project.
- *Parks.* Meet statutory requirements of City Park Dedication Ordinance, plus through negotiated exactions, dedicate additional land, and/or provide additional private parks.
- *Child Care.* Dedicate land or provide commercial space for child-care facility.
- *Inclusionary Housing.* Provide a percentage of units in the project for sale or for rent to households of low/moderate income. Sometimes payment of money or dedication of land in lieu of the housing set-aside have been accepted.
- *Transportation Improvements.* Various, including:
  a. Dedication of land and/or payment of fees for road widening.
  b. Signalization of intersections.
  c. Total or partial funding of freeway interchanges adjoining project.
  d. Pedestrian overpass, sometimes several miles from project.
  e. Implementation of transportation system management program, including dedication of land for park'n'ride facility.
- *Job Training.* Establish job-training program in connection with resort projects.
- *Other Dedications.* Provide land for beach access, hiking trails, school sites, government facilities such as police or fire stations, archaeological research, public parking, and wildlife sanctuaries.

PAYING FOR GROWTH, *supra* note 5, at 172-73.

[9] *Id.* at 172.

[10] *Id.* at 176-77.

[11] Governor John Waihee proposes to spend up to $120 million for raw land and another $120 million for infrastructure in order to stimulate construction of thousands of "affordable" ($90,000-$140,000) single-family homes in the Ewa district of Oahu, west of downtown Honolulu and adjacent to Pearl Harbor, as well as several thousand such units on each of the neighbor

grams.[12] The legal literature is filled with warnings and reservations about the defensibility of such set-asides, and the few cases on the subject sound an equally pessimistic tone, as discussed below in Part II-A.

B. The Legal Analysis

Of most interest to lawyers is the legal analysis chapter of *Paying for Growth* which attempts to set out the legal bases for impact fees and housing exactions.[13] Its author finds abundant support for the former, but precious little for the latter. In this he is probably right.

1. Impact Fees: The Need, The Ground Rules

The rapid growth of new development in many areas is placing a severe strain on the financial capacity of local government to fund the large capital outlays for schools, parks, roads, sewers and other facilities required by new residents. Traditional methods of funding such public facilities often prove inadequate. Customary funding of capital facilities out of general funds or bond proceeds may lead to existing residents paying more than their "fair share" of the cost of the public infrastructure built to serve new residents.[14] Assessments are often inadequate because they are usually restricted to a zone or improvement immediately adjacent to the property assessed.[15] "In-lieu" fees developed as a refinement of the now well-accepted practice of required dedication of some types of infrastructure as a condition of subdivision approval. In-lieu fees substitute a money payment for dedication when the latter is not feasible, as, for example, when a school is needed and dedication requirements based on a small proposed land development would result in an inadequate site, or one which is poorly located.

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islands of Hawaii, Maui, and Kauai. *Governor Pushes for 64,000 Affordable Homes*, Honolulu Advertiser, Feb. 5, 1988, at A3, col. 1; *see also Ewa Land Condemnation Eyed*, Honolulu Advertiser, Feb. 10, 1988, at A1, col. 1.

[12] The Office of State Planning has successfully sought conditions on State Land Use Commission approval of converting private land from agricultural to urban use (for residential development) which would require developers to "set aside" 60% of the residential units as "affordable": available to those families with incomes 80% to 120% of median - $34,000 - income. The selling price would be $80,000 - $125,000. *Condition Put On Housing Project*, Honolulu Advertiser, Nov. 17, 1987, at A3, col. 5.

[13] Kudo, *Impact Fees and Housing Exactions Programs: A Legal Analysis*, in PAYING FOR GROWTH, *supra* note 5, at 87.

[14] *See* Gilhool & Heyman, *The Constitutionality of Imposing Increased Community Costs on New Suburban Residents Through Subdivision Exactions*, 73 YALE L.J. 1119, 1121 (1964).

[15] Callies, *A Hypothetical Case*, 16 URB. LAW. ANN. 155 (1979).

Impact fees have recently emerged as a more flexible method of coping with inadequate public facilities brought about by rapid growth and development. In *Contractors & Builders Association v. City of Dunedin*[16] the Florida Supreme Court grasped the financial plight of cash strapped municipalities seeking alternative sources of revenue:

> We see no reason to require that a municipality resort to deficit financing, in order to raise capital by means of utility rates and charges. On the contrary, sound public policy militates against any such inflexibility. It may be a simpler task to amortize a known outlay, than to predict population trends and the other variables necessary to arrive at an accurate forecast of future capital needs. But raising capital for future use by means of rates and charges may permit a municipality to take advantage of favorable conditions, which would alter before money could be raised through issuance of debt securities; and the day may not be far distant when municipalities cannot compete successfully with other borrowers for needed capital.[17]

Impact fees are charges collected by local governments from new land developments, to pay for a public facility constructed to benefit such new developments, which fees are no more than the costs of the facility. The fees collected are set aside, separate from general revenues.[18]

Impact fees are superior to in-lieu fees, dedications, and assessments for the following reasons:

(1) Impact fees can be used to fund types of capital facilities not usually subject to dedication requirements and fees in-lieu thereof.
(2) Since they are not tied to dedication requirements, impact fees can more easily be applied to public facilities the need for which is generated by, but located outside of, the development.
(3) Impact fees can be applied to condominiums, apartments, and commercial developments which create the need for extra-development capital expenditures, but which often escape dedication or in-lieu fee requirements.
(4) Impact fees can be collected at various stages, such as when building permits are issued, or at other times when growth creating a need for new services occurs, rather than at the time of subdivision platting, where traditional exactions and in-lieu fees are usually collected.[19]

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[16] 329 So. 2d 314, 319-20 (Fla. 1976).

[17] *Id.*

[18] Callies, *Propery Rights*, *supra* note 1, at 632; Nicholas, *Capital Improvement Finance and Impact Fees After the Growth Management Act of 1985*, in PERSPECTIVES ON FLORIDA'S GROWTH MANAGEMENT ACT OF 1985 175, 178, 188 (1986).

[19] Callies, *Property Rights*, *supra* note 1, at 632-33; Juergensmeyer, *Funding Infrastructure: Paying the Costs of Growth Through Impact Fees and Other Land Regulation Charges*, in THE CHANGING STRUCTURE OF INFRASTRUCTURE FINANCE (J. Nicholas ed. 1985) [hereinafter Juergen-

a. The Legal Tests

In assessing the validity of impact fees, courts first inquire into whether local government is authorized to impose the fee. (This issue is addressed above in subsection b.) If there is sufficient authority to impose a fee, courts commonly address the relationship between the development upon which the fee was levied and the amount and use planned for the fee. Generally, courts have used three approaches in determining the reasonableness of this relationship: (1) the "rational nexus" test, as applied by the Florida courts and the majority of other jurisdictions; (2) the more restrictive "specifically and uniquely attributable" test, as applied in Illinois; and (3) the less restrictive - indeed generous - "reasonable relationship" test, applied by the California courts.

i. The Rational Nexus Test

The rational nexus test is the most widely used standard for examining development exactions, and especially the impact fee. This test has two parts. First, the particular development must create a "need," to which the amount of the exaction bears some roughly proportional relationship. Second, the local government must demonstrate that the fees levied will actually be used for the purpose collected, by proper "earmarking" and timely expenditure of the funds.[20]

The Florida courts have adopted the rational nexus test for impact fees in a series of recent decisions, beginning with *Contractors & Builders Association v. City of Dunedin*.[21] There, the Florida Supreme Court upheld the concept of impact fees, even though it struck down the particular ordinance requiring an impact fee for sewer and water connection, for failing to sufficiently restrict the use of fees collected: "In principle, however, we see nothing wrong with transferring to the new user of a municipally owned water or sewer system a fair share of the costs new use of the system involves."[22] For an impact fee ordinance to be valid, the court held that: (1) new development must generate a need for expansion of public facilities; (2) the fees imposed must be no more than what the municipality would incur in accommodating the new users of the system; and (3) the fees must be expressly earmarked for the purposes for which they were charged.[23]

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smeyer, *Funding Infrastructure*].

[20] Bosselman & Stroud, *supra* note 2, at 397-99; Callies, *Property Rights*, *supra* note 1, at 633; Stroud, *Legal Considerations of Development Impact Fees*, 54 J. AM. PLAN. A. 29, 31 (1988).

[21] 329 So. 2d 314 (Fla. 1976).

[22] *Id.* at 317-18.

[23] *Id.*

The rational nexus test developed by the Florida courts comes from requirements set out by the Wisconsin Supreme Court in *Jordan v. Village of Menomonee Falls*.[24] There, the court upheld an ordinance requiring a developer to dedicate land for school, park and recreation purposes, or pay an in-lieu fee of $200 per residential lot for schools and $80 per lot for park and recreation development:

> In most instances it would be impossible for the municipality to prove that the land required to be dedicated for a park or school site was to meet a need solely attributable to the anticipated influx of people into the community to occupy this particular subdivision.[25]

If the municipality could establish that a *group* of subdivisions over a period of years generated the need for school or park facilities to benefit the influx of new residents, then this would establish a reasonable basis for finding that the need for the exaction was occasioned by the activity of the subdivider. In this case, the municipality met the "need" portion of the rational nexus test by showing increases in both school population and village population, requiring the village to expend large sums for acquisition of park and school lands and construction of additional school facilities.

The court also upheld the reasonableness of the exactions because the public expenditures for school and park facilities greatly exceeded the amount exacted from subdividers by way of land dedication and in-lieu fees. This established a sufficient benefit to the subdivision, thus meeting another part of the rational nexus test. The court rejected the argument that residents other than those living in the subdivision would make use of the school and park facilities as immaterial.

These requirements were further refined in *Hollywood, Inc. v. Broward County*,[26] upholding an ordinance requiring dedication, an in-lieu fee, or an impact fee as a condition of plat approval, to be used for the capital costs of expanding the county park system. The court held that the ordinance was a valid exercise of the police power:

> [W]e discern the general legal principle that reasonable dedication or impact fee requirements are permissible so long as they offset needs sufficiently attributable to the subdivision and so long as the funds collected are sufficiently earmarked for the substantial benefit of the subdivision residents. In order to satisfy these requirements, the local government must demonstrate a reasonable connection, or *rational nexus*, between the need for additional capital facilities and the growth in

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[24] 28 Wis. 2d 608, 137 N.W.2d 442 (1966).

[25] *Id.* at 617, 137 N.W.2d at 447.

[26] 431 So. 2d 606 (Fla. Dist. Ct. App.), *cert. denied*, 440 So. 2d 352 (Fla. 1983).

