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Labor Law Issues Facing Multinational and Japanese Companies Operating in the United States and United States Companies Using Japanese-Style Labor Relations: Agenda Items Under the "New Labor Relations"*

by Ronald C. Brown**

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I. INTRODUCTION

> One of the largest obstacles Japanese companies face when they advance to a foreign market and set up their branches is that of personnel management. There is a remarkable difference between the image of labor and current labor practices in the United States and that in Japan. . . . As a result, therefore, labor practices upon which the so-called Japanese-style management depends cannot be easily applied *as they are* without problems.

> Therefore, Japanese companies have to select the essential elements of Japanese-style management which they want to maintain, transplant them onto American soil, and aim to adapt them to the local situation.[1]

Labor relations in the United States have undergone dramatic changes in recent years with the emphasis on efficiency and competitiveness, the establishment of more non-unionized work places, the phenomenon of declining union membership, and the emergence of alternative forms to collective bargaining.[2] These changes have been fueled by the increased presence of foreign competitors whose less expensive imports may displace not only American products but also American businesses and their workers. Conversely, these foreign businesses, particularly Japanese companies, are creating new job opportunities for American workers by their direct investments in the United States. Japanese companies also are attempting to implement many of their traditional management and industrial relations policies in their United States ventures.

These events present challenges of great significance to both American and Japanese companies. American industries must meet foreign competition by changing traditional management and labor relations approaches[3] or face the possibility of extinction or, at least, a lesser share of the market. Japanese companies operating in the United States must adapt their traditional management and labor relations practices to comply with applicable United States labor laws. The Japanese to date, however, have been reluctant to change the essential elements of such practices.

This article identifies the legal issues generated as a result of attempts by American and Japanese companies to adjust to changing management and labor relations in the United States. Japanese companies often discover to their dismay that American unions perceive their management styles emphasizing employee cooperation and loyalty as anti-union and women view their use of male nationals in many key managerial positions as exclusionary and discriminatory.

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[1] Y. Kuwahara, Foreign Investment and Labor-Problems Involved in Japan's Direct Investment in the United States 15 (Aug. 1985) (unpublished manuscript available with author) [hereinafter cited as Japan's Direct Investment] (emphasis added).

[2] *See* Farber, *The Extent of Unionization in the United States*, in CHALLENGE AND CHOICES FACING AMERICAN LABOR 15, 16-22 (T. Kochan ed. 1985). Secretary of Labor William Brock recently emphasized the increasingly close relationship between international trade and domestic labor policies and the need to seek appropriate accommodations: "Our ability to compete in world markets suffers when confrontation rather than cooperation becomes the preferred approach to labor-management relations. Fortunately, the trend now seems to be going in the other direction." DAILY LAB. REP. (BNA), Oct. 23, 1985, at F-3.

[3] The automobile industry's labor agreements at General Motors-Toyota and General Motors' new Saturn Project are recent examples of changing labor and management relations in the United States. These approaches are of general use outside that industry as well. *See infra* text accompanying notes 83-91.

When Japanese companies resort reluctantly to American-style dismissals, they find that resulting damages under an unjust dismissal lawsuit may cause liability unimaginable under the Japanese legal system. These not atypical situations, combined with traditional Japanese reluctance to seek early legal advice from their attorneys, create legal issues that more often should be resolved by accommodation of Japanese management and labor practices with applicable United States labor law requirements rather than by confrontational litigation.[4]

Section II, by way of background, examines the nature and type of Japanese business ventures in the United States and the emerging Japanese styles of managing the operations and labor relations of both Japanese and American companies, and the resulting adaptations of these practices by United States companies. In Section III this article will focus on the applicability of American labor laws to Japanese and multinational companies. Section IV will identify and analyze in some detail the many emerging substantive labor law issues faced by Japanese companies operating in the United States and by American companies using Japanese-style labor relations. These issues include equal employment opportunity laws, especially Title VII of the Civil Rights Act of 1964, the National Labor Relations Act, and developing case law dealing with unjust termination.

II. Japanese and Multinational Companies Operating in the United States

A. *Nature and Type of Investments and Relationship to Trade Deficit*

Japan and the United States would have much to lose if the amount of Japanese direct investment in the United States or the amount of trade between Japan and the United States were substantially curtailed by legislative prohibitions. While net capital inflows of all foreign direct investment into the United States totalled nearly $10 billion in 1983,[5] about $2 to $2.5 billion is estimated to have been invested by Japanese companies alone.[6] United States trade

[4] Although commentators have written about various aspects of this subject area, none has sought to integrate comprehensively the "new industrial relations" practices of Japanese and American companies with United States labor laws by identifying and discussing the emerging legal "agenda items."

[5] Int'l Trade Admin., U.S. Dep't of Commerce, International Economic Indicators 55 (June 1984).

[6] Japan's Direct Investment, *supra* note 1, at 2 (estimate of Japan's Ministry of Finance). United States statistics show that the net increase in Japanese direct investment in 1983 was $1.5 billion. *Id.* The estimates differ because the Commerce Department's practice, unlike that of Japan's Ministry of Finance, is to calculate on the year end balance of investment. *Id.* at 3. At the end of 1983, the remaining amount of Japan's direct investment in the United States was over

exports to Japan in 1983 totalled nearly $22 billion, while imports from Japan approximated $43.5 billion.[7]

The countries' mutual reliance has created problems, especially for the United States. Increased imports from Japan have created not only a burgeoning trade deficit, but growing trade friction between the two countries.[8] The Japanese government is quick to point out that while the United States trade deficit is growing, Japan's share of that deficit is actually declining, having fallen from 44% in 1982 to 30% in 1984.[9] Still, lively debate in Congress on trade barrier legislation concerning Japan is expected to continue.[10]

The impact of the trade deficit on the American economy is direct and great. It is estimated that the import of less expensive products has displaced over one million American jobs.[11] Various solutions to this problem are being debated in the United States.[12] Many people are calling for the politically sensitive develop-

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$11 billion. *Id. See generally* Yoshino, *Emerging Japanese Multinational Enterprises*, in MODERN JAPANESE ORGANIZATION AND DECISION-MAKING 146, 165 (E. Vogel ed. 1975) (Japan's direct investments); Belli, *U.S. Business Enterprises Acquired or Established by Foreign Direct Investors in 1980*, SURV. CURRENT BUS., Aug. 1981, at 58 (survey of foreign direct investors).

[7] Japan's Direct Investment, *supra* note 1, at 4.

[8] Japan, one of the largest trading partners of the United States, has one of the largest trade imbalances with the United States. The trade imbalance with Japan in 1985 stood at $49.7 billion. Honolulu Advertiser, Feb. 1, 1986, at B3, col. 3. This is a significant part of the estimated total trade deficit of $150 billion in 1985. Church, *The Battle over Barriers*, TIME, Oct. 7, 1985, at 22.

[9] Address by Tetsuya Endo, Consul General of Japan, at the 24th Annual Meeting of the National Conference of Lieutenant Governors, Honolulu, Hawaii 4 (Aug. 13, 1985) (unpublished manuscript available with author).

[10] Legislative debate is expected even though the recent trend in the declining value of the dollar vis-a-vis the yen has eased the trade deficit disparity and some of the political pressures. For a discussion of various trade barrier bills in Congress, see Church, *supra* note 8, at 27-31.

[11] *See* DAILY LAB. REP. (BNA), Nov. 12, 1985, at A-9 (jobs lost in 700,000 households per year); *id.*, Oct. 23, 1985, at F-1 (Senator Dan Quayle reported "loss of thousands, sometimes millions, of jobs"). There is some debate, however, whether other factors—such as out-moded American managerial practices, out-dated labor relations practices, and inefficient and obsolete production facilities—have also contributed to this phenomenon.

[12] Proposed solutions include trade barrier legislation, laws which assist interim adjustments of declining industries and aid in renovating the production-base of certain industries, and other approaches which shift resources to meet the challenges of foreign competition. *See* P. LAWRENCE & D. DYER, RENEWING AMERICAN INDUSTRY 1-16, 275-87 (1983). *See also* Tanaka & Middleton, *Injured Industries, Imports and Industrial Policy: A Comparison of United States and Japanese Practices*, 15 CASE W. RES. J. INT'L L. 419 (1983) (discussion of comparative approaches used by Japan and the United States with regard to "escape clause relief" under 19 U.S.C. § 2251(a)(1) (1976)).

One commentator proposed four reforms based on the Japanese experience to solve some of the problems facing American industry: (1) "[m]easured exposure of American firms to international competition," (2) linking of "industry-specific governmental assistance . . . to ascertainable changes in corporate behavior," (3) curbing of hostile takeovers of corporations, and (4) "reexam-

ment of a "national industrial policy"[13] which would coordinate United States resources and government support of industries in a manner vaguely similar to the Japanese approach, in an attempt to better equip American companies to develop strategic industries and to vie with overseas competition.[14]

Although the United States trade deficit displaces American jobs, hundreds of thousands of jobs are being *created* by overseas direct investment in the United States.[15] As of early 1985, the size of Japanese direct investment in the United States included 440 Japanese-based or affiliated factories[16] and has been valued at some $11 to $14 billion.[17] Japan has also increased its "hi-tech" imports into the American and world markets.[18] Although the precise number of jobs and the ultimate impact on the trade deficit are difficult to measure, overseas direct investment in the United States seems to be "part of the solution" rather than the problem in easing possible trade friction with United States trading partners, especially Japan.

Recent years have also seen an increase in joint ventures between Japanese

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ination of business and legal education in the United States." Tsurumi, *Labor Relations and Industrial Adjustment in Japan and the United States: A Comparative Analysis*, 2 YALE L. & POL'Y REV. 256, 270-71 (1984).

[13] *See* Kantrow, *The Political Realities of Industrial Policy*, HARV. BUS. REV., Sept.-Oct. 1983, at 76; Reich, *Making Industrial Policy*, 60 FOREIGN AFF. 852 (1982); Tsurumi, *supra* note 12, at 270; Blumenthal, *Drafting a Democratic Industrial Plan*, N.Y. Times, Aug. 28, 1983, § 6 (Magazine), at 31.

[14] *See* Tsurumi, *supra* note 12, at 256-59. One author took the national industrial policy one step further by boldly calling for greater "joint economic growth" and cooperation between the United States and other countries such as Japan. J. GRESSER, PARTNERS IN PROSPERITY: STRATEGIC INDUSTRIES FOR THE UNITED STATES AND JAPAN 343-76 (1984).

[15] As of 1979, American affiliates of foreign corporations employed approximately 1.6 million workers in the United States. Howenstine, *Selected Data on the Operations of U.S. Affiliates of Foreign Companies, 1978 and 1979*, SURV. CURRENT BUS., May 1981, at 36.

It is difficult for economists to measure the precise number of jobs created by Japanese companies. Japanese estimates place the number at 80,000 to 150,000. *See* Japan's Direct Investment, *supra* note 1, at 11; Address by Tetsuya Endo, *supra* note 9, at 5. A 1981 United States Department of Commerce survey revealed that Japanese-affiliated manufacturers in the United States employed 47,726 workers; other unofficial estimates placed the figure at nearly 100,000 persons. Japan's Direct Investment, *supra* note 1, at 11-12.

[16] Japan's Direct Investment, *supra* note 1, at 11.

[17] *See* Address by Tetsuya Endo, *supra* note 9, at 5.

[18] The companies investing in the United States involve many of Japan's premier manufacturing and "hi-tech" industries such as Nippon Electric Co., Hitachi Ltd., Fujitsu Ltd., Mitsubishi Electric Corp., Oki Electric Industry Co., Shimadzu Corp., and Sumitomo Electric Industries, Ltd. Japan's Direct Investment, *supra* note 1, at 7. *See* Tanaka & Middleton, *supra* note 12, at 429-30 (discussing the television industry). *See also* Emch, *Japanese Direct Investment in American Manufacturing*, 17 STAN. J. INT'L L. 1, 1-4 (1981) (televisions, semiconductors, high speed data printers, electronics).

and American interests,[19] which permit a more direct method of sharing profits between Japanese and American partners. They also allow easier sharing of technology and, in certain industries such as steel, promote the possible revitalization of an otherwise declining industry. A draw-back for Japanese companies is their loss of retained management rights which they prize so highly and consider to be a dominant reason for their business successes. Whether Japanese companies utilize a subsidiary or joint venture form, however, they seek to adjust their management and labor practices to the American business environment.

B. *Emerging Styles of Management and Labor Relations: Understanding the "New Labor Relations"*

1. *Dominant Characteristics of Japanese Personnel Management Practices*

Central to the Japanese system of management and industrial relations has been its somewhat benign treatment of workers. Although some United States labor unions would view as paternalistic the Japanese system of close cooperation and concern for the workers, some employers and unions are finding that there are several advantages to the Japanese system.[20] Management philosophies and industrial relations policies of Japanese employers generally contain five underlying principles:

> First, their primary concern is the continued existence and further development of their corporation. Second, they regard all company employees, including themselves, as members of the same corporate community. Third, they take an egalitarian view of income distribution between labor and management within the company. Fourth, they are crucially concerned with maintaining stability and peace in

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[19] In the automobile industry, for example, NUIMI, the joint venture of Toyota and General Motors, started production in California in 1984. Japan's Direct Investment, *supra* note 1, at 8. In addition, a number of Japan-United States co-ventures have been formed in the steel industry: Nisshin Steel-Pittsburgh Steel, Nippon Kokan-National Steel, and Kawasaki Steel-Kaiser Steel. *Id.* at 9.

[20] One author has suggested that resource managers in the United States should consider human resource management the most important aspect of corporate strategic planning by treating human resources as a renewable asset rather than as a disposable cost of production. Tsurumi, *supra* note 12, at 266-67. *See also* Horton, *Training: A Key to Productivity Growth*, MGMT. REV., Sept. 1983, at 2-3 (advocating training of employees).

Japanese companies operating in the United States have already implemented human resource management, and American companies have started to give serious attention to this approach. Certainly there is no lack of interest in Japan's managerial policies and much continues to be written about them at a technical and popular level. *See, e.g.*, W. OUCHI, THEORY Z (1981); E. VOGEL, JAPAN AS NUMBER ONE (1979).

> the company's industrial relations. In other words, they strive to avoid industrial disputes and strikes, often at any cost. Fifth, they tend to reject the intervention of outside labor groups in any negotiations over internal labor problems, an attitude that might be described as exclusionist.[21]

These principles pervade the Japanese personnel management system, and although there are many similarities with the American system, one of the most apropos of the many comparisons made of American and Japanese management approaches is that "Japanese and American management is 95 percent the same and differs in all important respects."[22]

a. Collectivism

Japanese notions of familism and collectivism, which are based on Japanese culture and the *amae* relationship,[23] merge individual interests with group interests.[24] Japanese workers see themselves as contributing to a group effort rather than to an individual cause.[25] These same principles are also evident in Japanese corporate structures. For example, the managerial structures of the *zaibatsu*, a pre-World War II Japanese conglomerate, was based on "familial principles of hierarchy, loyalty, and dependency" which were "essentially that of

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[21] Shirai, *A Supplement: Characteristics of Japanese Managements and Their Personnel Policies*, in CONTEMPORARY INDUSTRIAL RELATIONS IN JAPAN 369, 374-75 (T. Shirai ed. 1983) [hereinafter cited as *Characteristics of Japanese Managements*]. These principles are derived from deeply held historical customs and traditions in Japan. Japanese have long used the family analogy, "appealing to workers in terms of the Confucian concept of *wa*—spiritual ascendency through harmony and common effort." Karsh, *Managerial Ideology and Worker Co-Optation: The US and Japan*, in VIABILITY OF THE JAPANESE MODEL OF INDUSTRIAL RELATIONS 81, 87-88 (Int'l Indus. Relations Ass'n 1983).

[22] R. PASCALE & A. ATHOS, THE ART OF JAPANESE MANAGEMENT 85 (1981) (quoting Interview with Taizo Ueda, senior economist, Honda Motor Co., in Tokyo, Japan (July 1, 1980)).

[23] *Amae* is defined as a family or group dependency and patronage relationship. *See* T. HANAMI, LABOR RELATIONS IN JAPAN TODAY 48-49, 55 (1979) (discussing *amae* in the employer-employee relationship).

[24] Japanese employers and employees enjoy a mutually beneficial relationship. Employers often provide recreational facilities and bonuses and treat workers in a paternalistic manner. Employees reciprocate by being loyal and by increasing productivity and quality. *See* E. VOGEL, *supra* note 20, at 146-52. *See also* E. REISCHAUER, THE JAPANESE 127-37 (1978) (discussing the Japanese emphasis on "group"). The Japanese principle of collectivism, therefore, is self strengthening. The Japanese employee's often unwavering loyalty to his company is not a real sacrifice because he also gains from such loyalty. Similarly, an employer benefits from its benevolent treatment of its employees by profiting from increased productivity and quality.

[25] In the United States, on the other hand, an individual is responsible for his own fate, often to the exclusion of responsibilities to others, and is warned about the dangers implicit in collective responsibilities. *See* F. SUTTON, S. HARRIS, C. KAYSEN & J. TOBIN, THE AMERICAN BUSINESS CREED 251-54 (1956).

the hierarchical familism of traditional Japan."[26] These principles seem to persist in modern Japanese corporations. The parent-child or lord-servant (*oyabun-kobun*) relationship is analogous to the parent (*oya-gaisha*) and subsidiary (*ko-gaisha*) company relationship.[27] The parent maintains firm control over its subsidiary by providing managerial, technical, and financial support; the subsidiary, in turn, provides services and out-reach for the parent.

Personnel practices are also based on a cultural background of familism. Two of the most significant management personnel practices are the tradition of cooperation between employer and employees and the system of seeking consensus before implementing decisions.

Japanese firms try to achieve cooperation by treating their employees as part of the family, thus humanizing employment relations. These efforts manifest themselves in policies which discourage layoffs and firings and which encourage retention and retraining rather than replacement of employees when new technology would otherwise displace them. The system of having supervisors, as "associates," working side-by-side with workers de-emphasizes "management-worker" class distinctions. All levels of management attempt to mix with workers at the work place and at work-related social gatherings.[28]

Cooperation is further manifested in company policy providing for joint consultation (*roshikyogiseido*) through committees and meetings between the employer and the workers. While Japanese law mandates some of these joint committees, or at least their subject matter,[29] these committees also deal with issues involving terms and conditions of employment and seek to raise productivity and prevent industrial conflict.[30]

An example of such joint consultation in Japan is collective bargaining.[31]

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[26] K. HAITANI, THE JAPANESE ECONOMIC SYSTEM 118 (1976). Although the *zaibatsu* was outlawed after World War II, some commentators suggest that it has reappeared as *keiretsu* (a grouping or alignment). The *keiretsu*, however, while frequently involving group consultation, ultimately exercises independent business judgments. *See id.* at 121. The Sumitomo Keiretsu is composed of 16 firms, including Sumitomo Shoji, the parent company, Sumitomo Metal Industries, Sumitomo Chemical, and Sumitomo Bank. The Dai-ichi Kangyo Banking Keiretsu comprises 57 firms, including C. Itoh & Co. *Id.* at 122.

[27] *See id.* at 17-18, 25-26.

[28] *See generally* Tsuda, *Personnel Administration at the Industrial Plant Level*, in WORKERS AND EMPLOYERS IN JAPAN 399-440 (K. Okochi, B. Karsh & S. Levin eds. 1974). This practice of "paternalism" has been dubbed "welfare corporatism." T. HANAMI, *supra* note 23, at 28-31, 36-40.

[29] Mandated subject matters include legal requirements for occupational safety and health and labor standards dealing with work rules and overtime requirements. Kuwahara, *Worker Participation in Decisions Within Undertakings in Japan*, 5 COMP. LAB. L. 51, 54 (1982) [hereinafter cited as *Worker Participation*].

[30] *Id.* at 54, 63.

[31] "Collective bargaining at the enterprise level through joint consultation is the most popular form of worker participation at present." *Id.* at 53. Joint consultation "exists in 63 percent of the

Three features characterize the Japanese collective bargaining system: "(1) it is practiced within the boundaries of each individual enterprise; (2) labor unions are concentrated in the large enterprises; and (3) both white- and blue-collar workers are members of and are represented by the same union."[32] Joint consultation, regardless of form, is further facilitated by the sharing of information with employees, which in turn supports a necessary element of cooperation—trust.

Consensus decision-making (*ringi* system) also flows from the continual meetings of quality control groups, joint consultation committees, and collective bargaining representatives. The workers and management, through a series of "orchestrated" meetings, contribute and exchange ideas as they strive for unanimity in the announcement of the final "decision," now accepted by all.[33]

b. Job Flexibility

Another characteristic of Japanese management is job flexibility: the hiring, training, and utilization of employees for a variety of job functions within the employer's enterprise. Job flexibility permits greater managerial use of the worker to provide performance when and where it is needed without the encumbrances of job classifications, inadequate training, work rules, or contract restrictions.[34] Thus, Japanese management emphasizes functional interdependence rather than job specificity, and group rather than individual perform-

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labor-management relationships where there are more than 100 employees." W. GOULD, JAPAN'S RESHAPING OF AMERICAN LABOR LAW 12 (1984). Many Japanese claim, however, that joint consultation is more "an attack on collective bargaining . . . than an adjunct to it." *Id.*

[32] Koshiro, *Development of Collective Bargaining in Postwar Japan*, in CONTEMPORARY INDUSTRIAL RELATIONS IN JAPAN 205, 205 (T. Shirai ed. 1983).

[33] Consensus decision-making differs from American management decisions which more often originate from and are implemented by top executives without prior consultation with work force or subordinate staff personnel.

> Whatever amount of time is required by the Japanese *before* the "decision" is made, a similar amount is required by westerners *after* the decision is taken. The basic difference between the two approaches is to be found in the style of execution. It is obvious that following a decision by consensus (Japanese-style) the execution of that decision by those involved will be highly motivated in the sense that "this is *our* decision." On the other hand, the execution of a decision "on command" remains just that—motivation being a very secondary implicit element.

Ballon, *Management Style*, in BUSINESS IN JAPAN 127 (P. Norbury & G. Bownas rev. ed. 1980) (emphasis original). *See also* Rohlen, *The Company Work Group*, in MODERN JAPANESE ORGANIZATION AND DECISION-MAKING 185, 191-95 (E. Vogel ed. 1975). The Japanese also engage in before-meeting maneuvering (*nemawashi*) to ensure the desired unanimous outcome. Karsh, *supra* note 21, at 86.

[34] These "restrictions" are often found in the United States and are fostered by unions, particularly the craft unions, to protect and promote the worker's skills.

ance.[35] By reducing job categories and rotating workers within a plant, Japanese managers seek to "[broaden] an employee's job skills . . . improve employee morale and help nurture a holistic perspective regarding the firm's business and competitive posture."[36]

The characteristics of job flexibility require that Japanese employers take great care in the recruitment of new employees "into the family" since they generally will be retained for their entire work career.[37] Japanese recruiters emphasize not just the somewhat objective factor of the worker's ability to perform the work but also place great importance on subjective qualifications relating to personal and social characteristics, such as how well the worker will "fit in," his or her prior conduct, character, thought, and home environment.[38] The use of these subjective factors in interviews, background checks, and testing may expose the Japanese employer to charges of racial and anti-union motivations in potential violation of American labor laws.[39]

c. *Conflict Avoidance*

Another dominant characteristic of Japanese personnel management relations is the use of pervasive, culture-based, conflict-avoidance techniques to resolve disputes. Cooperation and joint consultation procedures both work toward harmony in the workplace.[40] Japanese labor dispute resolution has three distin-

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[35] One commentator described the Japanese approach as follows:

> Rather than the job function being the basic unit of shop-floor individual worker behaviour (job description, classification and job evaluation translated into wage payment programmes), job function in Japan is related to work unit rather than to individual performance. The Japanese employer pursues efficiency through the improvement of the performance of the work unit as a whole and not the aggregate behaviours of individual workers. In order to improve the achievement of the entire unit, it is normal and expected that individual workers will cross job lines within the unit to lend a helping hand to a unit cohort.

Karsh, *supra* note 21, at 88.

[36] Tsurumi, *supra* note 12, at 267.

[37] The thoroughness of the Japanese recruiting process is exemplified by the practice of the American-based Nissan Motor Manufacturing Corp. Nissan's plant managers chose "2,650 factory workers from 30,000 applicants after severe selection and training." Japan's Direct Investment, *supra* note 1, at 17. The company also selected 425 people—including supervisors, managers, technicians and field workers—and sent them to its Kyushu factory in Japan for further training. *Id.*

[38] Karsh, *supra* note 21, at 88-89.

[39] *See infra* Section IV.

[40] For a discussion of collectivism, see *supra* text accompanying notes 23-33. It is, the author suspects, no coincidence but a tribute to the Japanese approach that Japan, with one-half the population of the United States, lost only one-twelfth the number of working days because of strikes or lockouts. W. GOULD, *supra* note 31, at 13. The United States lost 38 million working

guishing characteristics:

1. There is a "societal pressure towards consensus, which places a heavy responsibility on the parties to resolve a dispute by themselves and without resorting to overt conflict."
2. There is a "tendency for industrial action to be taken in demonstrative form."
3. The union, "being mindful of the extent to which its numbers' interests are bound up in the enterprise, is likely to refrain from any action likely to prejudice its long-term future: thus, harassment rather than damage is what is aimed at."[41]

The Japanese, therefore, while certainly having their share of conflicts, emphasize cooperation, compromise, and reconciliation in resolving disputes.[42] Labor unions in the United States, on the other hand, have tended to approach most violations of workers' rights in a somewhat more legalistic manner under contract and statutes.[43] There is an observable trend, however, that United States companies and United States-based Japanese companies are adopting some of the features of the Japanese system of dispute resolution.[44]

d. The "Three Pillars" of Japanese Industrial Relations

The Japanese have incorporated the traditional attributes of their personnel management relations, such as cooperation and working for the common good of the enterprise, into their more recent industrial relations policies.[45] These policies, the so-called "three-pillars" of Japanese industrial relations, are lifetime or permanent employment (*shushin koyo*), wage-seniority policies (*nenko*), and

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days in 1976; Japan lost only 3.25 million. *Id.*

[41] Duff, *Japanese and American Labor Law: Structural Similarities and Substantive Differences*, 9 EMPLOYEE REL. L.J. 629, 636 (1984) (citing Organization for Economic Cooperation and Development, The Development of Industrial Relations Systems: Some Implications of Japanese Experience 25-26 (1977)).

[42] One commentator stated, "To an honorable Japanese the law is something that is undesirable, even detestable, something to keep as far away from as possible. . . . To take someone to court to guarantee the protection of one's own interests . . . is a shameful thing. . . ." Y. NODA, INTRODUCTION TO JAPANESE LAW 159-60 (1976).

[43] *See* W. GOULD, *supra* note 31, at 14-16.

[44] *See infra* text accompanying notes 83-91. For a discussion of the Japanese practice of dispute resolution, see T. HANAMI, *supra* note 23, at 113-224; Matsuda, *Conflict Resolution in Japanese Industrial Relations*, in CONTEMPORARY INDUSTRIAL RELATIONS IN JAPAN 179, 181-201 (T. Shirai ed. 1983).

[45] These policies, while drawing on tradition, were actually devised after World War II. *See* S. LEVINE, INDUSTRIAL RELATIONS IN POSTWAR JAPAN 46-58 (1958).

enterprise unionism.[46]

The first pillar, lifetime or permanent employment, is based on the idea that, in exchange for job security, the employee will remain loyal to his employer.[47] An employee is retained even though his work performance needs improvement and is dismissed only for grave misconduct.[48]

Employers, however, also make great use of temporary employees whose job security and other benefits are usually dramatically less than regular employees.[49] Temporary employees have been dubbed "the shock absorbers of business fluctuations in a lifetime employment system" and have contributed to Japanese employers' flexibility in quickly responding to market changes.[50]

Women often serve in this capacity. They are concentrated in lower skill, "traditionally female jobs"[51] and in jobs requiring "patience . . . manual dexterity, and work calling for a warm, personal touch or care."[52] Nearly 70% of Japanese women workers are employed as clerks, service workers or factory operatives,[53] and a mere 1% serve in supervisory or managerial positions.[54] Although some legal reforms were instituted to improve the status of women after World War II, societal norms run deep and women still stand inferior to men by custom and law.[55]

Once an employee leaves employment, permanent status usually will be forfeited. Many women, by "choice" or employer expectation, resign their jobs

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[46] For a general discussion of these three policies, see T. HANAMI, *supra* note 23, at 25-28, 88-112.

[47] *See id.* at 28.

[48] *Id.* at 25-26. This employment practice is available to a diminishing number of Japanese workers, estimated at well below 30%, and usually is provided only by employers with more than 1000 employees. *See* R. COLE, JAPANESE BLUE COLLAR: THE CHANGING TRADITION 81-82 (1971); R. COLE, WORK, MOBILITY, AND PARTICIPATION 119-20 (1979); T. HANAMI, *supra* note 23, at 31-35.

[49] *See* T. HANAMI, *supra* note 23, at 26.

[50] *Id.*

[51] Women are usually employed as "nurses, midwives, kindergarten teachers, stenographers and typists, key punchers, telephone operators, spinners, yarn twisters, sewing-machine operators, canned food preparers, packers and wrappers, housekeepers, maids, beauticians, waitresses, bar and cabaret hostesses." Nakanishi, *Equality or Protection? Protective Legislation for Women in Japan*, 122 INT'L LAB. REV. 609, 610 (1983).

[52] *Id.*

[53] *Id.* at 609 (citing Prime Minister's Office, Basic Survey on Employment Structure (Oct. 1, 1982)).

[54] Only 6.9% of all supervisory and managerial personnel are women. *Id.*

[55] *See id.* at 610-21. The Japanese, however, are beginning to change their traditional view of women. A new Equal Employment Act, supplementing older laws, was passed by the Japanese National Diet in the spring of 1985 and is scheduled to be implemented in the spring of 1986. Suwa, *The Equal Employment Opportunity Law*, JAPAN LAB. BULL., July 1985, at 5. The measures include equal employment opportunities and treatment; equality in education, training, and welfare benefits; and prohibitions on sex, retirement age, and displacement discrimination. *Id.* at 5-7.

following marriage or before birth of their first child. If a woman worker wishes to return at a later time, she often will only be rehired as a temporary worker.[56] Historically, women have been used in this way as a "buffer and stabiliser" against the vagaries of a changing national or business economy.[57]

The second pillar of industrial relations is the wage-seniority system in which wages, relatively low for the beginning years of employment, are "tied-to" seniority and in effect deferred until later years of employment when the "loyalty" of employees is recognized.[58] This practice promotes harmony in the enterprise since the wages of younger employees usually will not surpass those of older employees.[59] The popularity of this system as a pure employment practice, however, seems to be dwindling.[60]

Within companies that have implemented some form of the wage-seniority system, it nevertheless remains a strong motivation for employee productivity and has been described as "[o]ne of the key clues to the mystery of Japanese efficiency."[61] Workers who are hired in the same year compete fiercely for the few openings which appear at their level. This competition motivates employees to increase their productivity.[62]

"Promotion from within" is also a standard employment practice in Japan which increases worker loyalty and productivity.[63] This policy promotes loyalty because the present employees know that they will have an opportunity some

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[56] K. HAITANI, *supra* note 26, at 104-05.

[57] Such practice tends to protect permanent employees who receive greater benefits and retention rights based on their seniority (*nenko seido*). Matsuura, *Sexual Bias in the Nenko System of Employment*, 23 J. INDUS. REL. 310, 316-20 (1981).

[58] *See* T. HANAMI, *supra* note 23, at 26. Yearly bonuses, which may range from three to six times the average monthly wage in good business periods, supplement the workers' low wages. *Id.* For an analysis of the Japanese seniority-wage system in a comparative international context, see Koike, *Internal Labor Markets: Workers in Large Firms*, in CONTEMPORARY INDUSTRIAL RELATIONS IN JAPAN 30, 30-60 (T. Shirai ed. 1983).

[59] Such a system can also retard worker mobility, particularly when it requires employees who leave one employer to start work at another employer at the bottom of the seniority ladder or as temporary employees. *See* T. HANAMI, *supra* note 23, at 34; Koike, *supra* note 58, at 34-35.

[60] In 1978 only 1% of Japanese enterprises had a strict wage-seniority system, and 46% had a mixed system that considered "age, length of service, past performance, and present performance in job potential." Moreover, there appears to be a shift "toward simply denying wage increases to workers who are beyond their mid-40s." W. GOULD, *supra* note 31, at 104.

[61] T. HANAMI, *supra* note 23, at 27.

[62] *See id.* at 26-27. *Cf.* E. VOGEL, *supra* note 20, at 141 (Workers hired in the same year generally receive the same pay. This "tends to dampen competition and strengthen camaraderie among peers during their early years.").

[63] Seniority-based promotion schemes in Japan may result in smooth decision-making when a superior is confident that a subordinate "cannot surpass him on the ladder of advancement in the organization, does not feel threatened by competent subordinates and hence can accept their recommendations and criticisms with equanimity. On the contrary, a good work by his subordinates is a credit to the quality of his leadership." K. HAITANI, *supra* note 26, at 91.

time in the future to be considered for new openings. The goal of achieving rank and status, more than the increase in total wages and retirement benefits,[64] motivates Japanese employees. The "overwhelming majority of Japanese managers" have been promoted from within their particular company.[65]

The third pillar of Japan's industrial relations is enterprise unionism wherein employees are organized on a plant-wide basis rather than on an industrial or craft (occupational) basis.[66] This provides several advantages.[67] It enables employers to transfer employees within the company and across job lines, thereby providing the employer with the flexibility to respond to competitive business needs. Enterprise unionism does not involve a strong "outside" union sitting at the bargaining table to pressure the employer into an agreement. The local enterprise union has complete autonomy to make decisions and change its rules as needs arise. This makes the local enterprise union responsive to the employer but may also make the union vulnerable to pressure.

The major characteristic of enterprise unions in Japan, as contrasted with those in some Western societies, is its successful blending of sometimes contradictory functions. "[I]t confronts and resists the employer in order to protect the employees' interests when they conflict with those of the employer. It also cooperates with the employer in promoting the mutual interests of the parties in a

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[64] Wage increases in Japan are relatively modest by United States standards. *See* Koike, *supra* note 58, at 32-33.

[65] *Characteristics of Japanese Managements*, *supra* note 21, at 373. It should also be noted:

> [B]oth blue- and white-collar employees of a Japanese company belong to the same enterprise union and . . . those employees who demonstrate competence and leadership abilities have good prospects of being promoted to top management positions under the internal promotion system. Thus, the appointment of a former union official to a company's board of directors is regarded as a normal progression in Japan's industrial relations system. . . .

Id. at 374.

[66] T. HANAMI, *supra* note 23, at 88. In enterprise unions:

> (1) Membership is limited to the regular employees of a particular enterprise. Other workers not regularly employed in the same plant or firm (temporary and part-time workers) are not eligible for membership. (2) In general, both blue- and white-collar workers are organized in a single union. (3) Union officers are elected from among the regular employees of the enterprise, and during their tenure in office, they usually retain their employee status but are paid by the union. (4) About 72 percent of the enterprise unions are affiliated with some type of federation outside the enterprise, but since most of these federations are loosely organized national industrial unions, sovereignty is retained almost exclusively at the local enterprise-union level.

