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## ARTICLES

Compensation for Lost Aesthetic and Emotional Enjoyment: A Reconsideration of Contract Damages for Nonpecuniary Loss
*Amy H. Kastely* 1

Lost Earnings Calculations and Tort Law: Reflections on the *Pfeifer* Decision
*Sumner J. La Croix and H. Laurence Miller, Jr.* 31

Trading Money for Silence
*Walter Block* 57

## COMMENTS

Regulating Pornography Through Zoning: Can We "Clean Up" Honolulu? 75

The Contract Clause: The "Regulated Industry" Exception 135

## NOTES

*Ravelo v. County of Hawaii*: Promissory Estoppel and the Employment At-Will Doctrine 163

*Supreme Court of New Hampshire v. Piper*: Invalidation of Bar Residency Requirements Under the Privileges and Immunities Clause of the United States Constitution 191

*State v. O'Brien*: Right to Jury Trial for Driving Under the Influence of Intoxicating Liquor 209

## RECENT DEVELOPMENTS

Decentralized Power Generation: Alternative Energy Exemption from State Public Utility Regulation—*In re Wind Power Pacific Investors-III* 227

Development of Occupational Hazard in Hawaii: *Lopez v. Board of Trustees, Employees Retirement System*; *Komatsu v. Board of Trustees, Employees Retirement System* 245

Taxation: Who Pays Attorney's Fees? 253

# Compensation for Lost Aesthetic and Emotional Enjoyment: A Reconsideration of Contract Damages for Nonpecuniary Loss

by Amy H. Kastely*

When a buyer purchases property for resale, its value to him is roughly equal to the resale price.[1] If the seller breaches the contract, he generally will be required to compensate the buyer for the loss of this value even if it is higher than the contract price.[2] Similarly, when a buyer purchases property for use in the production of goods or services to be sold for economic gain, a seller in breach will be required to compensate for the loss of the property's utility value if it was foreseeable at the time of the contract.[3]

When a buyer purchases property for personal consumption or enjoyment, again its value to him is often greater than the contract price, for he may well expect to receive aesthetic or emotional enjoyment beyond that reflected in the

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[1] The value to the buyer of property purchased for resale would be reduced by transaction costs and any uncertainties of resale. *See generally* 1 J. BONBRIGHT, THE VALUATION OF PROPERTY 71-74 (1937) ("The value of a property to its owner is identical in amount with the adverse value of the entire loss, direct and indirect, that the owner might expect to suffer if he were to be deprived of the property."); E.A. FARNSWORTH, CONTRACTS § 12.11, at 856 (1982) ("[T]he middleman's *loss in value* is the profit that he would have made on that resale, account being taken of the costs of resale.") (emphasis original).

[2] If the resale price is equal to the market price at the time of the breach, then the buyer would recover this amount under a market differential formula (Damages equal market price minus contract price.), *see* U.C.C. § 2-713 (1978); if the resale price is higher than the relevant market price, and the buyer was unable to cover, the loss most likely would be compensated as a foreseeable consequential loss, U.C.C. § 2-715 (1978). *See generally* E.A. FARNSWORTH, *supra* note 1, § 12.11, at 855-58 (discussing recipient's damages); Farnsworth, *Legal Remedies for Breach of Contract*, 70 COLUM. L. REV. 1145 (1970) [hereinafter cited as Farnsworth, *Legal Remedies*] (earlier version of Professor Farnsworth's analysis).

[3] E.A. FARNSWORTH, *supra* note 1, § 12.11, at 855-58.

contract price.[4] A specially designed home, for example, may have an enhanced value to the buyer because it is especially suited to his particular needs and aesthetic tastes.[5] Yet the common law traditionally has not compensated an injured party for lost expectations of this kind. Such damages generally have been precluded by a rule denying damages for "sentimental" or "fanciful" value.[6] Although courts often have been willing to protect nonpecuniary interests indirectly, either through an order of specific performance or by awarding the full costs for completing performance, still the law generally has refused to allow direct compensation for these losses.

This rule conflicts with basic principles of contract damages, which require that the promisee be compensated for the full value of promised performance to him.[7] The rule is unfair because it arbitrarily denies recovery for value based on emotional and aesthetic interests while allowing compensation for loss of economic interests. In order to avoid this unfairness, courts have developed a parallel doctrine that allows recovery for "emotional distress" where the contract involves nonpecuniary benefits. This doctrine enables the courts to award compensation in many cases that otherwise would be barred by the general prohibition on sentimental value.[8] This circuitous route to recovery is problematic, however, for the link to emotional distress doctrine raises false issues and confuses analysis.[9] The thesis of this article is that compensation for aesthetic or emotional loss should be awarded directly, limited only by the traditional doctrines of avoidability, foreseeability, certainty, and disproportionality. The rule against sentimental value should be rejected as unwarranted and inaccurate.

Part I of the article compares the basic principles of contract damages with the general rule against sentimental value. Part II discusses the doctrine allowing emotional distress damages where the contract involves significant nonpecuniary benefits. Part III argues for direct compensation of nonpecuniary loss and considers the applicability of the traditional doctrines of avoidability, foreseeability,

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[4] *See generally* C. MCCORMICK, HANDBOOK ON THE LAW OF DAMAGES §§ 43-45 (1935). This excess value is often called the "consumer surplus." *See, e.g.*, P. SAMUELSON, ECONOMICS 412-13 (11th ed. 1980); Harris, Ogus & Phillips, *Contract Remedies and the Consumer Surplus*, 95 LAW Q. REV. 581 (1979); Hicks, *The Rehabilitation of Consumers' Surplus*, 8 REV. ECON. STUD. 108 (1941); Willig, *Consumer's Surplus Without Apology*, 66 AM. ECON. REV. 589 (1976).

[5] *Cf.* B & M Homes, Inc. v. Hogan, 376 So. 2d 667, 672 (Ala. 1979) (quoting F. Becker Asphaltum Roofing Co. v. Murphy, 224 Ala. 655, 657, 141 So. 630, 631 (1932)) (A person's home is "her castle."); 1 J. BONBRIGHT, *supra* note 1, at 19 (Value "refers to the advantage that is expected to result from the ownership of a given object."); Harris, Ogus & Phillips, *supra* note 4, at 583 (Utility value can be measured "in terms of the *maximum* amount a consumer would pay for a particular purchase.") (emphasis added).

[6] *See infra* note 30 and accompanying text.

[7] *See infra* notes 10-15 and accompanying text.

[8] *See infra* notes 68-73 and accompanying text.

[9] *See infra* notes 135-48 and accompanying text.

certainty, and disproportionality to cases involving lost aesthetic and emotional enjoyment.

## I. THE DOCTRINAL TANGLE: SUBJECTIVE VALUE AND THE TRADITIONAL BAN ON SENTIMENTAL VALUE

The fundamental goal of contract damages is to put the aggrieved party in the position he would have been in if the breaching party had fully performed.[10] Under the common law,[11] this is achieved primarily by awarding damages measured by the value of the promised performance.[12] Theoretically, there is no doubt that this measure should reflect the value of the promised performance to the promisee himself.[13] The goal is to give the promisee what he bargained for, and it is a fundamental principle of contract law that individuals should be free to set values according to their own choice, without interference by the government or its courts.[14] In order to give the promisee what he

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[10] *See* U.C.C. § 1-106(1) (1978) ("The remedies provided by this Act shall be liberally administered to the end that the aggrieved party may be put in as good a position as if the other party had fully performed. . . ."); RESTATEMENT (SECOND) OF CONTRACTS § 347 (1981) ("[T]he injured party has a right to damages based on his expectation interest as measured by the loss in the value to him or the other party's performance caused by its failure or deficiency. . . ."); 5 A. CORBIN, CORBIN ON CONTRACTS, § 992, at 5 (1964) ("In determining the amount of this compensation as the 'damages' to be awarded, the aim in view is to put the injured party in as good a position as he would have had if performance had been rendered as promised.").

[11] In contrast, civil law systems generally favor specific performance as a remedy for breach of many types of contract, at least in theory. *See* Treitel, *Remedies for Breach of Contract (Courses of Action Open to a Party Aggrieved)*, 7 INT'L ENCY. COMP. L. §§ 16-10 to 16-39 (1976).

[12] U.C.C. § 2-716 comment 2 (1978) (Specific performance is available only where goods are unique or where there are other special circumstances such as an inability to cover.); RESTATEMENT (SECOND) OF CONTRACTS § 359 ("Specific performance. . .will not be ordered if damages would be adequate to protect the expectation interest of the injured party."); Axelrod, *Specific Performance of Contracts for Sales of Goods: Expansion or Retrenchment in the 1980's*, 7 VT. L. REV. 249 (1982); Farnsworth, *Legal Remedies*, *supra* note 2, at 1145-47; Kronman, *Specific Performance*, 45 U. CHI. L. REV. 351 (1978).

[13] *See, e.g.*, RESTATEMENT (SECOND) OF CONTRACTS § 347 comment b ("In principle, this requires a determination of the values of those performances to the injured party himself and not their values to some hypothetical reasonable person or on some market."); E.A. FARNSWORTH, *supra* note 1, § 12.8, at 839. *Cf.* 5 A. CORBIN, *supra* note 10, § 1004, at 47 (inquiry should focus on the "actual loss" of the promisee).

This principle also suggests that a decrease in value caused by defective performance should be measured by the diminution in value to the promisee himself. *See* J. WHITE & R. SUMMERS, HANDBOOK ON THE LAW UNDER THE UNIFORM COMMERCIAL CODE 382 (1980).

[14] *See* RESTATEMENT (SECOND) OF CONTRACTS § 79 comment c:

> To the extent that the apportionment of productive energy and product in the economy are left to private action, the parties to transactions are free to fix their own valuations. . . .Valuation is left to private action in part because the parties are thought to be

was promised, the value of the promise must be measured by its particular worth to him.[15]

In many cases, however, it is not necessary to determine the subjective value of the promised performance because damages are otherwise limited to market value.[16] If a substitute for the performance was readily available at the time of the breach, the doctrine of mitigation limits the promisee's recovery to the cost of purchasing the substitute,[17] because he thereby could have avoided all losses beyond the cover price.[18] If the promisee expected pecuniary benefits from the performance, the substitute would satisfy his needs of resale or production. Similarly, if the promisee expected aesthetic or emotional enjoyment from the promised performance, a perfect substitute would yield equal enjoyment.[19] Thus, if the buyer of a specially designed house could purchase or construct another home, equally pleasing to him, then an award based on the market value of the house, or on the difference between the actual price paid and the contract price,[20] would fully compensate him.[21]

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better able than others to evaluate the circumstances of particular transactions.

*See also* E.A. FARNSWORTH, *supra* note 1, § 2.2, at 42 (doctrine accepting the parties' exchange of values "accorded well with the prevailing mood of nineteenth century America, which placed its trust in free enterprise and in the dignity and creativity of the individual"); R. POSNER, ECONOMIC ANALYSIS OF LAW 71 (2d ed. 1977) (The court is "less well equipped" than the parties to decide "whether the price (and other essential terms) specified in the contract are reasonable.").

[15] Farnsworth, as well as Fuller and Perdue, observed that this measure of recovery also is adequate to protect, and therefore to encourage, reliance on promises. Farnsworth, *Legal Remedies*, *supra* note 2, at 1147-48; Fuller & Perdue, *The Reliance Interest in Contract Damages* (pts. 1 & 2), 46 YALE L.J. 52, 373 (1936, 1937).

[16] *See generally* E.A. FARNSWORTH, *supra* note 1, § 12.12, at 863-65 (discussing standard damage formulae based on market value); C. MCCORMICK, *supra* note 4, § 44, at 165 ("[I]n assessing damages, market value is the usual standard.").

[17] *See* U.C.C. § 2-715(2)(a) (1978) (Consequential damages are limited to those "which could not reasonably be prevented by cover or otherwise."); RESTATEMENT (SECOND) OF CONTRACTS § 350 (Avoidability as a Limitation on Damages); E.A. FARNSWORTH, *supra* note 1, § 12.12, at 858, 863-64.

[18] *See* E.A. FARNSWORTH, *supra* note 1, § 12.12, at 863-64 (Market formula reflects the doctrine of mitigation.); A. SEDGWICK, ELEMENTS OF DAMAGES 120-21 (1896) ("The reason why the market is usually taken as the measure of value is sometimes said to be that this is what the person entitled to the article would have to pay to replace it himself."). *See also* D. DOBBS, HANDBOOK ON THE LAW OF REMEDIES 189 (1973) ("[T]he basic rule [of mitigation] itself has the effect of saying that the plaintiff can minimize damages by going into the market and that he must do so, or take the consequences.").

[19] *See* Harris, Ogus & Phillips, *supra* note 4, at 584 ("[I]n the normal case the disappointed buyer should be able to obtain a sufficiently close substitute from which it is reasonable to assume that he should derive a similar consumer surplus.").

[20] *See* RESTATEMENT (SECOND) OF CONTRACTS § 347 illustration 12 (Loss in value is the difference between the cost of obtaining a substitute and the contract price.). *Cf.* U.C.C. § 2-712

If a substitute for the promised performance is not readily available after the breach, however, the promisee will lose not only the market value of the performance, but also any additional value that the property or service has for him. In such a case, damages limited to the market value would not compensate the promisee for his actual loss. Where this additional loss is pecuniary, the law does award damages based on the actual value of the performance to the promisee, so long as the loss was foreseeable and can be proved with reasonable certainty.[22] Thus, if a grain dealer purchased corn in order to resell it, and this was foreseeable, then damages for the seller's breach normally would include the grain dealer's expected profit on resale.[23] Similarly, if a dry cleaning company purchased a pressing machine for use in its business, then damages normally would include profits lost because of the seller's breach.[24]

Yet if the additional value of the performance was nonpecuniary, the law generally will not allow direct compensation for this loss, even where no substitute is available and where the loss was foreseeable.[25] If, for example, a photographer breached his contract to take wedding pictures, damages normally would be based on the market value of the photographer's services without compensation for the pictures' special emotional value to the promisee.[26] Even though

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(1978) (An aggrieved buyer may recover the difference between the cost of cover and the contract price.).

[21] Similarly, while a new Volkswagen may have great aesthetic and emotional value to its purchaser, another new Volkswagen presumably would carry similar value and the aggrieved buyer would be awarded damages based on the car's market value. *See* 5 A. CORBIN, *supra* note 10, § 1039, at 245 ("Losses other than the extra cost of making a new purchase can mostly be prevented. . . .This is the reason underlying the rule that measures the buyer's damages by the difference between the contract price and the market price.").

[22] *See* authorities cited *supra* note 2.

[23] *See* National Farmers Org., Inc. v. McCook Feed & Supply Co., 196 Neb. 424, 243 N.W.2d 335 (1976). *See also* U.C.C. § 2-715 comment 6 (1978) ("In the case of sale of wares to one in the business of reselling them, resale is one of the requirements of which the seller has reason to know. . . ."). *Cf.* Appliances v. Queen Stove Works, 228 Minn. 55, 63, 36 N.W.2d 121, 125 (1949) ("[T]he seller's knowledge that the buyer is a dealer in the kind of goods purchase is sufficient. . .[to charge him] with special damages based on the buyer's resale of the goods in the ordinary course of business. . . ."); Freund v. Washington Square Press, Inc., 34 N.Y.2d 379, 314 N.E.2d 419, 357 N.Y.S.2d 857 (1974) (damages allowed for loss of royalties and monetary value of enhanced reputation).

[24] *See, e.g.*, Victoria Laundry (Windsor), Ltd. v. Newman Indus., Ltd., [1949] 2 K.B. 528 (recovery for loss of profits caused by five month delay in delivery of boiler). *Cf.* Jones v. Johnson, 41 Hawaii 389 (1956) (lost profits resulting from breach of trailer lease).

[25] *See* authorities cited *infra* note 30; *see also* W. CLARK, HANDBOOK OF THE LAW OF CONTRACTS 608 (3d ed. 1914) ("[A]s a rule, only the pecuniary loss can be recovered. . . ."); A. SEDGWICK, *supra* note 18, at 100-01 ("For pure breaches of contract in general the governing principle. . .[is] that the elements of injury are pecuniary in their nature, and consequently for mental suffering caused by the breach there is no redress.").

[26] *See* Carpel v. Saget Studios, Inc., 326 F. Supp. 1331 (E.D. Pa. 1971), discussed *infra* notes

the photographer easily could have foreseen that the bridal couple would place a special value on their wedding pictures, still he would not have to repay them for this loss.

Similarly, if a carpenter breached his contract to produce specially designed cabinets, damages normally would be based on their market value, without compensation for any special aesthetic value to the buyer.[27] While their market price undoubtedly would be influenced by the cabinets' aesthetic worth,[28] still it may not reflect their full aesthetic value to an individual buyer. Competitive pressures may lead to a market price below the full aesthetic value. Similarly, an individual buyer may appreciate the beauty of the cabinets more highly than the average purchaser. Yet the loss of these values generally would not be compensated in a breach of contract action.

The refusal to allow compensation for nonpecuniary loss in cases like these is based on the general rule that "sentimental"[29] or "fanciful" values cannot be considered in assessing damages for lost property or services.[30] The origin of

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43-44 and accompanying text. *Cf.* Seidenbach's, Inc. v. Williams, 361 P.2d 185 (Okla. 1961) (no recovery for nonpecuniary losses resulting from breach of contract to deliver wedding gown). *But see* Dieson v. Samson, [1971] Scot. L.T. 40 (Sl. Ct.) (Scottish case allowing recovery for emotional distress caused by breach of contract to take wedding pictures).

[27] *Cf.* Levin v. Halston, Ltd., 91 Misc. 2d 601, 398 N.Y.S.2d 339 (N.Y. Civ. Ct. 1977) (damages for breach of contract to sell designer dress limited to return of deposit where plaintiff sought additional compensation for mental anguish).

Property can have a market value even though no substitute is readily available for the promisee to buy, where, for example, the property is temporarily unavailable, where production requires significant time, or, in the case of a unique good, where offers to buy have been made. *See* 1 J. BONBRIGHT, *supra* note 1, at 42. *But see* Airtight Sales v. Graves Truck Lines, 207 Kan. 753, 486 P.2d 835 (1971) (Where there is no actual market the court will determine the "real" value of the good.).

[28] *Cf.* C. MCCORMICK, *supra* note 4, § 45, at 170 (sentimental value may be reflected in market price).

[29] Webster's Dictionary defines the common meaning of "sentiment" as "an attitude, thought, or judgment permeated or prompted by feeling, a complex of emotion and idea." WEBSTER'S THIRD NEW INTERNATIONAL DICTIONARY (unabridged) 2069 (1971). "Sentimental" is defined as "of, relating to, or characterized by sentiment." *Id.*

[30] *See, e.g.*, Cherry v. McCutchen, 65 Ga. App. 301, 16 S.E.2d 167, 169 (1941) ("[T]here can be no recovery for the sentimental value. . . .The measure is the value of the property to the owner. . .the actual loss in money."); Pettella v. Corp Bros., Inc., 107 R.I. 599, 611, 268 A.2d 699 (1970) (quoting DeSpirito v. Bristol County Water Co., 102 R.I. 50, 54, 227 A.2d 782, 784 (1967)) (Value of personal property is "actual value to the owner. . .excluding, of course, any fanciful or sentimental value. . . ."); Merritt v. National Warehouse Co., 605 S.W.2d 250, 256 (Tenn. Ct. App. 1980) (Recovery is limited to the "useful" value to the plaintiff, not the sentimental value.); Herberg v. Swartz, 89 Wash. 2d 916, 578 P.2d 17 (1978) (Recovery for sentimental value is "impermissible."). *But see* Brown v. Frontier Theaters, Inc., 369 S.W.2d 299 (Tex. 1963) (Sentimental value may be compensated where this is the primary value of the property.); Meiske v. Bartell Drug Co., 92 Wash. 2d 40, 593 P.2d 1308 (1979) (rule against

this rule is obscure[31] and its rationale is not often discussed.[32] Although some courts and commentators have asserted that it is inappropriate for the law to recognize sentimental value,[33] they have not detailed the reasons for this judg-

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sentimental value excludes only "excessive" emotional attachment); 4 J. SUTHERLAND, A TREATISE ON THE LAW OF DAMAGES § 1099 (4th ed. 1916) (Heirlooms and the like should be valued "with reasonable consideration of and sympathy for the feelings of the owner."). *See generally* 5 A. CORBIN, *supra* note 10, § 1004, at 49 ("Sentimental value is something that cannot be considered in the law of contracts."); Farnsworth, *Legal Remedies*, *supra* note 2, at 1167 ("Courts have been reluctant to take account of such loss [involving personal taste and welfare] and have often expressed their reluctance by saying that there can be no recovery for 'sentimental' or 'fanciful' value.").

Many of the cases that expressly rely on the rule against sentimental value involve both contract and tort, most frequently concerning bailees or common carriers. Yet the rule is also cited in simple contract cases, *see, e.g.*, Carpel v. Saget Studios, Inc., 326 F. Supp. 1331 (E.D. Pa. 1971), and most courts implicitly assume that nonpecuniary values are not protected by contract law. *See* 1 J. BONBRIGHT, *supra* note 1, at 88; Farnsworth, *Legal Remedies*, *supra* note 2, at 1167.

[31] The Justinian Digest contains some indication that recovery for "affictiones aestimato," "pretium ex affectu" and the like was precluded under Roman law. *See, e.g.*, 2 THE DIGEST OF JUSTINIAN ¶ 7.7.6.2 (C. Monro trans. 1909) ("[T]he pleasure or the fondness felt by the owner will count for nothing in the valuation."); *id.* ¶ 9.2.33 ("Sextus Pedius agrees that the prices of things are not determined by personal feelings or convenience, but by average circumstances."). *Cf.* ¶ 9.2.2 (quoting lex Aquilia, ch. 1) (" 'If anyone slays unlawfully a slave. . .or a four-footed animal. . .then, whatever was the greatest value of the same in the year then last past, let the party be ordered to pay brass to that amount to the owner' 1. and, then, further on, it is provided that, against one who denies the fact, the action shall be for double the amount."). *But cf.* *id.* ¶ 9.2.22.1 ("Indirect elements of value (causae) attached to the particular individual must be brought into the account too; for instance, where a man kills one slave out of a troop of players or singers, or one of twins, or one horse out of a team, or one animal, male or female, or of a pair of mules; as in such cases a value must not be set only on the individual killed but account must be further taken of the extent to which the others are depreciated."); *id.* ¶ 9.2.23.6 ("In short, the rule is that any advantages which enhanced the value of the slave at any time within the year ending at the moment when he was killed formed an element in the valuation to be put on him.").

These paragraphs are inconclusive. Moreover, they generally focus on the valuation of slaves and do not necessarily mean that other aesthetic and emotional values were disregarded. For an American equivalent, see Mosely v. Anderson, 40 Miss. 49, 55 (1866). However, at least one commentator has concluded that Roman law recognized a general rule against compensation for sentimental value. Matthews, *The Valuation of Property in the Roman Law*, 34 HARV. L. REV. 229, 247 (1920).

[32] An overwhelming number of decisions simply assume that recovery is limited to the economic value of the promised performance. In those cases where additional value is claimed, most courts simply state the rule that sentimental value cannot be considered. *See, e.g.*, Pettela v. Corp Bros., 107 R.I. 599, 268 A.2d 699 (1970) (proper measure of personal goods is value to owner, but not sentimental value).

[33] *See, e.g.*, Herberg v. Swartz, 89 Wash. 2d 916, 578 P.2d 17, 26 (1978) (recovery for sentimental value "impermissible"); 5 A. CORBIN, *supra* note 10, § 1004, at 49 ("Sentimental value is something that cannot be considered in the law of contracts."). *Cf.* Furlan v. Rayan Photo Works, 171 Misc. 839, 840, 12 N.Y.S.2d 921, 923 (N.Y.C. Mun. Ct. 1939) ("[T]hat is

ment. These assertions, however, do suggest a more elaborate defense of the rule against sentimental value along two lines. First, some may claim that emotional or aesthetic value is not "real," in that it cannot easily translate into monetary terms.[34] Yet the economic concept of utility value[35] clearly includes any nonpecuniary value that the property has for the owner, and there is no reason to say that values based on sentiment are any less real than values reflecting other uses.[36] A person's emotional attachment to his or her wedding pictures, for example, enhances the value of the pictures to him or her in the same way that an opportunity for profit enhances the value of a commercial product to a merchant.

Moreover, economic analysts generally agree that it is efficient to allow compensation for nonpecuniary loss caused by a breach of contract.[37] Assuming that the loss was foreseeable[38] and unavoidable,[39] it is efficient to require the breaching party to compensate the promisee for his actual losses because that will assure that he will choose to breach only if his gains from the breach are greater than the promisee's actual losses, both pecuniary and nonpecuniary.[40] If a seller

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the realm of sentiment, and not of law with its practical viewpoint. . . .").

[34] *Cf.* International & G.N.R.R. v. Nicholson, 61 Tex. 550 (1884) (Value must not include "any fanciful price."); 5 A. CORBIN, *supra* note 10, § 1084, at 49 ("[I]n the law of contracts no price will be put upon mere feelings of pleasure or affection or feelings of sorrow and distress.").

[35] *See generally* P. SAMUELSON, *supra* note 4, at 408 ("As a customer you will buy a good because you feel it gives you satisfaction or 'utility.' ").

[36] 1 J. BONBRIGHT, *supra* note 1, at 89 ("Indeed, few modern economists attempt to draw any distinction between economic and noneconomic motives" for valuing property.).

[37] *See, e.g.*, Goetz & Scott, *Liquidated Damages, Penalties, and the Just Compensation Principle: Some Notes on an Enforcement Model and a Theory of Efficient Breach*, 77 COLUM. L. REV. 554, 570 (1977) (recovery for nonpecuniary loss efficient so long as the costs of proving idiosyncratic harm do not exceed the error costs of inaccurate damage measures); Harris, Ogus & Phillips, *supra* note 4, at 609. *Cf.* Posner & Rosenfield, *Impossibility and Related Doctrines in Contract Law: An Economic Analysis*, 6 J. LEGAL STUD. 83 (1977) (observing that full compensation operates as a disincentive only for willful breaches, but suggesting that the seller normally is in the best position to avoid or insure against such losses in other cases as well). *But see* Rea, *Nonpecuniary Loss and Breach of Contract*, 11 J. LEGAL STUD. 35 (1982) (arguing that it is not efficient to routinely award full compensation for nonpecuniary losses because buyers often are in the best position to make efficient insurance decisions).

[38] *See infra* notes 143-46 and accompanying text.

[39] *See infra* notes 140-41 and accompanying text.

[40] R. POSNER, *supra* note 14, § 4.9, at 89-90. This analysis is most persuasive regarding willful breaches. It is subject to greater debate with respect to unintentional breaches. *See* authorities cited *supra* note 37. For a more fundamental challenge to the concept of efficient breach of contract, see Macneil, *Efficient Breaches of Contract: Circles in the Sky*, 68 VA. L. REV. 947 (1982). These citations cannot stand without some reference to the extensive debate over the economic analysis of law. *See, e.g.*, *Symposium on Efficiency as a Legal Concern*, 8 HOFSTRA L. REV. 485 (1980); *A Response to the Efficiency Symposium*, 8 HOFSTRA L. REV. 811 (1980). My point here, however, is merely that a total ban on compensation for aesthetic and emotional value cannot be

knows that he will not have to compensate the buyer for nonpecuniary losses, then he is more likely to breach such contracts for minimal economic gain, and this would result in a net loss from the transaction.

A second rationale that may underlie the assertion that sentimental value is inappropriate to contract law is that emotional and aesthetic values represent either base materialism or idle triviality, both of which should be discouraged.[41] Some may argue, for example, that people should not become emotionally attached to property or that one should not indulge one's aesthetic sensibilities. Under this view, the law should not give recognition to sentimental value because it reflects these lesser human motives.

This argument raises the ethical question whether these qualities of aesthetic and emotional attachment are morally defensible, even within the activity of commerce.[42] Although public consensus is not determinative on such a question, it is important to note that most people probably would not agree that these nonpecuniary interests in property are undesirable. Indeed, for many people, their emotional and aesthetic engagement with the world is one of the most morally enriching aspects of life.

Perhaps recognizing that these normative arguments do not justify the general prohibition on recovery for aesthetic and emotional losses, a few courts and commentators have sought to justify the rule on the basis of traditional damage

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justified on grounds of efficiency.

[41] *Cf.* Rodrigues v. State, 52 Hawaii 156, 176, 472 P.2d 509, 523 (1970) (Levinson, J., concurring and dissenting). Addressing the question whether a tort action for negligent infliction of emotional distress should be recognized where the defendant's negligence caused damage to plaintiff's home, Justice Levinson wrote:

> I would question the policy behind recognizing the value of an attachment to material possessions. This attachment should neither be encouraged by society nor made a basis for recovery in a court of law in an age when man has surrounded himself with a veritable plethora of material possessions approaching the limits of what even an affluent society needs or can afford.

*Id.* at 179, 472 P.2d at 523. *See also* Carroll v. Rountree, 34 N.C. App. 16, 237 S.E.2d 566, 571 (1977) (noting lower court's remark that emotional distress damages cannot be recovered because "the law requires that men be of sterner stuff"), *cert. denied*, 295 N.C. 549, 248 S.E.2d 725 (1978). *But cf.* Mentzer v. Western Union Tel. Co., 93 Iowa 752, 755, 62 N.W. 1, 4 (1855) (The telegraph contract relates "to his feelings, his emotions, his sensibilities. . .those finer qualities that go to make the man."). A variation of this rationale appeared in Mieske v. Bartell Drug Co., 92 Wash. 2d 40, 45, 593 P.2d 1308, 1311 (1979), where the court redefined "sentimental" to apply only to excessive emotion. The court did not explain why the law should refuse to recognize even excessive emotion.

[42] Such normative questions are appropriate to debate over contract law, because the law inevitably reflects normative principles. *See generally* R. DWORKIN, TAKING RIGHTS SERIOUSLY (1978); Heller, *The Importance of Normative Decisionmaking: The Limitations of Legal Economics as a Basis for a Liberal Jurisprudence—As Illustrated by the Regulation of Vacation Home Development*, 1976 WIS. L. REV. 385; Kennedy, *Form and Substance in Private Law Adjudication*, 89 HARV. L. REV. 1685 (1976).

doctrines. In *Carpel v. Saget Studios, Inc.*,[43] for example, a Pennsylvania district court denied recovery for nonpecuniary loss resulting from the breach of a contract to take wedding pictures on the ground that emotional value could not be proved with reasonable certainty.[44] The court observed that "the alleged lost sentimental value of the pictures is so highly speculative that it is not a proper element of damages for consideration by the jury. There are no guidelines available to aid the jury in determining a dollar value for this loss."

Yet this rationale does not justify a total ban on damages for loss of aesthetic and emotional benefits.[45] Although there is always some difficulty in setting a monetary value for nonpecuniary interests, still it can be done with a reasonable degree of certainty and objectivity where the nonpecuniary values are shared by the community. Tort law long has recognized, for example, that it is possible for a trier of fact to estimate what amount of money would compensate the reasonable man for various physical or psychological injuries.[46] Because we all value our physical and psychological well-being, we can estimate their monetary value to a reasonable person. Similarly, where property or services have aesthetic or emotional values that are shared by a community, the trier of fact rationally can assign them monetary values.[47] The process of setting monetary values for

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[43] 326 F. Supp. 1331, 1333 (E.D. Pa. 1971) (refused to allow sentimental value damages resulted in failure to meet $10,000 requirement for federal diversity jurisdiction).

[44] *Id. See also* 1 J. BONBRIGHT, *supra* note 1, at 351 ("Commentators. . .have explained the harsh rule primarily, at least, on the strictly practical ground that the *amount* of sentimental value is simply not susceptible of proof.").

[45] *Cf.* W. CLARK, *supra* note 25, at 611 ("The mere fact that the ascertainment of the damages is difficult cannot deprive him of his right to whatever damages he has suffered as the natural consequence of the breach; the difficulty, when it arises, must be met by the jury."); A. SEDGWICK, *supra* note 18, at 95 ("It should be noticed at the outset, that the difficulty, or even impossibility, of estimating with certainty in money the amount of injury done, is never a reason for refusing redress. . . .").

[46] *See* RESTATEMENT (SECOND) OF TORTS § 912 comment b (1977):

> There is no market price for a scar or for loss of hearing since the damages are not measured by the amount for which one would be willing to suffer the harm. The discretion of the judge or jury determines the amount of recovery, the only standard being such an amount as a reasonable person would estimate as fair compensation.

*Cf.* Rodrigues v. State, 52 Hawaii 156, 167, 472 P.2d 509, 517 (1970) (quoting C. MCCORMICK, *supra* note 4, § 137, at 561) (General rule for measuring damages is "to restore him [the plaintiff] to the position he would be in if the wrong had not been committed."). *But cf.* Miller, *The Scope of Liability for Negligent Infliction of Emotional Distress: Making "The Punishment Fit The Crime,"* 1 U. HAWAII L. REV. 1 (1979) (arguing that recovery for negligent infliction of emotional distress should be limited to economic loss).

[47] *See* Jarvis v. Swan's Tours, Ltd., [1973] 1 All E.R. 71, 74 (Lord Denning) ("I know that it is difficult to assess in terms of money, but it is no more difficult than the assessment which courts have to make every day in personal injury cases for loss of amenities."); Harris, Ogus & Phillips, *supra* note 4, at 601 ("[T]he judge can, by using the 'reasonable man' approach found in many common law rules, attempt to value the lost consumer surplus. . . .").

intangible interests is difficult, but so long as the value is shared by the community, there is a public reference for the assessment, and this can serve as a reasonable basis for judgment.[48]

A second doctrinal reason for banning recovery for aesthetic and emotional values is that these losses are not foreseeable at the time of contract formation.[49] In *Stifft's Jewelers v. Oliver*,[50] the defendant lost the plaintiffs' engagement ring and heirloom rings that had been left for repair. The court denied compensation for the sentimental value of the rings on the ground that it was unforeseeable and therefore could not be a basis for contract damages.[51] "Here the appellees have not pointed out where the appellant company was made aware of the sentimental value of the rings. Neither do they show any tacit agreement to assume responsibility."[52]

Yet as the court acknowledged,[53] this rationale does not justify the general rule prohibiting compensation for nonpecuniary loss. A total ban would be warranted only if aesthetic and emotional values were necessarily idiosyncratic and were therefore always unforeseeable. But aesthetic and emotional values are not always idiosyncratic. Many such values are shared by a wider community[54] and, therefore, are readily foreseeable in some circumstances.[55]

Indeed, if Stifft's Jewelers had been told that one of the rings was Mrs. Oliver's engagement ring and the others were heirlooms, it easily could have foreseen that the rings had substantial emotional and aesthetic value to the Olivers.[56] Although the rings do not have similar value to all members of the

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[48] The trier of fact may determine, for example, what amount of money would compensate the reasonable man for the loss of his annual vacation or what amount would compensate a newly married couple for the loss of a live band at their wedding reception. *See infra* notes 97-113 and accompanying text. *Cf.* 1 J. BONBRIGHT, *supra* note 1, at 88 (concluding that sentimental value is not necessarily idiosyncratic); C. MCCORMICK, *supra* note 4, § 44, at 169 (noting that sentimental value can be measured in many circumstances).

[49] *See* D. DOBBS, *supra* note 18, at 805-07, 819; E.A. FARNSWORTH, *supra* note 1, § 12.17, at 892-95.

[50] 284 Ark. 29, 678 S.W.2d 372 (1984).

[51] The complaint limited the plaintiffs' claim to a contract theory. *Id.* at 31, 678 S.W.2d at 373.

[52] *Id.* The court applied the tacit agreement test for foreseeability, as required by Arkansas law. *Id.* (citing Morrow v. First Nat'l Bank, 261 Ark. 568, 550 S.W.2d 429 (1977)).

[53] *Stifft's Jewelers*, 284 Ark. at 31, 678 S.W.2d at 373 (acknowledging that there could be circumstances in which sentimental values were foreseeable).

[54] *See generally supra* notes 46-48 and accompanying text.

[55] Deitsch v. The Music Co., 6 Ohio Misc. 2d 6, 453 N.E.2d 1302 (Hamilton County Mun. Ct. 1983) (Band breached contract to play at wedding reception; diminution of value of the reception was foreseeable.). *Cf.* Mieske v. Bartell Drug Co., 92 Wash. 2d 40, 593 P.2d 1308 (1979) (Emotional value of home movies recoverable where the customer told the film processor "Don't lose these. They are my life.").

[56] Windeler v. Scheers Jewelers, 8 Cal. App. 3d 844, 88 Cal. Rptr. 39 (1970) (Emotional

community, still it is commonly understood that such property would have special emotional and aesthetic value to the owner. The loss of these values would be readily foreseeable to members of the community.

The justifications for the rule against sentimental value that have been offered by courts and commentators are unpersuasive. They do not give compelling reasons for the unfairness that this rule promotes. It is undeniably true that people do have emotional and aesthetic attachments to property, and the actual loss of these values is at least as significant to the individual as is monetary loss. The rule is unfair because it denies compensation for losses that the community recognizes as significant.[57]

Moreover, the law's failure to recognize aesthetic and emotional value reduces our conception of human activity and achievement. The rule against sentimental value says, in effect, that monetary wealth is all that "counts" and that the pursuit of other values, although permissible, is not an important human activity. By this rule, we limit the conception of human value that structures our law and our community, and we are false to the reality of our situation. The failure to give nonpecuniary interests the direct protection of contract law is indeed a significant shortcoming in our legal system.

## II. A Parallel Doctrine Allowing "Emotional Distress" Damages for Breach of Contracts Involving Nonpecuniary Benefits

The unfairness and inadequacy of the rule against sentimental value has encouraged courts to protect aesthetic and emotional interests despite the rule. Two remedies that indirectly protect nonpecuniary interests are specific performance[58] and damages based on the cost of completion.[59] By allowing the injured party to obtain the actual property or services promised, these remedies protect

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distress damages granted for breach of contract to reset rings having sentimental value.).

[57] *See* J. Bonbright, *supra* note 1, at 285; C. McCormick, *supra* note 4, § 145, at 598.

[58] *See, e.g.*, Morris v. Sparrow, 225 Ark. 1019, 287 S.W.2d 583 (1956) (specific performance granted where plaintiff had personally trained the pony in dispute); Cumbest v. Harris, 363 So. 2d 294 (Miss. 1978) (Sentimental value of personally designed stereo system warrants specific performance.). *See also* U.C.C. § 2-716 comment 2 (1978) (observing that older cases typically involved heirlooms or priceless art); Harris, Ogus & Phillips, *supra* note 4, at 586-89 (noting that awards of specific performance protect the consumer surplus).

[59] Harris, Ogus & Phillips, *supra* note 4, at 589. *See, e.g.*, Fox v. Webb, 268 Ala. 111, 105 So. 2d 75 (1958) (cost of competition awarded for breach of contract to build specially designed home); Gory Assoc. Indus. v. Juniper Roofing, 358 So. 2d 93 (Fla. Dist. Ct. App. 1978) (Homeowner can recover cost of repairing discolored roof.). *Cf.* Jankowski v. Mazzota, 7 Mich. App. 483, 152 N.W.2d 49 (1967) (Cost of completion will fully compensate for nonpecuniary as well as pecuniary losses.). *See generally* Farnsworth, *Legal Remedies*, *supra* note 2, at 1169 (observing that an award based on cost of completion is appropriate where the value to the promisee involved personal taste and welfare not reflected in market value).

aesthetic and emotional enjoyment without requiring the courts to order direct compensation for these losses.

In addition, courts have allowed compensation for nonpecuniary losses by the circuitous route of awards for "emotional distress" damages for breach of contracts involving nonpecuniary benefits.[60] This doctrine holds, in essence, that emotional distress damages are recoverable when the contract was personal or, more broadly, where it involved substantial aesthetic or emotional benefits.[61] Inasmuch as these cases treat the general disappointment of not receiving a promised aesthetic or emotional value as emotional distress, they represent a significant circumvention of the rule against sentimental value.

### A. *Emotional Distress Damages for Personal Contracts*

The common law rule is that damages for emotional distress generally are not recoverable for a mere breach of contract.[62] One exception to this rule allows

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[60] *See infra* note 68 and accompanying text.

The correspondence between the common law concepts of sentimental value and emotional distress was recognized by the court in LaPorte v. Associated Indeps., 163 So. 2d 267, 269 (Fla. 1964) ("Without engaging in a discussion of the affinity between 'sentimental value' and 'mental suffering,' we feel that the affection of a master for his dog is a very real thing. . . .").

[61] *See, e.g.*, Mentzer v. Western Union Tel. Co., 93 Iowa 752, 762-63, 62 N.W. 1, 4 (1895) (emotional distress damages recoverable where "the defendant, in making his contract, is dealing with the feelings and emotions"); Stewart v. Rudner, 349 Mich. 459, 469, 84 N.W.2d 816, 823 (1957) (emotional distress damages recoverable where the contract involved "rights we cherish, dignities we respect, emotions recognized by all as both sacred and personal"); Lamm v. Shingleton, 231 N.C. 10, 55 S.E.2d 810, 813 (1949) (emotional distress damages allowed when the contract "is personal in nature").

[62] *See, e.g.*, Adams v. Frontier Airlines Fed. Credit Union, 691 P.2d 352 (Colo. App. 1984); Chrum v. Charles Heating & Cooling, Inc., 121 Mich. App. 17, 327 N.W.2d 568 (1982); Fiore v. Sears, Roebuck & Co., 144 N.J. Super. 74, 364 A.2d 572 (1976). *See generally* RESTATEMENT (SECOND) OF CONTRACTS § 353; 5 A. CORBIN, *supra* note 10, § 1076, at 426 ("Mental suffering is not itself a pecuniary harm; and it can scarcely be said to be measurable at all in terms of money."); E.A. FARNSWORTH, *supra* note 1, § 12.17, at 894-95 ("A limitation more firmly rooted in tradition is that generally denying recovery for emotional disturbance, or 'mental distress,' resulting from breach of contract."). *But see* 11 S. WILLISTON, WILLISTON ON CONTRACTS § 1341, at 21 (3d ed. 1968) ("Where other than pecuniary benefits are contracted for, damages have been allowed for injury to the feelings.").

In contrast, recent English cases have allowed mental distress damages for breach of contract in a broad category of cases involving nonpecuniary values. *See* Jarvis v. Swans Tour, Ltd., [1973] 1 All E.R. 71; Cox v. Philips Indus., Ltd., [1976] 1 W.L.R. 638 (employee contract for added responsibilities); Heywood v. Wellers, [1976] 1 Q.B. 446 (solicitors breaching contract by failure to get injunction against plaintiff's boyfriend for molestation); Perry v. Sidney Phillips & Son, [1982] 1 All E.R. 705 (surveyor's breach of contract for negligent house survey). *See generally* Burrows, *Mental Distress Damages in Contract—A Decade of Change*, 1 L.M.C.L.Q. 119 (1984) (arguing that the rationale for these cases depends on the fact that the contracts involved signifi-

emotional distress damages if the defendant's conduct was "wanton or reckless."[63] Thus in *Chung v. Kaonohi Center Co.*,[64] the Hawaii Supreme Court found that the defendants engaged in wanton or reckless conduct when they surreptitiously negotiated with a third party, made numerous representations to the plaintiffs that they would comply with their lease agreement, and falsely denied that they were negotiating with another party, all with knowledge that the plaintiffs had expended money and effort in reliance on their promise of a lease for a restaurant in the Pearlridge Shopping Center.[65] The rationale for allowing emotional distress damages in cases like *Chung* is generally that the wanton or reckless conduct itself constitutes a tort,[66] or at least a "fusion of contract and tort."[67]

A second exception to the rule against emotional distress damages is quite different. Focusing on the nature of the contract, rather than on the defendant's conduct, this exception allows compensation for emotional distress where the dispute involves a "personal" contract as distinguished from a "commercial"

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cant nonpecuniary benefits); Dawson, *General Damages in Contract for Non-Pecuniary Loss*, 10 N.Z.U.L. REV. 232 (1983) (discussing recent English, Canadian, Australian, and New Zealand cases); Hahlo, *Contracts—Sentimental Damages*, 50 CAN. B. REV. 304 (1972) (discussing Scottish case); Ramsey, *Contracts—Damages for Mental Distress*, 55 CAN. B. REV. 169 (1977) (discussing English cases); Rose, *Contract Damages—Non-Pecuniary Losses*, 55 CAN. B. REV. 333 (1977) (discussing English cases); Veitch, *Sentimental Damages in Contract*, 16 W. ONT. L. REV. 227 (1977) (focusing on Canadian law). Civil law systems also generally do not allow contractual recovery for emotional distress. *See* Litvinoff, *Moral Damages*, 38 LA. L. REV. 1 (1978).

The reasons given for the rule against emotional distress are that such injury is not foreseeable or that it is not within the risks normally assumed by a promisor. *See, e.g.*, D. DOBBS, *supra* note 18, at 805. *Cf.* E.A. FARNSWORTH, *supra* note 1, § 12.17, at 894-95 ("It could be argued that the real basis of this rule [precluding damages for emotional disturbance] is that such recovery is likely to result in disproportionate compensation.").

[63] *See, e.g.*, Trimble v. Denver, 697 P.2d 716 (Colo. 1985) (Mental anguish damages may be awarded for willful and wanton breach.); Thomas v. French, 30 Wash. App. 811, 638 P.2d 613 (1981) (To support emotional distress damages there must be intentional or wanton and reckless breach and defendant must know or have reason to know breach would result in emotional distress.). *Cf.* Sea-Land Serv., Inc. v. O'Neal, 224 Va. 343, 297 S.E.2d 647 (1982) (absent tortious behavior no damages allowed for humiliation or injured feelings resulting from breach of an employment contract).

[64] 62 Hawaii 594, 618 P.2d 283 (1980).

[65] *Id.* at 602, 618 P.2d at 289.

[66] *See, e.g., id. See also* Farmers Group, Inc. v. Trimble, 658 P.2d 1370 (Colo. App. 1982) (bad faith breach of insurance contract is tortious conduct sufficient to lead to emotional distress damages), *aff'd en banc*, 691 P.2d 1138 (Colo. 1984). *See generally* C. MCCORMICK, *supra* note 4, § 145, at 594 ("The result is made easier because usually the action could have been brought as for a tort, in which event the tradition against allowing damages for mental distress would be plainly inapplicable.").

[67] Dold v. Outrigger Hotel, 54 Hawaii 18, 22, 501 P.2d 368, 372 (1972) (dictum) (suggesting that emotional distress damages were permissible when hotel intentionally overbooked).

one.[68] Traditionally, this exception was applied to a relatively narrow class of contracts,[69] typically including contracts for the provision of funeral or burial services,[70] promises of marriage,[71] and contracts involving personal transportation[72] or hotel accommodation.[73]

The most common explanation of this exception is that the personal nature of the contract may make it foreseeable that the promisee would suffer emotional distress from the breach.[74] In *Lamm v. Shingleton*,[75] for example, the

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[68] *See, e.g.*, Adams v. Frontier Airlines Fed. Credit Union, 691 P.2d 352, 355 (Colo. App. 1984) (dictum) ("[A] plaintiff may recover [emotional distress] damages if he shows a breach of a limited class of contracts of a personal or special nature. . . ."); Stewart v. Rudner, 349 Mich. 499, 84 N.W.2d 816 (1957) (emotional distress damages recoverable for personal contracts); Lamm v. Shingleton, 231 N.C. 10, 14, 55 S.E.2d 810, 813 (1949) (emotional distress damages allowed "[w]here the contract is personal in nature and the contractual duty or obligation is so coupled with matters of mental concern or solicitude, or with the sensibilities of the party to whom the duty is owed"). *Cf.* Stanback v. Stanback, 297 N.C. 181, 254 S.E.2d 611, 620-21 (1978) (no recovery for emotional distress because plaintiff's contract with her husband, the defendant, was motivated by pecuniary interests, and the contract did not "relate directly to matters of dignity, mental concern or solicitude, or the sensibilities" of the plaintiff); Bossuyt v. Osage Farmers Nat'l Bank, 360 N.W.2d 769, 778 (Iowa 1978) (holding that "commercial" contracts are not covered by the RESTATEMENT (SECOND) OF CONTRACTS § 353 which allows emotional distress damages where the contract "is of such a kind that serious emotional disturbance was a particularly likely result").

This exception is not recognized in all American jurisdictions. *See, e.g.*, Cummings v. Prudential Ins. Co. of Am., 542 F. Supp. 838 (S.D. Ga. 1982) (Georgia law does not allow emotional distress damages for breach of contract, absent an independent tort.); Sackett v. St. Mary's Church Soc'y, 18 Mass. App. 186, 464 N.E.2d 956 (1984) (no recovery for emotional distress resulting from breach of funeral service contract, absent proof of intentional breach).

[69] For a historical account of the development of this doctrine, see Stanback v. Stanback, 297 N.C. 181, 254 S.E.2d 611 (1978).

[70] *See, e.g.*, Crenshall v. O'Connell, 235 Mo. App. 1085, 150 S.W.2d 489 (1941); Lamm v. Shingleton, 231 N.C. 10, 55 S.E.2d 810 (1949).

[71] *See, e.g.*, Thrush v. Fullhart, 230 F. 24 (4th Cir. 1915); Menhusen v. Dake, 214 Neb. 450, 334 N.W.2d 435 (1983) (dictum).

[72] *See, e.g.*, Browning v. Fies, 4 Ala. App. 580, 58 So. 931 (1912) (carriage to plaintiff's wedding); Chicago & Alton R.R. v. Flagg, 43 Ill. 364 (1867).

[73] *See, e.g.*, Dold v. Outrigger Hotel, 54 Hawaii 18, 25, 501 P.2d 368, 372 (1972) (dictum) (concurring opinion); Boyce v. Greeley Square Hotel Co., 228 N.Y. 106, 126 N.E. 647 (1920). *But see* Wells v. Holiday Inns, Inc., 522 F. Supp. 1023 (W.D. Mo. 1981) (although mental distress might be available in some states for dishonor of hotel reservations, Missouri and California law too unclear to permit a federal judge to allow).

[74] *See, e.g.*, Allen v. Jones, 104 Cal. App. 3d 207, 211, 163 Cal. Rptr. 445, 448 (1980) (citations omitted) ("There are, however, certain contracts which so affect the vital concerns of the individual that severe mental distress is a foreseeable result of breach. For many years, our courts have recognized that damages for mental distress may be recovered for breach of a contract of this nature."); Stewart v. Rudner, 349 Mich. 459, 471, 84 N.W.2d 816, 824 (1957) (Breach of personal contracts "inevitably and necessarily result in mental anguish.").

[75] 231 N.C. 10, 55 S.E.2d 810 (1949).

defendants allegedly breached a contract to furnish burial services and supplies by failing to properly lock the vault. The court held that emotional distress damages were recoverable because the contract was personal in nature. The court explained:

> Where the contract is personal in nature and the contractual duty or obligation is so coupled with matters of mental concern or solicitude, or with the sensibilities of the party to whom the duty is owed, that a breach of that duty will necessarily or reasonably result in mental anguish or suffering, and it should be known to the parties from the nature of the contract that such suffering will result from its breach, compensatory damages therefor may be recovered.[76]

The court reasoned that because this was a personal contract, involving matters of great significance to the plaintiff, then emotional distress was a foreseeable result of the breach, and therefore the general rule against emotional distress damages did not apply.

This rationale has the advantage of continuity with doctrine developed under *Hadley v. Baxendale*,[77] but it simply is not adequate to explain the distinction between personal and commercial contracts. If the sole issue is whether emotional distress was a foreseeable consequence of the breach of contract, then many commercial contracts would be indistinguishable from personal ones.[78]

In *Valentine v. General American Credit, Inc.*,[79] for example, the plaintiff alleged that she suffered emotional distress when she was fired by General American in breach of her employment contract. Ms. Valentine argued that this was a foreseeable result of the firing and that the exception for personal contracts should apply.[80] The court conceded that emotional distress may have been a foreseeable consequence of General American's breach[81] and, indeed, that emotional distress would be foreseeable in many commercial contracts: "Under the rule of *Hadley v. Baxendale*, literally applied, damages for mental

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[76] *Id.* at 15, 55 S.E.2d at 813-14 (citations omitted).

[77] 9 Ex. 341, 156 Eng. Rep. 145 (1854).

[78] *See* C. MCCORMICK, *supra* note 4, § 145, at 592-93 ("When such a bargain [commercial contract] is made, it may well be contemplated that, if one party fails to carry it out, financial loss may be inflicted on the other, and that he will sustain disappointment and mental suffering therefrom."). *Cf.* 5 A. CORBIN, *supra* note 10, § 1076, at 426 ("The breach of a contract practically always causes mental vexation and feelings of disappointment in the plaintiff; but he seldom thinks of asking for a money payment therefor. It is believed that an equivalent pecuniary satisfaction for his pecuniary injury will sufficiently restore the plaintiff's satisfaction; and his intervening vexation is disregarded.").

[79] 420 Mich. 256, 362 N.W.2d 628 (1984).

[80] *Id.* at 257-58, 362 N.W.2d at 628-29.

[81] *Id.* at 259, 362 N.W.2d at 629.

distress would be recoverable for virtually every breach of contact."[82]

Having recognized that emotional distress is foreseeable in many contexts, the *Valentine* court acknowledged that the exception for personal contracts rests on something other than foreseeability:

> Rather than look to the foreseeability of loss to determine the applicability of the exception, the courts have considered whether the contract "has elements of personality" and whether the "damage suffered upon the breach of the agreement is capable of adequate compensation by reference to the terms of the contract."[83]

Thus, the award of emotional distress damages in cases applying the personal contract exception cannot be explained merely on the grounds of the foreseeability of loss.[84] A more accurate explanation for this exception would be that additional damages were awarded in these cases in order to compensate for the loss of aesthetic and emotional benefits from the promised performance. As the *Valentine* court emphasized, the application of this exception depends on whether the contract involved nonpecuniary benefits.[85] By allowing emotional distress damages for the breach of such contracts, courts can, in effect, award compensation for sentimental value.[86]

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[82] *Id.* at 260, 362 N.W.2d at 629.

[83] *Id.* at 262, 362 N.W.2d at 630-31 (quoting Kewin v. Massachusetts Mut. Life Ins., 409 Mich. 401, 417, 295 N.W.2d 50, 54 (1980) and Stewart v. Rudner, 349 Mich. 459, 471, 84 N.W.2d 816, 824 (1957)). In a footnote to this passage, the court quoted *Stewart* to say that mental distress damages are recoverable "where a contract is made to secure relief from a particular inconvenience or *to confer a particular enjoyment.*" *Valentine*, 420 Mich. at 262 n.19, 362 N.W.2d at 630 n.19 (quoting *Stewart*, 349 Mich. at 471, 84 N.W.2d at 824 (1957)) (emphasis added).

[84] *Cf.* Fisher v. General Tel. Co. of the N.W., 510 F. Supp. 347 (E.D. Mich. 1980) (emotional distress damages not recoverable for breach of an employment contract deemed to be commercial even if such losses were foreseeable).

[85] 420 Mich. at 262, 362 N.W.2d at 630. *See also* Hatfield v. Max Rouse & Sons, 100 Idaho 840, 847, 606 P.2d 944, 951 (1980) ("In close cases, defining the distinction between 'commercial' and 'non-commercial' contracts is simply another way of putting the question. . .whether the parties to the contract considered emotional well-being a part of its subject matter.") (disapproved on other grounds, Cheney v. Palos Verdas Invest. Corp., 104 Idaho 897, 665 P.2d 661 (1983)).

[86] *Cf.* D. DOBBS, *supra* note 18, at 819 ("The essential idea seems to be that some contracts clearly have what might be called personal rather than pecuniary purposes in view, and that the purpose of such contracts is utterly frustrated until mental distress damages are awarded for the breach.").

### *B. Emotional Distress Damages for Breaches of Contracts Involving Aesthetic or Emotional Enjoyment*

Although the personal contract exception theoretically requires that the contract be characterized as "personal" or "noncommercial" before emotional distress damages can be awarded, many decisions have ignored that limitation and have awarded emotional distress damages for breaches of contracts not included on the traditional list of personal contracts.[87] Some courts have justified such damages on the simple ground that the contract involved significant nonpecuniary value.[88] Rather than expand the category of personal contracts, these decisions suggest a much broader exception allowing emotional distress damages whenever the contract involves significant aesthetic or emotional benefits.[89]

*B & M Homes, Inc. v. Hogan*,[90] for example, involved the breach of a contract to construct a private home. During construction, the owners complained of a hairline crack in the building's concrete foundation. The defendant refused to correct the defect, and after completion, the crack widened and caused severe damage throughout the house. The owners sued for breach of express and implied warranties, seeking damages for the full value of the house as promised and compensation for their "mental suffering."[91]

The jury found for the plaintiffs, and awarded damages for mental suffering

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[87] *See, e.g.*, Bazal v. Belford Trucking Co., 442 F. Supp. 1089 (D. Fla. 1977) (truck rental contract); McDowell v. Union Mut. Life Ins. Co., 404 F. Supp. 136 (C.D. Cal. 1975) (insurance policy); F. Becker Asphaltum Roofing Co. v. Murphy, 224 Ala. 655, 141 So. 630 (1932) (home roofing contract); Wynn v. Monterey Club, 111 Cal. App. 3d 794, 168 Cal. Rptr. 878 (1980) (contract to deny casino access to plaintiff's wife, a compulsive gambler); Windeler v. Scheers Jewelers, 8 Cal. App. 3d 844, 88 Cal. Rptr. 39 (1970) (contract to reset rings); Westesen v. Olathe State Bank, 78 Colo. 217, 240 P. 689 (1925) (contract to loan money for a trip to California); Guerin v. New Hampshire Catholic Charities, 120 N.H. 501, 418 A.2d 224 (1980) (nursing home contract); Bogner v. General Motors, Inc., 117 Misc. 2d 929, 459 N.Y.S.2d 679 (N.Y.C. Civ. Ct. 1982) (new car warranty).

[88] *See, e.g.*, cases discussed *infra* notes 90-113 and accompanying text.

[89] The Restatement (Second) of Contracts appears at first sight to endorse the broader doctrine recognized by the cases discussed in the text: Section 353 provides that recovery for emotional distress will be allowed if "the contract. . .is such a kind that serious emotional disturbance was a particularly likely result," and § 347 illustration 1 suggests that loss in value may include intangible values such as lost enhancement of reputation. RESTATEMENT (SECOND) OF CONTRACTS §§ 353, 347. Yet the focus on "serious emotional disturbance" in § 353 is problematic, *see infra* notes 139-47 and accompanying text, and § 352 illustration 1 undercuts the force of § 347 by suggesting that intangible losses are recoverable only to the extent of their pecuniary consequences. RESTATEMENT (SECOND) OF CONTRACTS § 352 illustration 1. In sum, the Restatement does not help to clarify this aspect of contract law.

[90] 376 So. 2d 667 (Ala. 1979).

[91] *Id.* at 671.

and disappointment.[92] The Alabama Supreme Court affirmed this award, concluding that emotional distress damages could be awarded where the contract involved emotional enjoyment:

> [W]here the contractual duty or obligation is so coupled with matters of mental concern or solicitude, or with the feelings of the party to whom the duty is owed, that a breach of that duty will necessarily or reasonably result in mental anguish or suffering, it is just that damages therefor be taken into consideration and awarded.[93]

In describing this contract, the court emphasized that it involved significant nonpecuniary value: "The largest single investment the average American family will make is the purchase of a home. The purchase of a home by an individual or family places the purchaser in debt for a period ranging from twenty (20) to thirty (30) years."[94] Quoting from an earlier case, the court observed that a person's home is "her 'castle,' the habitation which she had provided to protect her against the elements."[95]

A substantial part of the value to the Hogans of the home as promised arose from their feelings of emotional and aesthetic enjoyment. These were irretrievably lost until the Hogans were able to rebuild their home or purchase another. Damages limited to their pecuniary interest would not compensate them for these losses.[96]

In *Harris v. Waikane Corp.*,[97] the United States District Court for the District of Hawaii allowed compensation for nonpecuniary loss resulting from the breach of a yacht charter.[98] In this case, a large part of the value of the contract to the promisees was their expectation of a pleasant and restful cruise. The defendant, Waikane Corporation,[99] had promised to charter an eighty-four foot

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[92] The jury returned a verdict for $75,000. Although the verdict did not specify the elements of this award, the Alabama Supreme Court assumed that this included damages for emotional distress. *Id.*

[93] *Id.* (citations omitted). *See also* F. Becker Asphaltum Roofing Co. v. Murphy, 224 Ala. 655, 141 So. 630 (1932); Hill v. Sellnick, 355 So. 2d 1129 (Ala. Civ. App. 1978).

[94] 376 So. 2d at 672.

[95] *Id.* (quoting F. Becker Ashphaltum Roofing Co. v. Murphy, 224 Ala. 655, 657, 141 So. 630, 631 (1932)).

[96] *Cf.* Westervelt v. McCullough, 68 Cal. App. 198, 228 P. 734 (1924) (emotional distress damages allowed for breach of contract for room and board); Ducote v. Arnold, 416 So. 2d 180 (La. App. 1982) (under Louisiana civil law, mental anguish damages allowed for breach of home improvement contract), *cert. denied*, 421 So. 2d 238 (La. 1982). *But cf.* Emerman v. Baldwin, 186 Pa. Super. 561, 142 A.2d 440 (1958) (no emotional distress for breach of residential lease).

[97] 484 F. Supp. 372 (D. Hawaii 1980).

[98] The district court expressly held that the dispute was governed by admiralty law. *Id.* at 377.

[99] The plaintiffs also named the owner of the boat as a defendant but the court found that he

schooner to the plaintiffs for a ten-day sail in the Hawaiian waters. Four days before the cruise was to begin,[100] the boat's owner refused to allow the charter, forcing Waikane to breach its contract with the plaintiffs.[101] The plaintiffs visited Kauai and Maui during the ten days scheduled for the charter, but they did not enjoy their stay.[102]

The district court held that Waikane was obligated to compensate the plaintiffs for their "general disappointment" and "mental suffering."[103] The court's analysis focused on the content of the contract and on its emotional and aesthetic value to the plaintiffs: "Damage for this type of injury is recoverable, as it was clearly foreseeable when the contract was made that if the Astor [the schooner] was not delivered, plaintiffs might well suffer mental distress."[104] Such disappointment and distress were foreseeable because the defendant knew that this was to be a vacation cruise. No extra information was necessary to foresee that the primary value of the contract to the plaintiffs was their expectation of an enjoyable and relaxing vacation.[105]

Some courts have used a similar approach in cases involving insurance contracts. These decisions have recognized that an important element in the value of an insurance policy to the insured is peace of mind and security.[106] In such

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was not liable on other grounds. *Id.* at 386.

[100] The plaintiffs, Harris and ten others, had already arrived in Honolulu by the time of the breach. *Id.* at 377.

[101] The court did not consider Waikane's conduct to be wanton or reckless in any way. Waikane's original agreement was with a man who was living on the boat but who, as it turned out, had no authority to act for the owner. Once the "Astor" became unavailable, Waikane offered the plaintiffs two alternative plans involving smaller or more expensive yachts but the plaintiffs declined these offers. *Id.*

[102] *Id.* Plaintiffs had arranged to stay in Kauai for the 10 days they had planned to sail. After four days, however, they went on to Maui. "Their dream sailing vacation had turned into a mess." *Id.*

[103] *Id.* at 381.

[104] *Id.* The court did not rely on the traditional doctrines of personal contracts or wanton and reckless behavior.

[105] *Cf.* Jarvis v. Swans Tour, Ltd., [1973] 1 All E.R. 71, 75 (Stephenson, L.J.) (Loss of enjoyment was a foreseeable result of a breach of a vacation package contract.).

[106] *See, e.g.*, McDowell v. Union Mut. Life Ins. Co., 404 F. Supp. 136 (C.D. Cal. 1975); Crisci v. Security Ins. Co., 66 Cal. 2d 425, 434, 426 P.2d 173, 179, 58 Cal. Rptr. 13, 19 (1967) ("Among the considerations in purchasing. . .insurance, as insurers are well aware, is the peace of mind and security it will provide."). *Cf.* International Union, United Auto v. Federal Forge, Inc., 583 F. Supp. 1350 (W.D. Mich. 1984) (Emotional distress damages may be awarded for breach of collective bargaining agreement obligation to pay insurance premiums because the contract deals "with matters obviously of mental concern and solicitude for the retirees."). *But see* Zimmerman v. Michigan Hosp. Serv., 96 Mich. App. 464, 292 N.W.2d 236 (1980) (The "essence" of a medical insurance contract is pecuniary, so no additional compensation is warranted.). *See generally* Note, *The Expectation of Peace of Mind: A Basis for Recovery of Damages for Mental Suffering Resulting from the Breach of First Party Insurance Contracts*, 56 S.

cases, insurance companies have been required to compensate the insured parties not only for the insurance benefits owed but also for the loss of this emotional value.

The fundamental fairness of allowing compensation for significant nonpecuniary value is demonstrated most clearly in those cases where there is no other loss.[107] This has influenced some courts in their application of emotional distress doctrine. In *Deitsch v. The Music Co.*,[108] a band was hired to play at a wedding reception. The band failed to appear; after about an hour, a friend brought stereo equipment, but clearly the music was not of the same quality as planned. Unless this diminution in aesthetic value were compensated, however, the plaintiffs would have been entitled merely to a return of their deposit.[109]

Recognizing this unfairness, the court held that the Deitsches were entitled to $750 compensation for "their distress, inconvenience, and the diminution in value of their reception."[110] The court observed that this contract was similar to one for special Pullman sleeping car accommodations,[111] or for a vacation hotel room,[112] in which the value of the thing being purchased is largely a matter of emotional or aesthetic enjoyment. The purchaser should be entitled, in such cases, to some amount over the contract price to compensate for this lost value.[113]

Thus, numerous courts have recognized a relatively broad doctrine allowing compensation for nonpecuniary losses under the head of emotional distress damages. This doctrine provides a circuitous route to compensation for lost expectations of aesthetic and emotional enjoyment that otherwise would be precluded under the rule against sentimental value.

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CAL. L. REV. 1345 (1983) (arguing that insurance contracts should be included within the category of personal contracts or "special circumstances" contracts the breach of which gives rise to a claim for emotional distress damages).

[107] *See, e.g.*, Golston v. Lincoln Cemetary, Inc., 573 S.W.2d 700, 704 (Mo. Ct. App. 1978) (mental anguish often the only loss resulting from breach of burial contract). *Cf.* Brown v. Frontier Theaters, Inc., 369 S.W.2d 299 (Tex. 1963) (sentimental value awarded where primary value of property is sentimental).

[108] 6 Ohio Misc. 2d 6, 453 N.E.2d 1302 (Hamilton County Mun. Ct. 1983).

[109] *Id.* at 8, 453 N.E.2d at 1304.

[110] *Id.*

[111] *Id.* (citing Pullman Co. v. Willett, 7 Ohio C.C. (n.s.) 173 (Richland App.), *aff'd*, 72 Ohio St. 690, 76 N.E. 1131 (1905)).

[112] 6 Ohio Misc. 2d at 8, 453 N.E.2d at 1304 (citing Dold v. Outrigger Hotel, 54 Hawaii 18, 501 P.2d 368 (1972)).

[113] 6 Ohio Misc. 2d at 8, 453 N.E.2d at 1304 (quoting *Pullman*, 7 Ohio C.C. (n.s.) at 177-78) ("The damages for deprivation of the comforts, conveniences and privacy for which he had contracted and agreed to pay are not to be measured by the amount to be paid therefor.").

### *C. Hawaii Cases*

*Dold v. Outrigger Hotel*[114] is usually considered to be the leading Hawaii Supreme Court decision on emotional distress damages associated with a breach of contract. Yet, as the concurring opinion noted,[115] this issue was not before the supreme court in that case. The plaintiffs were mainland residents who had been given confirmed reservations at the Outrigger Hotel. Upon arriving at the hotel, they were told that no rooms were available and were directed to the Pagoda Hotel, which apparently gave the Outrigger a portion of the payments it received from such overflow guests.[116] Among other counts,[117] the plaintiffs sued for breach of contract, seeking compensation for their disappointment and punitive damages.

The lower court held that emotional distress damages could be awarded if they were reasonably foreseeable,[118] but it refused to instruct the jury on punitive damages. Following a jury award of $1000,[119] the plaintiffs appealed on the ground that the trial court should have allowed punitive damages. The hotel did not appeal the award of emotional distress damages, and the Dolds did not present any argument for additional compensation for their nonpecuniary losses.[120]

The Hawaii Supreme Court held that punitive damages were properly denied. In dictum, however, the court observed that the plaintiffs were entitled to

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[114] 54 Hawaii 18, 501 P.2d 368 (1972).

[115] *Id.* at 24, 501 P.2d at 372 (Marumoto, J., concurring).

[116] *Id.* at 20, 501 P.2d at 370. The Pagoda Hotel billed the Outrigger for the cost of the rooms provided. Outrigger retained the difference between the advance payment at Outrigger's room rates and the value of the rooms provided at the Pagoda. *Id.*

[117] The complaint included three counts: breach of contract, fraud (dismissed voluntarily at trial), and breach of innkeeper's duty to accommodate guests. *Id.* at 18, 501 P.2d at 368.

[118] *Id.* at 21 n.1, 501 P.2d at 371 n.1. The trial court instructed the jury as follows:

> [If you find in favor of the plaintiffs] you must determine the amount of damages the plaintiffs are entitled to recover. [If you find in favor of the plaintiffs] [p]laintiffs have a right to recover all damages which they have suffered and which the defendants or a reasonable person in the defendants' position should have foreseen would result from their acts or omissions. Such damages may include reasonable compensation for emotional distress and disappointment, if any, which plaintiffs have suffered as a proximate result of the defendants' conduct. There is no precise standard by which to place a monetary value on emotional distress and disappointment, nor is the opinion of any witness required to fix a reasonable amount. In making an award of damages for emotional distress and disappointment, you should determine an amount which your own experience and reason indicates would be sufficient in light of all of the evidence.

*Id.*

[119] The jury awarded $600 to the Dolds and $400 to the Mantheis. *Id.* at 19, 501 P.2d at 370.

[120] *Id.* at 22, 501 P.2d at 371.

recover for emotional distress damages:

> We are of the opinion that the facts of the case do not warrant punitive damages. However, the plaintiffs are not limited to the narrow traditional contractual remedy of out-of-pocket losses alone. . . . Though some courts have strained the traditional concept of compensatory damages in contract to include damages for emotional distress and disappointment, we are of the opinion that where a contract is breached in a wanton or reckless manner as to result in a tortious injury, the aggrieved person is entitled to recover in tort. Thus, in addition to damages for out-of-pocket losses, the jury was properly instructed on the issue of damages for emotional distress and disappointment.[121]

In this passage, the court approved the jury's award solely on the ground that the defendant had engaged in tort-like behavior, and it appeared to reject the idea that nonpecuniary losses should be compensated as an element of the plaintiffs' lost expectations.

In a concurring opinion, Justices Marumoto and Abe agreed that emotional distress damages were recoverable for breach of a contract to provide hotel accommodation,[122] but they disagreed with the majority's characterization of these as tort damages. Instead, they suggested, the jury award was appropriate compensation for breach of a contract that involved "both an aesthetic expectation on the part of the plaintiffs and a particular type of accommodation, namely, one in a hotel located on the beach as is the Outrigger."[123]

The rationale adopted by the concurrence accords with *Hogan*, *Harris*, *Deitsch*, and numerous other cases that have allowed direct compensation for loss of aesthetic or emotional values.[124] Under this rationale, damages for the breach of a contract involving significant intangible values may include compensation for lost aesthetic and emotional enjoyment even if the breach was not wanton or reckless. Wanton and reckless behavior may be an independent ground for recovery in some cases, but it is not a requirement for the compensation of nonpecuniary damages in every case.

Thus, the award of emotional distress damages in *Dold* is justifiable on two alternative grounds. First, emotional distress damages were warranted because the defendant breached the contract in a wanton or reckless way. Second, even if the breach had not been wanton or reckless, damages should have been awarded to compensate the plaintiffs for the loss of the aesthetic and emotional enjoyment of the rooms in a hotel on the beach.

No subsequent decision of the Hawaii Supreme Court has expressly adopted

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[121] *Id.* at 22-23, 501 P.2d at 371-72 (citations omitted).

[122] *Id.* at 24, 501 P.2d at 372.

[123] *Id.* at 26, 501 P.2d at 373.

[124] *See supra* notes 87-113 and accompanying text.

the rationale suggested by the concurring opinion in *Dold*. Recent decisions have focused on the wantonness of the defendant's conduct as the exclusive basis for emotional distress damages.[125] The supreme court's opinion in *Chung v. Kaonohi Center Co.*,[126] for example, included dictum strongly suggesting that proof of wanton or reckless behavior is necessary for emotional distress damages: "We do not think that the dispositive factor in allowing damages for emotional distress is the nature of the contract. The dispositive factor is, rather, the wanton or reckless nature of the breach."[127] In this passage, the supreme court apparently rejected the doctrine allowing emotional distress damages for breach of personal contracts[128] and thereby made even this circuitous route to compensation for nonpecuniary losses unavailable.

Yet despite *Chung*, a recent case, *Quedding v. Arisumi Brothers*,[129] provides some support for the idea that emotional distress damages may be awarded under Hawaii law if the contract involved aesthetic or emotional enjoyment, even if the defendant's conduct was not wanton or reckless. Arisumi Brothers agreed to build a two-bedroom house for the Queddings. After completion, the Queddings discovered serious structural defects in their home and sued Arisumi Brothers for breach of contract. The jury awarded damages of approximately $12,000 as the cost of repairs, $10,000 for emotional distress, and $5,000 in punitive damages.[130]

On appeal, the Hawaii Supreme Court found that the trial court should not have instructed the jury on punitive damages because the evidence established that "Arisumi did not engage in conduct amounting to wanton, oppressive, malicious, or reckless behavior."[131] Despite this absence of wanton or reckless conduct, however, the court remanded the case for a new trial on the issue of emotional distress.[132] Thus, the supreme court indicated that emotional distress

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[125] *See* Island Holidays, Inc. v. Fitzgerald, 58 Hawaii 552, 574 P.2d 884 (1978); Uyemura v. Wick, 57 Hawaii 102, 551 P.2d 171 (1976). *See also* Hall v. American Airlines, 1 Hawaii App. 258, 617 P.2d 1230, *motion for recon. denied*, 1 Hawaii App. 312, 617 P.2d 1234 (1980).

[126] 62 Hawaii 594, 618 P.2d 283 (1980).

[127] *Id.* at 602, 618 P.2d at 289.

[128] The contract in *Chung* was a commercial lease of restaurant space in the Pearlridge Shopping Center. This clearly would have been characterized as a commercial contract under traditional emotional distress doctrine. Moreover, there is no indication that significant nonpecuniary values were foreseeable at the time the contract was formed. Thus, the supreme court's apparent rejection of the personal contract exception is dictum.

[129] 66 Hawaii 335, 661 P.2d 706 (1983).

[130] *Id.* at 337, 661 P.2d at 709. The trial judge allowed $5,000 remittitur against the award of $10,000 in general damages and $5,000 in punitive damages. *Id.*

[131] *Id.* at 340, 661 P.2d at 710.

[132] It is unclear whether the defendant objected to the content of the trial court's instruction on emotional distress. The supreme court discussed only whether the instruction on punitive damages might have influenced the jury's verdict on emotional distress.

damages would be proper even though there was no evidence of wanton or reckless behavior.

This decision allows compensation for the contract's nonpecuniary value to the promisee. The market value of a specially designed house does not necessarily reflect its special aesthetic or emotional value to the homeowner. An award measured by the cost of completion, which the supreme court affirmed as the proper measure of damages,[133] does protect these nonpecuniary values to the extent that the promisee is able to obtain a substitute performance. Theoretically, the plaintiffs should be able to hire a builder to complete the house according to the original plans. In that case the homeowner would receive the essential benefit of his bargain—the home he contracted for. Yet, while an award based on cost of completion would go a long way towards full compensation, it would not compensate for nonpecuniary losses caused by the delay in completion. A judge or jury may find, in a case like *Quedding*, that damages above the cost of completion should be awarded in order to compensate the plaintiff for lost emotional and aesthetic enjoyment during the delay caused by the defendant's breach.

*Quedding* does provide some support, then, for the compensation of nonpecuniary values. Yet the supreme court's rationale in this decision is unclear. In particular, the court did not address the question why additional compensation beyond the cost of completion was warranted. Moreover, because the plaintiffs characterized their injury as "emotional distress," the court was not required to decide whether direct compensation for lost nonpecuniary value would be allowed. At the very least, this case demonstrates that Hawaii law is still enmeshed in the doctrinal tangle that traditionally has structured the law governing compensation for nonpecuniary value.

## III. A Reconciliation: Compensation for Lost Aesthetic or Emotional Enjoyment

### *A. Direct Compensation for Nonpecuniary Loss*

The doctrine allowing emotional distress damages for breach of contracts involving substantial nonpecuniary benefits, as applied in decisions such as *Hogan*, *Harris*, and *Deitsch*, permits a court to avoid much of the unfairness that otherwise would result from the rule against sentimental value.[134] Yet this solution is

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[133] 66 Hawaii at 338-39, 661 P.2d at 709 ("Arisumi accurately reiterates that 'in Hawaii, the measure of damages in building contracts is generally the cost of correction.' Izumi v. Park, 44 Haw. 123, 128, 351 P.2d 1083, 1086 (1960); *See also* Ritchey v. Sato, 39 Haw. 500, 503 (1952).").

[134] *Cf.* Burrows, *supra* note 71, at 123 ("Therefore, where the expected benefit is a mental,

problematic.

The characterization of the injury covered by this doctrine as emotional distress is misleading. In *Deitsch v. The Music Co.*,[135] for example, recovery should not depend on whether the lack of music at their wedding reception caused the plaintiffs to suffer anxiety, loss of sleep, depression, or the like. Regardless of any psychological injury, the Deitsches had not received what they were promised, and the value to them of the promised performance included some aesthetic and emotional enjoyment beyond that reflected in the contract price. They wanted a live band for their wedding reception and all the aesthetic and emotional enjoyment that comes with it. The Deitsches had planned a special evening for themselves and their friends. This was an important reason for the contract with The Music Company, and it was an essential part of their expectations from that contract.

Thus, the Deitsches' claim for breach of contract should not depend on the intensity of their emotional reactions. Their psychological condition is not an accurate indicator of the aesthetic and emotional value of the promised performance. Yet under emotional distress doctrine, the court is required to evaluate the plaintiff's psychological state following the breach. Thus at trial, the Deitsches were compelled to produce evidence of their emotional distress and suffering sufficient to satisfy the doctrinal requirements.[136] This approach misdirects the attention of both litigants and the court. Rather than evaluating the plaintiff's emotional state, analysis should focus on the content of the contract with the goal of full compensation for the plaintiff's actual loss, nonpecuniary as well as pecuniary.

The use of emotional distress doctrine to circumvent the rule against sentimental value forces the court to evaluate aesthetic and emotional value in terms of psychological injury. This strains analysis and leads inevitably to inconsistent and unfair decisions. Yet this doctrinal confusion could be avoided. Compensa-

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rather than a financial one, and a normal award of damages does not enable a substitute giving the expected mental benefit to be bought, mental distress damages are necessary to compensate for disappointment at not receiving the expected benefit."); Dawson, *supra* note 62, at 233 ("Such an award [damages for mental distress, hurt feelings, anxiety] may be explained. . .as representing a loss of bargain where the promisor has undertaken expressly or impliedly to provide enjoyment or to prevent anxiety. . . ."). *See also* Rose, *supra* note 62, at 338-39 ("[W]hen we talk of loss flowing from a breach of contract we are primarily speaking of the plaintiff's failure to obtain the performance promised by the defendant—that is, his loss of bargain. . . .").

[135] 6 Ohio Misc. 2d 6, 453 N.E.2d 1302 (Hamilton County Mun. Ct. 1983).

[136] *Id.* at 7, 453 N.E.2d at 1303 ("wailing and gnashing of teeth"). *Cf.* Mentzer v. Western Union Tel. Co., 93 Iowa 752, 755, 62 N.W. 1, 4 (1895) (Defendant argued that plaintiff had failed to prove actual mental suffering from the defendant's failure to deliver a message regarding the death of plaintiff's mother. The court held that this burden was met by testimony that the plaintiff felt "hard" and that he immediately took steps to attend the funeral.).

tion for the nonpecuniary value of a promised performance is quite a different idea from damages for psychological injury. It should be analyzed independently of emotional distress, and this would be possible if the law abandoned the unjustified rule against sentimental value.

Compensation for aesthetic and emotional losses should be awarded directly—as a part of the promisee's expectations lost as a result of the breach of contract.[137] This would allow recovery based on the value of the promised performance in a manner which is consistent with the fundamental principles of contract damages.[138] Issues of avoidability, foreseeability, certainty, and disproportionality could be analyzed directly, rather than entangled with emotional distress doctrine as under current law. Once freed of the rule against sentimental value, courts can analyze lost aesthetic and emotional value under the general principles of contract damages.[139]

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[137] A few courts have allowed direct compensation for sentimental value where this constituted the primary value of the property involved. *See, e.g.*, Shewalter v. Wood, 183 S.W. 1127 (Mo. App. 1916) (heirlooms); Brown v. Frontier Theaters, Inc., 369 S.W.2d 299 (Tex. 1963) (heirlooms and irreplaceable personal goods); Bond v. Alt Belo Corp., 602 S.W.2d 105 (Tex. Civ. App. 1980) (family papers and photographs); Pennington v. Redman Van & Storage Co., 34 Utah 223, 97 P. 115 (1908) (heirlooms). Yet there is no reason to limit direct compensation to cases where there are no pecuniary losses. Fairness and efficiency require full compensation in every case. *See supra* notes 37-39 and accompanying text; Harris, Ogus & Phillips, *supra* note 4, at 595-96; Tomain, *Contract Compensation in Nonmarket Transactions*, 46 U. PITT. L. REV. 867 (1985). *See generally* E.A. FARNSWORTH, *supra* note 1, § 12.8, at 839 (Expectation interest represents what the promisee would have received if the contract had been performed as promised.).

[138] In addition, the approach suggested in the text should lead to greater clarity in law governing emotional distress damages unrelated to contractual expectations. Presumably such damages would be awarded only if the defendant committed an independent tort or breached a contractual duty of good faith. For an example of the difficulty in distinguishing emotional distress damages under tort and contract, see Silva v. Bisbee, 2 Hawaii App. 188, 628 P.2d 214 (1981).

[139] The analysis suggested here is similar to that mandated by article 1998 of the Louisiana Civil Code:

> Damages for nonpecuniary loss may be recovered when the contract, because of its nature, is intended to gratify a nonpecuniary interest and, because of the circumstances surrounding the formation. . .of the contract, the obligor knew, or should have known, that his failure to perform would cause that kind of loss.

LA. CIV. CODE ANN. art. 1998 (West 1985). Under this provision, the trier of fact is directed to consider whether the nature of the contract is such that it was intended to gratify a nonpecuniary interest. If so, then the damage award should compensate for this loss, so long as the normal requirements of contract damages are satisfied.

The comments to article 1998 define "nonpecuniary interest" as follows: "A contract made for the gratification of a nonpecuniary interest means one intended to satisfy an interest of a spiritual order, such as a contract to create a work of art, or a contract to conduct scientific research, or a contract involving matters of sentimental value." LA. CIV. CODE ANN. art. 1998 comment b (West 1985).

Comment (b) to article 1998 notes that damages for nonpecuniary loss is the same as "moral

### *B. Traditional Limitations*

Although none of the traditional doctrines limiting contract damages justifies a categorical prohibition on compensation for nonpecuniary loss, they clearly will operate to limit damages for loss of aesthetic or emotional enjoyment. First, the doctrine of mitigation provides that an aggrieved party may not recover for losses that he reasonably could have avoided.[140] If the loss of an aesthetic or emotional benefit can be avoided by a substitute purchase of similar property or services, no recovery will be permitted.[141]

The second major limitation on contract damages will limit damages to those that were reasonably foreseeable at the time the contract was formed.[142] As discussed earlier,[143] a particular community may share many aesthetic and emotional values, and these would be readily foreseeable to members of the community even if they are not reflected in market values.[144] In addition, unusual aesthetic or emotional attachments may be communicated to the promisor prior to formation of a contract and thereby may satisfy the foreseeability requirement.[145] Depending on a normal evaluation of the risks assumed by each party, a promisor may be liable for nonpecuniary losses in such circumstances.[146] Yet,

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damages" under civil law. *See generally* Litvinoff, *supra* note 62 (discussing the civil law regarding moral damages). For a comparison of French, Quebec, English, and Canadian common law governing contractual damages for nonpecuniary loss, see Bridge, *Contractual Damages for Intangible Loss: A Comparative Analysis*, 62 CAN. B. REV. 323 (1984).

[140] U.C.C. § 2-715(2)(a) (1978) (consequential damages include only those "which could not reasonably be prevented by cover or otherwise"); RESTATEMENT (SECOND) OF CONTRACTS § 350(1) ("[D]amages are not recoverable for loss that the injured party could have avoided without undue risk, burden or humiliation."). *See generally* 5 A. CORBIN, *supra* note 10, § 1039; E.A. FARNSWORTH, *supra* note 1, § 12.12, at 858-68; 11 S. WILLISTON, *supra* note 62, § 1353.