> population generated by the subdivision. In addition, the government must show a reasonable connection, or rational nexus, between the expenditures of the funds collected and the benefits accruing to the subdivision.[27]

Seven months later, another Florida court upheld an impact fee for road improvements in *Home Builders & Contractors Association v. Board of County Commissioners*.[28] The County ordinance required new land development activity generating road traffic (including residential, commercial and industrial uses) to pay a fair share of the cost of expanding new roads attributable to the new development. The court found that the ordinance met the *Dunedin* tests for a valid impact fee because it recognized that the rapid rate of new development would require a substantial increase in the capacity of the county road system, and tied this need to the new development by a formula based on the costs of road construction and number of motor vehicle trips generated by different types of land use. Moreover, the ordinance sufficiently earmarked the funds collected for the benefit of the fee payer because expenditure of funds is localized by a zone system with separate trust funds for each zone. The court finally noted that the cost of construction of additional roads would far exceed the fees imposed on the developer by the ordinance.[29] More importantly, *Home Builders* also rejected the argument that improvements paid for by impact fees must be used exclusively *or overwhelmingly* for the benefit of those who pay: "It is difficult to envision any capital improvement for parks, sewers, drainage, roads, or whatever, which would not in some measure benefit members of the community who do not reside in or utilize the new development."[30]

These decisions show that impact fees can be a valid and effective means of coping with rapid growth, but that the courts will scrutinize such fees to ensure that they remain within reasonable limits. The Florida courts, as well as courts of other jurisdictions applying the rational nexus test, follow the modern trend of limiting exactions not by arbitrary rules regarding the nature of the facilities or the type of development, but by requiring the earmarking of funds to be used to provide *some* nonexclusive "benefit" to the development which paid the fee.[31]

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[27] 431 So. 2d at 611-12 (emphasis added).

[28] 446 So. 2d 140 (Fla. Dist. Ct. App. 1983).

[29] *Id.* at 145.

[30] *Id.* at 143.

[31] *See, e.g.*, Bosselman & Stroud, *Land Development Linkages*, *supra* note 2, at 398.

ii. *The California "Reasonable Relationship" Test as Modified by the United States Supreme Court*

As a general rule, California courts uniformly upheld (until *Nollan v. California Coastal Commission*)[32] the constitutionality of required dedication or payment of a fee as a condition of land use approval where the following conditions were met: (1) the municipality is acting within its police power; (2) the conditions have a reasonable relation to the public welfare; and (3) the municipality does not act in an arbitrary manner.

As to the first requirement, the California courts gave a broad interpretation to the police power. Rigorous land use regulations, and development exactions in particular, constitute a proper exercise of the police power. The leading California case is *Associated Home Builders v. City of Walnut Creek*:[33]

> The rationale of the cases affirming constitutionality indicate the dedication statutes are valid under the state's police power. They reason that the subdivider realizes a profit from governmental approval of a subdivision since his land is rendered more valuable by the fact of subdivision, and in return for this benefit the city may require him to dedicate a portion of his land for park purposes whenever the influx of new residents will increase the need for park and recreational facilities. . . . Such exactions have been compared to admittedly valid zoning regulations such as minimum lot size and setback requirements.[34]

As to the second requirement, California courts required that exactions bear only *some* reasonable relationship to the needs created by the development. In *Walnut Creek*, the court rejected any direct or rational nexus theory, stating that an ordinance requiring dedication or in-lieu fees "can be justified on the basis of a general public need for recreational facilities caused by present and future subdivisions."[35]

This broad rationale was virtually eliminated by the United States Supreme Court in *Nollan v. California Coastal Commission*.[36] Decided on the last day of the Court's 1987 term, *Nollan* deals ostensibly with beach access. Plaintiffs sought a coastal development permit from the California Coastal Commission in order to tear down a beach house and build a bigger one. The Commission conditioned the permit on the granting of an easement to permit the public to use one-third of the property on the beach side. For the privilege of substantially upgrading a beach house, the owner was forced to dedicate to the public

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[32] 107 S. Ct. 3141 (1987).

[33] 4 Cal. 3d 633, 94 Cal. Rptr. 630, 484 P.2d 606 (1971).

[34] *Id.* at 644-45, 94 Cal. Rptr. at 639, 484 P.2d at 615.

[35] *Id.* at 638, 94 Cal. Rptr. at 634, 484 P.2d at 610.

[36] 107 S. Ct. 3141 (1987).

lateral access over much of his backyard for more beach for the public to walk upon. The California Court of Appeals had held this was a valid exercise of the Commission's police power under its statutory duty to protect the California Coast. The United States Supreme Court reversed. Noting that the taking of such an access over private property by itself would require compensation, the Court then examined whether the same requirement, imposed under the police or regulatory power of the Commission rather than under its powers of eminent domain, would modify the "just compensation" requirement.

The Court held that it did not and that compensation was required. The rationale of the Court is critical. The Court observed that land use regulations do not effect takings if they substantially advance legitimate state interests and do not deny an owner the economically viable use of his land. But even assuming (without deciding) that legitimate state interests include, in the Commission's words, protecting public views of the beach and assisting the public in overcoming the psychological barrier to the beach created by overdevelopment, the Court could not accept the Commission's position that there was a *nexus* between these interests and the condition attached to Nollan's beach house redevelopment:

> It is quite impossible to understand how a requirement that people already on the public beaches be able to walk across the Nollans' property reduces any obstacles to viewing the beach created by the new house. It is also impossible to understand how it lowers any "psychological barrier" to using the public beaches, or how it helps to remedy any additional congestion on them caused by construction of the Nollans' new house. We therefore find that the Commission's imposition of the permit condition cannot be treated as an exercise of its land use power for any of these purposes.[37]

However, said the Court, it is an altogether different matter if there is an "essential nexus" between the condition (read impact fee or exaction) and what the landowner proposes to do with the property:

> Thus, if the Commission attached to the permit some condition that would have protected the public's ability to see the beach notwithstanding the construction of the new house—for example, a height limitation, a width restriction, or a ban on fences—so long as the Commission could have exercised its police power (as we assumed it could) to forbid construction of the house altogether, imposition of the condition would also be constitutional. Moreover (and here we come closer to the facts of the present case), the condition would be constitutional even if it consisted of the requirement that the Nollans provide a viewing spot on their property for passersby with whose sighting of the ocean their new house would

[37] *Id.* at 3149.

interfere.

. . . .

The evident constitutional propriety disappears, however, if the condition substituted for the prohibition utterly fails to further the end advanced as the justification for the prohibition. [T]he lack of nexus between the condition and the original purpose of the building restriction converts that purpose into something other than what it was. The purpose becomes, quite simply, the obtaining of an easement to serve some valid governmental purpose, but without payment of compensation. Whatever may be the outer limits of "legitimate state interests" in the takings and land use context, this is not one of them.[38]

In short, the Supreme Court appears to have adopted the "rational nexus" test concerning exactions, in-lieu fees and impact fees over the broader California rule which apparently affected the imposition of the condition on the Nollan property. The case also means that naked linkage programs, which seek to impose fees, dedications and conditions on the development process merely because the developer needs a permit and the public sector needs an unrelated public project, are in all probability also illegal. As one well-known commentator suggests in comments upon a proposed Chicago ordinance:

It will be difficult enough to sustain a housing linkage program on the ground that there is a reasonable relationship between the construction of commercial office space and the need for additional housing. It will be even more difficult to demonstrate that connection when the exacted payments are used for a variety of unknown neighborhood development projects.[39]

Following the lead of the *first* (and still valid) requirement of *Walnut Creek*, California courts have upheld the use of impact fees as a proper exercise of a municipality's police power. In *J.W. Jones Co. v. City of San Diego*,[40] the Court of Appeals held that San Diego could use its police power to impose "facilities benefit assessments" (FBA's) on developers in order to fund a broad spectrum of public improvements including water, sewer, roads, parks, transit and transportation, libraries, fire stations, school buildings and police stations.[41] FBA payments were earmarked for the area of benefit and solely for the purpose for

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[38] *Id.* at 3147-48.

[39] Smith, *From Subdivision Improvement Requirements to Community Benefit Assessments and Linkage Payments: A Brief History of Land Development Exactions*, 50 LAW & CONTEMP. PROBS. 5, 28 (1987). *See also* Bosselman & Stroud, *Land Development Linkages*, *supra* note 2; Valla, *Linkage: The Next Stop in Developing Exactions*, GROWTH MGMT. STUD. NEWSL., June 1987, at 4; Kayden & Pollard, *Linkage Ordinances and Traditional Exactions Analysis: The Connection Between Office Development and Housing*, 50 LAW & CONTEMPT. PROBS. 127 (1987).

[40] 157 Cal. App. 3d 745, 203 Cal. Rptr. 580 (Dist. Ct. App. 1984).

[41] *Id.* at 749, 203 Cal. Rptr. at 582-83.

which the fee was levied.[42] The court rejected a challenge that the FBA's were an invalid tax, finding that the new development paying the fees was adequately benefited from the improvements since the FBA's were tied closely to the planning process. The court also examined the underlying policy of what the City was trying to do in controlling explosive growth: "The vision of San Diego's future as sketched in the general plan is attainable only through the comprehensive financing scheme contemplated by the FBA."[43]

As these decisions demonstrate, the California test grants broad discretion to municipalities in the area of development exactions. Because of the underlying rationale of development as a "privilege," developers rarely succeed in challenging fees imposed as a condition of development. The standard employed by the California courts in reviewing such fees is, however, less stringent than the rational nexus test applied by the majority of other jurisdictions.[44]

iii. The Specifically and Uniquely Attributable Test: Impact Fees Stillborn?

A shrinking minority of jurisdictions apply the specifically and uniquely attributable test, primarily in cases involving dedication and/or in-lieu fees. Illinois has in the past made the most prolific use of this test, established in *Pioneer Trust & Savings Bank v. Village of Mount Prospect.*[45] There, a developer challenged the validity of an ordinance requiring subdividers to dedicate one acre per 60 residential lots for schools, parks, and other public purposes. The Illinois Supreme Court said:

> But because the requirement that a plat of subdivision be approved affords an appropriate point of control with respect to costs made necessary by the subdivision, it does not follow that communities may use this point of control to solve all of the problems which they can foresee.[46]

To be considered a reasonable regulation under the police power, requirements imposed upon the subdivider must be within the statutory grant of power to the municipality, and must be "specifically and uniquely attributable" to his development. The need for additional school and recreational facilities, although admittedly aggravated by the 250-unit subdivision, was not specifically and uniquely attributable to the new development and thus, should not be "cast upon the subdivider as his sole financial burden." The fact that the present

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[42] *Id.* at 749-50, 203 Cal. Rptr. at 583.

[43] *Id.* at 758, 203 Cal. Rptr. at 589.

[44] *See* Parks v. Watson, 716 F.2d 646, 653 (9th Cir. 1983).

[45] 22 Ill. 2d 375, 176 N.E.2d 799 (1961).

[46] *Id.* at 379-80, 176 N.E.2d at 801 (quoting Rosen v. Village of Downers Grove, 19 Ill. 2d 448, 167 N.E.2d 230 (1960)).

school facilities of Mount Prospect were near capacity was the result of the *total* development of the community.[47] Therefore, the dedication requirement was held to be an invalid taking without just compensation.