Shirai, *A Theory of Enterprise Unionism*, in CONTEMPORARY INDUSTRIAL RELATIONS IN JAPAN 117, 119 (T. Shirai ed. 1983) [hereinafter cited as *Enterprise Unionism*]. Employees in the United States, on the other hand, are organized in unions on an industrial or craft basis. W. GOULD, *supra* note 31, at 3.

[67] *See* W. GOULD, *supra* note 31, at 3-5.

particular enterprise."[68]

A final related point is the Japanese use of *kaizen*, a personnel technique to improve efficiency and productivity. This technique calls for employees to act as "ombudsmen" in identifying and suggesting solutions to labor-management problems.[69]

2. *Adjustments of Managerial and Employment Practices of Japanese Companies in the United States*

Japanese companies must examine the extent to which the parent company should become involved in the management of its United States affiliates, whether they are subsidiaries or branches.[70] This involves two considerations—legal liabilities and benefits and business advantages. Common business reasons for setting up a Japanese parent-American subsidiary relationship include injecting capital and technology from the parent into the subsidiary and entering a desirable market for domestic sale or export. For example, the parent can export components from Japan to the United States subsidiary to complete a product, thus establishing a domestic market presence. The relationship also permits control over quality, domestic competitiveness, work force development, and productivity comparisons.

Once this subsidiary relationship is established, the Japanese parent must decide what employment practices to utilize.[71] Many Japanese management practices, such as worker participation in decision-making, cannot easily be

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[68] *Enterprise Unionism, supra* note 66, at 121.

[69] The fact that some United States and Japan-United States companies are considering the use of *kaizen* underscores its significance. Telephone interview with Masaaki Imai, Chairman of the Cambridge Corp., Tokyo, Japan (Feb. 20, 1986). *See also* M. IMAI, KAIZEN (forthcoming).

[70] It should be emphasized that Japanese efforts to transplant their style of management are not limited to non-union environments but are used in all settings. *See* Tsurumi, *supra* note 12, at 269; *Worker Participation, supra* note 29, at 63.

[71] Case studies reveal that the Japanese do not automatically transfer their management styles to their American subsidiaries:

> For the Japanese subsidiaries, the key to success is being the quality producer and the low-cost producer. They accomplish this via their technology strategies. If they can accomplish both via product or process control, which results in their being different, or better than the competition, they do it. If not, or as added insurance, they then seek to implement a "management-centered" strategy dependent upon the successful transfer of Japanese management practices.

D. Kujawa, American Workers and Japanese Direct Investment: Case Study Evidence 15-16 (May 2, 1985) (unpublished manuscript available with author) [hereinafter cited as Kujawa Case Study]. *See also* Kujawa, *Technology Strategy and Industrial Relations: Case Studies of Japanese Multinationals in the United States*, J. INT'L BUS. STUD., Winter 1983, at 9-22 [hereinafter cited as *Technology Strategy*].

transferred.[72] Japanese companies, however, have managed to transfer some traditional Japanese industrial relations practices to their American subsidiaries.[73] For example, there often seems to be a "pervasive presence" of Japanese-style management in the details of production and in the daily life of the workers. The Japanese have introduced the principles of quality circles and other joint committees, working supervisors, and sharing information with workers on traditional "management subject-areas." There also seems to be increased use of job flexibility although this tends to be curbed in unionized settings.[74]

Japanese companies must then adapt these practices to the culture of the United States in order for such practices to be compatible with the American business climate.[75] Modification or displacement varies with the interest of the Japanese parents in effectuating transfers of their personnel systems.[76] Although Japanese, like American, management usually prefers a non-union environment, it seems quite able to cooperate and work well with American-style unions.[77]

Japanese companies must also determine the extent to which Japanese nationals will operate their American-based companies.[78] Japanese companies em-

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[72] *Worker Participation, supra* note 29, at 63. According to Kuwahara, "[d]ifficulties would result from the lack of characteristics peculiar to Japan; its trade union organization, its historical background, and its legal framework." *Id.*

[73] *See generally* Kujawa Case Study, *supra* note 71, at 3-19.

[74] *See* Japan's Direct Investment, *supra* note 1, at 20.

[75] Kuwahara noted:

> It is quite unrealistic to assume that a specific management system developed in a country, for example Japanese management, can be transferred to firms in other countries without any transformation in the cultural climate of the respective country . . . [especially] in the case of industrialized countries where indigenous culture or management institutions are firmly established.

Id. at 24. Studies on the transferability of Japanese-style management and industrial relations into various countries confirm the thesis that the Japanese must adapt their system in order to be effective. *See, e.g.*, Jain & Ohtsu, *Viability of the Japanese Industrial Relations System in the International Context: The Case of Canada*, in VIABILITY OF THE JAPANESE MODEL OF INDUSTRIAL RELATIONS 95, 106 (Int'l Indus. Relations Ass'n 1983); Thurley, *How Transferable Is the Japanese Industrial Relations System? Some Implications of a Study of Industrial Relations and Personnel Policies of Japanese Firms in Western Europe*, in VIABILITY OF THE JAPANESE MODEL OF INDUSTRIAL RELATIONS 116, 127 (Int'l Indus. Relations Ass'n 1983). One study indicated that at least in a union-management setting, however, Japanese subsidiaries are "truly not innovators in personnel matters." Kujawa Case Study, *supra* note 71, at 12.

[76] *See* Kujawa Case Study, *supra* note 71, at 3-13.

[77] *See* Tsurumi, *supra* note 12, at 269 (discussing Hitachi Metals and United Auto Workers Union, and Sanyo and International Union of Electrical Workers). Japanese companies, however, are often not averse to opposing unionization at a number of plants. Kujawa Case Study, *supra* note 71, at 10, 12. *See* Marett, *Japanese-Owned Firms in the United States: Do They Resist Unionism?*, 35 LAB. L.J. 240, 245-50 (1984) (discussing Japanese resistance to unions).

[78] Companies hire home-country nationals for executive positions "to exercise parental control and to introduce their own way of doing business into their U.S. affiliates." Sethi & Swanson,

ploy Japanese nationals in all executive levels—high, middle, and junior levels[79]—while other foreign companies tend to employ their nationals only in higher management positions.[80] Furthermore, the proportion of Japanese to non-Japanese executives is far greater in trading companies than in manufacturing companies.[81] Sometimes the managerial positions themselves become permanent and different Japanese nationals are rotated in and out of such assignments.[82]

3. *Resulting Adaptations by United States and Japanese-United States Joint Venture Companies*

Japanese-American joint ventures[83] and an increasing number of United

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Problems for Foreign Companies: Compliance with U.S. Discrimination Laws, MGMT. REV., June 1979, at 32 [hereinafter cited as *Foreign Compliance*].

[79] *Id.*

[80] Statistics reveal that few foreign companies staff their American-based management positions exclusively or even predominately with home-country nationals. Only one-half "frequently" use such persons as directors and in executive positions. The approximate percentages are 17% for presidents, 32% for vice-presidents, 32% for upper management below vice-president, 25% for middle management, and 0% for front-line supervisory positions. Greer & Shearer, *Do Foreign-owned U.S. Firms Practice Unconventional Labor Relations?*, MONTHLY LAB. REV., Jan. 1981, at 44, 45.

[81] In fact, "[t]rading companies have largely transplanted the Japanese management system abroad," and "officials dispatched from the Japan head office virtually monopolized all the top management positions abroad. . . ." A. YOUNG, THE *Sogo Shosha*: JAPAN'S MULTINATIONAL TRADING COMPANIES 228-29 (1979). One reason for this is that executives in trading companies must be familiar with the Japanese language, culture, customs, and products in order to facilitate communication between the home office and customers.

> The transfer of the Japanese management system and the occupation of middle- and top-level management positions by Japanese ensures the flow of communications (including whom to send a telex to or talk to in the consensus oriented decision-making process), avoids misunderstandings (so easy in a culture where unspoken words and gestures can be more important than spoken and written words), and saves much time.

Id. at 229. *See* Krause & Sekiguchi, *Japan and the World Economy*, in ASIA'S NEW GIANT: HOW THE JAPANESE ECONOMY WORKS 383, 389-97 (H. Patrick & H. Rosovsky eds. 1976) (general discussion of the characteristics and successes of Japanese trading companies).

[82] Kujawa concluded from his study of nine Japanese subsidiaries in the United States that:

> Substantial numbers of parent-company technical specialists have been assigned to the Japanese subsidiaries to facilitate technology transfers, to train U.S. workers and to monitor production systems. This has been true in every case. In some, however, the assignments have become permanent (even though specific personnel on assignment have rotated).

Kujawa Case Study, *supra* note 71, at 15. *See also Technology Strategy*, *supra* note 71, at 18-19.

[83] Joint ventures occur in many product areas including the steel (e.g., Nippon Kokan K.K. Co. with Martin Marietta and National Steel Co.), high-technology (e.g., Fanuc Ltd. and General Motors), and auto (e.g., Toyota-General Motors) industries. Japan's Direct Investment, *supra* note

States companies have adopted many Japanese-style approaches to management and industrial relations.[84] In the Toyota-General Motors joint venture, for example, the joint venture agreement calls for use of a variety of "adaptive" management-labor relations approaches including joint consultation, flexible job duties, and incentive systems designed to humanize employee relations and to increase efficiency and productivity.[85] The collective bargaining agreements of

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1, at 14. *See* Note, *The GM-Toyota Joint Venture: Legal Cooperation or Illegal Combination in the World Automobile Industry?*, 19 TEX. INT'L L.J. 699 (1984) (history and implications of the Toyota-General Motors joint venture).

Most joint ventures in the United States are bilateral, although there is some indication that multinational joint ventures may become more prevalent. For example, Shin-Etsu Semiconductors Co., Dow Corning, Monsanto, and a West German enterprise are joining to set up two new factories in the United States. Japan's Direct Investment, *supra* note 1, at 14. *See also* C. WALLACE, LEGAL CONTROL OF THE MULTINATIONAL ENTERPRISE 15-16 (1983); Brodley, *Joint Ventures and Antitrust Policy*, 95 HARV. L. REV. 1523 (1982); Hadari, *The Choice of National Law Applicable to the Multinational Enterprise and the Nationality of Such Enterprises*, 1974 DUKE L.J. 1.

[84] It should be noted that official United States policy is to promote cooperative labor-management relations. Labor Management Cooperation Act of 1978, 29 U.S.C. §§ 173, 175a (1982). *See* DAILY LAB. REP. (BNA), Nov. 5, 1982, at A-3 (Secretary of Labor Raymond Donovan stated that labor and management must "stop fighting and start helping each other."). *But see* Levitan & Johnson, *Labor and Management: The Illusion of Cooperation*, HARV. BUS. REV., Sept.-Oct. 1983, at 8 (Cooperative labor-management relations are "more of a placebo than a panacea.").

Several American companies, in fact, have developed management industrial relations policies independent of the Japanese model. *See* T. PETERS & R. WATERMAN, IN SEARCH OF EXCELLENCE: LESSONS FROM AMERICA'S BEST-RUN COMPANIES (1982) (analysis of successful American companies). For example, Delta Airlines, a largely non-union company has been run like "family" since the 1920's and has long had policies of retraining employees, lifetime job security, promotion from within, open door management, and joint consultation, and an emphasis on high quality. *See* R. PASCALE & A. ATHOS, *supra* note 22, at 177-80, 205. *See also Airline Industry Update*, MONTHLY LAB. REV., Nov. 1983, at 72 ("In 1982, as appreciation for a pay increase, Delta's 36,000 employees contributed $30 million to buy the company an airplane."); Serrin, *The Way That Works at Lincoln*, N.Y. Times, Jan. 15, 1984, § 3, at 4, col. 3 (reporting on Lincoln Electric Co.'s unique worker-management system "featuring high wages, guaranteed employment, few supervisors, a lucrative bonus incentive system and piecework compensation").

American employers have also established quality of worklife committees and programs to create a more cooperative and productive work environment. Companies which have successfully used such programs include ALCOA, IBM, 3M, General Electric, and Lincoln National Life Insurance Co. *See* Ackoff & Deane, *The Revitalization of ALCOA's Tennessee Operations*, 3 NAT'L PRODUCTIVITY REV. 239 (1984); Katz, Kochan & Gobeille, *Industrial Relations Performance, Economic Performance, and QWL Programs: An Interplant Analysis*, 37 INDUS. & LAB. REL. REV. 3 (1983) (General Motors programs). *See also* Guest, *Quality of Work Life—Learning from Tarrytown*, HARV. BUS. REV., July-Aug. 1979, at 76 (General Motors plant).

[85] A portion of the "Memorandum of Understanding" between the two companies is reprinted in 23 I.L.M. 36, 36-46 (1984). The Federal Trade Commission, after investigating the joint venture, reported that the joint venture agreement would permit General Motors "to complete its learning of the more efficient Japanese manufacturing and management methods." Statement of Chairman James C. Miller III, Commissioner George W. Douglas, and Commissioner

the United Steel Workers Union provide for a "multicraftsmen" job classification which permits job flexibility and for "labor-management participation teams" at plants "to promote, among other things, efficient and economic operations and to discuss, consider and decide on means to improve the performance of work units."[86] Agreements negotiated between the United Auto Workers Union and General Motors and the union and Ford also provide for joint union-employer committees to share and discuss information prior to management decisions.[87]

Perhaps one of the most innovative and potentially system-changing agreements adjusting management-labor relations is the new Saturn Agreement between the United Auto Workers and General Motors. The agreement calls for emphasis on work units, worker participation and joint consultation committee structures, consensus decision-making, limited job classifications, a system of qualified permanent employment for certain employees, and reward and bonus schemes.[88] One of the most striking features is the preamble:

> With the understanding that this philosophy of total cooperation offered an opportunity to forge a new relationship and demonstrate that a competitive, world class vehicle could be manufactured in the United States with a represented workforce, authorization to proceed with the Saturn project was obtained.[89]

The philosophy of the Agreement is underscored by its job security provision, "Saturn recognizes that people are the most valuable asset of the organization."[90] In essence the agreement sets forth a "social contract" and, very much in Japanese tradition, establishes a "relationship" and not just an agreement.[91]

III. APPLICABILITY OF UNITED STATES LABOR LAWS TO JAPANESE AND MULTINATIONAL COMPANIES UNDER FCN TREATIES

The actual application of United States labor laws to a foreign corporation or

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Terry Calvani Concerning Proposed General Motors/Toyota Joint Venture, 23 I.L.M. at 48, 51. *See* Nelson, *GM-Toyota Joint Venture and Its Implications Under the National Labor Relations Act*, 1984 DET. C.L. REV. 647.

[86] Kujawa Case Study, *supra* note 71, at 12.

[87] *See* W. GOULD, *supra* note 31, at 13.

[88] Unsigned Draft Memorandum of Agreement between Saturn Corporation, a wholly owned subsidiary of General Motors Corporation, and the International Union, United Automobile, Aerospace and Agricultural Implement Workers of America (July 23, 1985) (unpublished draft available with author).

[89] *Id.* at 1-2 (Preamble).

[90] *Id.* at 16 (Job Security).

[91] The "contract" reads, "The parties acknowledge that the matters set out in this memorandum are neither all inclusive nor complete." *Id.* at 31 (Commitment of Parties).

its American subsidiary involves several issues: procedurally determining jurisdiction, substantively showing that a violation occurred, and deciding whether an exception would excuse the violation.[92] This section deals with the first by discussing some of the more recent jurisdictional issues under the Treaty of Friendship, Commerce and Navigation (FCN Treaty)[93] which foreign companies operating in the United States must face.

A. *Determining "Corporate Nationality" of the Subsidiary*

The key jurisdictional issue is whether the legal form[94] and perhaps the "corporate nationality" of a foreign company will determine the applicability of United States labor laws or the availability of treaty defenses. The designation of "corporate nationality" has been an elusive concept over the years; rules have developed whereby the same corporation may have different nationalities for different purposes.[95] Three major doctrines have evolved for deciding "corporate nationality": (1) center of administration, (2) center of exploitation, and (3) place of incorporation.[96]

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[92] For a discussion of the substantive issues of violation and defense, see *infra* Section IV.

[93] The United States has entered into Treaties of Friendship, Commerce and Navigation (FCN Treaties) with many nations to strengthen peace and friendship by promoting mutually advantageous commercial intercourse and investments and by establishing mutual rights and privileges based on most-favored nation treatment. FCN Treaties provide foreign corporations "national treatment" and allow foreign persons to establish locally incorporated subsidiaries without discrimination based on alienage. "National treatment" includes the right of foreign companies to control and manage their enterprises. *See* Walker, *Modern Treaties of Friendship, Commerce and Navigation*, 42 MINN. L. REV. 805, 811 (1958); Note, *Commercial Treaties and the American Civil Rights Laws: The Case of Japanese Employers*, 31 STAN. L. REV. 947, 949-56 (1979).

[94] Foreign enterprises may choose from a number of forms when doing business overseas, including pure investment, representatives, branches, wholly owned subsidiaries, and joint ventures.

[95] Hadari, *supra* note 83, at 36-37. *See also* Vagts, *The Corporate Alien: Definitional Questions in Federal Restraints on Foreign Enterprise*, 74 HARV. L. REV. 1489, 1524-50 (1960).

[96] One student commentator observed:

> The two most common tests of corporate nationality are the Anglo-American place-of-incorporation test, and the continental *siege reel* (seat) test. Under the Anglo-American test, a corporation is deemed a citizen of the country under whose laws it is chartered. This test is endorsed by the Restatement (Second) of the Foreign Relations Laws of the United States [§ 27]. Under the civil law test, a corporation's nationality is determined by such factors as the location of its principal place of business or corporate headquarters. The main virtue of the place-of-incorporation test is said to be its simplicity and certainty, whereas the seat test is said to reflect better the underlying "economic reality" of the business.

Note, *Employment Rights of Japanese-American Joint Ventures in the United States Under the U.S.-Japan Treaty of Friendship, Commerce and Navigation*, 16 LAW & POL'Y INT'L BUS. 1225, 1238 (1984) (footnotes omitted) (emphasis original).

These tests invoke a variety of criteria, including nationality of management, control, dominant

In *Sumitomo Shoji America, Inc. v. Avagliano*,[97] the United States Supreme Court decided the issue whether a Japanese subsidiary incorporated in the United States was "foreign" and therefore entitled to protection under the United States-Japan Treaty of Friendship, Commerce and Navigation. The Court held that a wholly owned Japanese subsidiary which was incorporated in the United States was, for purposes of the availability of the FCN Treaty, a company of the United States solely by virtue of its incorporation under American laws.[98] The Court interpreted two provisions of the FCN Treaty:[99] Article VIII(1) which gave Japanese "companies" the right to employ "executive personnel . . . of their choice";[100] and Article XXII(3) which defined "companies" as "corporations, partnerships, companies and other associations . . . constituted under the applicable laws and regulations within the territories of either Party."[101]

The Court held that the language in the FCN Treaty compelled the "place of incorporation test"[102] and rejected[103] the analysis of the Second Circuit Court of Appeals that the Treaty merely "define[d] a company's nationality for the purpose of recognizing its status as a legal entity but not for the purpose of restricting substantive rights granted elsewhere in the Treaty."[104] *Sumitomo* therefore appears to have resolved the issue of the "corporate nationality" of wholly owned foreign subsidiaries incorporated and based in the United States.

Sumitomo did not, however, resolve the issue of the "corporate nationality" of branch offices or the growing numbers of multinational or international joint ventures. There is some question whether any of the "corporate nationality" tests described above would work very well. A multinational joint venture could fail all of the tests of "corporate nationality" yet have a greater impact on and involvement in American business than a joint venture that passed one or all of

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shareholders, principal place of business, and jurisdiction of incorporation. *See* M. WOLFF, PRIVATE INTERNATIONAL LAW 298-315 (1945); Note, *Employment Rights*, *supra*, at 1238-42.

[97] 457 U.S. 176 (1982).

[98] *Id.* at 182-83. *See* Note, *The Rights of a Foreign Corporation and Its Subsidiary Under Title VII of the Civil Rights Act of 1964 and Treaties of Friendship, Commerce, and Navigation*, 17 GEO. WASH. J. INT'L L. & ECON. 607, 625-27 (1983) (discussing the Court's adoption of the place of incorporation test).

The Second Circuit Court of Appeals had held that the determination of corporate nationality "would depend on a case-by-case analysis of the relevant facts." Avigliano v. Sumitomo Shoji Am., Inc., 638 F.2d 552, 557 n.4 (2d Cir. 1981), *vacated*, 457 U.S. 176 (1982).

[99] Treaty of Friendship, Commerce and Navigation, Apr. 2, 1953, United States-Japan, 4 U.S.T. 2063, T.I.A.S. No. 2863 [hereinafter cited as Japan FCN Treaty].

[100] *Id.* art. VIII(1), 4 U.S.T. at 2070.

[101] *Id.* art. XXII(3), 4 U.S.T. at 2079-80.

[102] 457 U.S. at 185, 188.

[103] *Id.* at 182-83.

[104] *Avigliano*, 638 F.2d at 557.

the tests. This is illustrated by joint ventures, such as the Toyota-General Motors joint venture which was incorporated in the United States but involves shared management (50% each),[105] and by other joint ventures that produce or manufacture the bulk of their products in a foreign country. In such cases, none of the tests would assess the true workings of the company or provide a fair result.

A literal reading of *Sumitomo* would permit a joint venture to claim the rights and immunities of the FCN Treaty, depending on its place of incorporation. Consequently, an American-based joint venture incorporated in Japan might be able to successfully invoke its protections and be free of the application of certain American labor laws regarding management executives.[106] Whether that would also lead to the absurd conclusion that the American partner in the joint venture could evade American labor laws is not likely but remains to be seen.[107]

Although the Court in *Sumitomo* explicitly noted that it did not intend the place-of-incorporation test to grant superior rights to branches of Japanese companies operating in the United States than to locally incorporated Japanese subsidiaries, the former do retain certain jurisdictional or affirmative defense advantages.[108] Other issues remain unresolved.[109] First, it is unclear whether all

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[105] *See* Nelson, *supra* note 85, at 647-51; Note, *The GM-Toyota Joint Venture*, *supra* note 83, at 705-11.

[106] Since the Toyota-General Motors joint venture was incorporated in the United States, it is subject to the rule of *Sumitomo* and is arguably free from certain American labor laws. The "control test," which considers a myriad of "signs of control," may be invoked to minimize the joint venture's discriminatory practices by obtaining jurisdiction over the joint venture. *See* Vagts, *supra* note 95, at 1544-45; Note, *Employment Rights*, *supra* note 96, at 1239 n.86.

[107] To avoid this result, a new test of corporate nationality for joint ventures has been proposed. This proposal calls for "lifting of the corporate veil" and applying a modified control test based on two factors—control of stock ownership and the joint venture's principal place of business. Note, *Employment Rights*, *supra* note 96, at 1242-47. *See* Recent Development, *Developing a Model Bilateral Investment Treaty*, 15 LAW & POL'Y INT'L BUS. 273 (1983) (discussing the "prototype bilateral investment treaty" which contains a clause that a party must have a "substantial interest" to receive the treaty's benefits).

[108] The Supreme Court in *Sumitomo* rejected the notion that its use of the place of incorporation test would "create a 'crazy-quilt pattern' in which the rights of branches of Japanese companies operating directly in the United States would be greatly superior to the right of locally incorporated subsidiaries of Japanese companies." 457 U.S. at 189. The Court explained that "[t]he only significant advantage branches may have over subsidiaries is that conferred by Article VIII(1)." *Id.* This advantage is the limited right to choose Japanese nationals for certain executive managerial positions.

[109] A tangential issue is *extraterritorial* jurisdiction: whether an American employer that did not hire employees for or rotate employees to a foreign affiliate because of the country's law or custom regarding race, sex, or religion may be held liable under American labor law for discrimination. This issue would pertain to an American-foreign joint venture, an American company, or a foreign employer with a United States incorporated subsidiary, all of which hire or rotate employees extraterritorially. *See* Edwards, *International Law and Employment Discrimination*, 8 OKLA.

United States labor laws will be interpreted in the same manner. For example, labor laws such as the National Labor Relations Act have been applied to foreign employers operating in the United States, including branches[110] and wholly owned subsidiaries incorporated in the United States.[111] Likewise, American subsidiaries of Japanese companies have been found subject to United States antitrust laws.[112] These examples, however, did not involve bilateral friendship treaties and thus would seem subject to the *Sumitomo* analysis. Second, *Sumitomo* did not answer the question whether the parent can be liable as a "joint employer." Third, it is not clear whether the subsidiary can assert the defenses of its parent.

CITY U.L. REV. 1, 13-19 (1983); Kirschner, *The Extraterritorial Application of Title VII of the Civil Rights Act*, 34 LAB. L.J. 394 (1983).

The leading case is Bryant v. International Schools Servs., Inc., 502 F. Supp. 472 (D.N.J. 1980), *rev'd on other grounds*, 675 F.2d 562 (3d Cir. 1982). In *Bryant*, American citizens working for an American school in Iran claimed sex discrimination by the American employer under Title VII. The federal district court held that Title VII may be applied extraterritorially. 502 F. Supp. at 483. The court noted that Title VII specifically excludes from its coverage "aliens outside any State." Therefore, "[b]y negative implication, since Congress explicitly excluded aliens employed outside of any state, it must have intended to provide relief to non-aliens, *i.e.*, American citizens, outside of any state by an employer otherwise covered by the Act." *Id.* at 482. See 42 U.S.C. § 2000e-1 (1982) for the current statute.

Other labor laws, however, have been held inapplicable. *See, e.g*, Zahourek v. Arthur Young & Co., 567 F. Supp. 1453 (D. Colo. 1983) (Age Discrimination in Employment Act), *aff'd*, 728 F.2d 607 (3d Cir. 1984); Cleary v. United States Lines, Inc., 555 F. Supp. 1251 (D.N.J. 1983) (Age Discrimination in Employment Act); GTE Automatic Elec., Inc., 226 N.L.R.B. 1222 (1976) (National Labor Relations Act); 29 U.S.C. § 213(f) (1982) (Fair Labor Standards Act specifically excludes extraterritorial application). *Cf.* McCulloch v. Sociedad Nacional de Marineros de Honduras, 372 U.S. 10, 13 (1963) ("[T]he jurisdictional provisions of the [National Labor Relations] Act do not extend to maritime operations of foreign-flag ships employing alien seamen.").

A related issue is the possible liability of an American company in a joint venture with a foreign company which discriminates against American citizens abroad. Even if the American company is not liable as an employer, it may be liable as an employment agency of its foreign partner or affiliate. *Cf.* 2 EMPL. PRAC. GUIDE (CCH) ¶ 6857 (Sept. 16, 1985) (Commission had no jurisdiction over an American company located in the United States concerning the discriminatory practices of its parent company, which was incorporated in the United States but was operating abroad, because the subsidiary did not act as an employment agency of the parent.). If the American employer is separate from the foreign operation and not involved in any discrimination, then there would likely be no jurisdiction. *See id.*

[110] *See In re* Royal Bank of Canada, 67 N.L.R.B. 403 (1946).

[111] *See* Delta Match Corp., 102 N.L.R.B. 1400 (1953).

[112] *See, e.g.*, United States v. R.P. Oldham, 152 F. Supp. 818 (N.D. Cal. 1957) (The court also held that the subsidiary could not invoke in its own right any rights under the FCN Treaty).

B. Liability of Parent and Availability of Defenses

A foreign parent corporation may be held liable for the activities of its wholly owned subsidiary when the parent so controls the subsidiary that the subsidiary is merely the agent or "instrumentality"[113] of the parent, or when they can be viewed as an "integrated enterprise" and thus a single employer.[114] Japanese companies, because of their traditional parent-child relationship, could be particularly vulnerable to this approach.[115] "Parent liability" raises two business and legal questions: (1) When, if ever, does a subsidiary have standing to raise the rights and defenses of its parent? (2) How closely may a parent control its subsidiary's managerial and labor relations before becoming an "employer" and risking liability?

The United States Supreme Court in *Sumitomo* did not deal with the issue of whether a subsidiary may assert the rights of its parents.[116] Prior to *Sumitomo*, however, at least one court permitted an American subsidiary of a West German parent company to raise the treaty immunities of its parent regarding the legality of import ban restrictions under a United States-West Germany treaty.[117]

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[113] Linskey v. Heidelberg E., Inc., 470 F. Supp. 1181, 1184 (E.D.N.Y. 1979). The Equal Employment Opportunity Commission recently ruled that a foreign hospital may be designated an "employer" under Title VII of the Civil Rights Act of 1964, thereby granting the Commission jurisdiction over the hospital's American "employment agency." 2 EMPL. PRAC. GUIDE (CCH) ¶ 6853 (July 31, 1985).

[114] This approach has been used under a variety of American labor laws: Title VII, *see, e.g.*, Baker v. Stuart Broadcasting Co., 560 F.2d 389 (8th Cir. 1977)); and the National Labor Relations Act, *see, e.g.*, Radio & Television Broadcast Technicians Local 1264 v. Broadcast Serv. Inc., 380 U.S. 255 (1965). It is unclear whether "joint employers" will qualify under the National Labor Relations Act as jointly exempt if only one of them fits under a statutory exemption. *See* Birenbaum, *Joint Employer Exceptions Under the National Labor Relations Act: Will the Real N.L.R.B. Please Stand Up*, 24 SANTA CLARA L. REV. 371 (1984).

[115] In Bulova Watch Co. v. K. Hattori & Co., 508 F. Supp. 1322 (E.D.N.Y. 1981), a New York federal district court found jurisdiction against a Japanese multinational corporation where its wholly owned United States subsidiary essentially marketed goods manufactured in Japan. The court described the Japanese parent-subsidiary relationship as a hub of a wheel with many spokes. *Id.* at 1338 (citing M. WILKINS, THE MATURING OF MULTINATIONAL ENTERPRISE: AMERICAN BUSINESS ABROAD FROM 1914 TO 1970, at 416 (1974)). *See* Griffin, *The Power of Host Countries Over the Multinational: Lifting the Veil in the European Economic Community and the United States*, 6 LAW & POL'Y INT'L BUS. 375 (1974) (examines cases in which a local subsidiary and foreign parent are treated as a single entity for purposes of obtaining jurisdiction).

[116] The Court noted, "We . . . express no view as to whether Sumitomo may assert any Article VIII(1) rights of its parent." 457 U.S. at 190 n.19.

[117] Calnetics Corp. v. Volkswagen of Am., Inc., 532 F.2d 674, 693 (9th Cir.) (On remand, the district court must assess the anticompetitive nature of the import restrictions in light of the treaty and its application to the foreign company and its American subsidiary.), *cert. denied*, 429 U.S. 940 (1976).

In *Spiess v. C. Itoh & Co. (America)*,[118] however, a federal district court, in reference to the holding in *Sumitomo*, held that an American-based subsidiary may not assert the substantive treaty rights of its foreign parent.[119] The subsidiary claimed that the Japanese staff who filled the positions in the United States was hired and trained by the parent in Japan. The subsidiary also claimed that, even though these Japanese employees were only temporarily rotated to the subsidiary, because of the "integrated relationship" of the parent and subsidiary, they were in reality employees of the parent company.[120] The court rejected this argument because the subsidiary was merely "attempting to accomplish indirectly what it [could not] accomplish directly."[121]

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[118] The federal district court's "opinion" is unreported. The court's order denying C. Itoh & Co. (America)'s Motion to Dismiss for Failure to State a Claim pursuant to FED. R. CIV. P. 12(b)(6) is reproduced in part in the opinion of the Fifth Circuit Court of Appeals. Spiess v. C. Itoh & Co. (Am.), 725 F.2d 970, 973 (5th Cir. 1984) (appeal dismissed for want of appellate jurisdiction), *cert. denied*, 105 S. Ct. 115 (1984).

A summary of the relevent history of the litigation follows: Spiess v. C. Itoh & Co. (Am.), 469 F. Supp. 1 (S.D. Tex. 1979) (holding that the subsidiary, Itoh-America, is a company of the United States under the Japan FCN Treaty and can therefore claim no *direct* protection under the treaty), *rev'd*, 643 F.2d 353 (5th Cir. 1981) (holding that Itoh-America may directly assert rights under the Japan FCN Treaty and may hire executive personnel of its choice), *vacated*, 457 U.S. 1128 (1982) (vacated in light of *Sumitomo*). The Fifth Circuit then remanded to the district court for further consideration. 687 F.2d 129 (5th Cir. 1982). The district court entered its order on September 27, 1983, denying Itoh-America's motion to dismiss. *See Spiess*, 725 F.2d at 973. The Fifth Circuit then dismissed the subsequent appeal for lack of jurisdiction. *Id.* at 975. The United States Supreme Court denied certiorari. 105 S. Ct. 115 (1984).

[119] The district court's order is quoted in *Spiess*, 725 F.2d at 973. The court ordered, in pertinent part, that:

> The defendant, by contending that it has standing to assert the substantive treaty rights of its parent, is attempting to accomplish indirectly what it cannot accomplish directly. The Court does not believe that either the [Japan FCN] Treaty or the *Sumitomo* case would permit that to occur. Accordingly, defendant's motion to dismiss for failure to state a claim is denied *in toto*.

Id. (emphasis original). The district court had earlier expressed no opinion on the issue of whether a subsidiary may assert the treaty rights of its parent. *Spiess*, 469 F. Supp. at 8 ("[T]he question of whether Itoh-America has standing to raise Itoh-Japan's Article VIII(1) rights is of no moment. . . .").

[120] *Spiess*, 725 F.2d at 972 (quoting Itoh-America's brief). Itoh-America argued that:

> As the Record shows, each member of the Japan staff has been hired and trained by the parent company in Japan. The parent company determines which positions with the subsidiary are to be filled with Japan staff, and selects the individuals to fill those positions. The parent company assigns these individuals to work for the subsidiary for a period of from three to five years. While in the United States, Japan staff compensation and promotions are determined by the parent. After completing their rotation in the United States, they return to Japan where they continue to work for the parent company.

Id. (quoting Itoh-America's brief).

[121] *Id.* at 973 (quoting the district court's order dismissing Itoh-America's motion to dismiss).

At least some Japanese parent companies are willing to risk potential liability in arguing that they are "integrated employers" in order to hire and place their own rotating national employees in key American executive positions.[122] On the other hand, this "integrated" relationship arguably could have the effect of establishing "standing" for the subsidiary. The American-based subsidiary by invoking the parent's standing as a "foreign employer" perhaps could benefit from or claim the parent's immunity from United States labor laws under the Japan FCN Treaty, at least vis-a-vis the rotating staff employees.[123] This is significant because this type of bilateral FCN Treaty is quite common; the United States presently has similar agreements with over twenty-four countries.[124]

Wickes v. Olympic Airways[125] involved facts which differed from those in *Sumitomo* in three respects: the defendant Greek company was a "foreign corporation," not a wholly owned subsidiary incorporated in the United States; it was owned by the Greek government; and a state discrimination law was in question.[126] The Sixth Circuit Court of Appeals held that a provision of the United States-Greece FCN Treaty,[127] which was similar to Article VIII(1) of the Japan FCN Treaty, afforded the Greek company "a narrow privilege to discriminate in favor of Greek citizens" when hiring managerial and technical personnel in order to ensure the company's "operational success" in the United States.[128] The court held that although under the treaty Greek companies "are permitted to discriminate in favor of their own nationals or citizens for certain high level positions," they are not permitted "to discriminate against others in the labor force of the host country on any other basis."[129] The court also held that there

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[122] *Cf. id.* at 972 (argument by American subsidiary that it is "integrated" with the Japanese parent).