[141] *See supra* notes 17-21 and accompanying text.

[142] *See* U.C.C. § 2-715(2) (1978) (consequential damages limited to losses "resulting from general or particular requirements and needs of which the seller at the time of contracting had reason to know"); RESTATEMENT (SECOND) OF CONTRACTS § 351(1) ("Damages are not recoverable for loss that the party in breach did not have reason to foresee as a probable result of the breach when the contract was made.").

[143] *See supra* notes 50-56 and accompanying text.

[144] Most Americans would recognize, for example, the sentimental value of one's wedding pictures. Although competitive pressures may set the price of a photographer's work at $50 for a set of wedding pictures, and their value to a stranger may be a mere $15, still it is foreseeable that the value of the pictures to the bridal couple will be significantly more than $50.

[145] *Cf.* Windler v. Scheers Jewelers, 8 Cal. App. 3d 844, 851, 88 Cal. Rptr. 39, 44 (1970) (Emotional distress damages allowed because "[i]n the present case, at the time the bailment was created plaintiff made known to defendant that the rings were cherished mementos of her husband and were old family rings which, because of their sentimental value, she wished to have made into an heirloom for her daughter.").

[146] Of course the parties may assign the risk of nonpecuniary loss by agreement. *See* U.C.C. § 2-719(3) (1978) ("Consequential damages may be limited or excluded unless the limitation or

if nonpecuniary losses are not foreseeable, recovery would not be permitted.

Third, compensation will be awarded only for those losses that can be proved with reasonable certainty.[147] By definition, nonpecuniary interests do not carry a specific monetary value. The assignment of such a value, therefore, is at best an approximation.[148] The fact that many nonpecuniary values are shared by a community provides an initial standard by which to set approximate monetary values, however. The trier of fact may evaluate the particular circumstances of the promisee and consider not only how dearly the plaintiff values the promised performance, but also what value the reasonable man would assign to it.[149] But without such a reasonable basis for determining the value of the loss, damages will not be awarded.

A fourth limitation on contract damage is disproportionality. Although this factor is not often articulated as a general limitation on contract damages,[150] still there is persuasive evidence that courts are reluctant to permit damage awards that are disproportionate to the benefits that the breaching party would have obtained from the contract.[151] If this is a relevant factor, however, courts

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exclusion is unconscionable."). *Cf.* Mieske v. Bartell Drug Co., 92 Wash. 2d 40, 593 P.2d 1308 (1979) (clause limiting recovery for breach of film processing contract to replacement of film was unconscionable where there was no actual agreement to this clause). However, there is no reason for the law to dictate that such losses always must be borne by the promisee. *See supra* notes 37-57 and accompanying text.

[147] *See* RESTATEMENT (SECOND) OF CONTRACTS § 352 ("Damages are not recoverable for loss beyond an amount that the evidence permits to be established with reasonable certainty."); 5 A. CORBIN, *supra* note 10, § 1020; E.A. FARNSWORTH, *supra* note 1, § 12.15, at 881-88. *Cf.* U.C.C. § 1-106 comment 1 (1978) (suggesting a very flexible certainty requirement).

[148] The requirement of "reasonable certainty" varies according to the nature of the loss involved. As comment 1 to § 1-106 of the Commercial Code notes, "Compensatory damages are often at best approximate: they have to be proved with whatever definiteness and accuracy the facts permit, but no more." U.C.C. § 1-106 comment 1 (1978). The RESTATEMENT (SECOND) OF CONTRACTS § 352 comment (a) echoes this observation: "Damages need not be calculable with mathematical accuracy and are often at best approximate."

[149] *See supra* notes 45-48 and accompanying text.

[150] *See* RESTATEMENT (SECOND) OF CONTRACTS § 351 comment f ("Sometimes these limits [to avoid disproportionality] are covertly imposed, by means of an especially demanding requirement of foreseeability or of certainty. The rule stated in this Section recognizes that what is done in such cases is the imposition of a limitation in the interests of justice.").

[151] *See* 56 A.L.I. PROC. 337-38 (1979) (comments on RESTATEMENT (SECOND) OF CONTRACTS § 351(3) by Professor Farnsworth, Reporter) ("There is a lingering dissatisfaction by courts in some cases with the scope of recovery in some cases under *Hadley v. Baxendale* that manifests itself occasionally by courts stating the rule in Subsection (3), almost in those words."); E.A. FARNSWORTH, *supra* note 1, § 12.17, at 892-93; Farnsworth, *Legal Remedies*, *supra* note 2, at 1809-10; Fuller & Perdue, *supra* note 15, at 376. *See, e.g.*, Lewis v. Mobil Oil Corp., 438 F.2d 500 (8th Cir. 1971) (time period restricted for recovery of lost profits to avoid lost profits award of $80,000 where direct damages were $9,250).

In the past, courts have avoided disproportionate damages through strained findings of lack of

should evaluate it directly rather than under the guise of the rule against sentimental value.[152]

## IV. CONCLUSION

The doctrinal tangle that currently structures the law regarding damages for lost aesthetic and emotional enjoyment is not necessary. There is no good reason for the general rule barring recovery, and the surreptitious use of emotional distress doctrine needlessly complicates analysis. Traditional limitations on contract damages are adequate to prevent excessive liability, while at the same time recognizing and protecting the significant aesthetic and emotional values that motivate much of human activity.

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foreseeability, *see, e.g.*, Daniel, Mann, Johnson & Mendenhall v. Hilton Hotels Corp., 98 Nev. 113, 642 P.2d 1086 (1982) (lost profit claim of one million dollars resulting from delays in constructing a casino addition denied on basis of unforeseeability); Seaman v. U.S. Steel Corp., 166 N.J. Super. 467, 400 A.2d 90 (App. Div.) (despite fact that Seaman asked U.S. Steel to verify steel was fit for intended use prior to purchase, court denied consequential damages of $85,000 where cost of the steel was $410.45), *cert. denied*, 81 N.J. 282, 405 A.2d 826 (1979); or lack of reasonable certainty, *see, e.g.*, Winston Cigarette Mach. Co. v. Wells-Whitehead Tobacco Co., 141 N.C. 284, 53 S.E. 885 (1906) ("[T]he breach of a very simple contract. . .might bring ruin upon the party in default, by leaving the damages to the unbridled discretion of the jury."). *See generally* E.A. FARNSWORTH, *supra* note 1, § 12.15, at 884 (quoting Fuller & Perdue, *The Reliance Interest in Contract Damages* (pt. 2), 46 YALE L.J. 373, 376 (1937)) ("If the test of foreseeability is met, but the court nevertheless concludes that liability would impose on the party in breach a risk disproportionate to the rewards that he stood to gain by the contract, 'the test of certainty is the most usual surrogate.' ").

[152] The Restatement endorses a direct approach to the issue of disproportionate damages: "A court may limit damages for foreseeable loss. . .if it concludes that in the circumstances justice so requires in order to avoid disproportionate compensation." RESTATEMENT (SECOND) OF CONTRACTS § 351(3).

# Lost Earnings Calculations and Tort Law: Reflections on the *Pfeifer* Decision

by Sumner J. La Croix* and H. Laurence Miller, Jr.**

## I. INTRODUCTION

In its 1983 term, the United States Supreme Court decided a case which has far reaching implications for tort law: *Jones & Laughlin Steel Corp. v. Pfeifer.*[1] This decision focused on a key issue in the calculation of the present value of lost earnings in tort cases. Over the last twenty-five years the rapid and pervasive increase in consumer prices (and wages) has posed an important problem for lawyers and economists: how to incorporate the effects of inflation into lost earnings estimates. In *Pfeifer*, the Court produced a set of guidelines which provides a rough outline for lawyers and economists to follow in their calculations.

Three years earlier, in *Norfolk & Western Railway v. Liepelt*,[2] the Supreme Court grappled with another controversial matter: whether income tax liabilities should be considered in calculations of lost earnings. Reversing its long-held doctrine that estimates of the present value of lost earnings must ignore income tax liabilities, the Court ruled that lost earnings calculations should incorporate the effects of federal income taxes.[3] In *Pfeifer* the Court clarified and affirmed the *Liepelt* decision, thereby providing a comprehensive treatment of two controversial issues in lost earnings calculations: inflation and taxes.[4]

The *Pfeifer* Court surveyed and correctly evaluated a large number of topics relating to calculations of lost earnings beginning with the factors that must be

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[1] 462 U.S. 523 (1983).

[2] 444 U.S. 490 (1980).

[3] *Id.* at 494.

[4] *See infra* text accompanying notes 24-48.

considered in an inflation-free economy. The Court then considered three different approaches used by American courts to adjust lost earnings estimates for the effects of expected inflation: the real interest rate approach, the market interest rate approach, and the total offset approach. All are discussed below. Instead of selecting one of the three approaches, the Court drew up a set of guidelines for courts to use, though the guidelines favor the real interest rate approach.

The Court's reluctance to mandate a single way to deal with inflation is probably wise. But, there are important problems in the decision. The Court's guidelines are inconsistent with its mandate that taxes must be considered in lost earnings calculations. Opportunities were missed to give additional guidance to the practitioner. Our analysis indicates that the Court should have been more critical of the "offset" method of calculating damages. In addition to demonstrating these and related points, we propose a new approach for adjusting lost earning estimates for the effects of expected inflation. We begin our analysis with a brief presentation of the rulings in the *Pfeifer* and *Liepelt* cases. While our interest is mainly in *Pfeifer*, not *Liepelt*, the subjects of present value, inflation, and taxes are much intertwined and cannot be considered in isolation.

## II. THE *PFEIFER* AND *LIEPELT* DECISIONS

### A. *Liepelt*

In 1973 a fireman, Delray Liepelt, suffered fatal injuries due to the negligence of his employer, Norfolk and Western Railway Company.[5] Kandythe Liepelt, the fireman's wife and the administratrix of his estate, brought suit in the Circuit Court of Cook County, Illinois, under the Federal Employers' Liability Act.[6] Liepelt's expert witness calculated the present value of the lost support and services to be $302,000. Norfolk objected to the use of gross of tax earnings and offered to prove via its expert that the pecuniary loss net of tax was $138,327. The jury awarded $775,000 to Liepelt. The Appellate Court of Illinois, First District, upheld the trial court's refusal to instruct the jury that the award would not be subject to income taxes and the judge's decision to exclude evidence of the effect of income taxes on future earnings of the decedent.[7] On

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[5] 62 Ill. App. 3d 653, 655, 378 N.E.2d 1232, 1236 (1978).

[6] *Id.* at 655, 378 N.E.2d at 1235. Under the Federal Employers' Liability Act (FELA) state courts are obliged to take jurisdiction of cases that meet the requirements of local laws. Hill, *Substance and Procedure in State FELA Actions - The Converse of the Erie Problem?*, 17 OHIO ST. L.J. 384 (1956) (citing The Second Employers' Liability Cases, 223 U.S. 1, 57 (1912)). Plaintiffs often choose to bring FELA actions in state courts as common law negligence actions in order to take advantage of state procedures. In such cases, federal law controls substantive issues. *Id.*

[7] 62 Ill. App. 3d 653, 378 N.E.2d 1232. Although federal law governs the taxibility of decedent's earnings the court noted that the federal circuits were split on whether the jury should

certiorari to the United States Supreme Court[8] two main issues were presented: (1) whether the trial judge was in error when he refused to instruct the jury that the damage award would not be subject to federal income tax; and (2) whether the trial judge erred in not allowing evidence concerning the impact of the federal income tax on the fireman's future earnings.[9]

The petitioner argued "that the jury must have assumed that its award was subject to federal income taxation; otherwise the verdict would not have exceeded respondent's expert opinion by such a large amount."[10] The Supreme Court concluded that "it was surely not fanciful to suppose that the jury erroneously believed that a large portion of the award would be payable to the Federal Government in taxes. . . ."[11] To instruct the jury on the taxability of the award "would not be prejudicial to either party, but would merely eliminate an area of doubt or speculation that might have an improper impact on the computation of the amount of damages."[12] Since the instruction to the jury could "do no harm,"[13] the Court found the trial judge to be in error.

On the second issue, offer of expert testimony on the effect of future income taxes on the net pecuniary loss, the Court began by noting that an individual supports his family out of his disposable personal income, i.e., his income net of taxes.[14] After-tax income measures his lost opportunities more accurately than before-tax income. In fact, the Court stated that "after-tax income . . . provides the only realistic measure of his ability to support his family."[15] Although future tax liabilities are not known with certainty, the Court reasoned that other relevant variables are also not known with certainty and, therefore, must also be "matters of estimate and prediction."[16] Some observers may believe that such matters are too complex to present to a jury, but the Court stated that "the

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be instructed on the taxibility of an award and whether to follow evidence of the effects of taxes on future earnings. In the absence of a United States Supreme Court holding on the issue, the Illinois appellate court was bound by an earlier Illinois Supreme Court decision. *Id.* at 669, 378 N.E.2d at 1245.

[8] The Supreme Court of Illinois denied leave to appeal. 444 U.S. at 491.

[9] *Id.*

[10] *Id.* at 492. Respondent explained the excess as the jury's estimate of the pecuniary value of the guidance, instruction, and training lost by the decedent's children. *Id.* n.4.

[11] *Id.* at 497. Justices Blackman and Marshall dissented on this point. They characterized the question of whether a jury must be instructed that the damage award is not taxable as a procedural issue. The required instruction did "not affect the determination of liability or the measure of damages." *Id.* at 502. They further argued that even if federal law did govern, to instruct the jury that the award would not be subject to taxation is "both unwise and unjustified, and almost an affront to the practical wisdom of the jury." *Id.* at 502-03. *See also infra* note 17.

[12] 444 U.S. at 498.

[13] *Id.* (citing Burlington Northern, Inc. v. Boxberger, 529 F.2d 284, 297 (9th Cir. 1975)).

[14] 444 U.S. at 493.

[15] *Id.* at 492.

[16] *Id.* at 494.

practical wisdom of the trial bar and the trial bench has developed effective methods of presenting the essential elements of an expert calculation in a form that is understandable by juries that are increasingly familiar with the complexities of modern life."[17] On this matter also, the Court held that the trial judge was in error and remanded the case.[18]

### B. *Pfeifer*

Pfeifer was employed by Jones and Laughlin Steel Corporation as a landing helper on its coal barges.[19] He was injured when he "slipped and fell on snow and ice that Jones and Laughlin had negligently failed to remove from the gunnels of a barge."[20] Action was brought in the United States District Court for the Western District of Pennsylvania under the Longshoremen's and Harbor Workers' Compensation Act.[21] The district court awarded respondent $275,881.31 as the present value of lost earnings.[22] In calculating the amount of the award, the court did not "increase the award to take inflation into account, and it did not discount the award to reflect the present value of the future stream of income."[23] The district court followed a decision of the Supreme Court of Pennsylvania which had held that as a matter of law, future inflation is assumed equal to future interest rates and that the two effects exactly cancel each other out.[24] The Court of Appeals for the Third Circuit agreed with

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[17] *Id.* The Court qualified its position by warning that "[t]his is not to say, however, that introduction of such evidence must be permitted in every case. If the impact of future income tax in calculating the award would be de minimis, introduction of the evidence may cause more confusion than it is worth." *Id.* n.7 (citing FED. R. EVID. 403). Justices Blackmun and Marshall dissented on the ground that calculating after-tax income "appropriates for the tortfeasor a benefit intended to be conferred on the victim or his survivors." *Id.* at 498-99. Justices Blackman and Marshall may be referring to Section 104 of the Internal Revenue Code (26 U.S.C. § 104(a)(2) (1976)) which specifies that awards of damages are not subject to federal income taxes.

[18] 444 U.S. at 498.

[19] 678 F.2d 453, 455 (1982).

[20] 462 U.S. at 526.

[21] *Id.*

[22] *Id.*

[23] *Id.* In Chesapeake & O. Ry. v. Kelly, 241 U.S. 485 (1916), the Supreme Court mandated that future benefits must be discounted when the lost earnings award is calculated. Discounting of future benefits is necessary because less than one dollar must be paid today to replace a dollar of future lost income. The rationale is that the smaller sum can be invested at a positive rate of interest, allowing the smaller sum to grow to the required amount. *See generally* A. ALCHIAN & W. ALLEN, EXCHANGE AND PRODUCTION 107-31 (3d ed. 1983); J. HIRSHLEIFER, INVESTMENT, INTEREST, AND CAPITAL 31-45 (1970).

[24] The Supreme Court noted that the fact that the Pennsylvania court had adopted the total offset rule for all negligence cases was "not of controlling importance," as the "respondent's cause of action is 'rooted in federal maritime law.' " 462 U.S. at 547.

the district court's use of this "offset method" and, consequently, affirmed the district court's decision.[25]

The Supreme Court began its consideration of this issue by carefully surveying the series of steps involved in determining the present value of lost earnings. First, an estimate of the lost stream of earnings must be constructed. "The stream may be approximated as a series of after-tax payments, one in each year of the worker's expected remaining career."[26] In *Pfeifer*, the Court explicitly noted that the worker's wage must be adjusted to take into account the effects of federal and state income taxes. This reference reaffirms its *Liepelt* decision and extends its scope to include the effects of state taxes.[27] The Court then cataloged a series of factors which must be considered in calculating the stream of lost earnings: the value of fringe benefits,[28] the worker's expected worklife,[29] unreimbursed work costs,[30] expected increases in the individual's and the society's productivity,[31] the probability of future promotions and merit pay,[32] and collective bargaining effects.[33]

Second, the stream of lost earnings must be discounted.[34] The discount rate should be based on the market interest rates earned on "the best and safest investments."[35] Since the lost stream of income is specified in after-tax terms, "the discount rate should also represent the after-tax rate of return to the injured worker."[36]

While we believe that the procedure outlined above is generally accepted by most lawyers and economists, it is difficult to implement, as future values of many relevant factors are not known with certainty. Estimates of these variables must be determined and incorporated into the analysis. In *Pfeifer*, the Supreme Court, aware of these difficulties, considered how to incorporate measures of

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[25] 678 F.2d 453 (3d Cir. 1982).

[26] 462 U.S. at 536.

[27] *Liepelt* dealt only with federal taxes. *See, e.g.*, 444 U.S. at 491. *Pfeifer* dealt with both federal and state taxes. *See, e.g.*, 462 U.S. at 534.

[28] 462 U.S. at 534.

[29] *Id.* at 533-34.

[30] *Id.* at 534.

[31] *Id.* at 535-36.

[32] *Id.* at 535.

[33] *Id.* at 536.

[34] Discounting involves finding the value now, or "present value," of sums available at later dates. Thus, the present value of $110 available a year from now at 10% interest is $100 because $100 x (1.1) = $110, and $100 = $110/(1.1). *See* ALCHIAN & ALLEN, *supra* note 23, at 107.

[35] 462 U.S. at 537 (citing Chesapeake & O. Ry. v. Kelly, 241 U.S. 485 (1916)). The "best and safest" investment usually refers to U.S. Government Treasury bills and bonds. See *infra* note 91 for further comments on this definition.

[36] *Id.* We discuss this issue in depth in Section IV. *See infra* notes 74-91 and accompanying text.

expected inflation into lost earnings calculations. The Court began its analysis by acknowledging that price inflation affects *both* lost earning streams and market rates of interest.[37] Until very recently, federal courts have not incorporated both effects into their procedures for calculating lost earnings. A common procedure was to prohibit estimating the effect of inflation on probable earnings but allow using market rates of interest, which incorporate estimates of inflation, for discounting.[38] While the Court admitted that past procedures resulted in incorrect estimates, "[t]he inequity was assumed to have been minimal because of the relatively low rates of inflation."[39] Recent increases in the level and variability of inflation have called this analysis into question; there is now "a consensus among courts that the prior inequity can no longer be tolerated."[40] The Court then noted that "[t]here is no consensus at all, however, regarding what form an appropriate response should take."[41] The Court briefly reviewed three different approaches used by American courts to adjust lost earnings estimates for the effects of expected inflation.

The first, "the real interest rate approach," does not use forecasts of future inflation. It endorses "the economic theory suggesting that market interest rates include two components—an estimate of anticipated inflation, and a desired 'real' rate of return on investment—and that the latter component is essentially constant over time."[42] It assumes that increases in earnings due to inflation will be offset by increases in market interest rates due to inflation. The two effects cancel out. The court must then determine only the expected increase in "real" (net of expected inflation) earnings as a result of increasing skills, improved general productivity, and such, and an appropriate "real" (net of expected inflation) interest rate for discounting.

The second approach uses market interest rates. Estimates of inflation-caused increases in earnings are introduced into the calculations. The earnings stream is then discounted by the market interest rate on the "best and safest invest-

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[37] 462 U.S. at 538. The Court carefully noted that it is always possible to ensure that a stream of *nominal* earnings can be generated by the damage award; the problem is to provide the victim "with a stream comparable to what his lost wages would have been in an inflationary economy." *Id.* at 540.

This was important because it indicates that the Court is aware of the distinction between nominal and real values. The influence of Judge Richard Posner on this decision is clear. The Court cites Judge Posner's decision in O'Shea v. Riverway Towing Co., 677 F.2d 1194, 1199 (7th Cir. 1982). *Id.* at 540 n.24. Judge Posner's opinion closely follows the analysis in his text. *See also* R. POSNER, ECONOMIC ANALYSIS OF LAW 144-49 (2d ed. 1977).

[38] 462 U.S. at 523 (citing Blue v. Western Ry. of Alabama, 469 F.2d 487, 496-97 (5th Cir. 1972)).

[39] 462 U.S. at 540.

[40] *Id.* at 540-41 (citing United States v. English, 521 F.2d 63, 75 (9th Cir. 1975)).

[41] 462 U.S. at 541.

[42] *Id.* at 542.

ment."[43] Previously, federal courts did not allow direct estimates of future inflation to be incorporated into the lost earnings calculations since they perceived such estimates to be "unreliably speculative."[44]

The third approach, usually referred to as the "total offset" method, is based on the assumption that increases in lost earnings due to future inflation and future productivity changes will be exactly offset by the market interest rate. If the market interest rate is exactly negated by the inflation/productivity adjustment factor, the lost earnings estimate can be obtained by multiplying lost earnings in the first year by the work expectancy, or, more generally, by simply summing the stream of lost earnings. One should not conclude that the stream of earnings is neither discounted nor adjusted for inflation. The market interest rate and the adjustment factor for wage inflation and productivity changes are included in the estimation formula, but cancel each other out of the formula when they are assumed to be equal.[45]

Instead of selecting one of the three approaches, the Court drew up a set of guidelines for courts to use when they select one of the approaches, though the guidelines favor the real interest rate approach. First, the Court warned that since "specific forecasts of future price inflation remain too unreliable to be useful in many cases," courts and the parties to the case "should be discouraged from pursuing [the inflation-forecasting] approach."[46] Second, the Court stated that, although economic evidence supporting the real interest rate approach is "distinctly inconclusive," a court using the real interest rate approach would not be "reversed if it adopts a rate between one and three percent and explains its choice."[47] Finally, the Court noted that while the offset method "has the virtue

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[43] *Id.* at 537. From the economic perspective, the "best and safest" investment is usually defined to be a United States Federal Government bond or bill. The "best and safest" investment should not be perceived as a riskless investment. Unexpected inflation poses major risks since it can erode the value of the bill or the bond. In an emergency, the government could suspend interest payments or restrict bond redemption. Nevertheless, the risk associated with federal government bonds is usually perceived as lower than the risk associated with any other type of bond. The federal government can pay its debt by printing money.

[44] *Id.* at 540.

[45] *Id.* at 544. There are several variants of the total offset rule. They are discussed in detail in Section VI. *See infra* notes 94-110 and accompanying text.

[46] *Id.* at 548.

[47] *Id.* at 549. The Court did not give any rationale for its choice of real interest rates between one and three percent. Elsewhere in its opinion, it cited a decision by Australia's High Court to adopt a 2% rate "on the theory that it represents a good approximation of the long-term 'real interest rate.' " Immediately thereafter, the Court observed that "[i]n this country, some courts have taken the same 'real interest rate' approach as Australia." *Id.* at 541-42 (citing Feldman v. Allegheny Airlines, Inc., 524 F.2d 384, 388 (2d Cir. 1975), *aff'g*, 382 F. Supp. 1271 (D. Conn. 1974) (1.5%); Doca v. Marina Mercanti Nicaraguense, S.A., 634 F.2d 30, 39-40 (2d Cir. 1980) (2% unless litigants prove otherwise)).

The Court also noted that Judge Posner stated in *O'Shea* that the real interest rate varies

of simplicity and may even be economically precise," more analysis of its implications is necessary before it could exclusively adopt this approach.[48]

The Court concluded its analysis by cautioning that trial judges should not "embark on a search for 'delusive exactness.' "[49] Lost earnings determinations are only "rough and ready estimates" which are often "overshadowed by a highly impressionistic award for pain and suffering."[50] In *Pfeifer*, the Court nonetheless considered the estimation of lost earnings to be sufficiently important to examine the lower court's adoption of the total offset method as a matter of law. The Court remanded the case and urged the trial court to choose the inflation adjustment approach most appropriate to the facts of this case.[51]

## III. Market and Real Interest Rate Approaches

It is hard to quarrel with the Court's preference for guidelines over a rule that establishes "for all time [the] exclusive method in all federal trials for calculating an award for lost earnings in an inflationary economy."[52] It is appropriate to "counsel hesitation"[53] when economists and businessmen cannot forecast inflation reliably for periods more than a few years into the future, when there are competing explanations for the recent high market and real rates of interest,[54] when the evidence regarding the stability of the real rate is, as the Court said, "distinctly inconclusive,"[55] and when the combined effect of income taxation and inflation on interest rates is unclear.[56]

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between 1% and 3%. *Id.* at 550 n.31 (citing *O'Shea*, 677 F.2d at 1199). While there is additional discussion of real interest rates in the decision, it does not not appear to pertain to the *choice* of the real interest rate, but to the *desirability* of a real interest rate approach. For example, the Court included a long but inconclusive discussion of the stability of real rates of interest. *Id.* at 548-49 n.30.

We believe that the Court settled on a slightly low range for the before tax real interest rate. In our opinion, a 2% to 4% range would be preferable. *See infra* note 92.

[48] 462 U.S. at 550-51.

[49] *Id.* at 552 (quoting Truax v. Corrigan, 257 U.S. 312, 342 (1921) (Holmes, J., dissenting)).

[50] 462 U.S. at 552. The Court noted that "[i]t has been estimated that awards for pain and suffering account for 72% of damages in personal injury litigation." *Id.* at 552 n.35 (citing 6 Am. Jur. Trials § 24 (1967)).

[51] 462 U.S. at 553.

[52] *Id.* at 546.

[53] *Id.* at 547.

[54] *See* Blanchard & Summers, *Perspectives on High World Interest Rates*, 2 Brookings Papers on Economic Activity 273 (1984).

[55] 462 U.S. at 548.

[56] The seminal articles are Darby, *The Financial and Tax Effects of Monetary Policy on Interest Rates*, 13 Econ. Inquiry 266 (1975) and Feldstein, *Inflation, Income Taxes, and the Rate of Interest: A Theoretical Analysis*, 66 Am. Econ. Rev. 809 (1976).

Since the economic and legal literature currently offers little guidance on this matter, the Court wisely chose a set of broad guidelines which can be narrowed in the future to reflect new developments. The Court was aware that there is extensive ongoing research by economists and legal scholars into these matters. Premature choice of a specific approach in this changing environment would invite rapid depreciation of the Court's decision.[57] If future research revealed that the Court's narrow rule was obsolete, then the Court would be forced to use its valuable time to reconsider this matter rather than other important issues. By considering both its own opportunity costs and the potential for a narrow rule to depreciate quickly, the Court has chosen an appropriate method for resolving this problem.[58]

### *A. The Real Interest Rate Approach*

Despite finding flaws in each of the three approaches to lost earnings calculations, the Court favored one pro tem rule in its guidelines, the real interest rate method. How does this method deal with inflation? Consider the case of an injured or deceased worker who would have been employed for the additional period of time implied by his or her work expectancy.[59] To simplify the presentation, assume a personal income tax with no deductions, a constant tax rate,

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[57] From the perspective of economics, legal precedents should be viewed as capital goods, i.e., goods which yield a stream of services over time. Like other stocks of capital, legal precedents depreciate and become obsolete over time. In order to maintain the legal stock of capital, there must be investment in updating legal precedents over time. For an excellent exposition of this view, see Landes & Posner, *Legal Precedent: A Theoretical and Empirical Analysis*, 19 J. OF L. & ECON. 249 (1976).

[58] The Court hinted that it may not be the proper branch of government to formulate rules in this case: "The legislative branch of the federal government is far better equipped than we are to perform a comprehensive economic analysis and to fashion the proper general rule." 462 U.S. at 551. But is Congress "far better equipped" for research in this area? Parties to disputes can present arguments concerning the merits of particular views. Legal experts and academic economists can generate new theory and data. Neither the Supreme Court nor the Congress has a comparative advantage in conducting research. Should not the Court concentrate on providing incentives for professionals to undertake the needed investigations?

[59] The *Pfeifer* Court may be incorrect in saying that "virtually all calculations . . . [take] the form of annual installments." 462 U.S. at 534 n.11. It is an easy matter with current computing resources to use any time unit. The suggestion in note 22 that losses be discounted to the date the loss began, and interest awarded on past losses for the period between injury and judgment, would result in not paying interest on past losses. *Id.* at 538 n.22. Our analysis in the text ignores the problems of earnings which result from savings from earnings. It assumes a specified consumption pattern such as zero savings. Problems associated with using the sum of earnings over expected worklife to measure expected earnings over the individual's lifespan have come under close scrutiny recently. *See* Alter & Becker, *Estimating Lost Future Earnings Using The New Worklife Tables*, 108 MONTHLY LAB. REV. 39 (1985).

and an interest rate which is constant over time. Assume initially no actual or expected inflation.

With no actual or expected inflation, the market rate of interest is the real, no inflation, rate of interest. There is no difference between the two. And the present value of the lost earnings (the lost earnings part of damages) would simply be the sum of probable earnings over the period in question discounted by an appropriate market (equal to the real) rate of interest. Probable earnings would take on different values at various points in time due to factors specific to the individual including seniority, experience, merit and promotions, factors summarized in terms of the "age-earnings profile,"[60] and to factors causing growth in the earnings of workers as a class, "broader societal forces,"[61] for example, productivity increases. All growth of earnings in the absence of inflation would be growth in real earnings.

Some readers will find it easier to follow the argument if we use a simple formula. Let Ej represent expected earnings of the injured or deceased worker in each year of an additional n years of expected work life ($1 \leq Ej \leq n$) as reflected in the age-earnings profile; $(1 + g)^j$ provide for growth of earnings of workers as a class; t be the flat rate proportional tax rate; and r be the market and real interest rate which is constant over time. Then the formula for the calculation of lost earnings in the inflation-free case initially discussed by the Court is:[62]

$$(1) \quad L = \sum_{j=1}^{n} (1 - t)\, E_j\, (1 + g)^j \frac{1}{(1 + r\,(1 - t))^j}$$

Given the flat proportional tax rate, t, after-tax earnings and the after-tax discount rate are obtained by multiplying earnings and the discount rate by $(1 - t)$. Our assumption of a flat rate tax means the tax coefficient is the same for wage and interest earnings and is unchanged from period to period. In this simple model we have also assumed that the market interest rate and the rate of productivity change will be constant in future periods. The current state of economic science allows a forecaster to predict average levels of these variables with high confidence, but is rarely precise enough to predict period-by-period variations.

There have been periods in the history of the United States and other countries, of course, with relatively stable prices. The level of market interest rates during such periods is part of the evidence regarding long run levels of real

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[60] 462 U.S. at 535.

[61] *Id.* at 535-36.

[62] *Id.* at 533-36.

interest rates. But stable prices are not the norm. How does inflation affect the picture? Inflation will be accompanied by inflationary increases in wages, approximately offsetting the effects of price inflation in the long run, though not necessarily in the short run.[63] Inflation also affects interest rates. As the *Pfeifer* Court noted, if the inflation is *anticipated*, lenders will demand, and borrowers will pay, a premium to compensate for the dollar's "shrinkage in value."[64] So anticipated inflation affects *current* as well as future interest rates. This is why the Court pointed out the unsatisfactory nature of not allowing estimates of inflation's effect on wages but allowing discounting by market interest rates.[65]

One simple and well known hypothesis about inflation's effect on market interest rates is known as "the Fisher Effect."[66] It suggests that market interest rates, the interest rates observed in money markets, will be equal to real interest rates, the ones that would have prevailed in the absence of inflation, *plus* an "inflation premium" reflecting the market's estimate of anticipated inflation. It is assumed that the market interest rate rises one percentage point for each point of anticipated inflation. Thus, if one-year Treasury securities would ordinarily yield (a real rate of) 3%, and the market expects inflation of 4% per year, the market interest rate would be 7%, the real rate of 3%, expected in a regime of stable prices, plus 4% to compensate for loss in the dollar's value.[67] If the Fisher Effect holds, anticipated inflation affects market interest rates but leaves real interest rates unchanged.

The real interest rate approach favored by the Court ignores the effect of inflation on the calculations above by assuming that the effect of inflation on wages more or less cancels out the effect of inflation on interest rates. Our formula above can be used to calculate damages with the real interest rate replacing the market interest rate.[68]

The point may be more easily understood with the aid of another simple

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[63] *See* Kessel & Alchian, *Meaning and Validity of the Inflation-Induced Lag of Wages Behind Prices*, 50 AM. ECON. REV. 43 (1960).

[64] 462 U.S. at 539. There is wide agreement in the economics profession that in the absence of tax effects, anticipated inflation produces only minimal dislocations in the economy. Production and consumption plans are not changed—the only effect of the price inflation is that all money payments and prices, i.e., interest rates, stock prices, wages, dividends, etc., increase to leave real prices unchanged; the adjustment costs incurred by individuals are thought to be relatively small. *See generally* S. FISCHER & R. DORNBUSCH, ECONOMICS (1983). Economists are, however, widely divided over the effects of unexpected inflation. *Compare* Friedman, *Inflation and Unemployment (Nobel Lecture)*, 85 J. POL. ECON. 451 (1977) *with* Tobin, *Inflation and Unemployment*, 62 AM. ECON. REV. 1 (1972).

[65] 462 U.S. at 539-40.

[66] For a lucid exposition of the Fisher Effect, see the excellent discussion by Irving Fisher, the economist who proposed it. I. FISHER, THE THEORY OF INTEREST 399 (1930).

[67] Another term for "market" in this context is nominal.

[68] The market interest rate and the real interest rate were the same in the initial example.

formula. Let r be the *real* rate of interest, z be the expected rate of inflation, and i be the *market* rate of interest, where, according to the Fisher Effect, $i = r + z$. Then the formula for lost earnings when inflation is expected is

$$(2) \quad L = \sum_{j=1}^{n} (1 - t) E_j (1 + g)^j \frac{(1 + z)^j}{(1 + (r + z)(1 - t))^j}$$

where $r + z$, the real rate plus expected inflation, can be substituted for i, the market rate, if the Fisher Effect holds. The increase in earnings due to general price inflation raises the estimate of lost earnings; this effect is, however, offset by increases in the interest rate due to the Fisher Effect. The Court's guidelines favoring the real approach presume that the inflation variables (z) in the numerator and denominator of formula (2) cancel out. One can focus then on the real variables r and g and on their difference. In fact, if the income tax rate t is 0, formulas (1) and (2) yield approximately equal results. But if the tax rate t is positive, then the inflation variables in formula (2) do not cancel and the two formulas yield different results. *In this respect the Court ignored its mandate that lost earnings calculations incorporate the effect of income taxation.* We explain this point further below.

### *B. The Market Interest Rate Approach*

The *market* approach to estimation uses *market interest rates* and makes some kind of estimate of inflation's probable effect on earnings. This is an explicit forecast of inflation, as compared to the implicit forecast contained in a market interest rate. The Court's preference for the real interest rate method over the market interest rate method was based on the view that predictions of future inflation are more speculative than predictions of real interest rates and real rates of earnings growth.[69] Most economists would agree. Moreover, the real approach does not require economists to agree on values of the real interest rate and the real rate of earnings growth. The real approach only necessitates agreement on the difference between the real interest rate and the real rate of earnings growth.

Given the present state of the art in economics, it is impossible for economists to forecast inflation at all accurately over long periods of time. Most studies indicate that the price level can be forecast very accurately in the short run, but that as the forecast period extends farther into the future, the variance of

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[69] The Supreme Court qualified its confidence in the real interest rate approach. 462 U.S. at 548 n.30.

the price level increases substantially.[70] In *Pfeifer*, the Court stated that since specific forecasts of inflation are unreliable, and it is undesirable to convert trials into graduate seminars on estimating inflation, the market approach should be discouraged.[71] No attempt should be made to forecast future inflation and no use should be made of market interest rates. Its pro tem approach encouraged the use of a real interest rate between 1 and 3 % if the trial court explains its choice.[72]

It is clear that *Pfeifer* is a great improvement in the legal treatment of lost earnings calculations. As the Court pointed out, some courts have prohibited forecasts of inflation in estimates of future earnings, but have allowed discounting by market rates of interest, which incorporate estimates of inflation.[73] *Pfeifer* eliminated this and other unsatisfactory practices. Moreover, the real interest rate approach is probably superior to the market approach in restricting the grounds for litigation and reducing errors in damage awards *if* one ignores the tax issue. That is an important "if." We examine the tax issue in the next section.

## IV. TAX EFFECTS BEFORE AND AFTER *Pfeifer*

The Court's decision in *Liepelt* that taxes are not too speculative and complex a matter for a jury's deliberations constituted a major change in direction for the Court.[74] It provided important ammunition in other jurisdictions for adoption of comparable law. And, it stimulated research by economists and legal scholars into the effects of taxes on lost earnings calculations. Two important results of this research are (1) awareness of what is sometimes called the "reverse tax effect," and (2) formulas for calculations that can deal with the variable tax

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[70] *See* Klein, *Our New Monetary Standard: The Measurement and Effects of Price Uncertainty, 1880-1973*, 13 ECON. INQUIRY 461 (1975). Some economic time series can be predicted with smaller errors over long time spans than over short time spans, as some types of forecast errors cancel out over time. This analysis does not, however, apply to forecasts of the price level. For an excellent evaluation of the performance of various economic forecasts, see McNees & Ries, *The Track Record of Macroeconomic Forecasts*, 10 NEW ENG. ECON. REV. 5 (1983).

[71] 462 U.S. at 548.

[72] *Id.* at 549.

[73] *Id.* at 539-40.

[74] For an example of rulings prior to *Liepelt*, see Johnson v. Penrod Drilling Co., 510 F.2d 234, 236-37 (5th Cir.) *cert. denied*, 423 U.S. 839 (1975), *overruled*, Culver v. Slater Boat Co., 688 F.2d 280 (5th Cir. 1982). *Liepelt* states "[i]t is his after-tax income, rather than his gross income before taxes, that provides the only realistic measure of his ability to support a family." 444 U.S. at 493. Neither the majority decision nor Justice Blackmun's dissent noted that the government is also a losing party to the tortfeasor's action. An argument could be made for a separate award to the government equal to the present value of its loss of taxes as a result of the injury. Of course, with the "reverse tax effect" described below, the "loss" might be negative.

rates of a progressive tax system.[75] At first glance *Pfeifer* appears simply to reaffirm *Liepelt* on taxes. But *Pfeifer* introduces a new problem. In making its decision the Court appears to have missed the connection between inflation and taxes.

Awards due to personal injuries or sickness, whether by suit or agreement, are exempt from income taxation, but interest earned is not.[76] Prior to *Liepelt*, both the taxes that would have been paid on earnings in the absence of injury or death, and the taxes that will be paid on interest earned from an award, were ignored in calculating damages.[77] *Liepelt* did not get into the details of the procedure required to include taxes in the calculations. One of the curiosities the post-*Liepelt* examination of tax effects brought to light is that, when taxes on both types of earnings are included, awards are reduced by substantially less than the average income tax rate; indeed, a tax-adjusted award can even exceed an unadjusted award, a somewhat counter-intuitive possibility often labelled the "reverse tax effect."[78] The reason is not too hard to understand. The aim is to provide the injured person with the after-tax income he or she would have had in the absence of injury. The award is decreased by the taxes payable on wage earnings in each period of work expectancy. But, since interest on an award is taxable, the award is increased by the amount required to pay taxes on interest obtained as a result of the damages. What will be the result of these opposing forces?

Consider first the simple problem of replacing a fixed, unchanging, level of earnings in a flat rate, proportional, tax system with a given interest rate. On the one hand, the numerator in the calculations is reduced by the tax rate t. On the other hand, a lower interest rate must be used for discounting to allow for taxes on interest earned, a net-of-tax rate i(1 - t), smaller than the before-tax rate i, that increases the present value of after-tax earnings relative to what it

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[75] Both are explained below *infra* at notes 76-91 and accompanying text.

[76] 26 U.S.C. § 104(a)(2) (1976). The statement applies to awards, usually lump sum awards, that can be used as the recipient wishes. Locked-in agreements on a series of payments which the recipient cannot alter, known as "structured settlements," are wholly exempt from income taxation. For examples of situations where it may be desirable to eliminate discretion because recipients are ill-equipped to manage large sums, see Krause, *Structured Settlements for Tort Victims*, 66 A.B.A. J. 1527 (1980). *See also infra* note 91.

[77] *Liepelt* refers to adjustment of the interest rate for tax as logical and admissable "if offered in proper form." 444 U.S. 495. *Pfeifer* refers to interest rate adjustment in terms of "should." 462 U.S. at 537.

[78] An early, pre-*Liepelt*, statement is found in Bassett, *The Impact of Income Taxes on Damage Awards in Personal Injury Trials*, 12 INT'L SOC'Y BARRISTERS Q. 301 (1977). Bassett almost suggests wrongly that a progressive tax structure is required for the result. Better known is Crick, *Taxes, Lost Future Earnings, and Unexamined Assumptions*, 34 NAT'L TAX J. 271 (1981). The term "reverse tax effect" is due to Joseph J. Benich, Jr. *See* Benich, *The Reverse Tax Effect in Wrongful Death or Injury Estimates*, 17 TRIAL 16 (1981).

would have been without this adjustment. So the award is reduced by less than the ratio of taxes to earnings. If the effective tax rate is 10%, the numerator in the calculations is reduced by 10%, but the smaller after-tax discount rate leads to a reduction of damages of less than 10%. With no growth in earnings, as the payoff period lengthens, the value of the after-tax award approaches, but can never exceed, the value of the no-tax award.[79]

On the other hand, if earnings are growing, an adjusted award can actually exceed an unadjusted award. The lump sum damages award must be large enough to pay taxes on interest earnings. The present value of these taxes on interest earnings can be greater than the present value of the taxes on wage earnings that reduce the award.[80] The same forces operate with variable tax rates, but in that case the tax rates applicable to wage earnings and interest earnings will usually differ, and the discounting formula must be reconsidered.

A very important result of post-*Liepelt* research is the development of correct procedures for dealing with rising marginal tax rates. The central problem raised by variable tax rates is that tax rates on interest earnings in each period depend upon the amount of the award while the amount of the award depends upon the taxes that must be paid, a simultaneity problem that does not arise in a flat rate system. A number of writers have shown how to construct a computer program that works recursively to calculate the award correctly.[81] We know the before-tax earnings and after-tax earnings to be replaced in each period of the worklife. After-tax earnings are obtained by applying the relevant tax rates to before-tax (wage) earnings. We also know the balance remaining at the end of the worklife, namely, zero.[82] Starting with after-tax (interest) earnings in the last period, and the ending balance, zero, the computer finds the tax rate applicable to interest earnings, and thus gross interest earnings, and the balance that begins that period, and ends the preceding one, consistent with this information, and does the same thing for the next-to-last period, and all other periods, back to the lump sum award.

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[79] Consider equation (1) with all $E_j$ equal to $E_1$ and g equal 0. As n goes to $\infty$, both the after-tax ($t > 0$) and the no-tax ($t = 0$) sums go to $E_1$.

[80] Now allow the rate of growth, g, in equation (1) (with other assumptions of note 79 unchanged) to be positive. With $g > 0$, the after-tax award is raised relative to the before-tax award. Suppose, for example that $g = .07$, $i = .08$, $t = .15$. The after-tax and no-tax awards are equal when $n = 28$. At larger n's the after-tax award is larger than the before-tax award.

[81] Bassett describes what is required but provides no formulas or proofs. *See supra* note 78, at 308. For good recent treatments that reach the same point independently, see Bell, Bodenhorn, & Taub, *Taxes and Compensation for Lost Earnings*, 12 J. LEGAL STUD. 181 (1983); Bruce, *An Efficient Technique for Determining the Compensation of Lost Earnings*, 13 J. LEGAL STUD. 375 (1984); Brady, Brookshire, & Cobb, *The Development and Solution of a Tax-Adjusted Model for Personal Injury Awards*, 51 J. RISK & INSURANCE 138 (1984).

[82] Work earnings come to an end at the end of worklife. The individual must then live on savings, retirement plans.

For the reader who finds the formulas helpful we note that the (not as simple) formula for the calculations is now

$$(3)\quad L = \sum_{j=1}^{n} \left[ (1 - t'_j)\, E_j\, (1 + g)^j \frac{(1 + z)^j}{\prod_{k=1}^{j} (1 + (r + z)(1 - t''_k))} \right]$$

where $t'_j$ and $t''_k$ are the tax rates applicable in each period to the lost wages and interest on the award respectively. $\Pi$ is a symbol indicating multiplication, and the other variables are defined as before.[83]

Almost everyone preparing calculations in jurisdictions that require consideration of taxes will be making some use of this procedure fairly soon. But the older approach that treats the progressive tax system "as if" it were a flat rate system, using effective tax rates appropriate for the problem at hand, is unlikely to disappear. More assumptions are built into the more complex models. The traditional approach is simple and flexible, and in many situations the simpler technique will suffice. As the Court pointed out, all results are "approximate."[84] The improved procedures are, however, an important and inevitable development.

Turn now to *Pfeifer*. The important facts have already been noted. The Court reaffirmed its decision in *Liepelt* that taxes must be considered, extended it to include state as well as federal taxes, and referred to adjustment of the interest rate for taxes in terms of "should" as opposed to "admissable."[85] The decision did not go into any details regarding inclusion of taxes in the Court approved below-market or other approach. If the Court saw a connection between inflation and taxes, it was unremarked.[86]

But how can a *real* interest rate be adjusted for taxes when the federal and state governments tax *market* interest received and allow *market* interest paid out to be a deductible expense? They do not tax only the real interest received

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[83] One can easily generalize this and the preceding formulas to allow for variation of the interest rate from period to period.

[84] The Court in *Pfeifer* noted that "It is perfectly obvious that the most detailed inquiry can at best produce an approximate result." 462 U.S. at 552.

[85] *Id.* at 537.

[86] This is also true of the post-*Pfeifer* decision of the Court of Appeals for the Fifth Circuit known as *Culver II*, Culver v. Slater Boat Co., 722 F.2d 114 (5th Cir. 1983) (en banc), that withdrew that Court's previous mandate that courts should use a case-by-case basis, stating, with eight of twenty-two justices dissenting, that it would not reverse below-market discount rates between one and three percent, or, in some cases, even lower. "[T]his pre-tax rate must then be adjusted for tax effects." *Id.* at 122.

and allow only the real interest paid out to be deducted. Economists are well acquainted with this fact. Important tax proposals in the United States would change this situation in some respects[87] but, in the meantime, it makes no sense to speak of adjusting a *real* interest rate for taxes on *market* interest.[88]

There is more to this story. Papers by Michael Darby and Martin Feldstein have pointed out that taxation of nominal interest invalidates the relation between market and real interest rates summarized in the Fisher equation.[89] The salient point is that the interaction between inflation and income taxation appears to affect real rates of interest. This matter was skipped over in our first approach to the subject. We assumed above that the market interest rate equals the real rate plus expected inflation, $i = r + z$, with perfectly anticipated inflation. But, with taxes levied on market rather than real interest, maintenance of a constant after-tax *real* return, say, $r^*$, requires that the after-tax market interest rate equal the real rate plus expected inflation, that is, $i - ti = r^* + z$. This yields the relationship:

$$(4)\quad i = (1/(1 - t))\, r^* + (1/(1 - t))\, z$$

which says that the market or nominal interest rate should change by $1/(1 - t)$ points with a one point change in the anticipated rate of inflation. Empirical research has, however, produced a range of estimated responses generally less than $1/(1 - t)$. Some recent work suggests that the gap can be closed by incorporating historical cost depreciation and a tax on capital gains into equation (4) but there is no consensus on the matter.[90] We need not go further into the large literature on this subject. The point is that the interaction between inflation and income taxation appears to affect real rates of interest. Much of the justification for using a real interest rate approach to estimate lost earnings then disappears, as the effects of inflation on earnings growth and on the discount factor will not wash out.

Our concern here is that the below market approach recommended by the Court in *Pfeifer* is ill-suited for incorporating taxes on interest income earned on the damages award. Applying actual tax rates to real interest rates biases damage awards downward; the bias is greater the longer the payout period.[91] As

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[87] *See*, for example, the discussion of the Regan tax reform plan now known as "Treasury I" in *Indexing Proposals in Treasury's Plan Will Add Complications for Taxpayers*, Wall St. J., Dec. 4, 1984 at 3, col. 2.

[88] In *Culver II*, 722 F.2d 114 (5th Cir. 1983), the Fifth Circuit appears to have identified the 1% to 3% real interest rate specified by the *Pfeifer* Court as an *after-tax* real rate. *Id.* at 118.

[89] *See supra* note 56.

[90] Rose, *A Respecified Tax-Adjusted Fisher Relation*, ECON. INQUIRY, forthcoming 1986. *See also* Peek & Wilcox, *The Degree of Fiscal Illusion in Interest Rates: Some Direct Estimates*, 74 AM. ECON. REV. 1061 (1984). The bibliographies in the two cited articles contain most of the major references in this area.

[91] We are mostly ignoring questions relating to the securities and maturities in which an award should be invested. An argument could be made, but usually is not, for using rates of

noted below, an analogous problem arises when using a total offset rule. The problem does not arise when using the market rate approach.

These considerations weaken the view that the real interest rate approach will provide less basis for disputes, and lead to smaller errors. A better pro tem rule might be one that allows predictions of inflation and uses market interest rates in conjunction with estimates of the real rate of interest and the real growth rate of earnings, i.e., a market approach checked by the real rate method. Is this practical? We believe it is.

## V. An Alternative Approach

The market approach allows consistent incorporation of tax effects and is more congenial to new research by economists and attorneys on matters ranging from the real rate of interest to Darby-Feldstein effects. But how can we use the market approach when parties to disputes often disagree about future inflation and interest rates? One alternative to the approach propounded by the Court is to use the market approach *checked* by the real interest rate approach. The Court has said it will not overrule cases in which a 1% to 3% real interest rate is used. If social productivity increases at 2% per year, then the net discount rate (r - g) is between -1% and 1%.[92] Estimates using the market approach could also be reviewed by this criterion: the Court would not overrule estimates where the difference between the nominal interest rate (i) and the nominal earnings growth rate (g + z) is in the -1% to 1% range. Thus, if the estimate of future wage inflation is 7%, and the market interest rate is 10%, the estimated real interest rate is 3%, which satisfies the Court's requirement. With real growth in earnings estimated at 2%, the real, net-of-growth, discount rate would be 1%.

What should be done when the data suggests a gap between market interest

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returns on assets the injured party or his representative is likely to choose, rather than returns on riskless investments. Note that it will not always be possible to invest an award once and for all with no dependence on future interest rates. Earnings in the early years can exceed the amounts required for consumption, leading to reinvestment of the excess. An award can be fully "locked in" in some cases only if there are appropriate securities futures markets. "Structured settlements," which lock in the payments to the recipient, present a different kind of problem. The original series of payments remains the same whatever happens. A partial solution to this problem, not presently allowed, would be to authorize investment in short term securities, controlled by a contract, but not controlled by payer or recipient. *See* Cane & Freitas, *Structured Personal Injury Settlements*, 1 Belli L. J. 65 (1984). We need not pursue this subject here.

[92] For evidence supporting the view that real earnings have grown at a rate equal to around 2% per annum, see R. Ehrenberg & R. Smith, Modern Labor Economics 20 (Table 2.5) (2d ed. 1985). For an estimate that the real rate of interest before tax is around 4%, see R. Gordon, Macroeconomics 372-74 (3d ed. 1984). As the Court notes, there is disagreement amongst economists regarding the real rate of interest.

rates and growth in earnings outside the allowed range? This kind of situation has been common recently. Suppose, for example, that money wages have been increasing (g + z) at about 5% per year and are expected to continue to increase at about that rate when the market interest rate (i) is 10%. Historical data suggests that this gap will not persist over long periods of time. If the estimate is for a short period of time, say two to three years, the gap may be justified by short term financial and labor market conditions.[93] But if the award period is for a longer period of time, the gap should be adjusted to reflect the long run net discount rate. Suppose the appropriate *net-of-growth discount rate* is thought to be 1%. Reducing the 5% gap requires either a reduction in the interest rate or an increase in wage growth or a combination of both. It is reasonable to simply average the polar cases. With i = 10% as the upper bound, a difference of 1% requires that g + z = 9%. By the same reasoning, i = 6% and g + z = 5% are the values at the lower bound. One could then use the mean values of i = 8.0% and g + z = 7.0% in formula (2) as described above. (8.0 - 7.0 = 1.0)

This approach does not overcome the inability to forecast inflation accurately for periods significantly into the future. But it allows the market rates at which awards are actually invested, that incorporate implicit estimates of inflation, and are relevant to taxation, to influence the calculations. Individuals pay taxes on market interest rates which reflect inflation. Our approach improves on the market approach by incorporating other relevant data (the net discount rate) into the damage estimation procedure. It also improves on the real approach, as it allows for the effect of taxes to be incorporated into the estimates. We believe that experts and courts should seriously consider adopting this new method for discounting damage awards, as it overcomes flaws in the market and real interest rate approaches without introducing any new difficulties into the estimation process.

## VI. Offset Rules

There are several variants of the offset rule.[94] All assume that the effects of expected earnings growth are cancelled out by the effects of discounting. Estimates can then be made without information on expected earnings growth or interest rates. Proponents argue that the technique is simple and inexpensive and reduces the errors in the estimates. It is suggested that it does not result in

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[93] *See infra* our discussion of the university professor and the computer programmer text following note 108.

[94] *See* 462 U.S. at 526-27 (noting that the lower court in *Pfeifer* had applied an offset rule propounded by the Pennsylvania Supreme Court in Kaczkowski v. Bolubasz, 491 Pa. 561, 583, 421 A.2d 1027, 1038-39 (1980)).

estimates substantially different from those obtained by the usual methods. It is also often claimed that the method is superior to some other methods in protecting the real value of awards from the effects of inflation. Proponents have said little or nothing about adjusting offset awards for taxes. In fact, the technique is even less amenable to appropriate adjustment for taxation of interest than the real interest (below market) method.

The first major offset case was a 1967 decision by the Alaska Supreme Court, *Beaulieu v. Elliott*.[95] The Alaska court held that the discount rate was "totally offset" by expected price inflation and by expected increases in general productivity. With this rule, once the victim's base period salary and his remaining worklife have been determined, the figures can simply be multiplied to arrive at a measure of lost earnings.[96] In *State v. Guinn*,[97] the Alaska court modified *Beaulieu* by holding that "certain and predictable" individual raises would not be offset by the discount rate and should be added to the victim's base period salary over his remaining worklife. The Pennsylvania Supreme Court adopted a third variant of the offset rule in *Kaczkowski v. Bolubasz*.[98] It ruled that the discount rate is offset totally by expected future inflation; therefore the victim's base salary should be adjusted to incorporate the effects of expected increases in general productivity and in the victim's productivity. In our notation the three rules are:

(5) *Beaulieu*: $L = E_1 \times n$

(6) *Guinn*: $L = \Sigma E_i$

(7) *Kaczkowski*: $L = \Sigma E_i(1 + g)^i$

As we noted in the opening section, the Supreme Court said in *Pfeifer* that the use of any of the above three offset rules is not "mandatory in the federal courts."[99] The Court then added that "nothing prevents parties interested in keeping litigation costs under control from stipulating to its use before trial." However, the Court also stated that it was "not prepared to impose [the rule] on unwilling litigants, for we have not been given enough data. . ." to evaluate the rule.[100] These pronouncements clearly leave the door open to consideration

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[95] 434 P.2d 665 (Alaska 1967). This was labeled "the seminal 'total offset' case" by the United States Supreme Court in *Pfeifer*. 462 U.S. at 544.

[96] Expert advice would still be needed under the *Beaulieu* rule to determine the base period salary, fringe benefits, the expected worklife, unreimbursed work costs, medical expenses, personal expenses, child support and other relevant variables.

[97] 555 P.2d 530 (Alaska 1976).

[98] 491 Pa. 561, 421 A.2d 1027 (1980).

[99] 462 U.S. at 550.

[100] *Id.* at 550-51.

of offset rules at a future date. No one would quarrel with the idea that interested parties can stipulate the use of an offset rule before trial. The practice is probably used frequently in situations resolved without an economic expert or trial. Elevating the procedure to a general rule of law applicable to unwilling litigants is a different matter. Let us briefly look at the arguments of offset proponents.

A number of studies, including some cited by the Court, have recently examined how injured parties would have fared over some of the post World War II years using different rules for calculating lost earnings.[101] The study by Brody is representative in terms of results. Brody asks how a victim would have fared over the period 1960-1979 with a variety of different rules. What he calls the "traditional approach" uses initial earnings with no adjustments for occupational progress, growth in real earnings generally, or inflation, and a discount rate of 5%, although, in 1960, the (nominal) return on Treasury bills was 2.66% (see Table 1). His version of the traditional approach badly undercompensates the victim.[102] The *Beaulieu* version of the offset method would have provided the tort victim about the correct amount over the period.[103] The *Kaczkowski* variant would have produced a windfall.[104]

There is no mystery to these results *after the fact*. Over a large part of this period, *unexpected* inflation eroded lump sum damages paid to victims. Look at the information in Table 1 on nominal interest rates on 180-day U.S. Treasury bills, the rate of inflation, and the real return, defined as the nominal yield minus the ex post inflation. The inflation rate increased throughout the period, with its variability increasing noticeably during the 1970's. Nominal yields failed to anticipate inflation. The real return fell from 2.32% in 1964 to −3.78% in 1974 and was negative through 1980. After-tax returns would present an even more discouraging picture. The results for longer term U.S. and corporate securities during this period are virtually identical.[105] During the early 1980's, the pendulum appears to have swung in the opposite direction. Financial markets have overestimated the amount of inflation actually prevailing over this period.

How would Brody's victim have fared if he had been injured at other times, in the 1920's, for example, or in recent years? An examination of various

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[101] *See* Brody, *Inflation, Productivity, and the Total Offset Method of Calculating Damages for Lost Future Earnings*, 49 U. CHI. L. REV. 1002 (1982); Carlson, *Economic Analysis v. Courtroom Controversy: The Present Value of Future Earnings*, 62 A.B.A. J. 628 (1976); Jensen, *The Offset Method for Determining Economic Loss*, 19 TRIAL 84 (1983).

[102] *See* Brody, *supra* note 101, at 1012.

[103] *Id.* at 1020.

[104] *Id.*

[105] *See* R. IBBOTSON & R. SINQUEFIELD, STOCKS, BONDS, BILLS, AND INFLATION: HISTORICAL RETURNS (1926-78).

twenty year sequences in Table 1 shows that it would be easy to pick out periods when the *Beaulieu* rule would overcompensate victims. Offset awards during periods like the recent one, 1981-1985, of high market and real rates of interest would significantly overcompensate injured parties.[106] Offset awards over the 1940-1960 period would have significantly undercompensated the victim. In general, the success of the total offset rule in compensating Brody's hypothetical victim is an artifact of the sample period chosen.

Some proponents of the total offset rule have argued that the rate at which productivity increases should "continue roughly to equal the real interest rate."[107] This argument parallels the neoclassical growth model conclusion ("the golden rule") that optimal growth requires the discount rate to equal the rate of real income growth. But this relationship has not been empirically verified and may hold, if it does, only over very long periods of time.[108]

What are the arguments against elevating the offset technique to a general rule of law? First, use of an offset method will not change the amount of an (before-tax) award greatly in many cases because the expected growth in real earnings will not differ greatly from the real rate of interest. But in others it will. Suppose, for example, that a victim is a 63-year-old university professor who would have worked four additional years, and that real salaries of full professors at the victim's university have not increased in fifteen years. Would it be reasonable to assume that his real salary would have grown at a rate equal to the real rate of interest? In the absence of some information that it would, the victim would be overcompensated by the offset method. On the other hand, consider a 60-year-old computer programmer who would also have worked four more years. If the real income of programmers has been increasing at 5% per year and is likely to continue to increase at that rate, the *Guinn* and *Beaulieu* offset rules would undercompensate him.

Such unequal treatment does not promote justice. It does not make the person whole. It is also undesirable from the standpoint of deterrence. In many situations tortfeasors do not know their victims beforehand and average characteristics are all that will be taken into account prior to the accident. This is

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[106] Awards are invested at current market rates.

[107] An outlying view of the offset method is found in Formuzis & Pickersgill, *Present Value of Economic Loss: A Guide to Jones & Laughlin v. Pfeifer*, 21 TRIAL 26, 27 (1985). The authors assume that g = 2.5, add an "experience factor" of 1.5 for the age-earnings profile, inputted as $E_i$, not included as a growth factor, in our formulas, and assume r = 1.5. This leads to a plus discount of 2.5% before tax. (2.5 + 1.5 - 1.5 = 2.5) They are aware of the difficulty of adjusting a real rate for taxes. They conclude that the offset method will ordinarily undercompensate the plaintiff, with the undercompensation exaggerated if the loss is stated in after-tax dollars.

[108] See I. FISHER, THE THEORY OF INTEREST 182-83 (1930) for an early statement of this position. R. SOLOW, GROWTH THEORY (1970), provides a modern development of this classical view.

probably the most common situation in an automobile accident. But in some cases, for example, malpractice suits, the injurer will know something about the injured. Should not this information be retained? In principle, the law should aim for accurate signalling of social costs.

Second, even when the offset method produces estimates not greatly different from estimates obtained with the other methods, there is a difference. A net discount rate of 0% is not the same as a positive net discount rate. Studies supporting the offset rule which use the period 1960-1980 are flawed. The success of the offset rule during this period stems from two decades of unexpected inflation. It is highly unlikely that participants in the bond market will underpredict future inflation by such a large margin after the experience of the 1970's.

Third, everything said in Section III about taxing interest income applies *a fortiori* to the offset method. One can easily adjust the earnings figures, the $E_i$'s, for taxes, but there is no way to correctly adjust for taxes on interest from awards. This is not a small matter. Substantial tax liabilities are generated by even moderate sized awards. The tax liabilities for large awards, of, for example, $5,000,000, are very large. How could the Court keep to its decision in *Liepelt* and *Pfeifer* regarding incorporating the effects of taxes if it elevated the offset method to a rule of law?

Finally, although the cost savings of offset methods are real, they can be overemphasized.[109] Virtually all consultants, and many attorneys, now use microcomputers for the calculations. At one time complex discounting formulas, which incorporated several variables, used variables like monthly wages, and ran over long periods of time, were laborious to calculate. While it is still laborious (and costly) to find the relevant data and to input data into the computer, calculations which previously took several hours can now be done in seconds. Calculations can be redone easily to see how damages would be changed if the court requests this. We argued earlier that the Court's guidelines should allow for ongoing economic and legal research.[110] Offset rules constitute a step in the wrong direction.

## VII. CONCLUSION

When experts talk about prospects for the United States' economy over the next few years, over the next generation, and beyond, the consensus is that inflation will persist. Discussion centers on whether the dramatic decline in in-

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[109] As noted above, expert advice will still be needed in many cases to determine base salaries, fringe benefits, and so forth. *See supra* note 96 for an elaboration of this point.

[110] This was first suggested by Justice White in Standard Oil of N.J. v. United States, 221 U.S. 1 (1911).

flation to 3% or 4% will be maintained or whether double-digit inflation will return. No one predicts stable prices. So it was appropriate, in 1983, for the Supreme Court to grapple with the problem inflation creates for calculating lost earnings awards. In doing so, the Court had to consider much technical economic material which inevitably surrounds this type of issue. In most respects, it did an excellent job incorporating current economic theory and practices into its decision.

We agree wholeheartedly with the Court's caution and preference for general guidelines in *Pfeifer*. The problem with using the market interest rate approach to estimate damages is its inability to forecast inflation accurately over long time periods. The Court's use of the real approach with a 1% to 3% real discount is a well founded choice when taxes are omitted from the analysis. It is a tremendous improvement on many of the practices courts had adopted over the last fifty years, including, for example, not allowing estimates of the effect of inflation on earnings, while allowing discounting by a market rate of interest that incorporates estimates of inflation. But how does one adjust a below-market (real) interest rate for taxes? In *Pfeifer* the Court reaffirmed and extended its *Liepelt* decision concerning tax effects without realizing, apparently, that the analysis of tax effects in *Liepelt* is inconsistent with the real approach recommended in *Pfeifer*. Taking this omission into account leads us to the conclusion that the Court made a mistake in discouraging use of the market approach.

It is possible to use the market approach checked by the real approach to achieve the Court's objectives. This solution has a number of important virtues. It utilizes current market data and forecasts of market variables, but checks the estimates with the real rate guidelines, thus preventing short run developments from unduly influencing estimates covering long periods of time. It also enables the effects of income taxes to be incorporated accurately into the estimates. This was an important concern of the Court in *Liepelt* and *Pfeifer*. Unlike the offset method, it uses all of the available information about an individual; nothing important, such as specific conditions in an occupation, is thrown away. Specifying damages correctly results in just compensation. Potential tortfeasors will act, at the margin, more efficiently. Finally, it is a simple technique which can be easily understood and implemented by all parties to disputes. It should aid in implementing the Court's general guidelines in specific cases.

TABLE 1

NOMINAL AND REAL TREASURY BILL RETURNS: 1926-1984

| YEAR | NOMINAL | REAL | YEAR | NOMINAL | REAL |
|---|---|---|---|---|---|
| 1926 | 3.27 | 4.78 | 1955 | 1.57 | 1.19 |
| 1927 | 3.12 | 5.23 | 1956 | 2.46 | -.40 |
| 1928 | 3.24 | 4.22 | 1957 | 3.14 | .11 |
| 1929 | 4.75 | 4.52 | 1958 | 1.54 | -.22 |
| 1930 | 2.41 | 8.89 | 1959 | 2.95 | 1.43 |
| 1931 | 1.07 | 11.59 | 1960 | 2.66 | 1.16 |
| 1932 | 0.96 | 12.39 | 1961 | 2.13 | 1.44 |
| 1933 | 0.30 | -.37 | 1962 | 2.73 | 1.49 |
| 1934 | 0.16 | -1.87 | 1963 | 3.12 | 1.44 |
| 1935 | 0.17 | -2.78 | 1964 | 3.54 | 2.32 |
| 1936 | 0.18 | -1.04 | 1965 | 3.93 | 1.97 |
| 1937 | 0.31 | -2.74 | 1966 | 4.76 | 1.36 |
| 1938 | -.02 | 2.80 | 1967 | 4.21 | 1.13 |
| 1939 | 0.02 | 0.45 | 1968 | 5.21 | 0.46 |
| 1940 | 0.00 | -.95 | 1969 | 6.58 | 0.45 |
| 1941 | 0.06 | -8.90 | 1970 | 6.53 | 0.98 |
| 1942 | 0.27 | -8.33 | 1971 | 4.39 | 0.99 |
| 1943 | 0.35 | -2.78 | 1972 | 3.84 | 0.41 |
| 1944 | 0.33 | -1.75 | 1973 | 6.93 | -1.75 |
| 1945 | 0.33 | -1.90 | 1974 | 8.00 | -3.78 |
| 1946 | 0.35 | -15.52 | 1975 | 5.80 | -1.14 |
| 1947 | 0.50 | -7.93 | 1976 | 5.08 | 0.26 |
| 1948 | 0.81 | -1.92 | 1977 | 5.12 | -1.56 |
| 1949 | 1.10 | 2.93 | 1978 | 7.18 | -1.71 |
| 1950 | 1.20 | -4.39 | 1979 | 10.38 | -2.62 |
| 1951 | 1.49 | -4.18 | 1980 | 11.24 | -1.05 |
| 1952 | 1.66 | 0.76 | 1981 | 14.71 | 5.33 |
| 1953 | 1.82 | 1.18 | 1982 | 10.89 | 4.76 |
| 1954 | 0.86 | 1.36 | 1983 | 8.69 | 5.47 |
| | | | 1984 | 9.69 | 5.69 |

The returns data for 1926-1981 were taken from R. IBBOTSON & R. SINQUEFIELD, STOCKS, BONDS, BILLS AND INFLATION: THE PAST AND THE FUTURE 17, 30 (1982). The returns data are expressed in percentage terms. The real return is the nominal return adjusted for the effects of inflation. The returns for the years 1982-1984 were calculated from data taken from the U.S. COUNCIL OF ECONOMIC ADVISORS, ECONOMIC REPORT OF THE PRESIDENT 291, 310 (1984).

# Trading Money for Silence

by Walter Block*

## I. INTRODUCTION

When the term "blackmail" was first used in 1722, it had a specific and exact meaning. Its legal meaning was precise; it prohibited actions which were clearly at variance with the most basic and cherished of all human rights—the right to remain unmolested in one's person and property.

The Waltham Black Act of 1722 was passed as the result of the depredations of a gang of deer thieves called the Waltham Blacks, operating near the town of Waltham, England, who blackened their faces. Moreover, this gang undertook the quaint practice of sending letters "demanding venison and money, and threatening some great violence, if such their unlawful demand should be refused."[1] Hence the term "blackmail."[2] This law was clearly meant to punish demands for a victim's money or wealth coupled with threats to inflict violence on person or property.[3]

If the law prohibiting blackmail began with a clear and limited mandate, it was soon expanded through judicial determinations and legislative enactments. The law of blackmail began proscribing threats to do that which one would otherwise have a full and complete right to do—such as to publicize true information about another.[4]

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[1] *See* Winder, *The Development of Blackmail*, 5 MOD. L. REV. 21, 34-35 (1941). *See also* Williams, *Demanding with Menaces: A Survey of the Australian Law of Blackmail*, 10 MELB. U.L. REV. 118, 122-23 (1975) [hereinafter cited as *Demanding with Menaces*].

[2] *See* Winder, *supra* note 1, at 24 (This term also has been traced to piracy: "Blackmail was originally the tribute exacted by free-booters in the northern border countries to secure lands and goods from despoilment or robbery.").

[3] *See id.* at 21 ("[I]n those forms which require the presence of 'menaces' there had to be, originally, and until fairly recently, something like a threat of personal violence or of violence to property.").

[4] *See Demanding with Menaces*, *supra* note 1, at 140. The Criminal Law Revision Committee held that

In common parlance, the concept of blackmail has come to be used very loosely compared with its original meaning and is now applied to practically any commercial transaction disapproved of by the speaker. For example, the OPEC price hike of 1973 was widely castigated as "economic blackmail." The legal definition of blackmail has also been significantly broadened. This article shall attempt to chronicle the widening of the legal definition of blackmail. Section II attempts to show that the ever more encompassing behaviour prohibited under modern blackmail legislation has been inimical to the public good and has transgressed canons of justice, logic, and rights to free speech and has endangered, not protected, persons and property rights. Section III explores whether one can legitimately threaten to tell secrets one would otherwise have the right to reveal—unless one is paid to desist. Section IV discusses cases (1) where the "victim" approaches the blackmailer, (2) where the threat is to expose a victimless crime, and (3) where the threat is to expose a real crime.

## II. The Changing Definition of Blackmail

Originally, blackmail in the common law was confined to threats of violence, or other violations of the rights of person or property.[5] In *Rex v. Parker*,[6] for

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there are some threats which should make the demand amount to blackmail even if there is a valid claim to the thing demanded. For example, we believe that most people would say that it should be blackmail to threaten to denounce a person, however truly, as a homosexual unless he paid a debt. It does not seem to follow from the existence of a debt that the creditor should be entitled to resort to any method, otherwise *noncriminal*, to obtain payment.

*Id.* (emphasis added).

[5] *See* Williams, *Blackmail* (pt. 1), [1954] Crim. L. Rev. 79, 87:

As has been seen, there can in general be no stealing where the property is handed over as the result of threats, unless the threats are of force or false imprisonment. . . .[T]he common-law doctrine has never been extended beyond threats of physical force or false imprisonment; thus a person who obtains goods by threats of accusation of immorality would not be guilty of larceny.

*See also* Winder, *supra* note 1, at 42:

The Act of 1734 recites that "many of His Majesty's subjects have of late frequently been put in great fear and danger of their lives by wicked and ill-disposed persons assaulting and attempting to rob them" and declares to be felony the conduct of such persons who "with any offensive weapon or instrument, unlawfully and maliciously assault, or shall by menaces, or in or by any forcible or violent manner, demand any money, goods or chattels, of or from any other person or persons with a felonious intent to rob or commit robbery." In its original context there can be no doubt that "menaces" means such menaces as, if the demand accompanying them be complied with, robbery is committed: the words "with intent to rob" make this clear and they give effect to the declared object of the Act. There can be no intent to rob unless the handing over of the property demanded amounts to robbery. Therefore, "menaces" in section I meant present threats of immediate battery if

example, a creditor was found guilty of blackmail for forging a letter in an attempt to recover money owed him. This is consistent with the limited construction since forgery is itself equivalent to an assault on property, and hence an action which is *per se* proscribed.[7] Similarly, a threat made at gunpoint that the victim would "suffer the consequences,"[8] and threats to burn down the prosecutor's premises[9] were deemed to be violations of law. On the other hand, a threat of a civil suit in order to facilitate the collection of a debt was ruled not actionable: "A threat to do what one has a legal right to do is not, as a general rule, duress and will not support an action for damages."[10]

Thus blackmail was originally limited to the use of a threat of violence, or rights violations, in order to obtain valuable considerations. The concept of blackmail was soon extended, however, to include threats which did not entail physical abuse or the violation of rights.

As early as 1776, the extortion (blackmail) of money by verbal "threat to accuse a man of unnatural practices" was held to be criminal.[11] Similarly, the draftsmen of the (Blackmail) Act of 1823 extended the definitions of blackmail from "demands coupled with a threat of violence to the person or to property" to the utterance of "verbal threats to accuse another of serious crime."[12] In the modern day, the concept of blackmail has been extended to include the threat of anything that might discomfort a person. This change is so thorough that many legal commentators and much modern legislation even fail to acknowledge the traditional distinctions between threats of violence, threatened accusations of a serious crime, and threatened accusations of embarrassing

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the property be not delivered up to the accused.

[6] 74 J.P. 208 (1910), *cited in* Campbell, *The Anomalies of Blackmail*, 219 LAW Q. REV. 382, 391 n.18 (1939).

[7] In the narrow definition of blackmail, threats of force against persons or property are the *only* proscribed threats. But are such threats *always* illegitimate? Surely not. Suppose, for example, that the father of a kidnap victim threatens the kidnapper with personal physical violence unless he releases his child. As long as the threatened violence is not out of proportion to the original crime (the kidnap), there would appear nothing untoward in such an extortionate demand. For the remainder of this paper, however, unless otherwise indicated, we shall assume that threatened (or carried out) acts of violence are all initiatory and hence unjustified, not retaliatory, or in response, and hence possibly justified. For a discussion of the proportion of punishment and retaliation, see M. ROTHBARD, THE ETHICS OF LIBERTY 85-95 (1982) [hereinafter cited as ETHICS].

[8] *See, e.g.*, State v. Morgan, 50 Tenn. 262 (1871).

[9] *See, e.g.*, Rex v. Smith, 169 Eng. Rep. 350 (Ch. 1850).

[10] *See* Shelton v. Lock, 19 S.W.2d 124, 126 (Tex. Civ. App. 1929).

[11] *See* Campbell, *supra* note 6, at 382-83. *But see* Winder, *supra* note 1, at 24 ("At first, therefore, blackmail implied a threat of violent injury to property and according to the Oxford dictionary was not used, by extension, in its modern sense until the nineteenth century. The first example given of its modern use is from the year 1840.").

[12] *See Demanding with Menaces*, *supra* note 1, at 135.

misconduct.[13]

*Rex v. Tomlinson*[14] was considered to be the first case to extend significantly the concept of blackmail.[15] Tomlinson was convicted of demanding money under the threat of telling a man's wife and friends of his alleged immoral behaviour with another woman. Lord Chief Justice Russell of Killowen stated:

> I should have regretted if the Court had felt compelled to confine the construction of the word "menaces" in the way suggested [limited to injury to person or property], with the result of excluding such conduct as that of the prisoner from the purview of the criminal law. . . .[I]t may [also] well be held. . .to include menaces or threats of a danger by an accusation of misconduct, though of misconduct not amounting to a crime, and that it is not confined to a threat of injury to the person or property of the person threatened.[16]

This history supports the conclusion, on the one hand, that while the traditional, limited concept of blackmail is indeed criminal behaviour, deserving the full punishment of law, the additional behaviour proscribed by the modern, extended concept of blackmail is generally legitimate and noncriminal and should be legalized, however immoral it may be.[17] As the modern conception

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[13] *See, e.g.*, Livermore, *Lawyer Extortion*, 20 ARIZ. L. REV. 403, 403 n.2 (1978) (discussing the Arizona Revised Criminal Code: "In addition to the conventional proscription of threats of physical injury, property damage, criminal conduct, and reputational injury, a general clause forbids threatening 'any other act which would not in itself materially benefit the defendant but which is calculated to harm another person materially.' "). *See also* Williams, *Blackmail* (pt. 2), [1954] CRIM. L. REV. 162, 168 ("[I]t is rightly treated as blackmail to attempt to obtain money. . .by the threat to accuse of discreditable conduct.").

Moreover, there are numerous cases which have cemented the widened comprehension of blackmail. See, e.g., Thorne v. Motor Trade Ass'n, 1937 A.C. 797, 817, where Lord Wright states, "I think the word 'menace' is to be liberally construed and not as limited to threats of violence but as including threats of any action detrimental to or unpleasant to the person addressed." Stated Lord Atkin in this case:

> If the matter came to us for decision for the first time I think there would be something to be said for a construction of "menace" which connoted threats of violence and injury to person or property, and a contrast might be made between "menaces" and "threats" as used in other sections of the various statutes. But in several cases it has been decided that "menace" in this subsection and its predecessors is simply equivalent to threat. . . .

*Id.* at 806.

*See also* Rex v. Boyle & Merchant, [1914] 3 K.B. 339, 343, where Lord Reading, C.J., stated: "We do not think that the meaning of the word 'menaces' in the section is so restricted. Whatever may have been the view in earlier days under the older statutes and decisions a wider meaning has been given to the word by later decisions. . . ."

[14] [1895] 1 Q.B. 706.

[15] *See* Winder, *supra* note 1, at 37-38 ("[I]t was not until *R. v. Tomlinson* in 1895 that there was indisputable authority for interpreting 'menaces' in a wide sense.").

[16] [1895] 1 Q.B. at 708-09.

[17] *See, e.g.*, State v. Stockford, 77 Conn. 227, 58 A. 769 (1904) (Any words or acts calculated

of blackmail prohibits both threats of violence as well as other threats, we cannot wholly condemn it.

The difficulty is that there is now no single word which describes only the original narrow concept of blackmail (a threat of criminal conduct) and no single word to describe what has been added to this concept (a threat which does not itself violate rights). Blackmail and extortion are used synonymously to describe the wider, modern concept of blackmail (threat for money which either violates rights or does not).

There is always a risk in offering a stipulative definition. "The world will little note, nor long remember," such efforts. Nevertheless, in this confused situation, this is the path we have chosen. We shall use the term "extortion" to refer only to a demand for money made on the basis of a threat of physical violence or other clearly criminal behaviour.[18] We shall reserve the appellation "blackmail" for those threats which, in the absence of a demand for money, would be considered legal.[19]

There is a vitally important distinction to be drawn between those who threaten violence to persons or property in order to obtain money from other people, and those who only threaten to exercise their legitimate prerogatives

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and intended to cause an ordinary person to fear injury to his person, business, or property are sufficient to constitute a punishable threat.); Rex v. Pacholko, [1941] 2 D.L.R. 444 (Saskatchewan Court of Appeal found that any threat of injury to character is equivalent to blackmail.); Rex v. Robinson, 168 Eng. Rep. 475 (Ch. 1796) (defendant demanded property, threatening to accuse a man of murder).

[18] For a discussion of the history of blackmail, see *In re* Sherin, 27 S.D. 232, 130 N.W. 761 (1911) (Extortion is derived from the Latin word "extortus" which means to twist or wrench out.).

[19] According to the Model Penal Code adopted by the American Law Institute:

> A person is guilty of theft [by extortion] if he obtains the property of another by threatening to:
>
> (a) inflict bodily injury on anyone or commit any other criminal offense; or
>
> (b) accuse anyone of a criminal offense; or
>
> (c) expose any secret tending to subject any person to hatred, contempt or ridicule, or to impair his credit or business repute; or
>
> (d) take or withhold action as an official, or cause an official to take or withhold action; or
>
> (e) bring about or continue a strike, boycott, or other collective unofficial action, if the property is not demanded or received for the benefit of the group in whose interest the actor purports to act; or
>
> (f) testify or provide information or withhold testimony or information with respect to another's legal claim or defense; or
>
> (g) inflict any other harm which would not benefit the actor.

MODEL PENAL CODE § 223.4 (Proposed Official Draft 1962).

Based on our definitions, and subject to the considerations as discussed below, only (a) is extortionate. The remainder should be considered merely blackmail.

unless such funds are forthcoming.[20] This distinction can and must be drawn.

Now it may be that both blackmail (threatening to exercise one's own rights) and extortion (threatening to violate the rights of other people) are, or should be, criminal acts. If so, this conclusion should be based on analysis, not assumptions, or mere definition.[21] By distinguishing "blackmail" and "extortion," we are at least in a position to argue that one is legitimate, the other not.

## III. Can One Threaten What One Has a Right to Do?

An overwhelming majority of courts and commentators agree that a threat to disclose embarrassing information if money is not paid can be illegal even though the disclosure itself would not be.[22] There is, however, limited support for the view that blackmail as we have defined it, should be legalized. Lord Justice Romer in *Hardie & Lane v. Chilton*[23] expressed this view:

> I cannot find that the defendants have done anything of which complaint can be made in a Court, whether of civil or criminal jurisdiction. In my opinion the evidence shows at the most no more than that the defendants in good faith proposed and agreed to abstain from doing something that they could lawfully do, on the condition that the plaintiffs made a payment that they could lawfully make.[24]

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[20] *See* M. Rothbard, Man, Economy and State 443 (1962) ("*[B]lackmail* would not be illegal in the free society. For blackmail is the receipt of money in exchange for the service of not publicizing certain information about the other person. No violence or threat of violence to person or property is involved.") (emphasis original). *See also* W. Block, Defending the Undefendable 53-58 (1976).

[21] *See* Hibschman, *Can "Legal Blackmail" Be Legally Outlawed?*, 69 U.S.L. Rev. 474 (1935). The editors of this article note, "The phrase 'Legal Blackmail'. . .involves. . .a contradiction of terms." *Id.* at 474 ed. note.

[22] For a general discussion of this point, see Williams, *Blackmail* (pt. 2), *supra* note 13, at 162-63; *Demanding with Menaces*, *supra* note 1, at 129-30.

[23] [1928] 2 K.B. 306.

[24] *Id.* at 335-36.

As one commentator on *Hardie & Lane* has written:

> In the present case the threat involved no legal injury to (the trader). There was nothing contrary to public policy in expelling him or abstaining from so doing on condition that he paid a sum of money. But the fact that a thing perfectly legal in itself is not consistent with legal views of morality or public policy is often the dominating factor which causes a transaction to be found illegal. The (association) merely proposed and agreed to abstain from doing something that they could lawfully do, on condition that (the trader) made a payment which he could lawfully make, and there was no illegality in making the payment the consideration for the abstention. Nor was the letter in this case a demand with menaces without reasonable and probable cause, within the meaning of sec. 29(1), though I rest my judgment on the surer ground that it was not uttered without reasonable and probable cause.

This minority position derives additional support from Professor Livermore, who claims "that one may threaten to do what one is legally entitled to do to enforce that claim."[25] And again, the obverse: "There is no sound reason to allow lawyers to threaten what is legally unavailable to them to influence actions of others."[26] If lawyers are to be prohibited from threatening that which they cannot do, then the presumption is that they should be *allowed* to threaten that which they can legally do.[27]

So we have two schools of thought as to whether blackmail should be illegal. The overwhelming majority of the profession holds that it should be. Under this view two rights can make a wrong. This conclusion is troubling. First, it would appear that the burden of proof should be on the side that is making a counter-intuitive claim. And there can be hardly anything more counter-intuitive than the claim that two rights can make a wrong. And yet the majority opinion does not explain how this is can be so.