Rhode Island briefly adopted the *Pioneer Trust* test in *Frank Ansuini, Inc. v. City of Cranston.*[48] The court struck down a city regulation requiring subdividers to dedicate at least seven percent of the land area of the proposed plat to the city to be used for recreation purposes. It held that the involuntary dedication of land is a valid exercise of the police power only to the extent that the need for the land required to be donated results from the "specific and unique activity attributable to the developer."[49]

The New Hampshire Supreme Court recently applied the specifically and uniquely attributable test in a similar case, *J.E.D. Associates v. Town of Atkinson.*[50] The court struck down as an unconstitutional taking an ordinance requiring each subdivision developer to dedicate seven and one-half percent of their total acreage or pay a proportionate fee for playgrounds or for other town use.

By applying the restrictive *Pioneer Trust* test to developer exactions, courts imposed substantially the same requirements as a special assessment, thus effectively precluding their use for most extra-development capital funding purposes. The *Pioneer Trust* test quickly became difficult to reconcile with local governments' planning and funding problems caused by rapidly accelerating development. Consequently, state courts began turning away from this restrictive standard.[51] Indeed, both Illinois and Rhode Island appear to have abandoned it altogether.[52]

b. Authority

In analyzing the validity of impact fees and other developer exactions, many courts first inquire whether the local government has sufficient authority to impose the fee.[53] However, lack of explicit enabling legislation is rarely fatal. Most jurisdictions lack specific legislative authority for impact fees, though several have recently enacted such statutes. Most courts find authority in one or a combination of the following sources: (1) the home rule powers granted to municipalities by the state constitution; (2) state statutes empowering local governments to regulate in the general areas of zoning, planning, subdivisions, or in

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[47] *Id.* at 381, 176 N.E.2d at 802.

[48] 107 R.I. 63, 264 A.2d 910 (1970).

[49] *Id.* at 71, 264 A.2d at 914.

[50] 121 N.H. 581, 432 A.2d 12 (1981).

[51] J. Juergensmeyer, *Funding Infrastructure*, *supra* note 19.

[52] Krughoff v. City of Naperville, 68 Ill. 2d 352, 369 N.E.2d 892 (1977).

[53] J. Juergensmeyer, *Funding Infrastructure*, *supra* note 19, at 23, 25.

specific areas like water and sewer; or (3) in a state statutes' general welfare clause.

i. Broad Interpretation of Police Power

The California courts have found authority for impact fees and exactions on developers in a broad interpretation of the home rule powers of municipalities set forth in the California Constitution. Such fees and exactions are uniformly upheld as a valid exercise of police power as long as they are "reasonable" and not arbitrary.[54] As to the police power, the California Constitution states that "a county or city may make and enforce within its limits all local, police, sanitary and other ordinances and regulations not in conflict with general laws."[55] The leading California case which established developer exactions as a valid exercise of a municipality's police power is *Associated Home Builders, Inc. v. City of Walnut Creek*.[56] Following the lead of *Walnut Creek*, the California courts have upheld the use of impact fees as a proper exercise of a municipality's police power.[57]

In *Amherst Builders v. City of Amherst*,[58] the Ohio Supreme Court also interpreted its state constitution broadly to find authorization for a municipality to impose "connection" fees to fund capital improvements to the city sewer system:

> It is well-settled that Section 4, Article XVIII, grants a municipality broad power to own and operate public utilities, and that a municipal sewage system is a type of "public utility" by that constitutional provision. There can be no doubt that, in order to exercise that power, a municipality must be able to impose charges upon the users of the system to defray the costs of both its construction and operation . . . . When this unimproved land is developed, the tap-in charge is imposed so that these new users will now assume a fair share of the original construction costs, thereby reimbursing the community for the previous benefit received.[59]

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[54] D. CURTIN, DEDICATIONS, EXACTIONS AND IN LIEU FEES; THE INVERSE CONDEMNATION-TAKING ISSUE (1986).

[55] CAL. CONST. art. XI, § 7.

[56] 4 Cal. 3d 633, 644-45, 94 Cal. Rptr. 630, 639, 484 P.2d 606, 615 (1971).

[57] In J.W. Jones Co. v. City of San Diego, 157 Cal. App. 3d 758, 203 Cal. Rptr. 580 (1984), the Court of Appeals held that San Diego could use its police power to impose "facilities benefit assessments" (FBA's) on developers in order to fund a broad spectrum of public improvements including water, sewer, roads, parks, transit and transportation, libraries, fire stations, school buildings and police stations.

[58] 61 Ohio St. 2d 345, 402 N.E.2d 1181 (1980).

[59] *Id.* at 347, 402 N.E.2d at 1183.

Until 1985, Florida lacked specific statutory authority for impact fees. Despite the absence of express enabling legislation, Florida courts have interpreted the home rule powers of local governments broadly in upholding their authority to impose impact fees. Home rule powers of municipalities and counties come from different sources. Municipalities receive home rule powers from the Florida Constitution: "Municipalities shall have governmental, corporate and proprietary powers to enable them to conduct municipal government, perform municipal functions and render municipal services, and may exercise any power for municipal purposes except as otherwise provided by law."[60] These home rule powers are further broadened by the Municipal Home Rule Powers Act which provides that "the Legislature recognizes that pursuant to the grant of power set forth in . . . the State Constitution, the legislative body of each municipality has the power to enact legislation concerning any subject matter upon which the state Legislature may act."[61]

In *Contractors & Builders Association v. City of Dunedin*,[62] the Florida Supreme Court held that a water and sewer impact fee ordinance was authorized under article VIII, section 2(b) of the state constitution, even though the court eventually struck down the ordinance on the grounds that it did not sufficiently restrict the uses of fees collected. Since no state laws existed governing impact fees for capital improvements, the municipality was free to act:

> "Under the constitution, Dunedin, as the corporate proprietor of its water and sewer systems, can exercise the powers of any other such proprietor (except as Fla. Stat. [sections 180.01-.31] or statutes enacted hereafter, may otherwise provide) . . . . Implicit in the power to provide municipal services is the power to construct, maintain and operate the necessary facilities."[63]

In granting home rule powers to *counties*, the Florida constitution differentiates between charter and non-charter counties: "Counties operating under county charters shall have all powers of local self-government not inconsistent with general law, or with special law approved by vote of the electors."[64] This delegation of powers is equivalent to the broad home rule powers granted municipalities. In *Hollywood, Inc. v. Broward County*,[65] the court held that the constitutional provision cited above authorized the county to enact an impact fee ordinance for parks:

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[60] FLA. CONST. art. VIII, § 2(b) (1968).

[61] FLA. STAT. § 166.021(3) (1979) (citing FLA. CONST. art. VIII, § 2(b) (1968)).

[62] 329 So. 2d 314 (Fla. 1976).

[63] *Id.* at 319 (quoting Coolesey v. Utilities Comm'n, 261 So. 2d 129, 130 (Fla. 1972)).

[64] FLA. CONST. art. VIII, § 1(g) (Supp. 1968).

[65] 431 So. 2d 606 (Fla. Dist. Ct. App. 1983).

> Through this provision, the people of Florida have vested broad home rule powers in charter counties such as Broward County. . . .
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> The people have said that charter county governments shall have all the powers of local government unless the state government takes affirmative steps to preempt local legislation . . . . In the absence of preemptive federal or state statutory or constitutional law, the paramount law of a charter county is its charter.[66]

Non-charter counties, on the other hand, must find a source of enabling legislation to authorize their actions.[67] Various sources of enabling legislation have been broadly interpreted to authorize non-charter counties to enact impact fee ordinances. In *Home Builders & Contractors Association v. Board of County Commissioners*,[68] the court found authority for Palm Beach County to impose a roads impact fee in a state statute granting counties broad powers to carry on county government:

> (1) The legislative and governing body of a county shall have the power to carry on county government. To the extent not inconsistent with general or special law, this power shall include, but shall not be restricted to, the power to:
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> . . . .
>
> (m) Provide and regulate arterial, toll, and other roads, bridges, tunnels and related facilities . . . .
>
> (w) Perform any other acts not inconsistent with law which are in the common interest of the people of the county, and exercise all powers and privileges not specifically prohibited by law.[69]

The court emphasized that "one of the legislative purposes in passing Chapter 125 was to enable local governments to govern themselves without the necessity of running to the legislature every year for authority to act."[70]

In 1985, the Florida Legislature enacted the Local Government Comprehensive Planning and Land Development Regulation Act that substantially amended the state's major land development laws and created explicit statutory authority for impact fees for the first time.[71]

ii. Implied Authority from Enabling Statutes

While not recognizing such broad home rule powers of local governments as California and Florida, other states have upheld impact fees as valid exercises of

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[66] *Id.* at 609.

[67] FLA. CONST. art. VIII, § 1(f) (Supp. 1986).

[68] 446 So. 2d 140 (Fla. Dist. Ct. App. 1983).

[69] *Id.* at 142 (quoting FLA. STAT. §§ 125.01(1)(m) & (w) (1981)).

[70] *Id.* at 143.

[71] Bosselman & Stroud, *Legal Aspects*, *supra* note 1, at 549-50.

local government authority by implication from a variety of statutory sources. In *Coulter v. City of Rawlins*,[72] the Wyoming court held that the enactment of impact fee ordinances for water and sewer was not a constitutional home rule power of the municipality and thus was subject to express legislative control. After an extensive review of the City's enabling legislation, the court found implied authority to impose impact fees for water and sewer connections. General powers granted to cities included taking any action necessary to establish, alter and regulate public water sources. In addition, zoning powers included power to enact zoning regulations to "*facilitate adequate provisions for transportation, water, sewerage, schools, parks, and other public requirements.*"[73] Another statute empowered municipalities to "take any action necessary to establish, purchase, extend, maintain and regulate a water system for supplying water to its inhabitants and for any other public purposes" and to charge rates for such services.[74] Reading all of these statutes together, the court held:

> Given the above authorities, we come to the conclusion that the Wyoming statutory provisions previously cited grant the City of Rawlins the power to levy the sewer and water connection charges . . . . Although no cited statute specifically provides that cities and towns are authorized to charge new users a certain specified fee for connecting or hooking up with the sewer and water systems, we concluded that the authority for such ordinances as those enacted by the City of Rawlins, in this case, can be fairly and necessarily implied from the powers expressly granted in the statutes.[75]

In *City of Arvada v. City of Denver*,[76] the Colorado Supreme Court held that the city was authorized to enact an ordinance imposing a "development fee" on all new users connecting into the city water system for the purposes of future development. The court looked to enabling legislation giving municipalities the power to collect from users any rates, fees, or charges for services furnished in connection with water facilities.[77] The court stated:

> While the imposition of a development fee as such is not authorized in this section, we hold that such a charge is within the general contemplation of this broadly worded statute . . . these provisions reveal that the General Assembly intended to give municipalities broad, general powers to construct, improve and extend all the facilities necessary to operate a viable water system, and that this

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[72] 662 P.2d 888, 895 (Wyo. 1983).