[123] *See Spiess*, 643 F.2d at 358 (observing the incongruity if branches of Japanese companies were protected under the FCN Treaty but American subsidiaries of the same Japanese company were not).

[124] Note, *Commercial Treaties*, *supra* note 93, at 948.

[125] 745 F.2d 363 (6th Cir. 1984).

[126] *Id.* at 364.

[127] Treaty of Friendship, Commerce and Navigation, Aug. 3 & Dec. 26, 1951, United States-Greece, art. XII(4), 5 U.S.T. 1829, 1857, 1859, T.I.A.S. No. 3057 ("executive personnel . . . and other employees of their choice . . . regardless of their nationality").

[128] 745 F.2d at 368. The court noted, "Whether plaintiff has made out a valid claim of age discrimination, or national origin discrimination *not protected* by the Treaty, involves questions of fact for the District Court to resolve." *Id.* at 369 (emphasis added).

[129] *Id.* at 367. The Equal Employment Opportunity Commission recently held that when a foreign corporation is a representative of a foreign government it may be immune under the Foreign Sovereign Immunities Act of 1976, 28 U.S.C. § 1602 (1982). In that instance, however, the corporation was conducting *commercial* activities, which is an exception to the general rule of immunity. The Commission therefore had jurisdiction over a foreign corporation which was the subject of a receptionist-switchboard operator's claim of racial and national origin discrimination.

was no conflict between the treaty and the state labor law because the state law did not prohibit the use of citizenship per se as a hiring criterion.[130]

If the FCN Treaty applies and exempts a foreign corporation from application of United States labor laws, the issue of the definition of "executive" personnel becomes important. Case law does not provide a definitive answer.[131] This is especially critical because studies show that Japanese companies tend to staff their American subsidiaries with more middle- and junior-level managers than most other multinational companies operating in the United States.[132] Japanese companies, therefore, conceivably could avoid American labor laws if the term "executive" were defined broadly.

IV. Developing Legal and Practical Employment Law Issues

A. *Equal Employment Opportunity*

1. *Developing Agenda Items*

Sumitomo left unresolved many issues regarding the applicability of American labor laws to multinational companies operating in the United States. For example, it is unclear whether FCN treaties provide foreign incorporated companies doing business in the United States total immunity or only partial immunity limited to preferences based on citizenship, but not to preferences based on age, sex, or national origin, except where such employment decisions are part of the foreign companies' accepted practices.

While there is very little law on this issue, in *Wickes*, the Sixth Circuit held that the United States-Greece FCN Treaty provided only limited immunity to a Greek company: the company had "no license to discriminate against or among non-Greek citizens it hire[d] for positions not covered by the Treaty on the basis of race, sex, national origin, or any of the other factors prohibited by [state] law."[133] The *Wickes* approach creates the following "agenda item": (1)

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2 Empl. Prac. Guide (CCH) ¶ 6852 (July 16, 1985).

[130] 745 F.2d at 368. The state law prohibited discrimination based on "religion, race, color, national origin, age, sex, height, weight or marital status." Mich. Comp. Laws Ann.] 37.]2202(1)(a) (West 1984).

[131] *See, e.g., Wickes*, 745 F.2d at 368-69 (The definition of "executive personnel" under the FCN Treaty would be determined by the United States Department of State and the regulations governing "treaty trader visas."). See *infra* note 134 for a discussion of treaty trader visas.

[132] *Foreign Compliance, supra* note 78, at 32. *See* Greer & Shearer, *supra* note 80, at 45 (statistics showing use of *foreign*, not only Japanese, nationals in American subsidiaries).

[133] 745 F.2d at 369. In its analysis of the FCN Treaty, the *Wickes* court noted that its decision rested in part on the "juxtaposition of the words 'of their choice' and 'regardless of nationality' {which had] been interpreted by the State Department as creating both a right to employ and a limitation on that right." *Id.* at 367. It is perhaps significant that some of the other

whether this approach "waters down" treaty rights, and (2) whether it accords a proper balance between American social values prohibiting discrimination and the interests of foreign enterprises to maintain adequate control over their choice of personnel permitted under treaties and treaty trader visas.[184]

If FCN treaties are inapplicable, then the question is how American labor laws will be applied and whether interpretations under them will take into account or be influenced by the foreign management and industrial relations which "come with the company."[185] Foreign companies traditionally send a

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FCN Treaties have a slightly different wording. For example, the Japan FCN Treaty provides that "[n]ationals and companies . . . shall be permitted to engage . . . executive personnel . . . and other specialists of their choice." Japan FCN Treaty, *supra* note 99, art. VIII(1), 4 U.S.T. at 2070.

Other courts have also limited a foreign company's immunity. *See, e.g.*, Avigliano v. Sumitomo Shoji Am., Inc., 638 F.2d at 558 (The court rejected the Japanese employer's argument that it should be exempt under the FCN Treaty from Title VII of the Civil Rights Act of 1964 as well as from other labor laws.); Mattison v. Canon U.S.A., Inc., 28 Fair Empl. Prac. Cas. (BNA) 1685, 1686 (N.D. Ill. 1981) (The court noted in dictum that even if the FCN Treaty applied it would not provide a blanket exemption from Title VII.). *Cf.* McClure v. Salvation Army, 460 F.2d 553 (5th Cir.) (The court permitted an exemption from Title VII for a religious organization's discrimination based on religion but did not extend the exemption to other bases unless the practice can be shown to be part of a proper religious preference), *cert. denied*, 409 U.S. 896 (1972).

[184] Under the Immigration and Nationality Act, 8 U.S.C. § 1101(a)(15)(E) (1982), the term "immigrant" does not include "an alien entitled to enter the United States under and in pursuance of the provisions of a treaty of commerce and navigation between the United States and the foreign state of which he is a national." Such an "alien" may obtain a "treaty trader" visa by establishing that he will be

> engaged in duties of a supervisory or executive character, or, if he is or will be employed in a minor capacity, he has the specific qualifications that will make his services essential to the efficient operation of the employer's enterprise and will not be employed solely in an unskilled manual capacity.

22 C.F.R. § 41.40(a) (1985), 9 Foreign Affairs Manual, Part II, § 4.40 n.16 (1975). *See also* 22 C.F.R. § 41.41(a) (1985) (treaty investors).

The regulations further require that aliens seeking a trader visa must be employed by "an organization which is *principally owned* by a person or persons having the nationality of the treaty company." *Id.* § 41.40(a) (emphasis added). This regulation may place severe limits on Japanese-American joint ventures in their recruiting of foreign national executives in the United States because joint ventures, such as Toyota-General Motors, are often in a 50%-50% ownership split arrangement. It can be argued that these restrictions may not be controlling for Article VIII(1) of the Japan FCN Treaty since the Immigration and Nationality Act was enacted prior to the treaty. For a discussion of treaty trader and treaty investor visas under the Japan FCN Treaty, see Kanter, *The Japan-United States Treaty of Friendship, Commerce and Navigation: Lawyers as Treaty Traders*, 8 U. HAWAII L. REV. 343 (1986).

[185] In *Avigliano*, the Second Circuit noted that "as applied to a Japanese company enjoying rights under the . . . Treaty [the bona fide occupational qualification exception] must be construed in a manner that will give due weight to the Treaty rights and unique requirements of a Japanese company doing business in the United States. . . ." 638 F.2d at 559.

nucleus of key personnel to the United States to establish and maintain operations.[136] This employment practice highlights other currently perplexing labor issues faced by foreign companies operating in the United States. For example, foreign employers face potential liability under the equal employment opportunity laws by rotating employees and by utilizing employment practices that may provide different economic and job security benefits to the rotating staff, policies of promoting from within, and job testing procedures emphasizing subjective characteristics. These practices tend to limit opportunities for American citizens, especially women, and are the "emerging agenda items" which must be addressed by multinational companies operating in the United States.

The Supreme Court in *Sumitomo* did not decide the appropriate application of anti-discrimination laws to foreign multinational companies operating in the United States.[137] It did, however, provide the legal framework: "There can be little doubt that some positions in a Japanese controlled company doing business in the United States call for great familiarity with not only the language of Japan, but also the culture, customs, and business practices of that country."[138] The issue is whether a foreign company "can support its assertion of a bona fide occupational qualification or a business necessity" because of such a requirement.[139] This issue poses a perplexing policy dilemma. On the one hand, it must be recognized that foreign companies may have unique requirements that can often be filled only by their nationals.[140] On the other hand, to permit and accommodate the discriminatory practices of foreign companies would be to allow them to define and compel the non-enforcement of United States labor laws.[141]

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[136] For example, in 1977, Sumitomo Shoji America, Inc. employed about 464 people nationwide and over 200 people in its New York offices. Between 1975 and 1982, some 40-45% of the New York employees were "rotating staff." Avagliano v. Sumitomo Shoji Am., Inc., 103 F.R.D. 562, 568, 569 & n.7 (S.D.N.Y. 1984). "Rotating staff" consists of personnel assigned by the parent company from Japan to the United States. These workers typically must obtain a treaty trader visa and be certified as "executive personnel" or "other specialists." *See* Note, *Employment Rights*, *supra* note 96, at 1241-43.

[137] 457 U.S. at 180 n.4.

[138] *Id.* at 189 n.19.

[139] *Id.* at 190 n.19.

[140] The Second Circuit noted that the Japan FCN Treaty must be construed to give weight to several "unique requirements of a Japanese company doing business in the United States": "(1) Japanese linguistic and cultural skills, (2) knowledge of Japanese products, markets, customs, and business practices, (3) familiarity with the personnel and workings of the principal or parent enterprise in Japan, and (4) acceptability to those persons with whom the company or branch does business." *Avigliano*, 638 F.2d at 559. *Accord* Porto v. Canon U.S.A., Inc., 28 Fair Empl. Prac. Cas. (BNA) 1679 (N.D. Ill. 1981).

[141] *See* Fernandez v. Wynn Oil Co., 653 F.2d 1273, 1277 (9th Cir. 1981).

2. Determining Violations

Title VII of the Civil Rights Act of 1964 prohibits unlawful discrimination on the basis of "race, color, religion, sex, or national origin."[142] In applying that law, courts must determine, first, whether a violation exists and, second, whether a defense exists.[143] The theory of alleged violation will usually determine the appropriate defense. If the court bases a violation on intentional discrimination (disparate treatment), to avoid liability the employer must successfully refute the facts or show the existence of a bona fide occupational qualification. If the court finds a violation in a neutral practice which has a disparate or adverse impact on persons protected under the law, to prevail the employer must refute the facts or show that such practice is necessary to its business.[144]

A violation involving disparate treatment is established when the plaintiff provides sufficient evidence of prima facie (or presumptive) intentional discrimination (actual or inferred), such as proof of discrimination based on "race, color, religion, sex, or national origin."[145] The employer may rebut this charge by demonstrating a legitimate, non-discriminatory reason for the employment practice.[146] The plaintiff, who retains the ultimate burden of proof, may then attempt to show that the reason was merely pretextual.[147]

In *Shiseido Cosmetics (America) Ltd. v. State Human Rights Appeal Board*,[148] a woman employee alleged that she was dismissed by her employer, a wholly owned subsidiary of a Japanese corporation, because of her national origin. She maintained that the employer's retrenchment policy at the executive level was discriminatory in that it did not result in a comparable termination of Japanese employees. A New York court held that the retrenchment policy was unrelated to the employee's national origin and implied that the employer had acted upon a legitimate business reason.[149] The court also held that there was "no signifi-

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[142] Civil Rights Act of 1964, 42 U.S.C. § 2000e-2(a) (1982).

[143] *See* Note, *Yankees Out of North America: Foreign Employer Job Discrimination Against American Citizens*, 83 MICH. L. REV. 237, 248 (1984). *See generally* Comment, *The Multinational Corporation and Employment Discrimination: A Strategy for Litigation*, 16 U.S.F.L. REV. 491, 506-10 (1982) (examination of the liability of American companies operating in South Africa).

[144] The two defenses are distinguished in Harris v. Pan Am. World Airways, Inc., 649 F.2d 670, 674 (9th Cir. 1980).

[145] *See* Furnco Constr. Corp. v. Waters, 438 U.S. 567, 577 (1978).

[146] *See id.* at 577-78; McDonnell Douglas Corp. v. Green, 411 U.S. 792, 802 (1973).

[147] *Furnco*, 438 U.S. at 578; *McDonnell Douglas*, 411 U.S. at 804-05. *See generally* Mendez, *Presumptions of Discriminatory Motive in Title VII Disparate Treatment Cases*, 32 STAN. L. REV. 1129, 1161 (1980) (arguing that courts should impose on employers "more than a minimal requirement to produce some evidence of nondiscrimination").

[148] 72 A.D.2d 711, 421 N.Y.S.2d 589 (1979).

[149] *Id.* at ——, 421 N.Y.S.2d at 590.

cance" to the fact that the Japanese employees were not dismissed because

> the Japanese were in reality employees of the parent corporation assigned to an American subsidiary for varying periods of time as part of a rotation program of a familiar kind. The failure to dismiss such employees does not support the conclusion that a discriminatory policy was being pursued against Americans based on their national origin.[150]

A violation involving disparate or adverse impact is established when the plaintiff shows that an otherwise neutral employment rule or practice operates disproportionately on persons protected by Title VII, so as to exclude them from employment opportunities.[151] The employer may defend by proving that the practice was based on "business necessity."[152] The plaintiff may rebut this defense by demonstrating that the employer had other reasonable and equally effective alternatives with less discriminatory impact.[153]

Case law involving Title VII discrimination by multinational companies in

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[150] *Id.* at ___, 421 N.Y.S.2d at 591. There is no indication in the very brief opinion why the complainant did not also raise a theory that the rotation policy was a neutral policy with an adverse impact. The court did not attempt to show that the employer based its decision on a rotation policy which preferred Japanese nationals, nor did the court reveal whether it considered the rotating employees as joint employees of the wholly owned subsidiary. Although complainant's position was filled by a Japanese national with over 20 years of service with the company, the issue of seniority was not addressed. *Id.* at ___, 421 N.Y.S.2d at 590. *See* International Bhd. of Teamsters v. United States, 431 U.S. 324, 355-56 (1977) (holding that seniority preference not based on racial discrimination was lawful).

The New York court concluded that "following this program of retrenchment, the reduced staff continues to disclose a significant participation by Americans, some of them in high policy-making positions." 72 A.D.2d at ___, 421 N.Y.S.2d at 591. This "bottom-line" defense—the argument that if the end result of an employment practice is nondiscriminatory, then the practice is lawful—has been rejected by the United States Supreme Court. Connecticut v. Teal, 457 U.S. 440 (1982) (Title VII case dealing with job promotion examinations that discriminated against blacks and was not job-related).

[151] Dothard v. Rawlinson, 433 U.S. 321 (1977); Griggs v. Duke Power Co., 401 U.S. 424 (1971). The Equal Employment Opportunity regulations provide in pertinent part:

> A selection rate for any race, sex, or ethnic group which is less than four-fifths (4/5) (or eighty percent) of the rate for the group with the highest rate will *generally* be regarded by the Federal enforcement agencies as evidence of adverse impact, while a greater than four-fifths rate will generally not be regarded by Federal enforcement agencies as evidence of adverse impact.

29 C.F.R. § 1607.4D (1985) (emphasis added). On the question of proving violations, see Hazelwood School Dist. v. United States, 433 U.S. 299 (1977); Shoben, *Probing the Discriminatory Effects of Employee Selection Procedures with Disparate Impact Analysis Under Title VII*, 56 TEX. L. REV. 1, 45 (1977) (proposes a model based on "general skill jobs versus specialized skill jobs, and specific employment requirements versus a subjective employment process").

[152] Griggs v. Duke Power Co., 401 U.S. at 432. *See infra* text accompanying notes 208-16.

[153] *See, e.g.*, Albemarle Paper Co. v. Moody, 422 U.S. 405 (1975).

the United States is sparse. Courts have yet to decide the substantive legality of foreign companies giving alleged preferences to their own citizens to the disadvantage of American citizens, especially women.[154] Therefore, the present state of the law regarding this "agenda item"—foreign companies basing employment decisions on citizenship—is far from resolved.

In the leading case of *Espinoza v. Farah Manufacturing Co.*,[155] the United States Supreme Court held that Title VII's ban on national origin discrimination did not cover discrimination based on citizenship.[156] More specifically, the Court held that Title VII did not proscribe discrimination based on "alienage";[157] rather, the national origin provision refers "to the country where a person was born, or, more broadly, the country from which his or her ancestors came" and not to citizenship.[158] The Court did find, however, that a citizenship hiring preference could violate the national origin provision if it were pretextual and "part of a wider scheme of unlawful national-origin discrimination."[159]

Courts generally have interpreted *Espinoza* literally, holding that discrimination based on citizenship alone cannot be the basis for national origin discrimination.[160] Therefore, if a Japanese multinational company operating in the United States imposed a strict citizenship requirement, the courts might be receptive to its argument that no violation occurred. This conclusion would be bolstered if the facts showed that all non-Japanese citizens, regardless of their

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[154] *See, e.g.*, Avigliano v. Sumitomo Shoji Am., Inc., 473 F. Supp. 506 (S.D.N.Y. 1979) (charge of sex and national origin discrimination not fully addressed since decision hinged on treaty issues), *modified*, 638 F.2d 552, 558 (2d Cir. 1981) (The FCN Treaty does not exempt Japanese companies from Title VII but "does not give them license to violate American laws prohibiting discrimination in employment."), *vacated*, 457 U.S. 176 (1982); Linskey v. Heidelberg E., Inc., 470 F. Supp. 1181 (E.D.N.Y. 1979) (A United States citizen sued a Danish corporation and its American subsidiary claiming his discharge was based on age and his American citizenship. The court permitted the case to proceed but developed no substantive law.); Spiess v. C. Itoh & Co. (Am.), 469 F. Supp. at 9 (The court implied that defendant may be found in violation of Title VII when it denied defendant's motion to dismiss.). *See generally* Sethi & Swanson, *Are Foreign Multinationals Violating U.S. Civil Rights Laws?*, 4 EMPLOYEE REL. L.J. 485 (1979) (analysis of the issues in the then pending *Spiess* case); Note, *Beyond the FCN Treaty: Japanese Multinationals Under Title VII*, 51 FORDHAM L. REV. 871 (1983) (explaining that the legality of the management practices of Japanese subsidiaries in the United States is unsettled).

[155] 414 U.S. 86 (1973).

[156] *Id.* at 95.

[157] *Id.* at 95-96.

[158] *Id.* at 88.

[159] *Id.* at 92. *Accord* 29 C.F.R. § 1606.5(a) (1985) ("where citizenship requirements have the purpose or effect of discriminating against an individual on the basis of national origin, they are prohibited under Title VII").

[160] *See, e.g.*, Garcia v. Gloor, 618 F.2d 264 (5th Cir. 1980), *cert. denied*, 449 U.S. 1113 (1981); Vicedomini v. Alitalia Airlines, 33 Empl. Prac. Dec. (CCH) ¶ 34,119 (S.D.N.Y. 1983).

nationality or ancestry, were treated similarly and that the Japanese employer was seeking to insure that executives were familiar with business and cultural practices for legitimate business reasons.

The Equal Employment Opportunity Commission (Commission) guidelines go further and include as a violation employment practices based on "cultural or linguistic characteristics of a national origin group."[161] To some, however, there may be a significant difference between an *American* and a *foreign* citizenship requirement. For example, one author suggests that the latter requirement may be a per se national origin violation:

> A citizenship requirement, while perhaps providing employers with a shortcut to select qualified applicants, is unnecessarily concerned with *how* the applicant came to possess knowledge of Japanese business and culture, *i.e.*, being born into and growing up in the Japanese culture, rather than with whether the applicant *actually has* such knowledge. The citizenship requirement, therefore, is largely based on an accidental part of a person's life and unnecessarily excludes Americans with the requisite business and cultural familiarity.[162]

At least one court appears to have adopted this more restrictive view of the citizenship requirement and has rejected a Japanese employer's argument "that discrimination on the basis of national citizenship, as opposed to national origin, was not prohibited by Title VII."[163]

Moreover, in *Thomas v. Rohner-Gehrig & Co.*,[164] an Illinois federal district court held that an apparent citizenship discrimination complaint may be characterized as a national origin complaint in order to survive a motion to dismiss. Plaintiffs alleged that they were discharged by their employer, a Swiss-owned company incorporated in New York, because they were native born Americans. The company filled their positions with Swiss and German born employees. The employer moved to dismiss the complaint contending that the ban on national origin discrimination under Title VII was limited to "a person's ancestry, heritage, background, or possession of characteristics which are typically identified with ancestral groups," and did not limit discrimination based on "place of birth."[165] The court denied the motion to dismiss, citing *Espinoza*, and held

[161] 29 C.F.R. § 1606.1 (1985).

[162] Note, *Yankees Out of North America*, *supra* note 143, at 245-46 (emphasis original) (footnote omitted).

[163] It appears that the federal district court did not address this issue in its written opinion in *Avigliano*, 473 F. Supp. 506 (S.D.N.Y. 1979). The Supreme Court, however, observed that "Sumitomo argued in the District Court that discrimination on the basis of national citizenship, as opposed to national origin, was not prohibited by Title VII. The District Court disagreed, however." *Sumitomo*, 457 U.S. at 180 n.4.

[164] 582 F. Supp. 669 (N.D. Ill. 1984).

[165] *Id.* at 672-74.

that national origin does refer to the country where a person or his ancestors were born. The court held that an employer who discriminated against an applicant or employee merely because he was "American born" could be in violation of Title VII.[166]

There seems to be a tendency for Japanese employers to give job preferences to nationals, especially to those nationals who are male. This employment practice and the widely used policy of "promoting from within" will have an adverse impact on American women, screening them from job opportunities at a rate disproportionate to men. It may be possible to show that the Japanese employer's use of citizenship as an employment criterion is pretextual and really a policy designed to exclude American citizens, especially women, from managerial and executive positions, thereby violating the sex or national origin provision of Title VII.

In the author's opinion, Japanese employers who favor nationals are violating Title VII although exculpatory defenses may exist. Nationality discrimination can be a not-too-disguised form of national origin preference in that it is closely tied to reliance on "expediency" and "stereotype assumptions" about who possesses or lacks job qualifications regarding the language, customs, and business practices of Japan. This, combined with the inevitable wholesale national origin inclusionary preference for those of Japanese ancestry due to Japan's homogeneous population,[167] adversely impacts on Americans because of their race, sex, and national origin. Nationality discrimination also might be viewed as pretextual in that Japanese employers merely seek a more efficient method of identifying candidates who generally possess company or country knowledge (*shosha*). Such employment practices may violate Title VII under either a disparate treatment or an adverse impact theory. The latter, however, is more likely the easier to prove.[168]

Other Japanese employment practices also tend to create potential violations under Title VII and, therefore, require appropriate attention. These practices include providing different economic and job security benefits to the predominantly Japanese rotating staff, promoting from within, and requiring Japanese

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[166] *Id.* at 675. *See also* Linskey v. Heidelberg E., Inc., 470 F. Supp. 1181 (E.D.N.Y. 1979).

[167] Statistics show that more than 99% of Japan's population is of Japanese origin. D. WHITAKER, P. JUST, J. MACDONALD, K. MARTINDALE, J. RECORD, R. SHINN, C. TOWNSEND & N. VREELAND, AREA HANDBOOK FOR JAPAN 70 (3d ed. 1974).

[168] In proving disparate impact, the portion of the employer's workforce chosen for comparison (executives versus a larger pool of workers) is quite crucial. The law, however, is beginning to develop a fairly good standard of predictability on this point. *See* Connecticut v. Teal, 457 U.S. 440 ("bottom line" percentages of blacks and whites promoted does not justify discrimination); Bonilla v. Oakland Scavenger Co., 697 F.2d 1297 (9th Cir. 1982) (An employer's restriction of company wages and ownership benefits to family or close friends of present owners, all of whom are of Italian ancestry, has an adverse impact on employees of other national origins or races and is a violation of Title VII.), *cert. denied*, 104 S. Ct. 3533 (1984).

language skills.

Job testing by Japanese multinationals also must be re-examined in light of Title VII requirements. The Japanese selection process involves a detailed investigation into an applicant's personal life in order to determine if the applicant would be compatible with company goals and in "harmony" with the present work force. One commentator described this selection process as

> a checklist approach, including schooling, family background, and other factors which ensure that the person will "fit in" to the corporation. This is extremely important since the company and the employee expect the employment to last a lifetime. Japanese also approach promotions much differently than American firms. Years of service is the basic criterion used for salary determination, not the quality or quantity of work.[169]

When hiring high level employees, Japanese companies in the United States often do not utilize general job descriptions but hire on the basis of subjective factors such as position requirements and prior experience.[170] At the "work floor" level, Japanese employers may also utilize subjective factors in hiring employees, often American workers, who will perform "flexible job duties."[171]

This emphasis on compatibility and other subjective factors and the absence of any formal job description is a legal quagmire inviting litigation under Title VII. Japanese employers often will have problems justifying why applicants or employees were distinguishable for purposes of receiving benefits and opportunities and how their screening devices were job-related.[172] The lack of standards to measure worker qualification and performance will inevitably lead disgruntled employees to feel that their job benefit or opportunity is less than it should

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[169] Hiller, *Civil Rights Enforcement and Japanese Subsidiaries*, 21 AM. BUS. L.J. 463, 470-71 (1984).

[170] Sumitomo Shoji testified that for the "few executive, managerial, and sales positions" which it fills, it "does not have or utilize any generally applicable written criteria, but instead fills such positions based on the particular requirements of each position" and that the "most important criterion is relevant prior experience." *Avagliano*, 103 F.R.D. at 569 (quoting Defendant's Supplemental Answers and Objections to Plaintiffs' Interrogatories at 3).

[171] For example, Sumitomo Shoji "maintains no job descriptions for any of the twenty-one job titles in the company." *Avagliano*, 103 F.R.D. at 568-69.

[172] *See* Kraszewski v. State Farm Gen. Ins. Co., 38 Fair Empl. Prac. Cas. (BNA) 197 (N.D. Cal. 1985). In *Kraszewski*, the employer's job selection procedures were not shown to be job related, predictive of, or correlated to important elements of job behavior necessary to safe and efficient job performance. The employee had relied on multiple subjective criteria which had a disparate impact on women. *But see* Reilly v. Califano, 537 F. Supp. 349 (N.D. Ill.) (upholding employer's use of the subjective factor of "personality" in hiring an applicant with a lower evaluation "ranking" than plaintiff), *aff'd mem.*, 673 F.2d 1333 (7th Cir. 1981), *cert. denied*, 456 U.S. 916 (1982).

be.[173] At least one author, however, has suggested that courts have been reluctant to apply the same rigorous standards for job discrimination against executive employees as against blue-collar employees and that relatively few cases regarding executive discrimination are brought.[174]

An alternative basis for liability is found under section 1981 of the Civil Rights Act of 1866,[175] which provides that "[a]ll persons . . . shall have the same right . . . to make and enforce contracts . . . as is enjoyed by white citizens. . . ."[176] The United States Supreme Court has held that this provision applies to private employment discrimination[177] and prohibits discrimination against whites as well as non-whites.[178] Courts have also expanded the term "white citizens" to protect not only blacks and whites, but also Hispanics and Asian-Americans.[179]

It is still unsettled, however, whether decisions protecting Hispanics and Asian-Americans protect against discrimination based on national origin or race.[180] Some courts have held that discrimination on the basis of national origin does not violate section 1981.[181] Other courts have held that section 1981

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[173] These employees may not complain if the Japanese managerial approach of promoting harmony in the work place actually displaces the American tendency to seek vindication of rights, often through litigation.

[174] Bartholet, *Application of Title VII to Jobs in High Places*, 95 HARV. L. REV. 947, 948-50 (1982).

[175] 42 U.S.C. § 1981 (1982).

[176] *Id.*

[177] Johnson v. Railway Express Agency, Inc., 421 U.S. 454, 459-60 (1975). *Cf.* Jones v. Alfred H. Mayer Co., 392 U.S. 409 (1968) (availability of 42 U.S.C. § 1982, which governs right to real and personal property, to private discrimination).

[178] McDonald v. Santa Fe, 427 U.S. 273, 296 (1976) (law applies to whites and non-whites). *See also* Takahashi v. Fish & Game Comm'n, 334 U.S. 410, 419 (1948) (holding that rights under 8 U.S.C. § 41, which is now codified at 42 U.S.C. § 1981, protects aliens to the same extent as citizens).

[179] *See, e.g.*, Manzanares v. Safeway Stores, Inc., 593 F.2d 968 (10th Cir. 1979) (Hispanic). *Cf.* Bullard v. Omni Ga., Inc., 640 F.2d 632 (5th Cir. 1981) (preference for Orientals over whites is race and perhaps national origin discrimination). It seems clear, however, that § 1981 does not protect sex discrimination, *see, e.g.*, New York City Jaycees, Inc. v. United States Jaycees, Inc., 377 F. Supp. 481, 487 (S.D.N.Y. 1974) (dictum) (42 U.S.C. § 1981 does not apply to sex discrimination, only to persons denied rights as "white citizens."), *rev'd on other grounds*, 512 F.2d 856 (2d Cir. 1975); or to religious discrimination, *see, e.g.*, *Manzanares*, 593 F.2d at 971; Khawaja v. Wyatt, 494 F. Supp. 302, 304 (W.D.N.Y. 1980).

[180] *See* Thomas v. Rohner-Gehrig & Co., 582 F. Supp. at 671 n.4. *See also* Shah v. Mt. Zion Hosp. & Medical Center, 642 F.2d 268 (9th Cir. 1981) (§ 1981 does not protect "Caucasian" citizens against national origin discrimination); Khawaja v. Wyatt, 494 F. Supp. 302 (unclear whether § 1981 is founded on national origin, alienage, or race).

[181] *See, e.g.*, Ben-Yakir v. Gaylinn Assocs., 535 F. Supp. 543 (S.D.N.Y. 1982); Kurylas v. United States Dep't of Agriculture, 373 F. Supp. 1072 (D.D.C. 1974) (allegation of national origin does not state a cause of action), *aff'd*, 514 F.2d 894 (D.C. Cir. 1975).

will apply when national origin discrimination is motivated by or indistinguishable from racial discrimination.[182] Under this approach the distinction between race and national origin is not always clear in that "[b]oth classifications have the effect of excluding Caucasians and blacks from employment."[183]

This may lead to lawsuits brought by American citizens under claims of "reverse" discrimination based on race and national origin. In *Thomas v. Rohner-Gebrig & Co.*,[184] however, an Illinois federal district court denied a discharged employee's section 1981 "reverse" discrimination claim which was based on his being replaced by Swiss and German nationals who were Caucasian. The court concluded that there was insufficient evidence of racial discrimination when whites replace whites.[185] This raises the interesting question whether the result in *Thomas* might have been different if the replaced employee had been Oriental rather than Caucasian. The federal district court in *Avigliano v. Sumitomo Shoji America, Inc.*[186] tangentially addressed this issue. The court considered the race and national origin claims in a section 1981 cause of action to be intertwined. The court nevertheless rejected the section 1981 claim because one of the plaintiffs was a Japanese national and an action was already available under Title VII.[187]

Courts may be receptive to section 1981 claims by American citizens alleging discrimination by multinationals based on citizenship, national origin, and alienage, especially when such discrimination is intertwined with or characterized as "race" discrimination. This is one "agenda item" that should be watched closely as section 1981 does not contain the statutory defenses of Title

[182] *See, e.g.*, Enriquez v. Honeywell, Inc., 431 F. Supp. 901 (W.D. Okla. 1977) (Mexican-American can bring claim of racial discrimination); Cubas v. Rapid Am. Corp., 420 F. Supp. 663 (E.D. Pa. 1976) (Cuban-born naturalized citizen). *Cf.* Martinez v. Hazelton Research Animals, Inc., 430 F. Supp. 186 (D. Md. 1977) (unsupported allegation that plaintiff was a Hispanic male did not establish racial discrimination).

[183] Gray, *The National Origin BFOQ Under Title VII: Limiting the Scope of the Exception*, 11 EMPLOYEE REL. L.J. 311, 313-15 (1985) (analyzing race and national origin in the Title VII context and the BFOQ exception under Title VII after the Supreme Court's *Sumitomo* decision). Gray urges that national origin discrimination be considered more closely akin to racial discrimination because classifications based on race or national origin converge. "For example, an employment practice of hiring only Japanese nationals converges with a practice of hiring only members of the Oriental race." *Id.* at 313. *See* Bullard v. Omni Ga., Inc., 640 F.2d 632 (preference for those with Oriental heritage over whites and blacks is racial discrimination and possibly national origin discrimination).

[184] 582 F. Supp. 669 (N.D. Ill. 1984).

[185] *Id.* at 672. The court held, however, that a Title VII national origin violation may be proven. *See supra* text accompanying notes 164-66.

[186] 473 F. Supp. 506 (S.D.N.Y. 1979), *modified*, 638 F.2d 552 (2d Cir. 1981), *vacated*, 457 U.S. 176 (1982).

[187] 473 F. Supp. at 514.

VII.[188]

3. *Availability of Defenses*

Two primary defenses are available under Title VII: (1) the statutory bona fide occupational qualification (BFOQ) defense, which permits intentional discrimination on the basis of religion, sex, or national origin when it is "reasonably necessary to the normal operation of that particular business or enterprise";[189] and (2) the judicially created "business necessity" defense which permits discrimination even when it has an adverse impact on employees, unless a reasonable alternative exists.[190] This section deals with the effect these legal defenses may have on the business practices of foreign companies operating in the United States, including preference for nationals in executive positions, often as part of a "rotating staff," their policies of promoting from within, and testing procedures.

a. *BFOQ Defense*

The broad issue is whether foreign companies incorporated and operating in the United States should be permitted to retain business systems which otherwise would be found to violate American labor laws. The narrower issue is whether the discriminatory business practice, such as preference for nationals, is reasonably necessary to the normal operation of the employer's business. The BFOQ exception provides a statutory basis for intentional discrimination which accommodates legitimate business needs that go to the "essence" of the business.[191] Although the United States Supreme Court has indicated that this exception is limited,[192] recent Commission decisions have demonstrated a grow-

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[188] See *infra* text accompanying notes 189-216 for a discussion of the statutory defenses under Title VII.

[189] Civil Rights Act of 1964, 42 U.S.C. § 2000e-2(e) (1982). *See Sumitomo*, 457 U.S. at 189 n.19 (Some positions in a Japanese company operating in the United States "call for great familiarity with not only the language of Japan, but also the culture, customs, and business practices of that country."); Gray, *supra* note 183, at 311-20; Note, *Yankees Out of North America*, *supra* note 143, at 249-53.

[190] *See Dothard*, 433 U.S. at 331-32 & n.14; *Griggs*, 401 U.S. at 432.

[191] *Dothard*, 433 U.S. 321. *See also* Weeks v. Southern Bell Tel. & Tel. Co., 408 F.2d 228, 235 n.5 (5th Cir. 1969) (dictum). Mere increased administrative efficiency, however, is not usually an adequate basis. *See, e.g.*, Diaz v. Pan Am. World Airways, Inc., 442 F.2d 385 (5th Cir.), *cert. denied*, 404 U.S. 950 (1971).