Second, given that the action is legal, then it can be legally implemented without recourse. That is, the would-be blackmailer can avoid the legal proscription by actually revealing the secret or embarrassment—so long as he does not ask for money for his silence. But if he does implement the threat without first offering his silence in return for payment, the blackmail victim may be far worse off as a result of the criminalization of this act. If blackmail were legalized, the victim would have the option of paying money in order to avoid what for him would be a worse fate, the publication of his secret.[28] With blackmail illegal, the victim's welfare is paradoxically diminished.[29]

Two influential cases involved the question of a cartel's right to discipline a violator of price fixing arrangements, and to fine the chiseling firm in lieu of

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> The real principle, in my view, may be expressed thus: Anyone who, without contravening morality or public policy, offers and agrees to receive, as an alternative to an act which he may lawfully perform, money which the other party may lawfully agree to pay as a consideration for such forbearance, is not guilty of a criminal offence.

Lecture, *Blackmail and Innocent Pressure: Interesting Middle Temple Moot*, 73 LAW J. 224, 225 (1932).

[25] Livermore, *supra* note 13, at 406.

[26] *Id.* at 409.

[27] *Id.* at 411 (A "lawyer would, of course, remain free to threaten legal action which is available to his client.").

[28] For a ringing affirmation of this principle, see ETHICS, *supra* note 7, at 121-27. *See also* W. BLOCK, *supra* note 20, at 53-54.

[29] *See* Livermore, *supra* note 13, at 406:

> Anomalously, it would be permissible to destroy reputation by bringing suit but not to allow the defendant to avoid that destruction by paying the claim. Not only would this mean a net loss to the privacy that the extortion status is, in part, aimed at protecting, but it would also involve significantly expanded litigation costs and burdens on efficient utilization of judicial resources.

expelling or boycotting it. In *Hardie & Lane v. Chilton*,[30] decided in 1928, the court held that the trade association did not breach the law by threatening to publicize a member's misconduct.[31]

Seven years later in *Thorne v. Motor Trade Association*,[32] a price-fixing violator was offered the option of paying a fine as an alternative to being boycotted (stop-listed) by the cartel. The House of Lords held that since the trade association had a right to place the violator on the stop list, it also had a right to demand a money payment as an alternative. Stated Lord Atkin:

> It appears to me that if a man may lawfully, in the furtherance of business interests, do acts which will seriously injure another in his business he may also lawfully, if he is still acting in the furtherance of his business interests, offer that other to accept a sum of money as an alternative to doing the injurious acts. He must no doubt be acting not for the mere purpose of putting money in his pocket, but for some legitimate purpose other than the mere acquisition of money.[33]

In addition, Lords Wright and Roche held that were the fine too high, or "unreasonable," then the Motor Trade Association would have been guilty of extortion.[34]

The *Thorne* case may thus be interpreted as giving support to our contention that blackmail ought to be legalized. After all, the accused blackmailer, the secretary of the MTA, was found innocent. But *Thorne* furnishes only the weakest support for this position. The requirement that the fine be "reasonable" is a significant limitation on the blackmailer's ability to charge a market price for his services.[35] In addition, the defendant was held not guilty only because the MTA was deemed to have been acting "for some legitimate [business] purpose other than the mere acquisition of money." This, too, restricts the conduct of blackmailers. As well, it is nonsensical, for the major purpose of business is the

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[30] [1928] 2 K.B. 306.

[31] A commentator on *Hardie & Lane* analyzed the court's reasoning and wrote:

> [W]here a trade association was entitled by its constitution to put on a stop list the name of a person who had infringed its rule forbidding the sale of articles at other than the fixed prices, the association might, instead, lawfully adopt the more lenient course of asking the person to make a payment of money by way of compromise, and such money could be accepted and was not recoverable as if paid under duress.

*Blackmail and Innocent Pressure*, *supra* note 24, at 225.

[32] 1937 A.C. 797.

[33] *Id.* at 807.

[34] *Id.* at 817-18, 824.

[35] Williams, *Blackmail* (pt. 2), *supra* note 13, at 171 ("[It] appears to be somewhat anomalous, for in no other instance of an absolutely justifiable threat is there authority for saying that the matter is affected by the amount asked as the price for abstaining from carrying out the threat.").

"mere acquisition" of money. Certainly the MTA's objection to the price-cutter stemmed from its fear that such a practice would reduce the money that could be otherwise acquired. Not much furthers business interests *apart* from the acquisition of money.[36]

Let us consider one last version of this majority view before closing this section. In Campbell's view:

> If X and Y are rival candidates for an appointment and X offers to withdraw his name if Y pays him money, doubtless X is offering to surrender a material advantage which he might legitimately enjoy. But if X threatens to reveal some secret failing of Y's to the appointing board unless Y pays him money, is X not a blackmailer? Yet he had the right to reveal Y's secret to the board and if the revelation resulted in the rejection of Y and the appointment of X this would be a furthering of X's legitimate material interests and might even be in the public interest. *The real point is not whether X had an interest which he could legitimately* enjoy *but whether he had an interest which he could legitimately* surrender, *or offer to surrender, in return for money.* There may well be interests which a man can legitimately enjoy himself, and rights and liberties which he can legitimately exercise in furtherance of these interests, but which he cannot legitimately transfer to another, *e.g.* his interest in and right to the consortium of his wife, and there may well be interests and rights and liberties which he can enjoy and exercise himself but which he cannot legitimately covenant not to enjoy or exercise, *e.g.* he has an interest in pursuing his trade and a liberty to pursue his trade or not as he pleases, but he cannot validly covenant, save within certain limits, to refrain from pursuing his trade. *And in most cases of blackmail we are dealing with interests which may be legitimately enjoyed and liberties which may be legitimately exercised but whose surrender, or attempted surrender, for money is not only void but is a crime. The question we have to answer is not: Had the accused an interest which he could legitimately enjoy? but: Had the accused an interest which he could legitimately surrender for money?*[37]

This statement is based on the premise that one can own or enjoy a right but cannot sell or transfer it. The argument stands or falls with this questionable premise. Campbell, unfortunately, provides no reasons or justification for this basic assumption. He merely asserts it.

The one example he vouchsafes us, that a man cannot legitimately transfer interest in and rights to the consortium of his wife,[38] does not prove Campbell's basic premise. The issue in the debate over blackmail is not whether the right

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[36] To the extent that the businessman acts in any other way, for example by renting a more plush office than strict considerations for bottom line, profit maximizing would require, to that degree he is acting as a consumer, not a businessman.

[37] Campbell, *supra* note 6, at 388-89 (emphasis added).

[38] *Id.* at 389.

to disclose information can be transferred to another, but rather whether one can seek money in exchange for not exercising the right. Thus in the context of marital rights, the question is not whether the right to consortium can be transferred to another, but rather whether one can take money in exchange for not exercising the right. The question is unresolved to our knowledge.

At least the example of the consortium of the wife had a certain shock value. But what are we to make of the assertion that a person "has an interest in pursuing his trade and a liberty interest to pursue his trade or not, as he pleases, but he cannot validly covenant, save with certain limits, to refrain from pursuing his trade?" If a person really has a right to pursue his trade, why can he not accept a payment not to pursue it?

## IV. BLACKMAIL CASES

Having outlined the rudiments of the case in favour of legalizing blackmail, one may apply this analysis to a series of cases to contrast this position with the more orthodox one on this subject.

### *A. Victim Approaches Blackmailer*

Let us first consider several cases where it is not the blackmailer who approaches the "victim," but rather the "victim" who approaches the blackmailer.[39] In these cases, the victims clearly prefer to pay money rather than have their "blackmailers" exercise some legal right. In *People v. Dioguardi*[40] a stationery business was struck by four unions in an attempt to organize the employees. The labour pickets made it impossible for the firm to conduct business. The owner approached McNamara, a teamster official, and offered him money to end the labour troubles. McNamara agreed, making a proposition for payment. After he and his codefendant Dioguardi were paid off, the pickets vanished and labour peace ensued.[41]

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[39] See ETHICS, *supra* note 7, at 125, where Rothbard raises this point in opposition to the outlawry of a blackmail contract:

> Suppose that. . .instead of Smith going to Jones with an offer of silence, Jones had heard of Smith's knowledge and his intent to print it, and went to Smith to offer to purchase the latter's silence? Should that contract be illegal? And if so, why? But if Jones' offer should be legal while Smith's is illegal, should it be illegal for Smith to turn down Jones' offer, and then ask for *more* money as the price of his silence?

*See also* Stern, *Prosecutions of Local Political Corruption Under the Hobbs Act: The Unnecessary Distinction Between Bribery and Extortion*, 3 SETON HALL L. REV. 1, 7 (1971) (concerning businessman (victim) who "himself makes the solicitation").

[40] 8 N.Y.2d 260, 168 N.E.2d 683, 203 N.Y.S.2d 870 (1960).

[41] *Id.* at 266-67, 168 N.E.2d at 687-88, 203 N.Y.S.2d at 875-76. For a discussion of this

As a result, McNamara and Dioguardi were indicted, tried and convicted of extortion under a then current New York statute which defined extortion as the "obtaining the property of a corporation from an officer. . .thereof, with his consent, induced by a wrongful use of. . .fear."[42] The defendants argued that their behaviour did not constitute a threat to do an unlawful injury because if their proposition had been rejected they would have done absolutely nothing. In the view of a student commentator: "Clearly, defendants failed to consider § 858 of the Penal Law which expressly brings a threat 'not to do something' within the scope of extortion."[43] The commentator further stated:

> Might not any refusal to act unless paid (as with doctors, lawyers and plumbers) in response to a request for help be extortion? A doctor or lawyer says simply "I will not remove your troubles unless I am paid." There is no implication of power to continue the victim's troubles and the victim knows it. But when a labor official says, "I will not remove the pickets unless I am paid," a logical inference arises (which in the instant case was encouraged by the defendant) that he has the power to maintain the picket—the very thing the victim fears. The two situations are distinguished by the presence in the latter of power and a threat, express or implied, to use it wrongfully. Therein lies the wrongful use which turns an otherwise lawful act into extortion.[44]

But this analysis overlooks the fact that the union pickets were entirely legal. It is of course true that the doctor or lawyer was not the cause of the victim's troubles in the first place, and has not the power to continue them. It is also true that the union officials were the cause of the victim's difficulties in the first place, and can cause them to continue, merely by refraining from any further activity. Yet their conduct during the labour dispute was within their powers under the various United States labour laws and their power to continue these labour problems merely by doing nothing was also lawful.[45]

Suppose that the unionists, when approached by the businessmen, had recoiled in horror from any suggestion that they relinquish their lawful picketing in return for anything so gross as money. Suppose, that is, they had realized that by falling in with the businessman's suggestion, they would be themselves subject to charges of extortion. Under these conditions, would the position of the unionists have been illegal? Certainly not. They would have been completely

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case, see Decision, *Criminal Law-Extortion-Defendant Need Not Initiate the Fear*, 27 BROOKLYN L. REV. 346, 346-51 (1961).

[42] 8 N.Y.2d at 275, 168 N.E.2d at 693, 203 N.Y.S.2d at 883 (quoting N.Y. PENAL LAW § 850).

[43] *Criminal Law-Extortion*, *supra* note 41, at 349.

[44] *Id.* at 349 n.13.

[45] It may be true that the power given them by the labour legislation is improper, but that is beyond the scope of this article.

within their rights to continue the picketing activities permitted them by law. Would the businessman have been better or worse off? To ask this question is to answer it. Obviously, the businessman would have been *worse* off—how else to explain the fact that *he* approached the unionists, and agreed to pay for labour peace? How can this power of the unionist be used "wrongfully," if, as a result of its use, the supposed victim of extortion is made better off?

In the arena of labour relations, threats to engage in legal protest are either forbidden outright or at the very least highly suspect. We have found only two English blackmail cases where labour threats were found to be unequivocally legitimate. In *Hardie & Lane v. Chilton*[46] it was stated in dicta that a cook may ask for a rise in wages in exchange for not giving notice of termination. And as Lord Wright stated in *Thorne v. Motor Trade Association*: "[A] valued servant may threaten to go to other employment unless he is paid a bonus or increased wages."[47]

It is not possible to reconcile these two statements with the findings of extortion in *Dioguardi*.[48] The cook or the "valued servant" who threatens to leave for greener pastures does no more wrong than do the picketing unionists. If the unionists have the right to strike, but not to surrender this right for money, why should the cook or servant with a right to quit be able to surrender it for money? Suppose the cook's employer approaches her and asks that she return to his employ for money considerations. If she agrees, logic demands that she too be considered an extortionist. Of course, the quitting cook and striking union engage in vastly different behaviour. But the point is, *both* their activities should be lawful.

### *B. Victimless Crimes*

We now turn to a consideration of several extortion cases which fall under the rubric of victimless crimes. The first grouping to be considered features a demand for money on the part of the accused blackmailer, and a threat to expose the "victim" of a contravention of heterosexual mores. Charges of blackmail have been made for threats to reveal a brothel visit,[49] a clergyman's sexual activities,[50] a husband's infidelity,[51] and threats to make a criminal complaint

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[46] [1928] 2 K.B. 306.

[47] 1937 A.C. 797, 820.

[48] That is, it is not possible for those who maintain the legitimacy of labour legislation which allows picketing and other forcible violations of human and property rights.

[49] *See, e.g.*, Regina v. Hamilton, 174 Eng. Rep. 779 (N.P. 1843) (threats to tell father, brothers, friends and newspaper that woman visited the brothels).

[50] *See, e.g.*, The Queen v. Miard, 1 Cox C.C. 22 (Midland Cir. 1844) (threats to tell the Archbishop of Canterbury, other bishops, and the newspapers of clergyman's sexual indiscretions).

[51] *See, e.g.*, Rex v. Tomlinson, [1895] 1 Q.B. 706 (threats to tell wife and friends); Rex v.

for allegedly indecent assault.[52]

The general analysis used by the courts in these cases focused not on the question of whether accused had threatened some illegal conduct but rather on the question of whether he or she was entitled in law to the money demanded or at least that were thought so in good faith.[53] This approach misses the important issues that were raised in these cases. The model developed in this paper presents a quite different view. Under this model, it is immaterial what the accused demanded, let alone whether the accused felt justified in making this demand. The only issue is whether the threatened conduct was legal. "[T]he threat is to do an act that is itself lawful. Nor is there any wrong merely in demanding payment of a sum of money. A man is at perfect liberty to importune a gift. The demand made is therefore lawful in itself."[54] Two legal rights do *not* make a legal wrong. The accused in all these cases are indeed guilty of blackmail—which should not be criminal. They are innocent of extortion—which should alone be a crime.

The analysis should be the same for cases related to threats concerning homosexuality and other allegedly deviant acts. Because of the social ramifications of charges of such behavior, the cases have generally held that threats of this type are illegal when in conjunction with demands for money.[55]

The decisions in these homosexual cases are flawed in the same way as the previous cases. Is it or is it not lawful to actually accuse someone of sodomy and other "unnatural" practices? It is lawful. If so, there is no crime, for, as we have seen, there is no reason to reject the view that what may be legally threatened also may legally be kept silent—for a fee.[56] Certainly, the "victim" is better off by having this option. With blackmail, he has a choice: to allow his secret to be told, or to pay up, and be spared the embarrassment.

The orthodox theory, upon which these cases are based, comes in for some sharp criticism. In the view of Professor C. R. Williams, relying on the belief of the perpetrator in the rightness of his act is entirely subjective in nature:

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Bernhard, [1938] 2 K.B. 264 (threats to tell wife and newspaper).

[52] *See, e.g.*, Rex v. Dymond [1920] 2 K.B. 260 (threats to bring charges against a mayor for allegedly placing his hands up a woman's clothes in a public park).

[53] *See, e.g.*, *Miard*, 1 Cox C.C. at 24 (jury instructed to determine whether the demand "was made at a time when the party making it really and honestly believed that she had good and probable cause for so doing"); *Dymond*, [1925] 2 K.B. at 265 ("It is for the jury to decide whether there was reasonable or probable cause for making the demand and it is not for them to decide whether the accused believed that she had reasonable or probable cause for making it.").

[54] *Dymond*, [1925] 2 K.B. 260.

[55] For a review of early cases finding such threats to be sufficient basis for conviction, see Winder, *supra* note 1, at 26.

[56] *See* Williams, *Blackmail* (pt. 1), *supra* note 5, at 80. *But see* Hogan, *Blackmail: Another View*, [1966] CRIM. L. REV. 474, 474 ("[A] demand against a threat to expose. . .sexual deviance [is] every bit as bad as a demand against a threat to do bodily harm.").

> The adoption of a wholly subjective test, making the accused's criminality depend upon his own view of the propriety of his actions, is a surprising departure from the approach taken in other offences contained in the Crimes (Theft) Act. It is a requirement of offences such as theft, obtaining property by deception and robbery, that the accused be shown to have acted "dishonestly." The standard to be taken for determining what constitutes dishonesty is objective. Whether the accused has acted dishonestly is a question to be determined by the jury, applying "the current standards of ordinary decent people." Thus a modern Robin Hood who asserted quite sincerely that he believed he was acting honestly in robbing from the rich to give to the poor would have no defence to a charge of theft or of robbery. This is because "ordinary decent people" do not believe it to be honest to rob from the rich to give to the poor. However, if Robin were to be charged with blackmail, it would seem that his beliefs would give him a defence. The subjective nature of the test is well illustrated by the case of *R. v. Lambert*. . . .
>
> The acquittal of the accused in *R. v. Lambert* because he subjectively believed he was entitled to demand money in such circumstances seems surprising and unsatisfactory. More extreme examples can easily be imagined. We live in times when members of terrorist organizations often act in the name of some higher morality which they assert, quite sincerely, justifies both their aims and any methods they choose to adopt to achieve those aims. If such people were to engage in activities which would, viewed objectively, be said to constitute blackmail, could their own beliefs, however, extreme, afford them a defence? One commentator has described the view that they could as "scarcely conceivable," yet such a result seems to follow with remorseless logic from the wording of the section. In his book, *The Law of Theft*, Professor J. C. Smith has suggested that such a result may be avoided by saying that a person can only believe he has reasonable grounds for making a demand when he believes that reasonable men would regard the grounds as reasonable. However attractive on policy grounds such a view may be, it is submitted that the words of the section are clear, and no objective requirement can be spelt out of them.[57]

The final set of cases that can be grouped under the rubric of victimless crimes involve demands for the repayment of debts arising out of gambling. And here, there is happily almost a unanimous belief in the proposition that one may threaten public posting, or other such negative publicity, in order to recover a gambling debt—without being held guilty of extortion.[58]

Any time the law treats demands accompanied by menaces and threats as noncriminal, that is an advance for the cause of liberty. But it will not do to make too much of this rare unanimity in celebration of the rights of free speech. These cases are only very limited support for the concept of legal black-

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[57] *See Demanding with Menaces*, *supra* note 1, at 142-43. *See also* MacKenna, *The Theft Bill-II, Blackmail: A Criticism*, [1966] CRIM. L. REV. 467, 468-69.

[58] *See generally* Campbell, *supra* note 6, at 388-96; *Demanding with Menaces*, *supra* note 1, at 129-30.

mail. The would-be blackmailer is hemmed in by a welter of restrictions: This threat must arise out of a "legitimate business interest" and might well not apply to "a casual bet made between two private persons."[59] No more than the amount actually owed may be demanded and he cannot make any threats other than posting. The blackmailer can only enforce debts owed to himself which arise out of a "merely void and not illegal transaction."[60] All in all, this is hardly a stirring victory for the forces of reason and justice to blackmailers.

### C. *Accusations of Real Crimes*

We now turn to blackmail attempts in which the "victim" is threatened with a charge of criminal behaviour. This is serious business because if the threat is carried out, the "victim" faces a potential term in prison, in some cases for many years. But there is no difference in principle between being threatened with exposure as a real criminal, and as a perpetrator of a victimless "crime." Acts such as sodomy carried stiff penalties, at least in bygone eras. And in the modern day, drug-related "criminals" can receive large fines and lengthy jail sentences.

Threatening to accuse someone of a crime is considered legitimate on all sides. We are analyzing rather the propriety of refraining from accusing someone of a crime for a fee. And this is an entirely different matter. It is certainly legal to threaten to accuse someone of a crime—provided it is not motivated by being paid off for one's silence. If the accused is actually guilty, then the accusor is considered a public benefactor, not an extortionist. But if the threat is made in order to elicit a payment from the guilty party, then the preponderance of legal opinion is that the accusor is indeed guilty of extortion.[61]

There is also some legal precedent and support for the view that one may threaten to prosecute for a crime, and offer the "victim" the option of paying him off for withdrawing without being considered guilty of menacing (extortion).[62] Most commentators have drawn a sharp distinction between the threat

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[59] *See* Campbell, *supra* note 6, at 394-95.

[60] *Id.* at 393.

[61] *Id.* at 388 ("[S]urely my liberty to inform the police that I know or suspect a crime to have been committed is a moral liberty—what is immoral, and what I have no liberty to do, is to sell or attempt to sell it for money."). *See, e.g.*, Regina v. Woodward, 88 Eng. Rep. 949, 949 (K.B. 1707) ("Every extortion is an actual trespass, and an action of trespass will lie against a man for frighting another out of his money."). *See* Comment, *Extortion-Collection of Debts by Threat of Criminal Prosecution*, 13 BAYLOR L. REV. 383, 388 (1961) ("The threat of a criminal prosecution though possibly a very efficient collection tool could be misused by the unscrupulous, for under the guise of the collection of a just debt such a threat could be used to fleece persons not owing debts who would rather pay than be troubled with the matter.").

[62] *See, e.g.*, State v. Burns, 161 Wash. 362, 297 P. 212 (1931) (demand can not exceed the

of a civil and a criminal suit. Although the mainstream opposition to the threat of criminal prosecution is very strong, most commentators advocate the legitimacy of a threat of civil suit for recovery of owed money.[63]

In our view, this distinction should have no legal relevance whatsoever. Since it is entirely legitimate to bring suit in civil court or to assist in the prosecution of a crime, it ought to be legal to threaten to do so. And if this be so, it ought to be lawful to offer the "victim" the option of payment for the dropping of a suit—of *either* type.[64]

Moreover, one cannot overlook the indirect effect of the blackmailer in reducing crime.[65] Not that it was ever necessarily any part of the intention of the blackmailer to play so public-spirited a role. But as Adam Smith concluded, it is "not from benevolence" that many economic actors accomplish beneficial, but unintended goals. And so it is with the blackmailer.

How does this work? Consider the following example:

> A writes to B saying "Pay me $100 or I will tell the police I saw you shoplifting." Assuming A saw B shoplifting he is not only legally entitled to inform the police, but he has a moral duty to do so. Nonetheless, A commits an offence because although the action threatened is justifiable the demand as an alternative to it is not.[66]

Let us assume that the effect, at least marginally, of declaring A's blackmailing behaviour criminal will be that he is less likely to engage in it. If so, there will be *less* pressure placed upon the real criminal, B, the shoplifter. A has two motives for opposing B: financial considerations (the blackmail) and public spiritedness (turning B over to the police purely for the emotional satisfaction of stopping crime). If blackmail were illegal, A might act against B out of public

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amount actually owed).

[63] *See* Winder, *supra* note 1, at 31 ("It was held to be no offence at common law to obtain money by means of a threat to bring a penal action and the *ratio decidendi* would apply also to a threat to prosecute for any crime.").

[64] *See Demanding with Menaces*, *supra* note 1, at 128:

> [T]he effect upon the recipient [of a threat of civil suit] would be much the same as a threat of criminal proceedings. In such a case what the victim generally fears most is public exposure of his improper conduct, and such exposure takes place equally in civil as in criminal proceedings.

*See also* Williams, *Blackmail* (pt. 2), *supra* note 13, at 166:

> It may also be pointed out that the distinction between threatening civil proceedings (which is allowable) and threatening criminal proceedings (which is not) is somewhat artificial when what the victim most dreads is exposure. Exposure follows as much from the bringing of civil proceedings as from the launching of a criminal prosecution.

[65] For the argument that blackmailers indirectly benefit society, see Nadelmann, *The Newspaper Privilege and Extortion by Abuse of Legal Process*, 54 COLUM. L. REV. 359, 360-61 (1962).

[66] *Demanding with Menaces*, *supra* note 1, at 127.

spiritedness, but presumably he would not blackmail B. If blackmail were legalized, however, there will arguably be *more* pressure placed upon the real criminal. While it is true that some of the formerly public-spirited might lose their sense of civic responsibility, and take up the profession of blackmail, this too would tend to reduce the activity of real criminals. It might be less effective in that the blackmailer might offer the criminal a "lighter sentence," i.e., an option preferable to incarceration. On the other hand it might be more effective in crime prevention if the blackmailers are more efficient at ferretting out such crimes.

The point is, the blackmailer is like a parasite on the criminal. In this case A preys on B. And the more he does so, the less shoplifting and other such crime there will be. The law of economic incentive applies to shoplifters as well as blackmailers.

## V. CONCLUSION

Let nothing said above be interpreted as affirming the propriety or morality of blackmail.[67] This practice has not been claimed to be ethical. The thesis of this article is merely that blackmail is not akin to theft, not an invasive act, nor threat thereof, nor an initiation of violence, nor a violation of rights—and that therefore it should not be prohibited through force of law.

Our present blackmail statutes do not protect the persons or property of the so-called victims of blackmail. Society would be better off, and human rights more secure, if our blackmail legislation were terminated.[68]

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[67] *See* ETHICS, *supra* note 7, at 127:

> When I first [articulated a] right to blackmail. . .I was met with a storm of abuse by critics who apparently believed that I was advocating the morality of blackmail. Again—a failure to make the crucial distinction between the legitimacy of a right and the morality or esthetics of exercising that right!

[68] For a reply to objections to the theory of blackmail defended above, see Block & Gordon, *Blackmail, Extortion and Free Speech: A Reply to Posner, Epstein, Nozick and Lindgren*, 19 LOY. L.A.L. REV. 37 (1985).

# Regulating Pornography Through Zoning: Can We "Clean Up" Honolulu?


I. INTRODUCTION ..... 76
II. CONSTITUTIONAL LIMITS ON REGULATING SEXUAL SPEECH ..... 80
A. First Amendment Protection ..... 80
B. Police Power Regulation ..... 88
1. Protecting Children from Sexually Explicit Material .. 89
2. Protecting the Quality of Life ..... 90
3. Deterring Crime, Excluding Undesirable Transients, and Protecting Property Values ..... 91
4. Protecting Children from Exploitation ..... 92
III. COMPETING PUBLIC CONCERNS ..... 94
A. Parental Rights ..... 94
B. Women's Rights ..... 96
C. Pornographers' and Civil Libertarians' Rights ..... 100
IV. ZONING ADULT BUSINESSES/THE COMPROMISE ..... 102
A. HISTORY ..... 104
1. *Young v. American Mini Theatres*: Zoning Adult Businesses ..... 104
a. Exclusionary Zoning Ordinances After *Young* .. 106
(1) Constitutional ..... 106
(2) Unconstitutional ..... 108
b. Restrictive Zoning Ordinances After *Young* .... 110
(1) Constitutional ..... 110
(2) Unconstitutional ..... 111
2. *Schad v. Borough of Mount Ephraim*: Limits to Zoning Adult Businesses ..... 112
a. Unconstitutional ..... 115
b. Constitutional ..... 118
3. *City of Renton v. Playtime Theatres, Inc.*: Zoning Nonexistent Adult Theaters ..... 121
B. Can Pornography Be Zoned in Honolulu? ..... 124
1. Honolulu's Attempts to Control Pornography ..... 124

2. A Proposal for Zoning ..... 126
a. The Ordinance ..... 126
b. The Governmental Interest ..... 128
c. The Factual Basis ..... 130
V. CONCLUSION ..... 131

## I. INTRODUCTION

Pornography,[1] an $8 billion dollar a year industry[2] sanctioned by the first amendment right to freedom of speech,[3] has recently become the focus of a growing national controversy.[4] Feminists, social conservatives, and parents[5] who

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[1] Although the words "pornography" and "obscenity" are often used interchangeably, for purposes of this comment, the two should be kept distinct. Pornography receives first amendment protection; obscenity does not. "Pornography" comes from the Greek word *pornographos*, meaning "writing of harlots." A more current definition is "a depiction (as in writing or painting) of licentiousness or lewdness." WEBSTER'S THIRD INT'L DICTIONARY 1767 (P. Gove ed. 1971). The feminist definition of pornography encompasses sexually explicit materials that connect physical abuse or degradation of women with men's or women's sexual pleasure. *See infra* notes 58-59. According to THE RANDOM HOUSE DICTIONARY 499 (1967), obscenity is defined as "offensive to modesty or decency, causing or intending to cause, sexual excitement or lust." *See infra* notes 30-34 and accompanying text for the definiton of obscenity set forth in Miller v. California, 413 U.S. 15, 24, *reh'g denied*, 414 U.S. 881 (1973).

According to F.B.I. agent Kenneth Lanning, the F.B.I.'s behavioral sciences unit comes in contact with three sorts of pornography: "commercial products available in most stores; commercial items available in so-called 'adult' bookstores and through the mail; and a kind of pornography . . .simply call[ed] 'homemade.' " The pornography in the F.B.I.'s collection has all been associated with sex crimes ranging from exhibitionism to multiple rape-murder. Stoltz, *Porn in the U.S.A.: The Attorney General's Commission on Pornography Goes Public—and on the Road—to Find Out the Difference Between Bad Taste and Bad Influence*, STUDENT LAW., Sept. 1985, at 40.

[2] Estimates of sales volume of legal pornography vary considerably. *See, e.g.*, Dworkin, *Against the Male Flood: Censorship, Pornography, and Equality*, 8 HARV. WOMEN'S L.J. 1, 10 (1985) ($8 billion per year); *The Place of Pornography*, (Panel Discussion), HARPER'S, Nov. 1984, at 31 ($7 billion per year). *See also* Comment, *Feminism, Pornography, and Law*, 133 U. PA. L. REV. 497, 515 n.101 (1985):

> The recent demand for pornographic home video cassettes alone has increased sales by several billion dollars. It is estimated that half of all video cassettes sold are pornographic. Serrin, *Sex Is A Growing Multibillion Dollar Business*, N.Y. Times, Feb. 9, 1981, at B6, col. 2. The New York Times estimated that total pornography sales in 1980 were $5,000,000,000, primarily generated by over 20,000 adult bookstores around the country. *See id.* at col. 1. More recent estimates put the total volume at $10,000,000,000 for 1983. *See* Smith, *All-American Sex*, Phila. Inquirer, Jan. 15, 1984 (Magazine), at 18, col. 1.

[3] "Congress shall make no law respecting an establishment of religion, or prohibiting the free exercise thereof; or abridging the freedom of speech, or of the press; or the right of the people peaceably to assemble, and to petition the Government for a redress of grievances." U.S. CONST. amend. I.

[4] *See infra* notes 5-21 and accompanying text.

are convinced that pornography is undeserving of first amendment protection,[6] have campaigned vigorously for ordinances that would effect a virtual ban on pornography.[7] In addition to anti-pornography legislation, state and local governments have responded to public sentiment with stricter enforcement of already existing obscenity laws[8] or more ingenious application of antipandering laws.[9] The federal government has also become involved[10]—Attorney General

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[6] One major argument against pornography is that it contributes to sex crimes. For feminist views regarding pornography and sex crimes, see *infra* notes 129-48 and accompanying text. The F.B.I. has a collection of pornographic material that it has connected with sex crimes ranging from exhibitionism to multiple rape-murder. *See* Stoltz, *supra* note 1, at 40. According to Honolulu, Hawaii's City Prosecutor, Charles Marsland, " 'all pornography, even soft-core pornography,' contributes to sex crimes." Ryan, *Marsland Denounces Pornography as Leading to Sex Crimes*, Honolulu Star-Bull., June 5, 1985, at A8, col. 1.

[7] Professor Frederick Schauer, a leading free speech scholar, advocates the view that first amendment principles should not protect hardcore pornography. The protection of tangential first amendment concerns (such as hardcore pornography and commercial speech) only dilutes the first amendment's protection of political speech. *Watching Your Language*, LAW QUADRANGLE NOTES, Fall 1984, at 6, 8.

[8] *See infra* notes 56-70 and accompanying text.

[9] In Honolulu, for example, the City Prosecutor's Office sent letters to movie rental centers threatening to close shops dealing in pornographic materials. This crackdown on pornographic businesses came after a circuit court jury, on April 16, 1985, convicted a 71-year-old woman of selling a sexually explicit magazine. Memminger, *Adult Videos Go Under the Counter*, Honolulu Star-Bull., June 11, 1985, at A3, col. 1. *See infra* notes 16-17 and accompanying text. Since the City Prosecutor's warning, arrests for exhibition, sales, and rentals of allegedly obscene movies and videos have continued. A man was sentenced to 15 days in jail and fined $500 for selling a videotape entitled "The Erotic World of Angel Cash" to an undercover police officer. *Harshest Sentence Yet Imposed in Porn Crackdown*, Honolulu Advertiser, Nov. 6, 1985, at A4, col. 5. Honolulu's third obscenity conviction by a jury was returned against a woman who sold a sexually explicit magazine to an undercover police officer. *Porn Conviction in Wahiawa Case*, Honolulu Advertiser, Oct. 12, 1985, at A5, col. 1. Next, the owner of Queen Theater in Honolulu was arrested for promoting pornography and his movies were confiscated. After the owner agreed to stop exhibiting the films altogether, charges against him were dropped and all of his allegedly obscene movies were burned. Catterall, *ACLU Burns U.S. Constitution to Protest Marsland Policies*, Honolulu Star-Bull., Dec. 23, 1985, at A3, col. 1. Subsequently, a 22-year old sales clerk at a store whose merchandise was not predominantly sexual in nature, was arrested for renting a videotape entitled "Boys of Venice" depicting explicit male homosexual acts. The same day, a clerk at another video outlet was arrested on charges of renting a film entitled "Delivery in the Rear" to an undercover police officer. Wright, *Adult Videos Pulled Off Shelves But Owners Vow to Fight 'Scare' Tactics*, Honolulu Advertiser, Jan. 10, 1986, at A1, col. 1. Some state legislators view the crackdown on obscenity as "harrassment" by the police and prosecutors. They would like to change Hawaii's obscenity law "to allow adults to rent or buy for home use tapes that depict acts between adults." Dingeman, *Legislators Seek Change to State Pornography Law*, Honolulu Star-Bull., Jan. 17, 1986, at A1, col. 1. Other legislators feel that any liberalization of Hawaii's current obscenity law would show disrespect for women and would encourage rape and sexual assaults. *Id.*

[10] Antipandering laws make it illegal to procure clients for prostitution. Los Angeles police

Edwin Meese III appointed an eleven-member panel[11] to "determine the nature, extent and impact on society of pornography in the United States."[12] In opposition to this anti-smut fervor are the opinions of those in the pornography business[13] and the views and warnings from civil libertarians who believe regulating the content of speech will erode first amendment rights.[14]

Honolulu recently joined the national controversy over the effect of pornography.[15] After a jury of nine women and three men convicted a 71-year-old woman for promoting obscenity by selling a sexually explicit Swedish magazine,[16] the City Prosecutor began an anti-pornography crackdown aimed at video

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recently arrested Harold Freeman, a pornography filmmaker, on pandering charges for hiring a woman to perform sex acts in front of his cameras. His conviction by a jury for soliciting clients for prostitution, sent a warning to Los Angeles's porn-flick industry. "We concluded the acting was secondary," said a juror. "The girls were hired for sex." *A Novel Crackdown on Porn Films in L.A.*, NEWSWEEK, June 3, 1985, at 61. Freeman's attorney argues that the antipandering law is unconstitutionally broad, reaching "everyone from Bo Derek to Masters and Johnson." Los Angeles Police Department Lieutenant Dennis Conte does not agree: "Simulating sex is not against the law, but paying for actual sex is." *Id.*

[10] Fifteen years ago, a commission appointed by President Nixon found no direct link between pornography and sexual exploitation and crime. THE REPORT OF THE COMMISSION ON OBSCENITY AND PORNOGRAPHY (1970). *See infra* notes 173-76 and accompanying text. Since then, according to Attorney General Edwin Meese III, pornography has become more graphic, violent, and accessible. Stolz, *supra* note 1, at 41.

[11] The Attorney General's Commission on Pornography was created when President Reagan signed the Child Protection Act of 1984. The Panel consists of seven men and four women, including four attorneys, one judge, two academic doctors, two social service professionals specializing in child abuse, one medical doctor, one vice-mayor, one Franciscan priest, and the editor-in-chief of WOMAN'S DAY. Stoltz, *supra* note 1, at 41.

[12] *Id.* at 40.

[13] *See infra* notes 167-72 and accompanying text.

[14] *See infra* notes 162-66 and accompanying text. In response to the possibility that the Attorney General's Commission on Pornography might lead to further restrict pornography, Barry Lynn, legislative counsel for the American Civil Liberties Union observed:

> The terrible thing about governmental interest in regulating content of speech. . .is that it quickly becomes an unstoppable impulse. It is not simply that no lines can ever be drawn in regard to speech, but that as a matter of policy, they should not be drawn. It is unwise to draw the first one because there are always two hundred people with magic markers behind you ready to draw the next one.

Stoltz, *supra* note 1, at 40.

[15] *See infra* notes 16-21 and accompanying text.

[16] Kobayashi, *Jury Finds Magazine Pornographic*, Honolulu Advertiser, Apr. 17, 1985, at A3, col. 2. Although the jury convicted Mrs. Omiyo for selling an obscene magazine to an undercover police officer, the store where the magazine was sold has remained open. The proprietor, Mr. Moore, has simply changed the way he does business. "Customers must be from out of state and be able to prove it. . . .[E]mployees make sure that Japanese customers, who make up most of his clientele, speak 'Tokyo' Japanese and are not Honolulu police posing as Japanese tourists." Memminger, *Porno Case Verdict to Generate New Arrests*, Honolulu Star-Bull., Apr. 18, 1985, at A1, col. 1.

movie centers.[17] Supporting the City Prosecutor's efforts, the Oahu Citizens for Decency, a fledgling group whose goal is to eliminate pornography,[18] has held public rallies and organized tours of Honolulu sex shops to educate the community on its position that pornography causes "crime, disease, and antisocial behavior."[19] The owners of adult boutiques, whose businesses have fallen off considerably,[20] argue that access to their type of walk-in entertainment keeps rapists and killers off the streets.[21]

In light of the charged atmosphere surrounding the issue of pornography, regulation of adult businesses that protects the public health, safety, and welfare and squares with the first amendment may be in order. Fortunately, the United States Supreme Court has laid down guidelines through which content-based regulation can be achieved.[22] Zoning adult businesses has been accepted by the Court as a method for pornography control as long as its impact on constitutionally protected expression is incidental.[23] Zoning could be a compromise so-

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[17] Ryan, *Marsland Denounces Pornography as Leading to Sex Crimes*, Honolulu Star-Bull., June 5, 1985, at A8, col. 1. *See supra* note 8. Anyone who owns a VCR can rent for home use an X-rated movie from a video outlet for as little as 48 cents a day. As a result, there is less interest in sitting in a "sleazy" theater and pornography theaters nationwide are closing down at the rate of approximately 15 a month. Shearer, *X-Rated Movie Houses in Decline*, PARADE MAGAZINE, July 25, 1985, at 14.

[18] Oahu Citizens For Decency hope to eliminate "pornography" by establishing local community standards that prohibit pornography. The group's purpose is "to demand and assist enforcement of obscenity laws so that. . .legal determinations can be properly made by local judges and juries." Wright, *Anti-Pornography Group Takes a Direct Look at Sex Industry*, Honolulu Advertiser, July 24, 1985, at A4, col. 3. In Hawaii, obscenity is partially defined as material that the average person, applying contemporary community standards, would find, taken as a whole, appeals to the prurient interest. Specifically, HAWAII REV. STAT. § 712-1210(6) (Supp. 1984) provides:

> (6) "Pornographic." Any material or performance is "pornographic" if 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.

[19] Wright, *Anti-Pornography Group Takes a Direct Look at Sex Industry*, Honolulu Advertiser, July 24, 1985, at A4, col. 3. During a recent tour of Hotel Street, ten members of Oahu Citizens for Decency stopped at three area sex shops. One shop "featured a gay movie theater upstairs where, for $6, a customer [could] visit any one of three movie rooms, take a shower, and use one of a series of private, lockable rooms furnished only with a rough bed upholstered in plastic." *Id.*

[20] A manager of a Honolulu video business with eight locations said that although she is renting adult films again, she lost one-third of her business when she was forced, out of a fear of being closed down, to remove sex films from her shelves. Memminger, *Adult Videos Go Under the Counter*, Honolulu Star-Bull., June 11, 1985, at A3, col. 1.

[21] Wright, *Anti-Pornography Group Takes a Direct Look at Sex Industry*, Honolulu Advertiser, July 24, 1985, at A4, col. 3.

[22] *See infra* notes 77-108 and accompanying text.

[23] *See* Young v. American Mini Theatres, Inc., 427 U.S. 50, 78 (1976) (Powell, J., concur-

lution if courts accept, in addition to traditional justifications for zoning pornography, parental and feminist content-based concerns regarding pornography's injurious impact on all of society. A zoning ordinance enacted after a full hearing, which includes testimony from parents, feminists, and civil libertarians, expressing their respective views, should address all community concerns. The Court's acknowledgement of the validity of content-based pornography regulation would simplify enacting zoning ordinances and would result in a stronger, more honest basis for zoning.

It is the purpose of this comment to explore the possibility of zoning adult businesses, as a compromise between anti-pornography and anti-censorship groups, consistent with first amendment values and permissible content-based regulations. Part II of this comment examines the tension between protecting first amendment values and protecting the community from the deleterious effects of various types of obscenity and pornography. Part III presents the competing public concerns that pornography has recently generated. Part IV suggests zoning pornography as a compromise, with an analysis of various successful and unsuccessful attempts to zone sex-oriented businesses in the United States.[24] This comment concludes with (1) an examination of past attempts to zone pornography in Honolulu and (2) a proposed plan for zoning adult entertainment consistent with case law in other jurisdictions, with emerging evidence of pornography's harm, and with the current political and economic climate in Hawaii. The zoning proposal addresses Honolulu's particular interests in preserving the quality of tourism and ensuring the safety of children. It is structured as a means of coalescing the major analysis which follows and is intended primarily to facilitate further discussion.

## II. Constitutional Limits on Regulating Sexual Speech

### A. *First Amendment Protection*

Among the values protected by the first amendment are the right to express and disseminate ideas,[25] and the right to privacy.[26] These values have been

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ring); Schad v. Borough of Mount Ephraim, 452 U.S. 61, 71 n.10 (1981). For in depth discussion of *Young*, see *infra* notes 94-101 and accompanying text. For an analysis of *Schad*, see *infra* notes 266-77 and accompanying text.

[24] This comment will focus on zoning adult businesses sanctioned in Young v. American Mini Theatres, Inc., 427 U.S. 50 (1976).

[25] *See* Kingsley Int'l Pictures Corp. v. Regents of the Univ. of New York, 360 U.S. 684 (1959); Cohen v. California, 403 U.S. 15, *reh'g denied*, 404 U.S. 876 (1971), *infra* notes 36-46 and accompanying text. This includes the right to receive information and ideas. *See* Martin v. City of Struthers, 319 U.S. 141, 143 (1943); Griswold v. Connecticut, 381 U.S. 479, 482 (1965); Lamont v. Postmaster Gen., 381 U.S. 301, 307-08 (1965) (Brennan, J., concurring).

guarded closely to assure representative government,[27] to advance knowledge and promote truth,[28] and to preserve individual autonomy.[29]

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This right to receive information and ideas does not depend on their social worth. *See* Winters v. New York, 333 U.S. 507, 510 (1948).

[26] A person has a limited right to view pornography in his home. *See* Stanley v. Georgia, 394 U.S. 557 (1969), *infra* notes 51-53 and accompanying text. *See also* Rowan v. Post Office Dep't, 397 U.S. 728 (1970) (person who has received a pandering advertisement for sexually provocative material through the mail may request the Postmaster General to order the sender to refrain from further mailings to the complainant). The right to privacy also extends to personal matters of childbearing, Roe v. Wade, 410 U.S. 113, *reh'g denied*, 410 U.S. 959 (1973); family living arrangements, Moore v. City of Cleveland, 431 U.S. 494 (1977); marriage, Zablocki v. Redhail, 434 U.S. 374 (1978); Griswold v. Connecticut, 381 U.S. 479 (1965); motherhood, procreation, Carey v. Population Servs. Int'l, 431 U.S. 648 (1977); Eisenstadt v. Baird, 405 U.S. 438 (1972); and child-rearing, Prince v. Massachusetts, 321 U.S. 158, *reh'g denied*, 321 U.S. 804 (1944); Pierce v. Society of Sisters, 268 U.S. 510 (1925); Meyer v. Nebraska, 262 U.S. 390 (1923).

[27] P. BREST & S. LEVINSON, PROCESSES OF CONSTITUTIONAL DECISIONMAKING 1092 (2d ed. 1983). Writing for the Court in Mills v. Alabama, 384 U.S. 214 (1966), Justice Black said:

> Whatever differences may exist about interpretations of the First Amendment, there is practically universal agreement that a major purpose of that Amendment was to protect the free discussion of governmental affairs. This of course includes discussions of candidates, structures and forms of government, the manner in which government is operated or should be operated, and all such matters relating to political processes. . . .Thus the press serves and was designed to serve as a powerful antidote to any abuses of power by governmental officials and as a constitutionally chosen means for keeping officials elected by the people responsible to all of the people whom they were selected to serve.

384 U.S. at 218-19.

A purpose of the first amendment related to protecting representative government is protecting participation in civil life. "[M]an in his capacity as a member of society has a right to share in the common decisions that affect him." T. EMERSON, THE SYSTEM OF FREEDOM OF EXPRESSION 6 (1970).

[28] P. BREST & S. LEVINSON, *supra* note 27, at 1092-94. Writing a separate opinion in Whitney v. California, 274 U.S. 357 (1927), Justice Brandeis asserted that "freedom to think as you will and to speak as you think are means indispensable to the discovery and spread of political truth." *Id.* at 375. Justice Holmes' dissent in Abrams v. United States, 250 U.S. 616 (1919) was similar:

> Persecution for the expression of opinions seems to me perfectly logical. If you have no doubt of your premises or your power and want a certain result with all your heart you naturally express your wishes in law and sweep away all opposition. . . .But when men have realized that time has upset many fighting faiths, they may come to believe even more than they believe the very foundations of their own conduct that the ultimate good desired is better reached by free trade in ideas—that the best test of truth is the power of the thought to get itself accepted in the competition of the market, and that truth is the only ground upon which their wishes safely can be carried out.

250 U.S. at 630.

[29] P. BREST & S. LEVINSON, *supra* note 27, 1094-96. Commentators have stressed the value of individual liberty, autonomy, or self-fulfillment. For example, Professor David A. J. Richards wrote:

First amendment protection does not shelter all forms of speech, however. In 1957, obscene speech, with its capacity to sexually arouse or offend its audience, was denied protection in *Roth v. United States*.[30] The *Roth* test for obscenity was "whether to the average person, applying contemporary community standards, the dominant theme of the material taken as a whole appeals to the prurient interest."[31] In a subsequent decision, the Court refined its test, restricting the classification of obscenity to that which is "patently offensive" and "utterly without redeeming value."[32] Later, the test was replaced with the current standard announced in *Miller v. California*.[33] Under the *Miller* three-pronged test for obscenity, the trier of fact must determine:

> (a) whether "the average person, applying contemporary community standards" would find that the work, taken as a whole, appeals to the prurient interest, (citations omitted); (b) whether the work depicts or describes, in a patently offensive way, sexual conduct specifically defined by the applicable state law; and (c) whether the work, taken as a whole, lacks serious literary, artistic, political, or scientific value.[34]

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> [P]eople are not to be constrained to communicate or not to communicate, to believe or not to believe, to associate or not to associate. The value placed on this cluster of ideas derives from the notion of self-respect that comes from a mature person's full and untrammelled exercise of capacities central to human rationality. Thus, the significance of free expression rests on the central human capacity to create and express symbolic systems, such as speech, writing, pictures, and music, intended to communicate in determinate, complex and subtle ways. Freedom of expression permits and encourages the exercise of these capacities: it supports a mature individual's sovereign autonomy in deciding how to communicate with others; it disfavors restrictions on communication imposed for the sake of the distorting rigidities of the orthodox and the established. In so doing, it nurtures and sustains the self-respect of the mature person.

Richards, *Free Speech and Obscenity Law: Toward a Moral Theory of the First Amendment*, 123 U. PA. L. REV. 45, 62 (1974). *See also* Emerson, *Towards a General Theory of the First Amendment*, 72 YALE L.J. 877, 879-81 (1963); Baker, *Scope of the First Amendment Freedom of Speech*, 25 UCLA L. REV. 964, 990-1005 (1978).

[30] 354 U.S. 476 (1957). Writing for the Court in *Roth*, Justice Brennan declared obscenity a class of speech, "utterly without redeeming social importance," that both historically and functionally was not within the sphere of first amendment protection. *Id.* at 484-85.

[31] *Id.* at 489.

[32] In Memoirs v. Massachusetts, 383 U.S. 413 (1966), the *Roth* standard was refined to include two new elements in addition to "prurient interest." 354 U.S. at 489. Under the *Memoirs* test, obscene material also had to be both "patently offensive because it affronts contemporary community standards relating to the description or representation of sexual matters" and "utterly without redeeming social value." 383 U.S. at 418.

[33] 413 U.S. 15, *reh'g denied*, 414 U.S. 881 (1973).

[34] *Id.* at 24. The majority also felt that:

> To require a state to structure obscenity proceedings around evidence of a *national* "community standard would be an exercise in futility". . . .
>
> . . . .

Once obscene speech was left constitutionally unprotected, other first amendment values in allegedly "offensive" sexual contexts were challenged.[35] Challenges to the right to privacy and the right to freedom of expression, however, were unsuccessful.

For example, the Court held that the first amendment guarantees the right to espouse views that conflict with the public's conception of virtuous conduct. In *Kingsley Corp. v. Regents of the University of New York*,[36] the United States Supreme Court dealt with an attempt to prevent the exhibition of "Lady Chatterley's Lover." The state argued that the attractive portrayal of adultery, a sexual theme, was "contrary to the moral standards, the religious precepts, and the legal code of its citizenry."[37] The Court declared, however, that although a state may have an interest in preventing moral corruption, it cannot prohibit the advocacy of a change in moral standards. The first amendment, the Court maintained, guarantees the freedom to express ideas that are not "conventional or shared by a majority."[38]

The right to offensive, political criticism was tested in *Cohen v. California*.[39] Cohen was convicted for "maliciously and willfully disturbing the peace"[40] when he wore a jacket bearing the words "Fuck the Draft" in the corridor of a Los Angeles courthouse.[41] In Justice Harlan's majority opinion, the Court declared that Cohen's expression was not obscene and was therefore protected by the first amendment:[42]

> Whatever else may be necessary to give rise to the State's broader power to prohibit obscene expression, such expression must be, in some way, erotic. It cannot plausibly be maintained that this vulgar allusion to the Selective Service System would conjure up such psychic stimulation in anyone likely to be confronted with Cohen's crudely defaced jacket.[43]

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. . .[a]s it would be "neither realistic nor constitutionally sound to read the First Amendment as requiring that the people of Maine or Mississippi accept public depiction of conduct found tolerable in Las Vegas, or New York City."

*Id.* at 30-32.

[35] *See infra* notes 36-70 and accompanying text.

[36] 360 U.S. 684 (1959).

[37] *Id.* at 688.

[38] *Id.* at 689.

[39] 403 U.S. 15, *reh'g denied*, 404 U.S. 876 (1971).

[40] 403 U.S. at 16.

[41] *Id.* California argued that this was an inappropriate setting for such speech because the statute under which Cohen was convicted sought to preserve an "appropriately decorous atmosphere in the courthouse." *Id.* at 19.

[42] *Id.* at 20.

[43] *Id.* The Court also found that Cohen's three words, directed at no one in particular, could not be banned as "fighting words," as there was no evidence that they had provoked a violent reaction on anyone's part. *Id. See* Chaplinsky v. New Hampshire, 315 U.S. 568 (1942) (spoken

Reiterating the general rule that governmental bodies cannot prescribe the form and content of individual expression,[44] the Court stated that in the area of public debate, matters of taste and style should be left to the individual.[45] Particularly concerned that governments might seize upon the censorship of certain words as a convenient method for banning the expression of unpopular views, the Court overturned Cohen's conviction.[46]

The first amendment also protects the right to depict scenes of occasional nudity where, without the camera focused on the actors' bodies, there is an understanding that sexual conduct is taking place. In *Jenkins v. Georgia*,[47] the exhibition of a woman's bare midriff was challenged as legally obscene, undeserving of first amendment protection. A local jury had convicted the manager of a theater for exhibiting the movie "Carnal Knowledge." Applying local community standards they determined that the film appealed to the prurient interest and was patently offensive.[48] The Supreme Court unanimously reversed the lower court decision. Exposure of a naked midriff, the Court said, was not the kind of hard-core conduct *Miller v. California* had intended to reach.[49] Nudity without more, the Court held, was insufficient to make the film legally obscene.[50]

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words that are likely to provoke the average person to retaliation, thereby causing a breach of the peace, are not protected by the first amendment). Unwilling or unsuspecting viewers, the Court suggested, could avoid "further bombardment of their sensibilities simply by averting their eyes." 403 U.S. at 21.

[44] 403 U.S. at 24. There are various established exceptions to the general rule. The exceptions to regulating form and content examined in *Cohen* were: obscenity; fighting words; words intentionally provoking a group to hostile reaction, *see* Feiner v. New York, 340 U.S. 315 (1951); Terminiello v. Chicago, 337 U.S. 1, *reh'g denied*, 337 U.S. 934 (1949); and words thrust upon unwilling or unsuspecting viewers. 403 U.S. at 19-20.

[45] 403 U.S. at 25. The Court declared that:

> [T]he State has no right to cleanse public debate to the point where it is grammatically palatable to the most squeamish among us. . . . For, while the particular four-letter word being litigated here is perhaps more distasteful than most others of its genre, it is nevertheless often true that one man's vulgarity is another's lyric. Indeed, we think it is largely because governmental officials cannot make principled distinctions in this area that the Constitution leaves matters of taste and style so largely to the individual.

*Id.*

[46] *Id.* at 26.

[47] 418 U.S. 153 (1974).

[48] These were criteria established in *Miller*, 413 U.S. at 24. *See supra* note 34 and accompanying text.

[49] *Miller* provided two examples of what the Court would consider to be obscene: "(a) Patently offensive representations or descriptions of ultimate sexual acts, normal or perverted, actual or simulated. (b) Patently offensive representations or descriptions of masturbation, excretory functions, and lewd exhibition of the genitals." *Id.* at 25.

[50] 418 U.S. at 161. The Court has also determined that nude, nonobscene dancing is protected expression. *See* Schad v. Borough of Mount Ephraim, 452 U.S. 61, 66 (1981), *infra* at

Once obscenity finds its way into the sanctuary of the home, it is there protected by the right to privacy.[51] In *Stanley v. Georgia*,[52] the Court overturned a conviction for possession of obscene material in favor of protecting the individual right to personal autonomy and privacy. Writing for the Court, Justice Marshall concluded:

> If the First Amendment means anything, it means that a state has no business telling a man, sitting alone in his house, what books he may read or what films he may watch. Our whole constitutional heritage rebels at the thought of giving government the power to control men's minds.[53]

In a context of what is perceived by some to be obscene,[54] the first amendment has prevailed, protecting nudity, and immoral, unpopular, and private views.[55]

Recent legislation declaring pornography a discriminatory practice has attempted to effectively outlaw the first amendment right to produce, sell, or distribute such material. In *American Booksellers Association v. Hudnut*,[56] the Indianapolis City-County Council enacted an ordinance, drafted by feminists, which sought to deal with the problems of pornography and sex discrimination "by limiting the availability of materials that depict the sexually explicit subordination of women."[57] The ordinance defined pornography as the "graphic sex-

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notes 264-77 and accompanying text. *See also* Doran v. Salem Inn, Inc., 422 U.S. 922 (1975) (ordinance prohibiting topless dancing overbroad); Southeastern Promotions, Ltd. v. Conrad, 420 U.S. 546 (1975) (prior restraint placed on performance of rock musical "Hair" unconstitutional where municipality's action was based solely on reports of others as to musical's alleged obscenity); California v. La Rue, 409 U.S. 109 (1972), *reh'g denied*, 410 U.S. 948 (1973), *infra* note 367 (under twenty-first amendment, state may prohibit lewdness and naked entertainment where liquor is served). *But c.f.* International Food & Bev. Sys. v. City of Ft. Lauderdale, 614 F. Supp. 1517 (S.D. Fla. 1985) (ordinance prohibiting establishments serving alcohol and permitting nudity from locating within 750 feet of like establishments or of residences, churches, public parks, or playgrounds violated first amendment rights of the operator and the public).

[51] Stanley v. Georgia, 394 U.S. 557, 568 (1969).

[52] 394 U.S. 557 (1969).

[53] *Id.* at 565.

[54] There has been a great difference of opinion among the Supreme Court justices over whether, in a society governed by the first amendment, a law of obscenity can even exist. *See, e.g.*, Roth v. United States, 354 U.S. at 508-14 (Douglas, J., dissenting); Miller v. California, 413 U.S. at 42-43 (Douglas, J., dissenting); Paris Adult Theatre I v. Slaton, 413 U.S. 49, 73 (1973) (Brennan, J., dissenting).

[55] *See supra* notes 36-53 and accompanying text.

[56] 598 F. Supp. 1316 (S.D. Ind. 1984), *aff'd*, 771 F.2d 323 (7th Cir. 1985), *aff'd*, 54 U.S.L.W. 3548 (U.S. Feb. 25, 1986).

[57] The feminist conception of pornography includes sexually explicit material that associates physical abuse or degradation of women with men's or women's sexual pleasure. *See also* Note, *Anti-Pornography Laws and First Amendment Values*, 98 HARV. L. REV. 460, 460 n.3 (1984).

ually explicit subordination of women, whether in pictures or in words,"[58] which violates women's right to be free from sex-based discrimination, and prevents sexual equality.[59] The ordinance, which was signed into law by Indianapolis's mayor,[60] outlawed "trafficking in pornography," "coercion into a

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[58] 598 F. Supp. at 1320. Specifically, the Indianapolis, Ind., Ordinance 35 (Apr. 23, 1984) defined "pornography" as follows:

> (q) Pornography shall mean the graphic sexually explicit subordination of women, whether in pictures or in words, that also includes one or more of the following:
>
> (1) Women are presented as sexual objects who enjoy pain or humiliation; or
>
> (2) Women are presented as sexual objects who experience sexual pleasure in being raped; or
>
> (3) Women are presented as sexual objects tied up or cut up or mutilated or bruised or physically hurt, or as dismembered or truncated or fragmented or severed into body parts; or
>
> (4) Women are presented being penetrated by objects or animals; or
>
> (5) Women are presented in scenarios of degradation, injury, abusement, torture, shown as filthy or inferior, bleeding, bruised, or hurt in a context that makes these conditions sexual; and
>
> (6) Women are presented as sexual objects for domination, conquest, violation, exploitation, possession, or use, or through postures or positions of servility or submission or display.
>
> The use of men, children, or transsexuals in the place of women in paragraphs (1) through (6) above shall also constitute pornography under this section.

*Id.*

[59] *Id.* at 1320. Specifically, the Indianapolis, Ind., Ordinance 35 (Apr. 23, 1984) described pornography as:

> [A] discriminatory practice based on sex which denies women equal opportunities in society. Pornography is central in creating and maintaining sex as a basis for discrimination. Pornography is a systematic practice of exploitation and subordination based on sex which differentially harms women. The bigotry and contempt it promotes, with the acts of aggression it fosters, harm women's opportunities for equality of rights in employment, education, access to and use of public accommodations, and acquisition of real property; promote rape, battery, child abuse, kidnapping and prostitution and inhibit unjust enforcement of laws against such acts; and contribute significantly to restricting women in particular from full exercise of citizenship and participation in public life, including in neighborhoods.

*Id.*

[60] A similar ordinance to the one in *Hudnut* was first introduced in Minneapolis but was vetoed by the city's mayor on the ground that it violated the first amendment. *See A Court Test for Porn*, NEWSWEEK, Aug. 13, 1984, at 40. Since then, the ordinance has lost substance at every turn. According to feminists, by the time the ordinance got to Indianapolis, the definition of pornography had been narrowed to concentrate on *violent* pornography. Unhappy feminists derisively labeled this change "The *Playboy* Exemption" because it "arguably excluded actions against 'soft-core' porn." Blakely, *Is One Woman's Sexuality Another Woman's Pornography?*, MS., Apr. 1985, at 37, 44. A similar ordinance emerged in Suffolk County, New York where right-wing groups changed both the wording and the intent. The Suffolk County bill, which "sought a ban on all pictures that degrade women in magazines and movies," was narrowly defeated by a 9-8

pornographic performance," and "forcing pornography on a person," as a form of sexual discrimination against women.[61] Various booksellers brought suit, alleging that the antipornography ordinance unconstitutionally regulated protected speech.[62] Despite the attempt in the ordinance to redefine offensive speech as harmful action,[63] the Indiana district court held that the wording of the ordinance sought to regulate or prohibit speech, not conduct.[64] Further, as the ordinance went beyond legally obscene material[65] in imposing its controls, and could not be justifed by any other well-defined exception for regulating speech,[66] it suppressed protected speech.[67] The state's interest in prohibiting

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vote of the Suffolk County Legislature. *Smut: Laws Aren't the Solution to Ridding It From Our Midst*, Syracuse Herald-J., Dec. 29, 1984, at A6, col. 1. According to Professor Catharine MacKinnon, who co-authored the Minneapolis ordinance, the New York version "was not merely truncated—it was lobotomized." Blakely, *supra* at 44-45.

[61] *Id.* at 1320-21. The ordinance introduced in Minneapolis would have permitted women to sue distributors of pornographic books, magazines or movies for damages. Quade, *Smut Furor*, 70 A.B.A. J. 42 (1984). The proposed bill in Suffolk County would have allowed "residents to sue the makers or sellers of material that met any three of nine standards on a list that included violent portrayals such as rape, the depiction of women as dehumanized sexual objects, as prostitutes or in postures of sexual submission." *Smut: Laws Aren't the Solution to Ridding It From Our Midst*, *supra* note 60.

[62] 598 F. Supp. at 1327-28. Plaintiffs claimed that the ordinance prohibited protected speech, sought to violate Supreme Court precedents that precluded the banning of speech because its content was socially or politically offensive to a majority, and failed to provide fair notice as to what was covered and what was exempt. *Id.*

[63] *See supra* note 59 and accompanying text.

[64] 598 F. Supp. at 1330-31.

[65] *Id.* at 1331-32. The obscenity standard applied was the three-pronged test established in Miller v. California, 413 U.S. 15, *reh'g denied*, 414 U.S. 881 (1973). *See supra* notes 33-34 and accompanying text.

[66] In an effort to support their contention that *Miller* was not controlling, defendants pointed out that the Supreme Court did not use the traditional obscenity test in Federal Communications Comm'n v. Pacifica Found., 438 U.S. 726, *reh'g denied*, 439 U.S. 883 (1978), where broadcast speech dealing with sex and excrement was regulated because of its pervasive, intrusive character, and its accessibility to young children. 598 F. Supp. at 1334. *See infra* notes 80-85 and accompanying text. The court determined, however, that the Indianapolis ordinance was distinguishable. Pornography, as defined in the ordinance, was not being disseminated over the airwaves, bombarding unwilling listeners; an individual offended by the pornography had the option of avoiding it. 598 F. Supp. at 1334. Additionally, as the ordinance was not written specifically to protect children from the distribution of pornography, the state interest in protecting the well-being of its youth could not be used as an underlying justification. 598 F. Supp. at 1333-34. *See* Ginsberg v. New York, 390 U.S. 629, *reh'g denied*, 391 U.S. 971 (1968), *infra* at notes 77-79 and accompanying text.

In support of their proposition that the traditional obscenity standard in *Miller* should not be used, defendants also attempted to use Young v. American Mini Theatres, Inc., 427 U.S. 50 (1976). *See infra* notes 91-101 and accompanying text, where adult businesses were zoned on the basis of content without resort to the *Miller* obscenity standard. 598 F. Supp. at 1334-35. In distinguishing this ordinance from the one in *Young*, the court held that this ordinance was not

sex-discrimination, the court held, was not so compelling as to outweigh the interest in free speech.[68] Furthermore, the court found that the ordinance was unconstitutionally vague,[69] and called for an unlawful prior restraint.[70]

Material that is not legally obscene, but which women's rights advocates claim dehumanizes and directly harms them,[71] has survived constitutional challenge. The district court acknowledged, however, the importance of the concerns expressed in the Indianapolis ordinance, that pornography and sex-discrimination are harmful, offensive, and inimical to an enlightened approach to equality.[72] These concerns should be addressed through the state's power to regulate on behalf of the health, safety, and welfare of its citizenry.

### *B. Police Power Regulation*

In the past, state and local governments, under the aegis of police power, have been able to regulate obscenity and certain types of pornography to protect the health, safety and welfare of individuals.[73] Since the first amendment pro-

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an attempt to "restrict the time, place and manner in which 'pornography' may be distributed. Instead, [it] prohibits completely the sale, distribution, or exhibition of material depicting women in a sexually subordinate role, at all times, in all places and in every manner." *Id.*

[67] *Id.* at 1335.

[68] *Id.* at 1333-34. The defendants argued that the state's interest in protecting women from sexual exploitation was analogous to the interest in protecting children from being used as pornographic models, *id.*, an interest recognized in Ferber v. New York, 458 U.S. 747 (1982). *See infra* notes 102-08 and accompanying text. The court found that adult women generally have the capacity to protect themselves from participating in and being personally victimized by pornography, despite testimony to the contrary which supported the legislation. *See infra* notes 129-44 and accompanying text. The state's interest in safeguarding the physical and psychological well-being of women by prohibiting pornography, the court held, was not so compelling to sacrifice first amendment guarantees. 598 F. Supp. at 1333-34. *But cf.* Roberts v. United States Jaycees, 104 S. Ct. 3244 (1984), *infra* at notes 150-58 and accompanying text, where a state's compelling interest in eradicating sex discrimination outweighed first amendment associational rights.

[69] 598 F. Supp. at 1337-39. The court indicated that the term "subordination of women" was not specifically defined in the ordinance. The ordinance did not suggest whether the forbidden "subordination of women" related "to a physical, social, psychological, religious, or emotional subordination or some other form or combination of these. What constitutes subordination under the Ordinance," the court declared, "is left finally to the censorship committee or to individual plaintiffs who choose to bring actions to enforce [the ordinances'] provisions. . . ." *Id.* at 1338.

[70] *Id.* at 1340-41. An unlawful "prior restraint is an infringement upon [the] constitutional right to disseminate matters that are ordinarily protected by the First Amendment without there first being a judicial determination that the material does not qualify for First Amendment protection." BLACK'S LAW DICTIONARY 1074-75 (5th ed. 1979).

[71] *See infra* notes 129-44 and accompanying text.

[72] 598 F. Supp. at 1327.

[73] Police power generally refers to the power inherent in the state to prescribe, within the limits of the state and federal constitutions, reasonable regulations necessary to preserve the public

scribes regulation of speech based on a dislike for content,[74] local governments have advanced various justifications for controlling offensive speech that obstensibly are not content-based.[75] The Court has accepted such justifications for regulating speech as the state interest in protecting minors, the quality of life, and the character of neighborhoods. In each case the interests have either outweighed or only incidentally implicated the first amendment.[76] The all-out ban on speech attempted in *Hudnut*, although justified by a state interest in protecting women from sexual exploitation and discrimination, was not an incidental implication of the first amendment and therefore did not succeed. Regulation, rather than prohibition, may be the key to protecting all the interests involved.

### 1. *Protecting children from sexually explicit material.*

Acting as parental surrogates, states have often resorted to their police powers to protect minors from access or exposure to sexually explicit material that is not legally obscene. In *Ginsberg v. New York*,[77] the Supreme Court affirmed the state's conviction of a magazine seller, under a state obscenity law prohibiting intentional sale to minors under seventeen of any picture portraying nudity.[78] Writing for the majority, Justice Brennan explained that:

> [T]he concept of obscenity or of unprotected matter may vary according to the group to whom the questionable material is directed or from whom it is quarantined. Because of the State's exigent interest in preventing distribution to children of objectionable material, it can exercise its power to protect health, safety, welfare and morals of its community by barring the distribution to children of books recognized to be suitable for adults.[79]

Similarly, states have protected children from audible indecency. In *Federal*

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order, health, safety, and morals. *See In re* Ramírez, 193 Cal. 633, 226 P. 914 (1924); Bruck v. State, 228 Ind. 189, 91 N.E.2d 349 (1950); Tighe v. Osborne, 150 Md. 452, 133 A. 465 (1926); Camas Stage Co. v. Kozer, 104 Or. 600, 209 P. 95 (1922); Conger v. Pierce County, 116 Wash. 27, 198 P. 377 (1921); 16A AM. JUR. 2D Constitutional Law § 363 (1979).

[74] *See supra* notes 36-46 and accompanying text.

[75] *See infra* notes 77-108 and accompanying text.

[76] *Id.*

[77] 390 U.S. 629, *reh'g denied*, 391 U.S. 971 (1968).

[78] The state had reformulated the then current obscenity law based on Memoirs v. Massachusetts, 383 U.S. 413, to apply to minors. The nudity "(i) predominantly appeals to the prurient, shameful or morbid interest of minors, and (ii) is patently offensive to prevailing standards in the adult community as a whole with respect to what is suitable material for minors, and (iii) is utterly without redeeming social importance for minors." 390 U.S. at 633.

[79] 390 U.S. at 636 (citation omitted).

*Communications Commission v. Pacifica Foundation*,[80] the Supreme Court upheld an FCC sanction against a New York radio station for its school-hours broadcast of a George Carlin monologue in which the comedian repeatedly emphasized seven "dirty" words.[81] The Court found the words "vulgar," "shocking," and "offensive," for the "same reason obscenity offends."[82] The Court noted that the time of the broadcast, in particular, was "uniquely accessible to children, even those too young to read."[83] Acknowledging that government has an interest in the well-being of children which permits it to give the support of the law to parents who have the primary responsibility in rearing and educating children, the Court held that government can assist parents who do not want their children to be exposed to indecent language. For these reasons, the monologue was banned from daytime broadcast.[84]

### 2. *Protecting the quality of life*

In *Paris Adult Theatre I v. Slaton*,[85] a commercial theater owner was enjoined from showing obscene films. The Court held that "[s]tates have a long-recognized legitimate interest in regulating the use of obscene material in local commerce and in all places of public accommodation."[86] To this end, state police powers were found to extend to protecting "the quality of life and the total community environment, the tone of commerce in the great city centers, and, possibly, the public safety itself."[87] The petitioners argued, however, that the state's "regulation of access by consenting adults to obscene material" was a violation of the right to privacy.[88] The Court's response was that the right to privacy had been extended to protect the "personal intimacies of the home, the family, marriage, motherhood, procreation, and child rearing,"[89] but that there was no fundamental privacy right "to watch obscene movies in places of public

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[80] 438 U.S. 726, *reh'g denied*, 439 U.S. 883 (1978).

[81] For a verbatim transcript of Carlin's monologue, see Appendix to Opinion of the Court. 438 U.S. at 751.

[82] *Id.* at 746-47.

[83] *Id.* at 749.

[84] *Id.* The majority indicated that a late-night broadcast might be fully protected under the first amendment: "[W]hether broadcast audiences in the late evening contain so few children that playing this monologue would be permissible is an issue neither the Commission nor this Court has decided." *Id.* at 750 n.28. *See also* A. COX, FREEDOM OF EXPRESSION 54-56 (1980).

[85] 413 U.S. 49 (1973).

[86] *Id.* at 57.

[87] *Id.* at 58. The majority cited to the Hill-Link Minority Report of the Commission on Obscenity and Pornography to demonstrate "at least an arguable correlation between obscene material and crime." *Id.*

[88] *Id.* at 65.

[89] *Id.* at 66 n.13.

accommodation."[90]

*3. Deterring crime, excluding undesirable transients and protecting property values*

Three years after *Paris Adult Theaters I*, the Supreme Court, in *Young v. American Mini Theatres, Inc.*,[91] permitted a content-based classification as a means of regulating sexually explicit material—by zoning and other licensing requirements. In *Young*, the City of Detroit had adopted zoning ordinances that differentiated between movie theaters that exhibited sexually explicit "adult" films and those that did not.[92] The ordinances specified that such adult theaters could not be "located within 1,000 feet of any two other 'regulated uses'[93] or within 500 feet of a residential area."[94] The ordinance was designed to disperse adult entertainment businesses throughout the city because concentration in limited zones tends "to attract an undesirable quantity and quality of transients, adversely affects property values, causes an increase in crime, especially prostitution, and encourages residents and businesses to move elsewhere."[95]

The four-justice plurality found three factors particularly persuasive: (1) a special waiver to the 1,000 foot restriction could be obtained;[96] (2) the ordinances did not "affect the operation of existing establishments but only the location of new ones. There [were] myriad locations in the [city] which [were] over 1,000 feet from existing regulated establishments;"[97] and (3) the record "disclose[d] a factual basis" for the conclusion that the zoning ordinances would

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[90] *Id.* at 66. The Court reaffirmed the holdings of United States v. Reidel, 402 U.S. 351, *reh'g denied*, 403 U.S. 924 (1971), and United States v. Thirty-seven Photographs, 402 U.S. 363, *reh'g denied*, 403 U.S. 924 (1971), that the constitutional doctrine of privacy does not protect commerce in obscene material. 413 U.S. at 69.

[91] 427 U.S. 50 (1976).

[92] *Id.* at 52.

[93] *Id.* The term "regulated uses" applied to ten different kinds of establishments in addition to adult theatres, including adult book stores, cabarets, bars, taxi dance halls, hotels, pawnshops, and pool halls. *Id.* at 52 n.3.

[94] *Id.* It is important to note that:

> The District Court held that the original form of the 500-ft restriction was invalid because it measured from "any building containing a residential, dwelling or rooming unit." The city did not appeal from that ruling but adopted an amendment prohibiting the operation of an adult theater within 500 feet of any area zoned for residential use.

The amended restriction was not directly challenged by the two adult theater operators at the Supreme Court level. *Id.* at 52 n.2.

[95] *Id.* at 55.

[96] *Id.* at 54 n.7.

[97] *Id.* at 71 n.35.

carry out the city's interest in preserving the character of its neighborhoods.[98] The Court concluded that the zoning ordinances, as applied to the plaintiff theater operators, were not unconstitutionally vague.[99]

The Court rejected the contention that the ordinances were invalid prior restraints on free speech, stating "[t]he mere fact that the commercial exploitation of material protected by the First Amendment is subject to zoning and other licensing requirements is not a sufficient reason for invalidating [the] ordinances."[100] The Court further stated that "[t]he city's interest in planning and regulating the use of property for commercial purposes [was] clearly adequate to support . . . [the 1000-foot] restriction applicable to all theaters within the city limits."[101] Therefore, this indirect regulation of manner and place of speech was not found to offend the Constitution.

### *4. Protecting children from exploitation*

In the early 1980's, a Manhattan bookstore owner was convicted under a New York criminal statute of selling two sexually explicit films depicting young boys masturbating. The Supreme Court, in *New York v. Ferber*,[102] held that sexually explicit materials depicting children, even if not obscene under *Miller*, were not protected by the first amendment. The Court found that the state had a compelling interest in safeguarding children from sexual abuse and exploita-

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[98] *Id.* at 71 n.34. The Common Council submitted evidence that a concentration of "adult" theaters caused the area to deteriorate and become a focus of crime, effects which were not attributable to theaters showing other types of films. *Id.*

There was evidence supporting the zoning ordinance consisting of "reports and affidavits from sociologists and urban planning experts, as well as some laymen, on the cycle of decay that had been started in areas of other cities, and that could be expected in Detroit, from the influx and concentration of such [adult] establishments." *Id.* at 81 n.4 (Powell, J., concurring).

[99] The ordinances were not unconstitutionally vague for failing to specify the permissible amount of sexually explicit material it would take to characterize a theater as adult, or for failing to specify the procedure for obtaining a waiver. *Id.* at 58-61.

[100] *Id.* at 62.

[101] *Id.* at 62-63. Only four justices agreed in Part III of the opinion which expressed the view that although communication via adult films is protected from absolute censorship by the first amendment, a city, without violating equal protection guarantees, could legitimately use film content to classify adult theaters differently from others for zoning purposes. The plurality justified its categorization of theaters by stating that the public's interest in protecting this type of speech was of a lesser magnitude "than the interest in untrammeled political debate," *id.* at 70, and the city's interest in the quality of its neighborhoods "adequately support[ed] its classification of motion pictures." *Id.* at 72.

[102] 458 U.S. 747 (1982). The statute prohibited knowing promotion of sexual performances by children under 16 years of age, by distribution of material portraying such performances. *Id.* at 749.

tion.[103] There was evidence that the use of children as models in sexually explicit material was harmful to their physiological, emotional and mental health.[104] In order to protect child models, the Court allowed the state to prosecute the distributors of pedophilia.[105] The Court was bothered both by the sexual exploitation of children and by the profit made by the promotion of such exploitation, noting that sales guaranteed additional abuse.[106] Further, since the *Miller* test for obscenity bore "no connection to the issue of whether a child had been physically or psychologically harmed" in the production of child pornography, it was abandoned as an approach to resolving the constitutional issue.[107] In dicta, the Court, citing *Young*, emphasized that speech could be classified according to content when "the evil to be restricted so overwhelmingly outweighs the expressive interests, if any, at stake. . . ."[108]

States may, therefore, legitimately regulate protected speech on the basis of its content.[109] States, however, have indirectly shown a dislike for the effect content may have on the community. Motivated by the negative effect content might have on youth, states have regulated pornography and indecent broadcasts accessible to children.[110] Clearly, states have believed the content of this material was injurious. The content of films shown by adult theaters has also been the basis for putting them in a particular classification for zoning purposes.[111] Content has, therefore, been central to any regulation of pornographic material.[112]

The tension between what the first amendment will not allow—content-based regulation—and what is actually behind state regulatory schemes is apparent. Perhaps, it is time to honestly acknowledge sex-oriented regulation for what it really is—a means of dealing with content that is injurious. Where a

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[103] *Id.* at 756-57 (citing Globe Newspaper Co. v. Superior Court, 457 U.S. 596 (1982)).

[104] 458 U.S. at 758 n.9. The Court noted that the distribution of sexually explicit material depicting children was related to their sexual abuse in that (a) "the materials produced [were] a permanent record of the children's participation and the harm to the child [would be] exacerbated by their circulation" and (b) "the distribution network for child pornography [had to] be closed if the production of material which require[d] the sexual exploitation of children [was] to be effectively controlled. 458 U.S. at 759.

[105] Pedophilia is a preference for or addiction to unusual sexual practices in which children are the preferred sexual object. WEBSTER'S THIRD NEW INT'L DICTIONARY 1638, 1665 (1971).

[106] 458 U.S. at 761 n.13.

[107] *Id.* at 761.

[108] *Id.* at 763.

[109] *See supra* notes 77-108 and accompanying text.

[110] *See supra* notes 80-85 and accompanying text.

[111] *Young*, 427 U.S. at 70-71. *See supra* notes 91-101 and accompanying text.

[112] Although states have pointed to secondary significant state interests—the symptoms—in order to regulate protected speech, content is the primary motivation and perhaps the root of the problem.

potential harm and a compelling state interest can be demonstrated, states should be able to point to the content of pornography as a grounds for regulation.

## III. Competing Public Concerns

Today, states are facing growing public outcry for regulatory control of pornographic businesses. The various citizen groups involved are claiming they have rights that the Constitution or the state, under its police power, should protect.[113] Parents and social conservatives are asserting rights to rear their children as they see fit, in a pornography-free environment.[114] Feminists insist that pornography violates their civil rights and denies them sexual equality.[115] In support of feminist contentions, there are recent sociological studies that verify—in a laboratory setting—increased male aggression against females after exposure to sexual violence.[116] Both parents and women's rights advocates have concerns that are content-based.

Against the rising flood of opposition to pornography stand the arguments of civil libertarians, pornographers, and feminists against censorship who do not want to erode the protection afforded pornography by the first amendment.[117] Theirs is the "floodgates" argument: If pornography is banned because it offends, the next thing to go may be rock concerts, for example. They have studies demonstrating no link between erotica and sex crimes.[118] The concerns of anti-pornography groups and anti-censorship organizations alike highlight the tension between the first amendment guarantee of free speech and state regulatory rights. Where speech harms individuals, or where individual rights outweigh the communicative impact of a particular type of expression, states may control speech.

### *A. Parental Rights*

The recent attention centered on the effects of pornography[119] has caused parents to become increasingly concerned that soft-core and violent pornography may have adverse effects on children.[120] Some are alarmed even by photo-

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[113] *See infra* notes 119-72 and accompanying text.
[114] *See infra* notes 119-26 and accompanying text.
[115] *See infra* notes 129-38 and accompanying text.
[116] *See infra* notes 145-48 and accompanying text.
[117] *See infra* notes 161-62 and accompanying text.
[118] *See infra* notes 173-76 and accompanying text.
[119] *See supra* notes 1-21 and accompanying text.
[120] Studies published in magazines such as *Psychology Today* have warned parents that only a

graphic displays of bare-breasted women in storefronts where children can see them.[121] Many parents object to the message pornography conveys, be it sexism or immorality, and to the adverse effects of exposure to pornographic content. These parental concerns have motivated the enactment of new zoning ordinances directed at pornography establishments.[122]

In America, it is well established that parents have a constitutional right to raise their minor children without unjustified state interference.[123] In 1972, in *Wisconsin v. Yoder*,[124] the Supreme Court held that Wisconsin violated the first amendment rights of Amish parents by forcing them to send their children to public or private schools beyond the eighth grade. The Court stressed that the "values of parental direction of the religious upbringing and education of their children in their early and formative years have a high place in our society."[125] In 1978, *Federal Communications Commission v. Pacifica Foundation*,[126] established that the government's interest in the well-being of children permits it to

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few minutes of exposure to sexually violent pornography can lead to antisocial attitudes and behavior. Wright, *Anti-pornography Group Takes a Direct Look at Sex Industry*, Honolulu Advertiser, July 24, 1985, at A4, col. 3. Newspaper articles also inform parents that the availability and influence of R-rated, sexually violent "slasher movies," such as "The Texas Chain Saw Massacre," are likely to cause a "spill-over to real violence." *See R-Rated Films Outrank Porn in Power to Harm, Scientists Say*, Sunday Honolulu Star-Bull. & Advertiser, June 2, 1985, at A24, col. 1.

[121] Wright, *Anti-pornography Group Takes a Direct Look at Sex Industry*, *supra* note 120.

[122] For cases dealing with first amendment challenges to these types of ordinances, see, e.g., Amico v. New Castle County, 101 F.R.D. 472 (D. Del. 1984), *aff'd*, 770 F.2d 1066 (3rd Cir. 1985), *infra* note 342 and accompanying text; Playtime Theatres, Inc. v. City of Renton, 748 F.2d 527 (9th Cir. 1984), *appeal granted*, No. 84-1360 (U.S. Apr. 15, 1985), *infra* note 346.

[123] *See* Meyer v. Nebraska, 262 U.S. 390 (1923) (states cannot prohibit the teaching of foreign languages to children who have not completed eighth grade); Pierce v. Society of Sisters, 268 U.S. 510 (1925) (the liberty of parents to direct the upbringing and education of children under their control includes the right to send a child to private or parochial school); Prince v. Massachusetts, 321 U.S. 158, *reh'g denied*, 321 U.S. 804 (1944) (the custody, care and nurture of the child resides first in the parents). The superiority of parental rights over those of their minor child, particularly in matters of education, religion and nurture generally, was underscored again in Polovchak v. Landon, 614 F. Supp. 900 (N.D. Ill. 1985), *appeal dismissed and vacated in part sub nom.*, Polovchak v. Meese, 774 F.2d 731 (7th Cir. 1985). Walter Polovchak had run away from his parents at the age of twelve rather than return with them to Russia. The district court held that the Immigration and Naturalization Service had violated the Polovchak's rights to due process when it issued a departure control order barring the plaintiffs from retrieving their son from America. Relying on Yoder v. Wisconsin, 406 U.S. 205 (1972), *infra* text accompanying note 124, and Stanley v. Illinois, 405 U.S. 645, 651 (1972) (absent powerful, countervailing interest, parental interest warrants deference and protection), the district court stated that parental rights can override specific constitutional rights. The private rights of Walter, the court held, were "considerably less than that of his parents." *Landon*, 614 F. Supp. at 902.

[124] 406 U.S. 205 (1972).

[125] *Id.* at 213-14. *See also Developments in the Law—The Constitution and the Family*, 93 HARV. L. REV. 1156, 1350 (1980).

[126] 438 U.S. 726. *See supra* notes 80-85 and accompanying text.

assist parents who have the primary responsibility in rearing and educating children. State regulation of pornographic businesses, based on parental rights and state powers, is a workable solution to the impact pornography may have on children.