[73] *Id.* at 896 (emphasis in original).

[74] *Id.* at 897-98.

[75] *Id.* at 900; *see also* Krughoff v. City of Naperville, 68 Ill. 2d 352, 369 N.E.2d 892 (1977).

[76] 663 P.2d 611 (Colo. 1983).

[77] *Id.* at 614.

power includes authorization to accumulate a fund for future development.[78]

iii. Broad Interpretation of General Welfare Clause

Other states have interpreted the general welfare clause of various state statutes as an independent source of municipal power, broad enough to confer power to enact impact fees and other developer exactions. For example, in the leading Utah case of *Call v. City of West Jordan*,[79] which upheld an ordinance requiring dedication of land or in-lieu fees for park and recreation facilities as a condition of subdivision, the court reviewed a series of statutes enabling cities to regulate for the health, safety, and general welfare and to regulate planning and subdivisions:

> If the above statutes are viewed together, and in accordance with their intent and purpose, as they should be, it seems plain enough that the ordinance in question is within the scope of authority and responsibility of the city government in the promotion of the "health, safety, morals and general welfare" of the community.[80]

The Utah Supreme Court also relied on the general welfare power of municipalities in upholding an ordinance requiring "connection fees" to defray the costs of a new sewer system. "In Utah, municipalities are granted broad powers for the protection of the health and welfare of their residents. Among these powers is the statutory authority to establish and maintain public utilities for the benefit of those residents."[81] The authority of local governments in Utah to impose impact fees is now well established. Citing *Call* and *Rupp*, the Utah Supreme Court, in *Banberry Development Corp. v. South Jordan City*,[82] stated, "These . . . decisions have resolved the legality of water connection and park improvement fees designed to raise funds to enlarge and improve sewer and water systems and recreational opportunities, as well as the legality of conditioning water hookups or plat approval on their collection."[83]

iv. Statutory Authority

Despite the general tendency of courts to find numerous grounds to uphold

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[78] *Id.* at 614-15.
[79] 606 P.2d 217 (Utah 1979).
[80] *Id.* at 219.
[81] Rupp v. Grantsville City, 610 P.2d 338, 339-40 (Utah 1980).
[82] 631 P.2d 899 (Utah 1981).
[83] *Id.* at 901.

impact fees without statutory authority, several commentators have suggested that such statutes would be useful.[84] Indeed, Texas, Florida and Illinois have enacted such statutes, in part as a result of court rulings striking down impact fees and in part in order to clarify or limit the application of impact fees to specific categories of public facilities.

The most publicized of these statutes is that of Texas.[85] Largely a reaction to Texas decisions implying that home-rule communities in Texas might have the unrestricted right to levy impact fees,[86] the statute limits the levy of impact fees to specific public improvements: water supply, treatment and distribution; wastewater collection and treatment; stormwater drainage and flood control, and certain roadway facilities.[87] The balance of the statute appears primarily directed toward limiting overreaching local governments in the levying and collection of impact fees. Thus, fees may not be levied until a local government has substantially documented the need for such fees by creating public facility service areas, making growth and land use projections therefore, calculating the cost of new and expanded facilities which will be required (carefully segregating out the repair and rehabilitation of existing facilities) and development of a conversion matrix to aid in calculating and applying fees. The fee itself is derived by dividing "service units" into capital improvement costs.[88] Funds collected must be deposited in trust funds, one each for each type of capital facility, and refunded within ten years if not spent as anticipated.[89] While assessment of the fee early in the development process is encouraged, so is late collection.[90]

While there appear to be sound arguments for authority of Illinois municipalities to adopt impact fees without specific enabling legislation,[91] the state adopted a limited authorization statute in 1987.[92] The purpose of the statute is to permit county legislative bodies in those counties within certain limited population ranges to levy transportation impact fees on new developments with

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[84] Larsen & Zimet, *Impact Fees; Et Tu, Illinois?* 21 J. MARSHALL L. REV. 489 (1988); Lillydahl, Nelson, Ramis, Rivasplata & Schell, *The Need For a Standard State Impact Fee Enabling Act*, 54 J. AM. PLAN. A. 7 (1988); T. MORGAN, THE EFFECT OF STATE LEGISLATION ON THE LAW OF IMPACT FEES, WITH SPECIAL EMPHASIS ON TEXAS LEGISLATION (1988); Taylor & McClendon, *Impact Fee Enabling Legislation: A New Approach to Exactions* 11 Zoning & Plan. Law Rep. 9 (1988).

[85] TEX. REV. CIV. STAT. ANN. art. 1269j - 4.11 (Vernon 1987).

[86] *E.g.*, City of College Station v. Turtle Rock Corp., 680 S.W.2d 802 (Tex. 1984).

[87] TEX. REV. CIV. STAT. ANN. art. 1269j - 4.11 §1(2) (Vernon 1987).

[88] *Id.* at §§ 1(5), 1(9), 1(10), 2(d) & 2(j).

[89] *Id.* at § 5(c).

[90] *Id.* § 2(e). For general analysis of the Texas Statute, see T. MORGAN, *supra* note 84; Taylor & McClendon, *supra* note 84.

[91] Larsen & Zimet, *supra* note 84.

[92] 42 ILL. REV. STAT ch. 121, ¶ 5-608 (1987).

access (direct or indirect) to county road or state highway systems. The fee must be calculated on the bases of the estimated traffic the new development is expected to generate, together with that which is needed to maintain service. The legislation contemplates the creation of transportation districts, and the money, to be placed in special funds as collected, must be spent either in the district in which the development paying the fee is located, or in areas immediately adjacent.[93]

Both statutes are clearly limited in their application and may have the effect of foreclosing other impact fees on the ground of state preemption unless courts can be convinced of the existence of some sort of "shared power" doctrine. The potential problem is illustrated in New Jersey which has a relatively recent land development exactions statute sufficiently narrow (and narrowly interpreted by the courts in the state) that there are presently calls for enabling legislation to make impact fees legal.[94]

c. Plan Implementation

Impact fee ordinances should implement comprehensive plans. This helps insure that the ordinance ties the fees to needs generated by new development and that the planned improvements adequately benefit the development paying the fee.

A recent Arkansas decision, *City of Fayetteville v. IBI, Inc.*,[95] emphasizes this point. The court invalidated a park impact fee ordinance because the city did not have a sufficiently definite plan for parks and park facilities to justify the fee.[96] If a fee is to be collected from new development for park acquisition and/or park facilities construction, then the jurisdiction should have a plan for parks and should have a standard for park facilities against which the validity and fairness of the parks impact fee can be judged. Courts have held that a payment of a fee by a developer in exchange for plat approval for acquiring and developing county parks was a valid exercise of the police power, approving of the county park program establishing a ratio of three acres for every thousand residents and restricting the funds to be used to an area within fifteen miles from the development which paid the fees.[97]

Tying impact fees into the general plan helps insure that the court will view

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[93] *Id.*

[94] Note, *Impact Fees in New Jersey: Allocating the Cost of Land Development*, 19 RUTGERS L.J. 341 (1988).

[95] 281 Ark. 63, 659 S.W.2d 505 (1983); *see* Kaiser & Mentes, *Permissible Parameter of Park Exactions*, 65 U. DETROIT L. REV. 1, at 19-20 (1987).

[96] 281 Ark. at 67, 659 S.W.2d at 507.

[97] *See* Hollywood, Inc. v. Broward County, 431 So. 2d 606, 607-08 (Fla. Dist. Ct. App. 1983).

the fees as valid development regulations, rather than illegal taxes. It is useful to lay the foundation for impact fees within the comprehensive plan itself and then implement them through regulatory ordinances that are consistent with the plan. Often, it is necessary to amend an existing comprehensive plan to make it a suitable basis for impact fees.[98]

In *Hillis Homes, Inc. v. Public Utility District*,[99] the Washington Supreme Court upheld a "general facilities charge" imposed for the purpose of funding capital improvements to the water system. There, the court held that the fee was authorized by statute, was not invalid as a tax, and was neither unreasonable nor discriminatory since it resulted from a classification based upon relative benefits received by each like group of customers. The general facilities charge was based on a detailed long range plan identifying facilities needed for the water system to serve anticipated new customers for the next ten years. Based on this analysis, a series of projects were identified and the cost allocated to the new customers. A separate charge was developed for each class of customer: single family, multi-family, commercial/industrial and other. The monies collected are restricted to paying for the new customers' share of the improvements, either directly to fund the construction of the improvements or indirectly to pay for the new customers' share of the debt service of the revenue bonds.[100]

On the other hand, judicial reaction to impact fees *without* such a plan (especially if the question of authority is not adequately resolved) is demonstrated by *Coronado Development Co. v. City of McPherson*.[101] The Supreme Court of Kansas held that the municipality did not have the authority to require a developer to dedicate ten percent of his total acreage or the cash equivalent for public parks. The in-lieu fees received were to be placed into a special fund restricted only for the purpose of purchasing land for public areas.[102] The court construed the zoning enabling authority narrowly because the court decided the power to regulate subdivisions did not extend to requiring the payment of an in-lieu fee that was not sufficiently earmarked. In addition, the location of the park was not mapped anywhere:

> The foregoing statute specifically grants authority to make regulations for convenient open spaces for recreation (parks and playgrounds) *in accordance with the mapped plan*. It would appear to go no further. It is not authority for a regulation requiring the developer to pay ten percent of the appraised value of the platted area to the city in the event that - as is here stipulated and conceded - there are

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[98] *See* Roberts, *Funding Public Capital Facilities: How Community Planning Can Help*, in THE CHANGING STRUCTURE OF INFRASTRUCTURE FINANCE 15-16 (J. Nicholas ed. 1985).

[99] 105 Wash. 2d 288, 714 P.2d 1163 (1986).

[100] *Id.* at 290, 714 P.2d at 1165-67.

[101] 189 Kan. 174, 368 P.2d 51 (1962).

[102] *Id.* at 174, 368 P.2d at 51-52.