[192] The Supreme Court noted that "the bfoq exception was in fact meant to be an extremely narrow exception to the general prohibition of discrimination on the basis of sex." *Dothard*, 433 U.S. at 334 (The Court, however, held that being male is a BFOQ for a job as a counselor in a male maximum-security penitentiary.). *See* Recent Development, Dothard v. Rawlinson: *Misap-*

ing sensitivity to foreign business practices.[193]

Whether the Japanese can maintain their practice of utilizing a rotating staff depends on their ability to show that the practice is central and necessary to the essence of the business, "not merely tangential."[194] Japanese companies operating in the United States are often part of a general trading company (*sogo shosha*); executive employees (frequently "lifetime" employees) working for these companies are trained in Japan and abroad.[195] These employees "rotate" through the subsidiaries to gain a better understanding of the parent company and to serve its needs. Under this rotation system, the parent company retains control and protects its investment. At times the managerial rotating staff can reach a fairly large percentage of the total staff of the American subsidiary.[196]

One of the first inquiries is what attributes "all or substantially all" Japanese nationals have that American citizens do not. Japanese nationals are likely to be familiar with Japanese language, customs, and interpersonal relations. They perhaps have insights into Japanese business practices, including knowledge of the product line, the central management structures, and company operations. They may fit in more easily and deal more effectively with the home office and the personnel of other Japanese subsidiaries.

It is debatable whether Japanese nationals possess all these attributes; whether some non-Japanese might possess more of them; and at what level—executive, managerial, technical, or sales—these attributes are significant. The burden of proving BFOQ as an affirmative defense lies on the employer and, although it has been suggested that BFOQ should be presumed,[197] the Commission and the courts will more likely approach the question on a case-by-case basis.

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plication of the Bona Fide Occupational Qualification Defense, 22 ST. LOUIS U.L.J. 197, 218-26 (1978) (criticizing the Court in *Dothard* for upholding the BFOQ exception in the absence of concrete evidence).

[193] This sensitivity was perhaps presaged by the Commission's amicus curiae brief to the Fifth Circuit in *Spiess v. C. Itoh & Co. (Am.)*. The Commission raised the possibility that the BFOQ exception would be "broad enough to encompass any rights that Japanese corporations legitimately could assert under the Treaty." 643 F.2d at 361.

[194] *See* Diaz v. Pan Am. World Airways, Inc., 442 F.2d at 388-89. In determining the "essence" of the business, the Second Circuit emphasized that executive "positions" reasonably necessary to the "successful *operation*" of the business would be considered. *Avigliano*, 638 F.2d at 559 (emphasis added). The Fifth Circuit emphasized the importance of "control." Spiess v. C. Itoh & Co. (Am.), 643 F.2d at 360-61.

[195] *See* Krause & Sekiguchi, *supra* note 81, at 389.

[196] For example, in Sumitomo Shoji Kaisha, Ltd., one of Japan's largest trading companies, some 40-45% of the New York staff were part of the rotating staff. *Avagliano*, 103 F.R.D. at 569. Other large trading companies include C. Itoh & Co., Nichimen Co., Mitsubishi Corp., Nissho Iwai Co., Marubeni Corp., Toyo Menka Kaisha Ltd., Mitsui & Co., and Kanematsu-Gosho Ltd. *See* Wiegner, *Outward Bound*, FORBES, July 4, 1983, at 96, 97.

[197] *See* Note, *Yankees Out of North America*, *supra* note 143, at 249-53.

A second inquiry is whether discrimination based on these culture-based attributes is "reasonably necessary" to the operation of the Japanese company's business. Although precedent dealing with Japanese companies is lacking, the following discussion and cases addressing other foreign companies may provide some insight by way of analogy. In sex discrimination cases, courts repeatedly have held that women may not be denied job opportunities based on inaccurate stereotypes and misconceptions about the general abilities of women.[198] If a factual basis for discrimination exists, however, it may be upheld. For example, the Commission recently held that an American employer operating extraterritorially could discriminate on the basis of sex on account of a foreign country's laws, customs, and refusal to grant an entry visa.[199] The Commission cautioned, however, that the "employer must have a current, authoritative, and factual basis for its belief, and it must rely upon that belief in good faith."[200] In *Kern v. Dynalectron Corp.*,[201] a Texas federal court held that religion was a BFOQ for pilots when the foreign laws of the host country provided that "non-Muslims flying into Mecca," if caught, would be beheaded.[202] A foreign multinational employer operating in the United States may also assert by analogy that it is necessary to adhere to its own customs and practices regarding citizenship, sex, or religious discrimination.

A national origin BFOQ exception could exist if national origin closely correlated with the legitimate needs of the business, including familiarity with business operations and cultural skills.[203] A Japanese employer's argument for a BFOQ exception would seem strongest on business and cultural familiarity requirements and weakest on pure citizenship because it stereotypes knowledge of business and culture based on the accident of birth.

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[198] *See, e.g.*, Rosenfeld v. Southern Pac. Co., 444 F.2d 1219 (9th Cir. 1971). *Cf.* Rosen v. Public Serv. Elec. & Gas Co., 328 F. Supp. 454 (D.N.J. 1970) (employer's pension plan could not permit retirement at different ages and lengths of service for men and women), *rev'd on other grounds*, 477 F.2d 90 (3d Cir. 1972).

[199] 2 EMPL. PRAC. GUIDE (CCH) ¶ 6851 (July 16, 1985) (An American employer in a foreign country denied employment to a female applicant for a job as an air traffic controller due to the country's customs and laws regarding working women.). The Commission emphasized that it

> will closely examine the facts of each case to determine whether the reasons given by the employer satisfy the Commission's standards. However, it is the Commission's view that the employer cannot rely upon mere conjecture upon the policies of the foreign country or upon stereotypical views of the individual's class.

Id. ¶ 6851, at 7055. Although the case involved a "business necessity" test, it could easily have involved a BFOQ defense if the employer proved that "all or substantially all" women could not perform the task. *See id.* ¶ 6851, at 7055 n.2.

[200] *Id.* ¶ 6851, at 7054.

[201] 577 F. Supp. 1196 (N.D. Tex. 1983), *aff'd*, 746 F.2d 810 (8th Cir. 1984).

[202] 577 F. Supp. at 1201.

[203] For a list of skills and traits which Japanese companies operating in the United States require, see *supra* note 140.

Other related case law has primarily involved attempts by American employers to use "customer preference" as a defense to national origin and sex discrimination. These attempts generally have failed.[204] Some BFOQ's, however, have been found where foreign custom or laws limited a United States employer's ability to refrain from discriminating for particular jobs that were located in a foreign country.[205] In addition, the Commission may be signaling that some cases go beyond mere customer preference and involve foreign policies, customs, practices, and law which might need to be accommodated for United States employers operating abroad[206] and perhaps by analogy for multinationals operating in the United States.

Finally, a foreign employer may be able to use language skills as a BFOQ defense to national origin discrimination. While an employer who attempts to impose foreign language requirements may face legal obstacles, the law recognizes that there may be legitimate business justifications for such discrimination.[207] Certain jobs may entail continual contact with home offices or other

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[204] *See, e.g.*, Diaz v. Pan Am. World Airways, Inc., 442 F.2d 385 (rejecting as a defense the preference of American airline customers to have women stewardesses); American Jewish Congress v. Carter, 23 Misc. 2d 446, 190 N.Y.S.2d 218 (Sup. Ct. 1959) (rejecting as a BFOQ an American employer's attempt to placate a Saudi Arabian customer by not hiring women for its New York office), *modified*, 10 A.D.2d 833, 199 N.Y.S.2d 157 (1960), *aff'd*, 9 N.Y.2d 223, 173 N.E.2d 788, 213 N.Y.S.2d 60 (1961).

Cf. Fernandez v. Wynn Oil Co., 653 F.2d 1273 (9th Cir. 1981). The *Fernandez* court held that being male is not a BFOQ for a position in a company that does business in foreign countries where customers refuse to do business with females. *Id.* at 1276-77. The court, however, found that sex was not a factor in the employer's refusal to promote the female employee. *But see* Ward v. Westland Plastics, Inc., 651 F.2d 1266 (9th Cir. 1980). In *Ward*, the customer, at the last moment, requested that other females be prohibited from attending the business lunch. The management, therefore, barred a female employee from attending. The court noted that, in this situation, the actions of management were "not to accommodate a buyer's sexist preference," but were merely "to avoid potential embarrassment to itself and to the individuals involved." *Id.* at 1269.

[205] *See, e.g.*, Kern v. Dynalectron Corp., 577 F. Supp. 1196 (religious BFOQ).

[206] *Cf.* 2 EMPL. PRAC. GUIDE (CCH) ¶ 6851 (July 16, 1985) (foreign laws and customs considered when hiring air traffic controller). *But cf.* 2 EMPL. PRAC. GUIDE (CCH) ¶ 6857 (Sept. 16, 1985) (American citizens working for American companies abroad are protected by American labor laws.).

[207] Similarly, courts have held that denial of employment based on the applicant's inability to speak English, if job-related, is not "national origin" discrimination. *See, e.g.*, Vasquez v. McAllen Bag & Supply Co., 660 F.2d 686 (5th Cir. 1981) (English-speaking rule was based on a legitimate business reason), *cert. denied*, 458 U.S. 1122 (1982); Frontera v. Sindell, 522 F.2d 1215 (6th Cir. 1975) (no violation of rights; state's requirement of English rationally related to legitimate objective). The Commission guidelines permit employers to require that employees speak only English at certain times, but only if "the rule is justified by business necessity." 29 C.F.R. § 1606.7 (1985). *See generally* Comment, *Language Discrimination Under Title VII: The Silent Right of National Origin Discrimination*, 15 J. MAR. L. REV. 667 (1982) (discussing language

foreign subsidiaries and suppliers and, therefore, may require a grasp of foreign language. Whether employers can use national origin or citizenship to screen for language facility depends on the employer's ability to provide a convincing statistical basis for its conclusion.

The BFOQ defense raises two "agenda items" for future resolution. First, should foreign companies operating in the United States be allowed to use their own business practices and customs as a basis for preferring home country employees? In resolving this policy issue, American decision-makers must consider whether, without such an exception, traditional and unique Japanese business practices and their efficient and profitable United States enterprises will "wither and die" and whether Japanese trade and direct investment in the United States may also be affected.

Second, what are the parameters of the BFOQ defense? Will the breadth of the exception include only national origin differentiation and exclude sex, race, and religion grounds for unlawful discrimination? Will it include managerial, supervisory and executive personnel as well as lower level executives and specialists or only those in the higher echelon? Finally, what level of proof will be required to show the relationship of a BFOQ to the various skills?

b. Business Necessity Defense

The judicially created "business necessity" defense[208] permits intentional or neutral discrimination when necessary for a safe and efficient operation of the business and when no reasonable alternatives are available.[209] There is no authoritative case law involving foreign multinationals in the United States and their use of this defense.

Discrimination by foreign multinationals based solely on citizenship probably will not be upheld under this defense because such discrimination likely will be seen merely as a means of using stereotypes to indirectly obtain business and cultural familiarity. The defense of "business necessity" probably will also fail because there are reasonable alternatives to identify job skills, such as job tests and interviews. For example, a Japanese language requirement might be necessary to the business because employees must properly communicate with the home office,[210] but Americans as well as Japanese could meet this requirement.

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requirements and the BFOQ and business necessity defenses).

[208] Griggs v. Duke Power Co., 401 U.S. at 431-32.

[209] *See* Dothard v. Rawlinson, 433 U.S. at 331 n.14; Comment, *The Business Necessity Defense to Disparate-Impact Liability Under Title VII*, 46 U. CHI. L. REV. 911 (1979). *See also* Leftwich v. United States Steel Corp., 470 F. Supp. 758, 765 (W.D. Pa. 1979) ("Good business management or job efficiency are recognized defenses to Title VII claims" and may be supported by proof of the employee's excessive errors and tardiness.).

[210] *See* Comment, *Language Discrimination*, *supra* note 207, at 687-91. *Cf.* 29 C.F.R. §

Therefore, foreign language proficiency could be achieved without a citizenship requirement by adequate testing.[211]

The foreign employer is more likely to prevail if job requirements necessitate familiarity with foreign business, managerial, and cultural practices and if the resulting adverse impact on American citizens from its selection of a large percentage of foreign nationals is purely incidental, without reasonable alternatives. It has been argued that the differences between Japanese and American cultures require Japanese trading companies to hire Japanese nationals or face the high costs that accompany the training of American applicants. Japanese nationals come equipped with the knowledge of the structure and needs of trading companies; Americans do not.[212]

A possible weakness in the business necessity defense could be the apparent absence of the first part of the requirement that the exclusion be reasonably necessary to the "safe and efficient" operation of the business. While increased efficiency is almost always considered, safety seems to be displaced by the desired goal of "better chance for profitability."

Several "agenda items" regarding the business necessity test await resolution. It is unclear for what category of employees the defense is valid and whether it shields discrimination based just on national origin and not consequential discrimination based on other factors, such as sex. In addition, it remains to be seen whether training American workers is a reasonable alternative and whether other equally effective employment practices with fewer discriminatory effects exist. Some of these issues are presently being tested in *Avagliano v. Sumitomo Shoji America, Inc.*[213] The employer had referred to personnel assigned from the Japanese parent to the American subsidiary as "rotating staff" and to local em-

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1606.7 (1985) (Speak-English-only rules may be allowed if there is a "business necessity."). *But cf.* Saucedo v. Brothers Well Serv., Inc., 464 F. Supp. 919 (S.D. Tex. 1979) (Absent "business necessity," rules requiring that only English be spoken are impermissible.).

[211] Arguably under a BFOQ analysis "all or substantially all" United States citizens may not meet a language proficiency requirement. Under a "business necessity" test, however, reasonable alternatives clearly exist to determine such proficiency and a citizenship requirement probably would fail.

[212] It has been noted that:

> Japanese citizenship can easily constitute a business necessity in a factual setting such as that present in *Sumitomo*. The extensive cultural differences between Japanese society and American society dictate that in any liason [sic] between the two, the parties must have a strong working knowledge of how both cultures operate. The structure of the trading company dictates such a liason [sic], and Japanese college graduates have been educated in how to handle the differences. Few potential American applicants have had this extensive training. The costs of the process are borne by the trading company, which has a vested interest and expectation in retaining the employee.

Lansing & Palmer, Sumitomo Shoji v. Avagliano: *Sayonara to Japanese Employment Practices in Conflict with Title VII*, 28 ST. LOUIS U.L.J. 153, 167 (1984).

[213] 103 F.R.D. 562 (S.D.N.Y. 1984).

ployees as "non-rotating staff."[214] The rotating staff was further categorized as employees with "titles" and "general" employees.[215] Plaintiffs have indicated they will argue "that even if a business necessity defense could be established as to relatively high echelon positions at Sumitomo, there could be no business necessity defense for positions filled by Japanese nationals listed as general employees."[216]

B. *Labor-Management Relations*

1. *Developing Agenda Items: Japan in the United States*

The form of foreign direct investment in the United States and the organization of the foreign multinational are critical in determining the types of labor management issues. Foreign companies operating in the United States usually establish United States-based affiliates, often through locally incorporated subsidiaries or branch offices. More companies, especially manufacturing industries, are beginning to form joint ventures with American companies to share technological and marketing advantages.[217] Sometimes a new or merged company results from a "buyout or takeover" of an already existing American company. Under United States labor law, this may place the foreign employer under a legal obligation to recognize and bargain with an existing union in the acquired company.

Multinational corporations often organize their personnel in a way that reflects their home country experience. In this way, the foreign employer, particularly the Japanese, often hopes to retain control over the labor force and attain a level of productivity similar to that reached in the home country. Some American labor unions have interpreted these efforts as anti-union which, if true, could be unlawful.

The foreign employer's adaptation of the major features of its labor relations emphasizing employer-employee cooperation raises legal issues under the National Labor Relations Act (Act)[218] in that these practices may interfere with rights of employees to establish an independent labor union.[219] Likewise, when American companies seek to emulate or improve upon these foreign approaches

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[214] *Id.* at 569.

[215] *Id.*

[216] *Id.*

[217] Japan's Direct Investment, *supra* note 1, at 13.

[218] 29 U.S.C. §§ 151-169 (1982).

[219] At times, the equal employment opportunity and labor relations laws may be triggered simultaneously. For example, in one case it was alleged that a foreign employer, a Kawasaki subsidiary in Georgia, had replaced American employees with Korean nationals during a union organizational drive. Bullard v. Omni Ga., Inc., 640 F.2d 632 (5th Cir. 1981).

to labor relations and utilize them in United States companies similar legal issues can arise.

While Japanese and American labor laws appear similar, the genesis was different. American labor after much social struggle "won" protections afforded by the Act; the Japanese workers to some extent were "given" their protections after World War II, partially to counterbalance the overwhelming power of the successful large intra-industry combines (*zaibatsu*).[220] The evolvement of each labor law has differed due to "cross-cultural differences relative to predispositions toward or against conflict or cooperation."[221]

The key to Japanese success in industrial relations is often touted as the high degree of cooperation between labor and management.[222] The Japanese system of shared responsibility and decision-making is exemplified by supervisors below the level of section chiefs (*kacho*) who often serve as "working foremen" sharing not only the workload but also some of the supervisory powers. It is also not uncommon for former union leaders to reach high level executive positions. The effect of this is "that Japanese unions have an abundance of white-collar and supervisory members, from among whom come a disproportionate number of the leaders."[223] Furthermore, in Japan

> [t]here is a hierarchical split between upper and lower management. Only the section chief (*kacho*) is clearly excluded as a supervisor under Japanese labor law. Those just below the *kacho* level, although they are supervisors or managerial employees and thus excluded in the United States, are protected by the Trade Union Law.[224]

Additionally, Japanese employers have come to expect and rely on widespread use of joint employer-employee committees, consensus decision-making, and sharing of information with one or several unions as successful methods of obtaining cooperation and increasing productivity.[225]

By contrast, American unions often seek a course independent from the employer which may work against the creation and use of more cooperative models. There is a traditional sense of "us versus them," and the union often finds itself in an adversarial role in order to obtain benefits from the employer. Consistent with this, there is a clearer line of demarcation between supervisors and

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[220] *See* W. GOULD, *supra* note 31, at 18.

[221] Duff, *supra* note 41, at 639.

[222] *See supra* text accompanying notes 20-69.

[223] W. GOULD, *supra* note 31, at 4. *See* R. CLARK, THE JAPANESE COMPANY 218 (1979) (sociological study of a Japanese company showing that "the union was under the control of older men, usually of the team leader rank").

[224] W. GOULD, *supra* note 31, at 143 (emphasis original).

[225] *See generally Worker Participation*, *supra* note 29, at 51-63 (discussing Japanese system of joint consultation).

employees. Supervisors usually are not protected by the Act,[226] and their involvement in the union's organization may constitute a violation of the Act.[227]

In the United States, an employer who too closely cooperates with a joint employer-employee committee and who shares information and otherwise "deals" with the committee on bargainable subjects in a way that "by-passes" the exclusive bargaining agent or who becomes too deeply involved in the "labor organization" may be in violation of the Act.[228] This may surprise some Japanese employers since they have no "exclusivity" doctrine and can have more than one union in the plant at the same time representing similar types of employees.

American labor unions may perceive this Japanese cooperative approach as paternalistic and anti-union. They argue that an employer's decision to hire workers who will fit in and refusal to quickly "recognize" a labor union for bargaining purposes are indicia of an anti-union attitude. To the extent such an attitude can be proven, it may be evidence of discriminatory intent against employees' union activities in violation of the Act.[229] Japanese employers operating in the United States may find that if they attempt to use traditional managerial and industrial relations approaches, they face not only union resistance but also legal difficulties.

In addition, Japanese employers are not familiar with American-style "economic warfare." They are only accustomed to occasional confrontations with unions—such as the annual Spring Offensive (*shunto*) when industry-wide wage guidelines are negotiated through collective action—and an occasional strike of very short duration which is often intended to embarrass, not economically harm, the employer.[230] Professor Tadashi Hanami has described the Japanese strike as follows:

> Most of the Japanese strikes are not strikes in the Western sense. Strike is a means of protest, or more precisely, it is the only means of showing [the Japanese workers'] will. When they go on strike, they do not mean that they will never return to their jobs until they are satisfied or completely defeated. Rather, sometimes they first go on strike and then start to bargain. Employers also start to

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[226] 29 U.S.C. § 152(3), (11) (1982). *See* Parker-Robb Chevrolet, Inc., 262 N.L.R.B. 402 (1982) (supervisor who actively participates in a union is not protected under the Act), *aff'd*, 711 F.2d 383 (D.C. Cir. 1983).

[227] 29 U.S.C. § 158(a)(2) (1982) (unfair labor practices by *employer*).

[228] *Id.* § 158(a).

[229] *Id.* § 158(a)(1), (3). It has been observed that "[t]he Japanese style of cooperation may indeed take on some of the characteristics of subordination, a subordination that involves a paternalism culturally alien to America. That is not an argument against promoting cooperation as a more significant element in the labor-management relationship, however." W. GOULD, *supra* note 31, at 99.

[230] *See* T. HANAMI, *supra* note 23, at 94-97, 152-54.

> bargain seriously only after the union carries out some short-term strikes and shows how serious they are.[231]

In an American strike the parties "proceed from contrary and to an extent antagonistic viewpoints and concepts of self interest. . . .The presence of economic weapons in reserve, and their actual exercise on occasion by the parties, is part and parcel of the [American] system. . . ."[232]

As Japanese companies in the United States deal with American labor unions and as disputes arise, the cooperative and conflict-oriented traditions will inevitably clash. Such a clash, however, can be managed if common sense and cultural sensitivity direct the parties' actions. The Japanese in the United States must recognize and deal with the American labor phenomenon of "symbolic conflict," the historically supported concept that "American unions must have conflict to survive; if no legitimate issues of contention exist, unions will *create* issues."[233] American managers and unions bargaining with Japanese ownership must work to replace symbolic conflict with cooperation.[234]

2. *Current Legal Implications of Replacing "Conflict" with "Cooperation" in the Employment Relationship*

a. *"Supervisors" and "Managerial" Employees*

The National Labor Relations Act grants employees the right to unionize and protects them against unfair labor practices.[235] The initial requirement under the Act is that one must be an "employee" to be accorded any of its benefits.[236]

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[231] W. GOULD, *supra* note 31, at 14 (footnote omitted) (quoting Hanami, *The Characteristics of Labor Disputes and Their Settlement in Japan*, in SOCIAL AND CULTURAL BACKGROUND OF LABOR-MANAGEMENT RELATIONS IN ASIAN COUNTRIES 209 (Proceedings of the 1971 Asian Regional Conference on Industrial Relations)).

[232] NLRB v. Insurance Agents' Int'l Union, 361 U.S. 477, 488-89 (1960) (In holding that good faith negotiations can take place during an economic strike, the Court described the "battlefield" and the anomaly of the United States system.).

[233] Duff, *supra* note 41, at 638 (emphasis original).

[234] Duff had the following advice for American management and labor:

> American managers reporting to Japanese superiors and American unions bargaining in situations where management positions are dictated by Japanese ownership might do well to adjust their bargaining behavior to come more in line with Japanese processes. Indeed it may well be profitable to all concerned to consider replacing symbolic conflict with cooperation.

Id.

[235] 29 U.S.C. § 157 (1982).

[236] *Id.* § 152(3).

The definition of "employee" has been held to include nonresident aliens.[237] The primary "agenda item" is the manner in which the law treats "supervisors" and "managerial" employees. This is of special importance in the case of "working foremen" and because of the over-abundance of managerial employees in multinational companies operating in the United States.

The definition of "supervisor" is significant because the Act specifically excludes supervisory employees who by exercise of independent judgment have the authority to determine or otherwise effectively recommend the hiring and firing of employees.[238] The National Labor Relations Board (Board) recently confirmed this exclusion when it upheld an employer's dismissal of a supervisor for union activities even though the dismissal was part of a pattern of unlawful conduct against employees who were protected by the Act.[239] The question of who is a supervisor is also important because, to the extent supervisors become involved within the labor union at the employer's premises, the employer could be "interfering" with other employees' rights and "dominating" the labor union in violation of section 8(a)(1) and (2) of the Act.

The line between supervisory and non-supervisory employees is blurred because Japanese and some American employers have begun giving "supervisors" more on-line responsibilities similar to other "employees," and allowing other employees to exercise increased shared supervisory responsibilities.[240] Whether the line has been crossed must be resolved on a factual basis depending on the actual authority the individuals possess.

"Managerial" employees also have been excluded from the Act's protection. This is a non-statutory, Board-created exclusion and has been upheld by the United States Supreme Court.[241] Managerial employees are ones

> who formulate and effectuate management policies by expressing and making operative the decisions of their employer, and those who have discretion in the performance of their jobs independent of their employer's established policy.
> . . . [M]anagerial status is not conferred upon rank-and-file workers, or upon those who perform routinely, but rather is reserved for those in executive-type

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[237] *See, e.g.*, NLRB v. Actors' Equity Ass'n, 644 F.2d 939, 941 (2d Cir. 1981) ("Nothing in the terms or construction of the [Act] limits the meaning of the word 'employees' to American citizens or permanent residents."). Illegal aliens have also been held to be covered. NLRB v. Apollo Tire Co., 604 F.2d 1180 (9th Cir. 1979).

[238] The term "supervisor" is defined as "any individual having authority, in the interest of the employer, to hire. . .discharge. . .or effectively to recommend such action." 29 U.S.C. § 152(11) (1982). The term "employer" includes "any person acting as an agent of an employer, directly or indirectly." *Id.* § 152(2).

[239] Parker-Robb Chevrolet, Inc., 262 N.L.R.B. at 402-04.

[240] For discussion of case law on supervisory status, see Note, *The NLRB and Supervisory Status: An Explanation of Inconsistent Results*, 94 HARV. L. REV. 1713 (1981).

[241] NLRB v. Bell Aerospace Co., 416 U.S. 267 (1974).

positions, those who are closely aligned with management as true representatives of management.[242]

The reason for this exclusion is that managerial employees are, in effect, the employer. To permit them labor bargaining rights would be to create a conflict of interest not intended by the law. This category has the potential to be large and subject to some manipulation by an employer who by adroit job assignment might attempt to make employees "managerial" to exclude the employer from the prohibitions of the Act vis-a-vis the employees as well as removing rights from those employees.

In *NLRB v. Yeshiva University*,[243] the United States Supreme Court applied the managerial exclusion rule to a university faculty which the Board determined consisted of managerial employees because of the degree of control it exerted over working conditions. It seems that this decision fails to grant proper recognition to and encourage the union's role not only to *confront* but also to *cooperate* with management and likely needs re-examination by the Board and the courts, especially in light of the increasing reliance on cooperative labor-management programs in the United States. The *Yeshiva* case and the managerial exclusion rule are of particular importance to Japanese enterprises operating in the United States because they retain significant numbers of management employees and utilize the traditional Japanese management practices of employing working supervisors and sharing their authority for decisions among various levels of the work force. It remains to be seen how far down the Japanese company's hierarchical ladder the Board will find "managerial" employees.[244]

b. *Joint Employer-Employee "Committees"*

The recent growth of employee participation plans implemented by employers, employees, and unions indicates a recognition of the advantages of changing labor-management relations from postures of conflict to positions of cooperation. Reasons for implementing such plans include improved work environment and worker satisfaction, as well as increased efficiency and productivity.[245] In addi-

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[242] General Dynamics Corp., Convair Aerospace Div. San Diego Operations, 213 N.L.R.B. 851, 857 (1974) (footnote omitted).

[243] 444 U.S. 672 (1980).

[244] Of less statistical impact is the exclusion from collective bargaining of nonmanagerial "confidential" employees who are engaged in the employer's labor relations functions. NLRB v. Hendricks County Rural Elec. Membership Corp., 454 U.S. 170 (1981) (approving the Board's labor nexus test to determine whether a "confidential" employee should be excluded).

[245] *See generally* Ackoff & Deane, *supra* note 84, at 241-45 (study of ALCOA's quality of worklife and trust and cooperation programs). There is some argument, however, that the price of cooperation and increased productivity may be the corresponding de-emphasis of individualism

tion, they have obvious potential for use by some employers as an alternative to a union work environment.

Joint employer-employee committees and programs are increasingly pervasive in the United States not only with foreign multinational companies, but also with American companies. These committees and programs include quality-of-work-life programs, safety committees, suggestion committees, and committees with a broader mandate to discuss and resolve problems related to production and working conditions. Broader committees concern themselves with production standards, product quality, job and product improvement methods, work assignment, market projections, safety equipment, automation effects, and other traditionally "management" matters. The exact composition of the committees varies, but they inevitably include management personnel, sometimes as a majority, and non-management employees. While the committees usually work to reach an agreement, their actual utility and power come in making recommendations to the employer.

Joint consultation committees in Japan and the United States are not limited to non-union employers. In Japan, it is reported that:

> Collective bargaining at the enterprise level through joint consultation is the most popular form of worker participation at present. This form of worker participation aims at efficiency and productivity because it deals with the introduction of new machinery, production plans, and the like, and it also is concerned with how job security may be affected by technological change. Improvements in the quality of work life are also handled by this form of worker participation because it deals with terms and conditions of employment as issues of joint consultation in collective bargaining at the enterprise level.[246]

Japanese employers in the United States also have been successful in using joint consultation in a unionized setting.[247] For example, in 1970, Sanyo of Japan took over a failing United States electronics firm and immediately obtained union input on improving quality and productivity. The company thereafter doubled its productivity and tripled its work force. Observers attribute much of this success to the joint efforts of union and management.[248] Legal issues under

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and resulting diminution of choice and quality of life.

[246] *Worker Participation*, *supra* note 29, at 53.

[247] One commentator has stated that "[c]ontrary to conventional wisdom, the Japanese style of management is not limited to non-union environments. In fact, there are a number of instances in which Japanese concerns acquired unionized, but unprofitable, American firms and turned them around by eliciting union cooperation." Tsurumi, *supra* note 12, at 269. *See* Sockell, *The Legality of Employee Participation Programs in Unionized Firms*, 37 INDUS. & LAB. REL. REV. 541 (1984) (discussing the legality under the Act of joint participation programs that co-exist with American unions).

[248] *See, e.g.*, Tsurumi, *supra* note 12, at 269-70. "As Sanyo learned, unionized workers are

American labor laws will arise regardless of whether these joint consultation approaches are in union or non-union settings or whether they are used by Japanese or American employers.

(1) *Labor Organization*

The "agenda item" discussed here is whether a joint employer-employee committee is a "labor organization" under the National Labor Relations Act. This is important because under section 8(a)(2) of the Act an employer may not "dominate or interfere with the formation or administration of any *labor organization* or contribute financial or other support to it."[249] Section 2(5) of the Act defines a "labor organization" as "any organization of any kind, or any agency or employee representation committee or plan, in which employees participate and which exists for the purpose, in whole or in part, of dealing with employers concerning grievances, labor disputes, wages, rates of pay, hours of employment, or conditions of work."[250]

The purpose of the law was to prevent an employer from getting so involved with an employee organization as to establish a "company union." More specifically, the law sought to prevent a collective bargaining setting in which the employer would in effect be sitting at the bargaining table conducting a colloquy with itself. The law, however, did not prevent employer-employee interaction and relations.[251]

In *NLRB v. Cabot Carbon Co.*,[252] the United States Supreme Court held that a committee which was set up by the employer with elected employee representatives and which dealt with grievances, labor disputes, wages, rates of pay, and conditions of work was a "labor organization."[253] The Court considered three factors: the structure of the organization, the subject matter with which it

often well positioned to join in decisionmaking processes and quality control programs precisely because of the job protection provided by unionization." *Id.* at 270.

[249] 29 U.S.C. § 158(a)(2) (1982) (emphasis added). See *infra* text accompanying notes 260-79 for a discussion of domination.

[250] 29 U.S.C. § 152(5) (1982).

[251] Senator Wagner, the sponsor of the law, commented that:

> Nothing in the bill prevents employers from maintaining free and direct relations with their workers. . . .The only prohibition is against the sham or dummy union which is dominated by the employer, which is supported by the employer, which cannot change its rules or regulations without his consent, and which cannot live except by the grace of the employer's whims.

79 CONG. REC. 2371-72 (1935). *See also* Feldman & Steinberg, *Employee-Management Committees and the Labor Management Relations Act of 1947*, 35 TUL. L. REV. 365, 376-85 (1961) (discussing the legislative history of the Act).

[252] 360 U.S. 203 (1959).

[253] *Id.* at 213.

dealt, and whether it was "dealing with" the employer.[254] The Court held that almost any formal or informal employee entity would qualify and that the entity's concern with only one of the subject matters in section 2(5) would be sufficient. Under section 2(5), "dealing" was not synonymous with "bargaining" but was larger and encompassed discussions and the proposal of recommendations.[255]

The Board generally has followed *Cabot*.[256] The most noteworthy exceptions are court decisions. In the leading case of *NLRB v. Streamway Division of the Scott & Fetzer Co.*,[257] the Sixth Circuit Court of Appeals held that an employee committee consisting of employees who served on a rotating basis, who were not intended to be representative of other employees, and who met with management to discuss company operations on a regular basis, was not "dealing" with the employer.[258] The court noted that *Cabot* should not "be read so broadly as to call any group discussing issues related to employment a labor organization."[259]

The current rule of law is that employee organizations and many of the joint consultation committees generally are "labor organizations" under the Act. As can be seen from *Scott & Fetzer*, however, such a determination will depend on the facts of each case.

(2) *Employer Domination, Interference, or Support*

The next "agenda item" is the degree to which an employer may get involved with a labor organization. More specifically, the issue is the amount of cooperation an employer may extend before it "dominates or interferes" with the formation or administration of the labor organization or otherwise unlaw-

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[254] *Id.* at 213-18.

[255] *Id.* at 211. *See* NLRB v. Ampex Corp., 442 F.2d 82, 84 (7th Cir.) (section 2(5) has been "broadly construed"), *cert. denied*, 404 U.S. 939 (1971).

[256] *But see* General Foods Corp., 231 N.L.R.B. 1232 (1977) (teams of employees administering job assignments and deciding overtime are not labor organizations); Sparks Nugget, Inc., 230 N.L.R.B. 275 (1977) (employee council acted only in an adjudicatory function in grievances), *modified sub nom.* NLRB v. Silver Spur Casino, 623 F.2d 571 (9th Cir. 1980), *cert. denied*, 451 U.S. 906 (1981).

[257] 691 F.2d 288 (6th Cir. 1982).

[258] *Id.* at 291-95.