### *B. Women's Rights*

The idea that pornography is dangerous is perhaps best represented[127] by views of leading feminist writers.[128] Catherine A. MacKinnon,[129] a co-author of the Indianapolis pornography ordinance,[130] believes that pornography violates women's civil rights. "[P]ornography is the celebration, the promotion, the authorization and the legitimization of rape, sexual harassment, battery and the abuse of children."[131] It is Professor MacKinnon's objective to "guarantee women's rights consistent with the first amendment by making visible the conflict of rights between the equality of rights guaranteed to all women and what are in some legal sense the rights of the pornographers and their consumers."[132]

Feminist author Susan Brownmiller[133] espouses the view that pornography is anti-female propaganda.[134] The intent of pornography, she writes, is to "distort

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[127] A number of experimental studies have linked pornography to violence. *See, e.g.*, PORNOGRAPHY AND SEXUAL AGGRESSION 185 (N. Malamuth & E. Donnerstein eds. 1984); Malamuth & Donnerstein, *The Effects Of Aggressive Pornographic Mass Media Stimuli*, 15 ADVANCES IN EXPERIMENTAL SOC. PSYCHOLOGY 103 (1982); Linz, Donnerstein & Penrod, The Effects of Long-Term Exposure to Filmed Violence Against Women (Mar. 22, 1984) (unpublished manuscript on file in Harvard Law School Library).

[128] Feminists have written a number of books and articles opposing pornography. *See* S. BROWNMILLER, AGAINST OUR WILL: MEN, WOMEN, AND RAPE (1975); A. DWORKIN, WOMAN HATING (1974); A. DWORKIN, PORNOGRAPHY: MEN POSSESSING WOMEN (1981); A. DWORKIN, RIGHT-WING WOMEN (1983); Brownmiller, *Pornography and the First Amendment*, 8 N.Y.U. REV. L. & SOC. CHANGE 225 (1978-79); Dworkin, *Pornography: The New Terrorism*, 8 N.Y.U. REV. L. & SOC. CHANGE 215 (1978-79); Dworkin, *Against the Male Flood*, *supra* note 2; MacKinnon, *Pornography, Civil Rights, and Speech*, HARV. C.R.-C.L. L. REV. 1 (1985); English, *Sex, Porn and Male Rage*, MOTHER JONES, Apr. 1980, at 15.

[129] Catharine A. MacKinnon is a feminist lawyer, teacher, writer and activist who is currently an associate professor of law at the University of Minnesota, where she teaches Sex Discrimination and Constitutional Law. *See Biddle Lecturer Advocates Women's Rights*, HARV. L. SCH. BULL., Summer/Fall 1984, at 8.

[130] *See supra* notes 59-60 and accompanying text. Professor Andrea Dworkin, a feminist writer and activist, was the other co-author.

[131] C. MacKinnon, Pornography: A Feminist Perspective (Oct. 28, 1983) (unpublished manuscript on file in the law review office).

[132] *Biddle Lecturer Advocates Women's Rights*, *supra* note 129.

[133] Susan Brownmiller is the founder of Women Against Pornography and the author of AGAINST OUR WILL: MEN, WOMEN AND RAPE (1975).

[134] *See The Place of Pornography*, *supra* note 2, at 34; Griffin, *Women, Pornography and the First Amendment*, STUDENT LAW., Dec. 1980, at 24, 25. *See generally* Brownmiller, *Pornography*

the image of [women as] a group or class of people, to deny their humanity, to make them such objects of ridicule and humiliation that acts of aggression against them are viewed less seriously."[135] She would deny pornography first amendment protection because it "incites people to commit violent acts, [and] it distorts the nature of sex."[136] Brownmiller is the founder of Women Against Pornography, whose members believe that pornography is instrumental in the terrorization of women as it instructs men to perceive women as objects rather than human beings.[137] "The ultimate result of this dehumanization of women, is rape, other forms of sexual violence, and virtually all manifestations of sexism."[138]

Other opponents are convinced that pornography encourages illegal acts against women including physical, psychological, and economic coercion of women into performing pornographic acts before a camera,[139] attacks by strangers,[140] and physical coercion by husbands or lovers compelled to re-enact scenes from pornography films or magazines.[141] Linda Marchiano,[142] a former pornography model, claims she was coerced by repeated rapes, beatings, and threats to make pornographic movies, including *Deep Throat*.[143] "Every time someone

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*and the First Amendment*, 8 N.Y.U. REV. L. & SOC. CHANGE 225 (1978-79).

[135] *The Place of Pornography*, *supra* note 2, at 34.

[136] *Id.* at 43.

[137] Griffin, *supra* note 134, at 26. Members of Women Against Pornography believe that even soft porn objectifies and degrades women for men's enjoyment and profit, while violent, hardcore pornography represents "the hate men have for women." *Id.* at 25. Robin Morgan explains that "[p]ornography is the theory, and rape is the practice." *Id.*

[138] *Id.* at 26.

[139] *See* L. LOVELACE & M. MCGRADY, ORDEAL (1980). Linda Marchiano, a.k.a. Linda Lovelace, a former pornography model, claims she was forced to make pornographic movies. *See infra* notes 149-51 and accompanying text.

[140] *See* English, *Sex, Porn and Male Rage*, MOTHER JONES, Apr. 1980, at 15.

[141] Such forms of coercion were discussed in Note, *Anti-Pornography Laws and First Amendment Values*, 98 HARV. L. REV. 460, 463 (1984).

> Witnesses before, and documents presented to, the Indianapolis city council [passing the anti-pornography ordinance] reported cases in which pornography had allegedly incited men to abuse women and children. Cases included an avid reader of pornography who forced his daughter to reenact pornographic scenes with him, a child molester who used pornographic magazines to "teach" his victim that she was doing the right thing by having sex with him, and a husband who used pornography as a "how-to" manual on his wife, putting her in bondage and performing humiliating sexual acts on her.

*Id.* at 464 n.14. "In a 1980 survey by Diana Russell, 10 percent of women reported being asked—or forced—by their mates to imitate sex acts that came out of pornography." *The War Against Pornography*, NEWSWEEK, Mar. 18, 1985, at 58, 65.

[142] Currently a mother and housewife, Ms. Marchiano was formerly known as Linda Lovelace. She has authored the book *Ordeal* which describes her forced involvement as a pornography model in the commercial sex industry.

[143] *See* L. LOVELACE & M. MCGRADY, ORDEAL (1980).

watches that movie they are watching me being raped."[144]

Recent studies by several psychologists indicate that *violent* pornography does have an effect on aggressive behavior towards women. Professor Seymour Feshbach[145] and his colleague Neil Malamuth conducted a series of experimental studies that led them to conclude that "the depiction of violence in pornography can have decided negative effects. Males, in particular, are prone to use violent erotica to reinterpret expressions of pain on the part of a female rape victim as indications of sexual excitement."[146] Psychologist Edward Donnerstein[147] reported that his experiments also indicate at least a short-term increase of male aggression against females following the viewing of sexual violence. "Men who had watched sexual violence were likely to administer more electrical shocks to their partners than those who had watched nonviolent sexual films," and female partners received more shocks than their male counterparts.[148]

Feminists believe that eliminating pornography will further their goal of achieving sexual equality.[149] The importance of this goal was underscored recently by the Supreme Court in *Roberts v. United States Jaycees*.[150] In *Roberts*, the Jaycees denied admission of women as full voting members although women had been invited to participate in the organization's training and community activities.[151] Before the Department of Human Rights of the Minnesota

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[144] *Minneapolis Asked to Attack Pornography as Rights Issue*, N.Y. Times, Dec. 18, 1983, at 1-44, col. 1.

[145] Professor Feshbach is the Chairman of the psychology department at the University of California at Los Angeles.

[146] Griffin, *supra* note 134, at 45. In one of his experiments, Feshbach had college student volunteers read one of two versions of a story—a sadomasochistic version or a similar but nonviolent version. "[D]ata indicated that males who had read the sadomasochistic version were more aroused by the rape than those who had read the control story. . . . In addition, their response to the pain of the rape victim was so altered that the more the rape victim was thought by the subject to be in pain, the greater was his level of sexual arousal." *Id.* at 46.

[147] Dr. Donnerstein is on the faculty of the University of Wisconsin.

[148] Griffin, *supra* note 134, at 46. *See also The War Against Pornography*, NEWSWEEK, Apr. 18, 1985, at 58, 61. The tests employed by these social scientists, however, have taken place in laboratory settings and have only measured the effects of pornography on individuals; the effect pornography may have on society as a whole has not been demonstrated. Griffin, *supra* note 134, at 46.

[149] For the text of the provision of the Indianapolis, Ind., Ordinance 35 (Apr. 23, 1984), describing "pornography," *see supra* note 59. *See also* MacKinnon, *Pornography, Civil Rights, and Speech*, HARV. C.R.-C.L. L. REV. 1, 22 (1985) ("We define pornography as a practice of sex discrimination, a violation of women's civil rights, the opposite of sexual equality."); Dworkin, *Against The Male Flood*, *supra* note 2, at 24 ("The [Indianapolis] civil rights law provides a new mode of action for women through which we can pursue equality. . . ."); Comment, *Feminism, Pornography, and Law*, 133 U. PA. L. REV. 497, 510 (1985) ("[T]he feminist view is neither virtue nor liberty but, instead, equality.").

[150] 104 S. Ct. 3244 (1984).

[151] *Id.* at 3254-55. The Minneapolis and St. Paul chapters of the Jaycees, unlike the regional

Human Rights Act could order the Jaycees to comply with the Act, which forbids discrimination on the basis of sex in "place[s] of public accommodation,"[152] and admit women as voting members, the U.S. Jaycees sued, claiming the Act abridged their first amendment right of free speech and association.[153] The Court held that Minnesota's compelling interest in eradicating discrimination against women in places of public accommodation justifies the impact of its Human Rights Act on first amendment rights of expressive association enjoyed by male members of the United States Jaycees.[154] Implicitly allowing the state's interest in sexual equality to outweigh first amendment rights,[155] the Court explained that the equality interest is not "limited to the provision of purely tangible goods and services,"[156] but involves the means to remove "the barriers to economic advancement and political and social integration that have historically plagued certain disadvantaged groups, including women."[157] In language reflecting feminist views, the Court said:

> [A]cts of invidious discrimination in the distribution of publicly available goods, services, and other [political and social] advantages cause unique evils that government has a compelling interest to prevent—wholly apart from the point of view such conduct may transmit. Accordingly, like violence or other types of potentially expressive activities that produce special harms distinct from their communicative impact, such practices are entitled to no constitutional protection.[158]

Feminist contentions that pornography harms are supported by testimony from victims of sex crimes and sociological studies.[159] Additionally, the Supreme Court has recognized a compelling state interest in sexual equality. The state should therefore be able to regulate material that has the capacity to harm and violates rights to sexual equality.

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organization, the U.S. Jaycees, began admitting women as regular members in 1974 and 1975. *Id.* at 3247.

[152] *Id.* at 3248.

[153] *Id.*

[154] *Id.* at 3253.

[155] *Cf.* American Booksellers Ass'n v. Hudnut, 54 U.S.L.W. 3548 (U.S. Feb. 25, 1986), *aff'g* 771 F.2d 323 (7th Cir. 1985), *aff'g* 598 F. Supp. 1316 (S.D. Ind. 1984) (state's interest in safeguarding physical and psychological well-being of women by prohibiting pornography not so compelling to sacrifice first amendment speech guarantees). *See also supra* notes 56-70 and accompanying text.

[156] 104 S. Ct. at 3254.

[157] *Id.*

[158] *Id.* at 3255.

[159] *See supra* notes 139-48 and accompanying text.

### *C. Pornographers' and Civil Libertarians' Rights*

Pornography purveyors[160] and civil libertarians[161] have responded to the feminist challenge. Fearing censorship, some argue that pornography serves a "useful" purpose. Others argue that the first amendment rights are absolute and should be protected at any cost.

Many civil libertarians disagree with the feminist theory that pornography causes violence against women. Human rights activist, Aryeh Neier,[162] who has worked for organizations concerned with human rights in various repressive countries, observed that in countries where there is no pornography,

> [T]here is a great deal of the same hostility toward women and the same violence against women that one finds in the United States. In fact, in many of these countries sexual violence—mass rape or sexual torture or sexual humiliation—is one of the main forms political repression takes. I conclude from the astounding level of sexual violence in these countries and the absence of pornography that pornography is really not very important. . . .[163]

The official American Civil Liberties Union (ACLU) position on obscenity statutes and pornography zoning ordinances is that it is unconstitutional for the government to restrain the right to create, publish, or distribute materials to adults or the right of adults to choose the material they read or view. "The freedom of speech and press and freedom to read can be safeguarded effectively only if the first amendment is applied as written and intended—to prohibit any restriction on these basic rights."[164] Although the ACLU objects to sexual exploitation of children for commercial purposes, it maintains that the first

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[160] The publishers of magazines such as *Playboy, Penthouse, Screw*, and *Hustler* are representative of this group.

[161] The American Civil Liberties Union (ACLU), Aryeh Neier, and the Feminist Anti-Censorship Task Force (FACT) are representative of those who have voiced civil libertarian opinions on the pornography issue. The Indiana Civil Liberties Union filed an amicus brief against the Indianapolis pornography ordinance in conjunction with the ACLU. *See* Ranii, *Indianapolis Porn Law Struck Down*, NAT'L L.J., Dec. 3, 1984, at 3, col. 1. Aryeh Neier, a former national executive director of the ACLU and the current vice chairman of Helsinki Watch and Americas Watch is outspoken against the censorship of pornography. For the views of an ACLU lawyer, see *supra* note 14 and accompanying text. There are also "feminists who doubt that eliminating pornography will end the violence against women. The Feminist Anti-Censorship Task Force (FACT) questions whether images cause violent acts; whether coalitions with the right wing will thwart feminist goals; whether law is the best strategy for changing misogynist attitudes." Blakely, *supra* note 60, at 37.

[162] *See supra* note 161.

[163] *The Place of Pornography*, *supra* note 2, at 35.

[164] POLICY GUIDE OF THE AMERICAN CIVIL LIBERTIES UNION 5, 7 (1981).

amendment protects the publisher and disseminator of pedophilia.[165] As for graphic depictions of sexual humiliation and subordination of women, these too must be protected by the first amendment because "it is impossible to censor speech we hate without imperiling the system of free expression upon which our political and social structure rests."[166]

Al Goldstein,[167] typical of others in the multi-billion dollar pornography business, also takes issue with the feminist viewpoint. Arguing that pornography and fantasy are closely related, Goldstein claims "[p]ornography helps us free ourselves from the puritanical attitudes about sex that have long dominated our society."[168] His retort to feminists who find pornography appalling is that:

> Anti-female propaganda has as much right to exist as anti-Jewish propaganda and anti-American propaganda. If someone hates women, or hates gay men or midgets for that matter, he has a right to express that opinion. The price of living in a free society is putting up with points of view you don't like.[169]

Goldstein also equates pornography with trivia, diversion, and junk entertainment.[170] Its popularity[171] indicates its "success" and "that people want the entertainment it provides."[172] In 1970, the President's Commission on Obscenity and Pornography[173] released its report analyzing the relationship between pornography and violence.[174] The Commission concluded that analyses of the United States crime rates do not support the thesis of a causal connection between the availability of erotica and sex crimes among either juveniles or adults.[175] The Hill-Link Minority Report of the same Commission, however, concluded that there was "at least an arguable correlation between obscene material and crime."[176]

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[165] *Id.* at 7.

[166] Blakely, *supra* note 60, at 44.

[167] Al Goldstein has been the publisher of *Screw* magazine for 18 years, and is the producer of a cable television program entitled Midnight Blue. *The Place of Pornography*, *supra* note 2, at 32.

[168] *Id.*

[169] *Id.* at 37.

[170] *Id.* at 39.

[171] "*Playboy* sells 4 million copies each month and *Penthouse* 3 million." *Id.*

[172] *Id.* While pornography may provide fantasy and diversion for some, this does not preclude the possibility that for others it reinforces a degrading female stereotype or incites violence against women. For feminist views regarding pornography, see *supra* notes 129-38 and accompanying text.

[173] THE REPORT, *supra* note 10.

[174] For information regarding the recently created Attorney General's Commission on Pornography, see *supra* notes 10-12 and accompanying text.

[175] THE REPORT, *supra* note 10, at 31.

[176] Paris Adult Theatre I v. Slaton, 413 U.S. 49, 58 (1973) (The Court referred to the Hill-Link Minority Report in THE REPORT OF THE COMMISSION ON OBSCENITY AND PORNOGRAPHY

Community opinion regarding the effect of pornography is sharply divided. On the one hand, many parents and feminists believe pornography is harmful.[177] Their objections are directed to the message pornography conveys—be it filth, sexism, or the subjugation and objectification of women.[178] Feminists have reinforced their claims with experimental studies linking violent sex to increased aggression against females.[179] Additionally, parents and feminists have well-defined rights with which they argue pornography is interfering—the parental right to child-rearing,[180] which is important, and the right to sexual equality, which a state may regard as compelling.[181] On the other hand, civil libertarians and pornographers argue strongly for the first amendment protection of all expression.

Legislatures have been unable to reconcile the competing viewpoints and legal justifications offered by each of these groups through legislative bans on pornography or obscenity. A viable means of reconciliation may lie in the state's exercise of their power to protect the health, safety, and welfare of their citizens,[182] and their duty to respond to the needs of the community.[183]

## IV. Zoning Adult Businesses/The Compromise

Zoning is a possible means of responding to the concerns of all parties in the pornography debate.[184] Through the careful exercise of police power, local gov-

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390-412 (1970)).

[177] *See supra* notes 119-38 and accompanying text.

[178] For parental and feminist views on pornography, see *supra* notes 119-38 and accompanying text.

[179] *See supra* notes 145-48 and accompanying text.

[180] *See supra* notes 124-26 and accompanying text.

[181] *See* Roberts v. United States Jaycees, 104 S. Ct. 3244 (1984), *supra* notes 150-58 and accompanying text.

[182] For a definition of police power, see *supra* note 73.

[183] *See* Alabama State Fed'n of Labor v. McAdory, 246 Ala. 1, 18 So. 2d 810 (1944), *cert. dismissed*, 325 U.S. 450 (1945) (It is a peculiar function of the legislature to determine when the welfare of the people requires the exercise of the police power and what are appropriate measures to that end, subject only to the power of the court to judge whether any particular law is an invasion of constitutional rights.); Bloomfield v. State, 86 Ohio St. 253, 99 N.E. 309, 311 (1912) (The police power "will be, and should be, put forth as an expression of the popular conception of the necessities of social and economic conditions. Under it may be done and should be done that which will best secure the peace, morals, health, and safety of the community.").

[184] States and municipalities have also attempted to regulate pornography by the use of building codes, nuisance laws, or police harassment. An analysis of the effectiveness of building codes, nuisance laws, and police harassment in regulating pornography is beyond the scope of this comment. *See generally* Note, *Pornography, Padlocks, and Prior Restraints: The Constitutional Limits of the Nuisance Power*, 58 N.Y.U. L. Rev. 1478 (1983); Fahringer, *The New Weapons Being Used in Waging War Against Pornography*, 7 Cap. U.L. Rev. 553 (1978).

ernments may legislate a compromise solution to protect all competing interests to some extent.

In *Young v. American Mini Theatres, Inc.*,[185] the Court gave approval to the zoning of adult businesses. Cases since *Young* reveal a willingness on the part of courts to accept a variety of reasons for zoning pornography, other than the protection of property values, deterring crime, and excluding undesirables.[186] The protection of children from the adverse effects of pornography has been successfully posited as a compelling state interest for zoning adult businesses.[187] Parental rights included in other regulatory schemes[188] could apply to a zoning scheme by analogy. Most states have carefully avoided articulating a dislike for content in any regulation of speech. This issue was recently addressed by the Court in *City of Renton v. Playtime Theatres, Inc.*[189]

Perhaps it is time to build a factual record for zoning that includes parental and feminist content-based objections to pornography, as well as civil libertarian defenses of pornography. Zoning that includes traditional as well as content-based reasons is simply a compromise solution,[190] but it would address all concerns, facilitate the zoning process,[191] and be honest. As discussed below, the history of zoning since *Young* should provide some answers and guidelines for a zoning plan that will accommodate all those concerned with the effects of pornography.

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[185] 427 U.S. 50. *See supra* notes 91-101 and accompanying text.

[186] *See infra* notes 79-90, 102-08 and accompanying text.

[187] *See* Amico v. New Castle County, 101 F.R.D. 472 (D. Del. 1984), *aff'd*, 770 F.2d 1066 (3rd Cir. 1985), *infra* notes 335-44 and accompanying text.

[188] *See* Federal Communications Comm'n v. Pacifica Foundation, 438 U.S. 726, *reh'g denied*, 439 U.S. 883 (1978), *supra* notes 80-85 and accompanying text.

[189] 54 U.S.L.W. 4160 (U.S. Feb. 25, 1986), *rev'g* 748 F.2d 527 (9th Cir. 1984). *See infra* note 355 and accompanying text.

[190] Zoning as a solution does not fully satisfy any party to the debate. For example, feminists maintain that zoning laws "have at times hurt poor and working-class neighborhoods or segregated women out of whole sections of cities." Paper from Catharine A. MacKinnon and Andrea Dworkin to Minneapolis City Council (Dec. 26, 1983) (discussing the proposed Minneapolis pornography ordinance) (available at the William S. Richardson School of Law Library, University of Hawaii). Civil libertarians believe that any content-based regulation—including zoning—of the right to produce or distribute materials adults wish to read or view is unconstitutional. *See supra* note 164 and accompanying text.

[191] Currently, an expressed dislike for the content of pornography—"impermissible motivation"—which is identified as a "substantial factor" in any factual record for rezoning, invalidates the ordinance. *See* Amico v. New Castle County, 101 F.R.D. 472, 491 (D. Del. 1984), *aff'd*, 770 F.2d 1066 (3d Cir. 1985). When the first amendment is involved, "questions of impermissible motivation are determined by asking whether the impermissible motivation was a 'substantial factor' in the absence of which the opposite decision would have been reached." *Id. See* Board of Educ., Island Trees Union Free School Dist. No. 26 v. Pico, 457 U.S. 853, 871 n.22 (1982) (summary judgment foreclosed where evidentiary materials raised genuine issue of fact relating to motivation); Mount Healthy City Bd. of Educ. v. Doyle, 429 U.S. 274, 287 (1977).

### A. History

In *Young*, the zoning scheme that was challenged was content-based. Adult businesses, while not banned, were dispersed in an effort to reduce their negative impact on the community. If pornography could not be completely eliminated, it could be relegated to certain areas, and perhaps reduced in quantity and influence.

Although the Court seemed to be endorsing such content-based zoning in *Young*, the subsequent Supreme Court decision in *Schad v. Borough of Mount Ephraim*,[192] added the requirement that a zoning ordinance infringing on protected speech be narrowly drawn to further a substantial governmental interest.[193] As a result, this invalidated many local zoning ordinances that were based on *Young*.[194]

Very recently, however, the Supreme Court, in *City of Renton v. Playtime Theatres, Inc.*, [195] again sustained the power of local governments to regulate the location of adult theaters, reaffirming and broadening its decision in *Young*. Unlike in *Young*, the Court in *Playtime* validated a city's attempt to zone only adult theaters into a 520-acre area, prior to the opening of such theaters in the city, where the zoning was based on the experience of other cities and where there was some alleged impermissible legislative motivation for the ordinance.[196] Since the ordinance attempted to preserve the quality of urban life—a substantial government interest—and did not ban adult theaters entirely, it was upheld as a content-neutral time, place, and manner regulation.[197] It remains to be seen, however, how this holding will be applied to an ordinance enacted by a city already heavily populated with sexually oriented businesses.

#### *1.* Young v. American Mini Theatres*: Zoning Adult Businesses*

In the wake of the Supreme Court's decision that a municipality could control the location of adult theaters as well as other commercial establishments, "either by confining them to certain specified commercial zones or by requiring that they be dispersed throughout the city,"[198] many municipalities rushed to enact pornography zoning laws.[199] A majority of cities copied the ordinance

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[192] 452 U.S. 61.

[193] *Id.* at 68.

[194] *See infra* notes 285-316 and accompanying text.

[195] 54 U.S.L.W. 4160 (U.S. Feb. 25, 1986), *rev'g* 748 F.2d 527 (9th Cir. 1984).

[196] 54 U.S.L.W. at 4160.

[197] *Id.*

[198] Young v. American Mini Theatres, Inc., 472 U.S. at 62; *see supra* notes 97-101 and accompanying text.

[199] *See Developments in the Law—Zoning*, 91 HARV. L. REV. 1427, 1557 (1978).

upheld in Detroit by requiring adult businesses to be dispersed or excluded from specified areas.[200] Other cities attempted to restrict adult uses to certain designated zones.[201] A handful of municipalities enacted zoning ordinances that both restricted the use to a zone and then excluded the use from designated areas within that zone.[202] Subsequently, owners of sexually-oriented businesses challenged these zoning ordinances on grounds that they were unconstitutionally vague, violated equal protection, or severely restricted access to protected speech.[203] In the five years following *Young*, challenged pornography ordinances were found to be constitutional about fifty percent of the time.[204] Zoning restrictions that strayed too far from the factors delineated in *Young*, however, were invalidated.

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[200] The ordinances in the following cases were enacted after the Supreme Court's approval in *Young*: Schad v. Borough of Mount Ephraim, 452 U.S. 61 (1981); Playtime Theaters, Inc. v. City of Renton, 748 F.2d 527 (9th Cir. 1984), *appeal granted* No. 94-1360 (U.S. Apr. 15, 1985); Tovar v. Billmeyer, 721 F.2d 1260 (9th Cir. 1983), *cert. denied*, 105 S. Ct. 223 (1984); Ebel v. City of Corona, 698 F.2d 390 (9th Cir. 1983); Alexander v. City of Minneapolis, 698 F.2d 936 (8th Cir. 1983); Avalon Cinema Corp. v. Thompson, 658 F.2d 555 (8th Cir. 1981), *rev'd*, 667 F.2d 659 (8th Cir. 1981) (en banc); Keego Harbor Co. v. City of Keego Harbor, 657 F.2d 94 (6th Cir. 1981); Stansberry v. Holmes, 613 F.2d 1285 (5th Cir.), *cert. denied*, 449 U.S. 886 (1980); North St. Book Shoppe v. Village of Endicott, 582 F. Supp. 1428 (N.D.N.Y. 1984); CLR Corp. v. Henline, 520 F. Supp. 760 (W.D. Mich. 1981), *aff'd*, 702 F.2d 637 (6th Cir. 1983); Purple Onion, Inc. v. Jackson, 511 F. Supp. 1207 (N.D. Ga. 1981); Shangri-La Enters., Ltd. v. Brennan, 483 F. Supp. 281 (E.D. Wis. 1980); Genusa v. City of Peoria, 475 F. Supp. 1199 (C.D. Ill. 1979), *modified*, 619 F.2d 1203 (7th Cir. 1980); Ellwest Stereo Theatres, Inc. v. Byrd, 472 F. Supp. 702 (N.D. Tex. 1979); Bayside Enters., Inc. v. Carson, 450 F. Supp. 646 (M.D. Fla. 1978); Strand Property Corp. v. Municipal Court, 14 Cal. App. 3d 882, 200 Cal. Rptr. 47 (1983); Walnut Properties, Inc. v. City of Long Beach, 100 Cal. App. 3d 1018, 161 Cal. Rptr. 411, *cert. denied*, 449 U.S. 836 (1980); State v. Huddleston, 412 A.2d 1148 (Del. 1980); Airport Book Store, Inc. v. Jackson, 242 Ga. 214, 248 S.E.2d 623 (1978), *cert. denied*, Gateway Books, Inc. v. Jackson, 441 U.S. 952 (1979); Dandy Co. v. Civil City of South Bend, County-City Complex, 401 N.E.2d 1380 (Ind. App. 1980); Kacar, Inc. v. Zoning Hearing Bd. of Allentown, 60 Pa. Commw. 582, 432 A.2d 310 (1981).

[201] The cities in these cases enacted restrictive zoning ordinances: E & B Enters. v. University Park, 449 F. Supp. 695 (N.D. Tex. 1977); Marco Lounge, Inc. v. Federal Heights, 625 P.2d 982 (Colo. 1981); Northend Cinema, Inc. v. Seattle, 90 Wash. 2d 709, 585 P.2d 1153 (1978), *cert. denied*, 441 U.S. 946 (1979).

[202] The cities in these cases enacted zoning ordinances that excluded uses from designated areas within restricted zones: Basiardanes v. City of Galveston, 682 F.2d 1203 (5th Cir. 1982); 15192 Thirteen Mile Rd. v. City of Warren, 593 F. Supp. 147 (E.D. Mich. 1984); Amico v. New Castle County, 571 F. Supp. 160 (D. Del. 1983), *rev'd*, 101 F.R.D. 472 (D. Del. 1984), *aff'd*, 770 F.2d 1066 (3d Cir. 1985); City of Whittier v. Walnut Properties, Inc., 149 Cal. App. 3d 633, 197 Cal. Rptr. 127 (1983).

[203] *See infra* notes 230-45, 254-62 and accompanying text.

[204] *See infra* notes 205-62 and accompanying text.

### *a. Exclusionary zoning ordinances after* Young

#### *(1) Constitutional*

In *Dandy Co. v. Civil City of South Bend, County-City Complex*,[205] the Indiana Court of Appeals upheld a city zoning ordinance that was patterned after the Detroit ordinance.[206] A bookstore owner who had lost the prior nonconforming use of his premises as an adult bookstore[207] challenged the ordinance as a violation of equal protection, as a taking of property without due process of law, and as unconstitutionally vague.[208] Relying on *Young*, the court held that classification of bookstores on the basis of content did not violate equal protection.[209] Neither was the ordinance a taking of property, as Dandy was not prohibited from operating a bookstore in the city.[210] The court declared that the only vagueness in the ordinance, relating to "the amount of sexually explicit activity that may be portrayed before the material can be said to be 'characterized by an emphasis' on such matter," would be given a narrow construction by the courts if there were any doubts.[211] Similarly, in *Shangri-La Enterprises, Ltd. v. Brennan*,[212] a municipal ordinance prohibiting the location of adult bookstores and movie theaters within 1000 feet of each other was challenged by the owner of an adult bookstore who was forced to relocate when his property was acquired by eminent domain.[213] The site on which the plaintiff had an option to relocate, however, was restricted by the zoning ordinance and he was unable to obtain a variance.[214] Since the Supreme Court had approved a similar zoning restriction in *Young*, the court reasoned that the plaintiff had to concede that the zoning ordinance was constitutional.[215] The court held that since any property interest in conducting the business at its current site had been extinguished

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[205] 401 N.E.2d 1380 (Ind. App. 1980).

[206] The ordinance restricted the establishment of "controlled uses" (one of which was an adult bookstore) by prohibiting any three such controlled uses to operate within 1000 feet of each other or any one such use to be established within 500 feet of a residential district. *Id.* at 1382.

[207] The prior nonconforming use of the premises as an adult bookstore had been abandoned when the zoning ordinance, restricting the establishment of an adult bookstore, was enacted by the city. *Id.*

[208] *Id.* at 1386.

[209] *Id.*

[210] *Id.* Further, the bookstore owner had the option of using the premises for any other lawful activity not prohibited by the ordinance. *Id.*

[211] *Id.* (quoting Young v. American Mini Theatres, Inc., 427 U.S. at 61).

[212] 483 F. Supp. 281 (E.D. Wis. 1980).

[213] *Id.* at 282.

[214] *Id.* at 283.

[215] *Id.* at 284.

by a valid exercise of eminent domain,[216] and that *Young* "clearly up[held] the city's power to prevent the relocation of the plaintiff's enterprise at the restricted site,"[217] the plaintiff's request for declaratory and injunctive relief was denied.[218]

Several municipalities expanded upon the Detroit ordinance, by lengthening the 1000-foot distance or including additional facilities from which adult businesses were to distance their operations or both. For example, in *Stansberry v. Holmes*,[219] the Fifth Circuit upheld a zoning ordinance prohibiting the location of certain sexually oriented commercial enterprises[220] from within 1500 feet of a child care facility, church, or place of worship, dwelling, public building or park, school, hospital, or building in which alcohol was sold.[221] Because bookstores and movie theaters were specifically exempt from the prohibition, the court held that no first amendment interests were implicated.[222] The court further concluded that the definitions for "school"[223] and "sexually oriented commercial enterprise"[224] contained in the regulations were not unconstitutionally vague or overbroad.[225]

Initially, zoning ordinances fashioned after the ordinance in *Young*, were up-

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[216] *Id.* Although the plaintiff conceded the zoning restriction was constitutional, it contended it had a property interest in conducting its business in the area of its present site even though the property was being acquired by eminent domain. The court declared that if such an interest existed, it was "extinguished by a valid exercise of the power of eminent domain." *Id.*

[217] *Id.*

[218] *Id.*

[219] 613 F.2d 1285 (5th Cir.), *cert. denied*, 449 U.S. 886 (1980).

[220] The commercial enterprises included in the definition of "sexually oriented commercial enterprise" were a "massage parlor, nude studio, modeling studio, love parlor and any other similar commercial enterprise whose major business is the offering of a service which is intended to provide sexual stimulation or sexual gratification to the customer." 613 F.2d at 1287.

[221] *Id.* at 1287.

[222] *Id.* at 1288.

[223] The trial court had determined that the definition of "school" was vague because it possibly could include "Karate schools, bartending schools, and buildings where Dale Carnegie courses, t'ai, chi'i' dancing or hypnotism [were] taught." *Id.* at 1289-90. The court held, however, that "[t]he reference in the provisions to 'the playgrounds, dormitories, stadiums and other structures or grounds used in conjunction therewith' clearly narrow[ed] the definition to schools for primary, secondary, and college education." *Id.* at 1290.

[224] The trial court had also determined that the definition of "sexually oriented commercial enterprise" was so vague that it could be used by police to harass legitimate commercial businesses that were engaged in activities that could sexually stimulate patrons or customers such as dancing studios and art schools using nude models. *Id.* at 1290. Dismissing this reading of the definition, the Fifth Circuit Court of Appeals pointed out that the definition was "limited to businesses 'whose *major business* [was] offering of *a service which is intended* to provide sexual stimulation or sexual gratification.'" *Id.* (emphasis in original.) It did not apply to "businesses whose activities might incidentally cause sexual stimulation." *Id.*

[225] *Id.*

held due to either strict or sloppy adherance to the facts in *Young*. The zoning ordinance in *Stansberry* was acceptable because it did not affect businesses that disseminated protected material.[226] The ordinance in *Shangri-La* was upheld because it was modeled after the location restrictions of adult businesses in *Young*, which had been upheld by the Supreme Court.[227] The South Bend zoning ordinance was upheld either because it was assumed that the entire zoning ordinance in *Young* was upheld, or because there was no overbreadth argument. If the Indiana Appeals court in *Dandy* had wanted to find unconstitutional South Bend's zoning ordinance, it could have ruled that the restriction from within 500 feet of a residential district was overly broad.[228] The 500-foot distance was the flaw in zoning ordinances patterned after Detroit's that later court decisions caught.[229]

### *(2) Unconstitutional*

A zoning ordinance can fail for a number of reasons.[230] The challenged ordinance in *Purple Onion, Inc. v. Jackson*,[231] was nearly an exact replica of the one in *Young*.[232] However, the regulation amortized[233] all existing adult entertain-

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[226] *Id.* at 1288.

[227] 483 F. Supp. at 284.

[228] *See infra* note 339 and accompanying text.

[229] *See, e.g.*, Amico v. New Castle County, 571 F. Supp. 160 (D. Del. 1983), *rev'd*, 101 F.R.D. 472 (D. Del. 1984), *aff'd*, 770 F.2d 1066 (3d Cir. 1985), *infra* note 339 and accompanying text.

[230] *See infra* notes 231-44 and accompanying text.

[231] 511 F. Supp. 1207 (N.D. Ga. 1981).

[232] Adult bookstores and theaters were excluded from within 1000 feet of any such other use or within 500 feet of the boundaries of any residential district or property used for residential purposes. 511 F. Supp. at 1212.

[233] A nonconforming use is amortized when it is required to close down or relocate within a specified time period. Amortization of nonconforming uses is constitutional if the time period in which to close down or relocate is reasonable. "[R]easonableness is generally a function of the owner's investment in the structure or use, and the structure's age in relation to its predetermined useful life." D. CALLIES, REGULATING PARADISE 25 (1984). If the requirement to relocate is unreasonably severe, amortization may constitute a taking:

> The general test, usually applied on a case-by-case basis, for determining the reasonableness of an amortization period is whether the public benefit gained from termination of the use outweighs the hardship to the business owner. Amortization requirements generally are not found to constitute a 'taking' of private property, since in most circumstances, the business can relocate and the old location can be converted to a conforming use without undue hardship. However, if an ordinance's locational restrictions are especially severe, relocation may not be possible, in which case the ordinance may be invalidated for unconstitutionally limiting public access to sexually-oriented expression.

2 A. RATHKOPF & D. RATHKOPF, THE LAW OF ZONING & PLANNING § 17B.02(4)(e) (4th ed. 1985). *See also* Tips, *Nonconforming Uses-What Can Be Done with Them and How to Get Rid of*

ment establishments (except for one) out of their current locations and into districts where only one-third of them could suitably relocate.[234] Based on this difference, the district court held that the ordinance was invalid for greatly restricting access to protected speech.[235] Furthermore, the 500-foot restriction was held to violate the equal protection clause as it severely reduced available sites for adult enterprises, even in industrial zones.[236]

In *Ellwest Stereo Theatres, Inc. v. Byrd*,[237] a Texas district court found that a zoning ordinance deviated too far from the factors outlined in *Young*. The content-based restriction in *Ellwest* prohibited exhibition of "sexually explicit" films within 1000 feet of a church, park, school, or residential neighborhood.[238] The ordinance failed, however, for several reasons: (1) it did not include a grandfather clause allowing for amortization of the plaintiff theater owner's business,[239] (2) there was no prior judicial determination that the plaintiff's business constituted a public nuisance,[240] and (3) unlike *Young*, the city council had not made specific findings as to the negative effects of the businesses prohibited by the ordinance and the necessity of the ordinance, and the ordinance did affect pre-existing businesses.[241]

A third ordinance, in *Bayside Enterprises, Inc. v. Carson*,[242] failed for expanding its distance requirements too far. The ordinance forbade the location of an "adult entertainment or service facility" within 2500 feet of any church, school, or any other adult entertainment or service facility and within 500 feet of any residential district boundary line.[243] After determining that the zoning plan essentially would ban the establishment of new adult bookstores or theaters in the city, the court held that the ordinance could not withstand constitutional scrutiny under a *Young* analysis.[244]

In summary, where a local government enacts an exclusionary zoning ordinance that fails to include a grandfather clause permitting amortization of a

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*Them*, 1980 INST. ON PLAN. ZONING & EMINENT DOMAIN 85, 105.

[234] 511 F. Supp. at 1216.

[235] *Id.* at 1217.

[236] *Id.* at 1226.

[237] 472 F. Supp. 702 (N.D. Tex. 1979).

[238] *Id.* at 704 n.1.

[239] *Id.* at 706. Unless there is an amortization provision that allows a nonconforming use to relocate within a reasonable, specified, time period, the owner of the business affected could argue that there has been a "taking" of private property. *See supra* note 233.

[240] *Id.*

[241] *Id.*

[242] 450 F. Supp. 696 (M.D. Fla. 1978).

[243] *Id.* at 701.

[244] *Id.* at 702-03. The court reasoned that "[s]ince the Jacksonville ordinance *does* effectively bar future access to the adult entertainment market, it obviously cannot be sustained under the analysis employed by the *Young* plurality." *Id.* (emphasis added).

distributor's investment, or one that severely limits access to pornography, courts will invalidate such ordinances. A majority of courts have also required a factual record reflecting a need for remedial zoning.[245] Courts appear very cautious in sanctioning any curtailment of first amendment rights, and look carefully at any deviation from the exact ordinance upheld by the Supreme Court in *Young*.

### *b. Restrictive zoning ordinances after* Young

#### *(1) Constitutional*

Although *Young* dealt with zoning that attempted to "scatter" adult businesses, the *Young* Court also approved of an alternative zoning scheme in which adult businesses are concentrated.[246] Attempting this alternative method of zoning pornography, the city of Seattle enacted two ordinances requiring all adult theaters to be located in certain downtown areas and terminating all nonconforming theater uses within ninety days.[247] The constitutionality of this zoning enactment was challenged, in *Northend Cinema, Inc. v. Seattle*,[248] by three theaters that were prohibited from showing their normal adult fare. Although there was no provision allowing waiver of the ordinance's restriction like there had been in the Detroit ordinance in *Young*,[249] the ordinance was upheld by a state court for other reasons: (1) an amortization clause terminating all nonconforming uses within ninety days was found reasonable;[250] (2) the definition of "adult motion picture theater" was not vague and gave adequate notice of the regulated use;[251] (3) the city's interests in regulating the use of its property for commercial purposes and protecting/preserving the quality of its neighborhoods

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[245] Some California courts have allowed a city to enact zoning ordinances without developing a factual basis. *See infra* note 324 and accompanying text.

[246] 427 U.S. 50, at 62.

[247] *See* Northend Cinema, Inc. v. Seattle, 90 Wash. 2d 709, 710, 585 P.2d 1153, 1154 (1978), *cert. denied*, 441 U.S. 946 (1979).

[248] 90 Wash. 2d 709, 585 P.2d 1153.

[249] *Id.* at 719, 585 P.2d at 1159. The court determined that the city's power to "regulate the location of adult movie theaters [was] not dependent in any way on the existence of possible waiver for existing theater locations [because] [t]he Detroit waiver provision. . .played no part in the reasoning of the majority in *Young*." *Id.*

[250] *Id.* at 720, 585 P.2d at 1160. The balancing test adopted by the court, to be applied on a case-by-case basis, to determine the reasonableness of the termination period, was "whether the harm or hardship to the user outweighs the benefit to the public to be gained from termination of the use." Applying the test to the three theaters, the court concluded that the 90-day termination period was not unreasonable. *Id.*

[251] *Id.* at 715-16, 585 P.2d at 1157. *See infra* note 372 for the definition of "adult motion picture theater" upheld in *Young* and copied by *Seattle*.

through land use planning were sufficient;[252] and (4) there was no restraint on the market for distribution or exhibition of the films.[253]

### (2) *Unconstitutional*

A similarly restrictive ordinance, however, was held unconstitutional by a federal court in Texas.[254] In *E & B Enterprises v. University Park*,[255] a theater operator challenged an ordinance prohibiting certain sexually explicit businesses from all but two areas of the city—one owned by the city, and the other occupied by commercial businesses.[256] The district court applied the *Young* test strictly, distinguishing the case before it from *Young* for the following reasons: (1) no studies had been made showing that a concentration of restricted uses had a deleterious effect on neighborhoods;[257] (2) there was no evidence of deterioration of any city neighborhoods;[258] (3) there was no evidence of transients being attracted;[259] (4) there was no evidence of minors being improperly admitted to the theater;[260] and (5) there was no evidence that the plaintiff had not been responsible in displaying promotional posters and marquee lettering.[261] The ordinance would have required plaintiff's existing theater—one of

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[252] *Id.* at 718-19, 585 P.2d at 1159. The court noted that the city had asserted an interest in protecting children as a justification for the ordinance. Such an interest alone, the court maintained, could not support a classification based on content of speech after Erznoznik v. Jacksonville, 422 U.S. 205, 213 (1975) (All nudity cannot be deemed obscene even as to minors.). The particular needs of children, however, were recognized as a "significant element in determining the quality of urban residential neighborhoods." 90 Wash. 2d at 720 n.7, 585 P.2d at 1159 n.7.

[253] 90 Wash. 2d at 717, 585 P.2d at 1158.

[254] Northern courts tend to uphold zoning ordinances more often than southern courts. State courts also tend to uphold zoning ordinances more often than federal courts. *Compare* Dandy Co. v. Civil City of South Bend, County-City Complex, 401 N.E.2d 1380 (Ind. App. 1980); and Northend Cinema, Inc. v. Seattle, 90 Wash. 2d 709, 585 P.2d 1153 (1978), *cert. denied*, 441 U.S. 946 (1979) (northern state courts upholding zoning ordinances) *with* Purple Onion, Inc. v. Jackson, 511 F. Supp. 1207 (N.D. Ga. 1981); Ellwest Stereo Theatres, Inc. v. Byrd, 472 F. Supp. 702 (N.D. Tex. 1979); Bayside Enters., Inc. v. Carson, 450 F. Supp. 646 (M.D. Fla. 1978); and E & B Enters. v. University Park, 449 F. Supp. 695 (N.D. Tex. 1977) (southern federal courts invalidating zoning ordinances).

[255] 449 F. Supp. 695 (N.D. Tex. 1977).

[256] *Id.* at 697.

[257] *Id.* at 696. The ordinance in *Young* was passed to preserve Detroit's neighborhoods and was based on receipt of testimony regarding the deleterious effect the concentration of adult uses had on the neighborhood. 427 U.S. at 71 n.34.

[258] 449 F. Supp. at 696. Apparently, the motivation for passage of the ordinance was prompted by the objection of certain community members to the content of the films shown at plaintiff's theater. *Id.* at 697.

[259] *Id.* at 696.

[260] *Id.*

[261] *Id.* at 697.

only two theaters in the city and the only adult theater—to exhibit a different type of film or move out of the city.[262]

By 1981 the success rate of anti-pornography ordinances dropped off significantly.[263] Only where a zoning ordinance implicating the first amendment was challenged in a state court did it stand a chance of survival.[264] In cases where a district court initially found an adult use regulation constitutional, many federal circuit courts reversed that decision, distinguishing the case from *Young*.[265]

### 2. Schad v. Borough of Mount Ephraim: *Limits to Zoning Adult Businesses*

Five years after *Young*, the Supreme Court in *Schad v. Borough of Mount Ephraim*,[266] considered a zoning ordinance that prohibited an adult bookstore from operating a machine whereby customers could observe a live dancer, usually nude, performing behind a glass panel.[267] The operators were found in violation of the borough's zoning ordinance,[268] which did not permit live en-

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[262] *Id. See also* Marco Lounge, Inc. v. Federal Heights, 625 P.2d 982 (Colo. 1981) (city ordinance limiting live, nude entertainment establishments to E-1 districts only, violated first amendment because there were no E-1 districts anywhere in the city and no assurance that such a district would ever be created).

[263] *See infra* notes 285-316 and accompanying text. The recent Supreme Court decision in *Playtime*, 54 U.S.L.W. 4160 (U.S. Feb. 25, 1986), may reverse this trend.

[264] *See infra* notes 320-34 and accompanying text.

[265] *Compare* Genusa v. City of Peoria, 475 F. Supp. 1199 (C.D. Ill. 1979) *with* Genusa v. City of Peoria, 619 F.2d 1203 (7th Cir. 1980) (circuit court modifying lower district court) and *compare* Avalon Cinema Corp. v. Thompson, 658 F.2d 555 (8th Cir. 1981) *with* Avalon Cinema Corp. v. Thompson, 667 F.2d 659 (8th Cir. 1981) (en banc) (Eighth Circuit reversing itself after *Schad*).

Increasingly, courts used the "four-part *O'Brien* test" outlined in Powell's concurrence in *Young*:

> a governmental regulation is sufficiently justified, despite its incidental impact upon First Amendment interests, "[1] if it is within the constitutional power of the Government; [2] if it furthers an important or substantial governmental interest; [3] if the governmental interest is unrelated to the suppression of free expression; and [4] if the incidental restriction on. . .First Amendment freedoms is no greater than is essential to the furtherance of that interest."

427 U.S. at 79-80 (citing United States v. O'Brien, 391 U.S. 367, 377, *reh'g denied*, 393 U.S. 900 (1968)) (arguing that but for Powell's acquiescence with the plurality, the Detroit ordinance would not have been found constitutional).

[266] 452 U.S. 61 (1981).

[267] *Id.* at 62.

[268] Section 99-15B of Mt. Ephraim's zoning ordinance permitted uses in the commercial zone in which the bookstore was located as follows:

> B. Principal permitted uses on the land and in buildings.
>
> (1) Offices and banks; taverns; restaurants and luncheonettes for sit-down dinners only and with no drive-in facilities; automobile sales; retail stores, such as but not

tertainment in any establishment.[269] Distinguishing this case from *Young*, the Court held that an ordinance, which in effect excluded all live entertainment throughout the borough[270] could not be supported by the reasons advanced by the city: First, there was no evidence that permitting live entertainment would conflict with the borough's plan to create a commercial area catering only to the "immediate needs" of its residents.[271] Second, there was no evidence that the exclusion would avoid problems associated with live entertainment such as parking, trash, police protection, and medical facilities.[272] Furthermore, the ordinance could not be justified as a reasonable time, place, and manner restriction because the borough did not "identify [its] interest making it reasonable to exclude all commercial live entertainment but to allow a variety of other commercial uses."[273] Additionally, the city presented no evidence that live entertainment was incompatible with the current permitted uses.[274] The ordinance, which did not "leave open adequate alternative channels of communication"[275] and infringed on a "protected liberty," the Court held, was not "narrowly drawn" to further a "sufficiently substantial governmental interest."[276] The Court concluded that the borough had not established that its interests could not be served by means that would be less intrusive on protected activity.[277]

After *Schad*, challenged pornography ordinances across the country were invalidated more often than they were upheld.[278] *Young* was narrowly interpreted to require three criteria: (1) that the zoning be motivated by a desire to elimi-

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limited to food, wearing apparel, millinery, fabrics, hardware, lumber, jewelry, paint, wallpaper, appliances, flowers, gifts, books, stationery, pharmacy, liquors, cleaners, novelties, hobbies and toys; repair shops for shoes, jewels, clothes and appliances; barbershops and beauty salons; cleaners and laundries; pet stores; and nurseries. Offices may, in addition, be permitted to a group of four (4) stores or more without additional parking, provided the offices do not exceed the equivalent of twenty percent (20%) of the gross floor area of the stores.

(2) Motels.

452 U.S. at 63 (quoting Mount Ephraim Code § 99-15B (1),(2) (1979)). "Section 99-4 of the Borough's code provided that '[a]ll uses not expressly permitted in this chapter are prohibited.' " 452 U.S. at 64.

[269] *Id.* at 64.

[270] *Id.* at 65.

[271] *Id.* at 72.

[272] *Id.* at 73.

[273] *Id.* at 75.

[274] *Id.* at 74-75.

[275] *Id.* at 75-76.

[276] *Id.* at 69, 74. *Young* had required that a zoning ordinance affecting only adult theaters be "justified by the city's interest in preserving the character of its neighborhoods." 427 U.S. at 71.

[277] 452 U.S. at 74.

[278] *See infra* notes 285-334 and accompanying text.

nate the adverse effects of speech, not by a distaste for speech; (2) that access to pornography not be severely limited; and (3) that there be a "factual basis" for the ordinance.[279] Often the courts based their analysis on the four-part *O'Brien* test contained in Powell's concurrence in *Young*.[280] This test required an important or substantial governmental interest, unrelated to the suppression of free speech, which could only be restricted to the extent necessary to further that interest.[281] Invariably, *Schad*'s requirements that an ordinance be "narrowly drawn [to] further a sufficiently substantial governmental interest" and the "less intrusive alternative" became the basis for most pornography zoning analysis. Although a significant or substantial governmental interest had originally been all that was necessary to zone under the police power,[282] some courts have further complicated matters by requiring a "compelling" state interest to justify an intrusion on first amendment liberties.[283] In light of *Young*'s stricter interpretation and *Schad*'s limitations, only a few state courts have upheld zoning ordinances aimed at protected speech.[284]

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[279] Specifically, the criteria are:

> [f]irst, regulations must be motivated not by distaste for the speech itself but by a desire to eliminate its adverse effects. . . .Second, even properly motivated legislation may be unconstitutional if it severely restricts first amendment rights. . . .Third, even a properly motivated ordinance with only a limited impact on free expression may be unconstitutional under Mini Theatres if the municipality cannot demonstrate an adequate 'factual basis' for its conclusion that the ordinance will minify the evils at which it is aimed.

*Developments in the Law—Zoning*, 91 HARV. L. REV. 1427, 1557-59 (1978). *See* Strand Property Corp. v. Municipal Court, 148 Cal. App. 3d 882, 886, 200 Cal. Rptr. 47, 49 (1983); CLR Corp. v. Henline, 520 F. Supp. 760, 765 (W.D. Mich. 1981).

[280] *See, e.g.*, City of Renton v. Playtime Theatres, Inc., 54 U.S.L.W. 4160, 4162 (U.S. Feb. 25, 1986), *rev'g* 748 F.2d 527 (9th Cir. 1984); Ebel v. City of Corona, 767 F.2d 635 (9th Cir. 1985); Avalon Cinema Corp. v. Thompson, 667 F.2d 659, 662 (8th Cir. 1981); Amico v. New Castle County, 571 F. Supp. 160, 167 (D. Del. 1983), *rev'd*, 101 F.R.D. 472 (D. Del. 1984), *aff'd*, 770 F.2d 1066 (3d Cir. 1985); CLR Corp. v. Henline, 520 F. Supp. 760, 766 (W.D. Mich. 1981); Kacar, Inc. v. Zoning Hearing Bd., 60 Pa. Commw. 582, 432 A.2d 310, 314 (1981); Olmos Realty Co. v. Texas, 693 S.W.2d 711, 713-14 (Tex. Ct. App. 1985).

[281] *See supra* note 265.

[282] 427 U.S. 50, 63 n.18. Zoning that does not implicate the first amendment only requires a "substantial relation to the public health, safety, morals, or general welfare," of the community. Euclid v. Ambler, 272 U.S. 365, 395 (1926); Nectow v. City of Cambridge, 277 U.S. 183, 187-88 (1928).

[283] *See, e.g.*, Adultworld Bookstore v. City of Fresno, 758 F.2d 1348, 1352 (9th Cir. 1985); Tovar v. Billmeyer, 721 F.2d 1260, 1264 (9th Cir. 1983), *cert. denied*, 105 S. Ct. 223 (1984); Ebel v. City of Corona, 698 F.2d 390, 392 (9th Cir. 1983); Amico v. New Castle County, 101 F.R.D. 472, 490 (D. Del. 1984), *aff'd*, 770 F.2d 1066 (3d Cir. 1985).

[284] *See, e.g.*, Strand Property Corp. v. Municipal Court, 148 Cal. App. 3d 882, 200 Cal. Rptr. 47 (1983); Texas National Theatres, Inc. v. City of Albuquerque, 97 N.M. 282, 639 P.2d 569 (1982); Kacar, Inc. v. Zoning Hearing Bd., 60 Pa. Commw. 582, 432 A.2d 310 (1981); Olmos Realty Co. v. Texas, 693 S.W.2d 711 (Tex. Ct. App. 1985). *See supra* note 263 and accompany-

### *a. Unconstitutional*

Within three months of the Supreme Court's decision in *Schad*, the Sixth Circuit in *Keego Harbor Co. v. City of Keego Harbor*[285] held unconstitutional a zoning ordinance that prohibited "adult motion pictures" within 500 feet of a church, school, or an establishment licensed to sell alcohol, or within 250 feet of property zoned residential, in a 300-acre recreational city that contained twenty bars, no grocery store, drugstore, or middle or high school.[286] Distinguishing it from *Young*, the Court found the ordinance overbroad as it effectively zoned adult movie theaters out of town.[287] The ordinance failed for other reasons as well: (1) there was no objective information presented to the city when it enacted the ordinance;[288] (2) there was no evidence, aside from the city planner's assertion, "that the traffic pattern for adult theaters [was] any different from that for traditional movie theaters";[289] (3) "there [was] no indication that less intrusive measures. . .would not sufficiently regulate traffic";[290] and (4) the city's post hoc justifications did not support its ordinance's severe restriction on protected speech.[291]

Seven months after *Schad*, the Eighth Circuit, in *Avalon Cinema Corp. v. Thompson*,[292] invalidated a zoning ordinance that prohibited the exhibition of sexually explicit films within 100 yards of certain structures and areas of the city.[293] The city enacted the zoning ordinance as an emergency measure when it realized Avalon was about to open.[294] Distinguishing it from *Young*[295] and de-

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ing text.

[285] 657 F.2d 94 (6th Cir. 1981).

[286] *Id.* at 96.

[287] *Id.* at 98.

[288] *Id.* "At trial the bulk of the evidence was presented by a city planner who admitted having no special expertise with the effects of placement of adult theaters. *Id.*

[289] *Id.*

[290] *Id.* The court could not see how "adult movie theaters would have a deleterious effect on a town that [had 20] bars and few attributes of a quiet residential community." *Id.*

[291] *Id.* The court noted, however, that the first amendment burden might be "rendered incidental if. . .county-wide zoning were present to ensure that there were reasonable access to the protected activity in nearby areas." *Id.*

[292] 667 F.2d 659 (8th Cir. 1981). This decision reversed the Eighth Circuit's prior consideration of the same ordinance, *see* 658 F.2d 555 (8th Cir. 1981).

[293] The ordinance prohibited movie picture shows or theaters exhibiting well-defined sexually explicit films within 100 yards (300 feet) of any church, public or private elementary or secondary school, or area zoned for residential use. Avalon Cinema Corp. v. Thompson, 658 F.2d 555, 557 (8th Cir. 1981), *rev'd*, 667 F.2d 659 (8th Cir. 1981) (en banc).

[294] 667 F.2d at 660. "[T]here were no other adult theaters in the City at the time, and none other than Avalon was preparing to open." *Id.* at n.1. A zoning ordinance enacted in anticipation of an adult business about to open smacks of an impermissible motivation to suppress speech.

[295] *Id.* at 660. The ordinance was "not based on any studies by social scientists or on a

termining that the ordinance failed the third part of the *O'Brien* test by prohibiting zoning based on a dislike for speech,[296] the court concluded that under an analysis based on *Schad*, the city had not justified its substantial restriction of public access to a form of protected speech.[297] Furthermore, as the ordinance did not define the amount of sexually explicit matter a film could exhibit[298] and still be exempt from the ordinance,[299] the city failed to justify the line between trash and art.[300] Ordinances like the one in *Avalon*, that adversely affect the only pornography purveyor in town, or are premised on an articulated municipal goal to rid the town of that particular business, have been consistently invalidated or viewed as likely to be invalid.[301]

Local government attempts since *Schad* to enact zoning ordinances that restrict businesses and then exclude them also have failed repeatedly at the federal court level. In *Basiardanes v. City of Galveston*,[302] the city sought to restrict adult movie theaters to three use districts[303] and then within the three districts, to disperse the theaters according to three different distance requirements.[304] The court found that viewer access was severely limited by the ordinance's dis-

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demonstrated past history of" neighborhood deterioration caused by adult theaters. There was no evidence suggesting neighborhood decline from the presence of a single adult theater, and the ordinance affected existing adult establishments, unlike *Young*. *Id.* at 661-62.

[296] *Id.* at 662. It was evident the city had embarked on an effort to suppress free expression as the zoning ordinance was enacted as an emergency measure only after the city learned of the imminent opening of the city's first adult theater. *Id.* at 661-62.

[297] *Id.* at 662. The court held that where there was no evidence suggesting neighborhood decline resulting from the presence of a single adult theater, the city council had not adequately justified its substantial restriction of speech. *Id.*

[298] The "ordinance would reach a two-hour film, for example, in which one of the enumerated acts or parts of the body is depicted for a few seconds, no matter how much artistic merit or intellectual content the film as a whole might have." *Id.* at 663.

[299] The ordinance upheld in *Young*, by contrast, restricted only material "distinguished or characterized by and emphasis" on certain specified activities or parts of the body. *Id.* at n.11.

[300] *Id.*

[301] *See also* Ebel v. City of Corona, 698 F.2d 390 (9th Cir. 1983) (zoning ordinance invalidated when town's only existing adult bookstore named in ordinance's preamble); Tovar v. Billmeyer, 721 F.2d 1260 (9th Cir. 1983) (summary judgment inappropriate for city where explicit city official statement that ordinance goal was to remove plaintiff's business from town where plaintiff operated the only adult-oriented business in town); North St. Book Shoppe v. Village of Endicott, 582 F. Supp. 1428 (N.D.N.Y. 1984) (preliminary injunctive relief warranted where zoning ordinance is invalid restriction of the only adult bookstore in town).

[302] 682 F.2d 1203 (5th Cir. 1982).

[303] The uses within the permissible areas were central business, light industry and heavy industry. *Id.* at 1209.

[304] The theater had to be (1) more than 500 feet away from a residential zone "or from any two, or combination of two, 'pool halls, liquor stores, or bars' "; (2) "more than 1,000 feet from another adult theater or adult bookstore"; and (3) "more than 1,000 feet from any church, school, public park, or recreational facility where minors congregate." *Id.* at 1209.

persal requirements that effectively banned the exhibition of sexually explicit adult films in the city.[305] The only possible relocation sites were in areas zoned for light and heavy industry, lacking "access roads and retail establishments" and consisting largely of "a patchwork of swamps, warehouses and railroad tracks."[306] Under the *Schad* analysis, the ordinance neither advanced significant governmental interests[307] nor accomplished the interests without undue restraint on speech:[308] there was no evidence that the state interest in accomplishing urban renewal had a "basis in fact" that was considered by the city in passing the ordinance;[309] the timing of the ordinance's passage cast suspicion on the relationship between the ordinance and its supposed purpose;[310] and the suspiciously narrow focus of the ordinance on adult bookstores and theaters did not appear aimed at curing the deterioration of the downtown area.[311] For these reasons, the court held that the ordinance was more restrictive than necessary to achieve its purported goals.[312]

Similarly, in *CLR Corp. v. Henline*,[313] a zoning ordinance that first restricted adult uses and then excluded them within the permitted zone was found unconstitutional.[314] The ordinance's effect of allowing only two to four restricted uses in a half-mile strip of the city severely restricted access to protected expression[315] without being based on a compelling state interest.[316]

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[305] *Id.* at 1214. "The dispersal requirements result[ed] in excluding adult theaters from 80% to 90% of the three areas from which they [were] not flatly banned." *Id.* at 1209.

[306] *Id.* at 1209.

[307] The city's mere assertion that its interest was to arrest deterioration of the downtown areas and to prevent and curtail crime was not sufficient. *Id.* at 1215.

[308] *Id.*

[309] *Id.* The assertion by Galveston's mayor that the state's interest in zoning was to arrest downtown deterioration, prevent and curtail crime, and advance urban renewal, was not enough in light of *Schad*. *Id.* It was also necessary for the city to support its claim with evidence that the city's interest had a basis in fact and that the factual basis was studied by the city before passing the ordinance. *Id.*

[310] *Id.* at 1216. There were no zoning restrictions on adult theaters in Galveston until the plaintiff announced the opening of a theater opposite the Grand Opera House. Since the Opera House was a major, expensive complex within the city redevelopment plan, the sequence of events suggested that there was opposition to the location of the plaintiff's theater, not concern with urban deterioration. The court concluded that the city's motive for the zoning was its fear that an adult theater in vicinity of the Opera House would drive patrons away. *Id.*

[311] *Id.* The city had placed no restrictions on bars, pool halls, pawnshops, or massage parlors, whereas the ordinance in *Young* regulated nine uses, in addition to adult theaters, that were determined to contribute to Detroit's blight. *Id.*

[312] *Id.* at 1217.

[313] 520 F. Supp. 760 (W.D. Mich. 1981), *aff'd*, 702 F.2d 637 (6th Cir. 1983).

[314] 702 F.2d at 638. The ordinance restricted adult uses to a B2 zone and then excluded them from an area within 500 feet of a residence, church, or school, and within 1000 feet of any other adult use. *Id.*

[315] *See also* Ebel v. City of Corona, 767 F.2d 635 (9th Cir. 1985) (zoning ordinance restrict-

Whether or not a particular zoning ordinance is upheld as a valid regulation appears linked to the particular court deciding the case. Federal courts have consistently applied *Young* and *Schad* narrowly to strike down zoning ordinances.[317] If an ordinance lacks a factual record, it will fail under federal standards. State courts, however, are more deferential to legislative findings and will take reasoned liberties with apparent Supreme Court requirements for an independent fact-finding study of deterioration.[318]

### *b. Constitutional*

In light of *Schad*'s narrow requirements that a city demonstrate a compelling state interest before ordinances are enacted, it has been very difficult to defend zoning that restricts pornographic businesses. Some state courts, however, have continued to interpret *Young* broadly, permitting exclusionary treatment of adult businesses.[319]

Zoning ordinances enacted in reliance on a factual basis developed by testimony in other cases will be upheld by state courts. In *Strand Property Corp. v. Municipal Court*,[320] an adult theater owner was charged with violating an exclusionary zoning ordinance that affected adult theaters.[321] The enactment of the

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ing defined adult uses to locations (meeting specific criteria) within only two commercial zones held to be substantial restriction on access to adult material); Alexander v. City of Minneapolis, 698 F.2d 936 (8th Cir. 1983) (zoning ordinance restricting adult-only facilities to 12 possible sites held to greatly restrict access to protected material.

[316] 702 F.2d at 639. The court found that the city could not "demonstrate even a rational relationship between the asserted purpose and the effect of the statute." *Id.* There was no evidence that the ordinance was enacted to prevent urban blight through deconcentrating restricted uses, and assuming the city's purpose was to deconcentrate, "the effect of the ordinance [was] to *concentrate* any adult bookstores and theaters in the city into a 2,500-foot frontage." *Id.* (emphasis original).

[317] *See supra* notes 285-316 and accompanying text. *Cf.* City of Renton v. Playtime Theatres, Inc., 54 U.S.L.W. 4160 (U.S. Feb. 25, 1986) (U.S. Supreme Court struck down Ninth Circuit's narrow reading of *Young*.).

[318] *See infra* notes 319-34 and accompanying text. For example, state courts have upheld zoning ordinances that "borrow" a factual record that has been developed by testimony in other cases. *See, e.g.*, City of Vallejo v. Adult Books, 167 Cal. App. 3d 1169, 213 Cal. Rptr. 143, 149 (1985); Strand Property v. Municipal Ct., 148 Cal. App. 3d 882, 200 Cal. Rptr. 47 (1983), *infra* notes 320-24 and accompanying text. See also *supra* notes 344-61 for a discussion of *Playtime*, where the Supreme Court upheld a city's reliance on studies developed by other cities.

[319] *See, e.g.*, Texas Nat'l Theatres, Inc. v. City of Albuquerque, 97 N.M. 282, 639 P.2d 569 (1982); Kacar, Inc. v. Zoning Hearing Bd. 60 Pa. Commw. 582, 432 A.2d 310 (1981); Olmos Realty Co. v. Texas, 693 S.W.2d 711 (Tex. Ct. App. 1985).

[320] 148 Cal. App. 3d 882, 200 Cal. Rptr. 47 (1983).

[321] 148 Cal. App. 3d at 885. The ordinance prohibited the "transfer of ownership or control of an adult motion picture theater within 1,000 feet of a residential zone, a church, school, public

ordinance differed from the procedure in *Young* in that the City of San Diego did not set forth a "factual basis" to support its deconcentration of adult theaters.[322] Because the theater owner, by demurrer, challenged the ordinance as a substantial restriction on his first amendment rights, the court's review was limited to determining whether the ordinance was unconstitutional on its face, rather than whether it was unconstitutionally applied.[323] The court held that it was unnecessary for the city to develop independently a "factual basis" to support its ordinance as applied to local conditions; San Diego could benefit from the experience of other cities.[324] The court also held that since the language of the ordinance did not appear to be motivated by a distaste for the speech involved but by a desire to preserve neighborhoods, it was facially constitutional.[325] The issue of whether the ordinance as applied would severely restrict access, however, was not answered.[326]

Another California Court of Appeals, in *City of Whittier v. Walnut Properties*,[327] refused to find a zoning ordinance unconstitutional where the trial court had failed to rule on proffered evidence [328] on the status of a theater as an adult theater[329] and of the availability of other sites in the city for adult theaters.[330]

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park, social welfare institution or another adult entertainment business." *Id.*

[322] *Id.* at 887.

[323] *Id.* at 888. The court reasoned that "a demurrer lies only to correct defects appearing on the face of the complaint," and since Strand's factual allegations were improperly admitted, the court could only limit its review to a determination of whether the ordinance was unconstitutional on its face. *Id.*

[324] *Id.* at 887. The court reasoned that "[w]hile the city did not set forth any factual basis for the ordinance, the factual basis supporting zoning laws requiring dispersal or deconcentration ha[d] been developed by testimony in other cases. Lawmakers in one locale should not be denied the benefit of the wisdom and experience of lawmakers in another community." *Id. Playtime* validates this method of developing a factual basis. *See infra* notes 357-58 and accompanying text.

[325] *Id.* at 886-87.

[326] The court noted that even if it could "reach Strand's factual allegations as to the limited amount of land available for the establishment of *new* adult motion picture theaters, those allegations alone would not be determinative." *Id.* at 888 n.7. Before invalidating the ordinance as unduly restrictive of first amendment rights, the court would need to know the extent of permitted, established adult theaters. It could be the case that the city's "established theaters provide sufficient numbers and access for First Amendment purposes." *Id.*

[327] 149 Cal. App. 3d 637, 197 Cal. Rptr. 127 (1983).

[328] The parties in the case had stipulated that the city would call a witness to testify as to the availability of other locations within the city for adult theaters if the plaintiff's objection on the ground of relevancy was overruled. Apparently, the objection was never overruled or even ruled upon. *Id.* at 641-42.

[329] *Id.* at 643. "At the hearing before the city council, Lieutenant Marino testified that he made periodic inspections of the movies at the Walnut Theatre, and these movies depicted various acts from which the city council could have concluded that the movies were 'adult movies' within the legal meaning of that term." *Id.*

The city enacted an ordinance that both restricted and excluded adult businesses.[331] The court held that the code's term "adult theatre" was not unconstitutionally vague or overbroad.[332] Further, there was no evidence that the 120-day amortization period included in the ordinance was unreasonable on its face.[333] Finally, the court remanded the case for a ruling on the proffered evidence of the character of the respondent's theater and availability of alternative sites in which an adult theater might locate.[334]

In jurisdictions outside of California nearly all pornography ordinances have been invalidated. In *Amico v. New Castle County*,[335] however, the United States District Court for Delaware federal accepted the protection of children attending churches and schools from the adverse effects of adult entertainment centers as a compelling state interest supporting distance restrictions.[336]

In 1977 New Castle County had enacted a zoning ordinance[337] that prohibited plaintiff from opening an adult entertainment center. Plaintiff's business would have been located within 500 feet of residential property, in violation of the ordinance.[338] In 1983 the Delaware federal district court held the ordinance unconstitutional because the restriction prohibiting adult entertainment centers

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[330] *Id.* at 642. The city's planning director was willing to testify that there were other industrially and commercially zoned properties where adult businesses could locate. *Id.*

[331] An adult business was first restricted to a zone C2, or a less restrictive zone. Within this zone, it was prohibited from within 500 feet of a residential zone or lot on which there was located a business with an alcohol license, and from within 1000 feet of a church, "a lot upon which there [was] located a city-owned, operated and maintained public park," or another adult business. 149 Cal. App. 3d at 638.

[332] *Id.* at 642. This California court maintained that the term "adult theatre": (1) had "become part of the American vernacular"; (2) was specifically defined within the ordinance; and (3) had "been used frequently in courts to describe a specific kind of entertainment." *Id.* at 642-43. Furthermore, if there were any vague language in such an ordinance, California courts have "construfed] the language narrowly in order to preserve its validity." *Id.* at 643. *See* Kuhns v. Board of Supervisors, 128 Cal. App. 3d 369, 375, 181 Cal. Rptr. 1 (1982); Pringle v. City of Covina, 115 Cal. App. 3d 151, 155, 171 Cal. Rptr. 251 (1981); Pryor v. Municipal Court for Los Angeles Judicial Dist., 25 Cal. 3d 238, 599 P.2d 636, 158 Cal. Rptr. 330 (1979).

[333] 149 Cal. App. 3d at 644.

[334] *Id.* at 642-43.

[335] 101 F.R.D. 472 (D. Del. 1984), *aff'd*, 770 F.2d 1066 (3d Cir. 1985).

[336] 101 F.R.D. at 490.

[337] The ordinance, which was later amended, provided in pertinent part:

> (13) Massage parlors which provide services on and/or off premises, adult bookstores, and adult entertainment centers shall be permitted as follows: (a) No such uses shall be permitted within 500 feet of any property used solely for residential purposes. (b) No such uses shall be permitted within 2,800 feet of a school, church or other place of worship. (c) No such uses shall be permitted within 1,500 feet of each other. . . .The ordinance further restricted adult entertainment centers to areas zoned for general business.

571 F. Supp. at 163.

[338] *Id.*

from within 500 feet of residential property had not been narrowly drawn to safeguard the city's interests in protecting children and maintaining the integrity of neighborhoods.[339] Based on this decision, the plaintiff proceeded with plans to open his business. Before the plaintiff could begin operations, however, the county discovered that plaintiff's proposed location would be less than 2800 feet away from a church in violation of a different section of the zoning ordinance.[340] In a second suit the plaintiff challenged the 2800-foot restriction. The district court first held that the spacing requirement for churches and schools was severable from the invalidated 500-foot residential spacing requirement.[341] Under an equal protection analysis, the court then concluded there was a sufficient underlying factual basis to support the conclusion that the minimum distance requirement was narrowly drawn to further the asserted state interest of protecting children attending churches or schools from the adverse effects of adult entertainment businesses.[342] Finally, the court determined that a trial would be required to decide the issues relating to overbreadth and impermissible content motivation.[343]

### 3. City of Renton v. Playtime Theatres, Inc.: *Zoning Nonexistent Adult Theaters*

Compelled by its decision in *Young*, the United States Supreme Court, in *City of Renton v. Playtime Theatres, Inc.*,[344] recently upheld a city's right,

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[339] The court pointed out that the 500-foot restriction described in *Young* had been held unconstitutional by a Michigan district court and this ruling was not overturned by the Supreme Court's decision in *Young*. "The 500 foot restriction [was] overly broad because it act[ed] to prevent the opening of an adult entertainment center in areas where there might be no children and because it prohibit[ed] the location of an adult entertainment center in areas where there [were] no neighborhoods." *Id.* at 169.

[340] 101 F.R.D. at 478.

[341] *Id.* at 481-82.

[342] *Id.* at 487. The County Council had considered the following facts:

> (1) adult book stores caused decreases in property values; (2) strangers filtered into the communities located near such establishments, which caused residents to feel unsafe; (3) book store patrons parked their cars on neighborhood streets which caused parking problems; (4) men were seen urinating and masturbating in the parking lots; (5) trash, especially beer cans, was thrown from parking lots onto residential property; and (6) automobiles and trucks of book store patrons were directly involved in accidents involving Midvale residents."

*Id.*

[343] *Id.* at 489-91. The district court determined that where evidence allows inferences which support either "that impermissible motivation was a 'substantial factor' in the decision-making process" in the first amendment area or that such motivation was not a substantial factor, "summary judgment may not be granted." *Id.* at 491.

[344] 54 U.S.L.W. at 4160.

despite articulated criticism of film content, (1) to set aside a developed and undeveloped area for the location of adult theaters, and (2) to rely on the experiences of and studies produced by other cities in enacting an adult theater zoning ordinance. When Renton's zoning ordinance went into effect, there were no adult theaters in the city.[345] Subsequently, the purchaser of an adult theater who wanted to locate within the area proscribed in the ordinance sued the city, seeking a declaration that the ordinance was unconstitutional.[346] The city then brought suit in state court seeking a declaratory judgment that the ordinance was constitutional on its face and as applied to the purchaser's proposed use. The city action was twice removed to federal court and twice remanded to the state court. Both parties appealed from decisions of the Washington district court which denied a permanent injunction and the city's motion for fees and costs on the second removal.[347] The Ninth Circuit subsequently held that (1) the ordinance seriously limited the number of possible sites for adult theaters,[348] (2) there was insufficient evidence to establish a substantial governmental interest in regulating adult theaters,[349] and (3) the ordinance was motivated by a distaste for content.[350] The United States Supreme Court reversed. As the Renton ordinance was designed to preserve the quality of urban life,[351] and like the ordinance in *Young*, did not bar adult theaters altogether,[352] it was upheld as an acceptable time, place, and manner regulation.[353] The Court approved the district court's finding that the Renton City Council was predominantly concerned with the secondary effects of adult theaters[354] on the adjacent commu-

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[345] *Id.* at 4161.

[346] 748 F.2d at 530. The ordinance "prohibited any 'adult motion picture theater' within [1,000] feet of any residential zone or single or multiple family dwelling, any church or other religious institution, and any public park or area zoned for such use. The ordinance further prohibited any such theater from locating within one mile of any public or private school." *Id.* at 529. Renton subsequently enacted an emergency ordinance after Playtime's suit. The new ordinance added reasons for the ordinance's enactment, further defined the word "used," and reduced the required distances from schools from one mile to 1000 feet. *Id.* at 530. For the reasons which Renton gave for adopting the ordinance, see Appendix.

[347] *Id.* at 529.

[348] *Id.* at 534.

[349] *Id.* at 536.

[350] *Id.* at 537.

[351] 54 U.S.L.W. at 4162.

[352] *Id.* at 4161.

[353] *Id.*

[354] *Id.* at 4162. The ordinance was "designed to prevent crime, protect the city's retail trade, maintain property values, and generally 'protec[t] and preserv[e] the quality of [the city's] neighborhoods, commercial districts, and the quality of urban life.' " *Id.* The Supreme Court did not address the fact that these secondary effects are directly related to the content of the movies. *See also Redlining the Right Lights*, NEWSWEEK, Mar. 10, 1986, at 69.

nity, and not with the content of adult movies.[355] This determination established that Renton's interest in zoning was unrelated to the suppression of speech.[356] Although Renton's ordinance, unlike the ordinance in *Young*, was enacted without the benefit of studies specifically dealing with Renton's particular problems and needs,[357] the Court additionally held that "Renton was entitled to rely on the experiences of [and studies produced by the nearby city of] Seattle and other cities" in enacting its adult theater zoning ordinance.[358] In response to charges that Renton's ordinance was "under inclusive" in failing to regulate other kinds of adult establishments likely to generate secondary effects similar to those produced by adult theaters, the Court determined that Renton's choice to first address the potential problems created by adult theaters was not discriminatory treatment.[359] There was debate, however, as to whether the 520-acre set-aside area for adult theaters, consisting of undeveloped land and land developed for existing commercial uses provided "reasonable alternative avenues of communication" as required by the first amendment.[360] The Court declared that because prospective owners of adult theaters "must fend for themselves in

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[355] *Id.* at 4162. Apparently, the Ninth Circuit Court of Appeals viewed the stated reasons for the ordinance, *see* Appendix, as unrebutted inferences of a dislike for content. 748 F.2d at 537. If any "motivating factor" in enacting the ordinance was to restrict first amendment rights, the ordinance would be invalid. *Id.* The United States Supreme Court disapproved the Ninth Circuit's interpretation of the law:

> It is a familiar principle of constitutional law that this Court will not strike down an otherwise constitutional statute on the basis of an alleged illicit legislative motive. . . .
>
> . . . What motivates one legislator to make a speech about a statute is not necessarily what motivates scores of others to enact it, and the stakes are sufficiently high for us to eschew guesswork.

54 U.S.L.W. at 4162 (quoting United States v. O'Brien, 391 U.S. 367, 383-84 (citations omitted)).

[356] 54 U.S.L.W. at 4162.

[357] *Id.*

[358] *Id.* at 4163. In particular, Renton was entitled to rely on the "detailed findings" summarized in the Washington Supreme Court's opinion, Northend Cinema, Inc. v. Seattle, 90 Wash. 2d 709, 585 P.2d 1153 (1978), which was before the Renton City Council when it enacted the ordinance. 54 U.S.L.W. at 4163. *See supra* notes 247-53 for discussion of *Northend Cinema*. The Court stated that:

> [t]he First Amendment does not require a city, before enacting such an ordinance, to conduct new studies or produce evidence independent of that already generated by other cities, so long as whatever evidence the city relies upon is reasonably believed to be relevant to the problem that the city addresses.

54 U.S.L.W. at 4163.

[359] 54 U.S.L.W. at 4163.

[360] *Id.* Respondents argued that part of the 520 acres was "already occupied by existing businesses, that 'practically none' of the undeveloped land [was] currently for sale or lease, and that in general there was no 'commercially viable' adult theater sites within the [area] left open by the Renton ordinance." *Id.*

the real estate market, on an equal footing with other prospective purchasers and lessees, [this did] not give rise to a First Amendment violation."[361]

Duplication of the zoning ordinance in *Playtime*, which did not affect any *existing* adult theaters, may be limited to cities wherein no adult businesses have located or are intending to move. The right of cities to rely on the experiences of and studies produced by other cities in compiling a factual record, however, should facilitate adult business zoning by cities already inundated by sexually oriented establishments. The fact, too, that cities do not have to ensure that adult businesses will be able to obtain sites at bargain prices outside of prescribed zones, but must compete with other purchasers, should encourage cities to zone existing adult businesses even if nonconforming uses are amortized out and forced to relocate.

### *B. Can Pornography Be Zoned in Honolulu?*

Regulation of pornography through zoning laws that comply with the criteria set forth in *Young*, *Schad*, and *Playtime* requires advanced planning. What is needed is (1) a carefully worded and narrowly drawn ordinance; (2) a substantial or a compelling state interest; and (3) a compilation of legitimate facts, supporting the governmental interest, which would be presented to a legislative body as a basis for the ordinance. Any testimony before a city council expressing a dislike for pornography would seriously jeopardize a zoning attempt fashioned after *Young*. The availability of pornography and the location and adverse effects of sex-oriented businesses in Waikiki and other sections of Honolulu has continuously plagued Honolulu residents and businessmen concerned with the quality of life, the quality of tourism, and the safety of children.[362] Since *Young*, Honolulu has entertained various means of controlling pornographic establishments in an effort to improve the face of Waikiki and surrounding residential areas. Regulation, however, has not been adopted or implemented.

#### *(1) Honolulu's attempts to control pornography*

In 1976, a week after the decision in *Young*, Honolulu's Mayor Frank F. Fasi announced plans to submit a bill to the City Council that would permit the council to restrict the location of pornographic theaters and bookstores through

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[361] *Id.* The first amendment does not require a local government to "ensure that adult theaters, or any other kinds of speech-related businesses . . . will be able to obtain sites at bargain prices." *Id.* Renton had provided adult theater owners a "reasonable opportunity to open and operate an adult theater within the city." *Id.*

[362] For current Honolulu citizen concerns, see *supra* notes 17-19 and accompanying text. For past concerns see *infra* notes 363-71 and accompanying text.

zoning.[363] The bill was modeled after Boston's zoning ordinance that restricted all pornography to a "combat zone"[364] in contrast to the Detroit dispersal model. Donald Bremner, head of the Waikiki Improvement Association, objected to the bill for the following reasons: (1) allowing pornography in certain locations gave it legal sanction;[365] (2) Boston's "combat zone" was a "nest of crime that [was] out of control";[366] and (3) as zoning could not be made retroactive, there was no guarantee that existing pornography outlets, grandfathered in as nonconforming uses, would be eliminated.[367] In 1977 the bill to control pornographic establishments was shelved by the City Council.[368] In 1983, there was a second attempt to zone pornography.[369] Then City Council Chair Patsy T. Mink introduced a bill amending the Comprehensive Zoning Code to require new theaters to get conditional use permits from the Department of Land Utilization (DLU).[370] The DLU opposed this measure because (1) it allowed existing adult establishments to remain, (2) it left out bookstores and boutiques, and (3) it could "actually increase adult entertainment places on Oahu as well as run up against constitutional protections of free speech."[371] No action was taken on the bill.

For apparently practical and constitutional reasons, zoning pornography in Honolulu seems to have lost its attraction.[372] City Councilwoman Mink has

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[363] *City Proposal on Pornography Is Criticized*, Honolulu Star-Bull., June 26, 1976, at A2, col. 1.

[364] *Id.*

[365] Bremner, *Porno Zoning Won't Work*, Honolulu Star-Bull., May 10, 1977, at A17, col. 4; *Zoning Pornography*, Honolulu Star-Bull., June 25, 1976, at A18, col. 1.

[366] *Zoning Pornography*, Honolulu Star-Bull., June 25, 1976, at A18, col. 1.

[367] Bremner, *Porno Zoning Won't Work*, Honolulu Star-Bull., May 10, 1977, at A17, col. 4; *City Proposal on Pornography Is Criticized*, Honolulu Star-Bull., June 26, 1976, at A2, col. 1.

[368] Oshiro, *Committee Shelves Bill to Control Porn*, Honolulu Advertiser, Oct. 20, 1977, at A3, col. 3. "Committee members said the proposal, patterned after a Detroit ordinance, would not solve the problems related to regulating bookstores and movie theaters that deal in 'adult' fare." The bill called for pornography businesses to be separated by a minimum of 1000 feet and kept away from residential and apartment-zoned districts by 500 feet. Waikiki groups questioned "whether the measure would be effective in eliminating shops and theaters that already exist." *Id.*

[369] *See infra* notes 370-71 and accompanying text.

[370] H.R. 57 (Draft No. 1) (1983). Chairwoman Mink introduced the bill after learning two theaters in downtown Honolulu planned to show X-rated films. Manuel, *Mink's Porno Bill Won't Work, Agency Says*, Honolulu Star-Bull., Nov. 2, 1983, at A12, col. 1.