> not public open spaces required by the planning commission and the governing body, within the subdivision, by any plan, mapped or otherwise . . . . Indeed, a careful analysis of the statute compels a conclusion there is nothing in any of its provisions authorizing the assessment of money as a revenue measure for *other public areas*.[103]

d. The "Uniformity" Issue and Equal Protection

An impact fee must be fairly and equitably levied among similarly situated landowners whose developments are contributing to the need for public facilities. However, courts do not require *perfect* uniformity. Thus the Supreme Court of Colorado upheld the constitutionality of a municipal ordinance imposing "facilities development fees" as a condition to connection with the sewer system. Plaintiffs, owners of apartment buildings, challenged the ordinance as an invalid tax and a violation of equal protection since it required only new customers to pay the fees. The court held that since new connections are more directly related to the need for increased capacity than old connections, there is a rational basis for the distinction made by the ordinance.[104]

The New Jersey courts have decided a line of cases upholding the validity of connection fees imposed to fund capital improvements to water and sewer systems based on equality between old and new users. The leading case establishing the validity of such fees is *Airwick Industries v. Carlstadt Sewerage Authority*.[105] There, the court upheld connection fees imposed by the Authority to pay off bonded indebtedness incurred in building a new sewer system. The court recognized that both improved and unimproved properties benefit from the increased capacity of the system:

> [T]he legislature intended that the installation and construction costs, *i.e.*, debt service charges, should in the first instance be financed by the actual users but should ultimately be borne by all the properties benefited, including the unimproved lands. For that reason there was provided a charge in the nature of a connection charge to be imposed upon unimproved properties in order that they assume a fair share of the original construction costs when they become improved properties.[106]

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[103] *Id.* at 175, 368 P.2d at 53 (emphasis added).

[104] Loup-Miller Constr. Co. v. City & County of Denver, 676 P.2d 1170, 1173-75 (Colo. 1984).

[105] 57 N.J. 107, 270 A.2d 18 (1970).

[106] *Id.* at 122, 270 A.2d at 26.

e. *Calculation of Fee*

An impact fee ordinance must connect the fee charged to needs generated by the new development and benefits conferred. Calculation of fees should be tied to a study, report, or plan based on an analysis of the new development's impact on the public facility. For example, most water and sewer impact fees are based on the amount of flowage required by a certain type of development. The analysis should demonstrate that the capital improvements planned with the funds collected are necessitated at least in part by the fee payer and that fees collected will adequately benefit the new development paying the fee.[107]

One way to show this is when the fee paid is less than the cost to the system of accommodating the new users. In *Amherst Builders Association v. City of Amherst*,[108] the schedule of fees was based on average sewage flow for various types of structures, as estimated by the Environmental Protection Agency, resulting in a fee of $400 for a single family home. In response to charges that the fee was invalid, the city introduced evidence demonstrating that the "capital cost" of each connection (the cost of facilities required to service each new user of the system) was an average of $1,186 per connection:

> While it is true that the $1 per gallon charge is not a mathematically precise estimate of the cost of service to each new user, appellant is hard-pressed to assert this as a basis for invalidating the ordinance when one considers that the resultant $400 fee is much less than the figure derived from a more precise analysis.[109]

The court also noted that, by keying the schedule to the Environmental Protection Agency guidelines, the city was attempting to make the fee of each new user proportionate to the gallons of sewage flow contributed by a particular type of structure. "Thus, the fee attempts not only to equalize the burden between present and new users, but also among the latter, depending on the burden each puts on the system."[110]

Similarly, in *Dunedin*, the Florida Supreme Court noted that the water and sewer connection fees imposed were less than the costs the city would incur in accommodating new users of its water and sewer systems, leading the court to reject characterizing the fees as taxes.[111] The court stated that "[r]aising expan-

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[107] J. NICHOLAS, AMERCIAN PLANNING ASSOCIATION, THE CALCULATION OF PROPORTIONATE-SHARE IMPACT FEES, (1988); J. Nicholas, *Flordia's Experience With Impact Fees*, in THE CHANGING STRUCTURE OF INFRASTRUCTURE FINANCE (J. Nicholas ed. 1985) [hereinafter *Florida's Experience*]; Nicholas & Nelson, *Determining the Appropriate Development Impact Fee Using the Rational Nexus Test*, 54 J. AM. PLAN. A. 56 (1988).

[108] 61 Ohio St. 2d 345, 349, 402 N.E.2d 1181, 1182 (1980).

[109] *Id.* at 352, 402 N.E.2d at 1184.

[110] *Id.*, 402 N.E.2d at 1184.

[111] Contractors & Builders Ass'n v. City of Dunedin, 329 So. 2d 314, 318 (Fla. 1976).

sion capital by setting connection charges, which do not exceed a *pro rata* share of reasonably anticipated costs of expansion, is permissible where expansion is reasonably required, *if use of the money collected is limited to meeting the costs of expansion.*"[112]

The sewer and water "development fee" ordinances in *Milton L. Coulter v. City of Rawlins*,[113] were upheld even though the city did not demonstrate how it arrived at a fee schedule. The facts state only that the city estimated a need for $36,000.00 in capital improvements to expand the sewer and water system to meet population projections, according to a plan developed by the city.[114] However, the dissent noted that nothing in the record showed that new users were not paying all, or a disproportionate part of the capital cost of a water and sewer system for the city:

> [T]here is absolutely nothing in the record to reflect the relationship of the amount of such fees with any aspect of the annexed area . . . . The $750.00 and $1,000.00 figures seem to have been plucked out of thin air . . . . Somewhere in the scheme of this situation, we must set guidelines of reasonableness, or fairness, or uniformity. We cannot say that once a charge is called a "fee," it will have no perimeters, or fairness, or uniformity.[115]

In *Lafferty v. Payson City*,[116] an impact fee imposed partly for sewer and water was struck down by the Utah Supreme Court because the ordinance did not specify what the funds collected would be used for. The court remanded the case for a determination of the reasonableness of the fees in accordance with the test identified in its prior decision in *Banberry Development Corp. v. South Jordan City*,[117] discussed above. The court held that the municipality has the burden of disclosing the basis of its calculations to whomever challenges the reasonableness of the fees.[118]

The New Jersey enabling statutes for municipal utility authorities were amended in 1986 to provide a uniform method for calculating a permissible fair share connection fee for water and sewer systems.[119] The court quoted the senate committee report on the amendment:

> Under the uniform connection fee formula established by this bill, a connector

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[112] *Id.* at 320 (emphasis added).

[113] 662 P.2d 888 (Wyo. 1983).

[114] *Id.* at 890.

[115] *Id.* at 905 (Rooney, C.J., dissenting in part).

[116] 642 P.2d 376 (Utah 1982).

[117] 631 P.2d 899 (Utah 1981).

[118] *Id.* at 904.

[119] Meglino v. Township Comm. of Eagleswood, 103 N.J. 144, 510 A.2d 1134, 1143 (1986).

> will pay a charge based upon the actual cost of the physical connection, if made by the authority, plus a fair payment towards the cost of the system. The fair payment is to be computed by deducting from the total debt service and capital expenditures previously made by the authority the amount of all gifts, contributions or subsidies received by the authority from any federal, state or local government or private person. The remainder is then divided by the number of service units served by the system, and the results are apportioned to the connector based upon the number of service units attributed to him.
>
> The bill requires that, in attributing service units to a connector, the estimated daily flow of water or sewerage for the connector shall be divided by the average daily flow for an average single family home in the authority's district. This permits the authority to attribute a larger number of service units to a commercial building, for instance, than to a single family home.[120]

Broward County, Florida, calculates road fees using a sophisticated computer model called TRIPS (Traffic Review and Impact Planning System). There is no road impact fee schedule as such. Instead, each requested plat approval is subject to analysis by TRIPS. TRIPS performs four essential tasks: (1) it estimates the traffic impact of each development; (2) it evaluates the capacity of road segments that are likely to be impacted; (3) it estimates the cost of improvements; and (4) it calculates the development's fair share of the cost of the planned improvements.[121]

Impact fees can be computed without computers as, for example, in Palm Beach County. The Palm Beach County road impact fee system is based upon a set of data which showed that: (1) the average cost of a road was $300,000 per lane mile; (2) that traffic varied by land use types; (3) that average trip length was six miles; (4) that road capacity was 6,000 trips per day at a certain level of service.[122] In *Home Builders & Contractors Association v. Board of County Commissioners*,[123] the court stated:

> [T]he Palm Beach County ordinance in question here was crafted with *Dunedin*'s

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[120] *Id.*, 510 A.2d at 1134.

[121] Frank, *How Road Impact Fees Are Working in Broward County: The Computer Model*, PLANNING, June 1984, at 15. For detailed computation of impact fees as well as examples from many fee ordinances, see *J. Nicholas, Florida's Experience*, *supra* note 107.

[122] J. Nicholas, *Florida's Experience*, *supra* note 107 at 54. The fee for a single family home was determined to be $1,800, but was reduced to one sixth that amount or $300, for the following reasons: First, the county was receiving road revenues from the state motor fuels tax and from a road and bridge property tax, thus reducing its gross costs; second, reducing the fees allowed room for error in the formula components. Third, when the impact fee ordinance was litigated, the one-sixth fee schedule insured that the "Dunedin Test" (which requires that the fee cannot exceed the pro rata share of costs attributable to the new development) was met. *Id.* at 54-56.

[123] 446 So. 2d 140 (Fla. Dist. Ct. App. 1983).

> lessons in mind. The present ordinance recognized that the rapid rate of new development will require a substantial increase in the capacity of the county road system. The evidence shows that the cost of construction of additional roads will far exceed the fair share fees imposed by the ordinance. In fact the county suggests that under the ordinance the cost will exceed the revenue produced by eighty-five percent.[124]

The court also noted that "[t]he formula for calculating the amount of the fee is not rigid and inflexible, but rather allows the person improving the land to determine his fair share by furnishing his own independent study of traffic and economic data in order to demonstrate that his share is less than the amount under the formula set forth in the ordinance."[125] The *Home Builders* court also pointed out that the Palm Beach County ordinance avoided the defects inherent in the Broward County roads impact fee ordinance litigated in *Broward County v. Janis Development Corp.*[126] The money generated by the *Janis* ordinance far exceeded the cost of meeting the needs brought about by the new development.[127]

All Florida local governments imposing impact fees utilize a "discount" or similar reduction from net cost to encourage use of the fee schedule. The discount is designed to induce developers to pay the fees rather than incurring the expense of independent studies. The discounts also insure against violating the court imposed prohibition against charging impact fees which are greater than local governments' costs.[128]

The above cases and examples demonstrate that impact fees must be rationally related to needs generated by new development and benefits actually conferred. As the dissent in *Coulter* pointed out, the amount of fees charged cannot

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[124] *Id.* at 145.

[125] *Id.*

[126] 311 So. 2d 371 (Fla. Dist. Ct. App. 1975).

[127] 446 So. 2d at 144.

[128] J. NICHOLAS, TECHNICAL MEMORANDUM ON THE METHODS USED TO CALCULATE FRINGE AREA IMPACT FEES 4 (1986).

> Lee County, Florida, has drafted a "Fringe Area Road Impact Fee Ordinance," to impose additional impact fees on outlying areas. Draft of An Ordinance Providing for the Imposition of an Impact Fee on Land Development in the Fringe Area of Lee County for Providing New Roads and Related Facilities in the Fringe Area which are Necessitated by Such New Development (Aug. 27, 1986) (Lee County, Fla.). The Lee County Plan does not provide for any public facilities to fringe areas; rather, development is allowed in these areas only if the development provides all necessary public support facilities itself. However, experience revealed that attempting to require each development, on its own, to be self-sustaining has many complications. Thus, the county developed fringe area impact fees, which are imposed in addition to the existing impact fees and have the objective of attaining the self-sufficiency for fringe area developments required by the county plan.