[259] *Id.* at 294. Also important to the court was the fact that there was no evidence that anti-union animus existed and that the employees' free choice seemed best served by this vehicle (that union had twice been defeated in elections). For a critical analysis of this approach, see Note, *Collective Bargaining as an Industrial System: An Argument Against Judicial Revision of Section 8(a)(2) of the National Labor Relations Act*, 96 HARV. L. REV. 1662, 1668-72 (1983). *See also* Hogler, *Employee Involvement Programs and* NLRB v. Scott & Fetzer Co.: *The Developing Interpretation of Section 8(a)(2)*, 35 LAB. L.J. 21 (1984).

fully supports the organization in violation of section 8(a)(2) of the Act. The Board has emphasized that it will strictly construe the Act and find a violation even when there is evidence of potential control.[260] It has found employer "assistance and support" unlawful when the employer provided the labor organization with facilities or other compensation.[261] The Board has also found violations when the employer sets up the employee committee, designates its members, or sets or controls the agenda, and the courts have agreed.[262]

The number of "managerial" or "supervisory" employees who are on the committee or otherwise involved in its establishment or administration is important. The more involved such employees are, the more likely a violation will be found. Also of significance are the numbers of "working foremen," for if they are considered supervisors, their involvement with labor organizations can taint the validity of the organization and render the employer liable under section 8(a)(2) of the Act.

Lawful employer-employee cooperation, however, is possible.[263] In *NLRB v. Northeastern University*,[264] the First Circuit Court of Appeals held that the Board should apply a standard of *actual*, not *potential*, domination in section 8(a)(2) cases.[265] The court rejected the Board's finding of a violation where an employer had "cooperated" with an employee committee by appointing part of the group and providing facilities and supplies.[266] In *Chicago Rawhide Manufacturing Co. v. NLRB*,[267] the Seventh Circuit Court of Appeals also refused to enforce the Board's finding of a section 8(a)(2) violation, holding that actual domination was required in domination cases.[268] The court concluded that "[c]ooperation only assists the employees. . .in carrying out the independent intentions."[269] Thus, when the employer helped establish a joint consultation

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[260] *See* Note, *New Standards for Domination and Support Under Section 8(a)(2)*, 82 YALE L.J. 510, 511-15 (1973) (discussing the traditional posture of the Board to find per se violation).

[261] *See, e.g.*, Homemaker Shops, Inc., 261 N.L.R.B. 441 (1982).

[262] *See* NLRB v. Fremont Mfg. Co., 558 F.2d 889 (8th Cir. 1977) (holding that employer's unilateral creation of a progress team was unlawful domination and interference); NLRB v. Ampex Corp., 442 F.2d 82 (ruling that a communications committee was a labor organization dominated by the employer).

[263] *See generally* Schmidman & Keller, *Employee Participation Plans as Section 8(a)(2) Violations*, 35 LAB. L.J. 772, 774-75 (1984) (discussing recent Board and court cases allowing more employer-employee cooperation); Schurgin, *The Limits of Organized Employer-Employee Relations in Non-Union Facilities; Some New Evidence of Flexibility*, 57 CHI.-KENT L. REV. 615 (1981) (recognizing a potential shift in the Board's attitude which could allow more management-employee relations).

[264] 601 F.2d 1208 (1st Cir. 1979).

[265] *Id.* at 1213.

[266] *Id.* at 1214-16.

[267] 221 F.2d 165 (7th Cir. 1955).

[268] *Id.* at 167-68.

[269] *Id.* at 167.

committee that met during working hours and contributed to the committee's recreation fund, it was "not intending. . .to coerce or influence the employees' choice of bargaining representative."[270]

The Ninth Circuit Court of Appeals in *Hertzka & Knowles v. NLRB*[271] also upheld the test of actual domination, holding that a joint committee which considered employment issues was not dominated by the employer.[272] The court held that the employees merely had been exercising their free choice in establishing and maintaining such a committee and had been satisfied with it.[273] The court noted two additional points. First, employees should be free to allow management partners to serve on the committees even if this results in "weaker" bargaining than under a formal union setting.[274] Second, the court noted that

> [f]or us to condemn this organization would mark approval of a purely adversial [sic] model of labor relations. Where a *cooperative* arrangement reflects a choice freely arrived at and where the organization is capable of being a meaningful avenue for the expression of employee wishes, we find it unobjectionable under the Act.[275]

Therefore, there is a growing body of largely court-made law which permits greater latitude and more cooperation in employer-employee joint consultation committees. Absent evidence that the employer is actually interfering or dominating the labor organization, and under the right economic conditions, the law may continue to be redirected toward permitting employer-employee cooperation.[276] Three issues remain: (1) whether the entity was freely chosen by em-

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[270] *Id.* at 170.

[271] 503 F.2d 625 (9th Cir. 1974), *cert. denied*, 423 U.S. 875 (1975).

[272] 503 F.2d at 630-31.

[273] *Id.* at 631.

[274] The court noted that:

> The question essentially comes down to the significance of having management partners on the committees. True this may mean bargaining is "weaker" than if there were a formally organized union. Yet this feature too was chosen by the employees, and it is one with which, for all the record shows, they are not dissatisfied.

Id.

[275] *Id.* (emphasis added).

[276] *See* W. GOULD, *supra* note 31, at 99 (arguing that although the Japanese system may have "characteristics of subordination," cooperation should be encouraged); Jackson, *An Alternative to Unionization and the Wholly Unorganized Shop: A Legal Basis for Sanctioning Joint Employer-Employee Committees and Increasing Employee Free Choice*, 28 SYRACUSE L. REV. 809, 822-45 (1977) (discussing the Board's shift toward emphasizing employee free choice and recognizing changes in the American labor climate); Schmidman & Keller, *supra* note 263, at 774-75; Schurgin, *supra* note 263, at 623-31.

ployees,[277] (2) whether employees remain satisfied with it,[278] and (3) whether the committees were operating in an anti-union environment.

At the same time, the Board and courts should be cautious that such cooperative approaches are not used as anti-union devices by sophisticated employers. A warning has been sounded:

> Except in blatant cases, antiunion animus is difficult to prove. Managers are increasingly sophisticated and subtle in their strategies to keep unions out. The publicly stated goals of employee participation plans are often mere gloss and state only a portion of the intended goals. No informed manager will openly reveal that an important goal of an employee participation plan is to weaken existing unions or to keep employees from unionizing. Cases involving less direct evidence of motive are often found not to violate the Act.[279]

(3) By-Passing the Exclusive Representative

The legal implications of establishing a joint consultation committee are manageable if the employer and union cooperate. Unions often see these joint approaches as enhancing their influence and responsibilities. For example, a union has no right under the Act to bargain over non-mandatory subjects;[280] therefore, much information relating to productivity and managerial decisions affecting plant operations remains unavailable.[281] If the employer and union agree to cooperate, however, both parties may deal with all of these matters in addition to the usual bargaining opportunities guaranteed under the Act. If a union does not wish to cooperate with the employer in joint consultation programs, the employer may decide non-mandatory matters without the union's input or "blessing."

Problems could arise in this setting because the Board-certified union is the exclusive representative of the employees. The employer must deal (bargain) only with that "labor organization" and not with other "labor organizations," including joint consultation committees, over mandatory subjects of bargaining or be in violation of the Act.[282] The "agenda items" discussed in this section

[277] *Hertzka*, 503 F.2d at 631. The courts have been criticized for their lack of critical analysis or strict evidence requirements on this issue. *See, e.g.*, Schmidman & Keller, *supra* note 263, at 778.

[278] *Hertzka*, 503 F.2d at 631.

[279] Schmidman & Keller, *supra* note 263, at 778.

[280] 29 U.S.C. § 158(d) (1982).

[281] *See, e.g.*, Detroit Edison Co. v. NLRB, 440 U.S. 301, 317-20 (1979) (company's refusal to turn over to the union individual employee test results without the employee's consent did not violate the statutory good faith obligation).

[282] 29 U.S.C. § 159(a) (1982). *See* Schatzki, *Majority Rule, Exclusive Representation, and the*

are the conditions under which the employer, in a unionized setting, may properly deal with a joint committee on bargainable items without "by-passing" the exclusive representative. The "by-passing" problem is allayed when the union is also the joint committee, but the issue of section 8(a)(2) domination remains.

Unlike American labor law, Japanese law lacks the "exclusivity" principle. One author has described the Japanese system as follows:

> Under Japanese law, all bona fide unions have the right to bargain, and employers *must* bargain with *all* bona fide unions. . . .Conspicuous by its absence is any notion of a *single* union for all the employees of a plant. As a practical matter, employers must bargain with *majority* and *minority* unions.[283]

Thus, Japanese employers operating under American law must be wary in "dealing" with joint consultation "labor organizations" on mandatory subjects of bargaining in a unionized setting.[284]

As Japanese and American employers move into new dimensions of employer and employee joint cooperation and as clear lines between management and workers become blurred, employers and employees must resolve the following issues in light of new Japanese-American business dealings: (1) What is a "labor organization"? (2) When does excessive and unlawful employer involvement occur in joint participation programs? (3) When and to what extent may an employer deal with a joint consultation committee to the exclusion of a certified bargaining representative?

c. Unionization and Bargaining Obligations

(1) Unionization

There seems to be a prevailing stereotype that Japanese employers operating in the United States are anti-union and tend to resist unionization whenever possible in order to utilize their own successful personnel systems.[285] Statistics and studies show that this may not be true, at least not to a greater extent than American employers.[286] As of 1980, the unionization rate in the United States

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Interests of Individual Workers: Should Exclusivity Be Abolished?, 123 U. PA. L. REV. 897, 897-919 (1975).

[283] Duff, *supra* note 41, at 633 (emphasis original).

[284] *See* 29 U.S.C. §§ 158(a)(5), 159(a) (1982).

[285] *See* Kujawa Case Study, *supra* note 71, at 10; Marett, *supra* note 77, at 245-50.

[286] As a recent study comparing Japanese subsidiaries in the United States with American firms concluded:

> Managements at the majority of the Japanese subsidiaries preferred a non-union environment. They stated they wanted to be free to manage and to innovate at the shop level.

was 24.5%, whereas United States-based Japanese companies had a rate of 22.7%.[287]

Surveys have also dispelled the popular stereotype that Japanese plants are most often placed in non-union, "right-to-work" areas of the United States. In fact, these plants are dispersed in many locations.[288] One study concluded that:

> True, most of the [Japanese] subsidiaries don't want a union relationship. But their location decisions subjugate this preference to other concerns, as do their entry decisions that include a takeover of a unionized firm. Also, where a union relationship exists, the Japanese seem to be able to work with it to their own satisfaction. They appear to be "environmental takers" in their union related matters.[289]

The Japanese approach to labor relations presents an alternative to the traditional American adversarial system. Although Japanese employers attempt to maximize managerial control where they can, the Japanese approach is not necessarily incompatible with unionization.[290] The difference between Japanese and American employers lies in their perceptions of "managerial control": the Japanese see it as involving a greater degree of employee participation. Whether American employees view the Japanese perception as anti-union or merely different will be reflected in large part by the success or failure of the unionization drives.

The Act prohibits employers, as well as unions, from interfering[291] with or discriminating[292] against employees because they engage in or support union

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> While the origin of this preference may in these cases be Japanese, the position is certainly not distinctively Japanese. The majority of the American and foreign firms expressed similar views for similar reasons.

Kujawa Case Study, *supra* note 71, at 10. "The data also suggest, however, that the U.S. firms were much more aggressive in their dealings with unions than were the Japanese subisidiaries." *Id.* at 12.

[287] Marett, *supra* note 77, at 247 & n.20 (citing Japan Trade Center/New York, U.S.-Japan Trade Update 5 (1982) (Japan External Trade Organization study)). In the manufacturing industry, it was estimated in 1983 that about one-fourth of some 300 Japanese-owned companies in the United States were unionized. English, *UAW vs. Japanese: An Uphill Battle*, U.S. NEWS & WORLD REP., July 4, 1983, at 75.

[288] As of 1982, Japanese plants were located in areas as diverse as California (116 plants), Alaska (35), New Jersey (23), Georgia (19), Washington (19), Illinois (17), Texas (17), New York (16), and North Carolina (16). Marett, *supra* note 77, at 246 & n.19 (citing Japan Economic Institute of America, Japan's Expanding Manufacturing Presence in the United States (1982)).

[289] Kujawa Case Study, *supra* note 71, at 13.

[290] *See* Marett, *supra* note 77, at 247.

[291] 29 U.S.C. § 158(a)(1), (b)(1) (1982).

[292] *Id.* § 158(a)(3), (b)(2).

activities or because they refrain from such activities.[293] The body of law interpreting these statutory provisions raises only a few "agenda items" regarding Japanese and other multinational employers.[294]

The leading case on employee discrimination is *Wright Line*[295] where the Board established a two-prong test for proving violations. First, the government must prove that the employer discriminated against the employee for anti-union reasons. Second, the employer has the burden to prove as an affirmative defense that its action would have been the same even in the absence of the protected conduct. The government may then seek to rebut the employer's defense by showing that the employer's conduct was pretextual.[296] Even if an employer refuses to hire or discharges someone because of his or her attitudes toward unions, the employer could prevail by showing that proper cause—such as the employee's substandard work performance—existed.

Japanese employers face a potential problem when they employ their traditional management practices of not readily discharging employees by encouraging improvement or retaining employees in non-promotable positions. When employers finally do fire an employee, they may not have a sufficient record of the employee's negative job performance to justify a discharge for cause. In addition, the failure of Japanese companies to consistently enforce rules may convince the Board that these employers have insufficient "cause" to discharge or that the otherwise sufficient reasons put forward were really "pretextual" because they were never used before in a consistent manner.

(2) *Bargaining Obligations*

Multinational employers may establish operations in the United States in a variety of ways. They may begin a new business, acquire an already existing American company, or enter into a joint venture arrangement with a United States company. Different legal doctrines are triggered and bargaining obligations vary depending on the method chosen.[297]

Under the Act, an American employer faced with potential unionization may

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[293] *Id.* § 157 (right of employees to organize).

[294] For a discussion of the application to the General Motors-Toyota Joint Venture of § 8(a)(3) (employer's unlawful interference with right to unionize), see Nelson, *supra* note 85, at 651-63.

[295] 251 N.L.R.B. 1083 (1980), *aff'd*, 662 F.2d 899 (1st Cir. 1981), *cert. denied*, 455 U.S. 989 (1982).

[296] 251 N.L.R.B. at 1089. The Supreme Court upheld the *Wright Line* test. NLRB v. Transportation Management Corp., 462 U.S. 393 (1983).

[297] For example, a new business has the right to (1) voluntarily accept a majority union if requested, or (2) wait for Board-conducted union election while it and the union seek to convince employees to vote "their way," or (3) voluntarily or "involuntarily" assume obligations from an "acquired" company to recognize and bargain with a union already at the acquired company.

legitimately resist or voluntarily recognize the union's or the employees' efforts.[298] Resistance to unionization by Japanese employers, however, has been characterized as follows: "No decent employer dares to deny establishment of a union or to refuse bargaining openly unless they believe that they have some special justification to do so."[299]

An "agenda item" arises when a foreign employer acquires through merger or sale a company that had an existing bargaining obligation with a union. The foreign employer may either voluntarily assume the obligation as part of the sale or "involuntarily" assume the obligation through application of the "successor doctrine." This doctrine requires "sufficient continuity" between the new and old enterprises.[300] Although the United States Supreme Court has noted that there can be "no single definition of 'successor' which is applicable in every legal context,"[301] a bargaining obligation will be found to exist when the old bargaining unit remains the same and when a majority of the new employees are represented by an agent of the old employee.[302] The key element is whether a majority of the new work force is composed of employees from the predecessor's unionized work force.

Another key consideration is the Board's and courts' use of "related factors" in determining continuity between the old and new employers. These factors include "whether the same jobs exist under the same working conditions" and "whether the new company employs the same supervisors."[303] If a foreign company implements a significant change in operations, management, or job duty responsibilities, it likely would not succeed to the old employer's duty to bargain.[304] If a majority of the new employer's employees are hired from the old employer's unionized work force and if there is continuity between the old and

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[298] Linden Lumber Div., Summer & Co. v. NLRB, 419 U.S. 301 (1974) (An employer may legitimately ask for an election to verify a union's claim that it received authorization from a majority of the employees to be their collective bargaining representative.). *But see* Sullivan Elec. Co. v. NLRB, 479 F.2d 1270 (6th Cir. 1973) (obligation may change upon independent knowledge of majority status).

[299] Hanami, *Unfair Labor Practices—Law and Practice*, JAPAN LAB. BULL., June 1983, at 5. Japan has enterprise unionism and no "exclusivity" principle, and there is no need for union elections. The employer, therefore, has no real hope of "defeating" a union in a unionization drive and conducts itself accordingly.

[300] *See* NLRB v. Burns Int'l Sec. Servs., Inc., 406 U.S. 272 (1972).

[301] Howard Johnson Co. v. Detroit Local Joint Executive Bd., 417 U.S. 249, 263 n.9 (1974).

[302] *Burns*, 406 U.S. at 281.

[303] Premium Foods, Inc., 260 N.L.R.B. 708, 714 (1982), *enforced*, 709 F.2d 623 (9th Cir. 1983); Border Steel Rolling Mills, Inc., 204 N.L.R.B. 814, 821 (1973) (The majority of the three-member panel adopted the opinion of the administrative law judge without drafting its own opinion.).

[304] The Supreme Court in *Burns* noted that the resulting "successorship" would have been a different case if Burns' operational structure and practices had differed from the predecessor's so that the bargaining unit would have been no longer appropriate. 406 U.S. at 280.

new enterprises, the new employer is obligated to recognize and bargain with the union. There is no corresponding obligation, however, which binds the successor to a prior collective bargaining agreement, even though that agreement may have contained a successor clause.[305]

Finally, once a duty to bargain exists, it continues during as well as before a collective bargaining agreement is reached.[306] Failure to meet that obligation and the duty of the employer to furnish the union with information relevant to bargaining violates the "good faith" bargaining obligation of the Act.[307] There is, however, no duty to bargain over "terms and conditions contained in a contract."[308]

Japanese employers who use joint consultation committees and other traditional forms of cooperation may find that, under American labor law, certain limits on bargaining obligations have been waived, thus resurrecting the continuing bargaining obligation. At any rate, the ongoing bargaining obligation seems to fit the Japanese style of labor relations because it promotes harmony and stability.

d. Dispute Settlement

The American phenomenon of the widespread use of strikes as a method of dispute resolution contrasts with the Japanese experience in which strikes are fewer and of shorter duration.[309] In the United States, strikes are called to exert economic pressure to coerce the employer into modifying its bargaining position; in Japan, strikes are usually called to bring the employer to the bargaining table and to shame and embarrass the company.[310] A Japanese company representative observed that:

> In Japan, the union lives with the company and never pulls the trigger unless it finds itself in an extremely serious situation. It tries as much as possible to work with us on the same ground, because its members' future and prosperity are directly linked with ours. The important question for us right now is how to

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[305] *Id.* at 272; Bartenders & Culinary Workers Union v. Howard Johnson Co., 535 F.2d 1160 (9th Cir. 1976). There are several exceptions in which case the successor could be obligated on the prior agreement. These include adoption, either explicitly or implicitly, *see* Audit Servs., Inc. v. Rolfson, 641 F.2d 757 (9th Cir. 1981); and alter ego, where no real change in ownership or management occurs, *see* NLRB v. Tricor Prods., Inc., 636 F.2d 266 (10th Cir. 1980). Mere transfer of stock, as opposed to purchase of assets, will probably not affect the liabilities.

[306] 29 U.S.C. § 158(d) (1982).

[307] *Id.* § 158(a)(5), (d).

[308] *Id.* § 158(d). *See* Jacobs Mfg. Co., 94 N.L.R.B. 1214 (1951), *enforced*, 196 F.2d 680 (2d Cir. 1952).

[309] W. GOULD, *supra* note 31, at 13.

[310] *See* T. HANAMI, *supra* note 23, at 149-54.

instill this concept in our American workers.[311]

Both Japanese and American employers usually look for alternatives to strikes and use conciliation and mediation whenever possible. If that fails, strikes seem to occur regardless of whether the employer is Japanese or American.[312] Traditionally, however, Japanese companies specifically design their labor relations systems to avoid strikes. Whether this will work in practice in their American ventures remains to be seen.

C. *Wrongful Discharge*

The ability of an employer in the United States to hire and fire employees long has been considered part of the American "free enterprise system" and a key to successful business control. This discretion has been a target for unions since their beginning. Unions inevitably seek to negotiate contract limitations, such as "just cause" provisions, into collective bargaining contracts for unionized employees. Non-union employees, although usually more dependent on the employer's discretion, also enjoy rights under various labor laws.[313]

In the past decade, courts have begun to limit the common law right of employers to dismiss at-will employees by utilizing contract and tort theories to make available to aggrieved parties a range of remedies including compensatory and punitive damages. Sympathetic juries do not seem to hesitate to award large relief to wrongfully discharged employees.[314] Many multinational companies, including Japanese enterprises operating in the United States, are closely watching this judicial trend. They are often shocked by the size and frequency of the awards and are concerned that their employment practices might result in similar judgments against them.

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[311] *How the Japanese Manage in the U.S.*, FORTUNE, June 15, 1981, at 102 (statement of Hajime Nakai, executive managing director of Sanyo Electric Co. and president of a United States subsidiary).

[312] *See* Kujawa Case Study, *supra* note 71, at 13.

[313] For example, a dismissal based on sex harrassment may violate Title VII and be a common law tort. An employer's failure to retain a "permanent" employee who replaced a striker may arguably violate the National Labor Relations Act and create the basis for a common law breach of contract cause of action.

[314] *See, e.g.*, Cancellier v. Federated Dep't Stores, 672 F.2d 1312 (9th Cir.) ($1.9 million awarded to three dismissed employees), *cert. denied*, 459 U.S. 859 (1982); Norton v. Kaiser Steel Corp., 115 L.R.R.M. (BNA) 4033 (Cal. Super. Ct. 1982) ($4.7 million awarded to a fired foreman). *See also National Steel is Told to Pay Fired Worker $850,000 Plus Interest*, Wall St. J., Mar. 23, 1983, at 58, col. 2 (employee fired because of disagreement over pension fund); *Kaiser Steel Told to Pay $4.7 Million in Damages to a Former Foreman*, Wall St. J., Aug. 4, 1982, at 38, col. 4 (jury agreed company breached implied contract and did not deal with employee in good faith).

This section briefly identifies and discusses some of the newly developing legal "agenda items" arising out of the wrongful termination of employees. While the law applies equally to American and Japanese companies, the latter may face special legal problems resulting from their managerial and labor relations practices, such as permanent employment and emphasis on company loyalty.

1. *United States-Japan Comparisons*

In the United States, there are several types of employment arrangements. A majority of American workers are employed at-will. They can be discharged at their employer's pleasure and enjoy no legal job tenure and very little job security. Courts have generally interpreted employment for unspecified terms as at-will employment.[315] Courts usually will find a "cause" requirement for termination of contracts for a definite term.[316] Contracts for permanent employment are relatively rare and require a clear commitment before they are enforced.[317]

At-will employment may be expressly altered through collective bargaining agreements. For example, unions, which represent about 20% of the American work force, normally negotiate "just cause" provisions into collective bargaining agreements and provide for review of the employer's decisions through private grievance arbitration.[318] Some collective bargaining agreements, such as those in the auto industry, have gone even further in providing job security:

> In six plants of General Motors and Ford, the 1982 collective bargaining agreements provide for permanent employment for 80 percent of the workers. Although the income-maintenance approach, which provides that dismissed employees with at least 10-15 years' seniority will receive at least 60 percent of their wage until retirement, will indirectly discourage management from dismissing workers. To a lesser extent, supplemental unemployment compensation benefits accomplish the same objectives. This is the first major collective bargaining agreement that appears to emulate the Japanese *shushin koyo* [permanent

[315] *See, e.g.*, Halsell v. Kimberly-Clark Corp., 683 F.2d 285 (8th Cir. 1982), *cert. denied*, 459 U.S. 1205 (1983); Walker v. Modern Realty, Inc., 675 F.2d 1002 (8th Cir. 1982); Parker v. United Airlines, Inc., 32 Wash. App. 722, 725, 649 P.2d 181, 183 (1982).

[316] *See, e.g.*, Alpern v. Hurwitz, 644 F.2d 943 (2d Cir. 1981) (rejecting argument that court should imply a provision allowing termination without cause).

[317] *See, e.g.*, Savarese v. Pyrene Mfg. Co., 9 N.J. 595, 89 A.2d 237 (1952) (An oral promise to hire plaintiff for life was not enforceable because the terms and conditions were not clearly and definitely expressed.).

[318] In a recent study, grievance arbitration provisions were estimated to be in 1528 of the 1550 collective bargaining agreements analyzed. BUREAU OF LABOR STATISTICS, U.S. DEP'T OF LABOR, BULL. NO. 2095, CHARACTERISTICS OF MAJOR COLLECTIVE BARGAINING AGREEMENTS, JANUARY 1, 1980, at 112-13 (May 1981).

employment].[319]

In addition, the courts may find implied-in-fact contractual limitations on discharging an at-will employee based on written or oral assurances by the employer.[320]

The Japanese system of loyalty and cooperation tends to promote job stability and, to a certain degree, permanent employment.[321] In Japan and the United States, workers are protected by statute against dismissals based on illegal grounds, such as union activity. In addition, Japanese law requires not only thirty days notice, but also just cause.

> Despite the absence of explicit statutory or constitutional authority, the courts have imposed a just-cause substantive limitation on employers' right to dismiss workers. If an employer does not have just cause for dismissing a worker, the dismissal will be regarded as invalid. . . . The fact that the just-cause obligation applies to economic dismissals or layoffs attributable to a business decline as well as to disciplinary disputes makes the Japanese situation quite different from the American.[322]

Temporary employees in Japan, however, usually can be terminated without cause. Some Japanese courts have devised a "good faith" limitation to protect temporary employees who have had their contracts repeatedly renewed.[323]

Some 1300 labor-related civil cases per year are brought in Japanese district

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[319] W. GOULD, *supra* note 31, at 103 (emphasis original).

[320] *See, e.g.*, Weiner v. McGraw-Hill, Inc., 57 N.Y.2d 458, 443 N.E.2d 441, 457 N.Y.S.2d 193 (1982) (course of conduct can show intent for definite term contract). *Contra* Heidick v. Kent Gen. Hosp., Inc., 446 A.2d 1095 (Del. Super. Ct. 1982) (employer booklet was unilateral statement of policy which did not set out a definite term of employment).

[321] *See supra* text accompanying notes 47-57.

[322] W. GOULD, *supra* note 31, at 106. Examples of just cause are typical: chronic lateness, insubordination, theft, and gross negligence. *Id.* at 108 (quoting K. Hokao, Employer Initiative in Employment Termination and the Income Security of the Worker Concerned, National Report 3 (n.d.)). The requirement of "cause" for dismissals is consistent with other international practices. The International Labor Organization recently promulgated standards for the termination of employees. One of the standards provided: "The employment of a worker shall not be terminated unless there is a valid reason for such termination connected with the capacity or conduct of the worker or based on the operational requirements of the undertaking, establishment or service." INTERNATIONAL LABOUR ORGANIZATION, TERMINATION OF EMPLOYMENT AT THE INITIATIVE OF THE EMPLOYER (Report V(2)) 68 (68th Sess. 1982). For a discussion of the European experience on employee dismissals, see PROTECTING UNORGANIZED EMPLOYEES AGAINST UNJUST DISCHARGE 46-80, 135-68 (J. Stieber & J. Blackburn eds. 1983) (Proceedings of the Conference on Protecting Unorganized Employees Against Unjust Discharge, School of Labor & Industrial Relations, Michigan State University).

[323] W. GOULD, *supra* note 31, at 107 (quoting K. Hokao, *supra* note 322, at 4).

courts; most of these cases concern employees who have lost their jobs.[324] One author has reported that "a court interpretation of an individual employment contract or the way in which a court resolves a labor conflict will not be far removed from the practices that prevail in Japanese industrial relations."[325] The remedies provided by the courts are diverse and far-reaching though equitable in nature, including reinstatement and rescission of employer orders.[326] This is consistent with Japanese tradition in non-legal and non-contractual settlements where an apology or restoration of harmony is just as important as compensation of a victim.

Therefore, Japanese employers operating in the United States are not unfamiliar with the just cause requirement or with legal challenges to employee dismissals. There is some indication, however, that the Japanese are still adjusting to the American victim's tendency to litigate and to seek punitive as well as compensatory damages in a jury trial.

2. *Current Legal Developments*

Most states have now created some form of judicial exception to the at-will rule based on either contract or tort theories.[327] An increasing number of states

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[324] Matsuda, *supra* note 44, at 190. It is also reported:

> Another significant phenomenon in recent years is the steady increase in cases where an employer's order of transfer or discipline, short of disciplinary discharge, is challenged. The number of damage suits against employers, brought by employees or unions on the ground of either breach of contract or tort, though still not high, is remarkable, particularly considering the traditional unpopularity of this kind of litigation in Japanese industrial relations.

Id. at 191.

[325] *Id.* at 192. There is some argument that arbitrators, not courts, should be making these decisions.

> If a court plays the role of arbitrator, then labor litigation is no different from compulsory arbitration, which nobody likes to see in a free collective bargaining system. That may possibly be a reason that the number of labor cases is so small in Japan in comparison with other countries, despite the allegation that employees and unions in Japan are very aware of their endowed rights, if not suffering from excessive legalism. In other words, we may assume that the court's overcommitment to its role in resolving labor conflicts has an accelerating rather than a restraining effect upon the voluntary resolution of labor conflicts.

Id. at 193.

[326] *Id.* at 191-92.

[327] *See generally* Wald & Wolf, *Recent Developments in the Law of Employment at Will*, 1 LAB. LAW. 533 (1985) (discussing the public policy and good faith exceptions). Sometimes there is reluctance by the courts to "create" new law: The plaintiff's wrongful discharge action based on an allegedly retaliatory discharge by his employer "is best evaluated by the legislative branch and the determination of the appropriate format for such proposed legislative change, if any, is best weighed by the legislature." Bottijliso v. Hutchison Fruit Co., 96 N.M. 789, 794, 635 P.2d

are also passing legislation addressed at "unjust dismissals" although much of the law is directed toward specific abuses, such as dismissal of "whistleblowers."[328] Federal legislation has also been proposed.[329] Reasons for comprehensive legislation include employees' need for protection, employers' desire to place a cap on "run-away damages," employers' entrepreneurial interest in selecting and removing managerial staff, the hope of attorney fees, and the impact of dismissals on labor unions and their traditional role as protector of employees' job security.[330] Some commentators argue, however, that comprehensive state legislation may be inappropriate and an over-reaction that could spur increased litigation and interference with management affairs.[331]

a. Contract Theories

Liability of an employer for discharging an employee may be based on either of two contract theories. The first theory, requiring good faith and fair dealing

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992, 997 (Ct. App. 1981). Other jurisdictions, however, employ a contrasting approach: "Because the courts are a proper forum for modification of the judicially created at-will doctrine, it is appropriate that we correct inequities resulting from harsh application of the doctrine by recognizing its inapplicability in a narrow class of cases." Parnar v. Americana Hotels, Inc., 65 Hawaii 370, 379, 652 P.2d 625, 631 (1982) (footnote omitted).

[328] *See* Summers, *Individual Protection Against Unjust Dismissal: Time for a Statute*, 62 VA. L. REV. 481 (1976) (seminal article calling for legislation). *See also* DeGiuseppe, *The Recognition of Public Policy Exceptions to the Employment-at-Will Rule: A Legislative Function?*, 11 FORDHAM URB. L.J. 721, 738-44 (1983) (summary of state legislation); Wald & Wolf, *supra* note 327, at 550-53 (summary of state legislation).

[329] *See* Wald & Wolf, *supra* note 327, at 550-51.

[330] *See* Labor & Employment Law Section, State Bar of Cal., To Strike a New Balance, Labor & Employment Law News 1-7 (spec. ed. Feb. 8, 1984) [hereinafter cited as California Adhoc Committee] (recommending a comprehensive statute for California). The California legislature recently considered two bills regarding wrongful discharge. The Assembly proposal, A. 3017, 1983-84 Reg. Sess. (Feb. 14, 1984), called for use of mediation and arbitration and provided remedies including reinstatement, backpay, front pay (up to two years) where reinstatement is inappropriate, and attorney fees. The bill, as amended, provided some relief for violation of good faith dismissals but excluded tort damages including punitive damages. *Id.* (amended May 3, 1984).

[331] The minority members of the California Adhoc Committee on Termination at Will and Wrongful Discharge noted that:

> In short, we believe that [such comprehensive legislation] is an over-reaction to the current state of the law to suddenly provide millions of employees with still another forum to litigate the circumstances and motives of every termination and layoff in the State of California. The extensive litigation that will result and the inevitable interference with management's reasonable exercise of business judgment are too great a price to pay for the limitation of exposure against excessive damages which is offered by the majority.

California Adhoc Committee, *supra* note 330, at 39.

in discharges,[332] is illustrated by *Monge v. Beebe Rubber Co.*[333] In *Monge*, an employer discharged an at-will employee after she resisted her foreman's sexual advances. The New Hampshire Supreme Court held the employer liable for breach of an implied good faith obligation to retain the employee.[334] The court imposed the implied-in-law obligation in order to protect victimized employees from such unfair dismissals.[335] Other courts have permitted recovery in tort for breach of a "good faith" covenant.[336]

The second theory of liability, implied-in-fact contract liability, involves application of traditional contract analysis when there are sufficient oral or written representations to convince a court that a contract obligation exists.[337] Such representations may involve an employer's assurance of continued employment provided the employee performs satisfactorily. The employer can give assurance in personnel policies, employee handbooks, employer memoranda, or statements by supervisors.[338] The clear majority rule, however, is that personnel policies by

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[332] An example of courts which have rejected this theory is the Hawaii Supreme Court.

> [T]o 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 or such an imposition on the courts.

Parnar v. Americana Hotels, Inc., 65 Hawaii at 377, 652 P.2d at 629. *See also* Butz v. Hertz Corp., 554 F. Supp. 1178, 1183 (W.D. Pa. 1983) (no federal common-law right absent specific intent to cause harm); McNulty v. Borden, Inc., 474 F. Supp. 1111, 1119 (E.D. Pa. 1979) (cause of action for wrongful discharge only if specific intent to harm or clear mandate of public policy).

[333] 114 N.H. 130, 316 A.2d 549 (1974). *See also* Fortune v. National Cash Register Co., 373 Mass. 96, 364 N.E.2d 1251 (1977). The *Fortune* court held that an employer breached an obligation of good faith when it terminated an employee when the employee was about to complete a sale and thereby collect a commission. *Id.* at 104-05, 364 N.E.2d at 1257. The court did not go so far as to hold that a good faith requirement existed in all employment contracts. *Id.* at 104, 364 N.E.2d at 1257.

[334] 114 N.H. at 133, 316 A.2d at 551. First, this theory of liability requires that the employee show that the employer was "motivated by bad faith, malice, or retaliation." Cloutier v. Great Atl. & Pac. Tea Co., 121 N.H. 915, 921, 436 A.2d 1140, 1143 (1981). Second, the employee must show that he was "discharged because he performed an act that public policy would encourage, or refused to do something that public policy would condemn." *Id.* at 922, 436 A.2d at 1144.

[335] 114 N.H. at 133, 316 A.2d at 551.

[336] *See, e.g.*, Cancellier v. Federated Dep't Stores, 672 F.2d at 1318; Cleary v. American Airlines, Inc., 111 Cal. App. 3d 443, 168 Cal. Rptr. 722 (1980). *See* Miller & Estes, *Recent Judicial Limitations on the Right of Discharge: A California Trilogy*, 16 U.C.D. L. REV. 65, 83-97 (1982).