[371] *Id.* According to the DLU, Patsy Mink's bill that would have required recreational establishments to obtain conditional use permits did not address the Waikiki bookstores and boutiques, but encouraged pornography there. The DLU recommended instead that the State Legislature pass stricter anti-pornography laws. *Id.*

[372] *See supra* notes 363-71 and accompanying text. Reacting to the United States Supreme Court's recent decision in *Playtime*, City Councilwoman Patsy Mink has declared that she may revive her earlier efforts to exclude pornographic theaters from residential neighborhoods and from the Waikiki tourist district. "Certainly Waikiki strikes me as a place where we might make

decided to wait for a final court decision on the Indianapolis pornography ordinance before she takes further action on her proposal.[373] In March of 1985, a bill sponsored by Donald Bremner that would have empowered the Honolulu Liquor Commission to prohibit nude entertainment in Waikiki bars and cabarets[374] failed to pass a Senate third reading.[375] Most recently, Honolulu has turned to arresting pornography traffickers under its obscenity laws.[376] A zoning ordinance, however, carefully designed to address the shortcomings in earlier zoning proposals, is still a practical, constitutional means of regulating pornography.[377]

### *(2) A proposal for zoning*

#### *a. The ordinance*

To zone pornography in Honolulu, the Comprehensive Zoning Code Busi-

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a beginning. . . . The Waikiki Special Design District is the perfect place where we could say, 'No porno' . . . ." Wagner, *Mink Favors Use of Zoning to Control Oahu Pornography*, Honolulu Star-Bull., Mar. 1, 1986, at A3, col. 1.

[373] Letter from Patsy T. Mink, City Council Chairwoman, to the author (Feb. 12, 1985)(discussing proposed pornography bill). Since the Supreme Court has summarily affirmed *Hudnut, see Pornography Not Bias*, Honolulu Advertiser, Feb. 25, 1986, at D1, col. 2, City Councilwoman Patsy Mink is reconsidering her 1983 bill requiring movie theaters and arcades to have special permits to operate in business districts. Wagner, *supra* note 372.

[374] In California v. La Rue, 409 U.S. 109, the Court held that states have broad leeway under the twenty-first amendment to control the manner and circumstances under which alcohol may be dispensed. *Id.* at 116. Under the rational basis test, the Court concluded that it was not irrational to prohibit the combination of lewd or naked entertainment with liquor. *Id.* at 118. It was not unreasonable, the Court maintained, to devise a prophylactic solution to sex-related crimes that were alleged to have increased in or near these bars and nightclubs. *Id.* at 116.

U.S. CONST. amend. XXI, § 2 states: "The transportation or importation into any State, Territory, or possession of the United States for delivery or use therein of intoxicating liquors, in violation of the laws thereof, is hereby prohibited."

[375] On March 11, 1985, Senate Bill 891, Senate Draft 1, failed to pass a Senate third reading and did not cross over to the House of Representatives. Telephone interview with Cheryl Yim, Legislative Reference Bureau, State of Hawaii (Nov. 5, 1985). A Honolulu newspaper published an article on the bill when it was first introduced. *Bill May Keep Dancers Fully Clothed*, Honolulu Advertiser, Mar. 2, 1985, at A4, col. 4.

[376] *See supra* notes 8, 16 and accompanying text.

[377] A survey conducted by the American Bar Association reported that although most attorneys thought pornography discriminated against women and contributed to violent crimes against women, few attorneys approved of anti-pornography ordinances that defined pornography as a violation of women's civil rights. Nine out of ten attorneys agreed, however, that municipalities "have the right to enact" zoning ordinances that "restrict locations of porn shops and adult movie theaters." *Lawpoll: Pornography as Civil Rights Violation: Right Enemy, Wrong Attack*, 71 A.B.A. J. 46 (R. Allen ed. 1985).

ness District Use Regulations[378] could be amended as follows:

> 1. "Theaters" would be deleted as a permitted use for B-1 Neighborhood Business District, and a new subsection entitled "Conditional Uses and Structures" would be added.
> 2. The Conditional Uses and Structures subsection of the B-2 Community Business District would be amended to include special regulations that would be set forth as follows: Prior to establishing or conducting any adult business, including adult book stores, adult motion picture theaters, adult mini motion picture theaters, adult video tape viewing studios and arcades, and adult entertainment centers, a conditional use permit shall be obtained, and adult businesses shall be granted a conditional use permit only if the lot upon which such business is proposed to be located:
>
> (a) is not within 500 feet of any lot upon which there is located a church or place of worship that has after school programs for children; and (b) is not within 500 feet of any lot upon which there is located any public, private, or parochial elementary, junior high, or high school; YMCA; YWCA; and (c) is not within 500 feet of any lot upon which there is located a city or state-owned, operated, and maintained public park; and (d) is not within 500 feet of any two other adult businesses.

The definition for each adult business and the terms, "specified sexual activities" and "specified anatomical areas," could be the same as those in *Young*.[379]

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[378] HONOLULU, HAWAII, REV. ORDINANCES §§ 21-8.2(a), (d) and 21-8.11(c)-(d) (1978) (Comprehensive Zoning Code).

[379] "Adult Book Store" would be defined as follows:

> An establishment having as a substantial or significant portion of its stock in trade, books, magazines, and other periodicals which are distinguished or characterized by their emphasis on matter depicting, describing, or relating to "Specified Sexual Activities" or "Specified Anatomical Areas," or an establishment with a segment or section devoted to the sale or display of such material.

427 U.S. at 53 n.5.

"Adult Motion Picture Theater" would be defined as follows: "An enclosed building with a capacity of 50 or more persons used for presenting material distinguished or characterized by an emphasis on matter depicting, describing or relating to 'Specified Sexual Activities' or 'Specified Anatomical Areas,' for observation by patrons therein." *Id.*

"Adult Mini Motion Picture Theater" would be defined as follows: "An enclosed building with a capacity for less than 50 persons used for presenting material distinguished or characterized by an emphasis on matter depicting, describing or relating to 'Specified Sexual Activities' or 'Specified Anatomical Areas,' for observation by patrons therein." *Id.*

"Specified Sexual Activities" would be defined as follows: "1. Human Genitals in a state of sexual stimulation or arousal; 2. Acts of human masturbation, sexual intercourse or sodomy; 3. Fondling or other erotic touching of human genitals, pubic region, buttock or female breast." 427 U.S. at 53 n.4.

"Specified Anatomical Areas" would be defined as: "1. Less than completely and opaquely covered: (a) human genitals, pubic region, (b) buttock, and (c) female breast below a point

Nonconforming uses would be amortized[380] over a six-month period.[381] Ninety-day extensions would be allowed in case of hardship, with no more than two such extensions granted per adult business.

As outlined above, the proposed zoning amendments would terminate nonconforming adult businesses within a year. New adult businesses or those having to relocate would be deconcentrated outside of the restricted areas.[382] The adult peep shows along Kalakaua Avenue in Waikiki would have to relocate as they are presently located within 500 feet of Waikiki Beach.[383] As applied, the ordinance would affect adult businesses that have continuously troubled Honolulu residents and businessmen.[384]

### *b. The governmental interest*

Honolulu has a twofold interest in regulating adult businesses. First, the state has a substantial economic interest in preserving the quality of Waikiki as an

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immediately above the top of the areola; and 2. Human male genitals in a discernibly turgid state, even if completely and opaquely covered." *Id.*

[380] HAWAII REV. STAT. § 46-4 (Supp. 1984) provides for the amortization of nonconforming uses in commercial, industrial, resort, and apartment zoned areas only. Sections 21-1.7(a) to (e) of Honolulu's Comprehensive Zoning Code, however, would have to be amended to provide for amortization of nonconforming uses.

[381] In Hart Book Stores, Inc. v. Edmisten, 612 F.2d 821 (4th Cir. 1979), *cert. denied*, 447 U.S. 929 (1980), a non-location-specific ordinance with a six-month amortization period was upheld. In City of Whittier v. Walnut Properties, Inc., 149 Cal. App. 3d 633, 197 Cal. Rptr. 127 (1983), a 120-day amortization period was acknowledged as a short period, but not unreasonable on its face. In Northend Cinema, Inc. v. Seattle, 90 Wash. 2d 709, 585 P.2d 1151 (1978), *cert. denied*, 441 U.S. 946 (1979), an amortization clause terminating all non-conforming uses within 90 days was found reasonable. *But cf.* Ebel v. City of Corona, 767 F.2d 635 (9th Cir. 1985) (60-day amortization period unreasonable in light of plaintiff's five-year lease and financial and investment in adult bookstore); Alexander v. City of Minneapolis, 698 F.2d 936 (8th Cir. 1983) (four-year grace period irrelevant where ordinance declared an unconstitutional restriction on access to protected material).

[382] This would have affected the Queen Theater, often a target of those who object to adult theaters, which is located within 500 feet of Liliuokalani Elementary School. Because of the efforts of the Prosecutor's Office, the theater is being converted into a performing arts center. *See* Ryan, *Dowdy Queen Theater Getting Another Fling at Respectability*, Honolulu Star-Bull., Jan. 7, 1986, at A1, col. 2.

[383] This ordinance would effectively ban adult businesses from Diamond Head to the *ewa* end of Ala Moana Beach Park, an area heavy with tourist traffic. If the distance were lengthened to 1000 feet, the ordinance would affect any adult business along Kuhio Avenue as well.

[384] *E.g.*, On Apr. 16, 1985, Mrs. Omiyo, a salesperson at the Peep-A-Rama Bookstore on Kalakaua Avenue in Waikiki was convicted by a jury of selling a legally obscene magazine to an undercover police officer. Kobayashi, *Jury Finds Magazine Pornographic*, Honolulu Advertiser, Apr. 17, 1985, at A3, col. 2. *See supra* notes 8, 16 and accompanying text.

international tourist destination.[385] The concentration of adult businesses at the *ewa* (west) end of Waikiki, for example, may adversely affect the quality of the neighborhood, attract undesirable transients, and force other businesses to move elsewhere. Tourists, too, may decide to vacation elsewhere.[386] Second, the city has a compelling interest in protecting children[387] going to and from school, church, the parks, and the beach from the adverse effects of adult businesses.[388]

Protection of property values, the quality of neighborhoods, and children are the traditional reasons for regulating adult businesses.[389] The City Council must decide if it is going to create a factual basis for the ordinance consistent with *Young*, *Schad*, and *Playtime* and only set forth zoning reasons that on their face are not motivated by a dislike for content. A more honest, progressive approach, however, includes the mounting evidence that the content of pornography harms, in addition to the secondary effects of pornographic establishments.[390]

There is a substantial governmental interest in protecting parents' rights to direct the upbringing and education of their children. Parents' rights to raise their children free from dehumanizing ideas of sexism and images of sexual violence should be incorporated into a plan for regulating the location of sex-oriented businesses.

Women's right to be free from the harm of violent pornography, manifested in negative attitudes towards women in the bedroom, in the workplace, and in the community, is a compelling interest.[391] The state should be able to use its police power to regulate establishments that sell material promoting ideas that dehumanize women.[392]

A zoning ordinance supported partially by reasons based on a dislike for

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[385] This interest could be seriously undermined by the fact that adult businesses in Waikiki cater to a large percentage of Japanese tourists who travel abroad specifically to enjoy adult entertainment that is censored in their own country.

[386] Opinion or market surveys could prove this point.

[387] *See, e.g.*, *supra* note 342 and accompanying text.

[388] *See* Amico v. New Castle County, 101 F.R.D. 472 (D. Del. 1984), *aff'd*, 770 F.2d 1066 (3d Cir. 1985), *supra* note 342 and accompanying text. Increasingly, Hawaii is being advertised as a family destination. Vacationing children may be exposed to adult businesses as they walk along Kalakaua Avenue with or without their unsuspecting parents. Hawaii's school children too spend weekends engaged in water sports at Waikiki Beach. Their exposure to the negative effects of sex-oriented businesses, going to and from the beach, is of equal concern.

[389] *See, e.g.*, Young v. American Mini Theatres, Inc., 427 U.S. 50 (state has substantial interest in preserving qualify of neighborhoods) (discussed *supra* notes 97-101 and accompanying text); Amico v. New Castle County, 101 F.R.D. 472 (state has compelling interest in protecting children from the adverse effects of adult entertainment center) (discussed *supra* note 129 and accompanying text).

[390] *See supra* notes 129-48 and accompanying text.

[391] *See supra* notes 150-58 and accompanying text.

[392] For discussion of pornography's effects, see *supra* notes 129-48 and accompanying text.

content that advocates dehumanizing and injurious ideas is unorthodox, but honest. A responsive council could better serve all its constituents if it enacted a zoning ordinance that embraced (1) the interests of cities in promoting quality tourism and in providing safe communities, (2) the nationwide interest in protecting children, (3) the interests of parents in rearing their children to respect human rights and dignity, and (4) the interests of women in being free from sex-based discrimination.

### *c. The factual basis*

A factual record supporting the traditional reasons for zoning should avoid any suggestion of an impermissible motivation. In compiling such a record, the following actions would be appropriate:

(1) The ordinance should not be introduced just before a new adult business is scheduled to open.

(2) There should be evidence that the City has studied the deleterious effects of adult businesses and applied its findings to the particular problems or needs of Honolulu such as protecting children and the quality of tourism.

(3) Sociologists and urban planners should testify about the negative effects concentrations of adult businesses have on the neighborhood, i.e., lowering of property values, influx of loitering, undesirable transients, an increase in crime, and an adverse effect on tourism.

In addition, a factual record supporting parental and women's rights should include empirical studies establishing the following:

(1) Evidence of an increase in child molestation;[393]

(2) Evidence of the number of working mothers and latchkey children;[394]

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[393] In Honolulu, there has been an increase in reported sex abuse of children. Telephone interview with Maureen Yano, statistician, Research Division, Department of Social Services and Housing, State of Hawaii (Apr. 18, 1985). Confirmed child sex abuse cases in Hawaii increased from 228 in 1983-1984 to 351 in one year, according to figures compiled by researchers with the Department of Social Services and Housing. *Child Sex Abuse Increases at 'Disturbing' Rate*, Honolulu Star-Bull., Jan. 23, 1986, at A3, col. 1.

Detective Judy Wertzberger of the Honolulu Police Department reports that there has been an increase in reported child molestation cases since August 1984. Most of the attacks take place in the home of the perpetrator. Most pornography, she commented, is purchased from shops and then taken home. Telephone interview with Detective Judy Wertzberger, Honolulu Police Department (Apr. 23, 1985).

[394] The secretary at Liliuokalani Elementary School said that she had not handled any cases where parents pulled their children out of the school because of the proximity of the Queen Theater. Because Liliuokalani has no after school care program, many parents have been granted district exemptions to place their children where there are such programs or near their babysitter's residence. Telephone interview with Lynette K. Gomes, secretary, Liliuokalani Elementary School, Honolulu, Hawaii (Apr. 18, 1985). It is apparent that working or non-working parents who can

(3) Evidence of an increase in reported rapes;[395]

(4) Testimony by women who have been victims of illegal acts;[396] and

(5) The studies conducted by Professor Feshbach, Neil Malamuth, and Dr. Edward Donnerstein, concluding that violent pornography causes increased male aggression.[397]

If the City Council compiles a factual record that includes the traditional as well as "honest" reasons for zoning pornography, it will have formulated a powerful ordinance in the long run.[398]

## V. CONCLUSION

Pornography offends many. This fact is supported by a history of censorship and control of certain types of pornography via obscenity laws and legitimate state interests. There is also evidence that violent pornography causes male aggression against women. There are demands that pornography be banned as a violation of women's civil rights. The first amendment, however, still protects depictions of gang rape and sexual mutilation. Until a court of law decides that women's civil rights take precedence over a pornographer's right to produce and peddle material that dehumanizes and demeans women, communities must boycott, speak out against, and regulate offensive pornography businesses. Honolulu can do its part in the battle against pornography by zoning its adult businesses into areas not frequented by tourists or children. In doing so, Honolulu can protect its land values, preserve the quality of tourism, and improve the quality of life for all of its citizens.

Susan A. Bender

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afford it, want their children to be supervised.

[395] Although Hawaii's crime rate continues to decline, there was a 2% increase in rape reported between 1983 and 1984. Wright, *Island Crime Rate Continues to Decline*, Sunday Honolulu Star-Bull. & Advertiser, Apr. 21, 1985, at A1, col. 2. Last year two California researchers, in a study of 200 prostitutes, found 193 cases of rape; in roughly one quarter the male attacker appeared to be acting out a pornography script. "I seen it all in the movies," one told his victim. "You love being beaten. . . .You know you love it, tell me you love it." *The War Against Pornography*, NEWSWEEK, Mar. 18, 1985, at 58, 65.

[396] *See supra* notes 139-44 and accompanying text.

[397] *See supra* notes 145-48 and accompanying text.

[398] To insure the success of zoning adult businesses the City Council may want to consider a severability clause providing for the deletion of content-based reasons in the factual record should the need arise.

## APPENDIX

Renton gave the following reasons for the amended ordinance:

1. Areas within close walking distance of single and multiple family dwellings should be free of adult entertainment land uses.
2. Areas where children could be expected to walk, patronize or recreate should be free of adult entertainment land uses.
3. Adult entertainment land uses should be located in areas of the city which are not in close proximity to residential uses, churches, parks and other public facilities, and schools.
4. The image of the City of Renton as a pleasant and attractive place to reside will be adversely affected by the presence of adult entertainment land uses in close proximity to residential land uses, churches, parks and other public facilities, and schools.
5. Regulation of adult entertainment land uses should be developed to prevent deterioration and/or degradation of the vitality of the community before the problem exists, rather than in response to an existing problem.
6. Commercial areas of the City patronized by young people and children should be free of adult entertainment land uses.
7. The Renton School District opposes a location of adult entertainment land uses within the perimeters of its policy regarding busing of students, so that students walking to school will not be subjected to confrontation with the existence of adult entertainment land uses.
8. The Renton School District finds that location of adult entertainment land uses in areas of the City which are in close proximity to schools, and commercial areas patronized by students and young people, will have a detrimental effect upon the quality of education which the School District is providing for its students.
9. The Renton School District finds that education of its students will be negatively affected by location of adult entertainment land uses in close proximity to location of schools.
10. Adult entertainment land uses should be regulations [sic] by zoning to separate it from other dissimilar uses just as any other land use should be separated from uses with characteristics different from itself.
11. Residents of the City of Renton, and persons who are non-residents but use the City of Renton for shopping and other commercial needs, will move from the community or shop elsewhere if adult entertainment land uses are allowed to locate in close proximity to residential uses, churches, parks and other public facilities, and schools.
12. Location of adult entertainment land uses in proximity to residential uses, churches, parks and other public facilities, and schools, may lead to increased levels of criminal activities, including prostitution, rape, incest and assaults in the vicinity of such adult entertainment land uses.
13. Merchants in the commercial area of the City are concerned about adverse impacts upon the character and quality of the City in the event that adult en-

tertainment land uses are located within close proximity to residential uses, churches, parks and other public facilities and schools. Location of adult entertainment land uses in close proximity to residential uses, churches, parks, and other public facilities, and schools, will reduce retail trade to commercial uses in the vicinity, thus reducing property values and tax revenues to the City. Such adverse affect [sic] on property values will cause the loss of some commercial establishments followed by a blighting effect upon the commercial districts within the City, leading to further deterioration of the commercial quality of the City.

14. Experience in numerous other cities, including Seattle, Tacoma and Detroit, Michigan, has shown that location of adult entertainment land uses degrade the quality of the area of the City in which they are located and cause a blighting effect upon the City. The skid row effect, which is evident in certain parts of Seattle and other cities, will have a significantly larger affect [sic] upon the City of Renton than other major cities due to the relative sizes of the cities.

15. No evidence has been presented to show that location of adult entertainment land uses within the City will improve the commercial viability of the community.

16. Location of adult entertainment land uses within walking distance of churches and other religious facilities will have an adverse effect upon the ministry of such churches and will discourage attendance at such churches by the proximity of adult entertainment land uses.

17. A reasonable regulation of the location of adult entertainment land uses will provide for the protection of the image of the community and its property values, and protect the residents of the community from the adverse effects of such adult entertainment land uses, while providing to those who desire to patronize adult entertainment land uses such an opportunity in areas within the City which are appropriate for location of adult entertainment land uses.

18. The community will be an undesirable place to live in if it is known on the basis of its image as the location of adult entertainment land uses.

19. A stable atmosphere for the rearing of families cannot be achieved in close proximity to adult entertainment land uses.

20. The initial location of adult entertainment land uses will lead to the location of additional and similar uses within the same vicinity, thus multiplying the adverse impact of the initial location of adult entertainment land uses upon the residential, [sic] churches, parks and other public facilities, and schools, and the impact upon the image and quality of the character of the community.

748 F.2d 527, 529 n.3.

# The Contract Clause: The "Regulated Industry" Exception

Until very recently, the Contract Clause[1] of the federal constitution was considered an antiquated phrase. During the first half of the nineteenth century, it was frequently invoked to prevent legislative encroachments upon existing contracts,[2] but steadily declined in use during the latter half of the nineteenth century.[3] It lay dormant for over forty years. Then, in two major decisions in 1977 and in 1978, the United States Supreme Court resurrected the clause to strike down two state statutes as unconstitutional impairments of contracts.

In 1977, in *United States Trust Co. v. New Jersey*,[4] the Court struck down a repeal of a 1962 statutory covenant between New York and New Jersey, which prohibited the states and the Port Authority of New York and New Jersey from subsidizing any mass transit system with any of the revenues pledged as security for bonds issued by the Port Authority. The Court found that the covenant was a contract between the two states and the Port Authority bondholders and that the repeal unconstitutionally impaired that contract.

A year later, in *Allied Structural Steel Co. v. Spannaus*,[5] the Court invalidated a Minnesota private pension statute because it was in violation of the Contract Clause. The statute, which required an employer of more than 100 employees to pay into a state pension fund if it terminated its pension plan or closed a Minnesota office, was retroactively applied to a company that was in the process of relocating at the time of the enactment. The Court held that the statute unconstitutionally impaired a contract between the employer company and its employees.

As a result of these two decisions, constitutional commentators heralded the rebirth of the Contract Clause and the restoration of its former power by the Court.[6] However, the status of the Contract Clause became unclear when in

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[1] U.S. CONST. art. I, § 10: "No State shall. . .pass any Law impairing the Obligation of Contracts. . . ."

[2] *See infra* notes 15-20 and accompanying text.

[3] *See infra* notes 25-77 and accompanying text.

[4] 431 U.S. 1, *reh'g denied*, 431 U.S. 975 (1977).

[5] 438 U.S. 234, *reh'g denied*, 439 U.S. 886 (1978).

[6] *See infra* note 134 and accompanying text.

1983 the Court upheld a statute against a Contract Clause challenge. In *Energy Reserves Group, Inc. v. Kansas Power & Light Co.*,[7] the Court upheld a state regulation that retroactively imposed price controls on the sale of natural gas as it applied to a contract between a public utility and a natural gas supplier. Commentators viewed this 1983 decision as evidence that the United States Supreme Court was rethinking its position on the power of the clause.[8]

This comment takes the position that *Energy Reserves Group* does not necessarily reflect a change of posture by the Court. This comment is divided into three parts. Part I reviews the history of the clause and shows how the clause was very narrowly interpreted prior to the recent developments. Part II discusses the recent cases. It explains the tests set forth in *United States Trust* and in *Allied Structural Steel*, and it analyzes whether *Energy Reserves Group* represents a substantial change in the United States Supreme Court's view of the Contract Clause. It concludes that the case is consistent with *United States Trust Co.* and *Allied Structural Steel* in its focus on the severity of the impairment, and that the rationale underlying *Energy Reserves Group* is that those who deal in regulated industries should expect a certain amount of governmental interference and therefore such interference is not so severe as to be unconstitutional. Part III then explores the "regulated industry" exception, first by defining what is a regulated industry under the exception and then by examining whether the rationale for the exception holds true in all situations involving legislative encroachments on contracts in regulated industries.

## I. History of the Contract Clause

The terms of the Contract Clause, on its face, are clear: No state may pass laws impairing contracts. And yet, since the adoption of the Constitution, the clause has undergone several interpretations and has been affected by several policy changes. One commentator has described the clause as being the "product not of the Constitution but a process of judicial interpretation."[9]

Historical accounts of the debates at the drafting and ratifying constitutional conventions reveal little as to the original purpose for the adoption of the Contract Clause.[10] One way of determining the purpose of the clause is to examine

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[7] 459 U.S. 400 (1983).

[8] *See infra* note 140 and accompanying text.

[9] B. Wright, The Contract Clause of the Constitution 234 (1938).

[10] During the convention, Rufus King of Massachusetts moved to add a provision prohibiting states from interfering in private contracts. 2 M. Farrand, The Records of the Federal Convention of 1787, at 439 (1911). Two delegates opposed the motion on the ground that it would place too much restraint on the states, foreseeing that some kind of interference would be proper. *Id.* at 440. King's motion then was clarified to encompass only retrospective laws. King's proposal was instead replaced by another proposal prohibiting states from passing bills of attain-

the types of pressing contemporary problems faced by the members of the conventions.[11] During that period, there was great dissatisfaction among the wealthier classes because state legislatures were enacting a great deal of laws relieving debtors from paying their debts in accordance with their contracts.[12] Since the Contract Clause is the only provision in the Constitution that affords any protection against such laws, one possible interpretation is that the clause was adopted in response to those state debtor relief laws enacted during the period of economic depression following the Revolutionary War,[13] and that it was primarily intended to protect private contracts.[14]

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der and ex post facto laws. *Id.*

The clause was later changed by the Committee of Style, of which Rufus King was a member. The clause stated that, "No state shall pass laws altering or impairing the obligation of contracts." *Id.* at 597. There are no known records of the discussion in the committee or the reasons for the alteration. The provision was later amended by the convention, which dropped the word "altering." *Id.* at 619. On the copy of the draft of George Mason of Virginia, one of the two opponents of the initial proposal, there was a note indicating that a proposal was made to insert "previous" after "obligation of" but that this proposal was defeated. *Id.* at 617. The clause was accepted without further debate or much discussion, although Elbridge Gerry of Massachusetts moved that the prohibition be applied to the federal government as well, but his motion was not seconded. *Id.* at 619.

[11] *See* Epstein, *Toward a Revitalization of the Contract Clause*, 51 U. CHI. L. REV. 703, 706 (1984).

[12] These laws included those providing for the issuance of bills of credit and making them legal tender for the payment of debts, stay laws and laws temporarily closing access to the courts, and installment laws, which provided for the payment of debts in several installments rather than a lump sum in accordance with the terms stipulated in the contract. Home Bldg. & Loan Ass'n v. Blaisdell, 290 U.S. 398, 458 (1934) (Sutherland, J., dissenting); B. WRIGHT, *supra* note 9, at 4.

[13] L. TRIBE, AMERICAN CONSTITUTIONAL LAW § 9-5, at 466 (1978). *See* Home Bldg. & Loan Ass'n v. Blaisdell, 290 U.S. 398, 454-65 (1934) (Sutherland, J., dissenting).

[14] L. TRIBE, *supra* note 13; B. WRIGHT, *supra* note 9, at 16. *See* 13 THE DOCUMENTARY HISTORY OF THE RATIFICATION OF THE CONSTITUTION 283 (J. Kaminski & G. Saladino eds. 1981) (a letter from Reverend James Madison to his brother Thomas: "[The new federal constitution] will also give more Stability & Vigour to our State Govts., & prevent most of those iniquitous interfering in private Contracts, wch. destroy all Confidence amongst Individuals.").

Historical accounts indicate that the provision was seen merely as one facet of the general scheme of article I, § 10, rather than as a provision that is significant in itself. However, even among these accounts, there are various interpretations. For example, Alexander Hamilton, in THE FEDERALIST No. 7 (A. Hamilton), saw the provision as one of a number of preventive measures against territorial disputes. *See* 14 DOCUMENTARY HISTORY, *supra* at 135 ("Laws in violation of private contracts as they amount to aggressions on the rights of those States, whose citizens are injured by them, may be considered as another probable source of hostility."). Antoine de La Forest, who was the French vice consul for the United States during the convention, regarded the provision as one of the many proposals by the "New General Government" to the general populace to relinquish to the new federal government many of the integral powers of sovereignty on the part of the states. 13 *id.* at 259. And Charles Cotesworth Pinckney, South Carolina's delegate who also had attended the South Carolina state convention considered § 10 as a restraint on states from enacting laws that affect the payment of money. *See* 1 THE DOCUMENTARY

The United States Supreme Court, however, did not limit the application of the clause to those types of legislation. It is helpful to an understanding of the early Contract Clause decisions to consider the jurisprudential philosophies of the individual justices, particularly that of Chief Justice Marshall, the author of the early Contract Clause opinions. First of all, Marshall, like many of his contemporaries, felt that individuals possessed certain natural rights, such as life, liberty, property and the pursuit of their own happiness.[15] He believed that governmental interference with these rights was suspect—for example, interference with the holding or use of private property.[16] Second, Marshall, like many of his generation, advocated a strong federal government and strove to establish federal supremacy.[17] One method of implementing such beliefs was through the Contract Clause, by establishing that the safeguarding of private property rights was primarily a federal, and not a state, function.[18] Thus, in 1810 the Court struck down a rescission of a public land grant as an unconstitutional impairment of a contract between the state of Georgia and its grantees in *Fletcher v. Peck*,[19] and in 1819 it held that a corporate charter was a contract and therefore that its covenants could not be altered by subsequent legislation without violating the Contract Clause in *Trustees of Dartmouth College v. Woodward*.[20]

However, the Court's intervention into state activities created new problems because it limited the states' ability to adequately deal with the new social problems that were emerging with the rapidly growing economy of the nineteenth century.[21] For example, during the Marshall era, the states developed new means of transportation primarily through the use of joint ventures between the states and state-chartered monopolies.[22] State-chartered monopolies were used because the states were able to maintain substantial control over them. The states could limit the duration of these monopolies by altering the monopolies' charters.[23] After the Court's decision in *Dartmouth College*, the states lost control over the monopolies, which were intended to be only temporary. These monopolies became permanent enterprises which prevented states from developing new means to accomodate the growing economy.[24]

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HISTORY OF THE RATIFICATION OF THE CONSTITUTION 350 (M. Jenson ed. 1976).

[15] G.E. WHITE, THE AMERICAN JUDICIAL TRADITION 14 (1976).

[16] *Id.* at 15.

[17] *Id.* at 18-21, 27-28.

[18] *Id.*

[19] 10 U.S. (6 Cranch) 87 (1810).

[20] 17 U.S. (4 Wheat.) 518 (1819).

[21] G.E. WHITE, *supra* note 15, at 54.

[22] *Id.* at 53-55.

[23] *Id.*

[24] B. SCHWARTZ, A COMMENTARY ON THE CONSTITUTION OF THE UNITED STATES, THE RIGHTS OF PROPERTY 302 (1965).

A change in the Court's application of the Contract Clause became apparent when Marshall failed, for the first and only time in his thirty-four years as chief justice, to command a majority on a constitutional issue.[25] In 1837, the Court sustained a state solvency law as it applied to debts incurred subsequent to its enactment. In *Odgen v. Saunders*,[26] the Court found that the Contract Clause was limited to legislative infringements on preexisting contracts.[27] The Court reasoned that a statute does not impair a contract formed subsequent to its enactment because such a statute automatically becomes incorporated into the contract.[28] Marshall vigorously dissented, arguing that the Contract Clause was absolute and that, therefore, it should be applied retroactively as well as prospectively.[29] Had Marshall been able to carry one more justice, *Ogden* would have firmly established the absoluteness of the Contract Clause.[30] The majority, in a four-to-three decision, rejected Marshall's approach. Marshall's approach, said Justice Trimble in a concurring opinion, "would, as I would think, transform a special limitation upon the general powers of the states, into a general restriction."[31]

Further evidence that the Court was limiting its application of the clause can be found in a case decided shortly after Chief Justice Marshall's death, in which the Court held that it would construe public grants strictly in favor of the state. In *Proprietors of Charles River Bridge v. Proprietors of Warren Bridge*,[32] owners of a state-chartered toll bridge sought to prohibit a state legislature from authorizing the construction of a competing bridge. The Court held that the charter was not expressly an exclusive grant to operate a bridge and that the grant would be strictly construed.[33] While private property rights must be protected, those rights must be weighed against the rights of the general public.[34] Because the community has an interest in the development of new methods of transportation and commerce and an exclusive grant would stifle such development, it should never be assumed that the government intended to diminish its power to promote the interests of the community.[35] The strict construction rule of *Charles River Bridge* was applied in subsequent cases to allow states to alter or modify their contracts.[36]

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[25] L. TRIBE, *supra* note 13, at 467 n.9.

[26] 25 U.S. (12 Wheat.) 213 (1827).

[27] *Id.* at 261.

[28] *Id.* at 259.

[29] *See id.* at 331-57 (Marshall, J., dissenting).

[30] B. SCHWARTZ, *supra* note 24, at 302.

[31] 25 U.S. (12 Wheat.) at 322 (Trimble, J., concurring).

[32] 36 U.S. (11 Pet.) 420 (1837).

[33] *Id.* at 548-49.

[34] *Id.* at 548.

[35] *Id.* at 547-48.

[36] *See, e.g.*, City of Walla Walla v. Walla Walla Water Co., 172 U.S. 1 (1898) (grant to

The Contract Clause was further limited by the Court's introduction of the principle that the state can not by contract divest themselves of certain powers and that any attempt by a state to alienate them is void—the doctrine of inalienable powers.[37] This doctrine was first established in *West River Bridge v. Dix*,[38] in which the Court held that the state's power of eminent domain was inalienable.[39] The *Dix* ruling was significant because it protected the power of states to facilitate economic improvements through the taking of property upon payment of just compensation.[40] Thirty years later, the Court expanded the principle of *Dix* in *Stone v. Mississippi*,[41] when it stated that the legislature could not bargain away the state's power to preserve and protect the public health and morals of the people.[42] Later decisions relied on the doctrine of inalienable powers to limit the scope of the Contract Clause in public contracts.[43] The doctrine allowed states to infringe upon existing contractual obligations to achieve some public purpose.[44]

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company of right to supply a city with water for 25 years held not to be an exclusive grant); The Railroad Comm'n Cases, 116 U.S. 307 (1886) (A railroad company's charter which permitted company to set reasonable fees does not prevent legislature from determining what is reasonable.).

[37] B. SCHWARTZ, *supra* note 24, at 283; B. WRIGHT, *supra* note 9, at 202.

[38] 47 U.S. (6 How.) 507 (1848).

[39] *Id.* at 532. In *Dix*, the Court held that franchises, like other property, are always subject to the exercise of the power of eminent domain.

[40] *See* J. SCHMIDHAUSER, THE SUPREME COURT AS FINAL ARBITER IN FEDERAL-STATE RELATIONS 1789-1957, at 71 (1958). *See also* Hawaii Hous. Auth. v. Midkiff, 467 U.S. 229, 243 n.6 (1984) ("[T]he Contract Clause has never been thought to protect against the exercise of the power of eminent domain.").

[41] 101 U.S. 814 (1880).

[42] *Id.* at 820-21.

[43] The doctrine was originally applied only to justify the revocation or alteration of public contracts, i.e., contracts to which a state was a party. *See, e.g.*, Atlantic Coast Line R.R. v. City of Goldsboro, 232 U.S. 548 (1914) (A railroad's franchise to use the street of a town for its track could be altered by an ordinance prohibiting the shifting of cars during certain hours and requiring the grade of a track to be lowered to conform to that of the street.); Chicago, B. & Q.R.R. v. Nebraska, 170 U.S. 57 (1898) (contract between city and railroad to build a viaduct could be altered to impose the expense of maintaining the viaduct upon the railroad); Stone v. Mississippi, 101 U.S. 814 (1880) (state can revoke a 25-year charter to conduct a lottery). In *Atlantic Coast Line R.R.*, the Court stated:

> It is well settled that neither the "contract" clause nor the "due process" clause has the effect of overriding the power of the State to establish all regulations that are reasonably necessary to secure the health, safety, good order, comfort, or general welfare of the community; that this power can neither be abdicated nor bargained away, and is inalienable even by express grant, and all contract and property rights are held subject to its fair exercise.

*Id.* at 558.

[44] A similar doctrine developed alongside the inalienable powers doctrine and was used to modify private contracts: the police power doctrine. Phillips, *The Life and Times of the Contract Clause*, 20 AM. BUS. L.J. 139, 159 (1982). *See also* Hale, *The Supreme Court and the Contract*

The Depression of the 1930's had a devastating impact on the Contract Clause. In 1934, the Court sustained a retroactive application of a debtor relief law against a Contract Clause challenge. In 1933, the Minnesota legislature enacted a law that gave state courts the authority to extend the redemption period after a foreclosure sale. The law provided that before a court could approve an extension, it had to order the mortgagor to pay all or a reasonable part of the rental value of the property to the mortgagee. The law was to be in effect only during the period of economic emergency and not to exceed beyond May 1, 1935.[45]

The Court in *Home Building and Loan Association v. Blaisdell*[46] was faced with a dilemma. On one hand, the intolerable hardships caused by the Depression were difficult to ignore;[47] on the other hand, it was faced with the type of state legislation contemplated by the authors of the Contract Clause.[48] Out of "the necessity of finding ground for a rational compromise between individual rights and public welfare,"[49] the Court adopted a balancing test to determine

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*Clause: II*, 57 HARV. L. REV. 621, 671 (1944).

Two rationales were used to justify the application of this doctrine. One rationale is that all private contracts carry with them an implied condition that they may be impaired in the future by the exercise of the police power. *See* Hudson County Water Co. v. McCarter, 209 U.S. 349, 357 (1908) ("One whose rights, such as they are, are subject to state restriction, cannot remove them from the power of the state by making a contract about them. The contract will carry with it the infirmity of the subject matter."); Hale, *supra*, at 671-73; Phillips, *supra*, at 159.

Another rationale is that the police power supercedes any right protected by the Contract Clause. *See* Manigault v. Springs, 199 U.S. 473, 480 (1905) (The police power is "paramount to any rights under contracts between individuals."); Hale, *supra*, at 673-74; Phillips, *supra*, at 159.

The Court originally applied the police power doctrine to modify or impair contracts deemed to involve subject matter of great public importance—for example, *Hudson County Water Co.* involved the control of a public water supply, and *Manigault*, the control of a public waterway. Also, in Henderson Co. v. Thompson, 300 U.S. 258 (1937), a statute prohibited the manufacturing of carbon black from natural gas. Although the statute impaired the performance of a company's contracts with its producers, the Court sustained the statute as a valid exercise of police power to prevent the rapid depletion of an important natural resource.

[45] Home Bldg. & Loan Ass'n v. Blaisdell, 290 U.S. 398, 416-18 (1934).

[46] *Id.*

[47] The Court stated:

> It cannot be maintained that the constitutional prohibition should be so construed as to prevent limited and temporary interpositions with respect to the enforcement of contracts if made necessary by a great public calamity such as fire, flood, or earthquake. . . .And if state power exists to give temporary relief from the enforcement of contracts in the presence of disasters due to physical causes such as fire, flood or earthquake, that power cannot be said to be nonexistent when the urgent public need demanding such relief is produced by other and economic causes.

*Id.* at 439-40.

[48] *Id.* at 453 (Sutherland, J., dissenting).

[49] *Id.* at 442.

which interest should prevail. The Court stated that it would validate the legislation only if the legislation was "addressed to a legitimate end" and if "the measures taken [were] reasonable and appropriate to that end."[50] The Court listed five criteria under which a statute would survive a constitutional attack: (1) an impending emergency, (2) the protection of a basic societal interest, (3) appropriately tailored relief, (4) reasonable statutory conditions, and (5) limited duration of the legislation.[51]

The *Blaisdell* decision had a significant impact on the Contract Clause. It not only set forth an unprecedented balancing test, but also extended the scope of the police power doctrine.[52] First, unlike prior cases, the health, morals and safety of the people were not involved.[53] In *Blaisdell*, the Court extended the doctrine to protect the economic well-being of the people.[54] The doctrine was applied to prevent wholesale foreclosures of mortgaged properties and the depression of real estate values.[55] Second, unlike prior cases in which the Court intervened in private contracts, the subject matter of the contracts in *Blaisdell* was not a matter of great public importance;[56] as Professor Benjamin Wright stated in 1938, "It was not the nature of the subject matter of the contract, but rather the conditions of the times," which brought the contracts involved in *Blaisdell* "within the category of those which are subject to state restriction because [it concerns] the welfare of many people."[57] The *Blaisdell* Court justified intervention into the private contractual relationships:

> Where, in the earlier days, it was thought that only the concerns of individuals or of classes were involved, and that those of the State itself were touched only remotely, it has later been found that the fundamental interests of the State are directly affected, and that the question is no longer merely that of one party to a contract as against another, but of the use of reasonable means to safeguard the economic structure upon which the good of all depends.[58]

The *Blaisdell* Court, in upholding the Minnesota law as a valid exercise of police power, focused on the fact that the statute was a temporary measure enacted to meet an extreme economic crisis.[59] The state's police power must be

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[50] *Id.* at 438.

[51] *Id.* at 444-47.

[52] B. WRIGHT, *supra* note 9, at 211-13.

[53] *Cf. supra* note 44.

[54] *See* B. WRIGHT, *supra* note 9, at 211.

[55] *Id.*; B. SCHWARTZ, *supra* note 24, at 288.

[56] *Cf. supra* note 44.

[57] B. WRIGHT, *supra* note 9, at 213.

[58] *Blaisdell*, 290 U.S. at 442.

[59] *Id.* at 439 (While state's police power may not be exercised so as to destroy the Contract Clause, conditions may arise "in which a temporary restraint of enforcement may be consistent

balanced with the power of the Contract Clause.[60] The "reasonable and appropriate" balancing test set forth in the opinion, however, tipped the scales in favor of the exercise of government action. The test was applied to determine the seriousness of the economic conditions and to determine whether the state's exercise of its police power reasonably dealt with that social problem. It failed to include a criterion that would allow the scales to tip in favor of those rights that would be impaired by the statute, such as whether the legislation provided adequate protection to contracting parties. As long as the legislation was reasonable under the five criteria laid out by the Court, it would be upheld.

The power of the Contract Clause further diminished as the Court used the balancing test to uphold the exercise of police power in subsequent cases. Six years after *Blaisdell*, the Court sustained a state law that *permanently* altered the contracts between building and loan associations and their investors. In *Veix v. Sixth Ward Building and Loan Association*,[61] the Court found that the police power extended to safeguard various economic needs and that as long as some potential hardship existed, the legislation need not be temporary.[62] The Court took into consideration an additional criterion to the balancing test: whether the petitioner had "purchased into an enterprise already regulated in the particular manner to which he now objects."[63] The Court found that since the state had regulated building and loan associations for thirty years prior to the statute at issue, this criterion had been met.[64]

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with the spirit and purpose of the constitutional provision and thus be found to be within the range of the reserved power of the State to protect the vital interests of the community.").

[60] The court stated that:

> Undoubtedly, whatever is reserved of state power must be consistent with the fair intent of the constitutional limitation of that power. The reserved power cannot be construed so as to destroy the limitation, nor is the limitation to be construed to destroy the reserved power in its essential aspects. They must be construed in harmony with each other.

*Id.*

[61] 310 U.S. 32 (1940).

[62] *Id.* at 39.

[63] *Id.* at 38.

[64] *Id.* at 37-38. The Court apparently reached the conclusion that because financial institutions had been regulated for a long period of time, they were of significant public importance.

> [The challenged statute] was passed in the public interest to protect the activities of the associations for the economic welfare of the State. It is also plain that the 1932 Act was one of a long series regulating the many integrated phases of the building and loan business such as formation, membership, powers, investments, reports, liquidations, foreign associations and examinations. We are dealing here with the financial institutions of major importance to the credit system of the State.

*Id.* at 37. This conclusion would justify the placing of the building and loan industry within the category of "subject matter of great importance" to bring it under the application of the police power doctrine. *See supra* note 44.

The burial of the Contract Clause occurred in *City of El Paso v. Simmons*,[65] in which the Court was unwilling to declare a state statute unconstitutional, although it admitted that the statute impaired the obligations of the contract involved.[66] *El Paso* arose out of a public land program in 1910, under which the state of Texas sold land on long-term contracts calling for a small down payment plus annual interest and principal payments. State law provided that in the event of forfeiture, the purchaser or his vendee could reinstate his claim upon written request and payment of delinquent interest, provided that no third party rights had intervened.[67] The state legislature did not foresee at the time of the sales that the state would develop from a frontier community to a modern society attended by the discovery of oil and gas, resulting in speculators taking avid advantage of the land laws. In order to clarify land titles, eliminate litigation and bring more effective use of the land, the 1941 Texas Legislature limited the time to reinstate on default to five years.[68]

In 1965 the United States Supreme Court upheld the 1941 legislation as a reasonable exercise of police power.[69] The Court noted two determinative factors: (1) the promise of unlimited reinstatement rights could not have been a major inducement for the buyer's undertaking,[70] and (2) laws restricting a party to reasonable gains were valid.[71] The state's interest in remedying the problems encountered in the administration of the public land program outweighed any burdens to the contracting parties.[72]

*El Paso*, like *Veix*, further tipped the balance in favor of the exercise of police power, and thus against the interests protected by the Contract Clause. First, no economic crisis was involved, and the legislation permanently impaired existing contracts.[73] Second, the Court gave total deference to the state legislature to

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[65] 379 U.S. 497, *reh'g denied*, 380 U.S. 926 (1965).

[66] *See id.* at 507-08.

[67] *Id.* at 498-500.

[68] *Id.* at 509-12. Simmons' predecessors purchased land near El Paso in 1911. Simmons took quitclaim deeds to the property at issue after it was forfeited in 1947, but the state turned down his request for reinstatement because it came more than five years after the forfeiture. In 1955, the state sold the land to El Paso by special legislation, and Simmons sued to determine title. *Id.* at 500-01.

[69] *Id.* at 509.

[70] *Id.* at 514.

[71] *Id.* at 515.

[72] *Id.* at 516-17.

> The measure taken to induce defaulting purchasers to comply with their contracts, requiring payment of interest in arrears within five years, was a mild one indeed, hardly burdensome to the purchaser who wanted to adhere to his contract of purchase, but nonetheless an important one to the State's interest. The Contract Clause does not forbid such a measure.

*Id.*

[73] Justice Black stated in his dissent that the state had no valid reason for repudiating its

determine what was necessary for the general welfare.[74] And third, the Court assumed an impairment existed,[75] but stated that the validity of the legislation did not turn on the substantiality of the impairment but whether the legislation itself served a legitimate purpose and was reasonable and appropriate.[76]

The Court's decisions after *Blaisdell* reflected, at a minimum, a reluctance to invoke the protective power of the Contract Clause. The general view was that the Contract Clause was dead.[77]

## II. REVIVAL OF THE CONTRACT CLAUSE

In 1977, the United States Supreme Court revived the Contract Clause to strike down the repeal of a public contract. In *United States Trust Co. v. New Jersey*,[78] the Court made three substantial changes from its prior Contract Clause decisions.

First, it adopted a "reasonable and necessary" test.[79] The Court must determine, not only that the legislation serves a valid public purpose, but also that it is reasonable and *essential* to attain the public purpose.[80] This standard places a high burden of proof on the state, thereby giving more protection to the private rights being impaired by the legislation.

Second, the Court placed a limitation on the states' exercise of their power to protect their economic well-being. Post-*Blaisdell* decisions indicated that the Court viewed the states as having unlimited power to protect their economic interests.[81] But in *United States Trust*, the Court stated that "a State cannot

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contracts. The Court, by allowing Texas to impair its contracts, allowed the Contract Clause to be nullified by the most common reason for breaking contracts. The contracts "had turned out to be a bad bargain and Texas had lost millions of dollars by honoring them in the past." *See id.* at 520 (Black, J., dissenting).

[74] *See id.* at 508-09.

[75] *Id.* at 506.

[76] *Id.* at 507 n.9 & 508 (citing *Blaisdell*).

[77] *See, e.g.*, B. SCHWARTZ, *supra* note 24, at 306 (The contract clause was "reduced to a minor organic provision in the constitutional law of the twentieth century. . . ."); Hale, *The Supreme Court and The Contract Clause: III*, 57 HARV. L. REV. 852, 890-91 (1944) ("[T]he results might be the same if the contract clause were dropped out of the Constitution."); Powe, *Populist Fiscal Restraints and the Contracts Clause*, 65 IOWA L. REV. 963, 963 (1980) ("After all, in law school, everyone learned that the contracts clause was dead.").

[78] 431 U.S. 1, *reh'g denied*, 431 U.S. 975 (1977).

[79] 431 U.S. at 24. Under the old "reasonable and appropriate" test set forth in Home Bldg. & Loan Ass'n v. Blaisdell, 290 U.S. 398, 438 (1934), the constitutional inquiry ends upon the determination that the legislation in dispute serves a valid public purpose. Thus, in *El Paso*, the Court found it unnecessary to look at the rights impaired as long as the legislation was rationally related to the public purposes alleged by the state. *See supra* note 76 and accompanying text.

[80] *See United States Trust*, 431 U.S. at 29-30. *See also id.* at 54-55 (Brennan, J., dissenting).

[81] *See supra* notes 54-58, 62, 73-76 and accompanying text.

refuse to meet its legitimate financial obligations simply because it would prefer to spend the money to promote the public good rather than the private welfare of its creditors."[82] Notwithstanding the fact that a contract may involve the exercise of the state's taxing, spending or police power, if the state assumes financial obligations, it is bound by those obligations and cannot repudiate them for purely financial reasons.[83]

Third, the Court reversed its position regarding public contracts. After *Proprietors of Charles River Bridge v. Proprietors of Warren Bridge*,[84] the Court had construed public contracts in favor of the state.[85] In *United States Trust*, the Court stated that "complete deference to a legislative assessment of reasonableness and necessity is not appropriate because the State's self-interest is at stake."[86]

The main issue in *United States Trust* was whether New York and New Jersey could use revenues generated by the Port Authority of New York and New Jersey to expand their mass transit operations despite the fact that they had pledged those revenues to secure the payments of bonds issued to private investors.[87] In 1962 the two states passed legislation authorizing the Port Authority to take over the Hudson and Manhattan Railroad. In order to promote "continued investor confidence in the Authority," the legislatures included a covenant that placed a limitation on mass transit operations to be undertaken by the Authority.[88]

Losses exceeded the covenant's level of permitted deficits, and the Port Authority was unable to issue new bonds for any new passenger railroad system that was not self-supporting.[89] Because of increased public pressure to develop new mass transit systems and because of the onset of the national energy crisis in the early 1970's, the New York and New Jersey legislatures in 1974 retroactively repealed the 1962 covenant.[90]

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[82] *United States Trust*, 431 U.S. at 29.

[83] *Id.* at 26. ("If a State could reduce its financial obligations whenever it wanted to spend the money for what it regarded as an important public purpose, the Contract Clause would provide no protection at all.").

[84] 36 U.S. (11 Pet.) 420 (1837).

[85] For example, in *El Paso*, the Court assumed that the legislation in question was reasonable without making an independent determination of reasonableness. *See supra* text accompanying note 74.

[86] 431 U.S. at 26.

[87] *Id.* at 3.

[88] *Id.* at 9 (quoting United States Trust Co. of N.Y. v. New Jersey, 134 N.J. Super. 124, 338 A.2d 833 (1975)).

[89] 431 U.S. at 12.

[90] *Id.* at 12-14. In 1973, the legislatures repealed the covenant for bonds issued after May 10, 1973. But because of the numerous problems, the states in 1974 repealed the 1962 covenant with respect to all bonds. *Id.* at 13-14.

The Court stated that, although it had been reluctant in the past to invoke the protective power of the Contract Clause to invalidate state legislation, it never indicated that the clause was meaningless.[91] It would apply the Contract Clause to give due respect to both the purpose and prior decisions of the clause.[92]

The Court found that the repeal of the 1962 covenant substantially impaired the obligations of New Jersey's contract with its bondholders because it eliminated an important security provision.[93] The constitutional inquiry did not end with the finding of an impairment, however, since *Blaisdell* recognized that not all impairments violate the Contract Clause.[94] The power of the state to safeguard the welfare of its people must be balanced against the interests protected by the Contract Clause.[95]

Because a public contract is involved, the Court indicated that it must determine whether the contract involves an obligation which falls within one of the inalienable powers of the state.[96] The Court found that the 1962 covenant in-

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The state of New York was not a party to this case, although its attorney general filed a brief as *amicus curiae* urging affirmance. As of the date of the decision, a challenge to the parallel New York statute was pending in the Supreme Court of New York, County of New York: United States Trust Co. of New York v. New York, No. 09128/74. *United States Trust*, 431 U.S. at 4 n.4.

[91] *United States Trust*, 431 U.S. at 16 ("Whether or not the protection of contract rights comports with current views of wise public policy, the Contract Clause remains a part of our written Constitution.").

[92] *Id.*

[93] The Court found that the 1962 covenant constituted a contract between the two states and the bondholders. *Id.* at 18. The intent to make a contract was clear from the language of the covenant: "The 2 states covenant and agree with each other and with the holders of any affected bonds. . . ." *Id.* Furthermore, the contract was supported by ample consideration. The Court found that, "[i]n return of their promise, the States received the benefit they bargained for: public marketability of Port Authority bonds to finance construction of the World Trade Center and acquisition of the Hudson & Manhattan Railroad." *Id.*

The covenant was an important security provision because it limited the Port Authority's deficits and protected the general reserve funds from depletion. *Id.* at 19. The Court also stated that in determining the seriousness of the impairment, it looked at the "legitimate expectations" of the contracting parties. *Id.* at 20 n.17. In other words, the Court would consider not what the parties did in fact expect out of the contract, but what they could reasonably expect in light of the fact that state laws change over a period of time.

The Court indicated that if the covenant were merely modified or replaced by a similar security provision, no impairment would have been found. *Id.* at 19.

[94] *Id.* at 21. A finding of a "technical impairment" is merely a preliminary step in the constitutional analysis.

[95] *Id.*

[96] *Id.* at 23. If the obligation falls under such inalienable powers, then under the inalienable powers doctrine, the contract is not binding upon the state. *See supra* note 43 and accompanying text.

volved a purely financial obligation, which did not fall within the state's inalienable powers. Thus it was binding and could not be impaired under the guise of police power.[97]

The Court then turned to the issue of whether the impairment violated the Contract Clause. The fact that the state was bound by its financial obligations did not resolve the case since the Contract Clause is not an absolute bar to a modification of such obligations. An impairment may be constitutional if it is reasonable and necessary to serve an important public purpose. However, complete deference to legislative determination of reasonableness and necessity is not appropriate because of the state's self-interest.[98]

The Court found that although the repeal served an important public purpose in mass transportation, energy conservation and environmental protection,[99] the repeal was neither necessary nor reasonable to serve the otherwise important public purposes. The Court found that the repeal was unnecessary for two reasons: (1) a less drastic modification would have served the public;[100] and (2) without modifying the contract at all, the states could have adopted alternative means of achieving their goals.[101] The Court also found that the repeal was unreasonable because the concerns that led to the 1974 repeal were foreseeable at the time the covenant was enacted.[102]

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[97] *Id.* at 24-25. The state's obligation was related solely to the use of revenues. The Court stated, however, that not every security provision is necessarily financial. For example, a revenue bond might be secured by the state's promise to continue to operate the financed facility, and yet that promise could not be validly construed to bind the state never to close the facility for health or safety reasons. *Id.* at 25.

[98] *Id.* at 25-26.

[99] *Id.* at 21.

[100] The Court suggested three modifications, such as amending the covenant to exclude certain revenues from the revenue use limitation, modifying the formula for computing permitted deficits, and modifying the procedures for obtaining bondholder approval so that such consent would present a feasible means of undertaking new projects. *Id.* at 30 n.28.

The Court, however, warned that even these "lesser impairments" may be unconstitutional. *Id.* Justice Brennan, in his dissent, said he was puzzled whether the Court intended its suggestions to be taken in view of its closing warning. *Id.* at 38 n.4 (Brennan, J., dissenting). The Court should not be intruding upon complex matters that are for the states' legislatures to resolve and that the "Court's effort at fashioning its own legislative program for New York and New Jersey" is incompatible with the strategies of the states. *Id.* at 38-40.

[101] The Court suggested that the states could discourage automobile use through taxes on gasoline and parking and use the revenues to subsidize mass transit projects. The states could realign toll structures by eliminating commuter discounts and increasing tolls during peak commuting times to encourage carpools. *Id.* at 30 n.29.

The Court distinguished *El Paso*, where the imposition of the five-year limit on what was previously an unlimited right of redemption was "clearly necessary" to achieve Texas' vital interest in the orderly administration of its school lands program. *Id.* at 31. In the present case, New Jersey failed to demonstrate that the repeal of the 1962 covenant was necessary. *Id.*

[102] *Id.* at 31-32. The Court again distinguished *El Paso* from the present case. "[A] 19th

The Court recognized that its lack of deference to legislative judgment was a substantial departure from its customary approach to economic regulation.[103] The Court indicated that it would apply a dual standard of review to impairments of public and private contracts.[104] In the case of a public contract, a higher standard of scrutiny is necessary to prevent states from having an otherwise unlimited and unchecked power to impair their own obligations.[105]

However, a year later, the Court did not apply the dual standard of review to a private contract In *Allied Structural Steel Co. v. Spannaus*,[106] the Court held that the level of review would be determined by the severity of the impair-

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century statute had effects that were unforseen and unintended by the legislature when originally adopted [thus placing speculators] in a position to obtain windfalls." *Id.* The *United States Trust* Court noted that *El Paso* held that an adoption of a statute of limitation was a reasonable means to "restrict a party to those gains reasonably to be expected from the contract" when the contract was made. *Id.* at 31. However, in the present case, the need for mass transportation in the New York metropolitan area, the likelihood that publicly owned commuter railroads would produce substantial deficits, and the increased concern with environmental protection and energy conservation were concerns that were known in 1962. *Id.* at 31-32.

There is arguably a third distinction between *El Paso* and *United States Trust*. In *El Paso*, the Court found that the unlimited right of reinstatement was not a major provision relied on by the buyers, 379 U.S. at 514, whereas in *United States Trust*, the Court found that the covenant was an important bargained-for provision, 431 U.S. at 19, 32. However, it could also be argued that both provisions induced the parties to enter into their respective contracts.

[103] *United States Trust*, 431 U.S. at 22-23.

[104] The Court cited no precedent to support a dual standard of review for Contract Clause decisions but analogized it to the standard of review applied under the fifth amendment to federal legislation abrogating contractual gold clauses. The Court cited Perry v. United States, 294 U.S. 330, 350-51 (1935):

> There is a clear distinction between the power of the Congress to control or interdict the contracts of private parties when they interfere with the exercise of its constitutional authority, and the power of the Congress to alter or repudiate the substance of its own engagements when it has borrowed money under the authority which the Constitution confers.

The Court, however, did note in dicta one possible reason for the dual standard: The bases for the state's power to impair private and public contracts are different. If a law impairs a private contract, the Court will apply the police power doctrine, which is based on the policy that a state must possess broad power to adopt general regulatory measures. Mere incidental impairments should not stand in the way of the exercise of such power. Thus, the Court will uphold the law if it serves a legitimate public purpose and will give great deference to the state as to the necessity and reasonableness of the legislation. *United States Trust*, 431 U.S. at 22-23; *see supra* note 44 and accompanying text.

On the other hand, if a law impairs a public contract, then the police power doctrine is inapplicable. The state may then impair a contract only if its obligations fall within the inalienable powers of the state. If the inalienable powers doctrine is deemed inapplicable, the Court will not defer to legislative judgment. *United States Trust*, 431 U.S. at 23; *see supra* notes 43 and 96 and accompanying text.

[105] *United States Trust*, 431 U.S. at 26.

[106] 438 U.S. 234, *reh'g denied*, 439 U.S. 886 (1978).

ment.[107] If the impairment was not severe, the statute would be constitutional and the analysis would end. If the impairment was severe, the Court would examine carefully the nature and purpose of that statute.[108]

*Allied Structural Steel* involved a 1974 Minnesota statute which was enacted to affect employers with more than 100 employees and who provided pension plans to their employees. The statute subjected these employers to a pension funding charge if they terminated their plans or closed their Minnesota offices. The statute was designed to insure benefits for employees who had worked at least ten years. A provision also specified that periods of employment prior to the effective date of the Act were to be included in the ten-year employment criterion.[109]

Prior to the enactment of the statute, Allied Structural Steel was in the process of closing its Minnesota office but did not actually shut down until after the enactment, at which time it discharged several of its employees. Some of these employees would not have had vested rights under the company's pension plan, but because they had worked at least ten years, they were qualified as pension obligees of the company under the new statute. Subsequently, the state notified the company that it owed a pension funding charge of approximately $185,000 under the provisions of the Act.[110]

The Court found that the Minnesota Act severely impaired the company's contractual pension obligations to its employees. The Act nullified "express terms of the company's contractual obligations" and imposed "a completely unexpected liability in potentially disabling amounts."[111] The Act was also severe in that there was no provision for gradual applicability or grace periods.[112]

The Court also found that the statute did not possess those attributes that

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[107] 438 U.S. at 245.

[108] *Id.* The severity of an impairment can be measured by the factors that reflect the high value the framers placed on the protection of private contracts. One of those factors is that parties have certain rights and obligations that they are bound by and are entitled to rely on. *Id.* at 238-39.

[109] *Id.* at 239.

[110] *Id.*

[111] *Id.* at 247. The majority relied on the fact that the Act required the company to recalculate its past 10 years of contributions based on the new, unanticipated statutory vesting required and that it applied only to those employers terminating their pension plans or closing their Minnesota offices. Thus, an affected employer was forced to make all the retroactive changes at once. *Id.* at 246-47.

Justice Brennan in his dissent said that the Act did not act as a substantial impairment. The parties agreed that Allied Structural Steel did not rely on the possibility of a plant's closing in calculating the amount of its contribution to its pension plan fund. Thus, the Act would impose only minor economic burdens on employers whose pension funds were adequately funded, since an adequate pension plan fund would include contributions on behalf of terminated employers of 10 or more years of service whose rights have not vested. *Id.* at 253-54 (Brennan, J., dissenting).

[112] *Id.* at 247.

had enabled state laws to survive constitutional challenges in the past: (1) the law was not enacted to deal with a broad, generalized economic or social problem;[113] (2) it did not operate in an area already subject to state legislation; (3) it was not temporary, but worked a severe permanent change; and (4) its aims seemed unreasonably narrow in that it was leveled at a particular class of employers.[114]

The Court emphasized that these criteria set only the "outermost limits" and that a statute may be unconstitutional without meeting all.

> It is not necessary to hold that the Minnesota law impaired the obligation of the company's employment contracts 'without moderation or reason or in a spirit of oppression'. . . .But we do hold that if the Contract Clause means anything at all, it means that Minnesota could not constitutionally do what it tried to do to the company in this case.[115]

The constitutional analysis in *Allied Structural Steel* was different from the private contract analysis in *United States Trust*. In *United States Trust*, the Court stated laws affecting private contracts will be upheld so long as they serve a legitimate public purpose and that great deference will be given to the states as to the necessity and reasonableness of the legislation.[116] In *Allied Structural Steel*, the Court refused, however, to defer to legislative judgment and did not apply the *United States Trust* test for reasonableness and necessity.[117] Instead,

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[113] The main difference between the majority and the dissent was their views of pension plans in general. The majority viewed pension benefits as a mere "fringe benefit or additional form of compensation," which could be amended or terminated at will. *See id.* at 245. However, the dissent viewed them as important property rights reasonably anticipated by employees. *See id.* at 252 (Brennan, J., dissenting). Given these two points of view, it seems only a logical reaction that the majority found that the state's interest in protecting incidental benefits was not very high, whereas the dissent found the state's interest in protecting important property interests was very high.

[114] *Id.* at 247. The Court particularly focused on factors (1) and (4): "Moreover, the retroactive self-imposed vesting requirement was applied only to those employers who terminated their pension plans or who, like the company, closed their Minnesota offices." *Id.*

> It applies only to private employers who have at least 100 employees, at least one of whom works in Minnesota and who have established voluntary private pension plans, qualified under § 401 of the Internal Revenue Code. And it applies only when such employer closes his Minnesota office or terminates his pension plan.

*Id.* at 248. "Not only did the Act have an extremely narrow aim, but its effective life was extremely short." *Id.* at 248 n.21. These statements indicate that one of the Court's main reasons for striking down the statute was that it affected only one or two particular employers.

[115] *Id.* at 250-51.

[116] *United States Trust*, 431 U.S. at 22-23.

[117] In determining what was reasonable and necessary, the Court in *United States Trust* looked at whether the social and economic problems that led to the impairment were foreseeable at the time that the contract was made to determine what was reasonable and whether there were less

the Court used the factors of *Blaisdell* to determine the constitutionality of the Act. The effect of this difference was to give greater power to the Contract Clause in cases involving private contracts.

*United States Trust* and *Allied Structural Steel* signaled the revival of the Contract Clause and a departure from the earlier deference to state legislative judgment.[118] It seems from these two decisions that the power of the Contract Clause had been restored.[119]

However, five years after *Allied Structural Steel*, the Court upheld state legislation against a Contract Clause attack. *Energy Reserves Group, Inc. v. Kansas Power and Light*,[120] involved a dispute between a public utility company, Kansas Power and Light (KPL) and a natural gas supplier, Energy Reserves Group,

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drastic alternatives to attain the state's goal to determine the necessity of the impairment. *Id.* at 29-30.

[118] In both cases, the Court emphasized that the clause remains viable, despite its disuse in the past.

> [*Blaisdell* and *El Paso*] eschewed a rigid application of the Contract Clause to invalidate state legislation. Yet neither indicated that the Contract Clause was without meaning in modern constitutional jurisprudence, or that its limitation on state power was illusory. Whether or not the protection of contract rights comports with current views of wise public policy, the Contract Clause remains a part of our written Constitution.

*United States Trust*, 431 U.S. at 16. *See also Allied Structural Steel*, 438 U.S. at 241:

> [T]he Contract Clause receded into comparative desuetude with the adoption of the Fourteenth Amendment, and particularly with the development of the large body of jurisprudence under the Due Process Clause of that Amendment in modern constitutional history. Nonetheless, the Contract Clause remains part of the Constitution. It is not a dead letter.

In both cases, the Court found that the Contract Clause imposed limitations on state action. "[T]he Court has not 'balanced away' the limitation on state action imposed by the Contract Clause. Thus a State cannot refuse to meet its legitimate financial obligations simply because it would prefer to spend the money to promote the public good rather than the private welfare of its creditors." *United States Trust*, 431 U.S. at 29. *See also Allied Structural Steel*, 438 U.S. at 242: "If the Contract Clause is to retain any meaning at all, however, it must be understood to impose *some* limits upon the power of a State to abridge existing contractual relationships, even in the exercise of its otherwise legitimate police power."

In both cases, the Court did not defer to legislative judgment as to the reasonableness and necessity of the challenged statute. *United States Trust*, 431 U.S. at 25-26; *Allied Structural Steel*, 438 U.S. at 247.

[119] *See, e.g.*, Phillips, *supra* note 44, at 170 ("*U.S. Trust* and *Spannaus* obviously mark a sharp break with prevailing twentieth century contract clause doctrine and clearly signal the clause's revival as a force in American constitutional law. . . ."); Powe, *supra* note 77, at 963 ("[A] recent discovery by the United States Supreme Court that the contracts clause continues to impose limits on state power may have significant impact on legislative choices."); Schwartz, *Old Wine in Old Bottles? The Renaissance of the Contract Clause*, 1979 SUP. CT. REV. 95, 96 ("The Contract Clause, in repose for four decades, can be given new life whenever enough Justices see fit to revive it.").

[120] 459 U.S. 400 (1983).

Inc. (ERG), over the application of governmental price escalator clauses[121] contained in two intrastate gas contracts.[122] In 1978 the federal government enacted the Gas Policy Act,[123] which raised the price ceiling of gas sold in the intrastate gas market.[124] In response to this federal gas deregulation, Kansas enacted a statute, which in effect placed a ceiling on price increases which ERG could charge KPL under the governmental price escalator clauses in their contracts.[125]

The Court outlined a history of Contract Clause analysis. The threshold inquiry is whether there has been a substantial impairment. Three considerations are important to that determination: (1) total destruction of contractual expectations is unnecessary,[126] (2) state regulation can restrict parties to those gains,[127] and (3) a person who enters into a reasonably bargained-for industry that has been regulated in the past can expect further regulation in the future.[128]

Even if the state regulation constitutes a substantial impairment, it will still be upheld if it serves a legitimate public purpose and is reasonable and necessary to the attainment of that purpose. Legitimate public purposes include remedying a broad and general social or economic problem[129] which need not be an emergency or temporary situation,[130] or eliminating windfalls.[131] The requirement of a legitimate public purpose guarantees that the state is exercising its police power, rather than providing benefits to special interests.[132] Courts will defer to legislative judgment as to the necessity and reasonableness of a particu-

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[121] These clauses provide that if a governmental authority fixes a price for any natural gas that is higher than the one contracted for, the contract price would be increased to that level. *Id.* at 403.

[122] *Id.* at 698-99.

[123] Natural Gas Policy Act of 1978, 15 U.S.C. §§ 3301-3432 (Supp. V 1981).

[124] *Energy Reserves*, 459 U.S. at 405-06.

[125] *Id.* at 401. The Kansas statute imposed price controls on the intrastate market with regard to contracts executed before April 20, 1977, and prohibited consideration of either ceiling prices set by federal authorities or prices paid in Kansas under other contracts in the application of governmental price escalator and price redetermination clauses. *Id.*

[126] *Id.* (citing *United States Trust*).

[127] *Id.* (citing *El Paso*).

[128] *Id.* (citing *Veix*).

[129] *Id.* (citing *Allied Structural Steel*).

[130] *Id.* (citing *Veix*).

[131] *Id.* (citing *United States Trust*).

[132] *Id.* The Court is reiterating its point made in *Allied Structural Steel* that once a severe impairment is found, the Court will look at the actual effect of the legislation to determine whether the legislation applies to a large class of people or to a small interest group. *See id.* at 417 n.25 (The Kansas Act was not a special interest legislation as was the statute in *Allied Structural Steel*, where the Court found that the Minnesota statute was intended not to affect all large employers but to affect only a small part of that class.). *See also supra* note 114.

lar statute, unless the contract is one in which a state is a party.[133]

The *Energy Reserves Group* Court found that ERG's contractual rights were not substantially impaired by the Kansas statute, relying essentially on the fact that the parties were operating in a heavily regulated industry.[134] The Court was also persuaded by the fact that the contracts in dispute included governmental price escalator clauses and price redetermination clauses, which indicated that the contracts were structured against a background of regulated gas prices, and therefore that the parties themselves knew they were contracting in a heavily regulated area.[135] Under these circumstances, the Court held ERG's reasonable expectations were not impaired by the Kansas statute.[136]

Because there was no severe impairment, the constitutional inquiry should have ended there.[137] The Court nonetheless continued its analysis. The Court found that Kansas had a valid public purpose in protecting consumers from escalating prices and in correcting the imbalance between the interstate and intrastate markets caused by federal deregulation.[138] The Court then determined that the statute was reasonable and necessary to achieve the public purpose because (1) the statute prevented the price of intrastate gas subject to indefinite price escalator clauses from skyrocketing, (2) consistent with congressional policy, it encouraged the production of certain types of gas by exempting them from the price controls, and (3) it was a temporary measure that expired when the federal price deregulation terminated.[139]

As a result of *Energy Reserves Group*, the status of the Contract Clause is unclear. Some commentators have viewed the decision as evidence that *United*

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[133] 459 U.S. at 412-13.

[134] *Id.* at 416. In finding that the industry was heavily regulated, the Court looked at three factors. First, the Court in the past has recognized the validity of regulations in the natural gas industry in other states. *Id.* at 413 & n.16. Second, Kansas has regulated the industry extensively for over 75 years although not natural gas prices specifically. *Id.* at 413-14. By acknowledging that Kansas has not regulated natural gas prices per se, the Court indicated that it is unnecessary for a state to regulate a particular area within a regulated industry for purposes of Contract Clause analysis. Third, Congress has regulated natural gas prices since 1938. *Id.*

[135] *Id.* at 415-16.

[136] *Id.* at 416.

[137] Justice Powell, joined by Chief Justice Burger and Justice Rehnquist in his concurring opinion, pointed out that the conclusion that ERG's reasonable expectations have not been impaired was dispositive and therefore it was unnecessary for the Court to continue its analysis. *Id.* at 421.

[138] *Id.* at 416-17. The Court may have been swayed by the fact that Kansas was acting pursuant to congressional approval. *See generally id.* at 413 n.17. That would be persuasive in showing the lack of arbitrariness on the part of the state legislature. *See Allied Structural Steel*, 438 U.S. at 248 (company voluntarily set up pension plan in accordance with the Internal Revenue Code). *But see United States Trust*, 431 U.S. at 36-37 (Brennan, J., dissenting) (subsequent enactment of congressional acts insufficient to constitute changed conditions).

[139] 459 U.S. at 418-19.

*States Trust* and *Allied Structural Steel* are merely oddities,[140] primarily because the Court in *Energy Reserves Group* seemed more tolerant of legislative interference than in the two previous cases.[141] However, the Court was more tolerant for different reasons. Because *Energy Reserves Group* involved two highly regulated industries, it was unnecessary for the Court to scrutinize the legitimacy and reasonableness of the challenged law. The Court has frequently stated in prior decisions that one of the factors in determining the constitutionality of a state law is the degree of past regulation.[142] If an enterprise has been previously regulated, parties entering into a contract within that enterprise should expect further regulations to be imposed and therefore such regulations should not severely impair their contracts.[143] Moreover, an examination of the history of the Contract Clause shows that the Court has consistently given broad powers to states to regulate certain industries in the past.[144] Thus, the fact that two heavily regulated industries were involved was the distinguishing factor for the outcome of *Energy Reserves Group*.

## III. IMPACT OF *Energy Reserves Group* ON REGULATED INDUSTRIES

The key factor in the Court's decision in *Energy Reserves Group* was that the parties were involved in heavily regulated industries public utilities such as Kansas Power and Light have historically been subjected to comprehensive legislation.[145] Similarly, the natural gas industry has been heavily regulated.[146]

The rationale behind the "regulated industry" exception can be better under-

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[140] Baker, *Has the Contract Clause Counter-revolution Halted? Rhetoric, Rights, and Markets in Constitutional Analysis*, 12 HASTINGS CONST. L.Q. 71, 72 (1984) ("[I]n Energy Reserves Group, Inc. v. Kansas Power & Light Co. the Court employed another Contract Clause case to exhibit second thoughts."); Epstein, *Toward a Revitalization of the Contract Clause*, 51 U. CHI. L. REV. 703, 703-05 (1984) ("The occasional Supreme Court decision hints at renewed judicial enforcement of limitations on the legislative regulation of economic activities but these traces fade as quickly and quietly as they appear."); J. NOWAK, R. ROTUNDA & J.N. YOUNG, CONSTITUTIONAL LAW 471 (2d ed. 1983) ("[T]he *Allied Structural Steel Co. v. Spannaus* decision represents only a refusal to abdicate the judicial role in the enforcement of the contract clause, rather than a return to the pre-1937 model of judicial protection of economic interests.").

[141] *See generally*, Baker, *supra* note 140; Clarke, *The Contract Clause: A Basis for Limited Judicial Review of State Economic Regulation*, 39 U. MIAMI L. REV. 183, 203-06 (1985).

[142] *See Allied Structural Steel*, 438 U.S. at 242 n.13; *Veix*, 310 U.S. at 38. The statement most frequently cited for this proposition is that by Justice Holmes in Hudson County Water Co. v. McCarter, 209 U.S. 349, 357 (1908): "One whose rights, such as they are, are subject to state restriction, cannot remove them from the power of the state by making a contract about them. The contract will carry with it the infirmity of the subject matter."

[143] *See supra* note 128 and accompanying text.

[144] *See supra* notes 43-44.

[145] *See generally* B. WRIGHT, *supra* note 9 at 195. Regulated areas that have withstood a Contract Clause attack include public utilities, *see, e.g.*, Detroit United Ry. v. City of Detroit,

stood in light of the Court's major objective under the Contract Clause: to protect legitimate expectations in contractual relationships.[147] These expectations can be severely disrupted when states impose regulations which alter contractual obligations in areas never before subject to regulation.[148] In an already regulated area, however, the expectations are not the same. Parties are on notice that regulation is common and will continue. Therefore, the parties cannot reasonably expect that their private arrangements will be free from government interference.

Parties to a contract could not reasonably expect that state legislatures would enact laws intended to target certain individual contracts. In *Schieffelin & Co. v. Department of Liquor Control*,[149] however, the Connecticut Supreme Court upheld a statute that was enacted specifically to prevent the termination of three contracts. In the first of two consolidated cases, an out-of-state shipper sought to terminate its relationship with two Connecticut liquor distributorships. In the second case, an out-of-state liquor licensee sought to terminate a third distributorship.[150] The Connecticut legislature, upon learning that the distributorships were threatened with termination, reduced the holding period for "just cause" terminations from twenty-four months to six months.[151] Because the three de-

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255 U.S. 171 (1921), St. Paul Gaslight Co. v. City of St. Paul, 181 U.S. 142 (1901), Shields v. Ohio, 95 U.S. 319 (1877); lotteries, *see, e.g.*, Stone v. Mississippi, 101 U.S. 814 (1880), Boyd v. Alabama, 94 U.S. 645 (1877); insurance companies, *see, e.g.*, Chicago Life Ins. Co. v. Needles, 113 U.S. 574 (1885); and more recently, gas and oil industries, *see, e.g.*, Exxon Corp. v. Eagerton, 462 U.S. 176 (1983), Energy Reserves Group, Inc. v. Kansas Power & Light Co., 459 U.S. 400 (1983); the health industry, *see, e.g.*, American Hosp. Ass'n v. Hansbarger, 600 F. Supp. 465 (N.D.W.V. 1984), State v. Good Samaritan Hosp. of Md., Inc., 299 Md. 310, 473 A.2d 892, *appeal dismissed*, 105 S. Ct. 56 (1984); landlord-tenant relationships, *see, e.g.*, Troy, Ltd. v. Renna, 727 F.2d 287 (3d Cir. 1984); and taxpayer-local taxing authority, *see, e.g.*, Gateway Apartments, Inc. v. Mayor & Township Council of Nutley, 605 F. Supp. 1161 (D.N.J. 1985).

[146] *See supra* note 134 and accompanying text.

[147] *See Allied Structural Steel*, 438 U.S. at 245 ("[C]ontracts enable individuals to order their personal and business affairs according to their particular needs and interests. Once arranged, those rights and obligations are binding under the law, and the parties are entitled to rely on them.").

[148] *See id.* at 250 (Minnesota law did not operate in an area already subject to state regulation at the time the company's contractual obligations were originally undertaken).

[149] 194 Conn. 165, 479 A.2d 1191 (1984).

[150] *Id.* at ____, 479 A.2d at 1194-96.

[151] *Id.* at ____, 479 A.2d at 1197-98. Prior to 1971, there were no statutory restrictions on termination of liquor distributorships in Connecticut. In 1971 the Connecticut legislature enacted a statute which prohibited a manufacturer or out-of-state shipper from terminating a 24-month distributorship except on a year's notice or at an earlier date for "just and sufficient cause." In 1979 the one year notice was deleted, leaving "just cause" as the only basis for terminating such distributorships. In 1981 the legislature further amended the statute by reducing the durational period for just cause termination to six months. *Id.* at ____, 479 A.2d at 1194-95. Thus, under

fendants had held their distributorships for over six months but under twenty-four months, absent the new legislation these distributorships could have been terminated without cause.[152] The legislation was admittedly enacted specifically to prevent the termination of these three distributorships.[153] Yet, the court found that because the liquor industry was heavily regulated, including the termination of distributorships, the plaintiffs could reasonably have anticipated further regulations, and therefore the new legislation did not unconstitutionally impair their contracts.[154] While it may be true that the plaintiffs could have reasonably anticipated further regulation in the industry, they could not reasonably have expected that the legislation would be so narrowly aimed.[155] Nonetheless, the court's analysis arguably followed that set forth in *Energy Reserves Group*.

Contracting parties would also normally not expect state legislatures to abruptly impair existing contracts by amending new regulatory schemes after the parties had in good faith complied with the original scheme. In *N.A. Burkitt, Inc. v. J.I. Case Co.*,[156] the United States District Court of Maine upheld a 1981 amendment to Maine's 1975 dealership laws. The amendment changed the requirements for termination of existing dealership agreements.[157] The defendant, a manufacturer of construction equipment, had entered into a dealership agreement with the plaintiff, a Maine dealer in 1979 and amended the agreement in 1980. The law in force at that time required that manufacturers provide a written notice of cancellation at least sixty days prior to cancellation. In 1981 the Maine legislature amended the notice requirement to require that a manufacturer cancelling because of a dealer's inadequate sales or service performance must provide the dealer with a six-month opportunity to cure its inadequate performance.[158] In 1983, when the defendant sought to terminate the dealership by sending a ninety-day written notice of termination, the plaintiff brought an action for breach of contract. Despite a finding by the United States Magistrate that the six-month right-to-cure lessened the value of the contract to the

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the 1981 statute, a holder of a wholesale permit who had a distributorship for the sale of alcoholic beverages for six months could not have that distributorship terminated or diminished by the manufacturer or out-of-state shipper except for just and sufficient cause. *Id.* at ____, 479 A.2d at 1196-97.

[152] *Id.* at ____, 479 A.2d at 1199.

[153] Id. at ____. 479 A.2d at 1197-98. Intent was not a factor; the Court noted that "[t]he appropriateness of legislation is determined not by the impulse of the messenger but rather by the thrust of the message." *Id.* at ____, 479 A.2d at 1202.

[154] *Id.* at ____, 479 A.2d at 1201.

[155] *See Allied Structural Steel*, 438 U.S. at 250 (Minnesota's law severely impaired the company's contractual obligations because its narrow aim was leveled at particular employers.).

[156] 597 F. Supp. 1086 (D. Me. 1984).

[157] *Id.* at 1087-88.

[158] *Id.*

manufacturer,[159] the district court found that the 1981 amendment did not constitutionally impair the defendant's contractual rights. Since an extensive regulation of business practices was enacted in 1975, including the termination of dealership agreements, the parties could not reasonably expect to have absolute control over their ability to terminate their agreement.[160] Although the court relied on *Energy Reserves Group* to reach its decision,[161] the facts are distinguishable. In *Energy Reserves Group*, the oil and gas industry had been regulated for over seventy-five years by the state and over forty years by the federal government.[162] In *N.A. Burkitt*, dealerships were first regulated in 1975, only six years before the amendment was enacted.[163] Yet, the *N.A. Burkitt* decision would allow a state legislature to avoid a Contract Clause challenge by enacting comprehensive legislation to be applied prospectively and then a few years later amending the legislation retroactively.

A fairer outcome would be for courts to refuse to allow legislative amendments to newly enacted legislation to be applied retroactively absent exigent circumstances. Such an approach was taken by the Wisconsin Supreme Court in *Wipperfurth v. U-Haul Company of West Wisconsin, Inc.*,[164] in which the court struck down retroactive application of Wisconsin's fair dealership law. The Wisconsin legislature originally adopted a dealership law in 1973, which was prospective only. In 1977 the legislature repealed the prospective clause and adopted a statement of purpose that the law would apply to all dealerships.[165] The parties had entered into a contract in 1969, which permitted either party to terminate the contract upon thirty days written notice. The defendant company terminated in compliance with the terms of the contract. The issue before the Wisconsin Supreme Court was whether the law as amended affected the parties' contract. If the law did apply, the defendant would not have been able to terminate the agreement without good cause.[166] The court held that a retrospective application of the dealership law was prohibited by the Contract Clause absent evidence that the legislature had good reason that would necessitate such application.[167] *Wipperfurth* provides more protection for the reasonable expectations of parties entering a newly regulated field than *N.A. Burkitt* and therefore is more aligned with the rationale for the "regulated industry" exception.[168]

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[159] *Id.* at 1091.

[160] *See supra* note 134 and accompanying text.

[161] 597 F. Supp. at 1091.

[162] *Id.* at 1089.

[163] *Id.* at 1091.

[164] 101 Wis. 2d 586, 304 N.W.2d 767 (1981).

[165] *Id.* at 588-89, 304 N.W.2d at 768-69.

[166] *Id.* at 587, 304 N.W.2d at 768.

[167] *Id.* at 598-99, 304 N.W.2d at 773.

[168] Since *Wipperfurth* was decided two years prior to *Energy Reserves Group*, its authority may

The issue of how much regulation is required[169] before an industry falls within the "regulated industry" exception remains unclear. The Court in *Energy Reserves Group* stated that "[w]hen he purchased into an enterprise already regulated in the particular to which he now objects, he purchased subject to further regulation upon the same topic."[170] The Fourth Circuit Court of Appeals has interpreted this statement as a limitation on a state's ability to regulate within a regulated industry. In *Garris v. Hanover Insurance Co.*,[171] the statute in dispute was part of a comprehensive automobile insurance legislative scheme enacted by the South Carolina legislature in 1974.[172] The statute provided:

> No insurer of automobile insurance shall cancel its representation by an agent primarily because of the volume of automobile insurance placed with it by the agent on account of the statutory mandate of coverage nor because of the amount of the agent's automobile insurance business which the insurer had deemed it necessary to reinsure in the Facility.[173]

Prior to the enactment of the legislative scheme, the defendant insurance company and the plaintiff insurance agent had entered into an agency agreement which provided that either party could unilaterally terminate the agency within sixty days of notice.[174] In 1976, the defendant sought to terminate the agency according to the terms of the agreement, and the plaintiff sued on the ground that the defendant was in violation of the legislation.[175] The district court granted summary judgment for the defendant, holding that the contract, entered into before the enactment of the statute, allowed the defendant to terminate its agency for any reason.[176] The Fourth Circuit Court of Appeals af-

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be questionable. However, it is also possible to distinguish the two cases on their facts. In *Wipperfurth*, Wisconsin began to regulate the industry in 1975, while in *Energy Reserves Group*, Kansas had been regulating the natural gas industry for over 75 years.