Id. at 1-2.

be simply "plucked out of thin air."[129] Calculation of fees should be tied to an analysis of needs and benefits to insure that fees charged satisfy the rational nexus test.

f. Segregation, Use and Refund of Funds: Avoidance of "Tax"

Segregating fees collected into separate accounts apart from general funds meets the requirement that capital improvements or public facilities funded must "adequately" benefit the new development which paid the fee. In *Home Builders & Contractors Association v. Board of County Commissioners*,[130] the court held that benefits accruing to the community generally do not adversely affect the validity of a development regulation as long as the fee does not exceed the cost of the improvements serving the new development and the improvements *adequately* benefit the development which is the source of the fee: "It is difficult to envision any capital improvement for parks, sewers, drainage, roads, or whatever, which would not in some measure benefit members of the community who do not reside in or utilize the new development."[131] Earlier, *Amherst Builders Association v. City of Amherst*,[132] upheld a sewer tap-in charge, requiring the fees to be placed into a sewer fund, apart from general revenues.[133]

Dividing a local government into impact fee districts, depending upon the public facility or capital improvement, "localizes" the benefit, ensuring that capital improvements or public facilities funded "adequately" benefit the new development which paid the fee, even if the community at large also benefits.[134]

Many impact fee ordinances and model ordinances—especially in Florida—divided their local government territory into "impact fee districts" or "zones of benefit." A draft Charlotte County impact fee ordinance divides the county into three zones. Sarasota County's road and park impact fee ordinance

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[129] 662 P.2d 888, 905 (Wyo. 1983) (Rooney, C.J., dissenting & concurring in part).

[130] 446 So. 2d at 140.

[131] *Id.* at 143.

[132] 61 Ohio St. 2d 345, 348, 402 N.E.2d 1181, 1184 (1980).

[133] In Coulter v. City of Rawlins, 662 P.2d 888 (Wyo. 1983), the court held: "The limitation on this power is the requirement that any fees collected in lieu of raw-land dedication must be earmarked to accounts for the purpose of acquiring needed park and maintenance of existing park facilities." *Id.* at 903.

The *Amherst* court distinguished an earlier case, State *ex rel.* Waterbury Dev. Co. v. Witten, 54 Ohio St. 2d 412, 377 N.E.2d 505 (1978), which struck down a water connection fee as a tax because the ordinance did not provide for earmarking of the funds: "The fees collected pursuant to Ordinance 913.07 are earmarked specifically for a Sewer Revenue Fund, while the tap-in fees in *Waterbury* were not so earmarked for use." *Amherst*, 61 Ohio St. 2d at 347 n.2, 402 N.E.2d at 1183 n.2.

[134] Juregensmeyer, *Funding Infrastructure*, *supra* note 19, at 41.

has two zones. A draft of Lee County road impact fee ordinance has twelve zones and its park impact fee ordinance has fifteen zones. The Florida court in *Home Builders* approved of segregating funds into forty zones, thereby localizing the benefit, but did not explicitly require such a system.[135] Similarly, in *Hollywood, Inc. v. Broward County*,[136] the court upheld a condition to plat approval to dedicate land, pay an in-lieu fee or an impact fee to acquire more parks, favoring a restriction that the fees collected would be used for acquiring and developing new park lands within fifteen miles of the development which paid the fee.

Commingling the fees collected with general revenues has usually led courts to strike down impact fee ordinances as unauthorized taxes. In the leading case of *Contractors & Builders Association v. City of Dunedin*,[137] the Florida Supreme Court upheld the concept of impact fees, but eventually struck down the fee for sewer and water connection for failing to sufficiently restrict the funds.[138] A $720 impact fee for water connection met the same fate as the Ohio Supreme Court held in *State ex rel. Waterbury Development Co. v. Witten*[139] the ordinance was an illegal tax, after noting that fees collected were not earmarked. Similarly, the court in *Lafferty v. Payson City*,[140] struck down a $1,000 impact fee per family dwelling unit tied to the issuance of a building permit on the grounds that: "[An] impact fee deposited in the City's general revenues in this case is an illegal tax."[141]

A refund provision in an impact fee ordinance helps to ensure that the benefit requirement of the rational nexus test is met. Such a provision commonly provides that the fee payer is entitled to have fees returned if they are not spent for the purpose for which they were collected within a reasonable period of time after their collection. The reasonableness of the time period should probably be tied to the capital funding planning period for the infrastructure in question.[142]

The roads impact fee ordinance in *Home Builders* contained a provision that funds collected "must be spent within a reasonable time after collection (not later than six years) or returned to the present owner of the property."[143] In *City of Fayetteville v. IBI, Inc.*,[144] the Arkansas Supreme Court struck down an

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[135] Bosselman & Stroud, *Legal Aspects*, *supra* note 1, at 549.

[136] 431 So. 2d 606, 612 (Fla. Dist. Ct. App. 1983).

[137] 329 So. 2d 314 (Fla. 1976).

[138] *Id.* at 321.

[139] 54 Ohio St. 2d 412, 413, 377 N.E.2d 505, 506 (1978).

[140] 642 P.2d 376 (Utah 1982).

[141] *Id.* at 378 (footnote omitted).

[142] Jurgensmeyer, *Funding Infrastructure*, *supra* note 19, at 41-42.

[143] Home Builders v. Board of Palm Beach County Comm'rs, 446 So. 2d 140, 142 (Fla. Dist. Ct. App. 1983).

[144] 280 Ark. 484, 486, 659 S.W.2d 505, 506 (1983).

ordinance requiring all developers of new residential subdivisions to dedicate land or pay a fee to be used for acquisition or development of parks in the vicinity. The ordinance was struck down because (1) there was insufficient planning for expenditure of the funds, and (2) "no provision for a refund to the contributor even if the residential area should never be developed as expected."[145]

A road impact fee was struck down as a tax in *Broward County v. Janis Development*,[146] when the court held:

> The fee here is simply an exaction of money to be put in trust for roads, which must be paid before developers may build. There are no other requirements. There are no specifics provided in the ordinance as to where *and when* these monies are to be expended . . . . The fee being a tax, then it is improper.[147]

Although a trifle long on the issue of authority (which is not a major issue in most cases) the LURF Report Legal Analysis chapter sets out some of the aforementioned major cases[148] and principle basis for evaluating the legality of an impact fee (the rational nexus test):[149] there must be a reasonable connection between the fee charged and a development-generated problem which the fee will help alleviate.[150] The chapter also discusses the less-used "general public needs" test and the virtually unused "specifically and uniquely attributable" test.[151] The author reaches these tests by means of a rather superficial treatment of the so-called "takings" issue[152] (a regulation of land, if it goes "too far" may be construed as a taking of property potentially leading to compensation under the fifth amendment to the federal constitution) which is of only marginal relevance,[153] even given the need to deal with the United States Supreme Court's

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[145] *Id.* at 488, 659 S.W.2d at 508.

[146] 311 So. 2d 371 (Fla. Dist. Ct. App. 1975).

[147] *Id.* at 375 (emphasis added).

[148] PAYING FOR GROWTH, *supra* note 5, at 101-10.

[149] *Id.* at 102-10.

[150] Callies, *Property Rights*, *supra* note 1, at 633; Taub, *supra* note 1.

[151] PAYING FOR GROWTH, *supra* note 5, at 101-02 (citing *Pioneer Trust*, 22 Ill. 2d 375, 176 N.E.2d 799 (1961), and *Ayers*, 34 Cal. 2d 31, 207 P.2d 1 (1949)).

[152] *See* F. BOSSELMAN, D. CALLIES & J. BANTA, THE TAKING ISSUE (1973); Pennsylvania Coal Co. v. Mahon, 260 U.S. 393 (1922); Keystone Bituminous Coal Assoc. v. DeBenedictis, 107 S. Ct. 1232 (1987); First English Evangelical Lutheran Church of Glendale v. Los Angeles, 107 S. Ct. 2378 (1987); Callies, *Legal Aspects*, *supra* note 1.

[153] In the process, the author has generalized to the point of error by failing to distinguish between "facial" (*Keystone*) and "applied" (*Penn Central*) challenges to land use *ordinance* regulations made clear at the outset of land use common law at the Supreme Court level in Euclid v. Ambler Realty Corp., 272 U.S. 365 (1926) and Nectow v. City of Cambridge, 277 U.S. 183 (1927) with the result that the tests set out at page 100 are at best garbled and at worst misleading and inapplicable. The problem is accentuated by discussion of Hawaii's *Midkiff* case, which is

decision in *Nollan v. California Coastal Commission* which forms a basis for upholding exactions of all sorts, including impact fees, under a nexus test.[154] None of this—fortunately—detracts from the summary of impact fee common law, followed later by a useful summary of those few Hawaii statutes and local ordinances and charter provisions which appear to support impact fees and other exactions on the land development process, and a survey of where the various counties have gone with the impact fee concept.[155] Perhaps most useful of all is the checklist of potential drafting problems set out under the rubric, "Guidelines for Drafting a Defensible Impact Fee Ordinance."[156]

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of course not a regulatory taking case at all, but—as the Court defined it—a simple experience of the power of eminent domain, raising different issues—particularly with respect to public purpose—altogether.

[154] Nollan v. California Coastal Comm'n, 107 S. Ct. 3141 (1987).

[155] PAYING FOR GROWTH, *supra* note 5, at 116-20. The Scorecard: Maui has a limited ordinance (both geographically - in West Maui—and subjectively—only for traffic/roadways; Hawaii has a draft impact fee ordinance submitted to its Council; Kauai has an old Environmental Impact Assessment Ordinance (1980) which is a sort of catch-all measure, and Honolulu has pending before Council a Community Benefit Assessments bill which levies a general fee of *rezoning*, making it of dubious validity both because it is not *development* responsive (*rezoning* creates no new infrastructure needs, *development* does) and because it does not segregate funds into specific subject categories. The author understands that yet another draft ordinance for Honolulu is contemplated.

[156] *Id.* at 115-16: The following are guidelines which should be followed in drafting an impact fee ordinance, to best assure the validity of the ordinance from legal challenge based on state court decision in other jurisdiction and the *Nollan* decision.