[337] *See* Miller & Estes, *supra* note 336, at 97-102.

[338] *See, e.g.*, Toussaint v. Blue Cross & Blue Shield, 408 Mich. 579, 292 N.W.2d 880 (1980) (employees' manual); Pine River State Bank v. Mettille, 333 N.W.2d 622 (Minn. 1983) (employees' handbook); Weiner v. McGraw-Hill, Inc., 57 N.Y.2d 458, 443 N.E.2d 441, 457 N.Y.S.2d 193 (1982) (handbook, policy manual, employer conduct).

themselves will be insufficient to create contractual liability.[339]

A related theory is promissory estoppel.[340] In *Grouse v. Group Health Plan, Inc.*,[341] the plaintiff resigned a position in reliance on a promise of a new job, but was never given the opportunity to perform. The Minnesota Supreme Court held the employer liable on the basis of promissory estoppel because the employee acted reasonably and was justified in relying on the employer's promise of employment.[342] Most courts, however, have rejected this theory of recovery for wrongful discharge.[343]

b. Tort Theories

Tort theories of liability,[344] as exceptions to the at-will rule, are collected under the large and somewhat flexible doctrine that clear violations of public policy are grounds for recovery in tort. The initial problem under this exception is determining an acceptable definition of the term "public policy." The term is nebulous and leaves much room for judicial interpretation. The New Jersey Supreme Court has set forth the following guidance: "The sources of public policy include legislation; administrative rules, regulations or decisions; or judicial decisions. . . .Absent legislation, the judiciary must define the cause of action in case-by-case determinations."[345]

Courts applying the public policy exception have held employers liable for retaliatory discharges of employees who refused to violate the law,[346] who exercised various statutory rights against the interest of the employer,[347] and who

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[339] *See, e.g.*, Gates v. Life of Montana Ins. Co., 196 Mont. 178, 638 P.2d 1063 (1982) (An employee handbook distributed after hiring was not enforceable since it was not part of the employment contract.); Parker v. United Airlines, Inc., 32 Wash. App. 722, 649 P.2d 181 (1982) (Oral personnel policies and grievance procedures did not support employee's claim that she was terminable only for just cause.).

[340] *See* Ravelo v. County of Hawaii, 66 Hawaii 194, 658 P.2d 883 (1983) (promissory estoppel available as a cause of action against wrongful discharge of an at-will employee).

[341] 306 N.W.2d 114 (Minn. 1981).

[342] *Id.* at 116.

[343] *See, e.g.*, Page v. Carolina Coach Co., 667 F.2d 1156 (4th Cir. 1982).

[344] The significance of tort liability, unlike contract liability, under United States law is the availability of punitive damages. *See* D. DOBBS, HANDBOOK ON THE LAW OF REMEDIES § 12.4, at 818 (1973).

[345] Pierce v. Ortho Pharmaceutical Corp., 84 N.J. 58, 72, 417 A.2d 505, 512 (1980). A lower New Jersey court also held that this list may on occasion include a professional code of ethics. Kalman v. Grand Union Co., 183 N.J. Super. 153, 443 A.2d 728 (App. Div. 1982) (pharmacist code of ethics).

[346] *See, e.g.*, Tameny v. Atlantic Richfield Co., 27 Cal. 3d 167, 610 P.2d 1330, 164 Cal. Rptr. 839 (1980) (refusal to participate in illegal price-fixing scheme).

[347] *See, e.g.*, Smith v. Piezo Technology & Professional Adm'rs, 427 So. 2d 182 (Fla. 1982) (discharged for filing workers' compensation claims).

threatened to reveal the employer's illegal conduct. The last instance is illustrated by *Parnar v. Americana Hotels, Inc.*[348] where the Hawaii Supreme Court held that an employer violated public policy when he fired an employee who was about to testify before a grand jury investigating the employer's antitrust violations.[349] Courts usually have not found sufficient public policy when employees were dismissed for protesting company policies.[350]

Many jurisdictions have not yet recognized the public policy exception to the at-will rule. Some have rejected it. For example, in *Murphy v. American Home Products Corp.*,[351] a New York court refused to extend liability to employers for discharges in violation of public policy: "such recognition must await action of the Legislature."[352] Other courts have limited recovery when there were existing remedies to protect the interests of the aggrieved party because public policy already would be served and, therefore, no cause of action for wrongful discharge was required.[353]

Two other tort theories may permit recovery for wrongful discharge. One, although not widely accepted, is based on the intentional or negligent infliction of emotional distress when the discharge was outrageous.[354] The other is traditional tort negligence.[355]

An "agenda item" is whether employers should have more discretion to dismiss managerial employees than non-managerial employees, especially at the higher executive levels where "teamwork, loyalty, and trust" are valued as much as performance. It is possible that courts may fashion different tort standards or contractual expectations if such a distinction is in fact recognized. To date most courts have not explicitly delineated the two categories.[356] A pro-

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[348] 65 Hawaii 370, 652 P.2d 625 (1982).

[349] *Id.* at 380, 652 P.2d at 631.

[350] *See, e.g.*, Suchodolski v. Michigan Consol. Gas Co., 412 Mich. 692, 316 N.W.2d 710 (1982) (complaining about internal company policies); Pierce v. Ortho Pharmaceutical Corp., 84 N.J. 58, 417 A.2d 505 (opposing continued research on a controversial drug); Geary v. United States Steel Corp., 456 Pa. 171, 319 A.2d 174 (1974) (complaints to a superior about the unsafeness of a product).

[351] 58 N.Y.2d 293, 448 N.E.2d 86, 461 N.Y.S.2d 232 (1983).

[352] *Id.* at 297, 448 N.E.2d at 87, 461 N.Y.S.2d at 233. *Accord* Kelly v. Mississippi Valley Gas Co., 397 So. 2d 874 (Miss. 1981).

[353] *See, e.g.*, Wehr v. Burroughs Corp., 438 F. Supp. 1052 (E.D. Pa. 1977), *aff'd*, 619 F.2d 276 (3d Cir. 1980).

[354] *See* Agarwal v. Johnson, 25 Cal. 3d 932, 603 P.2d 58, 160 Cal. Rptr. 141 (1979) (outrageous and defamatory acts). *But see* Avallone v. Wilmington Medical Center, Inc., 553 F. Supp. 931 (D. Del. 1982) (no recovery).

[355] *See, e.g.*, Sherman v. St. Barnabas Hosp., 535 F. Supp. 564 (S.D.N.Y. 1982). For negligent employee performance evaluation, see Chamberlain v. Bissell, Inc., 547 F. Supp. 1067 (W.D. Mich. 1982) (employee recovered but was found to be 83% at fault).

[356] *But see* Crosier v. United Parcel Serv., Inc., 150 Cal. App. 3d 1132, 198 Cal. Rptr. 361 (1983) (managerial employee); Pugh v. See's Candies, Inc., 116 Cal. App. 3d 311, 171 Cal.

posed wrongful discharge bill in California, however, would have given implicit recognition to this distinction by excluding from its scope bona fide executives or high policymakers entitled to a pension of at least $27,000 per year.[357]

Another "agenda item" is whether a manager or supervisor with firing responsibilities may be held personally liable for wrongfully discharging an employee. This issue has not been fully developed since many victims obtain relief from the company and have no need to seek individual liability. A New York court, however, did find a school principal personally liable for firing an employee who had filed a discrimination complaint.[358]

c. Remedies

The usual common law relief for breach of contract and tort are available in wrongful discharge cases. In breach of employment contract cases, courts normally award compensatory damages[359] in lieu of reinstatement, which is viewed in many jurisdictions as an extraordinary remedy to be granted only when damages are inadequate.[360] Tort liability is often more desirable to a discharged employee because of the availability of potentially large damage awards including punitive damages.[361]

d. Defenses

Wrongful discharge cases brought under either contract or tort theories of liability are subject to the traditional defenses. For example, California courts have held that allegations of oral contract commitments by an employer to an employee may be barred by the statute of frauds when there is no writing to

Rptr. 917 (1981) (managerial employee).

[357] A. 3017, 1983-84 Reg. Sess. (Feb. 14, 1984).

[358] Maloff v. City Comm'n on Human Rights, 46 N.Y.2d 902, 387 N.E.2d 1213, 414 N.Y.S.2d 897 (1979). Courts have held that whether an individual defendant can be sued depends on whether the individual was acting within the scope of his authority. *See, e.g.*, Crossen v. Foremost-McKesson, Inc., 537 F. Supp. 1076 (N.D. Cal. 1982) (within scope); Cleary v. American Airlines, Inc., 111 Cal. App. 3d 443, 168 Cal. Rptr. 722 (1980) (outside scope); Harless v. First Nat'l Bank, 289 S.E.2d 692 (W. Va. 1982) (within scope).

[359] These damages may include lost fringe benefits—vacation pay, bonuses, and commissions. *See* DeGiuseppe, *supra* note 328, at 786-93.

[360] *See* D. DOBBS, *supra* note 344, § 12.25, at 929-31. Some commentators have proposed reinstatement as a remedy in wrongful discharge cases and the elimination of punitive damages for tort violations. *See* California Adhoc Committee, *supra* note 330, at 13-14.

[361] One California survey of wrongful discharge cases between 1980 and 1982 involving jury verdicts showed plaintiffs recovered in 32 of 41 cases; of those 32 cases, 17 had awards of punitive damages, 6 of those had awards above $600,000, and 13 of the 17 had awards above $100,000. *See* California Adhoc Committee, *supra* note 330, at 5.

prove that the otherwise at-will employment relationship was extended for a period in excess of one year.[362] A Michigan federal court held that in a tort cause of action an employee's contributory negligence in causing her own discharge reduced an employer's liability for negligent performance evaluations.[363]

One of the most rapidly growing defenses in wrongful discharge cases is that of pre-emption. This defense raises the following "agenda items": (1) whether federal or state statutes provide exclusive remedies; (2) whether there can be duplicative relief when the federal or state government already provides remedies; and (3) whether the presence of grievance arbitration under a collective bargaining agreement alters the availability of common law rights.

Courts have held that certain federal labor laws—including the National Labor Relations Act,[364] Title VII,[365] and the Employee Retirement Income Security Act of 1974[366]—pre-empt the common law wrongful discharge cause of action. One court noted that to hold otherwise would mean "the remedies provided by state and federal law would have no meaning."[367] Not all courts have agreed. For example, in *Cancellier v. Federated Department Stores*,[368] the Ninth

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[362] *See* Sorosky v. Burroughs Corp., 37 Fair Empl. Prac. Cas. (BNA) 1510 (C.D. Cal. 1985); Munoz v. Kaiser Steel Corp., 156 Cal. App. 3d 965, 203 Cal. Rptr. 345 (1984). Hawaii also follows this rule. McIntosh v. Murphy, 52 Hawaii 29, 429 P.2d 177 (1970). Not all courts, however, agree that the statute of frauds will apply to terminable at-will employees' employment agreements. Weiner v. McGraw-Hill, Inc., 57 N.Y.2d 458, 443 N.E.2d 441, 457 N.Y.S.2d 193 (1982) (contract need not "by its terms" be performed within one year).

[363] Chamberlain v. Bissell, Inc., 547 F. Supp. 1067 (W.D. Mich. 1982) (damages reduced by employee's 83% negligence).

[364] *See, e.g.*, Viestenez v. Fleming Cos., 681 F.2d 699 (10th Cir.), *cert. denied*, 459 U.S. 972 (1982) (alleging discharge for union activities). Of course what activity is arguably protected under a statute may be a matter of some debate. For example, the National Labor Relations Board and courts have "wrestled" with the proper interpretation of an individual employee's protected "concerted activity." *See* Meyers Indus., Inc., 268 N.L.R.B. 493 (1984) (no concerted activity), *rev'd sub nom.* Prill v. NLRB, 755 F.2d 941 (D.C. Cir.), *cert. denied*, 106 S. Ct. 352 (1985); NLRB v. City Disposal Sys., 465 U.S. 822 (1984) (on facts similar to *Meyers*, concerted activity was found due to rights under collective bargaining agreement). *See also* Grossman, *NLRA Preemption of Wrongful Discharge Actions: A Perspective*, 1 LAB. LAW. 583 (1985); Comment, *NLRA Preemption of State Wrongful Discharge Claims*, 34 HASTINGS L.J. 635 (1983).

[365] *See, e.g.*, Brudnicki v. General Elec. Co., 535 F. Supp. 84, 89 (N.D. Ill. 1982). *But see* Lucas v. Brown & Root, Inc., 736 F.2d 1202, 1206 (8th Cir. 1984) (no pre-emption). Title VII specifically provides that it does not "exempt or relieve any person from any liability, duty, penalty, or punishment provided by any present or future law of any State or political subdivision of a State, other than any such law which purports to require or permit the doing of any act which would be an unlawful employment practice under [Title VII]." 42 U.S.C. § 2000e-7 (1982).

[366] Johnson v. Transworld Airlines, Inc., 149 Cal. App. 3d 518, 196 Cal. Rptr. 896 (1983). *See* Employee Retirement Income Security Act of 1974, 29 U.S.C. § 1001 (1982).

[367] Brudnicki v. General Elec. Co., 535 F. Supp. at 89.

[368] 672 F.2d 1312 (9th Cir.), *cert. denied*, 459 U.S. 859 (1982). *See* Age Discrimination in

Circuit Court of Appeals held that the Age Discrimination in Employment Act did not pre-empt a tort claim when the state relief did not duplicate the federal statutory relief.[369] In *Belknap, Inc. v. Hale*,[370] the United States Supreme Court decided the issue whether an employee hired as a strike replacement, allegedly as a "permanent employee," had state common law contract rights even though the federal National Labor Relations Act provided for "exclusive remedies" regarding strikers' rights.[371] The Court held that "a State may regulate conduct that is of only peripheral concern to the Act or that is so deeply rooted in local law that the courts should not assume that Congress intended to pre-empt the application of state law."[372] The Court allowed the employee's state breach of contract cause of action to proceed.[373]

State law may also pre-empt common law rights against wrongful discharge. In *Strauss v. A.L. Randall Co.*,[374] the California Court of Appeals found that statutory relief for age discrimination under a state statute provided plaintiff an exclusive remedy and thus precluded a wrongful discharge action.[375] Some courts, however, have held that a state statute is not exclusive and merely cre-

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Employment Act of 1967, 29 U.S.C. §§ 621-634 (1982).

[369] 672 F.2d at 1318. *But cf.* Platt v. Burroughs Corp., 424 F. Supp. 1329, 1340 (W.D. Pa. 1983) (when claiming unfair practice based on age, the Age Discrimination in Employment Act is the exclusive remedy).

[370] 463 U.S. 491 (1983).

[371] *Id.* at 493.

[372] *Id.* at 509 (citing San Diego Bldg. Trades Council v. Garmon, 359 U.S. 236 (1959)). *Accord* Allis-Chalmers Corp. v. Lueck, 105 S. Ct. 1904, 1916 (1985) ("The full scope of the pre-emptive effect of federal labor-contract law remains to be fleshed out on a case-by-case basis."). *See* Note, *Labor Law Preemption After* Belknap, Inc. v. Hale: *Has Preemption as Usual Been Permanently Replaced?*, 17 IND. L. REV. 491 (1984).

Note that supervisors and managerial employees are not protected by the National Labor Relations Act and presumably the pre-emption issue would not be raised if they were to bring wrongful discharge cases. *Cf.* Parker-Robb Chevrolet, Inc., 262 N.L.R.B. 402 (1982) (supervisors not protected under the Act). *But cf.* Sitek v. Forest City Enters., Inc., 587 F. Supp. 1381 (E.D. Mich. 1984) (Under certain circumstances, discharge of a supervisor may violate § 8(a)(1) of the Act as an unfair labor practice.).

[373] 463 U.S. at 512.

[374] 144 Cal. App. 3d 514, 194 Cal. Rptr. 520 (1983). "Pre-emption" is sometimes used interchangeably with "exclusivity" of remedies, and "preclusion" of alternative relief.

[375] *Id.* at 519-21, 194 Cal. Rptr. at 523-24. *Cf.* Wolk v. Saks Fifth Ave., Inc., 728 F.2d 221 (3d Cir. 1984) (sex harrassment); Gates v. Trans Video Corp., 93 Cal. App. 3d 196, 155 Cal. Rptr. 486 (1979) (worker's compensation). *But cf.* McGee v. McNally, 119 Cal. App. 3d 891, 174 Cal. Rptr. 253 (1981) (cause of action for intentional infliction of emotional distress was exception to exclusivity of workers' compensation).

Often a court will decide that a statute provides exclusive relief when discussing whether a "public policy" exception to the "at-will" doctrine should be found and will conclude that the public policy is already served by the statutory relief. *See* Wehr v. Burroughs Corp., 438 F. Supp. 1052.

ates rights in addition to a pre-existing common law right.[376]

The most dramatic development of case law involving pre-emption of wrongful discharge causes of action arises when there is a collective bargaining agreement.[377] Under traditional American labor law, arbitration is the preferred method of settling labor disputes. Courts will defer to arbitration and will not readily second-guess or set aside an arbitrator's award.[378] Therefore, an employee, whose wrongful discharge claim involves a matter covered by a collective bargaining agreement containing a grievance arbitration provision, normally will not receive judicial review of his grievance on the merits.[379] This appears to be true for both tort[380] and contract claims, including those based on implied covenants of good faith.[381]

Courts have invoked exceptions to this rule when certain statutory rights form the bases of the claims. For example, the United States Supreme Court has held that Title VII claims[382] and claims arising under the Fair Labor Standards Act[383] may be heard de novo in federal court notwithstanding arbitration awards because of the important public interest embodied within these statutes. The Court, however, has held that federal rights to trial de novo may be lost through prior settlement or adjudication of the claims in a state proceeding.[384]

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[376] *See, e.g.*, Brown v. Transcon Lines, 284 Or. 597, 611, 588 P.2d 1087, 1094 (1978) (A workers' compensation statute did not expressly supersede the common law right, especially where the "new statutory right is not an adequate one.").

[377] For a discussion of the pre-emption doctrine in wrongful discharge cases where the employee was covered under a collective bargaining agreement, see Wheeler & Browne, *Preemption of Wrongful Discharge Claims of Employees Covered by Collective Bargaining Agreements*, 1 LAB. LAW. 593 (1985).

[378] *See* "Steelworkers Trilogy": United Steelworkers of Am. v. American Mfg. Co., 363 U.S. 564 (1960); United Steel Workers of Am. v. Warrior & Gulf Navigation Co., 363 U.S. 574 (1960); United Steelworkers of Am. v. Enterprise Wheel & Car Corp., 363 U.S. 593 (1960).

[379] *See, e.g.*, Lamb v. Briggs Mfg., Div. of Celotex Corp., 700 F.2d 1092 (7th Cir. 1983) (no cause of action for retaliatory discharge where employee was a party to a collective bargaining agreement which provided a just cause guarantee and arbitration remedies).

[380] *Id.*

[381] *See, e.g.*, Bertrand v. Quincy Mkt. Cold Storage & Warehouse, 728 F.2d 568 (1st Cir. 1984) (rejected tort theory and held the implied contractual term, if successful, would have been part of the contract and was thus a theory grounded in contract).

[382] Alexander v. Gardner-Denver Co., 415 U.S. 36 (1974).

[383] Barrentine v. Arkansas-Best Freight Sys., 450 U.S. 728 (1981).

[384] Kremer v. Chemical Constr. Corp., 456 U.S. 461, 485 (1982) ("[M]erits of a legal claim once decided in a court of competent jurisdiction are not subject to redetermination in another forum."). *Cf.* Olguin v. Inspiration Consol. Copper Co., 740 F.2d 1468 (9th Cir. 1984) (Federal labor law claims masked as state law claims must be pursued in federal court.). Absent settlement or final adjudication, Title VII clearly provides that state rights are not pre-empted by Title VII. 42 U.S.C. § 2000e-7 (1982). *See* Lucas v. Brown & Root, Inc., 736 F.2d at 1206 ("Title VII does not preempt this state-law contract claim.").

In *Garibaldi v. Lucky Food Stores, Inc.*,[385] the Ninth Circuit Court of Appeals addressed the issue of whether a wrongful discharge cause of action based on the public policy exception to the at-will doctrine may qualify for de novo state court proceedings after an adverse arbitration award, thus extending nondeference to arbitration from statutory rights to those grounded in "public policy."[386] In *Garibaldi*, a unionized employee was fired for protesting and refusing to deliver spoiled milk. He brought a wrongful discharge action after an adverse arbitration award. The Ninth Circuit held that his action was not precluded because public policy was involved.[387]

The application in *Garibaldi* of the wrongful discharge remedy to unionized employees would seem to threaten the finality and stability of arbitration awards under collective bargaining agreements. The authority of this holding, however, may be short-lived as the United States Supreme Court recently held in *Allis-Chalmers Corp. v. Lueck*[388] that state tort claims which could have been resolved by interpretation of a collective bargaining agreement were pre-empted.[389] The Court held that:

> [W]hen resolution of a state-law claim is substantially dependent upon analysis of the terms of an agreement made between the parties in a labor contract, that claim must either be treated as a § 301 claim. . .or dismissed as pre-empted by federal labor-contract law. This complaint should have been dismissed for failure to make use of the grievance procedure established in the collective-bargaining agreement. . .or dismissed as pre-empted by § 301.[390]

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[385] 726 F.2d 1367 (9th Cir. 1984), *cert. denied*, 105 S. Ct. 2319 (1985).

[386] 726 F.2d at 1371-76.

[387] *Id.* at 1376. *Contra* Lamb v. Briggs Mfg., Div. of Celotex Corp., 700 F.2d at 1095-96 (An employee who is a party to a collective bargaining agreement may not sue his employer in tort for a retaliatory discharge even if "public policy" is involved because, in part, there is a conflicting "policy" to protect "orderly industrial relations.").

[388] 105 S. Ct. 1904 (1985).

[389] *Id.* at 1916.

[390] *Id.* Section 301 of the National Labor Relations Act provides that suits for violations of collective bargaining agreements "may be brought in any district court." 29 U.S.C. § 185(a) (1982). The policy supporting the court's decision was, once again, to avoid undermining the arbitration process:

> Since nearly any alleged willful breach of contract can be restated as a tort claim for breach of a good-faith obligation under a contract, the arbitrator's role in every case could be bypassed easily if § 301 [of the Act] is not understood to pre-empt such claims. . . .A rule that permitted an individual to sidestep available grievance procedures would cause arbitration to lose most of its effectiveness. . .as well as eviscerate a central tenet of federal labor-contract law under § 301 that it is the arbitrator, not the court, who has the responsibility to interpret the labor contract in the first instance.

105 S. Ct. at 1915-16 (citation omitted).

The Court cautioned that its holding was limited to the facts of the case and was not necessarily applicable to other federal and state labor laws.[391]

Unionized workers' common law claims may therefore be pre-empted by statute or by a collective bargaining agreement.[392] Wrongful discharge claims of *non-unionized* workers, on the other hand, would only be pre-empted by statute. Thus, the non-unionized employee would have a greater chance of avoiding the pre-emption defense and recovering punitive damages.

Employers also use self-help techniques as "defenses" to avoid liability. These techniques include contract provisions wherein the employee agrees to his status as an at-will employee,[393] careful review of personnel manuals and statements made by supervisors during interviews and after hiring, and "patrol" policies to prevent unintentional creation of rights for at-will employees.[394] Management is

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[391] The Court noted that:

> We pass no judgment on whether this suit also would have been pre-empted by other federal laws governing employment or benefit plans. Nor do we hold that every state-law suit asserting a right that relates in some way to a provision in a collective-bargaining agreement, or more generally to the parties to such an agreement, necessarily is pre-empted by § 301. The full scope of the pre-emptive effect of federal labor-contract law remains to be fleshed out on a case-by-case basis.

105 S. Ct. at 1916.

[392] *Cf.* Midgett v. Sackett-Chicago, Inc., 105 Ill. 2d 143, 473 N.E.2d 1280 (1984), *cert. denied*, 106 S. Ct. 278 (1985). The *Midgett* court rejected the argument that non-union "at-will" employees needed more protection than unionized employees and held that unionized employees also had a right to contract and tort relief. 105 Ill. 2d at ____, 473 N.E.2d at 1283. The court added that relief under a collective bargaining agreement was incomplete since no punitive damages can be awarded as would be possible under tort relief and it would be unfair to permit the award of punitive damages to non-unionized employees while denying it to unionized employees. *Id.* at ____, 473 N.E.2d at 1284. This decision by the Illinois Supreme Court was prior to Allis-Chalmers Corp. v. Lueck, 105 S. Ct. 1904 (1985).

[393] Such disclaimer provisions have been upheld in pre-employment applications, *see, e.g.*, Batchelor v. Sears, Roebuck & Co., 574 F. Supp. 1480 (E.D. Mich. 1983); and post-hire agreements, *see, e.g.*, Ledl v. Quik Pik Food Stores, Inc., 133 Mich. App. 583, 349 N.W.2d 529 (1984).

[394] One commentator suggested the following:

> 1. Put the grounds for termination in writing and distribute this information to all employees. . . .
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> 2. Document every termination action. . . .
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> 3. Refine performance evaluations to give honest appraisals of each employee's weak and strong points. . . .
>
> 4. Provide advance warning that an employee has taken a course possibly leading to termination unless changes occur in his/her performance. . . .
>
> 5. Watch for signs of an employee's work problems. . . .
>
> 6. Involve two or more persons in the termination process. . . .
>
> 7. Review severance pay policies. . . .
>
> 8. Develop a severance package that includes continuance, for a limited time, of health and life insurance benefits. . . .

quite aware that it has much to lose if a jury awards punitive damages.

Knowledge of these legal and practical defenses to a wrongful discharge cause of action, whether based on contract or tort, is especially important to the Japanese. The Japanese practice of emphasizing job security and retaining employees even after poor evaluations might provide evidence that a discharge of an American employee was wrongful. Japanese employers are also reluctant to seek early legal advice before the problems occur. The Japanese must therefore increase their awareness of the "agenda items" identified above in order to avoid labor problems in their American ventures.

V. CONCLUSION

One of the most important problems confronting the United States and Japan is how to deal with increasing Japanese operations in the United States: "Next to international trade relations, Japanese direct investment in U.S. manufacturing is probably considered one of the most socially sensitive and significant issues in United States-Japan economic relationships. The reasons for this are several and likely differ depending which side of the Pacific one is on."[395]

The Japanese argue that American-based Japanese manufacturing companies which hire American citizens displace not only exports from Japan, but also Japanese workers who otherwise might have manufactured these same products in Japan. They further note that other foreign markets may present more economic opportunity and that uncertainties created by laws and trade regulations in the United States make these other markets a more attractive alternative to direct investment in the United States.[396] Many Americans, while worried about the increasing trade deficit, see Japanese direct investment as a positive step toward creating more job opportunities for American citizens and as a way of obtaining quality Japanese products at a lower price.[397]

When Japanese employers arrive in the United States they bring their management and industrial relations practices and seek to adapt them to local conditions. Japanese companies and American companies which are starting to

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9. Terminate only when you must, and terminate only with care and compassion. . . .

10. Consider buying "defense and judgment" insurance. This relatively new form of coverage protects employers against lawsuits arising from cases other than personal-injury or property-damage suits covered under conventional insurance policies.

Decker, *At-Will Employment in Pennsylvania—A Proposal for Its Abolition and Statutory Regulation*, 87 DICK. L. REV. 477, 504-05 (1983).

[395] Kujawa Case Study, *supra* note 71, at 1.

[396] *See id.*

[397] "From the U.S. perspective, foreign direct investment has been viewed (perhaps inaccurately) as an alternative to trade and as a method for reducing international commercial friction." *Id.* at 2.

adopt some Japanese-style approaches to labor relations may face legal tests: whether their management practices violate equal employment opportunity laws and laws relating to unionization and discharge of workers.

From the American lawyers' perspective, "too many parties fail to analyze thoroughly the labor impact. . .and they are taken by surprise when labor law matters either interfere with. . .or materially change the business planner's expectations."[398] While many technical areas of labor law must be considered and resolved, the large policy issues involved in international relations and domestic labor policies must not be ignored.

Indeed, the search for appropriate accommodation of Japanese management practices and United States labor laws will necessitate greater understanding of the two countries based on a sharing of information and on closer cooperation on common issues. As one author has observed:

> To understand Japan is to realize that the country is truly unique; its noticeable mantle of Americanization is just that, a cloak. It is also essential to realize the uniqueness of the American people, and to know that solutions and truth between the two countries spring from working together, not from merely comparing or studying the differences.[399]

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[398] Kelley & Lengel, *In Acquisition, Don't Get Tripped Up by Labor Law*, Legal Times of Wash., Feb. 22, 1982, at 17, col. 1.

[399] Yamada, *Japan: An Introduction*, 15 CASE W. RES. J. INT'L L. 415, 418 (1983).

The Japan-United States Treaty of Friendship, Commerce and Navigation: Lawyers As Treaty Traders*

by Richard S. Kanter**

I. INTRODUCTION

No trade issue confronting the United States and Japan is as intertwined with the deep cultural differences between the two nations as the long American struggle, against fierce Japanese opposition, for offices for American lawyers in Japan. Although American business access to American lawyers in Japan is essential to American penetration of the Japanese market,[1] and to American efforts to internationalize the yen and make Tokyo a world financial center,[2] since 1955 Japan has, with only one exception, prohibited American lawyers from

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[1] Hawaii Senator Daniel Inouye recently addressed this need:

> Currently, manufacturing and service industries attempting to penetrate Japanese markets must rely heavily on seven American attorneys resident in Japan for advice on legal procedures and administrative practices concerning market penetration. This is hardly an adequate number, and unless additional American lawyers are allowed to practice in Japan, vital legal assistance to American marketing efforts will cease.

131 CONG. REC. S13609 (daily ed. Oct. 18, 1985). Senator Inouye's remarks reflect a concern recognized 32 years earlier. In a July 17, 1953 letter to Senator Alexander Wiley, Chairman of the Senate Foreign Relations Committee, Elmer E. Welty, Chairman of the American Chamber of Commerce in Japan, stated, "American enterprise in Japan would be gravely handicapped—it is, indeed, not too much to say that it could hardly continue to function—if the American business community were deprived of access to the professional services of [American] lawyers. . . ." Letter from Elmer E. Welty to Senator Alexander Wiley (July 17, 1953).

[2] Senator Inouye also noted, " 'Primary' service industries, such as commercial banking, investment banking, and insurance, rely heavily on 'secondary' service industries such as law services, and accounting services, and consulting. Without a sufficient base of secondary support services, Japan cannot become an international financial center." 131 CONG. REC. at S13609.

opening offices in that country.[3]

The refusal of Japan to allow American lawyers to open offices in Japan reflects the cultural differences between business institutions in the respective societies and the disparities in the willingness of the United States and Japan to accommodate the business institutions and needs of the other that lie at the heart of what has become a serious trade issue.

American society values lawyers as the providers of essential international trade and investment facilitation services[4] as well as legal services.[5] In contrast, Japanese society prefers to use unlicensed personnel of trading companies as the providers of international trade facilitation services to business enterprises,[6] and unlicensed personnel of business enterprises as the providers of legal services to the employing enterprise.[7]

The similarity in function between American international lawyers and Japanese trading companies as trade facilitators is not generally known in the United States. This similarity has, however, been recognized in Japan: "In the United States, when an enterprise moves into a foreign country, or expands its operations abroad, it has lawyers examine the legal problems and gather information. Lawyers' offices perform part of the same function as Japanese trading companies."[8]

The result of the Japanese prohibition on American lawyers is comparable to

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[3] The one exception is the New York law firm of Milbank, Tweed, Hadley & McCloy, admitted in 1977. For a history of the controversy surrounding the admission of that law firm, see Crabb, *Providing Legal Services in Foreign Countries: Making Room for the American Attorney*, 83 COLUM. L. REV. 1767, 1767 n.3 (1983). For a history of this issue generally, see Brown, *A Lawyer by Any Other Name: Legal Advisors in Japan* in LEGAL ASPECTS OF DOING BUSINESS IN JAPAN 1983, at 201, 440-43 (1983); Fukuhara, *The Status of Foreign Lawyers in Japan*, 17 JAPANESE ANN. INT'L LAW. 21 (1973); Kosugi, *Regulation of Practice by Foreign Lawyers*, 27 AM. J. COMP. L. 678 (1979); Moffatt, *American Lawyers in Japan: Still Waiting in the Genkan*, J. AM. CHAM. COM. IN JAPAN, Apr. 1985, at 9-16; Shimazaki, *An American Lawyer in Tokyo: Problems of Establishing a Practice*, 2 PAC. BASIN L.J. 180 (1983); Rand Report, Case Studies of U.S. Service Trade in Japan (1984) (A. Alexander & H. Tan) (translated into Japanese as *Rando Ripoto—Nichibei Masatsu no Arata na Shoten "Bengoshi"*) (Rand Report—Lawyers: New Focus of Japanese American Trade Friction), EKONOMISUTO (ECONOMIST), June 11, 1985, at 50. *See also infra* text accompanying notes 51-59.

[4] Crabb uses the term "transaction facilitator":

> An American lawyer fulfills the role of transaction facilitator by providing pertinent information about financing, shipping, transfer of payments and other mechanical aspects of any large-scale transaction. In addition, the facilitator-lawyer will often be able to anticipate legal problems, and to aid his client in selecting a local lawyer.

Crabb, *supra* note 3, at 1769 n.9.

[5] *See infra* notes 23-27 and accompanying text.

[6] *See infra* notes 28-33 and accompanying text.

[7] *See infra* notes 40-47 and accompanying text.

[8] *Naze Ikenai Aoi Me no Bengoshi (Why Do We Keep Out the Blue-Eyed Lawyers?)*, Tokyo Shimbun, June 22, 1981, at 5.

the United States prohibiting Japanese trading companies from establishing offices in the United States. In fact no such prohibitions exist; there are networks of Japanese trading company offices in this country staffed by thousands of Japanese personnel.[9] Japanese business has essentially unrestricted access to Japanese trade facilitation services in the United States.[10]

In stark contrast, American companies desiring to export to and invest in Japan do not have sufficient access to American trade facilitators in Japan.[11] At present, American business is limited to seeking essential trade facilitation services from the seven remaining pre-1955 American lawyers and one firm that entered in 1977,[12] a handful of American accounting firms,[13] several management consulting companies,[14] approximately 350 Japanese barristers[15] and their 100 American "trainees,"[16] and Japanese trading companies.[17] Because of the lack of opportunity for American lawyers to open offices in Japan, only about

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[9] *See infra* text accompanying note 28.

[10] *The Business Intelligence Beehive*, BUS. WEEK, Dec. 14, 1981, at 52.

[11] Unless Japan allows free American access to American lawyers in Japan, American companies will continue to be handicapped in their efforts to penetrate the Japanese market and reduce the bilateral trade balance. In 1983, the United States trade deficit with Japan was approximately $19 billion. Keizai Koho Center (Japan Institute for Social and Economic Affairs), Japan 1984—An International Comparison 38 (1984) (citing U.S. Department of Commerce statistics). In 1984, the bilateral trade deficit jumped to $33 billion. *Worsening Imbalance in U.S.-Japan Trade*, Honolulu Star-Bull., Feb. 3, 1986, at A14, col. 1. By 1985, the bilateral trade deficit had grown to approximately $50 billion. *Yen's Rise Isn't likely to Significantly Trim Japan's Exports to U.S.*, Wall St. J., Mar. 21, 1986, at 1, col. 6.