[169] *Wipperfurth* and *N.A. Burkitt* involved regulations governing the specific types of contracts in dispute. The United States Supreme Court indicated in *Energy Reserves Group* that as long as the state had regulated other aspects of an industry, the fact that a particular area within an industry was not regulated at the time of the execution of a contract is immaterial. *See supra* note 132.

[170] *Energy Reserves Group*, 459 U.S. at 411 (quoting *Veix*, 310 U.S. at 38).

[171] 630 F.2d 1001 (4th Cir. 1980).

[172] The legislation required insurance companies to make automobile liability insurance available on a nondiscriminatory basis to all drivers licensed by the state. Before the Act, insurance was sold on a voluntary market with an assigned risk plan for those unable to obtain insurance. *Id.* at 1003.

[173] *Id.* (citing S.C. CODE ANN. § 38-37-940(2) (Law. Co-op. 1976)).

[174] *Id.*

[175] The plaintiff brought this action in state court, but the defendant removed the case to federal court on the basis of diversity of citizenship. *Id.* at 1003.

[176] The district court initially granted summary judgment in favor of the defendant, holding

firmed, holding that to the extent that the legislation conferred a private cause for termination of agency contracts entered into before its enactment, it violated the Contract Clause.[177] Although the insurance industry had traditionally been subjected to state regulation, there was no indication that the particular contractual relationship involved in this case was within the range of that prior regulation.[178] The state had, in the past, regulated other aspects of the insurer-insurance agent relationships,[179] but there was no such regulation in place at the time of the execution of the parties' contract.[180]

It is unclear whether *Garris*, decided three years before *Energy Reserves Group*, is in conflict with *Energy Reserves Group*.[181] The Fourth Circuit Court, by focusing on the insurer-agent relationship rather than on the insurance industry in general, had interpreted the case out of the "regulated industry" exception. The *Garris* approach of narrowing the area of regulation, nonetheless, provides more protection to contracts within regulated industries.

## IV. CONCLUSION

Together, *United States Trust*, *Allied Structural Steel*, and *Energy Reserves Group* clarify the scope of the Contract Clause as it is applied today. The test applied by the United States Supreme Court is essentially the balancing of two conflicting interests—the individuals' right to rely on their contracts and the rights of states to exercise their police powers to protect health, welfare and

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that the plaintiff had no standing to bring the action because the provision was not for the protection of insurance agents but for the protection of the public. *Id.* While appeal was pending in the United States Court of Appeals for the Fourth Circuit, the South Carolina Supreme Court held that the provision created in an agent a private cause of action for the wrongful termination of his agency. G-H Ins. Agency, Inc. v. Travelers Ins. Cos., 270 S.C. 147, 241 S.E.2d 534 (1978). The fourth circuit court remanded in light of the *G-H Ins. Agency* decision. *Garris*, 630 F.2d at 1003. Nonetheless, the district court again granted summary judgment for the defendant. Plaintiff appealed, challenging the district court's decision in light of the state court's interpretation of the statute. *Id.* at 1003-04.

[177] *Id.* at 1003. The court did not strike down the entire statute. It expressly limited its decision to the unconstitutionality of the private enforcement provision as construed by the state supreme court. *Id.* at 1011 n.11.

[178] *Id.* at 1007.

[179] *Id.* at 1007 n.3. Prior to the enactment of the legislative scheme, there were only three sections pertaining to the insurer-agent relationship—none of which pertained to the agency contract. *Id.* The court was also persuaded by the fact that the state and national federations of insurance agents generally favored a continued hands-off legislative policy with respect to the contractual relationship involved in the case. *Id.*

[180] *Id.* at 1007.

[181] *See supra* note 169. *Garris* had not been overruled. *See* Morgan v. Kemper Ins. Cos., 754 F.2d 145, 147-48 (4th Cir. 1985) (following *Garris*).

safety.[182]

The Court's decision in *United States Trust* indicates that legislation affecting public contracts will be closely scrutinized by the courts. Public contracts will be given a high level of judicial protection to discourage states from repudiating their own contracts absent valid reasons, such as unforeseen change in circumstances.

Similarly, with regard to private contracts, the implications of *Allied Structural Steel* are that the Court will protect legitimate contractually-based expectations where a state imposes regulations in areas never before subject to regulation. In such situations, the burden is on the party seeking to enforce the regulation to show that there are valid reasons for impairing pre-existing contracts. However, when a state has regulated an industry in the past, *Energy Reserves Group* indicates that the burden will shift to the party seeking to protect the sanctity of his contract to prove the unconstitutionality of the regulation.

The purpose of the Contract Clause is to protect the legitimate expectations of contracting parties from government interference. The rationale underlying the "regulated industry" exception is that when parties contract within a regulated industry, they should reasonably expect a certain amount of government interference with their contracts.

As new industries develop and new regulatory schemes are imposed, the "regulated industry" exception to the Contract Clause will play a major role in determining the future viability of the clause. Since *Energy Reserves Group* involved heavily regulated industries, the paradigm for the exception, further decisions are required to determine how the Court will apply the exception to less regulated areas or to legislation with questionable purposes.

Carolyn E. Hayashi

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[182] The tension between the two interests is evidenced by the majority and the dissent in *United States Trust* and in *Allied Structural Steel*. On the one hand, there exists the belief that "lawful exercises of a State's police powers stand paramount to private rights held under a contract." *United States Trust*, 431 U.S. at 33 (Brennan, J., dissenting). On the other hand, "[i]f the Contract Clause is to retain any meaning at all. . .it must be understood to impose *some* limits upon the power of a State to abridge existing contractual relationships, even in the exercise of its otherwise legitimate police power." *Allied Structural Steel*, 438 U.S. at 242.

# *Ravelo v. County of Hawaii*: Promissory Estoppel and the Employment At-Will Doctrine

## I. INTRODUCTION

In *Ravelo v. County of Hawaii*,[1] the Hawaii Supreme Court addressed the issue of whether there was a cause of action for which relief could be granted to Benjamin Ravelo and his wife, Marlene Ravelo. The Ravelos' complaint alleged that Hawaii County Police Department (County) accepted Mr. Ravelo's employment application.[2] The County subsequently rescinded its acceptance after Mr. and Mrs. Ravelo quit their jobs in reliance thereon.[3] The court held that although the complaint did not state a cause of action for a breach of contract[4] or for tortious infliction of emotional distress,[5] the complaint did state a cause of action under the doctrine of promissory estoppel[6] because of the Ravelos' detrimental reliance upon the County's promise of employment.[7]

This note will examine the Hawaii Supreme Court's application of promis-

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[1] 66 Hawaii 194, 658 P.2d 883 (1983).

[2] *Id.* at 196, 658 P.2d at 885.

[3] *Id.* The Ravelos lived on Oahu at that time and resigned from their jobs in order to move to the island of Hawaii.

[4] *Id.* at 197-98, 658 P.2d at 885-86. Because Mr. Ravelo was at best promised a job as a probationary employee, whose employment was terminable at-will, the County could terminate him at any time with impunity. Therefore, there was no cause of action based upon a contractual obligation.

[5] *Id.* at 198, 658 P.2d at 886. The circuit court had held that any attendant claim for emotional distress could not be maintained because it would have to be related to a breach of some contractual right, which did not exist in this case. Appellants' Opening Brief at 7.

[6] Section 90 of the RESTATEMENT SECOND provides:

> Promise Reasonably Inducing Action or Forbearance.
>
> (1) A promise which the promisor should reasonably expect to induce action or forbearance on the part of the promisee or a third person and which does induce such action or forbearance is binding if injustice can be avoided only by enforcement of the promise. The remedy for breach may be limited as justice requires.
>
> (2) A charitable subscription or a marriage settlement is binding under Subsection (1) without proof that the promise induced action or forbearance.

RESTATEMENT (SECOND) OF CONTRACTS § 90 (1979).

[7] 66 Hawaii at 199, 658 P.2d at 887.

sory estoppel to Mr. Ravelo's pre-employment termination. The court's opinion raises several questions. The court found that Mr. Ravelo had a cause of action against the County for revoking its promise to hire him. However, if Mr. Ravelo had been hired as a probationary employee,[8] the County could have fired him immediately without cause, leaving Mr. Ravelo with no legal redress.[9] This note will also discuss the court's extension of promissory estoppel to Mrs. Ravelo, who as a third party relied upon the County's promise to her husband.[10]

## II. FACTS

On December 13, 1978, Mr. Ravelo received a letter from the Hawaii County Police Department stating that his application for employment as a police officer was accepted and that he would be sworn in as a police recruit on January 2, 1979.[11] In reliance on this promise of employment, Mr. and Mrs.

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[8] Under the applicable provisions of the civil service rules and regulations set forth below, an employee may be dismissed at any time without written notice and have no legal redress while serving his probationary period:

> Rule 7.2. All employees shall successfully serve an initial probationary period before becoming members of the civil service; provided that in the case of a regular employee of the State or counties entering the County by inter-governmental movement his appointing authority in the County may waive the requirement to serve an initial probationary period. All regular employees and all other employees having a permanent appointment in civil service shall constitute the membership of the civil service.

County of Hawaii, Hawaii, Rules and Regulations on Civil Service and Compensation, Rule 7.2 (amended Sept. 1984).

Rule 12.4 provides in pertinent part: "A non-regular employee may be dismissed at any time without written notice and shall have no rights of appeal." *Id.* Rule 12.4(a).

The Civil Service Laws in Hawaii Revised Statutes provide in relevant part:

> All employees shall successfully serve an initial probation period before becoming members of the civil service. In addition, membership in the civil service shall require that the employee shall have been appointed in accordance with law and shall have satisfied all the requirements for employment prescribed by this chapter or by the rules and regulations promulgated thereunder including those qualifications prescribed by section 78-1.

HAWAII REV. STAT. § 76-27 (1976).

[9] In their opening brief, the Ravelos argued that since Mr. Ravelo was never hired he was not a probationary employee and, therefore, the civil service rules and regulations were not applicable. The Ravelos contended, however, that a contract for hire existed, which gave Mr. Ravelo rights distinguishable from those of a probationary employee. Appellants' Opening Brief at 18.

[10] RESTATEMENT SECOND § 90 recognizes third persons as potential beneficiaries of the doctrine. *See infra* text accompanying notes 66-79.

[11] The Ravelos contend that a sergeant from the Hawaii County Police Department called Mr. Ravelo at home to inform him that the County had accepted his application and requested that Mr. Ravelo resign from his job with the Honolulu Police Department by December 14, 1978. Appellants' Opening Brief at 3.

Ravelo resigned from their jobs on Oahu[12] and arranged to remove their children from a private school.[13] On December 20, 1978, Mr. Ravelo received word from the County that he would not be hired after all. The Ravelos attempted, unsuccessfully, to rescind their resignations.[14]

The Ravelos filed suit against the County for wrongfully breaching its agreement to hire Mr. Ravelo. The Ravelos sought specific enforcement and damages for mental anguish and loss of projected income for both Mr. and Mrs. Ravelo.[15]

The County moved to dismiss the suit[16] and argued that there was no basis upon which relief could be granted under either a breach of contract or a tortious infliction of emotional distress cause of action.[17] The circuit court dismissed the Ravelos' complaint without prejudice,[18] finding that Mr. Ravelo was, at best, promised a position as a probationary employee whose employment was terminable at-will prior to the completion of the probationary period.[19] The court also found that Mr. Ravelo had no enforceable claim sounding in breach of contract[20] or in tort[21] since as a prospective probationary employee, he was not considered a member of the county civil service and therefore would

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[12] Mr. Ravelo was a full time civil service employee as a motor patrol officer with the Honolulu Police Department at that time. *Id.* at 2. The record does not reflect what Mrs. Ravelo's position was.

[13] The complaint originally sought damages for Mr. and Mrs. Ravelo and their two minor children. Counsel for the Ravelos conceded that the claims on behalf of the minor children could not be sustained. Thus, the dismissal of those claims was not appealed. 66 Hawaii at 196, 658 P.2d at 885.

[14] *Id.*

[15] *Id.*

[16] The County also submitted an answer which asserted that it lacked sufficient knowledge to respond to the Ravelos' claims. Nonetheless, the answer raised several affirmative defenses including the Statute of Frauds and Mr. Ravelo's breach of a precondition of employment. *Id.* at 197, 658 P.2d at 885.

[17] In support of their motion to dismiss, or in the alternative, for summary judgment, the County also argued that Mr. Ravelo failed to exhaust administrative remedies. *Id.*

[18] *Id.*

[19] The circuit court held that Rule 12.4(a) of the Hawaii County Rules and Regulations on Civil Service and Compensation provides that a probationary employee may be dismissed at any time without written notice. Therefore, a probationary employee may be terminated with or without cause. For the text of the county rules on probationary employees, see *supra* note 8. The court noted that Mr. Ravelo was not a transferee who would have been exempted from probationary status. Instead, Mr. Ravelo would have entered the Hawaii County police force as a probationary employee. Appellants' Opening Brief at 5. It may be argued, therefore, that the employment arrangement is virtually identical to that of an employment at-will. *See infra* notes 26-27 and accompanying text.

[20] *See supra* note 4.

[21] *See supra* note 5.

have had no rights against removal.[22] The Ravelos were granted permission to seek an interlocutory appeal.[23]

The Hawaii Supreme Court noted that the complaint failed to state a cause of action for a breach of contract or for tortious conduct.[24] However, the court held that the Ravelos' complaint could give rise to a valid claim under the doctrine of promissory estoppel based upon the Ravelos' detrimental reliance on the County's promise of employment.[25]

## III. HISTORY

### A. *The Employment At-Will Doctrine and Its Exceptions*

#### 1. *Employment At-Will Doctrine*

The employment at-will rule provides that an employer may dismiss any employee hired at-will with or without cause without incurring legal liability in the absence of a statute or an agreement otherwise.[26] All hirings for an indefinite duration are considered prima facie hirings at-will.[27]

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[22] Probationary employees are non-regular employees who may be dismissed at any time without a right to appeal. For the text of the county rules on probationary employees, see *supra* note 8.

[23] The Ravelos first sought a reconsideration of the order dismissing their complaint. The court denied the motion to reconsider. The Ravelos then moved to amend their complaint and in the alternative requested leave to pursue an interim review by the supreme court. 66 Hawaii at 198, 658 P.2d at 886.

[24] *Id.*

[25] *Id.* at 199, 658 P.2d at 887. The supreme court reversed and remanded the case.

[26] For the purposes of this note, the definition of an at-will employee will include a probationary employee who may be discharged at any time with no rights of appeal.

A general rule of agency law states: "Unless otherwise agreed, mutual promises by principal and agent to employ and to serve create obligations to employ and to serve which are terminable upon notice by either party; if neither party terminates the employment, it may terminate by lapse of time or by supervening events." RESTATEMENT (SECOND) OF AGENCY § 442 (1957).

Commentary to § 442 emphasizes the at-will nature of the employment relationship by stating that a contract of employment for a salary proportionate to units of time "does not, of itself, indicate that the parties have agreed that the employment is to continue for the stated period of time."

*Id.* § 442 comment b.

*See generally* Blades, *Employment At Will vs. Individual Freedom: On Limiting the Abusive Exercise of Employer Power*, 67 COLUM. L. REV. 1404 (1967) (critically analyzes the employer's absolute right of discharge and the employment at-will rule's erosion).

[27] The general rule on prima facie hirings at-will, also known as the "American Rule," provides:

> [A] general or indefinite hiring is prima facie hiring at-will, and if the servant seeks to make it out a yearly hiring, the burden is upon him to establish it by proof. A hiring at so

The rationale for providing an employer with an absolute right to discharge an employee is based upon the contractual principle of mutuality of obligation.[28] Since an employee is free to terminate his employment at anytime without obligation to continue his services,[29] the employer similarly should not be obligated to continue to provide employment.

The widespread adoption of the employment at-will rule by American jurisdictions[30] during the late nineteenth and early twentieth centuries reflected the nation's concern with protecting freedom of enterprise and economic growth.[31] In 1919, the Hawaii Supreme Court adopted the employment at-will rule in *Crawford v. Stewart*.[32] The court held that a hiring at a certain sum per month

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> much a day, week, month or year, no time being specified, is an indefinite hiring, and no presumption attaches that it was for a day even, but only at the rate fixed or whatever time the party may serve.

H. WOOD, LAW OF MASTER AND SERVANT § 134 (1877), *quoted in* Parnar v. Americana Hotels, Inc., 65 Hawaii 370, 374, 652 P.2d 625, 628 (1982). Because of the inherently indefinite nature of permanent or lifetime employment contracts, these are also considered to be hirings at-will.

For Hawaii cases discussing the at-will rule, see Parnar v. Americana Hotels, Inc., 65 Hawaii 370, 652 P.2d 625 (1982); Crawford v. Stewart, 25 Hawaii 226 (1919); Vlasaty v. Pacific Club, 4 Hawaii App. 556, 670 P.2d 827 (1983).

[28] It is still considered that an employee provides labor in consideration for his pay and in the absence of some recognized additional consideration, there is no consideration to support the employer's promise for permanent employment. *See generally* 5 A. CORBIN, CONTRACTS §§ 1181, 1184 (1951 & Supp. 1971); Blades, *supra* note 26, at 1419; Murg & Scharman, *Employment At Will: Do the Exceptions Overwhelm the Rule?*, 23 B.C.L. REV. 329, 337-38 (1982); Note, *Implied Contract Rights to Job Security*, 26 STAN. L. REV. 335, 351-53 (1974) [hereinafter cited as Note, *Implied Contract Rights*].

[29] *See generally* RESTATEMENT SECOND § 367 comment c.

Generally, courts are unwilling to specifically enforce employment contracts. Therefore, an employer's damages in the case of an employee's breach are limited to the costs of finding a replacement. Unless the employee had unique abilities, damages are usually minimal. Murg & Scharman, *supra* note 28, at 336.

[30] Prior to the nationwide acceptance of the "American Rule," the "English Rule" prevailed which presumed that all indefinite hirings were for a one-year term. No master could discharge his servant without three month's notice unless reasonable cause was found by a Justice of the Peace. *See* 1 W. BLACKSTONE, COMMENTARIES *426, *cited in* Parnar v. Americana Hotels, Inc., 65 Hawaii 370, 374, 652 P.2d 625, 627-28 (1982).

[31] The employment at-will rule developed during an era of national growth. Freedom of bargaining was considered a fundamental and indispensable requisite of progress. *See* Note, *Judicial Limitation of the Employment At-Will Doctrine*, 54 ST. JOHN'S L. REV. 552 (1980) [hereinafter cited as Note, *Judicial Limitation*].

[32] 25 Hawaii 226, 230-31 (1919). *Crawford* involved an agreement where the plaintiff was to provide transportation to a group of teachers at the rate of $10 per month. The teachers were transported until December 14, the beginning of the Christmas holiday. The plaintiff was ready and willing to provide transportation during the holiday season and argued that the agreement was a month to month contract that was breached when the teachers refused to pay for more than

without specifying any duration, or showing an intent to the contrary, was an employment for an indefinite term and, therefore, terminable at the will of either party.[33]

Although the employment at-will rule has been accepted by many jurisdictions, it has also undergone criticism[34] due to its harsh effect upon employees[35] and its alleged inappropriateness to current employment conditions.[36] In response to this criticism, Congress and state legislatures have imposed limitations on the at-will rule to protect employees from being discharged at the whim of their employer.[37] Courts have also established several exceptions to mitigate the often harsh effects of the at-will rule.[38]

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one-half month's services.

[33] The court cited Wood's "American Rule," as authority for its holding. 25 Hawaii at 231. For a definition of the "American Rule," see *supra* note 27.

[34] *See generally* Blades, *supra* note 26; Murg & Scharman, *supra* note 28; Note, *Judicial Limitation*, *supra* note 31; Note, *Protecting At-Will Employees Against Wrongful Discharge: The Duty to Terminate Only in Good Faith*, 93 HARV. L. REV. 1816 (1980) [hereinafter cited as Note, *Wrongful Discharge*]; Note, *A Common Law Action for the Abusively Discharged Employee*, 26 HASTINGS L.J. 1435 (1975).

[35] Employees generally lack equal bargaining power and cannot sustain their burden to prove that the employment contract is anything other than one at-will. This in turn leads to job insecurity and the potential for unfair treatment by the employer. *See* Blades, *supra* note 26, at 1404-05 (employer's power over employee poses a threat to individual freedom and places one man's livelihood in another man's hands); Note, *Wrongful Discharge*, *supra* note 34.

[36] *See* Note, *Implied Contract Rights*, *supra* note 28, at 337 (criticizes the employment at-will rule for its inflexibility and harshness).

[37] The first major legislative attack on the at-will rule was the passage of the National Labor Relations Act of 1935. This Act fostered the growth of collective bargaining agreements and prohibited an employer from discriminating against employees to deter union membership. *See* 29 U.S.C. § 160(c) (1976). Other legislatively imposed limitations include the Civil Rights Act of 1964, tit. VII, 42 U.S.C. § 2000(e) (1976) and the Age Discrimination in Employment Act of 1967, 29 U.S.C. §§ 621-634 (1976).

[38] For judicial decisions which have undermined an employer's absolute right to discharge, see, e.g., 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 Hawaii 370, 652 P.2d 625 (1982) (public policy exception adopted); 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 411, 457 N.Y.S.2d 193 (1982) (additional consideration exception recognized).

### 2. *Judicial Exceptions*

The courts have formulated at least four exceptions to the at-will rule. The first is the public policy exception. When termination by an employer is found to have violated public policy, courts generally recognize a tort of wrongful discharge to provide relief to the aggrieved employee.[39]

The second exception is the good faith requirement. A minority of courts have imposed a duty on employers to terminate employees only in good faith.[40] This duty drastically limits the employer's right to discharge by requiring the employer to prove good cause or else be liable for wrongful discharge.[41]

The third is the additional consideration exception. An employment contract is terminable at-will unless there is a duration provision supported by consideration, other than services by the employee in exchange for his wages.[42] To constitute valid additional consideration, there must generally be some benefit flowing to the employer. Mere detriment flowing from the employee will not suffice.[43] Therefore, it is commonly held that changing jobs and moving do not constitute sufficient additional consideration to support a promise of employment for a specific duration.[44] These actions by the employee, are considered to be merely incidental to the acceptance of a new job, and confer no separate

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[39] *See, e.g.*, Petermann v. International Bhd. of Teamsters, 174 Cal. App. 2d 184, 344 P.2d 25 (1959) (discharge due to employee's refusal to commit perjury before a legislative committee contrary to employer's instructions was unlawful); Parnar v. Americana Hotels, Inc., 65 Hawaii 370, 652 P.2d 625 (1982) (termination in order to prevent employee from testifying against employer in a grand jury investigation violated public policy); Frampton v. Central Ind. Gas Co., 260 Ind. 249, 297 N.E.2d 425 (1973) (dismissal in contravention of state's public policy as announced in its worker's compensation act).

[40] *See* Fortune v. National Cash Register Co., 373 Mass. 96, 364 N.E.2d 1251 (1977) (termination of an at-will employee constitutes a breach of the employment contract when motivated by retaliation or bad faith); Monge v. Beebe Rubber Co., 114 N.H. 130, 316 A.2d 549 (1974) (termination motivated by the employee's refusal to date her boss constituted a breach of employment contract).

[41] *Cf.* Parnar v. Americana Hotels, Inc., 65 Hawaii at 377, 652 P.2d at 629. The Hawaii Supreme Court in *Parnar* refused to inquire into the amorphous concept of good faith when analyzing wrongful discharge cases. Therefore, the court did not adopt the good faith exception.

[42] *See supra* note 28.

[43] *See* Comment, *Employment At Will and the Law of Contracts*, 23 BUFFALO L. REV. 211, 225 (1973).

[44] *See, e.g.*, McLaughlin v. Ford Motor Co., 269 F.2d 120 (6th Cir. 1959) (giving up prior employment was only a necessary incident to place the employee in a position to accept a new job and conferred no benefit upon the employer); Bixby v. Wilson & Co., 196 F. Supp. 889 (N.D. Iowa 1961) (giving up prior employment and incurring moving expenses do not entitle person discharged after "permanent employment" to damages for breach of contract); Ohio Table Pad Co. of Ind. v. Hogan, 424 N.E.2d 144 (Ind. Ct. App. (1981)) (moving and giving up prior job in order to accept new employment did not constitute valid consideration).

benefit to the employer.[45] However, where the employer actively pursues the employee and induces him to abandon his prior livelihood so that these acts by the employee are bargained for, courts will generally find sufficient consideration to support a promise of continued employment.[46]

The fourth exception is the detrimental reliance exception. Courts finding detrimental reliance by the employee may use the doctrine of promissory estoppel as a means of protecting the employee's reliance interests.[47] Section 90 of the Restatement (Second) of Contracts states the doctrine as: "A promise which the promisor should reasonably expect to induce action or forbearance on the part of the promisee or a third person and which does induce such action or forbearance is binding if injustice can be avoided only by enforcement of the promise."[48] Typical forms of detrimental reliance by an employee that may trigger the applicability of promissory estoppel include uprooting a family and moving a long distance, terminating a prior source of livelihood, refusing other job offers, and giving up job security.[49] These actions standing alone, are gener-

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[45] *See, e.g.*, Moody v. Bouge, 310 N.W.2d 665 (Iowa Ct. App. 1981) (change of residence was merely incidental to accepting new employment).

[46] Courts have found that an employee's giving up his prior job or changing his residence because of the promise of a new job constituted additional consideration to support a promise of permanent employment. *See, e.g.*, Foley v. Community Oil Co., 64 F.R.D. 561 (D.N.H. 1974) (Employee's moving of his family at his employer's behest may constitute consideration for establishing contractual relation between parties.); Millsap v. National Funding Corp., 57 Cal. App. 2d 772, 135 P.2d 407 (1943) (Giving up prior employment is sufficient consideration to support a promise of permanent employment.); Collins v. Parsons College, 203 N.W.2d 584 (Iowa 1973) (Since the college knew that the employee was surrendering a tenured position in order to accept a new job with the college, there was additional consideration to enforce the college's agreement to employ Collins permanently at a specified salary.); Rowe v. Noren Pattern & Foundry Co., 91 Mich. App. 254, 283 N.W.2d 713 (1979) (Where the employee gave up an assured lifetime job and soon-to-vest retirement benefits in order to take a new job with defendant, the employment contract was not terminable at-will where employee would not have switched jobs but for his reliance upon the defendant's promise of union protection.); Weiner v. McGraw-Hill, Inc., 57 N.Y.2d 458, 443 N.E.2d 411, 457 N.Y.S.2d 193 (1982) (The detriment suffered by the employee does not have to benefit the employer to constitute valid consideration.).

[47] Courts have not consistently applied the detrimental reliance exception. Some courts have found that detrimental reliance by an employee furnishes additional consideration sufficient to enforce a permanent employment contract. If reliance by the employee at the request of the employer provides sufficient consideration, then there is no need to base the claim on promissory estoppel. *See supra* note 46. In O'Neill v. ARA Servs., Inc., 457 F. Supp. 182 (E.D. Pa. 1978), the court held that in the absence of a promise for permanent employment, reliance upon assurances of job security may support an inference that the employment was intended to continue for a reasonable period of time. Therefore, the plaintiff was given an opportunity to rebut the presumption that the hiring was one at-will. *See also* Note, *Wrongful Discharge*, *supra* note 34.

[48] RESTATEMENT SECOND § 90.

[49] *See, e.g.*, Hunter v. Hayes, 533 P.2d 952 (Colo. Ct. App. 1975) (not chosen for official publication) (court provided relief to employee who quit her prior job in reliance upon a promise

ally insufficient to invoke the additional consideration exception because they do not confer a benefit upon the employer.[50] However, under the detrimental reliance exception, a benefit to the employer is not required. Foreseeable reliance by the employee is the primary criterion to invoke relief under section 90.[51]

The Minnesota Supreme Court in *Grouse v. Group Health Plan, Inc.*,[52] granted relief based on foreseeable reliance. *Grouse*, a case with facts similar to *Ravelo*, involved a pre-employment revocation of an offer of employment. The plaintiff quit his prior job and declined other job offers in reliance upon the health clinic's offer of employment. The health clinic subsequently revoked its offer before the plaintiff began work. The court held that an employment contract did not exist because both parties had the power to terminate the agreement at will.[53] Instead, the court found the doctrine of promissory estoppel to be applicable to provide relief to the plaintiff.

Courts that recognize the detrimental reliance exception generally do not allow the employee to recover expectation damages.[54] When the employment agreement is such that the employee may be fired at any time, there is no basis upon which to calculate the amount of expected wages. In *Pepsi-Cola General Bottlers v. Woods*,[55] the Indiana Court of Appeals found a cognizable claim existed under promissory estoppel but found no basis upon which to award damages because the duration of the at-will employment contract was speculative. In *Pepsi-Cola*, the plaintiff had quit her prior job in reliance upon the defendant's promise of employment. The court held that because the defendant could have discharged the plaintiff after a single day's work with impunity, the plaintiff was not entitled to recovery.[56] In at-will employment arrangements,

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to be hired for an at-will position); Lorson v. Falcon Coach, Inc., 214 Kan. 670, 522 P.2d 449 (1974) (employee allowed to recover under promissory estoppel when he rented a new house and moved his wife and eight children in reliance upon promised employment); Grouse v. Group Health Plan, Inc., 306 N.W.2d 114 (Minn. 1981) (employee granted relief under promissory estoppel where he quit his job and declined other job offers in reliance upon promised at-will employment).

[50] *See supra* notes 43-45 and accompanying text.

[51] The reasonableness of the reliance is also an important consideration. *See infra* notes 90-99 and accompanying text.

[52] 306 N.W.2d 114 (Minn. 1981).

[53] *Id.* at 116.

[54] Expectation damages place the employee in as good a position as he would have been had the promise to employ been kept. RESTATEMENT SECOND § 347. *See generally* Fuller & Perdue, *The Reliance Interest in Contract Damages* (pt. 1), 46 YALE L.J. 52, 54 (1936).

[55] 440 N.E.2d 696 (Ind. Ct. App. 1982).

[56] The court noted that the plaintiff had failed to provide proof of out-of-pocket expenses caused by reliance upon Pepsi's promise of employment; therefore she was not entitled to reliance damages. *Id.* at 699.

In *Ravelo*, the circuit court had originally dismissed the action stating that because Mr. Ravelo could be terminated at-will, there was no reasonable basis upon which to measure damages. 66

arguably, the plaintiff could not have any reasonable expectations and therefore such damages have no value. Courts have not awarded expectation damages when future wages cannot be determined with reasonable certainty.[57]

Courts, however, may award reliance damages which place the employee in as good as position as he was before the agreement was entered into.[58] The *Grouse* court found that damages based upon what the plaintiff would have earned with the health clinic were inappropriate, and instead awarded damages based upon what the plaintiff lost in quitting his former position and declining other offers of employment in reliance upon the promised employment.[59]

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Hawaii at 197-98, 658 P.2d at 885-86.

[57] *See, e.g.*, Bennett v. Eastern Builders, Inc., 52 N.C. App. 579, 279 S.E.2d 46 (1981). The *Bennett* court found that damages resulting from the breach of an employment contract were too speculative because the employee's position was terminable at-will. The employer had promoted the employee to a supervisory position and agreed to demote her rather than fire her if she was unsuccessful in her new position. Contrary to the agreement, the employer later terminated the employee without affording her an opportunity to return to her former position. The court stated that the damages were "coextensive with her entitlement to continued employment" which were "none at all." *Id.* at ____, 279 S.E.2d at 49.

Similarly, in Forrer v. Sears, Roebuck & Co., 36 Wis. 338, 153 N.W.2d 587 (1967), the court held that an employee who sold his farm in reliance upon a promise of permanent employment was not entitled to damages because of the indefinite duration of employment. Because there was no additional consideration to support the permanent employment provision, the court treated the contract as one at-will.

The Hawaii courts also require that the amount of damages be ascertainable in some manner other than mere speculation, conjecture, or surmise. Uyemura v. Wick, 57 Hawaii 102, 111, 551 P.2d 171, 177 (1976) (facts must be proved which afford a basis for measuring the plaintiff's loss with reasonable certainty).

[58] *See* RESTATEMENT SECOND § 349; Fuller & Perdue, *supra* note 54.

[59] 306 N.W.2d at 116. A similar result was reached in Hunter v. Hayes, 533 P.2d 952 (Colo. Ct. App. 1975) (not chosen for official publication), where the court found promissory estoppel to be appropriate to enforce a promise of employment to avoid injustice to the plaintiff who quit her previous job in reliance thereon. The plaintiff was awarded reliance damages based upon her wages at her previous job and on her period of unemployment.

Also, in Lorson v. Falcon Coach, Inc., 214 Kan. 670, 522 P.2d 449 (1974), an employee who relied upon a promise of employment which was later withdrawn, was awarded moving and storage costs. The plaintiff alleged that he was offered a job by the defendant and was told to look for a new place to live. After the plaintiff rented a house and arranged to move his family, he was informed that he would not get the job. The Kansas Supreme Court held that there was no cause of action for a breach of an indefinite employment contract and, therefore, refused to allow recovery of lost wages. The court, however, allowed the plaintiff to recover his moving and storage costs incurred in reliance upon the defendant's promise to hire him.

3. Hawaii Caselaw

In *Parnar v. Americana Hotels, Inc.*,[60] the Hawaii Supreme Court addressed the judicial exceptions to the employment at-will rule. The plaintiff claimed that she was discharged to force her to leave the jurisdiction so that she would be unavailable to testify against her employer regarding possible antitrust violations. The court found that a discharge under those circumstances violated public policy and adopted the public policy exception to the at-will rule.[61] The court refused to adopt the good faith requirement,[62] but did not express its views as to the additional consideration or the detrimental reliance doctrines.[63] In adopting the public policy exception, the court noted the need for greater job security. "Because the courts are a proper forum for modification of the judicially created at-will doctrine, it is appropriate [that they correct] inequities resulting from harsh application of the doctrine by recognizing its inapplicability in a narrow class of cases,"[64] specifically, those involving violations of clear mandates of public policy.

Although the Hawaii Supreme Court had an opportunity in *Parnar* to address the public policy and good faith exceptions to the at-will rule, the detrimental reliance exception had not yet been considered.[65] Several issues thus

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[60] 65 Hawaii 370, 652 P.2d 625 (1982).

[61] The court cited Petermann v. International Bhd. of Teamsters, 174 Cal. App. 2d 184, 334 P.2d 25 (1959) as the landmark case on the public policy exception. *Petermann* involved an employee who was discharged for failing to commit perjury before a legislative committee, contrary to his employer's instructions.

[62] The court cited Fortune v. National Cash Register Co., 373 Mass. 96, 364 N.E.2d 1251 (1977) and Monge v. Beebe Rubber Co., 114 N.H. 130, 316 A.2d 549 (1974), and stated that "to imply into each employment contract a duty to terminate in good faith would seem to subject each discharge to judicial incursions into the amorphous concept of bad faith. We are not persuaded that protection of employees requires such an intrusion on the employment relationship. . . ." 65 Hawaii at 377, 652 P.2d at 629.

[63] Because neither the additional consideration doctrine nor the promissory estoppel doctrine had been urged as a ground for relief, the court stated that it would express no view as to their applicability in *Parnar*. 65 Hawaii at 376, 652 P.2d at 629.

[64] *Id.* at 379, 652 P.2d at 631 (citations omitted).

[65] Although the *Parnar* court did not address the detrimental reliance exception, Hawaii courts have considered the reliance interests of employees by utilizing promissory estoppel in the employment context. In McIntosh v. Murphy, 52 Hawaii 29, 429 P.2d 177 (1970), the Hawaii Supreme Court applied promissory estoppel to defeat a Statute of Frauds defense. The court held that where the employee had moved 2,200 miles from Los Angeles to Honolulu in reliance on an oral contract, and where such reliance was foreseeable by the employer, injustice could be avoided only by enforcing the contract and granting money damages to the discharged employee.

The Hawaii Intermediate Court of Appeals also addressed the applicability of promissory estoppel as a means of relief for a terminated employee in Suesz v. St. Louis-Chaminade Educ. Center, 1 Hawaii App. 415, 619 P.2d 1104 (1980). The court found promissory estoppel to be inappropriate because the alleged representations made by the employer were insufficient to

remain unsettled. First, in light of the *Parnar* court's rejection of the good faith exception because it would entail "judicial incursions" into the employment relationship, it is uncertain whether the supreme court would adopt the detrimental reliance exception which arguably would also entail judicial incursions. Second, if the supreme court adopts the exception, it is unclear whether the court will merely inquire into the foreseeability of the employee's reliance or if it will inquire further into the reasonableness of the reliance. The third remaining question is how courts will determine the appropriate measure of damages based on promissory estoppel.

### *B. Third Party Beneficiary Rule*

A third party beneficiary is one who has standing to enforce a contract made for his direct benefit even though he is not in privity to the contract.[66] The Restatement (Second) of Contracts has expanded promissory estoppel by revising section 90 to expressly include third parties as potential beneficiaries of the doctrine.[67] It is arguable, however, that a third party seeking to enforce a promise under section 90, must also qualify as an intended third party beneficiary.[68]

Section 90 originally did not protect the reliance interests of third parties. The first Restatement limited the applicability of promissory estoppel to action or forbearance on the part of the promisee.[69] However, in *Hoffman v. Red Owl*

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induce reliance. The plaintiff, a probationary school teacher, stated that his employer told him that he would be rehired for another term and be granted tenure if his work performance improved. The plaintiff alleged that he improved his performance as requested and therefore promissory estoppel precluded his termination. The court, however, found that there were no express or implied representations made to the plaintiff concerning his continued employment and therefore the employee's reliance was "baseless." The court noted that promissory estoppel applies only when there is a representation evidenced by a promise or other conduct which induced the employee to rely thereon. Although the *Suesz* court did not find promissory estoppel to be applicable, it is arguable that the employee's reliance was foreseeable. A more appropriate basis upon which the court could have denied the employee relief is that the employee's reliance was unreasonable.

[66] An incidental beneficiary is "a person who will be benefited by the performance of a contract in which he is not a promisee, but whose relation to the contracting parties is such that the courts will not recognize any legal right in him." 4 A. CORBIN *supra* note 28, § 779C, at 40.

[67] For text of § 90, see *supra* note 6.

[68] For text of § 302 which defines intended third party beneficiaries, see *infra* note 75.

[69] Section 90 of the first RESTATEMENT did not expressly recognize third parties:

> A promise which the promisor should reasonably expect to induce action or forbearance of a definite and substantial character on the part of the promisee and which does induce such action or forbearance is binding if injustice can be avoided only by enforcement of the promise.

RESTATEMENT OF CONTRACTS § 90 (1932). *See also* Boyer, *Promissory Estoppel: Requirements and Limitations of the Doctrine*, 98 U. PA. L. REV. 459 (1950); Eisenberg, *Donative Promises*, 47 U. CHI. L. REV. 1 (1979).

*Stores*,[70] the Wisconsin Supreme Court stated that "if the promisor actually foresees or has reason to foresee action by a third person in reliance on the promise it may be quite unjust not to perform the promise."[71] In that case, the plaintiff had relied upon the defendant's promise of a franchise and sold his business in which his wife was a joint owner. The court granted damages to both the plaintiff and his wife even though the wife was not a party to the negotiations relied upon.[72] The court noted that not only did the defendant foresee that it would be necessary for the wife to sell her joint interest, but the defendant actually requested that this be done.[73]

Subsequent to *Hoffman*, section 90 was revised to extend promissory estoppel to third parties who act in reasonable reliance upon a promise. Although the liability of the promisor has been expanded to include suits by relying third parties, it appears that the promisor is not open to undue burden. According to the commentary, the third party must be found to be a beneficiary in order to enforce the relied upon promise.[74]

If the third party must be a beneficiary, it appears that he must qualify as an intended third party beneficiary by meeting the requirements of section 302 of the Restatement Second.[75] Under section 302, the third party has standing to

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For a discussion of the expansion of the doctrine of promissory estoppel, see generally G. GILMORE, THE DEATH OF CONTRACT 69-74 (1974); Henderson, *Promissory Estoppel and Traditional Contract Doctrine*, 78 YALE L.J. 343, 355-56 (1969); Metzger & Phillips, *The Emergence of Promissory Estoppel as an Independent Theory of Recovery*, 35 RUTGERS L. REV. 472 (1983) [hereinafter cited as *Independent Theory*]; Metzger & Phillips, *Promissory Estoppel and the Evolution of Contract Law*, 18 AM. BUS. L.J. 139 (1980).

[70] 26 Wis. 2d 683, 133 N.W.2d 267 (1965).

[71] *Id.* at 701, 133 N.W.2d at 275.

[72] *Id.*

[73] *Id.*

[74] Commentary to § 90 states:

> If a promise is made to one party for the benefit of another, it is often foreseeable that the *beneficiary* will rely on the promise. Enforcement of the promise in such cases rests on the same basis and depends on the same factors as in cases of reliance by the promisee. Justifiable reliance by third persons who are not beneficiaries is less likely, but may sometimes reinforce the claim of the promisee or beneficiary.

RESTATEMENT SECOND § 90 comment d (emphasis added).

[75] Section 302 of the RESTATEMENT SECOND provides:

> Intended and Incidental Beneficiaries
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> (1) Unless otherwise agreed between promisor and promisee, a beneficiary of a promise is an intended beneficiary if recognition of a right to performance in the beneficiary is appropriate to effectuate the intention of the parties and either
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> (a) the performance of the promise will satisfy an obligation of the promisee to pay money to the beneficiary; or
>
> (b) the circumstances indicate that the promisee intends to give the beneficiary the benefit of the promised performance.
>
> (2) An incidental beneficiary is a beneficiary who is not an intended beneficiary.

enforce the promise only if the contracting parties intended to confer such a right upon the third party.[76] By referring to the third party as a "beneficiary," the commentary to section 90 implies that only an intended beneficiary under section 302 is a third party within the meaning of section 90.[77]

At least one state court, however, would not limit the applicability of section 90 to those third parties entitled to status as beneficiaries under section 302. In *Silberman v. Roethe*,[78] the Wisconsin Supreme Court stated that "[i]f the plaintiff can prove the essential facts he should not be precluded from recovery as a third party reasonably relying on promises made to others."[79]

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RESTATEMENT SECOND § 302.

[76] According to Professor Corbin:

> If the claimant under a contract made by others is [not an intended] beneficiary. . .he cannot create in himself any rights as a beneficiary by acting in reliance on the contract or upon the performance that has been rendered between the contracting parties. There must have been a promise made the performance of which would in itself operate to the benefit of the third party.

4 A. CORBIN, *supra* note 28, § 779B, at 38-39.

*But see* RESTATEMENT SECOND § 302 comment d ("if the beneficiary would be reasonable in relying on the promise as manifesting an intention to confer a right on him, he is an intended beneficiary").

[77] The RESTATEMENT SECOND § 90 comment d suggests that justifiable reliance by a non-beneficiary is relevant only in reinforcing the claim of the promisee or a true beneficiary. Illustration 6 of § 90 provides an example of how reliance by a third party who is not a beneficiary may reinforce the claim of the promisee or a true beneficiary. The illustration is based upon Horsfield v. Gedicks, 94 N.J. Eq. 82, 118 A. 275 (1922), *aff'd sub nom.*, Roberts-Horsfield v. Gedicks, 96 N.J. Eq. 384, 124 A. 925 (1924), where reliance upon an oral gift of land by the donee's aunt, who made improvements upon the land for her niece, could enforce niece's claim as owner of the land. RESTATEMENT SECOND § 90 comment c, illustration 6. *See also Independent Theory*, *supra* note 69, at 543.

[78] 64 Wis. 2d 131, 218 N.W.2d 723 (1974).

[79] *Id.* at 148, 218 N.W.2d at 731-32. In *Silberman*, the plaintiff claimed to be a third party beneficiary with a cause of action based upon promissory estoppel. The plaintiff alleged that he had reduced the amount of debt owed to him by the Milway Corporation in reliance upon representations by the defendant that it would purchase Milway and place it on sound financial footing. The court found that the defendant could have foreseen that the promise made to Milway would be repeated to the plaintiff and induce him to reduce his claims against Milway. Although the defendant only negotiated with Milway and did not deal personally with the plaintiff, the foreseeability of the plaintiff's reliance was all the more apparent because the defendant-corporation had requested that the plaintiff reduce his claim. The court cited Hoffman v. Red Owl Stores, 26 Wis. 2d 683, 133 N.W.2d 267 (1965) as authority for its proposition.

It can be argued, however, that in both *Silberman* and *Hoffman*, the Wisconsin Supreme Court was liberal in extending relief to the third parties because the defendant-promisors had both requested the very action that the third parties took and therefore, the reliance was not only foreseeable, but anticipated.

## IV. ANALYSIS

In *Ravelo*, the Hawaii Supreme Court limited an employer's absolute right to discharge an employee by recognizing that an employee, who detrimentally relied upon a promise of employment had a cognizable claim under promissory estoppel.[80] The court applied section 90 of the Restatement Second by extending relief to Mrs. Ravelo, who was not a party to the promise. The court also recognized the possibility of partial enforcement of the County's promise by limiting the award of damages so that "any relief granted [should] not place the Ravelos in a better position than performance of the promise to hire him as a police recruit would have."[81]

Although the complaint did not allege promissory estoppel as a basis for relief, the court found section 90 appropriate to protect the reliance interests[82] of Mr. and Mrs. Ravelo. The court's extension of promissory estoppel to a probationary employee, who could be terminated at-will without legal redress,[83] raises many questions. The court's extension of relief to Mrs. Ravelo, who probably would not qualify as an intended third party beneficiary under section 302 also raises interesting questions.[84]

### A. *The Detrimental Reliance Exception to the At-Will Rule*

The supreme court found that the allegations in the Ravelos' complaint stated the essential elements of promissory estoppel.[85] The complaint alleged that: (1) a promise of employment was extended to Mr. Ravelo, (2) the Ravelos relied on this promise by quitting their jobs and making plans to move from

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[80] 66 Hawaii at 199, 658 P.2d at 887. The supreme court found that the Ravelos' complaint did not state a cause of action for breach of contract, but *sua sponte* found that the allegations could give rise to a cause of action under promissory estoppel. The court noted

> that a complaint is not subject to dismissal if plaintiff is entitled to relief under any state of facts which could be proved in support of the claim, and a party shall be granted the relief to which he is entitled even if he has not demanded that relief in his pleadings.

*Id.* at 199, 658 P.2d at 886 (quoting Waterhouse v. Capital Inv. Co., 44 Hawaii 235, 248-49, 353 P.2d 1007, 1016 (1960)). The court said that it had a duty to view the complaint in a light most favorable to the Ravelos and to determine whether the allegations gave rise to any alternative theories of relief, even if not requested in the pleadings. 66 Hawaii at 199, 658 P.2d at 886-87.

[81] 66 Hawaii at 201, 658 P.2d at 888.

[82] Reliance measure of damages is that which would put the promisee in as good a position as he was before the promise was made. *See generally* Fuller & Perdue, *supra* note 54.

[83] *See* County of Hawaii, Hawaii, Rules and Regulations on Civil Service and Compensation, Rules 7.2 & 12.4(a) (amended Sept. 1984), *supra* note 8.

[84] *See infra* notes 109-22 and accompanying text.

[85] For text of RESTATEMENT SECOND § 90, see *supra* note 6.

Oahu to the Big Island, and (3) the County could have anticipated that the assurance of employment on a specified date would induce such reliance.[86] The court held that under these circumstances, the complaint could give rise to a cause of action under the doctrine of promissory estoppel and reversed the circuit court's dismissal.[87] The court did not expressly adopt the detrimental reliance exception to the employment at-will rule although the substance of its holding is virtually identical to the application of the exception. Because the court did not expressly set forth its reasoning in applying promissory estoppel in *Ravelo*, the appropriateness of the decision is open to question.

The *Ravelo* court did not analyze the reasonableness of Mr. Ravelo's reliance, but instead focused only upon the fact that the County could have anticipated that its promise would induce such reliance.[88] The court's limited inquiry appears to have been insufficient, especially in light of the empty nature of the promise relied upon by the Ravelos. The County never promised to employ Mr. Ravelo for a specific period of time; it only promised to hire him for a probationary position.[89] Although the Ravelos' reliance upon the County's promise was foreseeable, it can be argued that their reliance was not reasonable because Mr. Ravelo was fully aware of the probationary restrictions,[90] and therefore he assumed the risk of being terminated at-will. By limiting its inquiry to foreseeability, the court appears to have created a cause of action for all potential employees who can prove reliance upon a promise of employment, regardless of the reasonableness of such reliance. While an employee hired for a specified duration may be reasonable in relying upon that promise to hire,[91] a probation-

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[86] 66 Hawaii at 199, 658 P.2d at 887.

[87] The case was remanded to the circuit court for further proceedings consistent with the supreme court's decision. *Id.* at 201, 658 P.2d at 888.

On remand, the jury found that the County had sufficient reasons to refuse to hire Mr. Ravelo and therefore found that the County was not liable for any damages. Telephone interview with Christopher J. Yuen, Deputy Corporation Counsel, County of Hawaii (Oct. 1985). Although the supreme court held that the County's promise was enforceable based upon promissory estoppel, the circuit court appears to have allowed the County to be relieved of its promise if the County had good reason not to hire Mr. Ravelo.

[88] The court believed that the County "could have anticipated the assurance of employment at a definite time would induce a reaction of that nature." 66 Hawaii at 199, 658 P.2d at 887.

[89] The County merely promised to swear Mr. Ravelo in as a police recruit on a specific date. *Id.* at 196, 658 P.2d at 885. Since a police recruit is employed on a probationary status, a promise to be sworn in as a police recruit is only a promise to be hired as a probationary employee who may be terminated at will. For text of county rules on probationary employment, see *supra* note 8.

[90] Mr. Ravelo was a full-time employee of the civil service as a patrol officer for the Honolulu Police Department, having already successfully completed an identical probationary period. He was not hired as a transferee by Hawaii County, but as a new recruit who was required to serve a new probationary period.

[91] For example, it can be argued that an employee hired for a one-year period as in McIntosh

ary employee who assumes the risk of being fired at the whim of his employer is not. Therefore, by allowing relief under promissory estoppel to Mr. Ravelo, the court may have created a promise never contemplated by either party — that the employment relationship would be entered for something other than an indefinite period of time.[92]

In applying promissory estoppel in *McIntosh v. Murphy*,[93] the court inquired into the reasonableness of the plaintiff's reliance. The supreme court applied the doctrine of promissory estoppel to enforce the employer's oral promise to hire the plaintiff.[94] However, the promise enforced in *McIntosh* was much more substantive than the promise enforced in *Ravelo*. The plaintiff in *McIntosh* was promised employment for one-year, the best that Mr. Ravelo was promised was to be hired for a position terminable at-will, which could conceivably have lasted only one day. The court in *McIntosh* emphasized the importance of such factors as "the reasonableness of the action or forbearance."[95] The plaintiff was required to move from California to Hawaii to perform his services. Such action was reasonable in light of the specified duration of the promised employment. Mr. Ravelo never contended that he was promised anything other than a probationary position.[96] Any action in reliance upon a promise to hire for an unspecified duration is arguably insufficient to require invocation of promissory estoppel to avoid injustice. Therefore, it can be argued that the Ravelos' reliance was unreasonable and that the court enforced only an "empty" promise.[97]

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v. Murphy, 52 Hawaii 29, 429 P.2d 177 (1970), would be reasonable in relying upon being employed for that duration. *See infra* notes 93-95 and accompanying text.

[92] *See, e.g.*, Pepsi-Cola Gen. Bottlers, Inc. v. Woods, 440 N.E.2d 696, 699 (Ind. Ct. App. 1982). In a case with facts very similar to *Ravelo*, *Pepsi-Cola* found promissory estoppel to be applicable even though the promise sought to be enforced was an employment contract of indefinite duration which was unenforceable for vagueness. The defendant argued that the trial court, by awarding the plaintiff damages based upon wages for 26 weeks of employment, created a term not existing in the at-will employment contract. The appellate court agreed and concluded that there was no way to determine the amount of wages to which the plaintiff was entitled since she could have been discharged after a single day's work without legal redress.

[93] 52 Hawaii 29, 429 P.2d 177 (1970).

[94] Although the employment contract in *McIntosh* was for one year, the case is analogous to *Ravelo*. Had the employer been able to assert the Statute of Frauds as a defense, the oral contract would have been rendered unenforceable and Mr. McIntosh would have been a mere at-will employee. Mr. McIntosh then could have been terminated at any time notwithstanding the promise to employ for one year. Counsel for Mr. Ravelo cited *McIntosh* and argued that the County should be estopped from terminating Mr. Ravelo at-will. Appellants' Opening Brief at 25.

[95] 52 Hawaii at 36, 469 P.2d at 181 (quoting RESTATEMENT SECOND § 217A (Supp. Tent. Draft No. 4, 1969)).

[96] 66 Hawaii at 196, 658 P.2d at 885. The Ravelos' complaint alleged that Mr. Ravelo was informed that his application for employment as a police officer had been accepted and that he would be sworn in as a police recruit.

[97] In Suesz v. St. Louis-Chaminade Educ. Center, 1 Hawaii App. 415, 619 P.2d 1104

The unreasonableness of Mr. and Mrs. Ravelo's reliance is emphasized when considering the limited nature of the promise made by the County. Since the prospective employment was one at will, the only promise extended to Mr. Ravelo was a promise to be hired. If the County had kept its promise to hire Mr. Ravelo, it appears that its only obligation would have been discharged. Therefore, even if the County was bound by promissory estoppel to hire Mr. Ravelo for an at-will position, as the court found, the County would discharge its only obligation upon hiring Mr. Ravelo and would not be liable for breach upon firing him immediately thereafter.[98]

On the other hand, even if the *Ravelo* court did not inquire into the reasonableness of the Ravelos' reliance, it could be argued that their reliance was reasonable. An employee may have a right to assume that he would be given a good faith opportunity to perform his duties to the satisfaction of his employer once he was on the job.[99] Therefore, an employee's reliance may be reasonable even in an at-will arrangement. By revoking its offer of employment, the County denied Mr. Ravelo the opportunity to perform his duties satisfactorily.

Arguably, a promise to hire even for an indefinite term may lead to a long lasting job. Under this analysis, a promise to hire has value in and of itself since it provides a prospective employee a chance for long-term employment. However, the measure of damages still appears speculative. The value of a "chance to please" is dependent on the ability of each individual. Courts would be required to look in depth at an individual employee's qualifications to assess the value of the promise to employ. The Hawaii Supreme Court in *Parnar* has already expressed its reluctance to impose "judicial incursions into the amorphous concept of bad faith" when assessing wrongful termination claims.[100] It

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(1980), the intermediate court of appeals would not provide relief for a terminated school teacher under promissory estoppel because the court found that the employee's reliance was "baseless." *Id.* at 418, 619 P.2d at 1106. If the *Ravelo* court had applied the holding of *Suesz*, the County's promise to hire Mr. Ravelo may have been insufficient to invoke promissory estoppel since there was no promise made by the County concerning the duration of Mr. Ravelo's employment. Mr. Ravelo's reliance upon an empty promise to be hired for an at will position may be unreasonable in and of itself. Reliance upon anything beyond the promise to hire is baseless. Again, it is arguable that Mr. Ravelo was unreasonable in relying upon the County's promise to his detriment.

[98] Other jurisdictions have denied recovery to discharged employees who have relied upon similar empty promises. *See, e.g.*, Forrer v. Sears, Roebuck & Co., 36 Wis. 2d 338, 153 N.W.2d 587 (1967). In *Forrer*, the plaintiff sold his farm in reliance upon the defendant's promise of permanent employment. The court did not find promissory estoppel applicable, holding that because the employer kept its promise to hire the plaintiff, justice did not require relief for the plaintiff who was subsequently discharged without cause.

[99] *See, e.g.*, Grouse v. Group Health Plan, Inc., 306 N.W.2d at 116.

[100] The *Parnar* court noted that it could not ignore the trend to subject an employer's power to discharge to closer judicial scrutiny in appropriate circumstances. However, the court was not persuaded that an employee required protection to the extent of the courts' intrusion upon the

appears that the *Parnar* court would have refused to require the courts to intrude upon the employment relationship in such a manner. It can therefore be argued that the *Ravelo* court was not consistent with *Parnar*, because *Ravelo* requires judicial incursions to assess the value of an employee's "chance to please."[101]

It is virtually impossible to predicate damages on the value of a promise to hire where the employer can immediately terminate the employee without liability. Indeed, the lower court dismissed the Ravelos' action because there was no basis upon which to determine damages.[102] There was no promise made by the County to employ Mr. Ravelo for a specified duration or for a reasonable period of time. However, it is arguable that measuring damages by the extent of the employee's reliance, is an alternate basis upon which to award damages. The expense incurred by the employee in reliance upon a promise to hire may provide an indication of the value of the promise to that employee.[103]

By extending promissory estoppel to Mr. Ravelo, the court may have determined that Mr. Ravelo was reasonable in assuming that his employment would last for a reasonable period of time, so that he would be given the opportunity to perform his job satisfactorily. It was foreseeable that Mr. Ravelo would make that assumption; and therefore justice required that the promise be enforced at least to the extent of Mr. Ravelo's reliance.[104] A decision based on this theory

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employment relationship. 65 Hawaii at 375, 652 P.2d at 629.

[101] 66 Hawaii at 198, 658 P.2d at 886. Judicial intervention into the employment relation increases the employer's liability and in turn raises the costs of hiring and firing. However, it appears to be justifiable because an employer is in a better position to absorb the costs. If the employee alone had to bear the inherent risks involved in changing jobs, the result would often be harsh and inequitable. *See* Note, *Wrongful Discharge*, *supra* note 34, at 1830 (discussion of the inefficiency of the at-will doctrine).

A further justification for judicial intervention is that it is necessary to protect the employee because of his relative lack of bargaining power. Employers usually offer a job on a take-it-or-leave-it basis with no room for negotiation. *Id.* at 1828. Take-it-or-leave-it employment contracts are analogous to standard form contracts where judicial intervention is common to police an unconscionable bargain. *See, e.g.*, Williams v. Walker-Thomas Furniture Co., 350 F.2d 445 (D.C. Cir. 1965); *cf.* U.C.C. § 2-302 (1962). Individual employees often lack the power to negotiate a limitation of the employer's power to discharge. The duration of employment is commonly left indefinite so that the contract becomes terminable at-will. *See generally* Murg & Scharman, *supra* note 28, at 361.

[102] 66 Hawaii at 197-98, 658 P.2d at 885-86.

[103] *See, e.g.*, L. Albert & Son v. Armstrong Rubber Co., 178 F.2d 182 (2d Cir. 1949). In *Armstrong*, the court found that the value of the performance of the contract could not be determined. Nevertheless, the promisee was allowed to recover his costs expended in preparation for performance of the contract. However, the court would not allow reimbursement of losses incurred in reliance on a contract which would put the plaintiff in a better position than he would have occupied had the contract been performed.

[104] *See, e.g.*, O'Neill v. ARA Servs., Inc., 457 F. Supp. 182 (E.D. Pa. 1978) (reliance may indicate that the parties intended an at-will contract to last for a reasonable period of time);

severely limits an employer's absolute right to discharge.

### *B. The Extension of Relief to a Third Party*

#### 1. Section 90 of the Restatement Second

A third party seeking to invoke the doctrine of promissory estoppel must show that his action or forbearance in reliance upon the promise was foreseeable.[105] Foreseeability is the primary test of section 90, but if one argues that the promisee's reliance must also be reasonable, then the same requirement applies to third parties. Commentary to section 90 provides that "enforcement of the promise rests on the same basis and depends on the same factors as in cases of reliance by the promisee."[106] The court did not inquire into the reasonableness of Mrs. Ravelo's reliance. Although the County may have anticipated that Mrs. Ravelo would quit her job, the reasonableness of such reliance is subject to the same arguments applicable to Mr. Ravelo.[107]

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Grouse v. Group Health Plan, 306 N.W.2d 114 (Minn. 1981) (plaintiff entitled to assume that he would be given a good faith opportunity to perform his services satisfactorily).

[105] "If a promise is made to one party for the benefit of another it is often *foreseeable* that the beneficiary will rely on the promise." RESTATEMENT SECOND § 90 comment d (emphasis added).

The California Court of Appeals in Aronowicz v. Nalley's, Inc., 30 Cal. App. 3d 27, 106 Cal. Rptr. 424 (1972), provided relief to third parties under promissory estoppel where the defendant-promisor knew that the plaintiffs were leaving their previous employment and investing their entire fortunes to enable the promisee to meet the defendant's demands. The court concluded that because the defendant encouraged such reliance by the third parties, "[i]t would be a blemish on the face of justice to allow defendant to now disclaim any responsibility." *Id.* at 39, 106 Cal. Rptr. at 436.

In C.R. Fredrick, Inc. v. Sterling-Salam Corp., 507 F.2d 319 (9th Cir. 1974), the court refused to allow relief to a third party construction company which relied on a bid based on a reneged agreement between the sub-contractor and the defendant manufacturer. The court stated that the California courts have been cautious in their application of § 90 to third parties. Where third parties have been permitted to assert rights flowing from a promise, the third party has either been an alter ego of the promisee, or the recipient of substantially the same promise made by the promisor with the knowledge that the promisee would pass the promise to the third party. The third party may recover only when a promisor knows that he may reasonably rely on the offer, and only when the third party so relies, may he enforce the promise, as long as all other requisites are satisfied. *Id.* at 323 (Merrill, J., concurring).

*See also* Note, *The Requirements of Promissory Estoppel as Applied to Third Party Beneficiaries*, 30 U. PITT. L. REV. 174 (1968) [hereinafter cited as Note, *Requirements*]; Note, *Should a Beneficiary Be Allowed to Invoke Promisee's Reliance to Enforce Promisor's Gratuitous Promise?*, 6 VAL. U.L. REV. 353, 358-59 (1972).

[106] RESTATEMENT SECOND § 90 comment d.

[107] *See supra* text accompanying notes 88-98. See also Moody v. Bouge, 310 N.W.2d 665 (Iowa Ct. App. 1981), where the court held that the wife's termination of her employment, as a consequence of a change in her husband's employment, was irrelevant inasmuch as the wife was

*2. Section 302 of the Restatement Second*

If a third party must also qualify as an intended third party beneficiary with standing to sue under section 302, then additional requirements must be met. The test under section 302 is whether the contracting parties *intended* that the third party have enforceable rights.[108] Section 302 is the Restatement Second's primary provision concerning third party beneficiary contracts. The court did not address section 302 in *Ravelo*, perhaps because section 302 designates who is an intended beneficiary with standing to sue where the contract is based upon bargained-for consideration rather than reliance. The Restatement Second does not make it clear whether a third party seeking relief under promissory estoppel must also meet the requirements of section 302. However, by extending relief to Mrs. Ravelo, the court appears to have made it easier for a third party to qualify for relief under section 90 than under section 302.

If Mrs. Ravelo were required to qualify as an intended beneficiary under section 302, she would have had the difficult burden of proving that the promise was intended for her direct benefit.[109] Under section 302(1), Mrs. Ravelo would first have to prove that giving her the right to sue would be "appropriate to effectuate the intention of the parties."[110] If Mrs. Ravelo had met this test, she must further prove that either "the performance of the promise will satisfy an obligation of the promisee to pay money to the beneficiary,"[111] or "the circumstances indicate that the promisee intends to give the beneficiary the benefit of the promised performance."[112] There was no obligation to pay any money to Mrs. Ravelo in this case. Thus, Mrs. Ravelo would have to show that the circumstances indicated the intent to give her the benefit of the promise to hire Mr. Ravelo.[113]

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not a party to the contract. The court stated that the change of residence was merely incidental to accepting the new employment.

[108] For text of RESTATEMENT SECOND § 302, see *supra* note 75.

*But see* Note, *Third Party Beneficiaries and the Intention Standard: A Search for Rational Contract Decision-Making*, 54 VA. L. REV. 1166, 1174 (1968) [hereinafter cited as Note, *Intention Standard*] (argues that courts should cease their preoccupation with intent and look instead to reliance to determine third party beneficiary disputes).

[109] 2 S. WILLISTON, CONTRACTS § 356A, at 830 (3d ed. 1959). Factors which may be used by the courts to determine the existence of intent to benefit the third party include: (1) the performance of the promise rendered directly to the third party; (2) the express designation of the third party in the contract; (3) a close relationship between the promisee and the third party; and (4) foreseeable reliance by the third party.

[110] RESTATEMENT SECOND § 302(1).

[111] *Id.* § 302(1)(a). Subsection (a) applies to creditor beneficiaries where the promise will discharge a real or apparent debt owed by the promisee to the beneficiary. *See id.* comment b.

[112] *Id.* § 302(1)(b). Subsection (b) applies to donee beneficiaries where the promise discharges no debt owed to the beneficiary but is apparently designed to benefit him.

[113] The wording of § 302 raises some confusion regarding whose intent to benefit is control-

If Mr. Ravelo is viewed as the promisee, and his intent alone controls, it is likely that Mr. Ravelo intended his family to benefit as well as himself. Therefore, Mrs. Ravelo would qualify as an intended beneficiary under section 302. However, if the County's intent is also required, it is unlikely that the County intended to confer a benefit or a right upon Mrs. Ravelo when it accepted Mr. Ravelo's employment application. In this situation, Mrs. Ravelo would not qualify as an intended beneficiary.[114]

A federal district court, applying New Hampshire law, dismissed a third-party beneficiary suit brought by a wife for the wrongful discharge of her husband because it found that the wife was not an intended beneficiary. In *Pstragowski v. Metropolitan Life Insurance Co.*,[115] the court upheld the jury verdict and award of damages to the employee-husband based upon the New Hampshire rule that an employee who is discharged by reason of bad faith, malice, or retaliation by an employer has an action for breach of contract.[116] However, the court refused to recognize a cause of action for the employee's wife as a third party beneficiary. The court noted that the wife's third-party beneficiary claim was based entirely upon her expectation of pecuniary benefits from her husband's employment.[117] The court held that "it has never been the

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ling. It appears that to satisfy § 302(1), "a recognition of a right to performance" must be appropriate to effectuate the intent of *both* parties. However § 302(1)(b) states that the *promisee* must intend to benefit the beneficiary. *See* Note, Martinez v. Socoma Companies: *Problems in Determining Contract Beneficiaries' Rights*, 27 HASTINGS L.J. 137, 144-47 (1975).

[114] The inquiry is further complicated when the commentary to § 90 is read in conjunction with the commentary to § 302, suggesting that the respective tests are not so distinct. The commentaries suggest that "intent to benefit" may be the appropriate test used to determine whether the third person is entitled to relief under both § 90 and § 302.

The commentary to § 302 provides in relevant part:

> If the beneficiary would be reasonable in relying on the promise as manifesting an *intention* to confer a right on him, he is an intended beneficiary. Where there is doubt whether such reliance would be reasonable, considerations of procedural convenience and other factors not strictly dependent on the manifested intention of the parties may affect the question whether under Subsection (1) recognition of a right in the beneficiary is appropriate.

RESTATEMENT SECOND § 302 comment d (emphasis added).

The commentary to § 90 provides that:

> If a promise is made to one party for the *benefit of another*, it is often foreseeable that the *beneficiary* will rely on the promise. Enforcement of the promise in such cases rests on the same basis and depends on the same factors as in cases of reliance by the promisee. Justifiable reliance by third persons who are *not beneficiaries* is less likely, but may sometimes reinforce the claim of the promisee or beneficiary.

RESTATEMENT SECOND § 90 comment c (emphasis added).

[115] 533 F.2d 1 (1st Cir. 1977).

[116] *Id.* at 3.

[117] *Id.* at 4. The wife claimed to be a donee beneficiary based upon her belief that she would be entitled to pecuniary benefits from her husband's employment such as medical and survivorship benefits.

case that a nonparty to a contract has had a remedy for breach of contract whenever the performance of the contract would have made it possible for the nonparty to receive a pecuniary benefit."[118] The same argument could be applied to Mrs. Ravelo if she were required to qualify as an intended third party beneficiary.

By not addressing section 302 or the intent of the contracting parties, it appears that the supreme court did not find it necessary for Mrs. Ravelo to qualify as an intended beneficiary under section 302.[119] The court, instead, focused only on the foreseeability of Mrs. Ravelo's actions in reliance upon the promise.[120] The court used a foreseeability test to determine whether Mrs. Ravelo may recover under promissory estoppel rather than the intent to benefit test used to determine whether a third person is an intended beneficiary under section 302. Had the court utilized the latter test, it is unlikely that they would have extended relief to Mrs. Ravelo.[121]

Although the *Ravelo* court has made it easier for a third party to be entitled to relief under section 90 than under section 302, it may be appropriate due to the equitable nature of promissory estoppel. Because the purpose of section 90 is to protect reliance interests when justice so requires, the court's approach used in determining whether a third party may invoke the doctrine seems consistent with the notion of justice. It is important, however, that a court inquire into whether the third party's reliance was reasonable as well as foreseeable so that the burden upon the promisor is not unduly burdensome.[122]

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[118] *Id.* at 4-5. The court stressed the inefficiency of allowing a wife to recover for the wrongful discharge of her husband. "The cost to society would be disproportionate" if every dependent could raise a third party beneficiary claim creating "needless, duplicative litigation." *Id.* at 5. The court also noted that the wife's lost benefits were part of the husband's compensation package and could be reflected in the husband's contract damages. *Id.*

[119] The court allowed Mrs. Ravelo to recover under promissory estoppel based solely upon her foreseeable reliance upon the County's promise to employ her husband. If Mrs. Ravelo were required to qualify as a third party beneficiary under § 302, the focus would have shifted to concentrate on the subjective intent of the contracting parties. Section 90 focuses on the foreseeabiliaty of the third party's reliance rather than on the goals of the promisor and promisee. The third party usually has a greater advantage when he is not required to prove the subjective intent of the prime parties. *See generally* Note, *Intention Standard*, *supra* note 108, at 1188-89.

[120] The decision suggests that as long as Mr. Ravelo is entitled to recover under promissory estoppel, then relief should extend to Mrs. Ravelo. It can be argued, however, that the analysis must go further in the case of a third party seeking to recover under promissory estoppel. It is unlikely that the drafters of the Restatement intended that a third party have greater rights under promissory estoppel under § 90 than under § 302. If this were the case, all potential beneficiaries would choose to recover under promissory estoppel and attempt to deny the existence of a contract supported by consideration.

[121] *See supra* notes 109-19 and accompanying text.

[122] *See* Note, *Requirements*, *supra* note 105, at 177.

## V. IMPACT

### A. *Employment At-Will*

*Ravelo* has limited an employer's absolute right of discharge by recognizing a cause of action under the doctrine of promissory estoppel where an employee detrimentally relied upon a promise of employment.[123] Because virtually all new hirings require the employee to sacrifice his old job in order to accept the new, the ramifications of *Ravelo* are potentially widespread.

#### 1. *The Detrimental Reliance Exception*

The *Ravelo* court did not specifically state that it was adopting the detrimental reliance exception when it found a cause of action under promissory estoppel. Due to this lack of specificity, the opinion raises several questions. A primary question raised is how future courts should interpret *Ravelo*. The court's holding may be interpreted narrowly to apply only to pre-employment revocations of employment offers. Such a narrow interpretation would lead to the anomalous result that an employee who is terminated before he actually begins work has a remedy, while an employee who is discharged after the first day of work does not.[124]

Other courts may interpret *Ravelo* as not adopting the detrimental reliance exception to the at-will rule. One year after *Ravelo*, the federal district court for Hawaii said that Hawaii had not yet adopted the exception and therefore it would not grant relief to the plaintiff based upon detrimental reliance.[125] In *Stancil v. Mergenthaler Linotype Co.*,[126] the defendant was expanding its printing equipment business and hired the plaintiff as a salesman to handle local sales. The business was unsuccessful and the plaintiff was terminated six months later. The plaintiff alleged that although the employment contract did not state a specified duration, it was the intent of the parties that the employment would last for a long time, and he set up an office in reliance on continued employment. The court, however, granted summary judgment to the defendant noting that even if Hawaii had adopted the detrimental reliance exception, the facts did not show that the plaintiff's reliance was reasonable and justifiable because the success of the business was doubtful.[127] It is unknown whether *Ravelo* had been construed narrowly as applying only to the facts in that case, or if *Ravelo*

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[123] 66 Hawaii at 199, 658 P.2d at 887.

[124] *See, e.g.*, Grouse v. Group Health Plan, Inc., 306 N.W.2d at 116.

[125] Stancil v. Mergenthaler Linotype Co., 589 F. Supp. 78 (D. Hawaii 1984).

[126] *Id.*

[127] *Id.* at 83-84.

had been merely overlooked.

Conversely, it could be argued that the detrimental reliance exception was adopted. If *Ravelo* is construed to apply to any employee who detrimentally relies upon a promise by an employer, it may also be interpreted as providing a cause of action to employers in reverse situations. If an employee may recover under promissory estoppel, a logical extension is to provide a cause of action for an employer where a prospective employee revokes his acceptance of a job offer after the employer relies upon the acceptance.

If construed broadly, the court's holding may also be interpreted to limit unjustified discharges in cases where the contract is for permanent employment, but unenforceable due to the lack of additional consideration.[128] An employee who abandons his previous source of livelihood in reliance upon a promise of permanent employment will not be able to invoke the additional consideration exception if the employer receives no additional benefit. In such cases, promissory estoppel may be an alternative mode of relief if the employee's reliance was foreseeable.

### 2. *Damages*

The *Ravelo* court provided grounds for relief for Mr. and Mrs. Ravelo in a situation where there appeared to be no basis to calculate the appropriate measure of damages. In a case with facts similar to *Ravelo*, the Indiana Court of Appeals in *Pepsi-Cola General Bottlers v. Woods*[129] held a prospective at-will employee was not entitled to damages even though she had quit her prior job in reliance upon the employer's promise to hire. The court noted that it was unable to determine damages based upon lost wages, because the employer could discharge the at-will employee after a single day's work without incurring liability.[130]

The *Ravelo* court did not elaborate on the issue of damages, but did specify that "any relief granted [should] not place the Ravelos in a better position than

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[128] See *supra* note 44 for a list of cases where quitting a prior job and/or moving was not found to be valid consideration to support the employer's promise for permanent employment. In cases such as these, promissory estoppel would provide an alternative form of relief.

[129] 440 N.E.2d 696 (Ind. Ct. App. 1982).

[130] *Id.* at 699. Several courts have reached similar results. For example, in Bennett v. Eastern Rebuilders, 52 N.C. App. 579, 279 S.E.2d 696 (1982), the court held that damages in an at-will employment situation were nonexistent. Also, the court in Freeman v. Chicago, Rock Is. & Pac. R.R., 239 F. Supp. 661 (W.D. Okla. 1965) would not award damages for the wrongful termination of an at-will employment contract. The court held that without a definite term of employment, there is no way to determine the loss of earnings suffered due to premature termination.

performance of the promise to hire him as a police recruit would have."[131] There are two methods which may be used to determine the Ravelos' damages. The first method would measure the Ravelos' expectation interests so that the Ravelos are placed in the same position as if Mr. Ravelo had been hired. Mr. Ravelo was at best promised a position as a probationary employee whom the County could terminate immediately with impunity. Therefore, there would be no expectation damages because there is no basis for measuring future wages.[132] If this were the case, the court's extension of promissory estoppel to provide relief appears to have been futile.

The second method measures damages by the extent of the Ravelos' reliance. Both Mr. and Mrs. Ravelo quit their prior jobs in reliance upon the County's promise.[133] The *Ravelo* court noted that section 90 of the Restatement Second recognizes the potential of partial enforcement of the promise. Partial enforcement may measure damages by the extent of the promisee's reliance rather than by the extent of the promisee's expectations.[134] Courts which have adopted the detrimental reliance exception generally limit damages to protect the employee's reliance interest. For example, the Minnesota Supreme Court in *Grouse v. Group Health Plan*,[135] held that because the employment contract was terminable at-will, damages based upon future earnings were inappropriate. However, the court stated that the discharged employee was entitled to damages based upon what he lost by quitting his former employment and declining other offers.[136] Similarly, the *Pepsi-Cola* court noted in dicta that promissory estoppel would have entitled the plaintiff to recoup her out-of-pocket expenses incurred in reliance upon the promised employment if the plaintiff had provided sufficient

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[131] 66 Hawaii at 201, 658 P.2d at 888. The court quoted commentary which provides in relevant part:

> Partial Enforcement. A promise binding under this section is a contract, and full scale enforcement by normal remedies is often appropriate. But the same factors which bear on whether any relief should be granted also bear on the character and extent of the remedy. In particular, relief may sometimes be limited to restitution or to damages or specific relief measured by the extent of the promisee's reliance rather than by the terms of the promise. . . . Unless there is unjust enrichment of the promisor, damages should not put the promisee in a better position than performance of the promise would have put him. . . .

*Id.* at 201 n.4, 658 P.2d at 888 n.4 (quoting RESTATEMENT SECOND § 90 comment d).

[132] *See, e.g.*, Pepsi-Cola Gen. Bottlers v. Woods, 440 N.E.2d 696 (Ind. Ct. App. 1982).

[133] 66 Hawaii at 196, 658 P.2d at 885.

[134] *Id.* Damages measured by the plaintiff's reliance place the plaintiff in as good a position as he was before the promise was made. *See* Fuller & Perdue, *supra* note 54. Damages measured by the plaintiff's expectation interest place the plaintiff in as good a position as he would have been had the promise been performed. *Id.*

[135] 306 N.W.2d 114 (Minn. 1981).

[136] *Id.* at 116. *See also* Hunter v. Hayes, 533 P.2d 952 (Colo. Ct. App. 1975) (not chosen for official publication); Hoffman v. Red Owl Stores, Inc., 26 Wis. 2d 683, 133 N.W.2d 267 (1965); 1A A. CORBIN, *supra* note 28, § 200, at 217-19.

proof of these expenses.[137] Other examples of reliance damages include recovery for moving and storage costs or expenses incurred in seeking other employment.[138] When expectation damages are too speculative, the expenses incurred by the plaintiff in reliance upon the promise provides an indication of the value of that promise to the plaintiff.[139] Hence, for the court's intent to provide relief to the Ravelos to be effectuated, damages should be based upon the loss suffered as a result of their reliance.[140]

### *B. Promissory Estoppel Applied to Third Parties*

By extending relief to Mrs. Ravelo under section 90, without considering her status as an intended third party beneficiary to the contract, the court has afforded a third party a greater opportunity for relief under promissory estoppel than under a third party beneficiary contract claim.[141] The third party may invoke promissory estoppel without the difficult task of trying to prove the subjective intent of the prime parties to the contract. The focus, instead, shifts to whether the third party's reliance was foreseeable.[142] However, in order not to place an unreasonable burden upon the promisor, future courts should apply

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[137] The court noted that the plaintiff in *Pepsi-Cola* had not testified to any moving or job-hunting expenses from which damages could have been computed. 440 N.E.2d at 699.

[138] *See, e.g.*, Lorson v. Falcon Coach, Inc., 214 Kan. 670, 522 P.2d 449 (1974) (discharged at-will employee was not entitled to recover lost wages but could recover moving and storage costs incurred by detrimental reliance upon promised employment); Vallejo v. Jamestown College, 244 N.W.2d 753 (N.D. 1976) (discharged teacher entitled to recover necessary and reasonable expenses incurred by him in seeking or obtaining other employment).

[139] *See supra* note 103 and accompanying text.

[140] The Ravelos' reliance damages appear to extend to job hunting expenses and placing their children back in private school. Damages may also compensate them for wages lost in quitting their former jobs. However, the Ravelos both have a duty to mitigate their damages by seeking other employment. *See, e.g.*, Parker v. Twentieth Century-Fox Film Corp., 3 Cal. 3d 176, 474 P.2d 689, 89 Cal. Rptr. 737 (1970) (measure of damages for a wrongfully discharged employee is the amount of salary agreed upon for the period of employment, less the amount which the employer can prove that the employee has earned or could have earned elsewhere); Vieira v. Robert's Hawaii Tours, Inc., 2 Hawaii App. 237, 630 P.2d 120 (1981) (measure of damages for a wrongfully discharged employee is the amount of wages for the remaining term, less the amount which employee has earned or could have earned from other employment). *See also* 4 A. CORBIN, *supra* note 28, § 959.

[141] Section 302 requires that a third party must be an intended beneficiary in order to have enforceable rights. *See supra* notes 75-76 and accompanying text. Commentary to § 90 provides: "Justifiable reliance by third parties who are not beneficiaries is less likely, but may sometimes reinforce the claim of the promisee or beneficiary." RESTATEMENT SECOND § 90 comment c.

[142] The extension of relief to third parties who are not intended beneficiaries under § 90 will place an unreasonable hardship upon the promisor and promisee if the reliance is not carefully scrutinized to determine whether it is reasonable and justifiable as well.

the *Ravelo* court's holding with caution. The reasonableness of the third party's reliance should be considered in addition to the foreseeability of the reliance.

## VI. Conclusion

*Ravelo v. County of Hawaii* limits an employer's absolute right to discharge by recognizing a cognizable claim based upon promissory estoppel where an employee detrimentally relies upon a promise of employment. The court emphasized that section 90 of the Restatement (Second) of Contracts provides for a broader application of the doctrine of promissory estoppel than the original section 90. Therefore, the court also extended relief to a third party who foreseeably relied upon a promise between the promisor and promisee without inquiring into the third party's status as an intended third party beneficiary.

Cheryl Volta Brady

# *Supreme Court of New Hampshire v. Piper*: Invalidation of Bar Residency Requirements Under the Privileges and Immunities Clause of the United States Constitution

## I. INTRODUCTION

Until recently, almost every state in the Union has required some form of residency for admission to the bar.[1] These requirements increasingly have come under attack in the past few years.[2] In an attempt to clarify this area of the law,

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[1] *See* Brakel & Loh, *Regulating the Multistate Practice of Law*, 50 WASH. L. REV. 699, 709 (1975); Simson, *Discrimination Against Nonresidents and the Privileges and Immunities Clause of Article IV*, 128 U. PA. L. REV. 379, 390-91 (1979).

[2] *See, e.g.*, Martin v. Walton, 368 U.S. 25 (1961), *aff'g per curiam* Martin v. Davis, 187 Kan. 473, 357 P.2d 782 (1960) (requirement of association with local counsel for nonresident attorneys held not to violate due process or equal protection clauses of the U.S. Constitution); Goldfarb v. Supreme Court of Virginia, 766 F.2d 859 (4th Cir. 1985) (rule requiring out of state attorneys to take the bar examination but exempting attorneys who intend to practice full time in Virginia upheld); Sestric v. Clark, 765 F.2d 655 (7th Cir. 1985) (Illinois rule requiring out of state attorneys to take the bar examination but exempting attorneys who move into the state does not violate equal protection, the commerce clause, or the privileges and immunities clause); Golden v. State Bd. of Law Examiners, 452 F. Supp. 1082 (D. Md. 1978) (requirement of residence at time of admission held not to violate equal protection or privileges and immunities clause of the U.S. Constitution), *vacated and dismissed on other grounds*, 614 F.2d 943 (4th Cir. 1980); Suffling v. Bondurant, 339 F. Supp. 257 (D.N.M. 1972) (six month residency requirement did not deny equal protection or interstate travel), *aff'd sub nom.* Rose v. Bondurant, 409 U.S. 1020 (1972); Tang v. Appellate Div., 373 F. Supp. 800 (S.D.N.Y. 1972) (six month residency requirement permissible exercise of state police power), *aff'd on other grounds*, 487 F.2d 138 (2d Cir. 1973), *cert. denied*, 416 U.S. 906 (1974); Kline v. Rankin, 352 F. Supp. 292 (N.D. Miss. 1971) (90 day residence requirement does not impinge upon the fundamental right of interstate travel), *vacated and remanded for convention of three judge court*, 489 F.2d 387 (5th Cir. 1974); Lipman v. Van Zant, 329 F. Supp. 391 (N.D. Miss. 1971) (one year residence requirement held to violate equal protection); *In re* Robinson, 82 Neb. 172, 117 N.W. 352 (1908) (nonresident attorney not admitted to bar because not within jurisdiction of courts of state); *In re* Admission to Bar, 61 Neb. 58, 84 N.W. 611 (1900) (admission to practice law a privilege, states can exclude nonresidents); *In re* Titus, 213 Va. 289, 191 S.E.2d 798 (1972) (residence requirement held not to violate due process or equal protection). *But see* Potts v. Hon-

the United States Supreme Court decided in *Supreme Court of New Hampshire v. Piper*[3] in March of 1985 that the New Hampshire residence requirement for admission of attorneys to the bar violated the privileges and immunities clause of article IV of the United States Constitution. This decision is certain to affect a large number of state bar requirements, with possible implications for other residency requirements as well.