1. *Incorporation of Comprehensive Plans and Capital Improvement Plans.* The ordinance should show a need for impact fees by relating the expenditure of the impact fees within the context of a capital improvement plan. The capital improvement plan should also be related to a community wide development plan. The ordinance must demonstrate that the need for additional facilities is required by new development, and not by existing deficiencies. This can be accomplished through determination of appropriate facilities standards, and formulation of a capital improvement plan to schedule improvements that will correct existing deficiencies, upgrade service levels, and accommodate new development. The cost of additional facilities must then be apportioned between new and existing development.
2. *Fees Must be Proportional to the Need Created.* The ordinance must establish the proportionate share of costs that the new development will bear. The factors which may be considered are:
   a. the cost of existing facilities;
   b. the means by which existing facilities have been financed;
   c. the extent to which new development has already contributed, through tax assessments, to the cost of providing existing excess capacity;
   d. the extent to which new development will, in the future, contribute to the cost of constructing currently existing facilities used by everyone in the community or by people who do not occupy the new development (by paying taxes in the future to pay off bonds used to build those facilities in the past);
   e. the extent to which the newly developed properties are entitled to a credit for providing facilities that the community has provided in the past without charge to

2. *Housing Exactions*

The author is considerably more skeptical with respect to the validity of

other developments in the service area;

f. extraordinary costs, if any, in serving the new development; and

g. the time-price differential inherent in fair comparisons of amounts paid at different times.

The computation of the fee will vary depending on the improvement for which the fee is assessed and the financial restraints in the community.

3. *Avoidance of Double Payment.* The factors above should assure that new development does not pay for facilities twice i.e., once through impact fees and later through taxes or vice versa. In addition, the ordinance should take into consideration other forms of exactions which may be imposed on the development, such as subdivision exactions or earlier in the zoning unilateral agreement.

4. *Creation of a Separate Fund.* The funds should be earmarked and placed into a separate fund designed for the improvement(s) for which they were collected.

5. *Fees Must be Spent to Benefit the Development.* The improvement should be located where one may reasonably expect that occupants of the new development would use the improvements. However, the improvements need not be for the exclusive use of the occupants of the new development. Palm Beach County, Florida resolves this problem by requiring that road impact fees be spent within six miles of the new development. Montgomery County and Maryland, establishes districts within which road impact fees must be spent.

6. *Fees Must be Spent Within a Reasonable Time, or Refunded.* The ordinance should address the timing of the expenditure, since courts will require that impact fees be spent within a reasonable time (e.g., 4 to 6 years from collection). Some ordinances delay collection of the fee to give more time to consolidate collection efforts for major capital improvement projects. Many impact fee ordinances in Florida also contain a refund provision, under which funds which are not expended within a specified time are refunded to the current occupant of the property.

7. *Mechanism to Challenge the Fee and Exemptions.* The ordinance should allow those who pay the fee to challenge the criteria on which the fee is based. This may be accomplished through a hearing or appeals procedure which would allow developers to present their own studies and data to support a lesser fee amount. The ordinance should contain a hardship waiver provision for those cases where assessment of the fee would leave the developer with no economically viable use of his property. Exemptions should be provided and based on non-economic criteria.

8. *Equal Application.* The ordinance should assess fees on every development that creates a need for the infrastructure similarly. Both small and large developments should be assessed fees.

9. *Fees Should Only be Used for Construction.* The fees should be used only for construction of facilities, and not for the maintenance, repair or operation of the facilities once constructed. Taxes or user fees should be utilized to cover the cost of these latter items.

10. *Time of Payment.* The time of payment of the fee should be considered. A typical scenario is to provide for the payment of the fee when the building permit is issued or at subdivision approval.

11. *Documentation of State Interest.* Finally, in response to the *Nollan* case, local governments should establish that the exaction substantially advances a legitimate state interest.

housing exactions.[157] Here, he is probably on solid ground once again. Tying the approval of land development to the dedication of low- and moderate-income housing or the payment of fees to fund the building of low- and moderate-income housing has been the most controversial exaction levied by local governments.

Two commentators trace the evolution of exactions for housing and conclude: "[T]he fact that the output is housing does not present any compelling legal reason why the tests used to evaluate other development exactions may not be applied to such [housing] programs."[158] The same commentators point out that by being too exotic certain exactions do not pass the rational nexus test:

> When the exactions related to traditional public service and facilities usually provided to new residential development, the courts have generally accepted the proposition that the new development causes some need for new facilities such as streets, sewers, water, parks and schools. Where the exaction is for some more exotic service or facility, such as the geothermal well involved in parks, the courts may conclude that no need exists and reject the validity of the exaction without going further.[159]

Whether the building of new housing causes a need for low- and moderate-income housing is far from certain. Under one theory, when commercial development and conventional market units use up a scarce resource (lands in coastal regions), which could have been used for the building of low- and moderate-income housing, they can be required to contribute to low-income housing. This could also increase the property values of adjacent properties, thus excluding low- and moderate-income households from the communities.[160]

One commentator doubts that a housing exaction meets the rational nexus test:

> [E]ven these more permissive cases [*Walnut Creek* and others] would have to be stretched quite far to justify the inclusionary zoning ordinances. They do stand for the proposition that some exactions will be upheld although the need does not

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This can be done through a recital in the preamble of the ordinance to this effect and a finding by the legislative body that this is so based on the State Constitution or prevailing state laws.

[157] *Id.* at 110-15.

[158] Bosselman & Stroud, *Land Development Linkages*, *supra* note 2, at 406.

[159] *Id.* at 398.

[160] *See In re* Egg Harbor Assocs., 94 N.J. 358, 464 A.2d 1115, 1118-19 (1983). Under a quasi-public trust doctrine, since the market forces will result in the under allocation of low- and moderate-income housing, the local government should regulate land in a way to ensure the equitable distribution among economic groups. *Cf.* Bozung, *A Positive Response to Growth Control Plans: The Orange County Inclusionary Housing Program*, 9 PEPPERDINE L. REV. 819, 822 (1982).

> arise entirely from and the benefits extend beyond the particular development. However, the causal connection between new development and the types of services involved in the subdivision cases—streets, parks and schools—seems more immediate and direct than in the case of the inclusionary ordinances.[161]

The same commentator also raised the argument that permissive subdivision exactions pose a threat to an inequitable redistribution of wealth. Even if the need for lower cost housing could be connected with the new development, it could be argued that the benefits accrue to the community rather than to the particular developments. Courts might be hard pressed to see a reciprocal benefit to having lower cost or subsidized housing interspersed within the new development.

Municipalities have taken alternative paths in trying to cope with the problem that an increasing proportion of the population cannot afford adequate housing. Critics of traditional zoning point to its exclusionary effect. Minimum lot size, setbacks and front yard requirements contribute to the high cost of housing. In addition, many communities have residential districts zoned only for single family dwellings. These zoning regulations may offend notions of distributive justice. It has been well-argued that since the demand for affordable housing by low- and moderate-income households greatly exceeds the supply and has a disproportionate impact upon minorities by excluding them from certain communities and contributing to the economic segregation of ethnic groups, municipalities should change zoning laws to foster the production of all alternatives of housing for all ethnic and economic groups.[162]

The first method by which municipalities encourage the production of low- and moderate-income housing is through mandatory set-asides. These require residential developers to provide a certain percentage of their units below the market price be rented or sold to low- and moderate-income families.[163]

The second method is through linkage programs. Linkages involve conditioning approval of commercial development, like a downtown office building, upon a landowner's contributing to the construction of new housing.[164]

How courts have treated mandatory set-asides is generally beyond the scope of this essay. Suffice it to say that a heavily criticized and largely ignored decision from Virginia struck the concept down[165] and a pair of much-heralded New Jersey decisions has upheld them, though in relatively unique

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[161] Kleven, *Inclusionary Ordinances—Policy and Legal Issues in Requiring Private Developers to Build Low Cost Housing*, 21 UCLA L. REV. 1432, 1498 (1974).

[162] Bozung, *supra* note 160, at 819-21.

[163] Fox & Davis, *Density Bonus Zoning to Provide Low and Moderate Cost Housing*, 3 HASTINGS CONST. L.Q. 1015, 1015-16 (1976).

[164] Bosselman & Stroud, *Land Development Linkages*, *supra* note 2.

[165] Board of Supervisors v. DeGroff Enters., Inc., 214 Va. 235, 198 S.E.2d 600 (1973).

circumstances.[166]

So far, the only jurisdiction to have squarely addressed the use of linkage fees for such housing has done so only at the trial court level, which issue was then neatly avoided on procedural grounds on appeal. A recent Massachusetts case, *Bonan v. City of Boston*,[167] presented an opportunity to settle the issue of whether linkages and mandatory set-asides could be sustained under a rational nexus analysis applied to other types of exactions. However, the Massachusetts Supreme Judicial Court resolved the cases on procedural grounds without addressing the substantive issues.[168]

In *Bonan*, the zoning commission of Boston granted Massachusetts General Hospital a special exception, amending the zoning map to permit a greater building density for the property than otherwise permitted by the zoning code. The exception was contingent upon a payment of a Development Impact Project Exaction of five dollars for each square foot of gross floor area in the project in excess of 100,000 square feet.[169] The plaintiffs, owners of an adjacent property, maintained that they would be injured by the increased traffic, parking, people and loss of their view of the Charles River and the City of Cambridge.

The trial court rejected any purported linkage. According to the court, the powers listed in the zoning enabling act do:

> not include the power to exact a fee, a tax, or an in-kind contribution for the construction of low- and moderate-income housing as a condition of the granting of an amendment to the zoning map. . . . [Nor could the power be implied.] From this silence, the court must conclude that the power to exact linkage fees is not within the scope of the zoning power.[170]

Also, the court reasoned the nearly $4 million generated by the exaction was more like a tax than a fee since the benefits accrue to the community at large rather than the payer.[171]

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[166] Southern Burlington County NAACP v. Mount Laurel, 92 N.J. 158, 456 A.2d 390 (1983) where such set asides were required of recalcitrant local governments—not developers—only after a host of other measures such as eliminating design and non-health requirements like curbs and sidewalks and permitting mobile homes, to increase the supply of low-income housing, are tried and fail, and *In re* Egg Harbor Assocs., 94 N.J. 358, 464 A.2d 1115 (1983) where the approved development would take up virtually all the developable land in the coastal zone in the region thereby eliminating any low-income housing there without a set-aside.

[167] 398 Mass. 315, 496 N.E.2d 640 (1986).

[168] Letter from Donald L. Connors to James C. Nicholas (Sept. 29, 1986) (summarizing the holding in *Bonan* that the plaintiffs lacked standing to sue); Memorandum from Donald L. Connors to Persons Interested in Boston's Linkage Ordinance (May 1, 1986).

[169] 398 Mass. at 318-19, 496 N.E.2d at 642-43.

[170] Bonan v. City of Boston, No. 76438, slip op. at 17 (Mass. Super. Ct. Mar. 31, 1986).

[171] *Id.* at 19.