[12] *See* 6 MARTINDALE-HUBBELL LAW DIRECTORY 1942B-1972B (1985) (Japan).

[13] *See* THE 1983 DIRECTORY OF MEMBERS OF THE AMERICAN CHAMBER OF COMMERCE IN JAPAN 206 (listing the "Big Eight" American accounting firms).

[14] *See id.* at 209 (listing 39 "management and industrial consultants," some of whom are executive search firms, others of whom are true business consultants).

[15] *See* MARTINDALE-HUBBELL, *supra* note 12 (listing 362 Japanese barristers in 59 law firms); *Response Concerning the Foreign Lawyers Problem*, Nichibenren Shimbun, Jan. 1, 1985, at 4 (the monthly newsletter of the Nihon Bengoshi Rengokai, the Japan Federation of Bar Associations, or Nichibenren).

[16] *See* U.S.-Japan Trade Study Group, Progress Report: 1984, at 48 (1984). Trainee is the term used by Japanese barristers in applying to the Immigration Bureau of the Ministry of Justice for working visas for foreign employees. *See* Brown, *supra* note 3, at 460-73. Trainees are hired to draft and edit documents in English and advise them on American law. *See* Kosugi, *supra* note 3, at 693-94. Trainees are usually young, relatively inexperienced American law graduates. Only a few are associated with American law firms. An increasing number speak and read Japanese. Few trainees are allowed to stay in Japan longer than three years. *See* Crabb, *supra* note 3, at 1784 n.94 (citing Gilbert, The Attorneys Law Problem in Japan (1982) (unpublished manuscript) (on file at Columbia Law Review)). *See also* Arthurs, *U.S. Lawyers Eye Land of Rising Sun*, Legal Times, May 21, 1984, at 1, col. 2 (no career path for trainees and no incentive to stay on).

[17] *See infra* note 28 and accompanying text.

200 American lawyers are knowledgeable about doing business in Japan.[18]

At a time of $50 billion annual trade deficits with Japan,[19] the continuing Japanese denial of visas[20] to American lawyers desiring to open offices in Japan has become critical. Finally, after several years of persistent American demands to open Japan to American lawyers,[21] the Government of Japan has at last recognized that for political reasons it must allow American lawyers to open offices in Japan.[22]

To date, the American government pressure has been based solely on economic and political arguments. Such efforts might be more effective, however,

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[18] These 200 lawyers are among the Americans most familiar with Japan. Most speak and read Japanese and have networks of business contacts. Because of their appreciation of the history, culture, and business customs of Japan, they are a vital resource for American understanding of Japan. Fukuhara, *Status*, *supra* note 3, at 38-39. Roughly half of these lawyers are employed in approximately 20 American law firms based in New York, Washington, Chicago, Houston, Los Angeles, and San Francisco which specialize in international trade. These lawyers want to establish offices in Tokyo as their firms have already done in London, Brussels, Paris, Hong Kong, Singapore, and other leading financial and trade centers. The remainder includes the "trainees," Rand Report, *supra* note 3, at 55-56, as well as a few attorneys in Seattle and Honolulu. The Rand Report estimates that a total of 100 American lawyers would be attracted to Japan. *Id.* at 55.

[19] *See supra* note 11.

[20] The primary means of keeping American lawyers out of Japan is to deny them visas. *U.S. Lawyers Allege Tokyo Barriers*, Wall St. J., Apr. 20, 1982, at 35, col. 2. *See* Rand Report, *supra* note 3, at 42 (citing a Dec. 1, 1980 letter from the Japanese Embassy in Washington to a U.S. law firm: "[U]ntil such time as a conclusion [to the issue of allowing American lawyers to practice in Japan] can be reached it has been decided to freeze the status quo . . . and accordingly, to withhold judgment on this particular [visa] application.").

[21] In March, 1982, the United States officially informed the Japanese Government that it considers the bar to establishment of offices in Japan by American law firms to be a non-tariff barrier to trade in legal services. Shapiro, *Reclaiming a Place for Foreign Lawyers in Japan*, Japan Times, Oct. 17, 1982, at 12, col. 2. All American negotiating efforts on this issue have been handled by the United States Trade Representative on a government-to-government level with the Japanese Ministry of Justice.

[22] On July 30, 1985, the Japanese Government promised resolution of this problem in its Action Program Concerning the Foreign Lawyers Problem in which the Japanese Government declared: "While respecting the autonomy of the Nihon Bengoshi Rengokai [Japan Federation of Bar Associations], we will devise a solution that is appropriate both domestically and internationally, with the aim toward revising the law in the next regular session of the Diet." The Japanese Government views this issue as a matter of Japanese domestic law:

> Although this issue has an aspect as a trade problem, it is basically an issue regarding each country's lawyers system. It is a question of how each country should cope with the trend of internationalization and the increase in demand for international legal work. Specifically, it is a question of how much scope of activities foreign lawyers should be granted in each country while maintaining harmony with the lawyers system in that country.

Position Paper of the Japanese Side on Foreign Lawyers Issue for the Coming Consultation 3 (enclosed with an undated letter of approximately Oct. 25, 1985 from Michihiko Kunihiro, Director General, Economic Affairs Bureau, Minister of Foreign Affairs, to Michael B. Smith, Deputy United States Trade Representative) [hereinafter cited as Position Paper].

if they were based on legal authority for the proposition that Japan must now, even without special legislation, allow American lawyers to open offices in Japan. This article will show that there is a partial legal solution to this trade problem which allows American lawyers to open offices in Japan based on existing Japanese statutes and the bilateral Friendship, Commerce and Navigation Treaty (FCN).

II. Different Cultures, Different Business Institutions

A. *American Trade Facilitators: Lawyers*

Traditionally, American law practice has included representing clients in court, settling disputes, drafting legal documents, and providing legal advice, particularly to business enterprises. In addition to these activities, which only licensed lawyers may perform,[23] there are other activities lawyers do that may legally be performed by non-lawyers.[24] These include negotiating business contracts,[25] and in an international law practice, trade facilitation.

International trade facilitation services include gathering and providing business information about such matters as market and regulatory conditions and investment possibilities, foreign government policies, laws, regulations and standards, and foreign business customs and ways of doing business, and representation in business negotiations and in negotiations with foreign government officials over required permits and licenses.[26] It is these services that American businesses need from Americans knowledgeable about doing business in

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[23] States do not directly define the practice of law. Some state statutes list activities that constitute the practice of law. Rhode, *Policing the Professional Monopoly: A Constitutional and Empirical Analysis of Unauthorized Practice Prohibitions*, 34 STAN. L. REV. 1, 46 & nn.140-43 (1981). A number of states proscribe the practice of law, without defining it; others define the practice of law as that which lawyers do. *Id.* at 45 & n.135. The Code of Professional Responsibility defines the practice of law as that which "relates to the rendition of services for others that call for the professional judgment of a lawyer." MODEL CODE OF PROFESSIONAL RESPONSIBILITY EC 3-5 (1981).

[24] "[L]awyers often are paid for services that cannot be described strictly as lawyering. These services include assembling financings, promoting real estate syndicates (and keeping a share) *and other services that are essentially business activities, and that require no lawyer's license.*" B. HARNETT, LAW, LAWYERS, AND LAYMEN 44 (1984) (emphasis added).

[25] Entertainers and athletes have business agents who negotiate personal service contracts for them. Foreign manufacturers have general sales agents who negotiate complex contracts for sales of goods and otherwise manage the business of their principal. These agents may or may not be employees of the principal and may or may not be lawyers. In negotiations, American lawyers are acting as business agents, not as legal representatives or legal advisors, although in the course of a negotiation they may also render legal advice to their clients.

[26] Other services include the investigation of financing, shipping, and transfer of payments. *See* Crabb, *supra* note 3, at 1769 n.9.

Japan.[27]

B. *Japanese Trade Facilitators: Trading Companies*

In Japan, international trade facilitation is customarily performed by trading companies who play a central role in coordinating Japanese export and foreign investment. Trading companies are the "eyes and ears" of Japanese business abroad.[28] Through their worldwide networks, Japanese trading companies provide international trade facilitation services to Japanese and non-Japanese companies.[29]

Although trading companies provide a wide variety of trade services,[30] the research, information and marketing services of Japanese trading companies are among their most important functions.[31] These services overlap the trade facili-

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[27] *See* Arthurs, *supra* note 16, at 8, col. 1 ("[J]oint ventures, investments, licensing agreements, and other transactions will be more efficiently completed with the help of American lawyers in Japan.") (quoting Washington, D.C. attorney, Sherman E. Katz). *See also U.S., Tokyo Debate Letting U.S. Lawyers Practice in Japan,* Wall St. J., Nov. 22, 1985, at 35, col. 2 ("The real purpose [of seeking a law office in Japan] is to help us eradicate some of the tariff and nontariff barriers in Japan.") (quoting New York attorney Arthur Mitchell).

[28] There are 161 trading companies employing over 60,000 Japanese personnel, including 3300 in the United States. A. YOUNG, THE *Sogo Shosha*: JAPAN'S MULTINATIONAL TRADING COMPANIES 69 (1979). In 1982 the 16 *sogo shosha* (general trading companies) accounted for 52.7% of Japan's $139 billion in exports and over 62.2% of the $132 billion of imports to Japan. Japan Foreign Trade Council, The Sogo Shosha, A Statistical Guide 5 (1984). During 1981, the American subsidiaries of Japanese trading companies accounted for close to 10% of total United States exports. Young, *The Sogo Shosha, from Japanese to Transnational Enterprises ?*, in Japan Foreign Trade Council, The Sogo Shosha: What They Are and How They Can Work for You 13 (1983).

[29] The major trading companies maintain more than 100 offices each in business centers around the world. Japan External Trade Organization, The Role of Trading Companies in International Commerce 12-13 (1983) [hereinafter cited as JETRO] (containing a world map showing the communications system of a major trading company with 25 cities handled from the Tokyo Center, 29 cities from the New York Center, and 21 cities from the Brussels center). The communications systems of Japanese trading companies rival or exceed that of the largest governments. Japan Foreign Trade Council, The Sogo Shosha: What They Are and How They Can Work for You 3 (1983) [hereinafter cited as Sogo Shosha].

As of 1984 the nine largest sogo shosha had over 1500 Japanese employees in their United States offices alone. Nihon Kogyo Shimbun, 1984 Sogo Shosha Nenkan (1984) (Japan Industrial Newspaper, General Trading Company Yearbook).

[30] The other services of trading companies include import and export of goods, distribution of goods, organizing multinational projects, financing, serving as investment intermediary, resource development for food, fuel, and raw materials, setting up of joint ventures, transportation of goods, marketing, research, planning, and technology transfer. Sogo Shosha, *supra* note 29, at 2-3. JETRO adds to the list risk absorption and offshore (third-country) trade. JETRO, *supra* note 29, at 2. *See also* A. YOUNG, *supra* note 28, at 57-79.

[31] The Japan Foreign Trade Council describes these three important services as follows:

tation services provided by American international trade lawyers to a remarkable degree.[32] American lawyers thus serve much the same function in American business society as trading companies provide in Japanese business society. American law firms, however, are substantially different from Japanese trading companies in form as well as size. American lawyers are licensed legal professionals, while trading company personnel, although often legally trained, are not licensed. American lawyers charge their clients directly, often on an hourly-charge basis. Trading companies usually charge their customers indirectly, by including the cost of providing the information in the price of goods bought or sold, in markups and commissions, and in trade-finance interest charged sellers or buyers.[33]

> Research—Successful trade promotion and project feasibility assessment depend on extensive and accurate knowledge of markets, technological developments, changes in the structure of industry and demand, and business and financial conditions throughout the world. Research in all these areas is an important part of sogo shosha activities.
>
> Marketing—Their worldwide presence, marketing expertise and information facilities make the services of the sogo shosha particularly attractive to companies lacking overseas marketing networks or seeking to enter small or unfamiliar markets.
>
> Information—The sogo shosha possess information-gathering and telecommunications facilities that rival those of the largest governments, enabling instant access for both domestic and foreign clients to the most up-to-date intelligence bearing on trade development, business opportunities, and marketing.

Sogo Shosha, *supra* note 29, at 3.

[32] From the perspective of an American business client, the information and advisory services of trading companies are "legal services" since they are in the United States customarily provided by lawyers:

> An American company going to Japan will meet a bewildering array of legal regulations. Professional legal advice is a must, and a good trading company can answer most questions and provide legal services without the direct use of a lawyer. Some typical areas requiring sound legal advice:
>
> The usual health and safety standards that foreign products have to meet. . . .
>
> Import duties [that] can vary considerably from product to product. . . .
>
> Restrictions in advertising, such as forbidding the use of superlatives in advertising. . . .
>
> Many local regulations that can only be obtained in Japanese.
>
> Maintenance of extensive records and documentation.

M. DEUTSCH, DOING BUSINESS WITH THE JAPANESE 157 (1983).

[33] However, there is a trend toward directly charging consulting fees. *See* A. YOUNG, *supra* note 28 (Sogo shosha "are turning their impressive capabilities and services in information, communication, financing and management—hitherto provided at low cost or free to customers—into profitable management, financial (credit control, foreign exchange futures, investment, etc.), tax and engineering consulting business.").

C. *Bengoshi: Providers of Legal Services*

Because American lawyers are independent, licensed legal professionals, they are most often compared not with trading companies but with the Japanese *bengoshi* (barrister)[34] profession. *Bengoshi*, like American lawyers, call their offices law offices, are licensed to appear in court, give legal advice, and charge clients directly. This comparison is too superficial, however, because the scope of practice of lawyers in the United States and *bengoshi* in Japan is substantially different.

In contrast to the central role in business played by a large percentage of the 653,686 members of the American legal profession,[35] the 12,840 *bengoshi*[36] comprise only one of the several licensed Japanese legal professions,[37] and are

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[34] The term *bengoshi* was first used in the first Bengoshi Act enacted in 1893. K. OHTSUBO, HUNDRED YEARS OF THE JAPANESE BAR 34 (1984). *See* Shapiro, *supra* note 21, at 12, col. 1. Shapiro states:

> Historians tell us that the term bengoshi was coined in an attempt to translate the English term "barrister" into Japanese. The term *bengo-suru*, of course, means to defend or speak for a third person and the word *shi* means a samurai or a gentleman (as in *bushi* or *shinshi*).

The difficulty in translating the term *bengoshi* highlights the differences in the legal professions in Japan and the United States. The term "barrister" has been used in this article to refer to *bengoshi* when referring to Japanese lawyers, since *bengoshi* are just one of several of the Japanese legal professions, and since the work of *bengoshi* is 70%-85% courtroom litigation. Higuchi, *Gaikoku Bengoshi Mondai (The Foreign Lawyers Problem)*, 842 JURISUTO 56 (1985) (noting that the percentage of litigation is lowest in Tokyo and highest in locations in which there is no appellate court). As Higuchi remarks:

> Since this situation is called the courtroom-centered theory of the *bengoshi* profession, the social function of *bengoshi* in our country corresponds to that of barristers in England, and does not extend to the work of solicitors, so it is an obvious fact that the gap in this area is being filled by *shiho shoshi* [judicial scriveners], *zeirishi* [tax practitioners] and company legal departments.

Id. The leading Japanese commentators are in agreement. *See* Brown, *supra* note 3, at 205-08. Henceforth, as the discussion of the Japanese legal profession will become more detailed, the term *bengoshi* shall be used rather than barrister. However, since the term *bengoshi* is also universally used in Japanese as the translation for the American terms lawyer and attorney, even though the American profession is different from the Japanese profession, henceforth the term lawyer or attorney will be used in translating material from Japanese that refers to American lawyers or foreign lawyers. *But see* K. OHTSUBO, *supra*, at 121, who uses the term practicing attorney for *bengoshi*. *See also* International Relations Committee of Nichibenren, *Practicing Attorney Law* (translation of the Bengoshi Act, Act 205 of 1949); Brown, *supra* note 3, at 209, 211-12 (using the terms practicing attorney and attorney to refer to *bengoshi*).

[35] Telephone interview with ABA Membership Department (Mar. 12, 1986).

[36] *Nichibenren Kaicho wa Kitayama Rokuro Shi (Kobe) ga Tosen (Mr. Rokuro Kitayama (Kobe) Elected President of Nichibenren*, Toben Shimbun, Feb. 20, 1986, at 1 (number of Japanese *bengoshi* 12,840).

[37] Besides *bengoshi*, judges, and prosecutors, the other legal professions are the 15,103 *shiho*

almost entirely sole practitioners specializing in litigation.[38] *Bengoshi* are not usually engaged to provide business counselling, representation in contract negotiations, or other business services for Japanese companies:

> "Lawyers are considered undertakers," says one attorney. "The mere appearance of a lawyer in a business transaction is an unfriendly action," says [Japanese *bengoshi* Kunio] Hamada. "Even if I were asked to advise on a negotiation, to show up at the signing would be the last thing I would do."[39]

Instead of consulting a *bengoshi*, most Japanese companies first turn to their legal departments, which based on the trading company model,[40] draft and review contracts and give legal advice to the company.[41] The legal departments are staffed by legally trained and educated, but unlicensed, personnel hired directly from the undergraduate law program of a Japanese university.[42] Unlike in-house counsel of an American corporation, who are all licensed attorneys,[43] these personnel are not *bengoshi*[44] and are not considered by the Government of

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shoshi (judicial scriveners), Brown, *supra* note 3, at 353-77; the 2601 *benrishi* (patent practitioners), *id.* at 400-23; the 34,445 *zeirishi* (tax practitioners), *id.* at 424-39; and the 30,269 *gyosei shoshi* (administrative scriveners), *id.* at 378-99. In addition, legal services are provided by government in-house legal advisors, *id.* at 311-25; corporate in-house legal advisors, *id.* at 326-54; and legal educators, *id.* at 250-61.

[38] Higuchi, *supra* note 34. *See* Tanaka, *Courts and the Profession*, in LAW AND BUSINESS IN JAPAN 29, 32 (A. Kawamura ed. 1982) (In 1970 the average Tokyo law firm consisted of 2.7 *bengoshi*.). *See also* MARTINDALE-HUBBELL, *supra* note 12 (In 1985 the average for firms doing international work was 6.1.); *supra* note 22.

[39] Mayer, *Japan, Behind the Myth of Japanese Justice*, AM. LAW. 113, 115 (July-Aug. 1984). *See also* Stevens, *Japanese Law and the Japanese Legal System: Perspectives for the American Business Lawyer*, 27 BUS. LAW. 1259, 1272 (1972) ("Introduction of a lawyer into a business conference is thought to be an unfriendly act, an act equal to an explicit threat of litigation.").

[40] Brown, *supra* note 3, at 326-28; Stevens, *Multinational Corporations and the Legal Professions: The Role of the Corporate Legal Department in Japan*, in CURRENT LEGAL ASPECTS OF DOING BUSINESS IN JAPAN AND EAST ASIA 34 (1978).

[41] Brown, *supra* note 3, at 333-38; Stevens, *Multinational Corporations*, *supra* note 40, at 36-37.

[42] Brown, *supra* note 3, at 329. The Japanese degree in law is regarded as the most direct avenue to business and official power in Japan. D. HENDERSON, FOREIGN ENTERPRISE IN JAPAN 175 (1972). *See also* Tanaka, *supra* note 38, at 31 ("The fact that a particular law graduate has not joined the legal profession does not necessarily mean that he or she is of inferior ability in the Japanese intellectual environment."). Because there is an annual quota of fewer than 500 places in Japan's one school for *bengoshi*, judges and prosecutors, few of the estimated 30,000 annual Japanese university law undergraduates even bother to take the entrance examination. Brown, *supra* note 3, at 270; Stevens, *Multinational Corporations*, *supra* note 40, at 35. The number of entrants has varied between 380 and 554 from 1960 to 1983. Rand Report, *supra* note 3, at 48.

[43] There are only a handful of Japanese *bengoshi* employed in-house by Japanese enterprises. Brown, *supra* note 3, at 340 (only 10 *bengoshi* employed by companies in Japan).

[44] *See supra* note 43. *See also* Brown, *supra* note 3, at 332; Tanaka, *supra* note 38, at 31.

Japan to be engaged in the practice of law.[45] While a substantial number of Japanese companies have one or more outside *bengoshi* "on retainer,"[46] a Japanese company will generally only consult with an outside *bengoshi* when the problem at hand is beyond the capabilities of its unlicensed in-house legal staff, or when there is an unresolved dispute requiring litigation or other resolution.[47]

There are, however, approximately 350 *bengoshi* in Tokyo and Osaka[48] who like American lawyers, do provide international trade facilitation services.[49] These firms are composed primarily of *bengoshi* who are now or have been affiliated with one of the few American law firms left in Japan after 1955[50] or of *bengoshi* who have obtained a degree in law from an American law school.[51] In

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[45] *See* Position Paper, *supra* note 22, at 8 (The statutory provision defining the unauthorized practice of law in Japan does not prohibit a person from engaging "in legal affairs of a business organization as its employee.").

[46] *See* Stevens, *Multinational Corporations*, *supra* note 40, at 37-38 ("The emphasis is on oral consultation, often of a fifteen minute or half hour variety.").

[47] As one commentator notes:

> Since most Japanese lawyers are used for little besides litigation, Toyota [Motor Corporation] has little use for them. In fact, [Toyota general counsel Dr. Takeo] Tsukada himself is not a trained lawyer, and neither is anyone else in his 60-person "legal" department. They are "Toyota experts," as Tsukada calls them; with the benefit of in-house training and, in some cases, foreign law degrees, they handle everything from product liability settlements to the complex 1982 merger of Toyota's sales and manufacturing companies. Because they are company men, says Tsukada, they handle this work better than a lawyer could. "Attorneys can handle personal cases—but not cases for big corporations," he concludes.

Mayer, *supra* note 39. Japanese companies have a tradition of resolving all matters in-house and prefer not to entrust internal company matters to outside experts. Matsumoto, *Kokusai Horitsu Gyomu to Bengoshi Ho (International Legal Services and the Bengoshi Act)*, 681 JURISUTO 77, 78 (1979); Stevens, *supra* note 40, at 37. *See also* Brown, *supra* note 3, at 334 (Most legal departments' duties are drafting and reviewing contracts, giving general legal advice to other departments, assisting outside *bengoshi* in litigation, internal administration, tax advice, industrial rights protection, and education.).

[48] MARTINDALE-HUBBELL, *supra* note 12.

[49] These firms of *shogai bengoshi* (liaison barristers) are the largest, and by some accounts the highest-income, *bengoshi* firms. Rand Report, *supra* note 3, at 47-56 (based on National Tax Agency, List of Individuals with High Incomes (Over 10-Million Yen), May 1982 Survey (1983)). The Rand Report found that *bengoshi* in international practice who were over 50 years of age had an income almost five times that of a random sample of Tokyo *bengoshi* over 50 years of age. Rand Report, *supra* note 3, at 54.

[50] *See infra* note 56 and accompanying text.

[51] These *bengoshi*, through their influence over the Nihon Bengoshi Rengokai (The Japanese Federation of Bar Associations (Nichibenren)) have been since 1955 the primary source of opposition to American lawyers being allowed offices in Japan. Nichibenren, created by article 45 of the Bengoshi Act to regulate *bengoshi*, is very concerned that it, and not the Japanese Government, shall administer any future regulatory framework for foreign lawyers. This has been reflected in the *Fundamental Policy Concerning the Foreign Lawyers Problem*, Toben Shimbun, Aug.

1955, an unusual member's bill[52] was passed by the Japanese Diet repealing article 7 of the Bengoshi Act,[53] under which a cumulative total of sixty-eight American lawyers had been licensed to give legal advice on American law and to advise and represent American clients.[54] The intent of the repeal was to prevent further American lawyers from either opening offices in Japan or advising American clients in Japan.[55] However, the American lawyers licensed before

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10, 1985, at 4 (adopted by the Executive Council of Nichibenren on March 15, 1985).

This hostility was noted as early as 1952. *See* State Department Telegram No. 2143 from Ambassador to Japan, Robert Murphy to the Secretary of State. Ambassador Murphy noted:

> [G]reat concern [present in the] local [American] community to [a] situation which may affect not only attorneys, but all other American professionals in Japan.
>
> [It is] [o]bvious that unless the professions clause [(article VIII, paragraph 2) is retained in the] FCN treaty [the] way would be open for [the] Japanese to bar American professionals from practice. *Although no such official move [is] apparent, much discontent has been voiced privately by [the] Executive Council, Japanese Federation of Bar Association[s] re US and other alien attorneys in Japan, in [an] effort [to] prevent future admissions and restrict present privileges. [The] Embassy [is] informed some Japanese action [is] contemplated to restrict activities [of] foreign attorneys. . . .*

U.S. Foreign Serv., Despatch No. 2143 (Jan. 6, 1953) (emphasis added). *See also* Seno, *Zainichi Beijin Bengoshi no Gyomu Seigen Mondai (The Question of Restricting the Practice of American Lawyers Residing in Japan)*, JIYU TO SEIGI (LIBERTY AND JUSTICE), Jan. 1954, at 16-18 (regarding efforts to forbid American lawyers from being licensed if coming from states with citizenship requirements).

[52] Most bills in the Japanese Diet are government-drafted and sponsored. Brown, *supra* note 3, at 447. Consistent with Nichibenren's assertion of independence from the Japanese Government, both the 1949 Bengoshi Act and Act 155 of 1955 were member's bills. *See* K. OHTSUBO, *supra* note 34, at 36, 98-99.

[53] Repealed article 7 of the Bengoshi Act provided:

> 1. A person who is qualified to become an attorney of a foreign country and who possesses an adequate knowledge of the laws of Japan may obtain the recognition of the Supreme Court and conduct the affairs prescribed in Article 3. . . .
>
> 2. A person who is qualified to become an attorney of a foreign country may obtain the recognition of the Supreme Court and conduct the affairs prescribed in Article 3 in regard to aliens or foreign law. . . .
>
> 3. The Supreme Court may impose an examination or screening in those cases where it grants the recognition of the prior two paragraphs. . . .

Fukuhara, *Status supra* note 3, at 25-26 (translated by Fukuhara) (noting that 68 attorneys were thus grandfathered in).

[54] *See* Welty Letter, *supra* note 1. (As of 1953, the cumulative total was 55.).

[55] *Dai 22 Kai Kokkai Shugiin Homu Iinkai Kaigiroku (Record of Debate in the Committee on Legal Affairs in the House of Representatives)*, 22d Sess. Nat'l Diet No. 43, at 6 (July 28, 1955) [hereinafter cited as *Debate*]. Representative Koga argued that once Japan regained its independence after the American occupation, it was appropriate that article 7 of the Bengoshi Act (passed during the Occupation in 1949) be repealed, and for foreign lawyers not to be admitted to practice in Japan. *Id.* at 1. Foreigners who wanted to practice in Japan could qualify in the same way as Japanese. In addition, no foreign lawyers were allowed to practice in other countries. *Id.*

But see Fukuhara, *Status*, *supra* note 3, at 27-28 (Fukuhara, drafter of the 1949 Bengoshi Act,

the repeal were allowed to remain in practice as long as they continued to reside in Japan.[56] In addition, since 1955, several hundred American lawyers have been employed by these grandfathered lawyers and by liaison *bengoshi* as so-called "clerks" or "trainees" for periods varying from one to three years to draft and edit documents for them in English, and advise them on American law.[57]

In 1972, Nichibenren published in its monthly journal its notorious "Standards for the Prevention of the Unauthorized Practice of Law by Foreigners."[58] The Standards have been used to block all but one American law firm from establishing an office in Japan since 1955.[59] Since April 27, 1984, when the Japanese Government formally announced that it would respect Nichibenren's autonomy over the legal profession with respect to whether foreign lawyers should be allowed to open offices in Japan,[60] continued Nichibenren opposition to American lawyers has given Nichibenren complete control over the Japanese

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denies American pressure to pass article 7, noting the provision was resurrected from a 1924 draft of the Act). *See also* Brown, *supra* note 3, at 447-50 (In order to take the qualifying examination, a candidate must attend the Legal Training and Research Institute. With one exception—a Korean national born, raised, and educated in Japan—the Japan Supreme Court has required Japanese nationality as an entrance requirement.); Shimazaki, *supra* note 3, at 182-83 (Realistically, there is no chance of admission unless the candidate was born, raised, and educated in Japan. No Westerner has ever passed the entrance examination.). As Fukuhara writes:

> The western foreigner, no matter how able he is to speak and read Japanese and how well he knows the writing system, is rarely required to write Japanese at length under time pressure and therefore he never attains the requisite skill in writing the characters cursively that is necessary to pass the examination.

Fukuhara, *Status*, *supra* note 3, at 29 n.23. For an argument regarding foreign attorneys in other countries at the time, see *id.* at 26 n.22. The repeal was supported by Nichibenren. *Debate*, *supra*, at 6.

[56] Supplemental Provision 3 of The Act Concerning the Partial Amendment of the Bengoshi Act, Act No. 155 of 1955, which repealed article 7 of the Bengoshi Act, contained a grandfather clause which allowed the 68 American lawyers in Japan at the time to continue in practice as long as they continued to reside in Japan. Fukuhara, *Status*, *supra* note 3, at 32; Shimazaki, *supra* note 3, at 184 n.27. *See also supra* text accompanying note 50. In addition, nine foreign lawyers were allowed to continue practicing in Okinawa after the return to Japan in 1972. Act Concerning Special Measures for the Return of Okinawa, Act 129 of 1971, Article 65. *See* Brown, *supra* note 3, at 450; Fukuhara, *Status*, *supra* note 3, at 32; Kosugi, *supra* note 3, at 692.

[57] *See* Kosugi, *supra* note 3, at 693-94; Brown, *supra* note 3, at 460-73; Progress Report, *supra* note 16, at 48.

[58] JIYU TO SEIGI, Aug. 1972, at 39, *reprinted in* JIYU TO SEIGI, Feb. 1985, at 119. The Standards are discussed *infra* text accompanying note 93.

[59] *See supra* notes 3, 29; Crabb, *supra* note 3, at 1815 n.255. Citing the Standards, Nichibenren strongly opposed the entry of the Milbank firm in 1977. *See* Crabb, *supra* note 3, at 1767 n.3 & 1815 n.255. Although, the standards are unofficial and therefore have no legal binding force since Nichibenren's jurisdiction is limited to *bengoshi*, Bengoshi Act, art. 45, in reality, Nichibenren influences the Japanese Ministry of Justice's visa-granting powers.

[60] *Kore made no Keika (Chronology of the Events to Date)*, Toben Shimbun, Aug. 10, 1985, at 4.

response to American demands for law offices in Japan.[61]

D. *A Cultural Issue As A Trade Issue*

While the basis of *bengoshi* opposition is in the final analysis economic,[62] it is expressed primarily in cultural terms. The Japanese legal press has expressed fear of an impending invasion by highly competitive, aggressive, and well-financed lawyers from huge American law firms.[63] Emphasis has been placed on the cultural differences separating Japan from the rest of the world[64] and the

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[61] *See* Position Paper, *supra* note 22, at 2-3.

[62] *See* Rand Report, *supra* note 3, at 48-56; *infra* note 67.

[63] *For or Against—Gaikoku Bengoshi e no Horitsu Gyomu no Kaiho (For or Against—The Opening of Legal Services to Foreign Lawyers)*, Nichibenren Shimbun, Jan. 1, 1984, at 2 ("The high-pressure, aggressive, high-handed nature of some foreign attorneys, and the activities of the big capital law firms, do not fit the social milieu of our country."). *See also* Szymkowiak, *Oranges, Beef and . . . Lawyers?: A Strange Case of Trade Barrier Politics*, Japan Times, Dec. 28, 1983, at 11, col. 6 (quoting Japanese barrister Kunio Hamada: "Just to contend that American lawyers may do what they want wherever they go is somewhat imperialistic.").

American international lawyers are also accused of being mere businessmen, in contrast to the mandate of article I of the Bengoshi Act to uphold human rights and realize social justice. *See, e.g.*, Higuchi, *supra* note 34, at 58, 59:

> The prime consideration of [American] law firms is on increasing their own productivity and added value, and one receives quite a different image from the model of the jurist as one sworn to promote fundamental human rights and social justice. Our country's system under the Bengoshi Act demands strict qualifications, and the mission [of *bengoshi*] is to uphold fundamental human rights and realize social justice.

But see Nichibenren, Bengoshi Rinri Tenpan (Code of Bengoshi Ethics) (1955), which is similar to the 1908 Code of Professional Ethics of the American Bar Association. K. OHTSUBO, *supra* note 34, at 118-19.

[64] This theme of culture difference is echoed in virtually every Japanese discussion of the "foreign lawyers problem." *See, e.g.*, Position Paper, *supra* note 22, at 7:

> Every country has . . . its own peculiar system of lawyers based on its historical background. Being a part of the fundamental structure of a state, the lawyer system of each country should be paid due respect. The introduction of a new system to accept foreign lawyers needs to be made with a basic recognition that this issue is tantamount to the reformation of the lawyer system itself which is deeply related to legal activities of the people.

Similarly, Hideo Chikusa, director of the Judicial System Research Department, Secretariat of the Justice Minister, has stated that the trade friction problem is "a deep-rooted problem, which leads eventually to friction between the national characteristics of the two sides, or to cultural friction. Especially, the judicial system is a problem which is linked with national culture, even when viewed historically. . . ." *Gaikokujin Bengoshi Mondai (Foreign Lawyers Problem)*, 783 JURISUTO 14, 29 (1983) (roundtable discussion during visit of ABA delegation visit to Japan) [hereinafter cited as Roundtable Discussion]; *Bar Undecided Whether to Allow U.S. Lawyers to Work in Japan*, Japan Times, Dec. 5, 1983, at 2, col. 1 ("The lawyers' practices vary greatly from country to country including systems of licensing lawyers or their areas of services. Social roles also

sovereign right of Japan to regulate legal services without foreign interference.[65] Some *bengoshi* feel that the mere presence of American lawyers in Japan, with their alien culture, will disrupt the Japanese legal and social system and cause culture shock.[66] *Bengoshi* also express fear that American lawyers will take over the market for international legal services.[67]

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differ greatly from country to country. Under such circumstances, the liberalization of law service will have a great impact on the Japanese lawyers' system."). *See also* Rand Report, *supra* note 3, at 56-60; *infra* note 66.

Japanese expressions of cultural differences from other peoples stem in part from the view that the Japanese people have a unique origin and language. Shapiro, *Cultural Barriers To Delivery of Services*, in BUSINESS TRANSACTIONS WITH CHINA, JAPAN, AND SOUTH KOREA ¶ 8.02, at 8-3 (P. Saney & H. Smit eds. 1983). Geographical isolation, together with Japan's self-imposed near-isolation from the outside world from the sixteenth to nineteenth century, has contributed to this common Japanese view. J. TAYLOR, SHADOWS OF THE RISING SUN 34-35 (1983). Taylor notes, "If Americans assume that all people are fundamentally the same and note differences only as they appear, the Japanese assume that people are fundamentally different and note similarities only as they appear." *Id.* at 41. This attitude, in part, explains the great care and deliberation with which Japan has granted entry to foreigners and foreign business. D. HENDERSON, FOREIGN ENTERPRISE, *supra* note 42, at 274.