## II. FACTS

Kathryn A. Piper, a resident of Lower Waterford, Vermont,[4] passed the New Hampshire bar examination in 1979.[5] Because the Rules of the Supreme Court of New Hampshire limited bar admission to state residents,[6] the Board of Bar Examiners informed her that she would have to establish a home address in New Hampshire in order to be sworn in.[7]

Piper then requested a dispensation from the residency requirement, stating that the housing market was tight and that she and her husband had recently become parents, making it inconvenient for her to become a resident of New Hampshire at that time. When the clerk of the New Hampshire Supreme Court denied her request, she formally petitioned the Supreme Court of New Hampshire to become a member of the state bar. This request was also denied.[8]

An action was then filed in the United States District Court for the district of New Hampshire on March 22, 1982. Piper alleged that the exclusion of non-residents from the New Hampshire bar violated the privileges and immunities clause of the United States Constitution.[9] The district court granted Piper's

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orable Justices of Supreme Ct., 332 F. Supp. 1392 (D. Hawaii 1971) (residence requirement of six months plus voter registration held to violate equal protection).

[3] 105 S. Ct. 1272 (1985).

[4] Piper's residence in Lower Waterford was about 400 yards from the New Hampshire border. *Id.* at 1274.

[5] *Id.*

[6] *Id.* at 1275. The rule in question provides:

> Any person domiciled in the United States and who is either a resident of the State of New Hampshire or filed a statement of intention to reside in the State of New Hampshire shall be eligible to apply for examination provided he is possessed of the qualifications hereinafter provided.

N.H. SUP. CT. R. 42(3), *quoted in* Piper v. Supreme Court of New Hampshire, 359 F. Supp. 1064, 1066. This rule requires that the applicant be "a bona fide resident of the State. . .at the time that the oath of office. . .is administered." 359 F. Supp. at 1066 (quoting an affidavit from New Hampshire Supreme Court Judge King).

[7] 105 S. Ct. at 1274.

[8] *Id.*

[9] U.S. CONST. art. IV, § 2 provides that the "citizens of each state shall be entitled to all

motion for summary judgment[10] and concluded that there was a violation of the privileges and immunities clause. The Court of Appeals for the First Circuit reversed the district court,[11] but after reconsideration en banc, affirmed the district court decision.[12]

## III. HISTORY

This section is divided into three parts. The first part examines the formation and interpretation of the privileges and immunities clause of article IV before the *Piper* decision. Part two covers challenges to various residence requirements. The third part takes a closer look at the existence of and challenges to residence requirements in Hawaii.

### *A. The Privileges and Immunities Clause*

The privileges and immunities clause originated in the fourth article of Confederation.[13] Prior to the Confederation, many states passed laws which gave preference to their own citizens.[14] The fourth Article of Confederation attempted to eliminate this type of discrimination and to encourage the formation of a national economic union.[15] This provision, with slight revision, was incorporated into Article IV of the Constitution.[16]

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Privileges and Immunities of Citizens in the several States."

[10] 539 F. Supp. 1064 (D.N.H. 1982).

[11] 723 F.2d 98 (1st Cir. 1983). One panel judge dissented.

[12] 723 F.2d 110 (1st Cir. 1983) (affirmed by an equally divided vote).

[13] This article provided:

> The better to secure and perpetuate mutual friendship and intercourse among the people of the different States in this Union, the free inhabitants of each of these States. . .shall be entitled to all *privileges and immunities* of free citizens in the several States; and the people of each State shall have free ingress and egress to and from any other State, and shall enjoy therein all the privileges of trade and commerce, subject to the same duties, impositions and restrictions as the inhabitants thereof. . . .

CONGRESSIONAL RESEARCH SERVICE, THE CONSTITUTION OF THE UNITED STATES OF AMERICA: ANALYSIS AND INTERPRETATION 830 (1972 & Supp. 1980) (emphasis added).

[14] *See* Austin v. New Hampshire, 420 U.S. 656, 660 (1975).

[15] *Id.* at 661. *See also* Toomer v. Witsell, 334 U.S. 385, 395 (1948) (where the court struck down a South Carolina licensing statute requiring nonresidents to pay 100 times what residents paid for each commercial shrimp boat).

[16] The clause currently reads: "The citizens of each State shall be entitled to all Privileges and Immunities of Citizens in the several States." U.S. CONST. art. IV, § 2.

Charles Pinckney, the drafter of the shortened version of the clause for the Constitution, stated it "is formed exactly upon the principles of the fourth article of the present Confederation." 3 M. FARRAND, RECORDS OF THE FEDERAL CONVENTION OF 1787, at 112 (1911) (*cited in Piper*, 105 S. Ct. at 1274 n.7). Although similar, the privileges and immunities clause of the fourteenth

*Corfield v. Coryell*,[17] the first case to interpret the privileges and immunities clause of the Constitution, held that the clause protected those "fundamental rights" necessary to the development of the United States as a single entity.[18] Later decisions did not use the "fundamental rights" language but protected activities under the privileges and immunities clause including the marketing of produce,[19] commercial shrimp fishing,[20] the payment of income taxes,[21] state powers of incorporation,[22] and access to state medical services.[23] In two 1978 cases,[24] the Supreme Court returned to the "fundamental rights"[25] analysis employed in *Corfield*.[26] The first of these cases, *Baldwin v. Montana Fish and Game Commission*,[27] held that elk hunting was not a "fundamental right," and that a state may therefore charge nonresidents seven and a half times more than residents for elk hunting licenses. In the second case, *Hicklin v. Orbeck*,[28] the Court held that employment was a "fundamental right," and invalidated a state statute that gave residents absolute preference for jobs in Alaska's oil and gas pipeline industry.

Before the *Baldwin* and *Hicklin* decisions, the dearth of Supreme Court decisions based upon the privileges and immunities clause caused uncertainty regarding its scope.[29] However, a two-part test has emerged from the recent deci-

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amendment has been treated differently by the Court. It reads as follows: "[N]o State shall make or enforce any law which shall abridge the privileges and immunities of citizens of the United States. . . ." U.S. CONST. amend. XIV. The article IV clause deals with discrimination as to rights recognized by state law, while the fourteenth amendment was limited in the Slaughter-House Cases to a small number of rights that derive from national citizenship. The Slaughter-House Cases, 83 U.S. (16 Wall.) 36 (1873). *See* Adams, *Admissions to the Bar: A Constitutional Analysis*, 34 VAND. L. REV. 655, 765 n.697 (1981).

[17] 6 F. Cas. 546 (E.D. Pa. 1825) (No. 3230).

[18] *Id.* at 552. Justice Bushrod Washington's illustrative list of rights included:

> [t]he right of a citizen of one state to pass through, or *reside* in any *other state, for purposes of* trade, agriculture, *professional pursuits*, or otherwise; to claim the benefit of the writ of habeas corpus; to institute and maintain actions of any kind in the courts of the state; to take, hold and dispose of property, either real or personal.

*Id.* (emphasis added).

[19] Ward v. Maryland, 79 U.S. (12 Wall.) 418 (1870).

[20] Toomer v. Witsell, 334 U.S. 385 (1948).

[21] Austin v. New Hampshire, 420 U.S. 656 (1975).

[22] Paul v. Virginia, 75 U.S. (8 Wall.) 168 (1869).

[23] Doe v. Bolton, 410 U.S. 179 (1973).

[24] Hicklin v. Orbeck, 437 U.S. 518 (1978); Baldwin v. Montana Fish & Game Comm'n, 436 U.S. 371 (1978).

[25] The phrase "fundamental rights" is also important in equal protection law. *See, e.g.*, Kramer v. Union Free School Dist. No. 15, 395 U.S. 621 (1969) (voting rights).

[26] 6 F. Cas. 546 (E.D. Pa. 1825) (No. 3230).

[27] 436 U.S. 371.

[28] 437 U.S. 518.

[29] In *Baldwin*, Justice Blackmun, writing for the majority, noted that the privileges and im-

sions. The activity in question must first be "fundamental" within the meaning of *Baldwin*.[30] The Court defined fundamental activities as those which are basic and essential and support the purposes behind the formation of the Union. When a fundamental right is implicated, states may not draw "unnecessary distinctions" between residents and nonresidents. In *Hicklin*, "unnecessary distinctions" were defined as those which lack a "substantial relationship" to the particular "evil" at issue.[31]

### B. *The Residence Requirement*

#### 1. *Introduction*

Residence requirements frequently have been used by the states to ensure that certain services and activities remain in the hands of their own citizens.[32] Two types of residency requirements exist: actual and durational. Actual residency requirements, like the one in *Piper*, require residence prior to some event. Durational residency requirements specify a fixed period of residence within the jurisdiction.[33] The Court has treated these two types of requirements somewhat differently in the past, especially when considering the constitutional right to travel.[34]

The Court has also distinguished residence requirements by the nature of the activities involved. Permissible requirements have included activities where

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munities clause "is not one the contours of which have been precisely shaped by the process and wear of constant litigation and judicial interpretation over the years since 1789." 436 U.S. at 379.

[30] *Id.* at 384.

[31] Hicklin v. Orbeck, 437 U.S. at 527. This two-part test was later applied in United Bldg. & Constr. Trades Council v. Mayor & Council of Camden, 465 U.S. 208 (1984) (city ordinance requiring city residence of at least 40% of all construction workers invalidated). A similar ordinance in White v. Mass. Council of Constr. Employees, 460 U.S. 204 (1983), was held to be immune from scrutiny under the commerce clause because Boston was acting as a market participant rather than as a market regulator.

[32] *See, e.g.*, Smith, *Time for a National Practice of Law Act*, 64 A.B.A. J. 557 (1978). Smith, a former A.B.A. president, characterized states' "efforts to restrict unreasonably the interstate practice of law" through residency requirements as being generally motivated by economic protectionism. *Id.* at 559. One of the goals of a licensing restriction, such as residency, is to create a monopoly to eliminate competition and raise prices. W. FREDERICK & S. SPECTOR, OCCUPATIONAL LICENSING LEGISLATION IN THE STATES 1 (1952).

[33] Selinger, *Selected Constitutional Issues Related to Growth Management in the State of Hawaii*, 5 HASTINGS CONST. L.Q. 639, 672 (1978).

[34] *See, e.g.*, McCarthy v. Philadelphia Civ. Serv. Comm'n, 424 U.S. 645, 646-47 (1976) (regulation requiring that city employees be residents of the city does not violate employees' constitutional right to travel interstate).

there is an overriding state interest, such as voting[35] or holding elective office.[36] In addition, the Court has allowed states to require residence for the preferred use of services such as higher education.[37] The Court has also permitted a statutory scheme which provided nonresidents access to state courts on different terms from residents, because nonresidents were given reasonable and adequate access.[38] Earlier Court decisions also allowed a state to prohibit nonresidents from selling insurance[39] and to limit the dower rights of a nonresident.[40]

Attempts by states to require residence for activities with a greater national scope, especially those involving an occupation, such as commercial shrimp fishing,[41] access to medical services,[42] and employment in the state,[43] have been invalidated under the privileges and immunities clause. The emphasis in these cases on the right of "free exercise of common callings" has often been noted in analyses of bar admission requirements.[44]

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[35] Dunn v. Blumstein, 405 U.S. 330 (1972) (equal protection not offended by state requirment that voters be bona fide residents).

[36] Kanapaux v. Ellisor, 419 U.S. 891 (1979) (memorandum decision); Chimento v. Stark, 353 F. Supp. 1211 (C.D.N.H.) (seven year durational residency requirement of eligibility for the office of governor promotes legitimate state interests of exposure of the candidate to the community and therefore does not violate equal protection), *sum. aff'd*, 414 U.S. 802 (1973).

[37] *See, e.g.*, Vlandis v. Kline, 412 U.S. 441 (1973) (state has a legitimate interest in preserving the right of residents to attend state colleges and universities on a preferential tuition basis but cannot create an irrebuttable presumption of nonresidency); Montgomery v. Douglas, 388 F. Supp. 1139 (D. Colo. 1974) (one year residence requirement for residence tuition is constitutional because it is reasonably related to the purpose of distinguishing bona fide residents), *aff'd*, 422 U.S. 1030 (1975); Hasse v. Regents of Univ. of Hawaii, 363 F. Supp. 677 (D. Hawaii 1973) (one year durational residency requirement for resident tuition and admissions quota does not violate equal protection). The state would probably have to provide reasonable access to such governmental services. *See, e.g.*, Shapiro v. Thompson, 394 U.S. 618 (1969) (state residence requirement of one year for welfare benefits penalizes the constitutional right to travel and it is not necessary to the promotion of a compelling state interest).

[38] Canadian N. Ry. v. Eggen, 252 U.S. 553 (1920) (nonresident may be given access to the state's court on terms which are different from residents if such terms are reasonable and adequate for enforcing whatever rights he may have).

[39] LaTourette v. McMaster, 248 U.S. 465 (1919) (South Carolina requirement that licensed insurance brokers be residents and licensed insurance agents for two years does not violate privileges and immunities clause).

[40] Ferry v. Spokane P. & S. Ry., 258 U.S. 314 (1922) (dower is a right attached to the marital relation and subject to regulation by each state), *followed in* Ferry v. Corbett, 258 U.S. 609 (1922) (memorandum opinion).

[41] Toomer v. Witsell, 334 U.S. 385.

[42] Doe v. Bolton, 410 U.S. 179 (1973) (requirement that patient be Georgia resident to have abortion violates privileges and immunities clause by denying protection to persons who enter state for medical services).

[43] Hicklin v. Orbeck, 437 U.S. 518 (1978); United Bldg. & Constr. Trades Council v. Mayor & Council of Camden, 465 U.S. 208 (1984).

[44] Note, *A Constitutional Analysis of State Bar Residency Requirements Under the Interstate*

*2. Residence Requirements for Bar Admission*

The exclusive power to establish licensing requirements for the practice of law traditionally has resided with the states.[45] These requirements generally have included knowledge of the law, morality of character, and, in most cases, residence in the state.[46] The power to impose requirements is, however, subject to constitutional limitations.[47] Frequent constitutional challenges have been made to bar residence requirements based upon either the equal protection clause of the fourteenth amendment or the privileges and immunities clause of article IV.[48]

Attacks on residency requirements for bar admission based upon the equal protection clause of the fourteenth amendment generally have not been successful in the lower courts. Requirements of residency ranging from actual residency to six months durational residency before admission to the bar have been upheld as rationally related to state goals.[49] In addition, the Supreme Court has summarily affirmed[50] decisions upholding residency requirements for bar admission[51] when challenged on equal protection grounds.

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*Privileges and Immunities Clause of Article IV*, 92 HARV. L. REV. 1461 (1979) [hereinafter cited as *Constitutional Analysis*].

[45] In *Goldfarb v. Virginia State Bar*, the Court noted:

> We recognize that the States have a compelling interest in the practice of professions within their boundaries, and that as a part of their power to protect the public health, safety, and other valid interests they have broad power to establish standards for licensing practitioners and regulating the practice of professions. . . .The interest of the States in regulating lawyers is especially great since lawyers are essential to the primary governmental function of administering justice, and have historically been "officers of the courts."

421 U.S. 773, 792 (1975). *See also* Horneber, *The Future of State Bar Residence Requirements Under the Privileges and Immunities Clause*, 26 S.D.L. REV. 79 (1981).

[46] 7 MARTINDALE-HUBBELL LAW DIRECTORY (1985). Requirements are listed under "Attorneys and Counselors" heading.

[47] *See, e.g.*, Konigsberg v. State Bar, 353 U.S. 252, 273 (1973).

[48] *See supra* note 2.

[49] Tang v. Appellate Div., 373 F. Supp. 800 (S.D.N.Y. 1972), *aff'd on other grounds*, 487 F.2d 438 (2d Cir. 1973), *cert. denied*, 416 U.S. 906 (1974). *See also* Lipman v. Van Zant, 329 F. Supp. 391 (N.D. Miss. 1971).

[50] The precedential value of summary affirmance is doubtful, since only the judgment, and not necessarily the reasoning behind the judgment is affirmed. *See, e.g.*, Fusari v. Steinberg, 419 U.S. 379, 391-92 (1975) (Burger, C.J., dissenting). Burger states that "[w]hen we summarily affirm, without opinion, the judgment of a three-judge District Court we affirm the judgment but not necessarily the reasoning by which it was reached." *Id.* at 391. *See also* Note, *Summary Disposition of Supreme Court Appeals: The Significance of Limited Discretion and a Theory of Limited Precedent*, 52 B.U.L. REV. 373 (1972); Note, *Impact of the Supreme Court's Summary Disposition Practice on its Appeals Jurisdiction*, 27 RUTGERS L. REV. 952 (1974).

[51] Wilson v. Wilson, 416 F. Supp. 984 (D. Or. 1976) (requirement of residence at the time of admission is not a denial of due process or equal protection), *aff'd mem.*, 430 U.S. 925 (1977);

Challenges based upon the privileges and immunities clause have been more successful. In 1979, a residency requirement for admission to the New York bar was successfully challenged under the privileges and immunities clause.[52] After this successful challenge, similar cases were brought in Alabama,[53] Alaska,[54] Massachusetts,[55] South Dakota,[56] West Virginia,[57] and Wisconsin.[58] Moreover, New Jersey and Maryland have recently dropped their requirements.[59] The success of these attacks set the stage for the Court's decision in *Piper*.

### *C. Residence Requirements in Hawaii*

Residence requirements in Hawaii have been challenged under the privileges and immunities clause of article IV and the equal protection clause of the fourteenth amendment. In the first of the privileges and immunities challenges the Hawaii court upheld a three-year residency requirement for jury service.[60] In the second, the Ninth Circuit Court of Appeals upheld a fee structure for permanent boat mooring privileges which favored long-term residents.[61] In the latter case, the court held that boat mooring privileges were outside the "fundamental rights" realm set out in *Baldwin v. Montana Fish and Game*

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Brown v. Supreme Court, 359 F. Supp. 549 (E.D. Va. 1972) (permanent residence requirement for persons seeking admission by comity or reciprocity not violative of equal protection), *aff'd mem.*, 414 U.S. 1034 (1973).

[52] Gordon v. Committee on Character Fitness, 48 N.Y.2d 266, 397 N.E.2d 1309, 422 N.Y.S.2d 641 (1979).

[53] Strauss v. Alabama State Bar, 520 F. Supp. 173 (N.D. Ala. 1981) (residency requirement of three weeks prior to taking the exam violates privileges and immunities clause).

[54] Noll v. Alaska Bar Ass'n, 649 P.2d 241 (Alaska 1982) (requirement of domicile for applicants for admission to the bar invalidated as violation of privileges and immunities clause).

[55] *In re* Jadd, 391 Mass. 227, 461 N.E.2d 76 (1984) (requirement of residency for admission on motion violates the privileges and immunities clause).

[56] Stalland v. South Dakota Bd. of Bar Examiners, 530 F. Supp. 155 (D.S.D. 1982) (requirement that applicants for admission to the bar be residents or intend to become residents violates the privileges and immunities clause).

[57] Sargus v. West Virginia Bd. of Law Examiners, 294 S.E.2d 155 (W. Va. 1982) (requirement of more than 30 days residence prior to taking the bar exam held to violate the privileges and immunities clause).

[58] Canfield v. Wisconsin Bd. of Attorneys' Professional Competence, 490 F. Supp. 1286 (W.D. Wis. 1980), *vacated as moot*, 645 F.2d 76 (7th Cir. 1981) (challenge to requirement that applicants be residents or intend to become residents within 60 days after exam dismissed for failure to state a claim upon which relief could be granted).

[59] *The Bar Reader*, STUDENT LAWYER, Mar. 1985, at 38-50.

[60] State v. Johnston, 51 Hawaii 195, 456 P.2d 805 (1969), *appeal dismissed*, 397 U.S. 336 (1970).

[61] Hawaiian Boating Ass'n v. Water Transp. Facilities, 651 F.2d 661 (9th Cir. 1981).

*Commission*.[62]

Challenges based upon equal protection grounds have been more numerous and more successful. In the single unsuccessful challenge, the court upheld the state constitutional requirement of three years of state residence for service as a member of the state legislature.[63] The successful challenges have all involved requirements for either bar admission or public employment. The first challenge was to pre-examination residence requirements for the bar,[64] which required voter registration and continuous physical residence in the state for a period of six months after the age of fifteen.[65]

One year later, a statute requiring three years of residence for public employment was also successfully challenged.[66] The Hawaii Supreme Court invalidated the statute as it did not serve any compelling state interest or have a rational basis.[67] Five years later, the legislature enacted a one-year durational residency requirement for public employment.[68] The court held that this statute also violated the equal protection clause of the fourteenth amendment.[69] The legislature responded in 1978 by enacting yet another version of this statute, requiring residence in the state at the time of application for public employment.[70]

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[62] *Id.* at 668 (quoting Baldwin v. Montana Fish & Game Comm'n, 436 U.S. at 383). The court stated that because challenge was not made by non-residents, the privileges and immunities clause would be inapplicable in any event. 651 F.2d at 669.

[63] Hayes v. Gill, 52 Hawaii 251, 473 P.2d 872, *appeal dismissed*, 401 U.S. 968 (1970).

[64] Potts v. Honorable Justices of the Supreme Court of Hawaii, 332 F. Supp. 1392 (D. Hawaii 1971). This case was one of the few of this century before *Piper* to strike down a residency requirement of six months or less. *See* Binder, *The Constitutionality of State Residency Requirements for Attorneys Under the Privileges and Immunities Clause: The Attack Continues*, 60 NEB. L. REV. 200, 201 n.8 (1981). *See also In re* Avery, 44 Hawaii 26, 352 P.2d 607 (1959) (challenge of requirement to take bar examination by nonresident attorney who had been licensed for 50 years in another state mentions bar admission requirements, but the court ruled on other grounds).

[65] HAWAII SUP. CT. R. 15(c), HAWAII REV. STAT. § 605-1 (1976) (renumbered to 1(c)). Soon after this rule was invalidated, a new requirement was adopted in 1976 which required three months of residence before admission to the bar and had no requirement of voter registration. This is the requirement which existed at the time *Piper* was decided.

[66] York v. State, 53 Hawaii 557, 498 P.2d 644 (1972); HAWAII REV. STAT. § 78-1(a) (1976) (citizenship and residence of government officials and employees). An exception was made under subsection (b) for some persons recruited by the University of Hawaii.

[67] The rational basis test was cited in Allied Stores v. Bowers, 358 U.S. 522, 527 (1959); Hasegawa v. Maui Pineapple Co., 52 Hawaii 327, 329, 475 P.2d 679, 681 (1970).

[68] Act of June 21, 1977, ch. 78, 1977 Hawaii Sess. Laws (codified at HAWAII REV. STAT. § 78-1 (1977)).

[69] Nehring v. Ariyoshi, 443 F. Supp. 228, 239 (D. Hawaii 1977).

[70] The statute provides:

> (c) All employees in the service of the government of the State or in the service of any county or municipal subdivision of the State shall be citizens, nationals, or permanent resident aliens of the United States and residents of the State at the time of their applica-

This statute is currently being challenged.[71]

## III. ANALYSIS

Against the backdrop of previous decisions on residency requirements, the *Piper* decision is not surprising. However, the reasoning used by the Court merits careful study to clarify the boundaries of the privileges and immunities clause of article IV.

The United State Supreme Court held that the New Hampshire residency requirement for admission to the bar violated the privileges and immunities clause of article IV. Outlining the background and purpose of the clause, the Court noted that the purpose is to "fuse into one Nation a collection of independent, sovereign States."[72] An activity must support this purpose in order to fall within the protection of the privileges and immunities clause.[73]

The Court held that the practice of law should be protected as a "privilege." Consistent with prior cases which dealt with occupations, the Court found that a lawyer plays an important role in the national economy. In addition, the practice of law is important to the "maintenance or well-being of the Union"[74] in championing unpopular causes. The Court was persuaded that out-of-state attorneys often provide the only available counsel "to represent persons who raise unpopular federal claims."[75]

The Court rejected the state's argument that the role of the lawyer as an officer of the court who "exercises state power" through the judicial process should take the practice of law outside the privileges and immunities clause.[76] While noting that lawyers "enjoy a broad monopoly. . .to do things other citi-

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tion for employment.

"Resident" means a person who is physically present in the State at the time he claims to have established his domicile in the State and shows his intent is to make Hawaii his permanent residence. In determining this intent, the following factors shall be considered:

(1) Maintenance of a domicile or permanent place of residence in the State;

(2) Absence of residency in another State.

HAWAII REV. STAT. § 78-1(c) (1976).

[71] Honolulu Advertiser, July 31, 1985, at A6, col. 2. The case involves a person who was hired by the State Attorney General's Office as a part-time messenger. On his first day of work, it was discovered that he was a resident of Alaska and was ineligible for employment.

[72] 105 S. Ct. 1272, 1276 (1985) (quoting Toomer v. Witsell, 334 U.S. 385, 395 (1948)).

[73] *Id.* (citing Baldwin v. Montana Fish & Game Comm'n, 436 U.S. 371, 383 (1978)). An example of an activity which was found to uphold the purpose of formation of a national economic union is the "free exercise of a common calling," such as commercial shrimp fishing in *Toomer*. Conversely, elk hunting in *Baldwin* would not uphold this purpose.

[74] 105 S. Ct. at 1277.

[75] *Id.*

[76] 105 S. Ct. at 1277-78.

zens may not lawfully do," the Court held that "the state powers entrusted to lawyers do not involve matters of state policy or acts of. . .unique responsibility."[77] The Court was not persuaded[78] that lawyers play an important part in the formulation of state policy.[79]

Because the Court found the practice of law to be a privilege,[80] it reviewed the state's reasons for excluding nonresidents. Under the standard set in *United Building and Construction Trades Council v. Mayor and Council of Camden*,[81] the privileges and immunities clause would not be violated if there was a "substantial reason" for the discrimination against nonresidents and a "substantial relationship" between the discriminatory practices and the state's objective.[82] New Hampshire's justifications for the exclusion of nonresidents from its bar were examined in light of this standard.

New Hampshire's first justification for the residency requirement was nonresidents' lack of familiarity with local rules and procedures. The Court dismissed this reason out of hand, stating that there is "no evidence" that residency in and of itself will result in an increased familiarity with local rules and procedures.[83] Moreover, there was no reason to suppose that a nonresident lawyer would be more likely than a resident lawyer to "disserve his clients" by not knowing the rules. Lawyers would be unlikely to be members of the state bar unless they expected to maintain a considerable practice in the state.[84]

The state's second justification for the requirement was that nonresidents would be less likely to behave ethically. The Court found this to be without

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[77] 105 S. Ct. at 1278 (quoting *In re* Griffiths, 423 U.S. 717, 731 (1973), which held that an alien could not be excluded from the bar on the justification that the practice of law involves the exercise of governmental power).

[78] Justice Rehnquist argued in his dissent that the practice of law was "fundamentally different" in substance from other occupations and should not be considered within the context of the privileges and immunities clause. His position varied somewhat from the state's position. He argued that lawyers play an important role in the formulation of state policy through the adversarial process, while the state's position was that lawyers exercise state powers. Such formulation of state policy requires a lawyer knowledgeable in local concerns. In support of this position, he noted that certain legal positions, such as judge and legislator, make the practice of law different. In addition, he did not find *In re* Griffiths to be controlling because that case was decided upon equal protection grounds. 105 S. Ct. at 1282-83.

[79] 105 S. Ct. at 1277 n.12.

[80] *Id.* at 1278.

[81] 104 S. Ct. 1020, 1024 (1984).

[82] *See also* Toomer v. Witsell, 334 U.S. at 396.

[83] 105 S. Ct. at 1279.

[84] *Id.* The state did not appear to establish that there was a high degree of correlation between residency and familiarity with local rules. However, finding statistics to support this argument may not be possible, especially because New Hampshire presumably did not have a group of nonresident attorneys to compare to the resident attorneys. In the absence of this kind of data, the Court's dismissal of this argument seems warranted.

merit, as a good reputation is a matter of concern to any lawyer. As a member of the bar, the nonresident would be subject to any disciplinary action the Supreme Court of New Hampshire might impose, and therefore unethical behavior could be sanctioned.[85]

The Court accorded more merit to the state's third reason for the residency requirement that nonresidents would be less available than residents for court proceedings. The Court, however, found that this problem was not "substantial" and did not merit the exclusion of nonresident attorneys from the bar.[86] Less restrictive means of insuring the availability of counsel were possible, such as requiring distant attorneys to retain a local lawyer for unscheduled matters.[87]

The state's interest in the availability of counsel was twofold: administrative convenience and the protection of clients. While convenience is certainly an understandable state concern, especially in these days of congested court calendars, it would not be a "substantial reason" for discrimination against nonresidents. Moreover, it appears that restricting the practice of law to residents does not bear a "substantial relation" to administrative convenience.[88] Certainly the extra four hundred yards Piper would have had to travel to the New Hampshire border would not inconvenience the state courts. Many resident members of the bar would be more unavailable than nonresident attorneys for unscheduled proceedings.[89]

The effect of unavailability of nonresident attorneys on potential clients was not specifically mentioned by the Court. Protecting the quality of justice for its citizens is clearly consistent with the traditional exercise of a state's police powers. However, upon closer examination, this concern does not appear to pass muster. First, it is difficult to envision a "substantial reason" for the state's concern, since the clients presumably would have chosen the nonresident attorney of their own free will.[90] Even if the client had no choice in the selection of

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[85] *Id.* at 1279-80. If the state had been able to statistically show some correlation between nonresidence and unethical behavior, the outcome may have been different.

[86] *Id.*

[87] Justice Rehnquist dissented on this issue. He found the problem of nonresident lawyers' unavailability to be a substantial state interest. Moreover, he noted that the Court's suggestion of less restrictive solutions was ill advised and not manageable. Such an approach would "ultimately lead to striking down almost any statute on the ground that the Court could think of another 'less restrictive' way to write it." *Id.* at 1284.

[88] *Id.* The Court states that "[a] State may discriminate against nonresidents only where its reasons are 'substantial,' and the difference in treatment bears a close or substantial relation to those reasons. No such showing has been made in this case." Justice Rehnquist states in his dissent that delay in the courts is a substantial reason. *Id.*

[89] This would be especially true for resident lawyers with extremely busy practices or who lived in isolated rural areas of the state.

[90] It is possible to argue that the state has an interest in protecting its citizenry from a bad choice in counsel even if it is a choice of free will. However, bar examinations and licensing

the attorney, a malpractice suit would be possible if the client's interests had not been served. Second, the state must still prove a "substantial relationship" between excluding nonresidents and the unavailability of counsel. The problems of proving such a relationship in this case appear practically insurmountable.

The state's final argument was that nonresident lawyers would be less inclined to take on their share of pro bono and other volunteer work. The Court rejected this, stating that most attorneys will try to do their share of this work, and that the state can in fact require such service.[91]

The Court concluded that the practice of law was a privilege under the privileges and immunities clause. Because the state had not shown a substantial basis for the discrimination against nonresidents, New Hampshire's residence requirement for admission to the bar violated the privileges and immunities clause of article IV of the Constitution.[92]

The Court could have decided the issue on much narrower grounds.[93] The Court could have found that the application of the law to Piper was unconstitutional because she was "indistinguishable" from other lawyers in New Hampshire, except for the fact that she would traverse the state line. Her nonresidency would not threaten the state's interests any more than would members of the bar who lived within the state. If it had decided the case on these narrow grounds, the court would not have had to reach the broader question of the facial validity of the requirement.

## IV. IMPACT

### A. *Bar Admission*

Although the recent trend has been to eliminate residence requirements for bar admission,[94] at the time this case was decided twenty-six states besides New Hampshire required residency before admission to the bar.[95] *Piper* would

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requirements are much more precise methods of eliminating this problem than a residency requirement.

[91] 105 S. Ct. at 1281 n.22.

[92] *Id.* at 1281.

[93] *Id.* Justice White, concurring in the result, states: "I would postpone to another day such questions as whether a state may constitutionally condition membership in the New Hampshire bar upon maintaining an office for the practice of law in the state of New Hampshire." *Id.*

[94] In 1978, only five states had no residency requirements; in 1981 the number had increased to 11; in 1984 the number was up to 16 and at the time of the decision, the number was up to 21. 7 MARTINDALE-HUBBELL LAW DIRECTORY (1978, 1981, 1984 & 1985).

[95] These states include Arkansas, Colorado, Delaware, Hawaii, Idaho, Indiana, Iowa, Kansas, Kentucky, Maine, Minnesota, Missouri, Montana, Nevada, New Hampshire, New Jersey, New Mexico, North Carolina, Oklahoma, Rhode Island, South Carolina, South Dakota, Tennessee, Texas, Virginia, and Wyoming. 7 MARTINDALE-HUBBELL LAW DIRECTORY (1985).

appear to invalidate not only those statutes similar to New Hampshire's, but arguably any residency requirement.[96] If the Court had decided the case on the narrower grounds of application to Piper, it would not have invalidated a statute such as Missouri's which allows residence in another state if it is in an adjacent county.[97]

The statutes of Kansas and Kentucky do not prohibit nonresidents from practicing law; they do allow admission to nonresidents who have graduated from a law school within the state.[98] This type of restriction would still have prevented Piper from practicing law as a nonresident, and therefore presumably would be invalidated.[99] Several other states include residency as one means of qualifying for admission to the bar, but none of them absolutely requires it.[100] The most common type of these statutes requires either residency or intent to practice within the state. Because this statute does not strictly require residence, it appears to be unaffected by *Piper*.

### *B. Changes in the Practice of Law*

*Piper* will affect the nature and type of states' requirements and, therefore, lawyers and law students who should no longer have to establish residency in order to join a state's bar. This will provide greater flexibility in deciding where to practice but "[a]s a practical matter, someone out of law school will go where they have a job and not hop around."[101] This still will allow graduates as well as practitioners working near state boundaries more flexibility in the scope of their practices.

*Piper* may accelerate the growth of multistate practices,[102] and may thereby

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[96] *Id.* following states have residency requirements of approximately the same length as those of New Hampshire: Idaho, Maine, Oklahoma, and Tennessee. In addition, Colorado requires residence at the time of admission plus admission within eighteen months of passing the bar exam. The following states have longer requirements than those of New Hampshire: North Carolina (approximately one month prior to the examination); Tennessee (two months prior to admission); Arkansas (60 days prior to application); Hawaii, New Mexico, Rhode Island, and South Carolina (three months prior to admission); Nevada (approximately four months prior to the examination); and Montana and Wyoming (six months prior to admission).

[97] 7 MARTINDALE-HUBBELL LAW DIRECTORY (1985).

[98] *Id.*

[99] 105 S. Ct at 1281.

[100] *Id.* Minnesota and South Dakota require either residence, an office in the state, or designation of the clerk of the supreme court for service of process. Delaware has a similar requirement of domicile, intent to establish domicile by the time of admission, or principal office in the state. Iowa and Indiana have similar requirements. New Jersey, on the other hand, requires a bona fide office in the state in order to practice.

[101] McHugh, *Legal Aide*, STUDENT LAWYER, May 1985, at 10.

[102] Silas, *Law Firms Branch Out*, 71 A.B.A. J. 44 (1985).

increase competition for clients, especially those which are also engaged in multistate activities. This seems especially likely for small and midsize firms as the need for one person to maintain residence in each state of operation has been eliminated. Although under many existing state requirements which do not fall directly under *Piper* this would not be possible,[103] the likelihood of a successful challenge to these restrictions has certainly been enhanced.

States' responses to this decision may depend upon how likely, and how threatening, an influx of out-of-state practioners would be. As twelve states supported New Hampshire in an amicus curiae brief,[104] it seems likely that this decision will not be enthusiatically embraced in all quarters. In attempts to retain control over bar admissions, states may respond by making admission to the bar generally more difficult. This could be accomplished by making bar examinations more difficult and localized, requiring substantial practice, or raising dues to prohibitive levels. In addition, more states may require all attorneys seeking admission to the bar to pass the examination rather than allowing admission by motion.[105]

At the time of the *Piper* decision, Hawaii required three months of continuous residence for admission to the bar.[106] This requirement is apparently at odds with *Piper*. It does not appear, however, that the requirement will be discarded.[107] It is arguable that Hawaii's statute should be distinguished because of Hawaii's unique geographical position. As the distance between an attorney's place of practice and place of residence increases, the problems associated with availability of counsel become much greater. However, because every state in the country could claim uniqueness on some grounds this argument seems unlikely to prevail.

It appears likely that Hawaii will not change its current requirements in the absence of a direct challenge. In an analogous situation, where the state's public employment residency requirement was threatened, Governor George Ariyoshi indicated a willingness to "put this State in direct confrontation with the present laws of this land and possibily even the Constitution of the United States." He called for "bold. . .ideas and action" to combat the problem of potential

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[103] Many states have requirements of majority of practice within the state for admission. *See supra* note 100.

[104] 105 S. Ct. at 1279.

[105] *Id.* Admission by motion is a common device through which licensed attorneys can petition to be admitted to the bar of another state without taking the bar examination. Typically, three to five years of practice are required. Hawaii is one of the few states which does not allow admission by motion.

[106] HAWAII SUP. CT. R. 1(c) (1984).

[107] Honolulu Star-Bull., Mar. 4, 1985, at A4, col. 4. One state official's initial reaction to the *Piper* decision was that Hawaii's requirement would be upheld, although he did not offer any legal basis for that conclusion.

overpopulation in Hawaii.[108]

### *C. Expected Impact on Other Residency Requirements*

The effect of this decision on other residency requirements is less certain. Residency requirements for obtaining other occupational licenses appear to be invalid under the Court's interpretation of the privileges and immunities clause. Other requirements, such as those regarding admission into state sponsored educational institutions, or the payment of different fees for nonresidents attending those institutions, seem unlikely to be affected by this decision as the Court has previously upheld such requirements.[109] Finally, the Court noted that residency requirements for activities such as voting or serving as a legislator or member of the judiciary, will not be affected.[110]

In Hawaii, few licensed occupations currently have a residence requirement. Out of fifty-two occupational licensing statutes, five specifically require residence.[111] Nine others in effect require residence, most commonly by requiring a state driver's license.[112] Besides these requirements for licensed occupations, residency is required for public employment.[113] It would appear that *Piper* will facilitate challenges to all of these requirements, and in fact it may have provided impetus for the current challenge to the public employment statute.[114]

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[108] State-of-the-State Address by Governor George R. Ariyoshi, Ninth State Legislature Meeting in Joint Session (Jan. 25, 1977), *quoted in* Nehring v. Ariyoshi, 443 F. Supp. 228, 229 (1977).

[109] *See, e.g.*, Vlandis v. Kline, 412 U.S. 441 (1973).

[110] 105 S. Ct. at 1278 n.13 (1985).

[111] RESEARCH AND STATISTICS OFFICE, STATE DEP'T OF LABOR AND INDUS. RELATIONS, LICENSED OCCUPATIONS IN HAWAII (Aug. 1984). In addition to attorneys, residence is required of acupuncturists (resident at time of application), insurance salespersons (resident), real estate brokers (licensed for two years as state real estate salesperson), and real estate salespersons (legal resident).

[112] *Id.* The nine are ambulance driver (driver's license), commercial fisher (higher license fee), driver's education instructor (driver's license plus state teaching certificate), emergency medical technician (driver's license), motor vehicle operator (driver's license), osteopath (have to have visited state institution devoted to patients with Hansen's disease), private detective and guard (maintain local office for service of papers), public school specialist (two probational years with the Hawaii Department of Education), and public school teacher (same as for public school specialist). The requirements for a state driver's license are probably reasonable for traffic safety.

[113] *See supra* note 66.

[114] Honolulu Advertiser, July 31, 1985, at A6, col. 1. The article mentions the *Piper* decision, although not by name. It states: "For example, the United States Supreme Court this year declared a New Hampshire Supreme Court rule unconstitutional that would limit bar admission to state residents only."

## V. CONCLUSION

*Supreme Court of New Hampshire v. Piper* is consistent with previous Court decisions on the privileges and immunities clause and with the growing trend among the lower federal courts in finding that residency requirements for admission to the bar violate the privileges and immunities clause. The practice of law, as the practice of nearly every other occupation, is a privilege within the context of the clause. Because New Hampshire was unable to show a substantial reason for discrimination against nonresidents, the discrimination was not allowed to continue. States with similar or more stringent residency requirements for admission to the bar will be required to re-examine their policies.

Michele R. Wallace

# *State v. O'Brien*: Right to Jury Trial for Driving Under the Influence of Intoxicating Liquor

## I. INTRODUCTION

Driving under the influence of intoxicating liquor (DUI) poses a serious problem in Hawaii.[1] Drunk drivers not only threaten their own lives, they also threaten the safety of other drivers and the public at large. As the Hawaii legislature noted in 1982:

> It is frightening to realize that one of every two Americans will be involved in an alcohol-related auto crash in his or her lifetime. In our own state the dimensions of the drunk-driving problem can be highlighted by recent statistics. In 1981, almost two-thirds of Hawaii's traffic deaths were alcohol-related; drinking drivers involved in all accidents here numbered 2,465 in 1980.[2]

In response to this problem, the Hawaii legislature amended the drunken driving statute in 1982 to impose tougher, more effective sanctions.[3] By enacting such legislation, the legislature demonstrated its belief that DUI is a serious offense which deserved appropriate punishment.[4]

In 1983, Daniel O'Brien challenged the amended statute after he received a

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[1] S. STAND. COMM. REP. NO. 999, 12th Hawaii Leg., Reg. Sess., 1983 SEN. J. 1477-78 ("drunken driving is one of the State's most serious and tragic problems").

[2] S. STAND. COMM. REP. NO. 176, 11th Hawaii Leg., Reg. Sess., 1982 SEN. J. 1011.

[3] *See* Act of June 15, 1982, ch. 251, 1982 Hawaii Sess. Laws 472-74. This amendment changed the DUI statute in three major areas. First, the maximum possible term of imprisonment was reduced to 180 days as compared to one year. Second, the sentences were to be imposed "without possibility of probation or suspension. . . ." Third, there was an increase in the severity of the penalties from a first offense up to an offense occurring within four years of two prior convictions as compared to the same penalty for any DUI offense under the 1949 statute. See *infra* note 52 for the text of the original DUI statute.

[4] A Senate Standing Committee reported: "The problem is already of major proportions, yet it is growing, and will continue to increase unless and until this Legislature provides meaningful sanctions that will deter drunken driving." S. STAND. COMM. REP. NO. 176, 11th Hawaii Leg., Reg. Sess., 1982 SEN. J. 1011.

DUI citation.[5] He argued that because the statute prescribed serious punishment, he was entitled to a jury trial.[6] In *State v. O'Brien*,[7] the Hawaii Supreme Court affirmed the Intermediate Court of Appeals (ICA) decision that DUI constitutes a criminal offense sufficiently serious to entitle a defendant to a trial by jury.[8]

This note raises questions concerning the extent of judicial interpretation, the constitutional right to counsel,[9] and the viability of the implied consent law.[10] This note also presents a review and critical analysis of the reasoning of the Hawaii Supreme Court and the ICA, and reviews the possible impact *O'Brien* will have on the state judicial system.

## II. FACTS

On May 26, 1983, Daniel O'Brien received a DUI citation.[11] He did not submit to a breath or blood test.[12] The Wailuku District Court denied O'Brien's demand for a jury trial[13] and convicted him of the DUI offense.[14] Because he had a prior conviction in 1980, the district court fined him $500 and suspended his driver's license for one year under section 291-4(b)(2) of the Hawaii Revised Statutes.[15]

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[5] State v. O'Brien, 5 Hawaii App. ____, ____, 704 P.2d 905, 907 (1985). The state appealed the ICA decision and the Hawaii Supreme Court granted certiorari.

[6] *Id.* at ____, 704 P.2d at 910.

[7] 68 Hawaii 39, 704 P.2d 883 (1985).

[8] *Id.*

[9] U.S. CONST. amend. VI.

[10] HAWAII REV. STAT. § 286-151 (1976). See *infra* note 94 for the text of the implied consent law in Hawaii.

[11] 68 Hawaii at 40, 704 P.2d at 884.

[12] *Id.*

[13] City and County of Honolulu's Amicus Curiae Application for Writ of Certiorari at 1, State v. O'Brien, 68 Hawaii 39, 704 P.2d 883 (1985).

[14] 68 Hawaii at 41, 704 P.2d at 885.

[15] *Id.* The DUI statute applicable to Mr. O'Brien read:

> (b) A person committing the offense of driving under the influence of intoxicating liquor shall be sentenced as follows without possibility of probation or suspension of sentence:
>
> (1) For a first offense, or any offense not preceded within a five-year period by a conviction under this section, by:
>
> (A) A fourteen-hour minimum alcohol abuse rehabilitation program including education and counseling, or other comparable program deemed appropriate by the court; and
>
> (B) Ninety day prompt suspension of license with absolute prohibition from operating a motor vehicle during suspension of license; and
>
> (C) Any one or more of the following:

O'Brien appealed the DUI conviction on two constitutional grounds: 1) that the DUI statute used unconstitutionally vague language[16] and 2) that the district court denied his constitutional right to a trial by jury.[17] The ICA dismissed

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(i) Seventy-two hours of community service work; or
(ii) Not less than forty-eight hours of imprisonment; or
(iii) A fine of not less than $150 but not more than $1,000.

(2) For an offense which occurs within five years of a prior conviction under this section:
(A) Prompt suspension of license for a period of one year; and
(B) Any one of the following:
(i) Not less than ten days of community service work; or
(ii) Not less than forty-eight consecutive hours of imprisonment;
(iii) A fine of not less than $500 but not more than $1,000.

(3) For an offense which occurs within five years of two prior convictions under this section, by:
(A) A fine of not less than $500 but not more than $1,000;
(B) Revocation of license for a period not less than one year but not more than five years; and
(C) Not less than ten days but not more than one hundred-eighty days imprisonment.

(4) Notwithstanding any other law to the contrary, any conviction for driving under the influence of intoxicating liquor, shall be considered a prior conviction.

Act of May 25, 1983, ch. 291, 1983 Hawaii Sess. Laws 208 (codified in HAWAII REV. STAT. § 291-4) (Supp. 1984). The statute was amended in 1984 to add subsection (c):

(c) Whenever a court sentences a person pursuant to section 291-4(b)(2) or (3), it shall also require that the offender be referred to a substance abuse counselor who has been certified pursuant to section 321-193 for an assessment of the offender's alcohol dependence and the need for treatment. The counselor shall submit a report with recommendations to the court. The court may require the offender to obtain appropriate treatment.

All cost for such assessment or treatment or both shall be borne by the offender.

HAWAII REV. STAT. § 291-4(c) (Supp. 1984).

[16] O'Brien made two vagueness arguments. He first argued that the failure of § 291-4(a)(2) to provide adequate notice rendered it defective for vagueness. O'Brien argued that because persons lack the ability to determine their own blood alcohol level by their senses, they cannot be on notice of a potential violation. 5 Hawaii App. at ____, 704 P.2d at 908-09. The court dismissed this argument as O'Brien's conviction arose under another section of the statute, HAWAII REV. STAT. § 291-4(a)(1), due to his refusal to submit to a breath or blood test. *Id.* at ____, 704 P.2d at 909.

The second argument suggested that HAWAII REV. STAT. §§ 291-4(b)(1)(C)(ii) and 291-4(b)(2)(B)(ii) were constitutionally vague because they did not specify a maximum term of imprisonment. *Id.* at ____, 704 P.2d at 910. The ICA rejected this argument on two grounds. First, it concluded that since O'Brien did not receive a sentence of imprisonment, he had no standing to constitutionally challenge those statutes. Second, after examining the statutory scheme and legislative intent of the statute, the court held that the statute prescribed a maximum imprisonment term of 180 days. Therefore the statute was not unconstitutionally vague. *Id.* at ____, 704 P.2d at 908-10.

[17] 5 Hawaii App. at ____, 704 P.2d at 910.

the vagueness argument but held that O'Brien was entitled to a jury trial.[18] The State of Hawaii appealed.[19]

## III. The Reasoning Applied by the Hawaii Courts

The major issue in *O'Brien* was whether DUI constitutes a serious enough criminal offense[20] to entitle the defendant to a trial by jury. The Hawaii Supreme Court held that a DUI charge did indeed invoke the constitutional right to jury trial.[21] Even though both the United States and Hawaii Constitutions guarantee a jury trial in all criminal prosecutions,[22] this right has been interpreted not to apply to prosecutions for petty crimes.[23]

The Hawaii Supreme Court first reviewed Hawaii case law regarding petty offenses. In *State v. Shak*,[24] the court held that a traffic violation with a maximum possible penalty of a $200 fine and revocation or suspension of a driver's license was a petty offense.[25] In *State v. Kasprzycki*,[26] the court held that an

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[18] *Id.*

[19] 68 Hawaii at 39, 704 P.2d at 884.

[20] The state argued to the ICA that DUI was not a crime because it is listed in Hawaii Rev. Stat. ch. 291 (1976), which is labeled "Traffic Violations." 5 Hawaii App. at ____, 704 P.2d at 911. The ICA, however, held that DUI was a crime under Hawaii Rev. Stat. § 701-107(1) (1976) which states that "[a]n offense defined by this Code or by any other statute of this State for which a sentence of imprisonment is authorized constitutes a crime." *Id.*

[21] 68 Hawaii at 39, 704 P.2d at 884.

[22] The United States Constitution provides that "[i]n all criminal prosecutions, the accused shall enjoy the right to a speedy and public trial by an impartial jury." U.S. Const. amend. VI.

The Hawaii Constitution provides that "[i]n all criminal prosecutions, the accused shall enjoy the right to a speedy trial, by an impartial jury of the district wherein the crime shall have been committed. . . ." Hawaii Const. art. I, § 14.

[23] The United States Supreme Court has held that "there is a class of petty or minor offenses. . .[which may] be tried by the court and without a jury. . . ." Callan v. Wilson, 127 U.S. 540, 555 (1888). *See also* Cheff v. Schnackenberg, 384 U.S. 373 (1966); District of Columbia v. Colts, 282 U.S. 63 (1930).

[24] 51 Hawaii 612, 466 P.2d 422, *cert. denied*, 400 U.S. 930 (1970). The defendant was convicted of four traffic violations: failing to come to a complete stop at a red light, making a prohibited right turn on a red light without stopping, making an illegal U-turn, and disregarding a stop sign. 51 Hawaii at 613, 466 P.2d at 422.

[25] The Hawaii Supreme Court in *Shak* referred to United States Supreme Court cases and found two criteria for distinguishing petty from serious crimes.

> The first is whether the offense is by its nature serious. If so, the size of the penalty that may be imposed is only of minor relevance, and the right of trial by jury attaches . . . . If the offense is not by its nature serious, however, the magnitude of the potential penalty set for its punishment becomes important, since it is an indication of the ethical judgments and standards of the community.

51 Hawaii at 614, 466 P.2d at 424.

Applying the second criterion, the *Shak* court held that the traffic violations in question were

offense punishable by a fine of not more than $500 or imprisonment of not more than thirty days or both was a petty offense.[27] The court rejected the United States Supreme Court six-month test[28] for distinguishing between petty and serious crimes.[29]

Neither *Shak* nor *Kasprzycki*, however, was dispositive in the instant situation.[30] Therefore, the Hawaii Supreme Court in *O'Brien* looked to federal case

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petty because they were not punishable by imprisonment. *Id.* at 615, 466 P.2d at 424. The *Shak* court cited two cases which held that imprisonment is the potential penalty described by the criterion: Duncan v. Louisiana, 391 U.S. 145 (1968) (an offense with a maximum potential penalty of two years imprisonment was considered serious); Cheff v. Schnackenberg, 384 U.S. 373 (1966) (criminal contempt punishable by a maximum sentence of six months imprisonment was a petty offense).

The *Shak* court also held that the traffic violations were petty offenses even under the first criterion. 51 Hawaii at 615, 466 P.2d at 424. However, the court did not explain its conclusion other than to say that "the offenses themselves are of a petty nature." *Id.*

[26] 64 Hawaii 374, 641 P.2d 978 (1982). The defendant was charged with harassment which is classified as a petty misdemeanor under HAWAII REV. STAT. § 711-1106(2) (1976). 64 Hawaii at 374, 641 P.2d at 978.

[27] The court focused on the magnitude of the potential penalty in holding that harassment is a petty offense. It noted that the United States Supreme Court considered a penalty of six months imprisonment as the dividing line between petty and serious offenses. 64 Hawaii at 375, 641 P.2d at 979. Since harassment was punishable by no more than 30 days imprisonment, it was a petty offense. *Id.*

[28] *See* Codispoti v. Pennsylvania, 418 U.S. 506 (1974). "[O]ur decisions have established a fixed dividing line between petty and serious offenses: those crimes carrying a sentence of more than six months are serious crimes and those carrying a sentence of six months or less are petty crimes." *Id.* at 512.

*Codispoti*, in dictum, reaffirmed the holding of Baldwin v. New York, 399 U.S. 66 (1970), where the Supreme Court had established a bright-line distinction between petty and serious criminal offenses. "[No] offense can be deemed 'petty' for purposes of the right to trial by jury where imprisonment for more than six months is authorized." *Id.* at 69.

In *Baldwin* the defendant had been charged with a misdemeanor punishable by a maximum of one year imprisonment. *Id.* at 67. His motion for a jury trial was denied; he was convicted and sentenced for the maximum term. *Id.* The United States Supreme Court reversed his conviction. *Id.* at 74. The Court concluded that:

> Except for the criminal courts of New York City, every other court in the Nation proceeds under jury trial provisions. . .when what is at stake is the deprivation of individual liberty for a period exceeding six months. This near-uniform judgment of the Nation furnished us with the only objective criterion by which a line could ever be drawn.

*Id.* at 72.

[29] 64 Hawaii at 375, 641 P.2d at 979. "Whether such a fixed dividing line would be acceptable under our constitutional provisions, however, is a question which we need not now decide." *Id.*

[30] The DUI offense in *O'Brien* was punishable by 180 days imprisonment. 68 Hawaii at 43, 704 P.2d at 886. The offenses which the *Shak* court considered petty were not punishable by imprisonment. *See supra* note 24 and accompanying text. Therefore no valid comparisons can be made between *Shak* and the instant case. In *Kasprzycki*, punishment of not more than 30 days

law cited with approval in *State v. Shak*.[31] The *Shak* court had examined two criteria used by the United States Supreme Court to determine whether an offense is petty or serious: the nature of the offense and the magnitude of the potential penalty.[32]

### *A. The Nature of the Offense*

The Hawaii Supreme Court adopted the ICA two-factored analysis of the nature of the offense.[33] Under the first factor, the court evaluated the historical treatment of the offense—how was the offense treated at common law at the time of the adoption of the United States Constitution.[34] The ICA compared DUI to common law reckless driving[35] which was indictable and therefore required a jury trial.[36]

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imprisonment resulted in classification of the offense as petty. *See supra* note 26 and accompanying text. Since the *Kasprzycki* court declined to establish an acceptable line to distinguish between petty and serious crimes, 64 Hawaii at 375, 641 P.2d at 979, it is unclear whether that court would have considered DUI a petty or serious offense.

[31] The *Shak* court noted that "we have said that in interpreting [the Hawaiian counterpart of the sixth amendment of the United States Constitution] we will look to the federal case law on the subject as a guide. . . ." 51 Hawaii at 615, 466 P.2d at 424.

[32] *See supra* note 25.

[33] 68 Hawaii at 41, 704 P.2d at 885. For the ICA analysis, see 5 Hawaii App. at ____, 704 P.2d at 911.

[34] 5 Hawaii App. at ____, 704 P.2d at 911. In Callan v. Wilson, 127 U.S. 540 (1888), the United States Supreme Court indicated that a good test of the nature of a crime was whether it was indictable at common law. The Court reviewed the history of the common law and concluded that only serious crimes were indictable at common law and that indictable crimes required jury trials. *Id.* at 557.

In District of Columbia v. Clawans, 300 U.S. 617 (1937), the Supreme Court stated that "[a]t the time of the adoption of the Constitution there were numerous offenses, commonly described as 'petty,' which were tried summarily without a jury. . . ." *Id.* at 624. The Court concluded that an offense which by its nature fit such a class of common law offenses would be considered a petty offense. *Id.* at 625.

[35] 5 Hawaii App. at ____, 704 P.2d at 912.

[36] The state argued that DUI is similar to common law intoxication offenses which were considered petty at common law. *Id.* The ICA responded:

> At common law prior to 1776, any charge of driving while intoxicated must have involved horsedrawn or simple horseback transportation. Considering the limited speed of such animal-powered conveyance, it is doubtful that any such offense would have generated significant alarm among the citizenry. In contrast, the incredible destruction caused by modern automobiles is the subject of daily comment in the press, on television and radio, and among the populace. Therefore, it is this Court's belief that no valid analogy can be drawn between traffic offenses involving more primitive modes of transportation and those committed in the heavy and powerful motor vehicles of today.

*Id.* (quoting United States v. Woods, 450 F. Supp. 1335, 1345 (D. Md. 1978)).

The second factor considered by courts in determining the nature of an offense is the gravity of the offense.[37] The ICA referred to the legislative history of the DUI statute to establish the grave effect of DUI on the public—the inherent evil of the offense. The court cited a Hawaii Senate Standing Committee report on the 1982 amendment: "[The] problem is already of major proportions, yet it is growing, and will continue to increase unless and until this legislature provides meaningful sanctions that will deter drunk driving."[38] This concern with DUI, coupled with the expressed purpose of the statute "to provide increased penalties"[39] for DUI offenders, led the ICA to conclude that the "legislative history of the 1982 amendment indicates that DUI was deemed a serious problem."[40]

Both the Hawaii Supreme Court and the ICA stressed that penalties may also reflect the gravity of the DUI offense. The Hawaii Supreme Court concluded that the statutory scheme of the mandatory penalties of imprisonment, community service, loss of driver's license and fines "reflects the societal belief that drunk driving is a grave and therefore constitutionally serious offense."[41] The court added that "the mix of punishments which apply once a driver has been found guilty of drunk driving reflect the opprobrium with which the people of this State view such activity."[42] In other words, the nature of a penalty or

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[37] The United States Supreme Court established three tests to define the gravity of an offense: whether an offense is one (1) "of a grave character affecting the public at large," Callan v. Wilson, 127 U.S. 540, 556 (1888) (conspiracy was a serious crime); or (2) "involving any moral delinquency," Schick v. United States, 195 U.S. 65, 67 (1904) (sale or purchase of improperly stamped oleomargarine was a petty offense because it did not necessarily involve any moral delinquency); or (3) which by "its very nature is *malum in se*," District of Columbia v. Colts, 282 U.S. 63, 73 (1930) (reckless driving "properly cannot be described otherwise than a grave offense").

*Malum in se* is defined as: "A wrong in itself. . . . An act is said to be *malum in se* when it is inherently and essentially evil, that is, immoral in its nature and injurious in its consequences. . . ." BLACK'S LAW DICTIONARY 865 (5th ed. 1979).

For a more detailed discussion of the United States Supreme Court tests, see Note, *The Petty Offense Exception and the Right to a Jury Trial*, 48 FORDHAM L. REV. 205, 211-19 (1979); Note, *Jury Trial for Petty Offenses: Time to Drop the Common Law Tests?*, 14 STETSON L. REV. 191, 200-04 (1984).

[38] 5 Hawaii App. at ____, 704 P.2d at 913 (quoting S. STAND. COMM. REP. No. 176, 11th Hawaii Leg., Reg. Sess., 1982 SEN. J. 1011).

[39] S. CONF. COMM. REP. No. 57, 11th Hawaii Leg., Reg. Sess., 1982 SEN. J. 908.

[40] 5 Hawaii App. at ____, 704 P.2d at 912.

[41] 68 Hawaii at 44, 704 P.2d at 887.

[42] *Id.* Other courts have similarly considered the prescribed penalties to determine the gravity of an offense. *See, e.g.*, Baker v. City of Fairbanks, 471 P.2d 386, 393 (Alaska 1970), where the Alaska Supreme Court said:

> In determining whether an offense falls within one category or the other the courts, in the last analysis, have resorted to a weighing or grouping together of various factors. Not only must the maximum possible punishment be considered, but one must look also at the

combination of penalties may reflect the gravity of the offense.[43]

### *B. The Magnitude of the Potential Penalty*

According to the Hawaii Supreme Court in *State v. Shak*,[44] in determining the seriousness of an offense, "[i]f the offense is not by its nature serious. . .the magnitude of the potential penalty set for its punishment becomes important since it is an indication of the ethical judgments and standards of the community."[45] Federal case law, which the Hawaii Supreme Court uses as a guide in interpreting parts of the Hawaii Constitution,[46] established in *Codispoti v. Pennsylvania*[47] and *Baldwin v. New York*[48] that an authorized punishment of six months' imprisonment was the dividing line between petty and serious offenses.[49] Neither the Hawaii Supreme Court nor the ICA, however, discussed

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social and moral opprobrium which attaches to the offense, the degree to which it may be regarded as anti-social behavior, the possible consequences to the defendant in terms of loss of livelihood. . . .

*See also* United States v. Craner, 652 F.2d 23, 26 (9th Cir. 1981) ("The threat of loss of a license as important as a driver's license, a deprivation added to penal sanctions, is another sign that DUI defendant's community does not view DUI as a petty offense."); United States v. Woods, 450 F. Supp. 1335, 1346-47 (D. Md. 1978) ("The loss of driving privileges which is an automatic collateral consequence upon conviction for driving while intoxicated lends strong. . .support to the conclusion that driving while intoxicated is a very 'serious' crime. . . .").

[43] Courts in four other jurisdictions have held that DUI is a serious offense because of the severity of the prescribed penalties. The Arizona Supreme Court noted in Rothweiler v. Superior Court of Pima County, 100 Ariz. 37, 410 P.2d 479 (1966) that:

> It must be accepted that under present-day conditions driving an automobile while under the influence of intoxicating liquor is an offense of a serious nature. The offense is a matter of statewide concern as it is a frequent infringement of a state statute enacted within the police power of the state, and its moral quality has become offensive to the public as demonstrated by the severity of the punishment. . . .The power to imprison, fine and suspend the right to use the public highways must be considered today as the ability to impose grave criminal sanctions not comparable to petty crimes at common law which were tried summarily. In view of the foregoing considerations, we find the offense in question to be a serious crime which must be triable before a jury when properly demanded.

*Id.* at 44-45, 410 P.2d at 484-85. *See also* Brady v. Blair, 427 F. Supp. 5 (S.D. Ohio 1977) (federal district court following Ohio law); State v. Hoben, 256 Minn. 436, 98 N.W.2d 813 (1959); Brown v. Multnomah County Dist. Court, 280 Or. 95, 570 P.2d 52 (1977).

[44] 51 Hawaii 612, 466 P.2d 422, *cert. denied*, 400 U.S. 930 (1970).

[45] 51 Hawaii at 614, 466 P.2d at 424. *See supra* note 24.

[46] *Id.* at 615, 466 P.2d at 424. *See supra* note 31.

[47] 418 U.S. 506, 512 (1974). *See supra* note 28.

[48] 399 U.S. 66, 69 (1970). *See supra* note 28.

[49] *Codispoti*, 418 U.S. 512; *Baldwin*, 399 U.S. at 69.

the magnitude of the potential penalty criterion other than to say that it was not triggered in the instant case.[50]

## IV. COMMENTARY

The Hawaii courts reviewed the legislative history of the DUI statutes and concluded that DUI is, by its nature, a serious offense because of the serious penalties prescribed.[51] Yet the maximum imprisonment sentence was reduced from one year to six months.[52] The legislature was aware that this reduction in penalty would statutorily change DUI to a lesser offense.[53] The question then is whether the Hawaii legislature really intended the sanctions to indicate that DUI is serious enough to be characterized as a serious offense. Considering the change in the maximum imprisonment penalty by itself, the sanctions under the amended statute indeed appear to be weakened and the legislative intent to strengthen the statute is dubious.

The ICA emphasized, however, that the 1982 and 1983 amendments added other penalties[54] and that "[o]f greater impact, the specified penalties were made mandatory 'without possibility of probation or suspension of sentence.' "[55] This is significant because under the original DUI statute,[56] a trial court had the option of placing a defendant on probation or suspending the

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[50] The Hawaii Supreme Court stated that "the terms of imprisonment for a DUI conviction do not exceed six months and therefore do not trigger the requirement for a jury trial as contemplated by United States Supreme Court cases such as *Baldwin*. . . ." 68 Hawaii at 44, 704 P.2d at 877. The ICA noted: "For an offense not serious by nature, most jurisdictions use a six-month guideline to determine the right to a jury trial: the right attaches only if the maximum authorized punishment exceeds six months." 5 Hawaii App. ___, 704 P.2d at 911.

[51] See *supra* notes 3, 38-39 and accompanying text for a discussion of the legislative history of the DUI statute.

[52] The initial Hawaii DUI statute read as follows:

> Whoever operates or assumes actual physical control of the operation of any vehicle while under the influence of intoxicating liquor shall be punished by a fine not exceeding one thousand dollars or by *imprisonment for not more than one year*, or both.

REV. LAWS HAWAII § 311-28 (1955) (emphasis added).

[53] Senator Dennis O'Connor commented on the bill amending the DUI statute in 1982: "My first comment. . .and I'm speaking against it. . .my first comment on the bill is that it changes an existing law which is a misdemeanor under our statute to a petty misdemeanor. If that is being tough, I have difficulty in that approach." S. CONF. COMM. REP. NO. 57, 11th Hawaii Leg., Reg. Sess., 1982 SEN. J. 738.

[54] 5 Hawaii App. at ___, 704 P.2d at 913. The amendments added community service work and suspension or revocation of driver's license to the possible penalties. See *supra* note 15 for the text of HAWAII REV. STAT. § 291-4 (Supp. 1984).

[55] 5 Hawaii App. at ___, 704 P.2d at 913.

[56] See *supra* note 52 for the text of the original DUI statute.

sentence.[57] Thus a defendant could receive minimal punishment at the court's discretion. Under the amended statute, however, the court must impose some form of punishment.[58] Therefore, it appears that the new DUI sanctions are more serious and may indicate a legislative judgment that DUI is more than a petty offense.

This conclusion, however, appears inconsistent with the *nature of the offense* criterion because in considering the nature of the offense, "the size of the penalty that may be imposed is only of minor relevance."[59] Here, the penalty was of major relevance in determining the nature of the offense. The Hawaii courts used the authorized penalties to establish the gravity of the offense.[60] Still, the Hawaii courts seemed to focus more on the nature[61] rather than on the size or magnitude of the penalties. In this respect, they seem to go beyond the tests of the United States Supreme Court which have limited the consideration of penalties to maximum potential terms of imprisonment.[62]

It is not unusual for the Hawaii Supreme Court to extend the protections of the Hawaii Constitution beyond those of the United States Constitution.[63] In *State v. Kaluna*,[64] the Hawaii court reiterated that it would grant the citizens of

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[57] The statute which applies to sentencing reads as follows:

> The court shall deal with a person who has been convicted of a crime without imposing sentence of imprisonment unless. . .it is of the opinion that:
>
> (1) There is undue risk that during the period of a suspended sentence or probation the defendant will commit another crime; or
>
> (2) The defendant is in need of correctional treatment that can be provided most effectively by his commitment to an institution; or
>
> (3) A lesser sentence will depreciate the seriousness of the defendant's crime.

HAWAII REV. STAT. § 706-620 (1976).

Section 706-620 seems to favor the defendant since it does not require the court to impose imprisonment unless certain criteria are met. Section 291-4(b) however, makes some form of punishment mandatory although the court still has some discretion as to which penalty will be imposed. *See* HAWAII REV. STAT. § 706-621 (1976) (grounds favoring withholding sentence of imprisonment); HAWAII REV. STAT. § 706-622 (1976) (criteria for placing defendant on probation).

[58] *See supra* note 15.

[59] *Shak*, 51 Hawaii at 614, 466 P.2d at 424.

[60] *See supra* note 41-43 and accompanying text.

[61] The Hawaii Supreme Court found that the mandatory nature and the types of punishment were important in determining whether an offense was petty or serious. *See supra* note 42-43 and accompanying text.

[62] *See, e.g.*, Codispoti v. Pennsylvania, 418 U.S. 506 (1974); Baldwin v. New York, 399 U.S. 66 (1970); Duncan v. Lousiana, 391 U.S. 145 (1968); Cheff v. Schnackenberg, 384 U.S. 373 (1966).

[63] *See, e.g.*, State v. Tanaka, 67 Hawaii ____, 701 P.2d 1274 (1985); Huihui v. Shimoda, 64 Hawaii 527, 644 P.2d 968 (1982).

[64] 55 Hawaii 361, 520 P.2d 51 (1974) (warrantless body search of an arrestee incident to a lawful arrest and prior to incarceration held unreasonable).

Hawaii greater constitutional protections than that afforded by the United States Constitution in appropriate situations.[65] In the present case, the Hawaii Supreme Court appears to have afforded O'Brien a right to jury trial where the United States Supreme Court probably would have denied that right.[66]

The ICA also cited two lower federal court decisions which seemingly go beyond the *Baldwin* decision.[67] *United States v. Craner*[68] and *United States v. Woods*[69] considered penalties other than imprisonment as the critical factors in granting DUI defendants a right to jury trial.[70] The Hawaii Supreme Court cited *Craner* in support of its position that the revocation of a driver's license

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[65] *Id.* The Hawaii Supreme Court in *Kaluna* stated that:

> As the ultimate judicial tribunal in this state, this court has final, unreviewable authority to interpret and enforce the Hawaii Constitution. We have not hesitiated in the past to extend the protections of the Hawaii Bill of Rights beyond those of textually parallel provisions in the Federal Bill of Rights when logic and a sound regard for the purposes of those protections have so warranted.

*Id.* at 369, 520 P.2d at 58.

[66] In *Baldwin*, the United States Supreme Court announced that:

> In deciding whether an offense is "petty," we have sought objective criteria reflecting the seriousness with which society regards the offense. . .and we have found the most relevant such criteria in the severity of the maximum authorized penalty. . . . [W]e have concluded that no offense can be deemed "petty" for purposes of the right to trial by jury where imprisonment for more than six months is authorized.

399 U.S. at 68-69.

The Court seemed to have held that the authorized term of imprisonment is the most relevant objective indicator of whether an offense is petty or serious and that a maximum penalty of six months imprisonment is the dividing line. On that basis, the instant DUI offense is a petty offense which would not afford a defendant the right to a jury trial.

[67] 5 Hawaii App. at ___, 704 P.2d at 905.

[68] 652 F.2d 23 (9th Cir. 1981). In *Craner*, the defendant was charged with DUI in Yosemite National Park. He argued that he faced the possible loss of his state driver's license as a result of the federal DUI conviction. *Id.* at 25. The Ninth Circuit Court of Appeals agreed that "the threat of loss of a license as important as a driver's license, a deprivation added to penal sanctions, is another sign that the DUI defendant's community does not view DUI as a petty offense." *Id.* at 26. This notion coupled with the fact that the "penalty for drunken driving is the severest one the Secretary [of the Interior] may authorize," led the court to conclude that the defendant was entitled to a jury trial even though the maximum penalty did not exceed six months of imprisonment. *Id.* at 25.

[69] 450 F. Supp. 1335 (D. Md. 1978). In *Woods*, the defendant was charged with DUI on national park land. The United States District Court of Maryland stated that "the severity of the permissible punishment for an offense, if such punishment does not exceed six months imprisonment, cannot be the sole determinative factor." *Id.* at 1340. The court held that it could also consider the consequences of the revocation of a driver's license to gauge "the social and ethical judgments" of the people and to categorize DUI as either "petty" or "serious." *Id.* at 1346. The court concluded that the automatic loss of a driver's license for a DUI conviction indicated the offense was serious and thus afforded the defendant a right to jury trial. *Id.* at 1346-49.

[70] Both the *Craner* and *Woods* courts considered the possible loss of a driver's license as the important factor in granting the defendants a right to a jury trial. *See supra* notes 68-69.

indicates that a community does not regard DUI as a petty offense.[71] *Craner* and *Woods*, however, are distinguishable from *O'Brien* because they involved distinct, peculiar fact situations: DUI offenses in national parks.[72] Also, there is a conflicting holding in another federal district court on essentially identical facts.[73]

Since the Hawaii courts determined that DUI is, by its nature, a serious offense, they found it unnecessary to discuss the magnitude of the potential penalty.[74] There are, however, several courts in other jurisdictions that have interpreted the *Baldwin* and *Codispoti* decisions[75] as requiring that the magnitude of the potential penalty for a criminal offense be the sole test in distinguishing between petty and serious crimes.[76] It is unclear whether this interpretation accurately represents the holdings of *Baldwin* and *Codispoti*. If it does, the Hawaii Supreme Court would need to re-evaluate its holding in the instant case.

## V. IMPACT

The Hawaii decisions that conviction under the DUI statutes entitles a defendant to a trial by jury may have an impact in three areas. First, the right to jury trial may create administrative problems in the Hawaii judicial system. Second, the decision raises the question of whether the courts will be able to define other crimes for the purpose of determining the right to jury trial in a way which appears to contradict their statutory classifications. Third, the classification of DUI as a crime will raise new procedural questions in the prosecution of future crimes.

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[71] 68 Hawaii at 45, 704 P.2d at 887.

[72] The penalty for drunken driving in national parks is, statutorily, the severest that can be imposed for any offense on national park land. *See Craner*, 652 F.2d at 23; *Woods*, 450 F. Supp. at 1335.

[73] *See* United States v. Fletcher, 505 F. Supp. 1053 (W.D. Va. 1981). A defendant was not entitled to a jury trial on a charge of DUI in a national park because the maximum imprisonment did not exceed six months or $500; therefore, the offense was held to be petty. *Id.* at 1054. The District Court for the Western District of Virginia held that the possible loss of a driver's license was not a punishment for the crime and could not be considered as an increased penalty. The court cited Commonwealth v. Ellett, 174 Va. 403, 4 S.E.2d 762 (1939), "which held that. . .the revocation of the right to operate a vehicle upon the highways. . .is not a part of the punishment provided by law to be fixed by a court or jury upon conviction of a crime. The revocation. . .follows as a consequence and effect of conviction for crime." 505 F. Supp. at 1054.

[74] *See supra* note 50 and accompanying text.

[75] See *supra* note 28 for a discussion of their decisions.

[76] *See, e.g.*, State v. Young, 194 Neb. 544, 234 N.W.2d 196 (1975); State v. Smith, 99 Nev. 806, 672 P.2d 631 (1983); State v. Morrill, 123 N.H. 707, 465 A.2d 882 (1983); State v. Nuttall, 611 P.2d 722 (Utah 1980).

### A. *Judicial Administration*

In response to *O'Brien*, Judge Robert W.B. Chang of the First Circuit Court,[77] warned that DUI defendants requesting jury trials will have priority over all other cases.[78] By this he meant that the court would schedule DUI trials within two weeks of arraignment and that those convicted would face immediate sentencing.[79] This strong warning apparently indicates a concern that the *O'Brien* decision will result in a flood of jury trial requests in the circuit court.

District courts do not have jurisdiction over criminal cases in which the accused has a right to a jury trial;[80] therefore, demands for jury trials by DUI offenders require removal to the circuit courts. This may represent a transfer of an estimated 3900 to 5400 cases annually[81] if a majority of the defendants request jury trials. Such an increase in the circuit courts' case load would undoubtedly create administrative problems.

The judiciary might seek relief by creating a special court to handle DUI cases exclusively. The judiciary, however, would still face the problem of costs for additional judges and support facilities. With the increased number of jury trials, there would be further expenses inherent in the selection and use of juries. The judiciary must rely on biennial appropriations by the legislature to meet any increases in expenditures.[82] Therefore, the creation of a special court may be within the control of the legislature, not the judiciary. Since the antici-

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[77] Judge Chang is the administrative judge of the criminal calendar of the First Circuit Court of Hawaii. THE JUDICIARY, STATE OF HAWAII, ANNUAL REPORT 16 (July 1, 1983 to June 30, 1984).

[78] *Judge Says DUI Trials Top Priority*, Honolulu Advertiser, June 4, 1985, at A4, col. 3.

[79] First Circuit Court, State of Hawaii, Criminal Division Memo No. 45 from Judge Robert W.B. Chang to All Counsel (May 31, 1985) (regarding jury trials for DUI).

[80] The statute reads:

> In any case cognizable by a district court as aforesaid in which the accused has the right to a trial by jury in the first instance, the district court, upon demand by the accused, for such trial by jury, shall not exercise jurisdiction over such case.

HAWAII REV. STAT. § 604-8 (Supp. 1984).

[81] The total DUI caseloads for the district and circuit courts in three previous fiscal years were as follows:

| | Circuit Courts | District Courts |
|---|---|---|
| FY 1981-82 | 43 | 3950 |
| FY 1982-83 | 36 | 4137 |
| FY 1983-84 | 30 | 5456 |

THE JUDICIARY, STATE OF HAWAII, ANNUAL REPORT, Statistical Supplement, Table 7, Table 22 (July 1, 1981 to June 30, 1982; July 1, 1982 to June 30, 1983; July 1, 1983 to June 30, 1984).

[82] *Id.* at 48 (July 1, 1983 to June 30, 1984).

pated administrative problems created by possible increases in jury trials may be immediate and the legislature determines the judiciary budget biennially, as a practical matter, a special court may not be a viable solution.

It is uncertain whether a large number of DUI offenders will take advantage of the *O'Brien* ruling and thereby create the anticipated difficulties.[83] As of the time of the writing of this note, only two DUI offenders have had jury trials,[84] although at the time of Judge Chang's warnings, there were twenty-one accused DUI offenders with jury trials docketed on Oahu.[85]

### *B. Court Decisions Defining Crimes*

Statutorily, DUI is not a crime which warrants a jury trial. The maximum

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[83] One commentator stated that "[an] attorney defending a drunk driving case in which defendant's intoxication is at issue should try to obtain a jury trial whenever possible." 3 R. ERWIN, DEFENSE OF DRUNK DRIVING CASES 37-4 (3d ed. 1984). He reasoned that a jury would react more favorably to the defendant because jurors could relate to the situation through personal knowledge and experiences. *Id.* The judge, on the other hand, may "view the drunk driving case as cut and dried." *Id.* The danger still exists, however, that jurors might not react sympathetically to a DUI defendant. *See infra* note 84.

Judge Chang also warned that since a DUI defendant is now entitled to a jury trial, "the Court will consider the [DUI] offense as a serious offense and will impose sentence accordingly." First Circuit Court Memo No. 45, *supra* note 79. A DUI defendant who demands a jury trial will possibly incur stiffer penalties within the limits of the statute.

Whether this warning will dissuade an accused from demanding a jury trial is questionable because the United States Supreme Court has held that a defendant may not be penalized for exercising a constitutionally guaranteed right. *See* United States v. Jackson, 390 U.S. 570 (1968) (impermissible for Federal Kidnapping Act to provide for the possibility of the death penalty only as a result of a jury verdict). The Supreme Court noted that if a "provision had no other purpose or effect than to chill the assertion of constitutional rights by penalizing those who choose to exercise them, then it would be patently unconstitutional." *Id.* at 581.

Also, Judge Chang's warning does not seem to be consistent with the sentence he imposed in the first DUI jury trial since *O'Brien*. *See infra* note 84.

[84] The first DUI jury trial since the *O'Brien* decision ended on December 20, 1985, in the First Circuit Court with Judge Robert W.B. Chang presiding. The defendant, Timothy E. Lowther, was found guilty and sentenced to "six days in jail, a $250 fine, 72 hours of community service, attendance in an alcohol rehabilitation program and a 90-day suspension of his driver's license." Honolulu Advertiser, Dec. 21, 1985, at A9, col. 1. This sentence "was 'not disproportionate' from sentences of two or three days in cases tried by District Court judges" according to Ignacio Garcia, president of the Hawaii Association of Criminal Defense Lawyers. *Id.* at col. 4.

The second trial resulted in the conviction of Theodore Cronin on January 17, 1986. The defendant "failed the field sobriety test and refused to take the Intoxilyzer test." Honolulu Advertiser, Jan. 18, 1986, at A6, col. 2. The jury took "less than two hours to find him guilty." *Id.* The defendant was sentenced to "two days in jail, a 90-day suspension of his license and 14 hours in an alcohol-abuse program." Honolulu Advertiser, Jan. 21, 1986, at A5, col. 2.

[85] *Judge Says DUI Trials Top Priority*, Honolulu Advertiser, June 4, 1985, at A4, col. 3.

term of imprisonment for DUI is 180 days.[86] Thus, arguably DUI should be considered, at most, a petty misdemeanor.[87] The Hawaii Supreme Court, however, has now held that DUI is a serious crime, affording a defendant a jury trial.

This raises the question of whether the Hawaii courts will grant the right to jury trial in the future for other statutorily petty offenses. For example, the Hawaii Revised Statutes categorizes prostitution as a petty misdemeanor,[88] authorizing the following sentences:

> (a) For the first offense, a fine of $500 and the person may be sentenced to a term of imprisonment of not more than thirty days. . . .
>
> (b) For any subsequent offense, a fine of $500 and a term of imprisonment of thirty days, without possibility of suspension of sentence or probation.[89]

The penalties are similar to those of DUI, especially the provision for mandatory sentencing for repeated offenses.[90] The legislature stated that "some form of mandatory sentence of imprisonment is necessary to curb rising crimes of violence and property crimes, many of which occur as a consequence of the offense of prostitution."[91] If this indicates the "serious" nature of the crime of prostitution, then arguably, under *O'Brien*, an accused should have a right to jury trial.

If the courts can classify statutorily petty crimes as serious crimes, new opportunities may arise for offenders of various petty misdemeanors to challenge their statutory denial of a jury trial. This could have the effect of multiplying the administrative problems anticipated as a result of *O'Brien*.

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[86] HAWAII REV. STAT. § 291-4(b)(3) (Supp. 1984).

[87] A petty misdemeanor is designated as follows:

> A crime is a petty misdemeanor if it is so designated in this Code or in a statute other than this Code enacted subsequent thereto, or if it is defined by a statute other than this Code which provides that persons convicted thereof may be sentenced to imprisonment for a term of which the maximum is less than one year.

HAWAII REV. STAT. § 701-107(4) (1976). There seems to be an inconsistent definition of petty misdemeanors. Another section of the statute provides: "a person who has been convicted of. . .a petty misdemeanor may be sentenced to imprisonment for a definite term which. . .shall not exceed. . .thirty days in the case of a petty misdemeanor." HAWAII REV. STAT. § 706-663 (1976).

[88] HAWAII REV. STAT. § 712-1200(3) (Supp. 1984).

[89] *Id.* § 712-1200(4).

[90] *Id.* The DUI penalties are imposed "without possibility of probation or suspension of sentence." *See supra* notes 15 & 55 and accompanying text.

[91] H.R. CONF. COMM. REP. NO. 25, 11th Hawaii Leg., Reg. Sess., 1981 HOUSE J. 908.

### *C. Procedural Considerations*

In declaring DUI a serious criminal offense, the Hawaii Supreme Court and the ICA may have raised another procedural issue besides the right to jury trial which could affect future DUI prosecution. If DUI is indeed a serious crime invoking the right to a jury trial, then arguably, the accused is entitled to other constitutional protections guaranteed in criminal proceedings. For example, the United States Constitution guarantees that "in all criminal prosecutions, the accused shall. . .have the assistance of counsel for his defense."[92] This raises two critical questions: at what point would a DUI defendant be entitled to legal counsel[93] and how would it affect the implied consent statute?[94]

One commentator has argued that "requiring a driver to make the decision to submit to a chemical test without the aid of an attorney violates the sixth amendment of the United States Constitution."[95] If so, as a practical matter, the right to counsel before submission to chemical analysis would severely limit the value of the analysis and defeat the purpose of the implied consent statute. Since alcohol in the bloodstream diminishes markedly with time, the time required for an offender to contact an attorney would reduce the validity of the

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[92] U.S. CONST. amend. VI.

[93] For a full discussion of the right to legal counsel and the implied consent law, see Note, *Driving While Intoxicated and the Right to Counsel: The Case Against Implied Consent*, 58 TEX. L. REV. 935 (1980) [hereinafter cited as *The Case Against Implied Consent*].

[94] The Hawaii implied consent statute states that:

> Any person who operates a motor vehicle on the public highways of the State shall be deemed to have given consent. . .to a test. . .of the person's breath or blood for the purpose of determining the alcoholic content of the person's blood; such person shall have the option to take a test of the person's breath or blood, or both.

HAWAII REV. STAT. § 286-151 (Supp. 1984).

If a person refuses to submit to the testing, HAWAII REV. STAT. § 286-155 (L.R.B. Comp. 1985) provides that "none shall be given" but the following sanctions may be imposed:

> [T]he judge shall revoke the arrested person's license . . .as follows:
>
> (1) For a first revocation, or any revocation not preceded within a five-year period by a revocation under this section, for a period of twelve months; and
>
> (2) For any subsequent revocation under this section, for a period not less than two years and not more than five years.

*Id.*

[95] *The Case Against Implied Consent*, *supra* note 93, at 937. The United States Supreme Court would probably reject the notion that a DUI defendant has a sixth amendment right to counsel prior to submission to a blood alcohol test. *See* Nyflot v. Minnesota Comm'r of Pub. Safety, 106 S.Ct. 586 (1985). *Nyflot* was an appeal from a Minnesota Supreme Court ruling that there is no right to counsel prior to a DUI blood alcohol test. The United States Supreme Court dismissed the appeal for want of a substantial federal question. Justice White, in dissent, noted that "[m]ost courts that have considered this issue have rejected the argument that the Sixth Amendment right to counsel covers the stage at which the decision whether to consent to the blood alcohol test must be made." *Id.*

blood alcohol measurement.[96] If the DUI problem continues to increase, it is conceivable that issue eventually will be raised and the implied consent law may be in jeopardy.