This holding became moot when the Massachusetts Supreme Court held that the plaintiffs lacked standing to sue.[172]

Two commentators cautiously predict that linkage programs will be upheld under the rational nexus test.[173] They recognize that the key issue is whether commercial development causes the need for new housing. Linkage programs are justified by the argument that new commercial development creates jobs. This attracts new residents to the area, increasing the demand for housing which increases the price of housing, creating a need for low- and moderate-income housing. A San Francisco economist argues that "additions to the supply of office space don't make office employment any more than cribs make babies."[174] Even if the proposition that new development creates new jobs is accepted, it does not necessarily follow that such development generates a demand for new housing. The cities are in a state of flux. Birth rates, death rates and migration might even lower the demand for housing. Moreover, the housing stock is in constant flux as units are being constantly built, demolished or converted to nonresidential use. Although the proof of causation to validate linkage is not insurmountable, it will take careful documentation by the cities that intend to adopt housing linkage programs.[175]

On the other hand, the San Francisco housing linkage program has been ably defended on the grounds of housing mitigation: the need for housing for office workers who will be employed in new office buildings.[176] The theory goes that while the supply of housing in San Francisco will expand, it will not expand enough to provide housing for office workers on a market basis without government intervention. Otherwise, those with the greater incomes will be housed as competition for increasingly short supplies heats up. The linkage fee is derived from calculating how many jobs new office development will generate and how many workers will be there employed who cannot be expected to find housing in San Francisco.[177]

Dealing mainly with recent linkage programs in Boston and San Francisco, *Planning for Growth* concludes that despite the virtual dearth of appellate cases dealing with such linkage programs, there is little legal basis for them, particularly when the requirement to provide housing is tied to a proposed residential development. These are not clearly distinguished in this chapter from the so-called "voluntary" programs noted in the same category as if they are the same, in which a developer is provided with density or other construction and devel-

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[172] Bonan v. City of Boston, 398 Mass. 315, 320-21, 496 N.E.2d, 640, 645 (1986).

[173] Bosselman & Stroud, *Land Development Linkages*, *supra* note 2, at 411.

[174] *Id.* at 407.

[175] *See id.* at 407-09.

[176] Hausrath, *Economic Basis for Linking Jobs and Housing in San Francisco*, 54 J. AM. PLAN. A. 210 (1988).

[177] *Id.* at 212-13.

opment bonuses if certain percentages of affordable housing are constructed. There is obviously some choice inherent in the former, whereas there is none in the latter. The chapter concludes—as does the conclusion later—that raw linkage without any attempt at forming a nexus between the housing demanded and the development from which demanded, is in all likelihood legally flawed. The discussion which follows attempts to differentiate so-called inclusionary zoning, citing primarily the line of cases from New Jersey which appear to require such housing to be built in developing communities.[178] It is worth noting, however, that these cases arose when recalcitrant communities (not leery developers as in Hawaii) failed to take their fair share of low-income residents fleeing central cities. Moreover, the requirement that these communities require mandatory construction of low-income housing as part of other residential developments applied only to those communities which: (1) were "developing" and (2) had undertaken a plethora of other measures first to attempt to provide low-income housing, specifically such as permitting mobile homes and stripping their existing ordinances of none—health and safety requirements which drove up the cost of housing—like curbs, sidewalks, and so forth. The chapter concludes with a cautionary note that it should not be assumed these are applicable to Hawaii.

B. The Interviews

In early 1988 the authors interviewed state and county planning directors and other officials whose responsibilities would include providing infrastructure and housing through the land development process.[179] While it is possible to criticize devoting nearly half the report to responses to a common set of questions "in their entirety"[180] and wholly without editing, some of those responses are illuminating, showing as they do a common dedication to construct both infrastructure and public housing largely at the expense of the private sector by charges on the land development process.[181] Nowhere is the failure of tradi-

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[178] *Mt. Laurel*, 93 N.J. 158, 456 A.2d 390 (1983); *Egg Harbor*, 94 N.J. 358, 464 A.2d 1115 (1983).

[179] Harold S. Masumoto, Director, Office of State Planning; Joseph K. Conant, Executive Director, State Housing Finance & Development Corporation; Donald A. Clegg, Chief Planning Officer, City & County of Honolulu; John P. Whalen, Director of Land Utilization, City & County of Honolulu; Michael Moon, Director of Housing & Community Development, City & County of Honolulu; Christopher L. Hart, Director of Planning, County of Maui; Albert Lono Lyman, Director of Planning, County of Hawaii; Tom Shigemoto, Director of Planning, County of Kauai; *Foreward* to PAYING FOR GROWTH, *supra* note 5.

[180] PAYING FOR GROWTH, *supra* note 5, at 15-86.

[181] *Id.* at 36, 38-42 (Donald Clegg); *id.* at 68, 71 (Christopher Hart); *id.* at 77 (Albert Lyman); *id.* at 82, 85 (Tom Shigemoto).

tional sources of revenue—the property tax, the excise tax, and so forth—more evident. And nowhere is it more freely admitted that exactions for housing and infrastructure have been traditionally exacted for quite some time on an ad hoc basis.[182]

What the impact fees and housing exactions formally proposed and in place would do is regularize the process adding certainty to development cost projection where little exists today.[183] What disagreement there is generally revolves around who should make the exaction, particularly for housing: the state or the counties?[184]

C. Planning and Economics

The brief introductory chapter on planning[185] sets the tone of the study nicely. It lists key definitions[186] together with a concise history of development regulations before fixing on the impact fee and the critical requirements of "rational nexus."[187]

A useful example of how such an impact fee would be calculated, taken from Broward County, Florida, then follows.[188]

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[182] *Id.* at 24 (Harold Masumoto); *id.* at 52 (John Whalen); *id.* at 59 (Michael Moon).

[183] *Id.* at 31 (Joseph Conant); *id.* at 49 (John Whalen).

[184] *Id.* at 41 (Donald Clegg); *id.* at 25 (Harold Matsumoto); *id.* at 54 (John Whalen); *id.* at 66 (Christopher Hart).

[185] Rae, *Impact Fees and Housing Exactions Programs: A Planning Overview*, in PAYING FOR GROWTH, *supra* note 5, at 1.

[186] *Impact Fees*: Single payments required to be made by builders or developers at the time of development approval, and calculated to be the development's proportionate share of the capital cost of providing major facilities. Because they are single payments, as opposed to periodic payments such as taxes, it means that the capital outlay necessary to construct the facility or improvement is available at the time the facility is needed. Additionally, because the fee is based on a proportionate share, new development will not be required to pay other than its own way.

Nexus: Some courts discuss a "rational nexus," while others look to an "essential nexus." From a planning perspective, what is important is that there is a clear and documented connection or link between the impacts caused by a development project and the exactions imposed upon the developer to mitigate negative impacts. PAYING FOR GROWTH, *supra* note 5, at 2.

[187] *Id.* at 4.

[188] A general formula can be shown for calculating an impact fee for a given facility. An example of a park impact fee from Broward County, Florida is provided, which is designed to incorporate planning, legal, and economic considerations. The formula has three basic components, as shown below:

1. Total cost of park development per dwelling unit. The first step is to determine what the county's standards are for parks. In this example, there is a standard of 7.5 acres of park for every 1,000 people. Second, the average household size in Broward is 2.5 persons per unit. Third, it costs Broward County $38,140 for acquisition and development of each acre of park. Given these facts, the total cost per unit of new development can then be calculated as follows:

There then follows a brief discussion of inclusionary zoning and housing linkage programs. The author concludes generally that neither may be the most productive means for increasing the amount of low-income housing available in Hawaii.[189] In sum, this chapter is well-organized and concise.

The economics chapter is tough sledding.[190] The author analyzes the concepts of impact fees and development exactions according to several economic theories and concludes that impact fees may theoretically represent a more equitable mechanism of providing for necessary public infrastructure than ad hoc exactions, but they are likely to increase the costs of both rental and market housing in the process. However, apparently not all subject areas are amenable to impact fee treatment. The most salient deviation apparently occurs in the use of fees or exactions to provide for low-income housing. They have "no social merit and should be abandoned"[191] since they have truly pernicious effects on the supply and price of low-income housing. Rather, suggests the author, more efficient

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$38,140 x 7.5 = $286,050 per 1,000 residents.
$286,050/1,000 = $286.05 per person
2.5 x $286.05 = $715.13

The cost of park development per residential unit = $715.13

2. Determine other revenue sources that contribute to park development. The function of this step is to acknowledge that there are other sources of revenue for the park development than the impact fee. These must be taken into account so that the impact fee reflects real costs to government. Such revenues typically come from State and Federal grants, previously collected property taxes on undeveloped land, and future payments of new residents to existing obligation bonds. In Broward County, it was found that State and Federal grants paid for 25% of park costs. There was also an outstanding obligation bond for parks. It was calculated that undeveloped land was paying 10% of the bond debt service through property taxes. Thus the land will have already paid 10% of its park cost. It was further found that a new home will pay $25 per year for the next 20 years toward park bond issues. Revenues can then be calculated as follows:

- 25% of $715.13 = $178.78 (Federal and State grants)
- 10% of $715.13 = $71.51 (portion paid by undeveloped land)
- Present value of $25 per year for 20 year = $264.75 (future bond payments by a new house)
- Contribution of other sources to park development = $515.04.

3. Amount of impact fee. The impact fee per new dwelling can then be calculated by subtracting other revenue sources from the cost of providing the service.

In the park example, this is:

Park cost per dwelling	$715.13
Less other revenues	515.04
Impact fee per dwelling =	$199.99

Id. at 16.

[189] *Id.* at 9-10.

[190] PAYING FOR GROWTH, *supra* note 5, ch. 4.

[191] Rose, *Impact Fees and Housing Exaction Programs: An Economic Analysis*, in PAYING FOR GROWTH, *supra* note 5, at 137.

and equitable means are available to achieve housing objectives, such as relaxing zoning and permitting restrictions (supply-side restraints) and providing housing vouchers for low-income tenants and time-phased income tax credits for first-time moderate income home buyers.[192]

These are incisive conclusions, and they are amply documented in the analysis portion of the chapter. That analysis is complex, however, and the author has thoughtfully provided the less venturesome reader with an executive summary which, while requiring the reader to accept the conclusions at face value, has the virtue of simplicity and clarity.

III. CONCLUSION

In conclusion, the legal trends across the country clearly favor the upholding of impact fees which:

1. are designed to help pay for public projects the need for which is generated by the development upon which the fee is levied;
2. are segregated from general funds and placed in a designated special fund to pay for the public project for which levied;
3. are used promptly for such projects and not held for years.

It is useful, but not necessary, for such fees to be:

1. related to plans and studies showing the need for such public projects and their relation to anticipated development;
2. part of a funding program for capital facilities in which there is a substantial public contribution from other sources of funds;
3. spent for public projects which have more, rather than less, direct connection to the development upon which fees are being levied.

In other words, courts are concerned that the fee be reasonably arrived at (mathematical precision is not required, however) and that the paying development be benefited in some manner, though neither substantial public benefit nor relatively minor development benefit will render an impact fee illegal, as the cases in California and Florida—two developing states which make substantial use of such fees and in which there has been substantial litigation—clearly indicate.

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[192] *Id.* at 141.