Another procedural consideration is whether an accused should refuse to submit to a chemical analysis. For example, if a first-time offender refuses to submit to a breath or blood test, his driver's license will be revoked for one year.[97] In addition, he will face a trial on the DUI charge. The prosecution, however, will not have the benefit of the physical evidence from the chemical analysis. Here, the choice of a jury trial may be important because the prosecution's case will rely mainly on witness testimony.[98] There is, however, a drawback. If the accused is convicted of DUI, the resulting penalties will be in addition to the license revocation.[99]

If, on the other hand, the accused submits to the chemical analysis, the resulting evidence may be incriminating and lead to almost certain conviction. Although he will not have his license revoked under Hawaii Revised Statutes section 286-155,[100] he will incur the penalties for DUI under Hawaii Revised Statutes section 291-4(b)(1).[101]

## VI. CONCLUSION

The issue in *State v. O'Brien* was whether DUI is a crime of such a serious nature as to afford a defendant the right to a trial by jury. In deciding affirmatively, the Hawaii Supreme Court and the ICA have given DUI offenders in Hawaii a right to a jury trial that surpasses federal constitutional guidelines.

This decision has raised three important issues: the administrative impact on the circuit courts of additional jury trials, the conflict between legislative and judicial approaches to the crime of DUI and other petty crimes, and the possible demise of the implied consent law. Whether defendants will take advantage of this right to jury trial will depend in large part upon the success or failure of the first DUI defendants who demand jury trials. If a jury trial provides only a

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[96] Note, *To Submit or Not to Submit—Where is My Attorney?; The Right to Counsel Before Submission to Chemical Testing in a DWI Proceeding*, 63 NEB. L. REV. 373, 385 (1984).

[97] HAWAII REV. STAT. § 286-155(1) (L.R.B. Comp. 1985). See *supra* note 94 for the text of this statute.

[98] *See generally* 1 & 3 R. ERWIN, *supra* note 83.

[99] HAWAII REV. STAT. § 286-155(e) (L.R.B. Comp. 1985) states: "The penalties provided by this section are additional penalties and not substitutes for other penalties provided by law." It is interesting to note, however, that the defendant in the second DUI jury trial since *O'Brien* had refused to take the chemical test but was not sentenced according to the implied consent statute. See *supra* note 84 for a discussion of the second DUI jury trial.

[100] See *supra* note 94 for the text of the implied consent statute.

[101] HAWAII REV. STAT. § 291-4(b)(1) (Supp. 1984).

marginal advantage, *O'Brien* may not have any lasting administrative impact on the Hawaii judicial system.[102] The court's willingness to interpret the right to jury trial to include an offense like DUI, however, presents interesting possibilities for defendants accused of other offenses with similar penalties.

Kelvin Kaneshiro

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[102] As of the date of the writing of this note, two DUI defendants have opted for jury trials. *See supra* note 84. The juries found both defendants guilty. It would be premature, however, to draw any conclusions about the advantages or disadvantages of a jury trial. An appeal is pending in the *Lowther* case.

DECENTRALIZED POWER GENERATION: Alternative Energy Exemption from State Public Utility Regulation — *In re Wind Power Pacific Investors-III*

## I. INTRODUCTION

Hawaii derives over ninety percent of its energy from petroleum imports.[1] Approximately sixty percent of the crude oil and petroleum products brought into Hawaii is shipped directly from foreign sources.[2] The resulting uncertainty of supply and cost of Hawaii's energy base has led to a recognition of Hawaii's extremely vulnerable energy situation. In response, the 1978 Hawaii legislature identified energy as one of twelve functional areas requiring critical evaluation and long-term strategic planning.[3] Similarly, an intensified national concern over energy triggered by the Arab oil embargo of the early 1970's provided the impetus for situational analysis and remedial action by Congress.[4]

Under the enabling authority of the Hawaii State Plan,[5] the Department of Planning and Economic Development in 1980 outlined two major energy objectives for the state of Hawaii:

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[1] Hawaii in 1976 received approximately 92% of its energy from petroleum. The remainder consisted of energy supplied from indigenous energy resources: 7% from the combustion of biomass and 1% from stream-harnessed hydropower. In contrast, the nation as a whole derives only 47% of its energy from petroleum. A nationwide 20% cut in petroleum supply would decrease the mainland's total energy supply by only 9.5%. A similar 20% cut in petroleum supply in Hawaii would result in an almost full 20% energy shortage, with no readily available substitute sources. DEPARTMENT OF PLANNING AND ECONOMIC DEV., STATE OF HAWAII, STATE ENERGY PLAN III-13 to -14 (1980) [hereinafter cited as STATE ENERGY PLAN].

[2] Most of the petroleum products arriving from U.S. mainland refineries originate in foreign countries, with the amount approaching 20% of the state oil imports. *Id.* at III-15. Therefore, 83% of Hawaii's energy comes from foreign oil fields.

[3] Act of May 22, 1978, ch. 100, 1978 Hawaii Sess. Laws 136-63 (codified at HAWAII REV. STAT. § 226-18 (Supp. 1984)). Other areas identified included transportation, water resources, historic preservation, recreation, health, conservation lands, education, housing, higher education, agriculture, and tourism. *Id.* Ten of the 12 mandated State Functional Plans were adopted by the state legislature in 1984. Act of April 19, 1984, ch. 236, 1984 Hawaii Sess. Laws 489-506.

[4] *See* Fuller, *Cogeneration and Small Power Production: Florida's Approach to Decentralized Generation*, 9 NOVA L.J. 25, 25-26 (1984); *see also* Federal Energy Regulatory Comm'n v. Mississippi, 456 U.S. 742, 745 (1982).

[5] HAWAII REV. STAT. § 226-18 (Supp. 1984).

(1) Dependable, efficient and economical statewide energy. . .systems capable of supporting the needs of the people.
(2) Increased energy self-sufficiency.[6]

Congress identified similar goals for dealing with the perceived national crisis.[7] Legislative[8] and administrative[9] responses on both the federal and state levels, aimed at achieving these broadly defined objectives, have resulted in a comprehensive body of new energy law. Special focus has been directed to the combined areas of alternative energy technology and decentralized power generation.

The first venture of the Hawaii Supreme Court into decentralized power generation through alternative energy technology came in *In re Wind Power Pacific Investors-III*.[10] The primary issue[11] was whether the Public Utilities Commission can regulate as a utility a third-party investor/owner/operator of a wind farm who retails electric power to a private consumer, who, in turn, re-sells a portion of the purchased power to the local power utility.[12] The court held the investor was not a public utility under Hawaii statute and, therefore, exempt from regulation.[13] The court approved a marketing mechanism for the development of decentralized alternative-energy technologies in Hawaii which may have long-term ramifications. If the objectives of the State Energy Plan are avidly pursued through private investment in decentralized power generation, the probable consequence of *Wind Power Pacific* is a change in traditional notions of electric power generation impacting the consumer, the existing utility structure, and the types of commercial interests involved in the production and provision of electric power.

This examination of *In re Wind Power Pacific Investors-III* focuses primarily on the potential impact of the court's opinion. Legislative and agency developments of the past eight years in the area of alternative energy which have re-

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[6] *Id. See also* STATE ENERGY PLAN, *supra* note 1, at 8 (executive summary).

[7] Federal Energy Regulatory Comm'n v. Mississippi, 456 U.S. at 746.

[8] *See, e.g.*, Public Utilities Regulatory Policies Act of 1978, Pub. L. No. 95-621, 92 Stat. 3350 (1978) (codified at 16 U.S.C. § 824 (1985)); HAWAII REV. STAT. § 269-27.20 (Supp. 1984) (Utilization of electricity generated from non-fossil fuels).

[9] *See, e.g.*, 18 C.F.R. §§ 292.101-.602 (1985) (Federal Energy Regulatory Commission regulations pertaining to small power production and cogeneration); HAWAII ADMIN. RULES §§ 6-74-1 to -25 (1985) (Standards for Small Power Production and Cogeneration).

[10] 67 Hawaii ____, 686 P.2d 831 (1984).

[11] Two other issues were raised on appeal. As to the first, the supreme court held that it would not reverse the decision of the Public Utilities Commission because the Commission did not follow procedural requirements precisely. *Id.* at ____, 686 P.2d at 832. Second, the court held that the relationship between an owner of a generating facility and the consumer of electricity from the facility is not relevant to the qualified facility status of the facility. *Id.* at ____, 686 P.2d at 833.

[12] *Id.* at ____, 686 P.2d at 833-34.

[13] *Id.* at ____, 686 P.2d at 834.

cently come to the forefront in decentralized power generation issues are highlighted.

## II. FACTS

Wind Power Pacific Investors-III[14] (Wind Power) and Waikoloa Water Co.,[15] (Waikoloa Water) jointly applied to the Public Utilities Commission[16] (PUC) for an order certifying the applicants' wind energy conversion system[17] (wind farm) as a Qualified Small Power Production Facility (qualified facility).[18] Wind Power and Waikoloa Water proposed the building of a wind farm designed primarily to satisfy the internal power needs[19] of Waikoloa Water.[20]

Under a proposed Wind Power/Waikoloa Water agreement, Wind Power

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[14] Wind Power Pacific Investors-III (Wind Power) is a Hawaii limited partnership duly registered under the laws of the State of Hawaii and headquartered in Honolulu, Hawaii. *In re* Wind Power Pacific Investors-III, P.U.C. Decision and Order No. 7578, Docket No. 4779, at 3 (June 30, 1983).

[15] Waikoloa Water Co., Inc. (Waikoloa Water) is incorporated in Hawaii and headquartered in Waikoloa, Hawaii. Waikoloa Water is an operating public utility engaged in the sale of water to the residents of Waikoloa. The water is obtained from wells which Waikoloa Water owns and operates. *Id.*

[16] The Hawaii Public Utilities Commission (PUC) is an arm of the State Department of Budget and Finance and serves a quasi-judicial function in regulating firms providing communications, utilities, and transportation services to the public. The PUC is composed of three full-time commissioners and its objective is to ensure that the consumer is provided services meeting acceptable standards of quality, dependability, and safety at fair rates. Activities include, but are not limited to, establishing service standards; rendering decisions and orders affecting the operations, financial transactions and services performed by the companies including the reasonableness of rates, fares, and charges assessed by the companies; acting on applications for financing, capital improvements, as well as certificates or permits to operate; conducting audits and inspections of facilities for compliance with standards; and resolving consumer complaints against the regulated companies. STATE ENERGY PLAN, *supra* note 1, at VI-11. *See also* HAWAII REV. STAT. §§ 269-2, -6, -7, -14, -16 (Supp. 1984) (various statutory provisions delineating the powers, authority, and jurisdiction of the PUC).

[17] Wind power creates electricity using horizontal axis or vertical axis wind turbines. Wind generation systems have minimal environmental impact and unlimited fuel available. Capacities generally range up to 7.5 megawatts and are usually grouped in wind farms. Hamilton, *Standard Contracts and Prices for Small Power Producers*, 11 WM. MITCHELL L. REV. 421, 422 n.1 (1985). *See generally* Opedahl & Tarduno, *Wind Energy Conversion*, 5 HARV. ENVTL. L. REV. 431 (1981).

[18] 67 Hawaii at ____, 686 P.2d at 832.

[19] The power would be used primarily for the electric water pumps that draw the water from Waikoloa Water's wells. *Id.*

[20] *Id.* The land on which the windmills would be located is controlled by the Transcontinental Development Company (TDC). TDC entered into an agreement with Wind Power permitting the building of windmills at the proposed site in exchange for 10% of Wind Power's gross revenue from the site. *Wind Power Pacific*, P.U.C. Decision and Order No. 7578, Docket No. 4779, at 3.

would own and operate the facility, and sell all the electric energy produced directly to Waikoloa Water.[21] Waikoloa Water would pay Wind Power 95% of the Hawaii Electric Light Company[22] (HELCO) incremental energy rate for all electricity used by Waikoloa Water to meet its internal electrical needs.[23] Any power generated by the wind farm in excess of Waikoloa Water's requirements would be sold to HELCO by Waikoloa Water, with the revenue flowing to Wind Power.

Upon PUC certification, the local electric utility is required to interconnect[24] with the wind farm facility and purchase the excess energy[25] at a price not to exceed the avoided cost[26] to the public utility.[27] HELCO intervened in the hearing ordered by the PUC,[28] contesting the certification of the wind farm as a qualified facility and the facility's immunity from state utility regulation.[29] The PUC granted the certification[30] and HELCO appealed.[31]

## III. BACKGROUND

### *A. Federal Legislation and Regulations*

Congress enacted the Public Utilities Regulatory Policies Act of 1978 (PURPA) as part of a legislative initiative "designed to combat the nationwide

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[21] *Wind Power Pacific*, P.U.C. Decision and Order No. 7578, Docket No. 4779, at 4.

[22] Hawaii Electric Light Co. is a subsidiary of Hawaiian Electric Co. Hawaii Electric Light Co. provides the electric power to the island of Hawaii and is subject to Hawaii PUC regulation. STATE ENERGY PLAN, *supra* note 1, at III-26 to -27.

[23] *Wind Power Pacific*, P.U.C. Decision and Order No. 7578, Docket No. 4779, at 4.

[24] "An 'interconnection' is a physical connection that permits electricity to flow from one entity to another." American Elec. Power Serv. Corp. v. Federal Energy Regulatory Comm'n, 675 F.2d 1226, 1238-39 (D.C. Cir. 1982).

[25] Small power production facilities are often designed to meet peak electrical loads of the consumer. Optimal efficiency and economy are realized by operating at full capacity. Since electrical needs fluctuate, full capacity operation often results in excess power. Science Applications, Inc., Market Assessment for Fuel Cells in Hawaii 3-2 to 3-5 (May 1983) (pertinent sections available in University of Hawaii Law Review office) [hereinafter cited as Market Assessment for Fuel Cells in Hawaii].

[26] "Avoided cost" is defined as "the incremental costs to an electric utility of electric energy or capacity or both which, but for the purchase from the qualifying facility or qualifying facilities, such utility would generate itself or purchase from another source." 18 C.F.R. § 292.101(b)(6) (1985).

[27] 67 Hawaii at ____, 686 P.2d at 833.

[28] *Wind Power Pacific*, P.U.C. Decision and Order No. 7578, Docket No. 4779, at 16.

[29] 67 Hawaii at ____, 686 P.2d at 832.

[30] *Wind Power Pacific*, P.U.C. Decision and Order No. 7578, Docket No. 4779, at 2.

[31] 67 Hawaii at ____, 686 P.2d at 833.

energy crisis."[32] In an effort to reduce United States consumption of fossil fuels[33] and reliance on foreign energy supplies,[34] Congress sought to encourage the development of alternate energy sources,[35] including small power production[36] and cogeneration.[37]

Technical and economic viability of decentralized generation based on alternative energy technology depends upon utility interconnection.[38] Prior to PURPA, three generally recognized obstacles concerning interconnection impeded the development of decentralized power production. First, some utilities refused to purchase power generated from independent sources or offered inadequate "buyback" rates.[39] Second, various utilities charged decentralized, independent generators discriminatory rates for utility provided power and service.[40]

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[32] Pub. L. No. 95-621, 92 Stat. 3350 (1978) (codified at 16 U.S.C. § 824 (1985)). For a detailed discussion of the legislative history of PURPA, see Miles, *Full-Avoided Cost Pricing Under the Public Utilities Regulatory Policies Act: "Just and Reasonable" to Electric Consumers?*, 69 CORNELL L. REV. 1267, 1283 n.99 (1984). On November 9, 1978, Congress enacted the Comprehensive Energy Act. In addition to PURPA, this omnibus legislation consists of the following: The Energy Tax Act of 1978, Pub. L. No. 95-168, 92 Stat. 3174 (1978) (codified in titles 23 and 26 of the United States Code); the National Energy Conservation Policy Act of 1978, Pub. L. No. 95-619, 92 Stat. 3206 (1978) (codified in titles 12, 15, 23 and 42 of the United States Code); the Natural Gas Policy Act of 1978, Pub. L. No. 95-621, 92 Stat. 3350 (1978) (codified at 15 U.S.C. §§ 3301-3342 (Supp. III 1979) and 42 U.S.C. § 7255 (Supp. V 1981)); the Power Plant and Industrial Fuel Use Act of 1978, Pub. L. No. 95-620, 92 Stat. 3289 (1978) (codified in titles 15, 42, 45 and 49 of the United States Code).

[33] The legislative objective was to reduce oil imports to under six million barrels per day, and to slow the annual growth of energy demand to less than two percent. Miles, *supra* note 32, at 1267 n.4 (citing Aspen Inst. for Humanistic Studies, Decentralized Electricity and Cogeneration Options, Summary Report 16 (1979)).

[34] United States imports of foreign oil increased from 23% of total domestic oil consumption in 1970 to between 45% and 50% in 1977. H.R. REP. NO. 543, 95th Cong., 2d Sess. 5 (1977).

[35] "Section 210 of PURPA's Title II. . .seeks to encourage the development of cogeneration and small power production facilities. Congress believed that increased use of these sources of energy would reduce the demand for traditional fossil fuels." Federal Energy Regulatory Comm'n v. Mississippi, 456 U.S. at 750.

[36] A small power production facility's capacity does not exceed 80 megawatts and uses biomass, waste, geothermal or renewable resources (solar, hydro, or wind energy) as its primary energy source for the generation of electric energy. 16 U.S.C. § 796(17)(A) (1982).

[37] Cogeneration is the combined production of power and useful thermal energy by the sequential use of energy from one fuel source—the reject heat of one process can become the energy input to a subsequent process. *See* Cross, *Cogeneration: Its Potential and Incentives for Development*, 3 HARV. ENVTL. L. REV. 236, 236-37 (1979).

[38] *See* Gentry, *Encouraging Public Utility Participation in Decentralized Power Production*, 5 HARV. ENVTL. L. REV. 297, 315-18 (1981). *See generally* Cross, *supra* note 37.

[39] Miles, *supra* note 32, at 1268.

[40] *Id.* Most decentralized power providers require supplementary, back-up, and maintenance service provided by the public utility to ensure dependable power. *Id.* "Supplementary power" refers to "electric energy or capacity supplied by an electric utility, regularly used by a qualifying

Third, the threat of plenary regulation of interconnected small power producers by state and federal utility authorities discouraged investment because of the financial and administrative burdens associated with regulation.[41]

Sections 201 and 210 of PURPA contain the primary legislative response to these economic and institutional barriers.[42] PURPA established broad guidelines, requiring the Federal Energy Regulatory Commission (FERC) to issue explicit rules to encourage the development of alternative energy through regulations targeted at the three traditional barriers to decentralized power generation.[43]

FERC fulfilled the PURPA rule-making mandate in 1980.[44] With respect to the third barrier, FERC exempted qualified facilities from regulation under the Federal Power Act,[45] the Public Utility Holding Companies Act,[46] and certain state laws and regulations governing the financial and organizational structure of electric utilities.[47]

FERC also established certain ownership criteria as prerequisites to certifica-

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facility in addition to that which the facility generates itself." 18 C.F.R. § 292.101(b)(8) (1983). "Backup-power" refers to "electric energy or capacity supplied by an electric utility to replace energy ordinarily generated by a facility's own generation equipment during an unscheduled outage of the facility." *Id.* § 292.101(b)(9). "Maintenance power" refers to "electric energy or capacity supplied by an electric utility during scheduled outages of the qualifying facility." *Id.* § 292.101(b)(11).

[41] Miles, *supra* note 32, at 1268. *See also* Fuller, *supra* note 4, at 27-29.

[42] Federal Energy Regulatory Comm'n v. Mississippi, 456 U.S. at 751; *American Elec. Power*, 675 F.2d at 1230.

[43] PURPA requires FERC to:

> prescribe, and from time to time thereafter revise, such rules as it determines necessary to encourage cogeneration and small power production. . .which rules require electric utilities to offer to:
>
> (1) sell electric energy to qualifying cogeneration facilities and qualifying small power production facilities; and
>
> (2) purchase electric energy from such facilities.

Public Utilities Regulatory Policies Act of 1978 § 210(a), 16 U.S.C. § 824a-3(a) (1982). PURPA § 210(b) sets guidelines for FERC in adopting rules concerning the purchases of electricity by the utility:

> [t]he rates for such purchase—
>
> (1) shall be just and reasonable to the electric consumer of the electric utility and in the public interest, and
>
> (2) shall not discriminate against qualifying cogenerators or qualifying small power producers.

16 U.S.C. § 824a-3(b) (1982).

[44] 45 Fed. Reg. 12214-37 (1980) (codified at 18 C.F.R. §§ 292.301-.403, .601-.602 (1985)).

[45] 18 C.F.R. § 292.601 (1985).

[46] *Id.* § 292.602(b).

[47] *Id.* § 292.602(c).

tion. As a general rule, a "small power production facility [or cogenerator] may not be owned by a person primarily engaged in the generation or sale of electric power" other than electric power solely from small power production [or cogeneration] facilities.[48] This rule effectively preempts existing regulated electric utility companies from taking advantage of the benefits of PURPA.

The regulated electric utility companies have been among those challenging PURPA[49] and applications to FERC for qualified facility status.[50] Utilities perceive decentralized power as a threat to their economic viability and to the core nature of the electric utility business.[51]

In early 1984, prior to the *Wind Power Pacific* decision, Hawaiian Electric Co. (HECO) intervened in a PRI Energy Systems, Inc. (PRI) application seeking FERC certification of a cogeneration facility.[52] Since the facts surrounding the HECO challenge mirror the situation of *Wind Power Pacific*, the FERC decision provides an interesting backdrop to the *Wind Power Pacific* decision.

PRI proposed retaining ownership of a cogeneration facility and selling the energy produced to the end user at a discount from HECO's published rate structure.[53] HECO requested that FERC deny PRI's application for qualifying status on the grounds that PRI intended to engage only in direct retail sales of electricity to end users as opposed to selling to the regulated utility.[54] According to HECO, a grant of qualifying status to such a facility would violate the intent and purpose of sections 201 and 210 of PURPA and the regulations thereunder.[55] HECO further alleged that granting qualifying status to PRI would ultimately lead to further erosion of HECO's industrial load to qualifying facilities

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[48] *Id.* § 292.206(a). This ownership criterion also applies to cogeneration facilities. Furthermore, an otherwise qualified facility is not entitled to qualified status if an electric utility owns more than 50% of the equity interest in the plant. *Id.* § 292.206(b).

[49] *See, e.g.*, Federal Energy Regulatory Comm'n v. Mississippi, 456 U.S. 742. Mississippi Power and Light Co. was one of several parties challenging the constitutionality of PURPA. The Supreme Court affirmed the constitutionality of PURPA, finding that the Act was within Congress' authority to regulate interstate commerce and that it did not violate the tenth amendment of the U.S. Constitution by unjustifiably infringing on state sovereignty. *See also* American Paper Inst. v. American Elec. Power Serv. Corp., 461 U.S. 402 (1983).

[50] *See, e.g.*, PRI Energy Systems, Inc., 26 FERC ¶ 61,177 (1984) (challenge by Hawaiian Electric Co.). *See also* Bardin, *The Report of the Committee on Cogeneration and Small Power Production Facilities*, 5 ENERGY L.J. 161, 179-80 (1984) (challenge by the Puerto Rico Electric Power Authority).

[51] Gentry, *supra* note 38, at 315-17.

[52] PRI Energy Systems, Inc., 26 FERC ¶ 61,177, at 1. The energy from the cogeneration facility for which PRI was seeking qualified status was to supply both hot water and electricity to a food processing and preparation plant located on Oahu. *Id.*

[53] *Id.*

[54] *Id.* at 2.

[55] *Id.*

which would be detrimental to HECO's remaining customers.[56]

FERC found that its regulations did not involve a consideration of the type of purchaser to whom power sales may be made by a cogeneration facility.[57] FERC did not view the retailing of electricity to an end user as a limitation on the grant of qualified status.[58] PURPA does not require that a decentralized power generator sell its output exclusively to the regulated utility as a condition for qualified status. FERC maintained, however, that the regulations do not limit the individual states' authority to permit or prohibit retail sales by qualified facilities. Facilities meeting the criteria for qualifying status are only "eligible" for the exemptions from state regulation,[59] leaving much to the discretion of the states in terms of regulating the commercial activities of decentralized power generators.

FERC held that Congress intended that questions concerning retail sales be resolved pursuant to state law and are, therefore, more appropriately raised in state forums.[60] Consistent with this position, FERC did not pass judgment on the potentially detrimental effect on HECO's remaining customers of the loss of HECO sales to non-regulated small power producers. FERC did not foreclose the potential merit of this concern, but merely held that the concern was irrelevant to the issue of the qualifying status of a cogenerator. Accordingly, FERC granted PRI's application.[61] HECO made no further challenge in Hawaii courts or to the Hawaii PUC.

### *B. Hawaii Legislation and PUC Rules*

In PURPA, Congress delegated to the individual states' public utility commissions the practical implementation of the PURPA provisions and FERC regulations.[62] PURPA requires the state PUC's to adopt administrative rules which

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[56] *Id.* According to HECO, if electric utilities lose a number of their large commercial users to qualifying facilities, other customers will have to bear the cost of utility operations. HECO further stated that this situation would be aggravated since HECO would still be required to supply large commercial users, even if they contracted to purchase from qualifying facilities. HECO stated that since it cannot recover the costs of this reserve generation through standby charges, the remaining costs would have to be borne by other utility customers. *Id.*

[57] *Id.* at 3.

[58] *Id.*

[59] *Id.*

[60] *Id.* at 4. The legislative history of PURPA supports this interpretation. The Conference Report on PURPA states: "[T]he Conferees do not intend that this limitation on the Commissions' authority will limit the states from allowing such sales for purposes other than resale to take place. The cogenerator or small power producer may be permitted to make retail sales pursuant to state law." CONF. REP. NO. 1292, 95th Cong., 2d Sess. 97 (1978).

[61] PRI Energy Systems, Inc., 26 FERC ¶ 61,177, at 5.

[62] 16 U.S.C. § 824a-3(f) (1982).

are consistent, in substance, with the FERC regulations.[63] Hawaii complied with the federal requirement in 1982, adopting the "Standards for Small Power Production and Cogeneration" (PUC Standards).[64] The PUC Standards as to size, efficiency and ownership criteria for qualified facility status in Hawaii are essentially identical to the FERC regulations.[65] However, while the FERC regulations explicitly delineate the federal regulatory exemptions afforded qualified facilities, the Hawaii PUC Standards do not address exemption from state utility regulation. Consequently, uncertainty and ambiguity exists concerning the scope of or limits on state regulation of decentralized small power producers or cogenerators.

Exhibiting a pre-PURPA recognition of the inhibitory nature of regulation on the private development of alternate means of providing electricity, the Hawaii legislature in 1977 amended the Hawaii Revised Statute definition of "public utility."[66] The legislature excluded from the definition of public utility, and thereby exempted from PUC regulation, any person who:

> (A) controls, operates, or manages plants or facilities for production, transmission, or furnishing of power primarily or entirely from non-fossil fuel sources, and (B) provides, sells, or transmits all of such power, except such power as is used in its own internal operations, directly to a public utility for transmission to the public.[67]

Companion legislation prescribed PUC procedures to be followed in determining the purchase price of electricity produced by a non-fossil fuel generating facility and sold to the public utility.[68] The PUC is to afford consideration "not only to the near-term adverse consequences to the ultimate consumers of utility provided electricity, but also to the long-term desirable goal of encouraging to

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[63] *Id.*

[64] HAWAII ADMIN. RULES §§ 6-74-1 to -25 (1985) (Standards for Small Power Production and Cogeneration).

[65] *Compare* 18 C.F.R. § 292.204(a) (1985) *with* HAWAII ADMIN. RULES § 6-74-5(a) (1985) (size requirement for small power production facilities). *Compare* 18 C.F.R. § 292.206 (1985) *with* HAWAII ADMIN. RULES § 6-74-7 (1985) (ownership criteria for small power production and cogeneration facilities). *Compare* 18 C.F.R. § 292.204(b) (1985) *with* HAWAII ADMIN. RULES § 6-74-5(b) (1985) (fuel use criteria for small power production facilities). *Compare* 18 C.F.R. § 292.205(a), (b) (1985) *with* HAWAII ADMIN. RULES § 6-74-6(a), (b), (c), (d) (1985) (operating and efficiency standards for cogeneration facilities).

[66] Act of May 14, 1977, ch. 102, 1977 Hawaii Sess. Laws 183-86 (codified in HAWAII REV. STAT. § 269-1(7) (Supp. 1984)) (previous statute did not contain the non-fossil fuel exemption).

[67] HAWAII REV. STAT. § 269-1(7) (Supp. 1984). The price the PUC shall approve or independently establish between the electric utility and a decentralized producer "[s]hall not be less than one hundred percent of the cost avoided by the utility when the utility purchases the electrical energy rather than producing the electrical energy." *Id.* § 269-27.2(c).

[68] *Id.* § 269-27.2.

the greatest extent practicable, the development of alternate sources of energy."[69]

## IV. THE *Wind Power Pacific* Decision

The supreme court's opinion in *Wind Power Pacific* was short and concise. The court, in its brevity, did not consider or chose not to recognize various competing policy issues. Simply, the court held that given the legislative intent to promote alternative energy and some general notions of "public utility," a decentralized non-fossil fuel electric power generator may retail its energy output without being subject to regulation.[70]

### *A. The Court's Rationale*

The statutory definition of public utility includes every person who may own, control, operate, or manage as owner any plant directly or indirectly "for public use" in the production or furnishing of electric power.[71] Critical to the court's decision was the incorporation of the words "for public use." The court stated that the classification of an enterprise as a public utility "depends on whether or not the service rendered by it is of public character and of public consequence."[72] The issue of the public character or consequence of a particular decentralized power producer is purely factual.[73] The test, derived from the statutory language, is whether the enterprise *holds itself out*, expressly or impliedly, as engaged in the business of supplying its product *to the public* or to a limited portion of the public as opposed to representing itself as serving or ready to serve only particular individuals.[74]

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[69] *Id.* § 269-27.2(c).

[70] 67 Hawaii at ____, 686 P.2d at 834.

[71] *Id.* at ____, 686 P.2d at 833-34. Persons referred to in the statutory definition include "[o]wners, lessees, trustees, receivers or otherwise, whether under a franchise, charter, license, articles of association." HAWAII REV. STAT. § 269-1 (Supp. 1984).

[72] 67 Hawaii at ____, 686 P.2d at 833 (quoting 73B C.J.S. *Public Utilities* §§ 2-3 (1983)). The court also cited 1 A.J.G. PRIEST, PRINCIPLES OF PUBLIC UTILITY REGULATION 1-24 (1969); and Wilhite v. Public Serv. Comm'n, 150 W. Va. 747, 149 S.E.2d 273 (1966). Substantial case law exists for determining when a sale of surplus energy subjects the seller to regulation. The vast majority of courts hold that a producer of energy, to constitute a public utility, must devote its product and service to a public use so that the energy is available to the public generally and indiscriminately. There is, however, a lack of consistency in the holdings of the cases from jurisdiction to jurisdiction which as yet has not been resolved. Danzinger, *Renewable Energy Resources and Cogeneration: Community Systems and Grid Interaction as a Public Utility Enterprise*, 2 WHITTIER L. REV. 81, 86-87 (1979).

[73] 67 Hawaii at ____, 686 P.2d at 833.

[74] *Id.*

The PUC, in the hearings from which the appeal to the Hawaii Supreme Court was made, found that Wind Power did not intend to dedicate nor, in fact, would be dedicating its property, the wind farm, to public use despite the proposed retailing of electricity to Waikoloa Water and subsequent resale to HELCO.[75] The crucial fact in the PUC's determination was that Wind Power would sell power only to Waikoloa Water.[76] The court concluded that the PUC's findings and conclusion exempting Wind Power from regulation were not clearly erroneous under the "holding itself out to the public" test[77] and affirmed the Commission's Decision and Order.[78]

### B. *The HELCO Counterargument*

HELCO argued that non-utility status was contingent upon satisfying the conditions of the non-fossil fuel exemption to the statutory definition of public utility.[79] According to HELCO, Wind Power did not qualify for the exemption because Wind Power would not be selling *all* the power it generated, excluding its internal requirements, *directly* to HELCO.[80] In HELCO's view, Wind Power's exemption was contingent upon the sale of power by Wind Power entirely and exclusively to HELCO. However, satisfying the non-fossil fuel exemption criteria was not necessary because the court found that Wind Power's generating facility was not a public utility within the meaning of the general statutory provision.[81] Any discussion of the more restrictive language of the non-fossil fuel exemption was rendered moot.

Although the court did not have to deal with the non-fossil fuel exemption, the court noted the legislative purpose behind the exemption in support of its conclusion.[82] In doing so, the court provided judicial notice of the priority it

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[75] *Wind Power Pacific*, P.U.C. Decision and Order No. 7578, Docket No. 4779 at 15. The conclusion of the PUC was that Waikoloa Water's purchase of electricity would "in substance be a financing arrangement" between the parties. *Id.* at 14.

[76] *Id.* at 15.

[77] 67 Hawaii at ____, 686 P.2d at 834.

[78] *Id.*

[79] *Id.* at ____, 686 P.2d at 833. *See also* HAWAII REV. STAT. § 269-1(7) (Supp. 1984) (non-fossil fuel exemption).

[80] 67 Hawaii at ____, 686 P.2d at 833.

[81] The statutory definition is:

> "Public utility" means and includes every person who may own, control, operate, or manage as owner, lessee, trustee, receiver, or otherwise, whether under a franchise, charter, license, articles of association or otherwise, any plant or equipment, or any part thereof, directly or indirectly for public use. . .or for the production, conveyance, transmission, delivery or furnishing of light, power. . . .

HAWAII REV. STAT. § 269-1 (Supp. 1984).

[82] 67 Hawaii at ____, 686 P.2d at 835. The purpose is "to encourage the commercial devel-

attaches to the legislative aim of the commercial development of alternative energy. The court is willing, in the interest of alternative energy development, to sacrifice state regulatory control in certain factual contexts.

## V. IMPLICATIONS OF *Wind Power Pacific*

*Wind Power Pacific* will invariably impact the economics and marketing of decentralized power and, consequently, the development and growth of alternative energy in Hawaii. The non-regulated retailing of electricity will draw new types of investors and businesses into the energy field. It will infuse much needed capital and reduce the down-side risks[83] to the prospective consumer of energy from alternative energy technologies, resulting in the accelerated growth of alternative energy in Hawaii. Positive gains, however, may come at the expense of interests traditionally considered primary and, in some instances, protected under the regulated scheme. The economics and, possibly, the role of the regulated electricity utility will be altered. Also, new marketing schemes will favor larger consumers of power, increasing the cost of electricity to the remaining utility customers, primarily residential consumers.

### A. *The Future Marketing and Development of Alternative Energy*

Originally, the commodity for sale in the alternative energy market was hardware. The economics of the market place dictated that the buyer be a consumer of large quantities of electricity with access to a substantial amount of investment capital.[84] Following *Wind Power Pacific*, the commodity becomes electric power. The practical consequence of *Wind Power Pacific* is to produce a marketing environment conducive to the development of non-regulated "mini-utilities," owned and operated by investors who are separate from the consumer of the electricity.

For the consumer of electric power, the mini-utility concept removes the prohibitive first cost element of investing in alternative energy, while preserving significant economic incentives in terms of reduced operating expenses through discounted electricity purchases. The mini-utility eliminates for the electric power consumer many of the perceived risks of investing in new and, in some instances, unproven technologies. The regulated public utility must remain interconnected with the consumer providing him with back-up and stand-by

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opment of renewable energy resources by producers who desired not to be deemed public utilities." Act of May 21, 1980, ch. 77, 1980 Hawaii Sess. Laws 116-18.

[83] Decker, *Cogeneration Planning and Third Party Perspectives*, in THE COGENERATION SOURCEBOOK 149-53 (F.W. Payne ed. 1985).

[84] *Id.*

power in the event of a failure of the decentralized plant.[85] Therefore, there is minimal threat of the loss of power to the consumer. Additionally, since the consumer does not invest in plant and equipment, the investor incurs the entire financial risk that the plant will operate efficiently. Maximization of operating savings for the consumer and return on investment for the investor are both a direct function of the maximization of production and purchase of power from the alternative energy facility.[86] Therefore, the investor and the consumer have mutual interests in the optimal utilization of the decentralized facility. This common interest affords the consumer additional security.

To the investor, the mini-utility represents a new investment market. Since the investor does not run the risk of a regulated return or pricing structure, he can price the output of the facility at a discount from the public utility prices. "Free and abundant fuels," such as wind, solar, and biomass, and the fuel efficiency of cogeneration permit the discounting of electricity while ensuring a favorable return on investment as long as utility rates remain high. If the regulated utilities in Hawaii remain dependent upon the burning of fossil fuels in the production of electricity, a favorable rate of return appears virtually assured.

Target markets in Hawaii for investors employing the mini-utility scheme include condominium and hotel buildings, light industry, industrial parks and any other large consumer of electric power.[87] Uncertainty remains as to how the PUC[88] and the courts will interpret the *Wind Power Pacific* "holding itself out to the public" test with respect to the investors seeking non-regulated status in each of these particular applications. Because the test established by the court is purely factual and it is probable that the electric utilities[89] will continue to intervene to protect their own interests, case-by-case determinations will be nec-

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[85] HAWAII ADMIN. RULES § 6-74-21 (1985).

[86] Market Assessment for Fuel Cells in Hawaii, *supra* note 25, at 3-9 to 3-13. Fuel cells represent one type of cogeneration technology. *Id.* at 2-4. The various types of alternative energy technologies will be better suited in various applications than in others. Location, space, and local zoning laws are among the factors affecting the viability of a given technology in a given application.

[87] *Id.* at 3-9 to 3-13.

[88] It is unclear after *Wind Power Pacific* whether a determination of the status of an investor as regulated or non-regulated under the court's test is within the jurisdiction of the PUC. It is clearly within the PUC's jurisdiction to grant qualified status, but FERC took the position that qualified status issues are independent of the issue of the regulation of retail sales of electricity. PRI Energy Systems, Inc., 26 FERC ¶ 61,177, at 4. The Hawaii Supreme Court has held that public policy favors public utility commission jurisdiction over activities in which the public welfare depends upon proper conduct and regulation of public utilities. PUC v. Honolulu Rapid Transit Co., 56 Hawaii 115, 530 P.2d 742 (1975). It is unclear whether the threshold question of whether a decentralized power producer will be included within this jurisdiction.

[89] A question of electric utility standing may arise if the PUC is not the proper forum for determining the regulated or non-regulated status of a particular investor.

essary as investors attempt to avoid regulation in a particular application. Consequently, the courts, either as a body of first impression or an appellate body reviewing PUC rulings,[90] will significantly influence the growth of alternative energy in Hawaii.

### B. *The Future Economics and Role of the Regulated Electric Utility in Hawaii*

Since the FERC rules[91] and PUC standards[92] mandate interconnection and standby and backup power, Hawaii's electric utility companies must maintain at a large fixed cost a minimum available plant-in-service, i.e., facilities capable of simultaneously serving the full power needs of its remaining customers and those customers consuming primarily from decentralized plants. Because the public utility unit sales will decline, especially among larger customers, the cost per unit of electricity will increase to cover the fixed costs of maintaining required utility capacity. As decentralized alternative energy power generation becomes more economically attractive with increasing utility prices due to the eroding utility sales, a "snowballing" effect will result.

The PUC can respond to this economic dilemma in one of two ways. First, the PUC can allow the utility to maintain a relatively level rate of return, placing the burden on the remaining customers of the utility. Alternatively, the PUC can stem the rise of consumer prices by reducing the utility's allowable rate of return. The latter approach may eventually threaten the economic viability of the utility.[93]

Another possible effect of the development of decentralized power production is a change in the role the regulated utility traditionally played as "full-service" power provider. Private power production could potentially relegate electric utilities from producers and transmitters of power to primarily providers of transmission facilities.[94] In the long term, private power producers could serve the backup needs of one another with the public utility providing the necessary interconnection. The implication is a major down-scaling of the financial size and function of the electric public utility.

The threat to the economic viability and nature of the regulated utility may have healthy and desirable consequences. First, the threat may provide the necessary incentive for public utility development of alternative energy technologies more suited to centralized power production. In the absence of competition or

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[90] *See supra* note 88.

[91] 18 C.F.R. § 292.303 (1985).

[92] HAWAII ADMIN. RULES § 6-74-21 (1985).

[93] Gentry, *supra* note 38, at 317.

[94] *Id.*

any such threat, the regulated utility has had no incentive to invest in alternative energy because of the utility's financial investment in large oil burning power plants.[95] In non-growth markets with relatively stable electricity demands, investment in new plants and equipment would, in effect, canabalize profits otherwise attributable to maximizing the financial return on existing facilities. The advent of non-regulated decentralized power production introduces an element of competition never before experienced by the regulated electric utility.

The development by the utilities of alternative means of generating electricity in confronting this new threat may provide the operating efficiencies and fuel cost savings necessary to compete with decentralized power. Whether the threat is real and of sufficient magnitude to motivate utility investment in alternative energy will be dictated by response to the *Wind Power Pacific* decision by investors and future litigation concerning the scope of the "holding itself out to the public" test. The fact that HECO and HELCO contested the regulatory exemption of direct retail sales by alternative energy generators evidences a perception by the Hawaii electric utilities of an imminent, if not existing, competitive threat.

Second, in the interest of protecting the future vitality of the public utility system, Congress and the Hawaii legislature could relax the regulatory constraints on utility alternative energy endeavors.[96] At the present time, the regulated utility and any affiliated subsidiary or holding company is precluded from taking advantage of PURPA.[97] Gradual and limited relaxation of regulatory

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[95] *See* Fuller, *supra* note 4, at 27-29.

[96] *Id.*

[97] 18 C.F.R. § 292.206(b) (1985). The FERC regulations read:

(a) *General rule.* A cogeneration facility or small power production facility may not be owned by a person primarily engaged in the generation or sale of electric power (other than electric power solely from cogeneration facilities or small power production facilities).

(b) *Ownership test.* For purposes of this section, a cogeneration or small power production facility shall be considered to be owned by a person primarily engaged in the generation or sales of electric power, if more than 50 percent of the equity interest in the facility is held by an electric utility or utilities, or by an electric utility holding company or companies, or any combination thereof. If a wholly or partially owned subsidiary of an electric utility or electric utility holding company has an ownership interest of a facility, the subsidiary's ownership interest shall be considered as ownership by an electric utility or electric utility holding company.

(c) *Exceptions.* For purposes of this section a company shall not be considered to be an "electric utility" company if it:

(1) Is a subsidiary of an electric utility holding company which is exempt by rule or order adopted or issued pursuant to section 3(a)(3) or 3(a)(5) of the Public Utility Holding Company Act of 1935, 15 U.S.C. 79c(a)(3), 79c(a)(5); or

(2) Is declared not to be an electric utility company by rule of order of the Securities and Exchange Commission pursuant to section 2(a)(3)(A) of the Public

constraints through amendment to PURPA or other measures would provide an additional incentive to utility development of alternative energy. Utility and legislative response directed toward the development of centralized alternative energy facilities would ultimately promote long and short term energy objectives on the state and national levels.

### *C. The Effect on the Remaining Utility Customer*

A more rapid development of alternative energy among non-regulated decentralized power generators relative to development of alternative energy among the regulated utilities may result in spiralling prices to the remaining utility customers. Furthermore, the utility customer in residential areas is usually without access technically or economically to alternative means of electric power procurement. Therefore, most residential customers of the utility cannot take advantage of savings realized through "free fuel" or high efficiencies. Finally, from a technical and economic standpoint the larger consumer of electricity represents the most viable and promising investment area because of certain economies of scale.[98] Under the mini-utility scheme, the residential customer[99] does not represent an economically viable market to the investor. The bottom line is that the residential utility customers will be adversely affected by the non-regulated sales of electricity and will have no viable recourse.[100]

The concern of skyrocketing utility costs to the remaining utility customers is not novel, and, in fact, was on the record before the Hawaii Supreme Court. In a memorandum to the PUC supporting a motion for reconsideration, HELCO

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Utility Holding Company Act of 1935, 15 U.S.C. 79b(a)(3)(A).

*Id.* § 292.206.

[98] Market Assessment for Fuel Cells in Hawaii, *supra* note 86, at 3-9 to 3-13.

[99] Future residential subdivisions through energy and construction planning may be able to take advantage of the mini-utility scheme. This is especially true if the subdivision would incorporate as a unitary association so as to facilitate the selling of electricity to an identifiable class or entity.

[100] Arguments were made to the effect that the customer consuming small quantities of electricity will actually subsidize alternative energy development for the large electric consumer to its own detriment. Senator Charles Percy stated during hearings on PURPA that: "It would be wrong to subsidize small [power] producers at the expense of other customers." 123 CONG. REC. 32,403 (1977). Representative John Dingell expressed the principle that equitable buyback rates necessarily reflect the cost of the energy used by consumers and the cost saved by cogenerators:

> We are also concerned with the need for equitable rates to the over 84 million electric customers throughout the United States, *rates which do not discriminate against certain classes of user by providing unjustifiable subsidies to other classes of users,* subsidies which not only are inequitable but also encourage the wasteful use of this energy resource.

124 CONG. REC. 38,369 (1978) (emphasis added).

argued that the PUC's decision would open a "Pandora's Box,"[101] alluding to the potential adverse effects of the proliferation of non-fossil fuel power producers. Yet, the court did not discuss this concern in its opinion. Furthermore, the Hawaii non-fossil fuel legislation which the supreme court cited in support of its decision requires the PUC to consider the "near-term adverse consequences to the ultimate consumer"[102] as well as the long-term goals.[103]

Similarly, HECO argued in its request to FERC for denial of PRI's application for qualified status that the retailing of electricity without regulation would negatively impact the remaining customers.[104] FERC viewed this as a potentially valid concern but deferred its handling to the state forums.[105]

Since the supreme court saw fit to discuss policy supporting alternative energy development, it is surprising that the court did not mention the countervailing argument concerning the potential increase in electricity prices to small consumption consumers. The court is apparently giving extremely high priority to the solution of Hawaii's energy problem, despite the potential detriment to the small consumer.

## VI. CONCLUSION

The Hawaii Supreme Court has restrictively construed the statutory definition of public utility in the context of decentralized alternative energy power generators. The court's interpretation permits certain decentralized power producers to retail electricity free from regulation. A possible impact is an accelerated growth of alternative energy in Hawaii. This growth may have its costs in terms of increased prices to residential customers and threats to the economic viability of the electric utility. Because the court established a factual test as to what types of decentralized electric power generation will be regulated, determinations will be made initially on a case-by-case basis as new applications for the retailing of decentralized power will arise. Thus, the Hawaii courts will likely have substantial influence in the growth of decentralized alternative energy in Hawaii.

In *Wind Power Pacific*, the Hawaii Supreme Court took a strong position in favor of the development of alternative energy to the potential detriment of the existing electric utility structure and the small consumer of electric power. Unless the legislature or the regulated utilities take affirmative counteraction, the

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[101] *In re* Wind Power Pacific Investors, P.U.C. Decision and Order No. 7610, Docket No. 4779, at 2.

[102] HAWAII REV. STAT. § 269-27.2 (Supp. 1984).

[103] 67 Hawaii at ___, 686 P.2d at 834.

[104] PRI Energy Systems, Inc., 26 FERC ¶ 61,177, at 4.

[105] *Id.*

economic vitality of the existing electric utility may be jeopardized, and the price of electricity to the consumer of small quantities of electric power may dramatically increase. Such action, motivated by the court's decision in *Wind Power Pacific*, would inevitably foster the best interests of Hawaii.

Brad S. Petrus

# DEVELOPMENT OF OCCUPATIONAL HAZARD IN HAWAII: *Lopez v. Board of Trustees, Employees Retirement System; Komatsu v. Board of Trustees, Employees Retirement System*

## I. INTRODUCTION

The primary purpose of Hawaii Revised Statutes sections 88-77 and 88-79, Employees' Retirement System Law, is to provide compensation to an applicant who is incapacitated for the duties of his position as the natural and proximate result of an accident or as the cumulative result of some "occupational hazard."[1] The scope of coverage for the term "occupational hazard" under chapter 88 represents a central issue in awarding benefits to an employee who has been incapacitated by an illness related to his employment. This recent development will examine the Hawaii Supreme Court's attempt to define "occupational hazard" in two recent cases, *Lopez v. Board of Trustees*[2] and *Komatsu v. Board of Trustees*,[3] and will consider the impact of these decisions on future cases.

## II. CASES

### A. Lopez v. Board of Trustees

The Hawaii Supreme Court initially defined the scope of coverage for "occupational hazard" in *Lopez v. Board of Trustees*.[4] Ted R. Lopez, an industrial safety engineer with the Hawaii State Department of Labor and Industrial Relations, experienced a disability diagnosed as "manic depressive psychosis."[5] Lopez claimed service-connected disability retirement under section 88-77 of the Hawaii Revised Statutes.[6] Although evidence indicated that stress and job pres-

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[1] HAWAII REV. STAT. §§ 88-77, -79 (1976).

[2] 66 Hawaii 127, 657 P.2d 1040 (1983).

[3] 67 Hawaii 485, 693 P.2d 405 (1984).

[4] 66 Hawaii 127, 657 P.2d 1040 (1983).

[5] *Id.* at 128, 657 P.2d at 1041.

[6] The statute provides in pertinent part:

> [A]ny member who has been permanently incapacitated as the natural and proximate result of an accident occurring while in the actual performance of duty at some definite time and place, or as the cumulative result of some occupational hazard, through no willful negligence on his part, may be retired by the board of trustees for service-connected total disability. . . .

sures contributed to his disability,[7] the Board of Trustees of the Hawaii Employees' Retirement System ruled that his disability did not constitute an accident or occupational hazard within the meaning of section 88-77.[8]

On appeal to the Hawaii Supreme Court, Lopez contended that any job-related condition which results in incapacitation for gainful employment or further performance of duty is an occupational hazard.[9] The supreme court rejected this contention because, if "occupational hazard" could be read so broadly, the term would be meaningless and without operative effect.[10]

The court held that work-related psychosis was not an "occupational hazard," which it defined as a "danger or risk which is inherent in, and concomitant to a particular occupation."[11] The court added that "the causative factors must be those which are not ordinarily incident to employment in general and must be different in character from those found in the general run of occupations."[12] The supreme court found that the work pressures and frustrations experienced by Lopez were not exceptionally different from those experienced by employees in any other occupation and thus did not constitute an occupational hazard.[13]

### *B.* Komatsu v. Board of Trustees

*Komatsu v. Board of Trustees*[14] demonstrates the Hawaii Supreme Court's initial interpretation of the definitional boundaries established in *Lopez*. In *Komatsu*, the applicant was employed as executive assistant to a physician of the City and County of Honolulu from 1969 to October 1981.[15] Komatsu initially worked at Maluhia Hospital but transferred to the Pawaa Annex in 1974.[16]

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HAWAII REV. STAT. § 88-77(a) (1976).

[7] Several doctors who examined Lopez agreed that stress and job pressures he experienced over a period of years contributed to his disability. 66 Hawaii at 128, 657 P.2d at 1041.

[8] *Id.*

[9] *Id.* at 129, 657 P.2d at 1042.

[10] *Id.*

[11] *Id.*

[12] *Id.* In defining "occupational hazard" in *Lopez*, the Hawaii Supreme Court cited Detenbeck v. General Motors Corp., 309 N.Y. 558, 132 N.E.2d 840 (1956), and Fruehauf Corp. v. Workmen's Compensation, 31 Pa. Commw. 341, 376 A.2d 277 (1977), both worker's compensation cases interpreting "occupational hazard."

[13] The court held that "the work pressures and frustrations which the applicant experienced were not exceptionally different from those experienced by other employees in other occupations. These particular incidents of his employment could not readily be said to have been uncommon to the general run of occupations." 66 Hawaii at 130, 657 P.2d at 1042.

[14] 67 Hawaii 485, 693 P.2d 405 (1984).

[15] *Id.* at ____, 693 P.2d at 407.

[16] Komatsu encountered no serious health problems at Maluhia Hospital although he did

Several years after moving, Komatsu experienced severe respiratory disorders and became incapacitated for work. He attributed his incapacitation to his work environment, particularly to the improperly functioning air conditioning system which circulated mold contaminants.[17] Komatsu submitted an application for service-connected disability retirement under section 88-79 of the Hawaii Revised Statutes.[18] The Board of Trustees denied Komatsu's application.[19]

The First Circuit Court concluded that the findings and conclusions of the Trustees "were not supported by reliable, probative, substantial evidence,"[20] and were therefore clearly erroneous. The circuit court held that Komatsu's employment conditions constituted an "occupational hazard" under section 88-79 of the Hawaii Revised Statutes and that his permanent incapacitation was service-connected.[21] The Intermediate Court of Appeals (ICA) reversed the decision of the circuit court.[22]

The issue raised on appeal to the Hawaii Supreme Court was whether the ICA correctly held that Komatsu could not prevail because of lack of substantial proof: Komatsu had failed to prove all office workers suffered asthmatic bronchitis at greater rates than the general population as a result of working in

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experience occasional nasal stuffiness and frontal headaches. *Id.*

[17] *Id.*

[18] The statute reads in pertinent part:

> Service-connected occupational disability retirement. (a) Upon application of a member, or of the head of his department, any member who has been permanently incapacitated for duty as the natural and proximate result of an accident occurring while in the actual performance of duty at some definite time or place, or as the cumulative result of some occupational hazard, through no willful negligence on his part, may be retired by the board of trustees for service-connected disability . . . .

HAWAII REV. STAT. § 88-79(a) (1976).

While Lopez and Komatsu filed applications for disability retirement under different sections of chapter 88, the language at issue, "the cumulative result of some occupational hazard," appears in both § 88-77 and § 88-79. The Hawaii Supreme Court found no difference in the interpretation of "occupational hazard" under either section. 67 Hawaii at ____ n.6, 693 P.2d at 410 n.6.

[19] Upon receipt of Komatsu's application, the State Employees' Retirement System transmitted his application to the Medical Board pursuant to HAWAII REV. STAT. § 88-79(a)(4) (1976). The Medical Board certified that Komatsu was incapacitated for further performance of duty but found that his incapacitation was non-service connected. The Medical Board recommended denial of disability retirement benefits to the Board of Trustees. Komatsu appealed the Medical Board's decision pursuant to HAWAII REV. STAT. § 91-9 (1976), which provides for proceedings before a hearing officer in contested cases. The hearing officer recommended the Trustees determine that Komatsu's incapacitation was service-connected. The Trustees rejected the hearing officer's recommended decision. 67 Hawaii at ____, 693 P.2d at 408.

[20] *Id.* at ____, 693 P.2d at 409.

[21] *Id.* at ____, 693 P.2d at 408.

[22] 5 Hawaii App. ____, 687 P.2d 1340 (1984).

similarly contaminated environments.[23] In addressing the issue, the supreme court found the ICA's interpretation of *Lopez* to be too narrow. The court "never intended nor envisioned that *Lopez* would be so inhibitive . . . [because such a] requirement of proof would render 'occupational hazard' almost meaningless."[24] The court held that the incapacitation resulted from an "occupational hazard" because there was an undisputed causal nexus between Komatsu's disability and his employment. In addition, mold contaminants from a faulty air conditioning system are not a danger or risk incident to employment generally.[25] The court established the following criteria to clarify the definition of "occupational hazard": (1) the employment conditions actually cause the disability, and (2) these conditions are peculiar to the work environment in that they are encountered in a degree beyond those prevailing in employment in general.[26]

## III. IMPACT

*Komatsu* and *Lopez* were initial attempts by the Hawaii Supreme Court to define the scope of coverage for "occupational hazard" as contained in chapter 88 of the Hawaii Revised Statutes. It is important, therefore, to understand how the court approached these cases in order to understand their implications.

In *Lopez*, the Hawaii Supreme Court attempted to fashion a meaningful definition of "occupational hazard."[27] The court in *Komatsu* clarified the *Lopez* definition, presenting guidelines aimed at fostering equitable interpretations.[28] Two issues arise regarding the practical implications of these decisions: first, the extent to which the court will expand the definition of "occupational hazard," and second, the ramifications on the present standard of proof.

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[23] The intermediate court concluded Komatsu could not prevail because of lack of substantial evidence proving that: (1) office workers in general were subjected to equivalent amounts of mold or fungi from air conditioning systems as was Komatsu in his office; (2) the average office worker has a tendency to contract asthmatic bronchitis because of mold contaminants or fungi in the air conditioning system; and (3) the incidence of asthmatic bronchitis is substantially higher among officer workers than the general population. *Id.* at ____, 687 P.2d at 1345.

[24] 67 Hawaii at ____, 693 P.2d at 411.

[25] *Id.* at ____, 693 P.2d at 411-12.

[26] *Id.* at ____, 693 P.2d at 412.

[27] *See supra* text accompanying notes 9-10.

[28] In *Komatsu*, the court stated that a narrow interpretation of "occupational hazard" (as that given by the Intermediate Court of Appeals) would render the statute applicable only to firefighters, police officers, and sewer workers who are specifically covered by HAWAII REV. STAT. § 88-79(b) (1976). 67 Hawaii at ____, 693 P.2d at 411. *See also supra* text accompanying note 24.

### A. *Judicial Expansion of Occupational Hazard*

The decisions in *Komatsu* and *Lopez* do not indicate whether the court will expand "occupational hazard" to include traditionally nonoccupational disabilities—those that become occupational because employment facilitates their transmission.[29] It is possible to predict the outcome by viewing the general policy underlying *Lopez* and *Komatsu*.

In accordance with the court's reasoning in *Lopez*, benefits would be restricted in a situation where the hazard is a risk common to employment in general. Refining the definition of "occupational hazard" set forth in *Lopez*, *Komatsu* held the condition must be a distinctive feature of the claimant's particular work environment, not necessarily his occupation.[30] It would seem to follow that any permanent disability, however non-industrial in nature, could become an "occupational hazard" if the employment conditions actually cause the disability and the danger or risk is not ordinarily associated with the normal working environment.[31]

While these decisions could be interpreted to expand the coverage of "occupational hazard" under chapter 88, it seems improbable that the court would award compensation for incapacitation from a single exposure.[32] Sections 88-77 and 88-79 require that the incapacitation be the *cumulative* result of some "oc-

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[29] A similar principle was applied in Mason v. YWCA, 271 A.D. 1042, 68 N.Y.S.2d 510 (1947). Ordinarily tuberculosis would not be considered an occupational disease of a telephone operator. However, the enforced use of a close fitting mouth piece was a required part of the claimant's job, and since it enhanced the probability of transmission of the disease from one operator to another, the contraction of tuberculosis by the claimant was held to be an occupational disease.

[30] 67 Hawaii at ____, 693 P.2d at 412. The decision in *Komatsu* further expands coverage for "occupational hazard" under chapter 88 by holding an applicant's individual allergy or weakness immaterial if conditions of employment caused the disability. Komatsu's disease was distinctly associated with the employment setting: the causal nexus was undisputed. The fact that other employees may not contract asthmatic bronchitis due to a faulty air conditioning system was not controlling.

Most courts have held that when distinctive employment conditions act upon a pre-existing weakness to produce disability, the result is an occupational hazard. 1B A. LARSON, THE LAW OF WORKMEN'S COMPENSATION §§ 41-63, at 7-418 (1972).

[31] A hypothetical will help illustrate this type of situation. A police officer's desk is elevated four feet above the ground to enable workmen to perform repairs. She becomes permanently disabled when her legs weaken because she is required daily to jump off the platform, on which her desk is located, to reach the floor. Her entitlement to retirement benefits is a result of her employment conditions and not because the danger or risk is a distinctive feature of being a police officer.

[32] An example of an incapacitation from a single exposure is a disability resulting from a single event such as a school teacher permanently disabled after being sprayed with acid from a repair worker.

cupational hazard."[33] In construing the statute, the *Komatsu* court recognized that the condition must develop gradually over a period of time, culminating in disability.[34] However, it is possible that an incapacitation from a single exposure could be classified as an "accident."[35]

The expansion of coverage under "occupational hazard" will enable more claims to qualify under sections 88-77 and 88-79. The Hawaii Supreme Court may have placed a difficult burden upon the Trustees and the lower courts to guard against questionable claims. The court's decision, however, reflects the legislative intent of chapter 88 and judicial policy supporting a liberal interpretation of sections 88-77 and 88-79 favoring the awarding of benefits.[36]

### *B. Ramifications on the Present Standard of Proof*

In *Lopez* and *Komatsu*, the Hawaii Supreme Court did not specifically address the issue of which party bears the burden of proving whether incapacitation resulted from an "occupational hazard." However, *Komatsu* could be interpreted in future cases as favoring the reallocation of the burden of proof from the applicant to the Trustees.[37]

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[33] *See supra* note 18.

[34] "[T]he employee was exposed to mold or fungi in his particular work environment *over a lengthy period* and the causal nexus between the exposure and his disability is undisputed." 67 Hawaii at ____, 693 P.2d at 411 (emphasis added).

[35] HAWAII REV. STAT. § 88-77(a) and § 88-79(a) provide benefits for an applicant who has been permanently incapacitated as the natural and proximate result of an accident. In *Lopez*, the Hawaii Supreme Court defined an accident "as an unlooked for mishap or untoward event which is not expected or designed." 66 Hawaii at 130, 657 P.2d at 1043.

[36] The primary purpose in enacting HAWAII REV. STAT. § 88-79 was to broaden the scope of compensable applicants under chapter 88. The legislative history shows that § 88-79 was "designed to eliminate existing problems in granting full benefits for life when an applicant is incapacitated for the duties of his position." SEN. STAND. COMM. REP. NO. 497, 2d Hawaii Leg., Reg. Sess., 1963 SEN. J. 845.

In interpreting chapter 88, the Hawaii Supreme Court has followed the legislative intent, favoring the awarding of benefits. *Kikuta v. Board of Trustees* held that in construing chapter 88 of the Hawaii Revised Statutes, courts should avoid technical distinctions leading to "absurd and unjust results." 66 Hawaii 111, 117, 657 P.2d 1030, 1035 (1983).

[37] While the Hawaii Supreme Court did not specifically address this point, the court found the intermediate court's requirement that the applicant carry the full burden of proof to be unreasonable. *See supra* notes 21-23 and accompanying text. It should be noted, however, that the court record shows numerous documents presented by Komatsu indicating that office workers in general are subjected to higher than average concentrations of harmful mold and this exposure subjects them to a greater risk of respiratory problems than that faced by the general population. Petitioner-Appellant-Appellee Ralph Y. Komatsu's Supplemental Brief Regarding His Application For Writ Of Certiorari Which Was Granted On September 13, 1984, at Exhibit A-J, Komatsu v. Board of Trustees, 67 Hawaii 485, 693 P.2d 405 (1984).

In *Komatsu*, the Hawaii Supreme Court found that it would be unreasonable to require the applicant to carry the full burden of proof.[38] In doing so, the supreme court seemed to dismiss the requirement[39] that the applicant prove the danger or risk is not common to employment in general. "Where, as in this case, the employee was exposed to mold or fungi in his particular work environment over a lengthy period and the causal nexus between the exposure and his disability is undisputed, entitlement to service-connected disability retirement benefits is clear."[40] It appears that once the applicant presented evidence of a causal relationship, the burden shifted to the Trustees. In other words, once the applicant has established a causal nexus between his work environment and the disability, the burden shifts to the Trustees to prove the applicant's disability is a risk common to employment in general.[41]

This approach is more desirable than placing the full burden upon the applicant. The Trustees are usually in a better position to disprove the fact that the employee was not subject to an "occupational hazard," than it is for the applicant to carry the full burden of proof.[42] The applicant's limited access to resources and information justifies the shift in the burden of proof. This standard is consistent with the goals of the Employees Retirement System Law: to compensate work-injured employees.[43]

Altering the burden of proof could possibly be interpreted as inconsistent with section 91-10(5) of the Hawaii Revised Statutes which states that the party initiating the proceeding shall have the burden of proof.[44] *Komatsu*, however, satisfies section 91-10(5) by requiring the applicant to carry the initial burden of establishing a causal link.

While it is possible that *Komatsu* may open the "floodgates" to litigation, the requirement that the applicant first establish a causal nexus before the burden of proof shifts, and the language in *Lopez* stating that the disability must not be a risk common to employment in general, should restrict frivolous

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[38] *See supra* notes 21-23 and accompanying text.

[39] *See supra* text accompanying note 25.

[40] 67 Hawaii at ____, 693 P.2d at 412.

[41] Similarly, in Detenbeck v. General Motors Corp., 309 N.Y. 558, 132 N.E.2d 840 (1956), the New York Court of Appeals held that testimony of a causal relationship shifted the burden of coming forward with evidence from the claimant to the employer. *See also* Stone, *Detenbeck Revisited*, 52 N.Y. ST. B.J. 316 (1980).

[42] *Cf.* Schroder & Shapiro, *Responses to Occupational Disease: The Role of Markets, Regulation, and Information*, 72 GEO. L.J. 1231, 1237 (1984).

[43] *See supra* note 35.

[44] The statute provides:

> Except as otherwise provided by law, the party initiating the proceedings shall have the burden of proof, including the burden of persuasion. The degree or quantum of proof shall be a preponderance of the evidence.

HAWAII REV. STAT. § 91-10(5) (Supp. 1984).

claims.

Difficulty may arise in future cases where causation is questionable or disputed. The standard of proof enunciated in *Komatsu* may not apply. If causation were in issue, unlike *Komatsu*, where causation was undisputed, the case may be distinguishable.

## IV. CONCLUSION

*Lopez v. Board of Trustees* and *Komatsu v. Board of Trustees* have clarified the definition of "occupational hazard" within the meaning of chapter 88 of the Hawaii Revised Statutes. Recovery is allowed if there exists a causal relationship between the employment and the disability, and the causative factor is not a risk common to employment in general. In *Komatsu* the court also implied that once the applicant has established a causal nexus, the burden shifts to the Trustees to prove the applicant's disability is a risk common to employment in general.

The Hawaii Supreme Court's liberal position opens the door for more claims to be classified and compensated under "occupational hazard." This places a difficult burden upon the Trustees and the lower courts to guard against frivolous claims.

It is possible that future claims under sections 88-77 and 88-79 would result in a narrow interpretation of *Komatsu*, limiting its application to situations where the causal nexus is undisputed. Whether the full implications of the Hawaii Supreme Court's liberal position will be followed remains to be seen.

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TAXATION: Who Pays Attorney's Fees?

## I. INTRODUCTION

The case of *Kaufman v. Egger*[1] highlights "one of many unnecessary tribulations that can be brought to bear upon the unsuspecting citizenry by todays' computerized bureaucracy."[2] The issue in *Kaufman* was whether taxpayers could be awarded attorney's fees for unreasonable Internal Revenue Service's pre-litigation conduct. The United States Court of Appeals for the First Circuit affirmed a decision of the district court awarding the taxpayers fees for attorneys and accountants and for all court costs relating to the taxpayers' suit.[3] The taxpayers sought recovery for a wrongfully seized tax refund and an injunction against further tax collection by the IRS for the year in issue.

The court found the taxpayers were not required to exhaust their administrative remedies[4] because the IRS began collection procedures without sending a deficiency notice.[5] Acknowledging that there was a split in authority as to whether a taxpayer can be reimbursed for attorney's fees as a result of unreasonable conduct of the IRS prior to litigation, the court held that the underlying conduct of the IRS before the taxpayers filed suit should be considered in awarding attorney's fees.

This decision is significant because there is no deterrence of possible abuses in the pre-litigation behavior of the IRS if taxpayers are limited to recovery of attorney's fees only when the IRS acts unreasonably after commencement of litigation. In the past, if taxpayers' assets were seized without reasonable notice due to an IRS oversight, taxpayers were unable to collect litigation fees and costs incurred in a civil action merely because the federal government stipulated to the entry of judgment. The stipulation constituted reasonable behavior after the commencement of suit; thus, it often foreclosed recovery by the taxpayers. The court reiterated the policy behind 26 U.S.C. section 7430: The awarding of attorney's fees "will deter abusive actions and overreaching by the IRS and will

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[1] 758 F.2d 1 (1st Cir. 1985).

[2] *Id.*

[3] *Id.* at 2.

[4] 26 U.S.C. § 7430 (Supp. 1982) (The taxpayers must exhaust their administrative remedies before the awarding of court costs and certain fees.).

[5] *Id.*

enable individual taxpayers to vindicate their rights regardless of their economic circumstances."[6]

## II. FACTS

Taxpayers David and Barbara Kaufman (Kaufmans) filed their 1978 individual income tax returns with the Chicago, Illinois district of the IRS in February 1979 and later that year moved to Maine.[7] Two years later, the Chicago district of the IRS sent a notice to the Kaufmans' former residence in Chicago stating that their 1978 tax return was selected for audit.[8] Because they never received the audit notice, the Kaufmans did not appear at the appointed time for the tax audit.

The audit resulted in a $14,380 increased tax liability. The IRS erroneously mailed the Notice of Adjustment to a Stockton, Illinois address where the Kaufmans had never lived.[9] Additionally, the statutory Notice of Deficiency required under 26 U.S.C. section 6212[10] was erroneously sent to this address.

In 1983, the IRS sent to the correct Maine address a notice informing the Kaufmans that a $606 refund from their 1982 return was seized as a partial payment of their 1978 tax deficiency. This was the first notice that the Kaufmans received concerning the 1978 tax deficiency. Within eleven days, the Kaufmans received another notice from the IRS requesting the payment of $23,857 and providing a telephone number for the option of a payment schedule.

The Kaufmans' accountant was advised by the IRS that the matter had been referred to the Taxpayers Delinquent Account Section. In contemplation that the IRS might take further unannounced collection measures on the tax deficiency, the Kaufmans instituted an action seeking injunctive relief and return of

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[6] H.R. REP. NO. 404, 97th Cong., 2d Sess. 13, 16 (1982); SENATE COMM. ON FINANCE, TECHNICAL EXPLANATION OF COMM. AMENDMENTS, *reprinted in* 127 Cong. Rec. S15594-95 (daily ed. Dec. 16, 1981) [hereinafter cited as TECHNICAL EXPLANATION].

[7] 758 F.2d at 2.

[8] At the time the notice was sent, the IRS Chicago office had in the file of the Kaufmans an IRS "Transcript of Account" dated July 1980 showing their correct address in Norridgewock, Maine. *Id.* at 2 n.1.

[9] The Stockton, Illinois address was the address of another couple also named David and Barbara Kaufman. The IRS acknowledged its error in a handwritten memo placed in the Kaufmans' file stating that "Stat. Notice sent to wrong address." During the same period the IRS was also corresponding with the Kaufmans at their then correct address in Norridgewock, Maine about other unrelated tax matters. *Id.* at 2 n.2.

[10] The statute provided that: "Notice of Deficiency—If the Secretary determines that there is a deficiency in respect of any tax imposed by subtitle A or B or chapter 41, 42, 43, 44, or 45, he is authorized to send notice of such deficiency to the taxpayer by certified mail or registered mail." 26 U.S.C. § 6212 (Supp. 1982).

their previously seized $606 refund. Within two months, the IRS stipulated to the entry of a permanent injunction enjoining it from taking any steps to collect taxes based on the erroneously addressed Notice of Deficiency. Thereafter, the Kaufmans filed an Application for Attorney and Expert Fees and Costs.[11]

The IRS contended that the Kaufmans had failed to exhaust the available administrative remedies and therefore could not avail themselves of costs and fees.[12] In addition, the IRS argued that the government's position at litigation, and not the government's pre-litigation stance, must be proven to be unreasonable in order for the taxpayers to recover litigation expenses.[13] The IRS further argued that since it did not actually try the case, but rather stipulated to an entry of judgment, its position in the civil proceeding was reasonable.[14]

The district court found that the instant case fell within Congress' exception "that the exhaustion of remedies requirement may be inappropriate in some cases."[15] The court held that the IRS' pre-litigation conduct, which engendered the civil proceedings, would be examined for reasonableness. Upon determining that the pre-litigation position of the IRS was unreasonable, the court granted the Kaufmans' motion for attorney and expert fees, over the objection of the government.[16] The government appealed.

## III. SECTION 7430

Fee petitions in civil tax cases are governed by section 7430 of the Internal Revenue Code.[17] Section 7430(a) provides:

> (a) In general—In the case of any civil proceeding which is—
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> (1) brought by or against the United States in connection with the determination, collection, or refund of any tax, interest, or penalty under this title, and

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[11] 758 F.2d at 2.

[12] The exhaustion of administrative remedies is a requirement under 26 U.S.C. § 7430(b)(2) (Supp. 1982).

[13] 758 F.2d at 3.

[14] *Id.* at 2.

[15] Kaufman v. Egger, 584 F. Supp. 872, 876 (D. Me. 1984) (citing H.R. REP. No. 404, *supra* note 6; TECHNICAL EXPLANATION, *supra* note 6).

[16] 584 F. Supp. at 878.

[17] 26 U.S.C. § 7430 (Supp. 1982) was enacted on September 3, 1982, as part of the Tax Equity and Fiscal Responsibility Act (TEFRA). As stated in H.R. REP. NO. 404, 97th Cong., 2d Sess. 11 (1982), the congressional concern regarding 26 U.S.C. § 7430 is that the awarding of fees "will deter abusive actions and overreaching by the Internal Revenue Service and will enable individual taxpayers to vindicate their rights regardless of their economic circumstances."

TEFRA amends 28 U.S.C. § 2412 (the general litigation costs award statute) in that 26 U.S.C. § 7430 supersedes in cases involving tax litigation. *See* 28 U.S.C. § 2412 (1982).

(2) brought in a court of the United States (including the Tax Court), the prevailing party may be awarded a judgment for reasonable litigation costs incurred in such proceeding.

Section 7430 contains several requirements for awarding litigation costs. First, the taxpayer must have exhausted administrative remedies made available by the IRS prior to pursuing court action.[18] Second, the party seeking relief must have prevailed in the earlier action.[19] Third, the court must find that the "position of the United States in the civil proceeding" was unreasonable.[20]

In addressing the exhaustion of administrative remedies requirement, the IRS contended that the Kaufmans failed to exhaust the available administrative remedies by not utilizing the Appeals Office of the IRS. In the event that a taxpayer disagrees with the IRS findings after a correspondence examination of the taxpayer's tax return, a regulation provides for the taxpayer's access to the Appeals Office of the IRS.[21] This administrative remedy, however, was not utilized by the Kaufmans because they had no knowledge of any tax liability assessment taking place.

Title 26 U.S.C. section 6212[22] requires the IRS to send a Notice of Deficiency to the taxpayers whose tax it finds to be deficient. Since the IRS sent the preliminary Notice of Deficiency to an address where the Kaufmans no longer lived and the statutory Notice of Deficiency to an address at which the Kaufmans had never resided, the Kaufmans were never apprised of the existence of a tax deficiency. Without knowledge of a tax audit or of an adverse tax deficiency assessment, the Kaufmans had no opportunity to appeal.

Title 26 U.S.C. section 6213[23] provides that a taxpayer may file a petition

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[18] The statute provides: "Requirement that administrative remedies be exhausted.—A judgment for reasonable litigation costs shall not be awarded under subsection (a) unless the court determines that the prevailing party has exhausted the administrative remedies available to such party within the Internal Revenue Service." 26 U.S.C. § 7430(b)(2) (Supp. 1982).

[19] The statute provides that: "Determination as to prevailing party.—Any determination under subparagraph (A) as to whether a party is a prevailing party shall be made—(i) by the court, or (ii) by agreement of the parties." *Id.* § 7430(c)(2)(B).

[20] The statute provides that: "Prevailing party.—The term 'prevailing party' means any party to any proceeding described in subsection (a) [other than the United States or any creditor of the taxpayer involved] which—(i) establishes that the position of the United States in the civil proceeding was unreasonable." *Id.* § 7430(c)(2)(A)(i).

[21] 26 C.F.R. § 601.105(c)(1) (1985) (Examination of returns and claims for refund, credit or abatement; determination of correct tax liability—District Procedure—Office examination).

[22] 26 U.S.C. § 6212 (Supp. 1982).

[23] The statute provides that:

Restrictions Applicable to Deficiencies; Petition to Tax Court.—(a) Time for Filing Petition and Restriction on Assessments—Within 90 days, or 150 days if notice is addressed to a person outside the United States, after the notice of deficiency authorized in § 6212 is mailed. . .the taxpayer may file a petition with the Tax Court for a redetermination of the

with the Tax Court within 90 days for redetermination of the tax deficiency. This administrative remedy, however, was similarly not utilized by the Kaufmans because they never received the requisite statutory Notice of Deficiency.

The IRS contended that the 1983 letter sent to the Kaufmans' correct Maine residence provided an IRS address and telephone number, therefore, the Kaufmans could have contacted the Service to consider their claims informally over the telephone. Further, regardless of whether there were no formally prescribed procedures in exhausting administrative remedies, the Kaufmans should have made some effort at the agency level to correct the 1978 deficiency before seeking judicial relief. The court found that since the mix-ups were not caused by the Kaufmans, the Kaufmans could not be faulted for seeking immediate judicial relief.[24]

Persuasive evidence existed that the Kaufmans' administrative remedies would have been considered exhausted within the meaning of section 7430. A regulation adopted by the Secretary of Treasury, effective after the Kaufmans filed suit, addresses circumstances in which administrative remedies are deemed to be exhausted under section 7430.[25] Specifically, the regulation stated cases in which:

> [t]he party did not receive a preliminary notice of proposed disallowance and failure to receive such notice was not due to action of the party (such as the failure to supply requested information or a current mailing address to the district director or service center having jurisdiction over the tax matter).[26]

The circumstances of the present case fall squarely within the exception to the

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deficiency. Except as otherwise provided in § 6851 or § 6861, no assessment of a deficiency in respect of any tax imposed by subtitle A or B, chapter 41, 42, 43, 44, or 45 and no levy or proceeding in court for its collection shall be made, begun, or prosecuted until such notice has been mailed to the taxpayer, nor until the expiration of such 90-day or 150-day period. . . .

*Id.* § 6213 (Supp. 1982).

[24] 758 F.2d at 3.

[25] *Id.* at 3 n.4 (citing 26 C.F.R. § 301.7430-1-f(4)(h) (1985)). This regulation was issued in final form on April 17, 1984. Although it became effective after the Kaufmans filed this suit, the regulation provides that it applies to civil actions commenced after February 28, 1983, which is *before* the Kaufmans filed. The court, however, stated that since the regulation became effective after the Kaufmans filed suit, the regulation had no binding effect on their case. 584 F. Supp. at 876.

The district court's Memorandum of Decision and Order was issued on May 8, 1984; it expressly refers to the regulation in question: "As of this writing [it has] not been adopted as law and thus [has] no binding legal effect." *Id.*

[26] 26 C.F.R. § 301.7430-1-f(3)(ii) (1985) (exception to the requirement that party pursue administrative remedies).

exhaustion of remedies requirement.

The second requirement in section 7430 is that the party seeking relief must have prevailed in the earlier action. A "prevailing party" is defined as one who "(i) establishes that the position of the United States in the civil proceeding was unreasonable, and (ii)(I) has substantially prevailed with respect to the amount in controversy, or (II) has substantially prevailed with respect to the most significant issue or set of issues presented."[27] The IRS conceded that the Kaufmans had prevailed with respect to the most significant issues: that the IRS Notice of Deficiency was never received and that the Kaufmans' refund was wrongfully seized.[28]

The third requirement in section 7430 is that the court find that the position of the United States in the civil proceeding was unreasonable. There exists a split in authority as to whether the phrase "civil proceeding" refers to the government's position asserted at litigation only or to its pre-litigation stance—the government's position in the underlying administrative proceedings.

An example of cases supporting the "litigation" interpretation of civil proceeding is *Brazil v. United States*,[29] in which the United States District Court of Oregon held that, provided the United States position is reasonable from the point in time when litigation is commenced, an award of attorney's fees against the United States is inappropriate.[30] Similarly, the United States District Court of Minnesota in *Zieliensky v. United States*,[31] found that "[i]f Congress intended to deter administrative abuses, it would not have confined fee awards to litigation costs in the court proceeding or required that administrative remedies be exhausted before section 7430 comes into play to deter unreasonable positions in civil proceedings."[32] Arguably, had Congress intended pre-litigation conduct of the government to be considered in determining reasonableness, it would have been explicit.

In contrast, several courts have adopted the "pre-litigation" interpretation of civil proceeding.[33] In *Hallam v. Murphy*,[34] the United States District Court of

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[27] 26 U.S.C. § 7430(c)(2)(A) (Supp. 1982).

[28] 584 F. Supp. at 877.

[29] 84-2 U.S.T.C. ¶ 9596 (D. Or. 1984).

[30] *Id.*

[31] 84-1 U.S.T.C. ¶ 9514 (D. Minn. 1984).

[32] *Id. See, e.g.*, Eidson v. United States, 84-1 U.S.T.C. ¶ 9182 (N.D. Ala. 1984) (The reasonableness of the government's position in the administrative proceedings may not be considered.). *See also* Ashburn v. United States, 740 F.2d 843 (11th Cir. 1984); Ellis v. United States, 711 F.2d 1571 (Fed. Cir. 1983); Broad Ave. Laundry & Tailoring v. United States, 693 F.2d 1387 (Fed. Cir. 1982); Foley Constr. Co. v. United States Army Corps of Eng'rs, 716 F.2d 1202, 1204 (8th Cir. 1983) (The position of the United States refers to the government's position in litigation.); Tyler Bus. Servs., Inc. v. NLRB, 695 F.2d 73 (4th Cir. 1982) (The position of the United States is limited to that taken in litigation.).

[33] *See, e.g.*, Timms v. United States, 84-2 U.S.T.C. ¶ 9774 (9th Cir. 1984) (Attorney fees

Georgia stated that the proper time to view the defendant's conduct was through the entire proceeding and not just the time frame after the complaint was filed. Similarly, in *Moats v. United States*,[35] the United States District Court of Missouri stated that "litigation does not exist in a vacuum, the litigation position of the government cannot be insulated or extricated from the underlying factual and procedural background of the case."[36]

In *Kaufman*, the court held that the pre-litigation interpretation of "civil proceeding" was correct in keeping with Congress' remedial bias in enacting the statute.[37] The legislative history of section 7430 supports the proposition that Congress intended liability to be triggered by unreasonable IRS conduct regardless of the stage in the proceedings: "The committee believes that taxpayers who prevail in civil tax actions should be entitled to awards. . .when the United States has acted unreasonably *in pursuing the case*."[38] Accordingly, the court reasoned that it would frustrate the purpose of section 7430 if it interpreted the Code in such a way that the IRS, after causing a taxpayer all kinds of bureaucratic grief at the administrative level, could escape attorney's fee liability merely by changing its posture after the initiation of the suit by the taxpayer.[39]

## IV. CONCLUSION

*Kaufman v. Egger* exhibits the concern of the court in deterring unreasonable IRS pre-litigation conduct. The court held that unreasonable IRS pre-litigation behavior can result in the taxpayers' recovery of litigation costs. The taxpayer was awarded attorney fees, accountant fees,[40] and court costs[41] even though

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were awarded because the IRS had tried to renege on terms of prior closing agreement.); Natural Resources Defense Council v. EPA, 703 F.2d 700, 706-12 (3d Cir. 1983) (The position of the United States includes agency action which made it necessary for the party to file suit.); Randazzo v. IRS, 581 F. Supp. 1235 (W.D. Pa. 1984) (The reasonableness of the government's position was determined by examining not only the facts as revealed in the trial transcript but also by analyzing the conduct of parties which culminated in the court action.). *See also* Britton v. United States, 587 F. Supp. 834 (W.D. Mo. 1984) (Attorney fees were awarded because of refusal of the IRS to investigate taxpayer's claims and the frivolous position of the IRS.); McDonald v. Schweiker, 553 F. Supp. 536, 540-41 (E.D.N.Y. 1982). *Cf.* Rawlings v. Heckler, 725 F.2d 1192, 1196 (9th Cir. 1984) ("The remedial purpose of EAJA [Equal Access to Justice Act], is best effectuated if we consider the totality of circumstances prior to and during litigation.").

[34] 586 F. Supp. 1 (W.D. Ga. 1983).

[35] 576 F. Supp. 1537 (W.D. Mo. 1984).

[36] *Id.*

[37] 758 F.2d at 4.

[38] *See* TECHNICAL EXPLANATION, *supra* note 6, at S15594 (emphasis added).

[39] 758 F.2d at 4.

[40] In awarding reasonable accounting fees, the court must determine at which point the ac-

administrative remedies had not been exhausted.[42] The court correctly held that pre-litigation behavior can result in the taxpayer recovering reasonable litigation costs.

This case is important in signaling a trend that in future cases, when determining whether the government's position in civil litigation is unreasonable, the court will not limit its inquiry solely to the government's in-court litigation posture, but will also consider the IRS' position in the underlying pre-litigation administrative proceedings.[43]

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counting services were necessary for the preparation of the case, as opposed to services merely duplicative of the attorney's efforts. The accounting services which were necessary for the preparation of the case were awarded pursuant to 26 U.S.C. § 7430.

[41] Regarding court costs, 26 U.S.C. § 7430(b)(1) provides that the fees and costs which may be awarded to the prevailing party shall not exceed $25,000.

[42] The administrative remedies provided by the IRS included: (1) utilizing the Appeals Office of the IRS, (2) filing a petition with the Tax Court for redetermination of the tax deficiency, and (3) contacting the IRS to consider claims informally over the telephone before seeking judicial relief.

[43] *See* Rosenbaum v. IRS, 85-2 U.S.T.C. ¶ 9545 (N.D. Ohio 1985).