[65] *See Liberalization with Caution—Diplomatic Pressure Will Violate Sovereignty: Lawyer Yasuo Shimada*, The Yomiuri, Nov. 27, 1985, at 8 (quoting bengoshi Yasuo Shimada: "Having the bar system (legal system) of one nation change under diplomatic pressure, is a violation of sovereignty, and the Government must not ram a solution through by political power, after giving in to pressure."). *See also* Szymkowiak, *supra* note 63, at 11, col. 5 (quoting Japanese *bengoshi* Hiroshi Kawakami: "Japan should not amend the law under such unreasonable pressure because it affects Japanese sovereignty." Bengoshi Kunio Hamada is more blunt: "I'm against these big American [law] firms trying to take over the world with their international networks. It's a kind of imperialism."); Suzuki, *Fuunkyu! Gaijin Bengoshi no Shijokaiho Yokyu (Turbulence! Foreign Lawyers Demand Market Opening)*, NIKKEI BUSINESS, June 14, 1982, at 57, *cited in* Crabb, *supra* note 3, at 1768 n.3; Toben Shimbun, Oct. 20, 1985, at 5 (cartoon) (comparing the diplomatic pressure on this issue with Commodore Matthew Perry's "black ships" pressuring the shogunate into trading with the outside world in 1853).

[66] Bengoshi Rokuro Shimatani states:

> *It would definitely cause culture shock*, and give a bad influence on the society of Our Country. It would hinder the future growth of Our Country's liaison barristers, who have finally matured in the many years since the end of the war. If that were to come to pass, and the development of Our Country's liaison barristers were to stop, it would affect the national welfare of Our Country.

Shimatani, *Gaikoku Bengoshi Mondai (The Foreign Lawyers Problem)*, JIYU TO SEIGI, Feb. 1984, at 20, 21 (emphasis added). *See also* Higuchi, *supra* note 34, at 59 ("The admission of foreign lawyers means the admission of an alien culture. It is obvious that some degree of shock can be predicted."); Roundtable Discussion, *supra* note 96, at 25 (quoting Higuchi: "[T]he acceptance of lawyers, who are the cultural products of another country, will give rise to a certain kind of cultural shock.").

[67] See Matsumoto, *supra* note 47, at 87, who writes:

> If American and other international law firms, who are backed by enormous organizational strength and the economic power of clients such as American banks and multinational

In contrast to these emotional arguments, no Nichibenren commentator has ever discussed the primary reason for United States Government initiative on this issue—facilitation of American export to and investment in Japan. Although Nichibenren has recently approved in principle the idea of American lawyers being allowed offices in Japan under Nichibenren supervision,[68] the conditions imposed have been criticized by the United States Government as unacceptable because they do not accommodate the United States' clearly expressed needs.[69] Nichibenren has completely overlooked the differences between American and Japanese business institutions, the primary reason that American lawyers are needed by American business in Japan.

E. *International Trade and Business Consultants and the Scope of the Profession of the Practice of Law in Japan*

While *bengoshi* have opposed the activities of American lawyers,[70] it seems that they accommodate the law-related activities of their fellow countrymen. It

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> corporations, were to advance in, there is the fear that Our Country's international legal community, which has attained growth up to now, would revert back to the foreigner-dominated post-war Occupation era.

See also Hamada, *Gaikoku Bengoshi Mondai ni Tsuite (Concerning the Foreign Lawyers Problem)*, KISUI, Jan. 25, 1984, at 5; Roundtable Discussion, *supra* note 64, at 26 (Shunji Higuchi commented: "It is an actual anxiety to us that it may bring in a certain kind of confusion into the relationship and order which have taken root in Japan over a long period of time between clients and lawyers."). Similarly, in the Roundtable Discussion, Professor Kojima of Chuo University argued: "It is only very recently that Japanese lawyers have launched into the liaison business, on their own. The actual state of their business is still weak, and there are voices saying that some period of grace may be necessary." Roundtable Discussion, *supra* note 64, at 26. Under this "infant industry" rationale, Japanese trading companies should be barred from the United States because they overwhelm American import-export companies and law firms in size and volume of business.

[68] At a special general membership meeting on December 9, 1985, Nichibenren approved in principle allowing foreign lawyers to set up offices in Japan on the basis of reciprocity and with Nichibenren supervision. *Unyielding Plan of Nichibenren*, Tokyo Shimbun, Dec. 12, 1985, at 4 (editorial) (translation by U.S. Embassy in Tokyo).

[69] U.S. Government Statement on Foreign Lawyers in Japan (Dec. 17, 1985) ("The United States has studied the [Nichibenren] resolution and finds Nichibenren's restrictive position on this issue an unacceptable basis for permitting the entry of foreign lawyers into Japan.").

[70] The first public effort by Nichibenren to limit the activities of American lawyers in Japan was to try to forbid American lawyers from being licensed if they came from states with citizenship requirements. Seno, *supra* note 51, at 16-18.

The Nichibenren Standards state:

> In the case of unlicensed persons who have the qualification of a lawyer in a foreign country, there is great fear and likelihood that they will evade the terms of their permission of entry [into Japan] and will [illegally] engage in legal services.

Nichibenren Standards, *supra* note 58, at 123.

has not been considered illegal for trading companies to provide information and advisory services to their customers, or for corporate legal departments or judicial scriveners to give legal advice.[71] No commentator has suggested that a *bengoshi* license should be required of Japanese trading company personnel, accountants, or management consultants for providing business representation or trade facilitation or that Japanese companies' legal staffs are engaged in the unauthorized practice of law by giving legal advice to the corporation. There is, therefore, a strong presumption that the law-related activities of trading companies, management consultants, accountants, and corporate legal staffs are not within the scope of the regulated legal professions in Japan. That is, international trade facilitation, business representation, and legal services provided by employees of business enterprises fall outside the monopoly of the practice of law by *bengoshi*: although law-related, these activities are not legal services, but business services.

With certain exceptions, only *bengoshi* may practice law in Japan.[72] Article 3(1) of the Japanese Bengoshi Act sets forth the authorized duties of a *bengoshi*,[73] and article 72, a criminal statute, defines the scope of the monopoly of *bengoshi* by stating what a non-*bengoshi* is prohibited from doing.[74]

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[71] *See supra* text accompanying notes 41-45.

[72] *Id.* In addition, a *shihainin* (manager), may represent his principal, including a corporation, in court, under article 38 of the Commercial Code. T. FUKUHARA, BENGOSHI HO (THE BENGOSHI ACT) 266 (1976). *See infra* note 85.

[73] Article 3 provides:

> 1. The duties of a *bengoshi* are, upon request by a party in interest or other interested person, or upon appointment by the official government authorities, to engage in activities relating to adversarial litigation matters, non-adversarial litigation matters, matters consisting of a statement of dissatisfaction to an administrative agency such a demand for investigation, statement of objections, or demand for reinvestigation, and in other ordinary legal services.
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> 2. A *bengoshi* may, as a matter of course, engage in *benrishi* [patent practitioner] and *zeirishi* [tax practitioner] services.

Bengoshi Act, Act No. 205 of 1949, art. 3(1) (translation by author).

[74] Article 72 provides:

> (Prohibition on the Handling of Legal Services by Non-*Bengoshi*)
>
> Except as otherwise provided in this Act, a person who is not a *bengoshi* shall not, for the purpose of receiving remuneration, engage in, with respect to adversarial litigation matters, non-adversarial litigation matters, matters consisting of a statement of dissatisfaction to an administrative agency such as a demand for investigation, statement of objections, or demand for reinvestigation, or other ordinary legal matters, the practice of the handling of, or the serving as an intermediary for, professional advising, representation, arbitration or dispute-settling, or other legal services.

Bengoshi Act, art. 72 (translation by author). In the original Japanese, "non-adversarial litigation matters" is *hishojiken* which is usually, but somewhat inaccurately, translated as "non-litigious case" or "non-litigious matter." *See, e.g.*, Fukuhara, *Status*, *supra* note 3, at 32 & n.34; Kosugi, *supra* note 3, at 694. *Hishojiken* refers not to a matter not in court, but to non-adversary matters

The Japanese Ministry of Justice has not published an official interpretation of either article 72 or article 3(1).[75] Tadao Fukuhara, who supervised the drafting of the Bengoshi Act in 1949 and who is the leading scholar on its interpretation,[76] noted the difference between "legal services" (*horitsu jimu*) and "legal matters" (*horitsu jiken*) as used in article 72 and 3(1). Fukuhara cites Japan's highest pre-war court as holding: "[Article 72] only forbids persons, other than . . . *bengoshi* from handling those legal affairs which involve a matter that has crystallized into a Japanese case (*jiken*) or in regard to which there is a risk that is likely to become such a case."[77]

That is, while article 3(1) permits a *bengoshi* to engage in "other ordinary legal services," article 72 merely provides that a non-*bengoshi* is not prohibited from doing so, unless the legal services are in respect of one of the enumerated matters or "other ordinary legal matters."[78] As an adversarial litigation matter, a civil lawsuit is a legal matter (*jiken*). Non-adversarial litigation matters in-

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such as judicial auctions (sheriff's sales), land registration, and name changes. T. FUKUHARA, THE BENGOSHI ACT, *supra* note 72, at 259-60 (citing the Hishojiken Tetsuzuki Ho (Non-adversarial Litigation Procedure Act), Act No. 14 of 1898). See Nichibenren Standards, *supra* note 58, at 124, which includes incorporating of corporations as *hishojiken*.

The criminal penalties for violating article 72 are set forth in article 77 (maximum of two years imprisonment and hard labor or a fine of up to 50,000 yen).

[75] This is probably in deference to Nichibenren. The only unofficial interpretation of Article 72 by the Japanese Government limits the scope of the statute, but does not discuss what are "legal services":

> Article 72 of the Practicing Attorney Law [Bengoshi Act] does not prohibit: (a) a foreign lawyer to enter into Japan to deal with a specific case he or she was requested to undertake while abroad, and to act for this purpose including meeting with people concerned, or (b) to engage in legal affairs of a business organization as its employee, or (c) to work in a Japanese law office as a clerk or trainee.

Position Paper, *supra* note 22, at 8.

[76] Fukuhara, *Status*, *supra* note 3, at 21 n.2.

[77] *Id.* at 32 (citing *Shimizu v. Japan*, 18 Dai-han Keishu 359 (Japan 1939)).

[78] Fukuhara, *Status*, *supra* note 3, at 32. Fukuhara also noted:

> [T]he legal services regulated by this article are not all legal services; the requisite is that they are those "with respect to legal matters." That is, where there is a power of attorney for collection of a debt, it is a situation in which "collection by ordinary means is difficult" (Decision of the Supreme Court, Oct. 4, 1962, 16 Keishu (No. 10) 141), and there are already definite circumstances requiring recourse to suit; it is subject to regulation as it can be regarded as intervention in a matter which should be regarded as a legal matter. In other words, it is necessary that the legal services must have "the nature of a case." Accordingly, an interpretation that the legal services the handling of which is regulated by this article equal all of the legal services which belong to the occupation of *bengoshi* as provided in Article 3 (Osaka High Court Judgment, Feb. 19, 1969, 21 Kosai Keishu (No. 1) 80) overlooks the subtle, but very important, differences between the provisions of the two articles.

T. FUKUHARA, THE BENGOSHI ACT, *supra* note 72, at 261-62.

clude a land registration or a matter concerning the family register.[79] The scope of other ordinary legal matters is not clear, however. Fukuhara limits the scope of this phrase to actual controversies or disputes:

> [I]n view of the fact that this article has the nature of a criminal statute, the determining of what goes so far as to be the above "*ippan no horitsu jiken* [ordinary legal matter]" should be limited to where the probability of future litigation can be ascertained from definite circumstances. If this were interpreted broadly, an opposing relationship of rights and obligations, and therefore the possibility of adversarial litigation, could be recognized in quite any social phenomenon, so it is not suitable to call that a *jiken* (matter) with only that degree of possibility.[80]

Kosugi, without analysis, defines the phrase more broadly as:

> any matter other than those enumerated in Article 72, including such matters involving a dispute as to legal rights or obligations, or doubt as to such rights or obligations, or a matter giving rise to a new relationship of such rights and obligations." Generally speaking, whenever a person not admitted to practice handles for a fee a legal matter of the sort described above, a violation of Article 72 is thought to arise.[81]

Under Kosugi's definition, the application of legal principles to specific facts for a fee constitutes a legal matter. Under either of these definitions, ordinary legal matter appears to be a narrower concept than legal services. However, neither commentator has attempted to describe what are legal services that are not in respect of an ordinary legal matter, and which, therefore, are outside the prohibitions of article 72.

To explore this point, it is first necessary to consider Fukuhara's definition of legal services provided in connection with an ordinary legal matter. For example, he defines professional advising as "the giving of an opinion concerning specific facts based on specialized legal knowledge."[82] However, Fukuhara does not define "specialized legal knowledge." "Specialized legal education" could be that which law undergraduates have received in Japanese universities or the specialized professional training that a *bengoshi* receives at the Supreme Court Legal Research and Training Institute.[83]

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[79] *See supra* note 74.

[80] T. FUKUHARA, THE BENGOSHI ACT, *supra* note 72, at 261.

[81] Kosugi, *supra* note 3, at 694.

[82] T. FUKUHARA, THE BENGOSHI ACT, *supra* note 72, at 261.

[83] Since *bengoshi* do not receive education in foreign law, Fukuhara states that the monopoly of *bengoshi* does not extend to foreign law. Fukuhara, *Status*, *supra* note 3, at 32-33. *See also* Crabb, *supra* note 3, at 1782 n.84 (citing an unpublished letter by Fukuhara of July 23, 1977, supporting the visa application of the law firm Milbank, Tweed, Hadley & McCloy). As Kosugi points

Fukuhara defines representation as "handling a matter in the stead of the principal using the principal's name."[84] Of course, the word "representation" (*dairi*) must be read more narrowly than the same word as used in the Japanese Civil and Commercial Codes.[85] It does not refer to all business representation or agency, only to legal representation such as in court. Therefore since business representation such as contract negotiation falls outside the criminal prohibitions of article 72, it is not within the monopoly of *bengoshi*. Similarly, the terms arbitration and dispute-settlement refer to the necessary services that must be provided in order for a *bengoshi* to settle a dispute.[86]

"Other legal services," while a broad concept,[87] is not a catch-all for all services that could be provided by *bengoshi* but rather means legal services that, like the specifically enumerated services, are those customarily reserved for *bengoshi* in Japanese society. Fukuhara includes debt collection, allocation of payment, and waiver of debt among other legal services.[88] Under Fukuhara's analysis, the act of drafting of a contract is not a legal matter, but a dispute arising because of the breach of obligations under the contract would be. On the other hand, under Kosugi's analysis, the drafting of a contract which requires specialized legal knowledge is a legal matter since it gives rise to a new relationship of rights and obligations. This analysis is virtually the same as that offered by American commentator Bertram Harnett:

> What are legal services? Lawyers unquestionably share a monopoly of certain services—but what are they? Working appearances in court are the most clear-cut indications of practicing law. Conducting trials and preparing the pleadings and

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out, however, under this analysis anyone, whether a foreign lawyer or not, could advise the Japanese public on foreign law, thus leaving a major gap in the coverage of the Japanese statute. Kosugi, *supra* note 3, at 697. Kosugi argues, therefore, that only *bengoshi* may give advice on foreign law. *Id.*

Similarly, state courts in the United States have held that advising on the law of a foreign country without a license constitutes the unauthorized practice of law. *See, e.g.*, Bluestein v. State Bar of California, 13 Cal. 3d 162, 529 P.2d 599, 118 Cal. Rptr. 175 (1974); *In re* Roel, 3 N.Y.2d 224, 141 N.E.2d 24, 165 N.Y.S.2d 31 (1957), *appeal dismissed*, 355 U.S. 604 (1958).

[84] T. FUKUHARA, THE BENGOSHI ACT, *supra* note 72, at 261.

[85] *Dairi* (agency) is governed generally by Civil Code Articles 99 through 118 and specially by Commercial Code Articles 17 to 51. *See* Kitagawa, *Contract Law in General*, in 3 DOING BUSINESS IN JAPAN § 1.04[1][b] (Z. Kitagawa ed. 1985). Article 99 of the Civil Code states: "A declaration of intention made by an agent within his scope of authority . . . shall be effective directly against his principal." Article 37 of the Commercial Code states: "A merchant may appoint a manager to conduct his business either at its principal office or at a branch office." Article 38(1) of the Commercial Code states: "A manager is authorized to perform on behalf of the proprietor of the business all judicial and extra-judicial acts relating to such business."

[86] T. FUKUHARA, THE BENGOSHI ACT, *supra* note 72, at 261.

[87] *Id.*

[88] *Id.*

affidavits that go with them are indubitably legal services. So are the classic instruments of drawing wills, trusts, formal contracts, and security instruments. Advising people of their legal rights and duties might seem a clear enough legal instance, but this is not always so. Many activities regularly performed by nonlawyers have legal components and involve the lawful conveyance of legal information. Some examples come to mind: the accountant tells his client it is a crime to cheat on income taxes; the auto-driving instructor tells the pupil he must drive within prescribed speed limits and advises on the rules of the road; the building contractor informs the customer about the building code [and the trading company informs the manufacturer about foreign safety standards]. No one conceives the unlawful practice of law in these instances. *Quite obviously, some rule of reason sets in, enabling nonlawyers to advise others of generally known legal requirements. Giving general legal advice is acceptable, then, if it is truly incidental to another legitimate business activity. Giving specific legal advice by itself is practicing law, and this requires a license.*[89]

Under Harnett's approach, an ordinary legal matter in Japan, as defined broadly by Kosugi,[90] would fall within the concept of legal services in the United States since it involves specific legal advice. Thus even under Kosugi's broad definition, a person not licensed as a *bengoshi* may give general business advice as to generally known legal requirements. General legal/business advice may include advising of the requirements for setting up a joint venture or telecommunications equipment standards, in contrast to specific legal advice such as the legal liability of corporate directors for industrial pollution or whether a particular securities offering or contract complies with applicable law. In addition, under Fukuhara's narrow interpretation of ordinary legal matter, a non-*bengoshi* may draft a contract and render legal services up to the point of anticipated litigation.[91]

In contrast it appears that Nichibenren, in its 1972 "Standards for the Prevention of the Unauthorized Practice of Law by Foreigners,"[92] fails to distinguish between legal services and non-legal services or between legal services and legal matters. The Standards, which address only the activities of foreign lawyers in Japan, and do not in any way deal with the activities of Japanese non-*bengoshi* such as trading companies, are summarized by Fukuhara as follows:

1. Activities such as the drafting and rewording of the text of technical assistance and joint venture contracts must be performed under the direction and supervision of a Japanese attorney or a foreign attorney recognized under former Article 7 of the *Attorneys Law* [Bengoshi Act].

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[89] Harnett, *supra* note 24, at 42-43 (emphasis added).

[90] *See supra* text accompanying note 81.

[91] *See supra* text accompanying note 80.

[92] *See supra* note 58.

> 2. An unqualified alien may not independently express a legal opinion regarding such matters as the drafting or revision of a contract because to do so constitutes an act resembling the rendering of legal advice.
> 3. An unqualified alien may not meet independently with a client for purposes of legal consultation and express a legal opinion or give independent legal advice.[93]

Only article 72 is cited as the basis for limitations on the activities of foreign lawyers.[94]

Although the Standards recognize that American lawyers may be "consultants" in Japan as long as they do not engage in legal services,[95] they fail to define what constitutes legal services, legal consultations, legal opinions, or legal advice.[96] By not distinguishing legal matters (specific legal advice, according to Kosugi) from legal services (general business legal advice) the Standards prohibit all advisory activities by foreign lawyers (but not the activities of Japanese non-*bengoshi*) as violations of article 72.

A correct interpretion of article 72 must take into account its purpose. In the leading case of *Kato v. Japan*, the Japan Supreme Court held:

> Concerning the purpose of the enactment of this Article, a *bengoshi* is bound to protect fundamental human rights and bring about social justice, and to engage in a wide range of legal services. For that reason, the Bengoshi Act prescribes strict qualification requirements, and requires submission to necessary regulation for honest and upright behavior. . . .In this world, it is not unknown that persons without any license, and who have not submitted to any regulation, engage in the business of interfering in the legal matters of others indiscriminately, for their own profit. If this were left alone, it would harm the interests of the parties and other persons, and would obstruct the smooth functioning and justice of legal life and harm the legal order. Therefore, we believe this Article was enacted to prohibit this kind of conduct. However, to prevent these kinds of abuses, *it is sufficient to regulate that conduct which involves repeated indiscriminate interference in the legal matters of others for the purpose of private gain.* The object of this Article is not to regulate conduct which involves the mutual aid and cooperation which is to be expected in social life such as the elder who participates in settling a dispute, or the person who introduces a *bengoshi* to a friend as a favor.[97]

Thus the purpose of article 72 is not to protect *bengoshi* from foreign competition, but to protect the Japanese public from the unethical and incompetent

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[93] *See* Fukuhara, *Status*, *supra* note 3, at 36. The Standards, *supra* note 58, are in a rambling narrative form.

[94] Nichibenren Standards, *supra* note 58, at 124.

[95] *Id.* at 123.

[96] *Id.* at 124.

[97] 25 Keishu (No. 5) 690, 265 Hanrei Taimuzu 92, 93 (July 14, 1971) (translation by author).

activities of untrained persons. Article 72 does not proscribe legitimate business activity such as trade facilitation and business representation and consulting.

A somewhat different matter arises in respect to unlicensed legal personnel of Japanese companies who provide legal services to the company such as giving general legal advice or drafting a contract. As noted above,[98] the Japanese Government does not consider these activities to be in violation of article 72.

Since article 72 is a criminal statute, it must be construed narrowly.[99] In addition, article 72 must be given a narrow interpretation in light of the reality of Japanese society: "Any interpretation of Article 72 should recognize that legal activities in Japan are often handled by persons other than licensed *bengoshi*. Employees of corporations, for example, perform law-related activities without a *bengoshi* license."[100] Practice has been construed to refer to engaging in an independent profession,[101] rather than services rendered by employees to the employer:

> [W]hen law department employees give advice to other employees, the same legal entity is dealing with itself. Thus, there has been no giving of advice to another, only to oneself. Just as no individual is required to use an attorney for personnel matters, no corporation must use outside counsel for its own internal affairs.[102]

Shimazaki has used this rationale to explain why American lawyers employed by *bengoshi* may provide *bengoshi* with legal advice:

> [Company legal staff] employees are typically graduates of undergraduate departments of law who have gone directly to business and government jobs without entering the Legal Institute [Japan's only law school for *bengoshi*]. *Because of this accepted practice*, it seems clear that a U.S. attorney may perform *law-related activities* in Japan as an employee of a Japanese or American company. . . . This appears to be the rationale for permitting "legal trainees" in Japan. These trainees are foreign attorneys who are employees of Japanese law firms handling international transactions. . . .***The trainee is in effect giving legal advice directly to his employer and not to the client, much like the employee of a corporation.***[103]

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[98] *See* Position Paper, *supra* note 22.

[99] T. FUKUHARA, THE BENGOSHI ACT, *supra* note 72, at 261. Under the criminal due process provisions of article 31 of the Japanese Constitution, forbidden acts must be clearly defined. Article 31 of the 1946 Constitution of Japan states, "No person shall be deprived of life or liberty, or otherwise be subject to criminal penalty, except according to procedures established by law."

[100] Shimazaki, *supra* note 3, at 185-86.

[101] *Gyo* in the Japanese text of article 72.

[102] Brown, *supra* note 3, at 339.

[103] Shimazaki, *supra* note 3, at 186 & n.35(emphasis added). *See* Position Paper, *supra* note 22.

In other words, giving legal advice to one's employer, and drafting contracts for one's employer, while "law-related," do not constitute the practice of law in Japan because it is not the practice of an independent profession. It is only the independent practice of law in Japan that is forbidden by article 72 of the Bengoshi Act.[104]

F. *Summary: Access to Essential Trade Facilitation and Legal Services*

In summary, Japanese business society is structured in a way that does not require independent legal professionals for most business law or trade facilitation needs. Company personnel who provide these services to their companies do not violate Japanese law. No professional license is required of these Japanese personnel when they are transferred to the United States.[105] Thus Japanese companies have access to necessary Japanese trade facilitation and legal services in both countries.

In contrast, American business depends to a great degree on independent legal professionals for trade facilitation, contract-drafting, and legal advice. If Japan does not recognize this fundamental difference in business institutions, American enterprises in Japan would essentially have to restructure themselves in order to have access to necessary trade facilitation and legal services. This is not consistent with the basic principle of mutuality of bilateral trade,[106] and has been the source of trade friction on this issue.

III. Different Cultures, One Treaty

The disparity in access to home country trade facilitators is not only a cultural and economic problem, it is also a legal problem. In 1953, the two countries signed the United States-Japan Treaty of Friendship, Commerce and Navigation (FCN Treaty).[107] The Treaty is the supreme expression of the intention

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[104] Article 72 therefore prohibits law professors, company legal department personnel, and trading companies from giving specific legal opinions to litigants, customers, or other third parties for compensation.

[105] *See infra* text accompanying note 111.

[106] *See infra* text accompanying notes 139-44.

[107] 4 U.S.T. 2063, T.I.A.S. No. 2863 (1953). The United States-Japan FCN Treaty is one of many negotiated by the United States Department of State between 1948 and 1955 with its major trading partners to help revitalize the "free world" economy following the destruction in those countries in the Second World War. *Commercial Treaties: Hearing Before the Subcomm. on Commercial Treaties of the Senate Comm. on Foreign Relations*, 83d Cong., 1st Sess. 1-3 (1953) (Statement of Samuel Waugh, Assistant Secretary of State for Economic Affairs). The primary objective of those treaties was to "facilitate the protection of American citizens and their interests abroad." *Id.* at 2. These treaties have also provided a basis for foreign access to the United States

of the two governments to conduct mutual trade. The mutual recognition of the right of nationals and companies of each nation to establish and control enterprises in the other with home-country staff has been recognized as the heart of the treaty.[108] To the extent that the treaty requires each signatory nation to allow the trade facilitators of the other to establish offices within its territory, the refusal of one signatory nation to observe that requirement calls into question the continued vitality of the treaty.

Together with the 1951 Peace Treaty with Japan,[109] the FCN Treaty recognized that the Occupation should end.[110] Restoration of friendly relations with Japan was a primary purpose of the United States-Japan FCN Treaty:

> The treaty. . .is a treaty of friendship as well as a treaty of commerce. Obligations in the treaty are stated in reciprocal terms to make plain that the treaty rests on a foundation of mutual respect and trust. The encouragement and stimulation of the spirit of respect and trust are essential to the establishment of satisfactory business relationships between citizens of the United States and Japan. It is fully as essential as the careful delineation of rights and obligations in the treaty.[111]

Japanese companies have aggressively utilized it to protect their interests in the United States.[112] In contrast, the FCN Treaty was virtually ignored by the Governments of Japan and the United States for almost thirty years.[113] The

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market on mutual terms of "national treatment" and "most-favored nation" treatment. *See infra* text at notes 129-35.

[108] *See infra* text accompanying note 130.

[109] Treaty of Peace with Japan, Sept. 8, 1951, United States-Japan, 3 U.S.T. 3169, T.I.A.S. No. 2490.

[110] *Id.* art. 1(b), at 3172.

[111] Hearings, *supra* note 107, at 27 (Statement of U. Alexis Johnson, Deputy Assistant Secretary of State for Far Eastern Affairs).

[112] *See* Tokyo Sansei (N.Y.), Inc. v. Esperdy, 298 F. Supp. 945 (S.D.N.Y. 1969) (radio and tape recorder repairman denied "treaty trader" visa); Nippon Express U.S.A., Inc. v. Esperdy, 261 F. Supp. 561 (S.D.N.Y. 1966) (bookkeeper of Japanese subsidiary denied "treaty trader" visa).

[113] The United States, preoccupied with the political and military aspects of Japanese-American relations, failed to object to important Japanese economic laws which arguably violate the letter and spirit of the national treatment provisions of the FCN Treaty by discriminating against foreign controlled companies. Henderson, *The Management of Foreigners: Japan's New Foreign Exchange Controls*, in BUSINESS TRANSACTIONS WITH CHINA, JAPAN AND SOUTH KOREA § 701 at 7-3 (P. Saney & H. Smit eds. 1983) ("[U]ntil the present administration at least, the State Department's attitude has always been to emphasize the political, at the expense of economic interests."). The laws most often cited as restricting American export to and investment in Japan are the *Gaishi ni kansuru horitsu* (Foreign Investment Law), Act 163 of 1950 (FIL); the *Gaikoku kawase oyobi gaikoku boeki kanriho* (Foreign Exchange and Foreign Trade Control Law), Act 228 of 1949 (FECL); and Article 6 of the *Shiteki dokusen no kinshi oyobi kosei torihiki no kakuho ni kansuru horitsu* (Act Concerning the Prohibition of Private Monopoly and the Maintenance of

first generally-known attempt by an American enterprise to invoke the FCN Treaty was in 1977 when the New York law firm of Milbank, Tweed, Hadley & McCloy cited article VIII, paragraph 1 of the Treaty as grounds for establishing an office in Tokyo.[114] Although that firm was successful in being the first American law firm to establish an office in Tokyo since 1955, since then the Government of Japan has "frozen" the granting of long-term visas to American lawyers who wish to open an office in Japan.[115]

Only since 1982 has the matter of offices for American lawyers in Japan risen to a government-to-government level.[116] Bilateral negotiations on this issue continue as this article is being written, and by time of publication a regulatory framework for American lawyers to establish offices in Japan to provide legal advice on American law may have been enacted by the Japanese Diet.[117] How-

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Fair Trade), Act 54 of 1947, as amended (Anti-monopoly Law (AML)). The FIL and FECL were combined in the *Gaikoku kawase oyobi gaikoku boeki kanri ho no ichibu o kaisei suru horitsu* (Act Revising Part of the Foreign Exchange and Foreign Trade Control Act), Act 165 of 1979 (New FECL). For a discussion of the FIL and FECL, see generally D. HENDERSON, FOREIGN ENTERPRISE, *supra* note 42, at 195-96, 216-36. For an analysis of the New FECL, see generally Henderson, *The Management of Foreigners, supra*. Henderson is not impressed by the new law: "Most of [the] bramble of regulations has been repealed or rewritten, and now prohibitions [on inward investment] are more selective, or discretionary where useful to Japanese protectionism." Henderson, *Management of Foreigners, supra*, § 7.03, at 7-9. Article 6 of the AML requires a wide range of international contracts involving the introduction of technology into Japan or the distribution rights for foreign goods in Japan to be submitted to the Fair Trade Commission, which has the power to order the Japanese party to delete or revise contract provisions which favor the foreign party in contravention of the Act. Novo Industri A/S v. Kosei Torihiki Iinkai, 264 Hanrei Taimuzu 215-17 (Tokyo High Ct. 1971), *cited in* D. HENDERSON, FOREIGN ENTERPRISE, *supra* note 30, at 154 n.173. *See* Ohara, *International Contracts and Agreements*, in 5 DOING BUSINESS IN JAPAN § 7.02[3], at IX 7-18 (Z. Kitagawa ed. 1984) (Domestic contracts are not subject to this scrutiny.).

Enforcement of the U.S.-Japan FCN Treaty was given such low priority that the negotiating history of the Treaty was kept secret until 1982, when it was declassified apparently as the result of a Freedom of Information Act request by an American attorney representing a Japanese trading company's American subsidiary involved in litigation in New York over alleged hiring discrimination against American citizens. *See* Sumitomo Shoji Am., Inc. v. Avagliano, 457 U.S. 176 (1982). The author also obtained a copy of the negotiating history of the treaty by making a Freedom of Information Act request to the State Department.

[114] *See* Crabb, *supra* note 3, at 1767 n.3, 1783 n.84, 1814-15 n.255; Kosugi, *supra* note 3, at 695 n.40, 697 n.45; Shimazaki, *supra* note 3, at 185 n.32. D. HENDERSON, FOREIGN ENTERPRISE, *supra* note 42, at 273, states that allegations by American officials of Japanese FCN violations were made as far back as 1964. Henderson also remarks that an American investor "would have to be bent on litigation rather than business in order to build a record to support his complaint" that the Foreign Investment Law restrictions were inconsistent with FCN rights. *Id.* at 286. This may explain why few complaints surfaced before 1977.

[115] *See supra* note 20.

[116] *See supra* note 32.

[117] Although on July 30, 1985, the Japanese Government announced that a bill would be

ever, although a proposal in April of 1985 by the United States Trade Representative to solve this problem was founded upon the principle of not restricting any existing treaty rights,[118] the Japanese negotiators, deferring to Nichibenren,[119] have taken the position that the issue is purely a domestic matter of Japanese law governing the practice of law.[120]

A regulatory framework is necessary before American lawyers may establish offices in Japan to give legal advice to Japanese and third-country clients.[121] Any framework, however, that restricts the independent trade facilitation activities of American nationals who are lawyers in the United States, or their advisory activities for American clients, would be inconsistent with the most important provisions of the FCN Treaty.

It is the premise of this article that the FCN Treaty offers a solution to the question of access by American business to American lawyers in Japan. Articles I(1), VII(1) and XXII(1) of the Treaty give the right to American lawyers to open trade facilitation offices in Japan as consultants to provide trade facilitation, business representation, and all other unregulated business services such as those provided by Japanese trading companies to their customers. Under those treaty provisions, such consultants have the right of establishment in Japan, but do not have the right to practice law.

Article VIII(1) of the Treaty gives American nationals and companies in Japan the right to engage American lawyers to provide professional legal advice in Japan for such American nationals and companies' internal management purposes notwithstanding Japanese professional licensing requirements. Article VIII(1), however, does not grant the right to establish an office in Japan. This provision simply states that American professionals may be "engaged" by

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introduced in the Diet in early 1986, a regulatory framework is unlikely to go into effect before April 1, 1987, the start of the next Japanese fiscal year.

[118] The preamble of the United States Trade Representative proposal states:

> Nothing in these proposals is intended, nor shall they be so interpreted, as diminishing or circumscribing in any way rights and obligations of either Japan or the United States under existing internal law or bilateral or international treaties or agreements, such as, but not limited to, the United States-Japan Treaty of Friendship, Commerce and Navigation.

Starting from the FCN Treaty is the only way to build a case for opening legal services in Japan to American lawyers. *See* Michida, *Capital Liberalization as a Treaty Question and Offensive and Defensive Strategies Concerning Foreign Capital*, 2 LAW IN JAPAN: AN ANNUAL 1 (1968) ("[T]he core of the problem is that there would be no liberalization if there were no treaty."), *quoted in* D. HENDERSON, FOREIGN ENTERPRISE, *supra* note 42, at 462-63 n.155. Henderson comments that Japan "has since performed her commitments only when 'pressured' into it, which was very little until recently." Henderson, *Foreign Enterprise*, *supra* note 42, at 463.

[119] *See* Action Program, *supra* note 22.

[120] *See* Position Paper, *supra* note 22, at 3.

[121] A licensing scheme is necessary because providing legal services to Japanese clients from offices in Japan even only as to American law is, under Kosugi's broad reading of article 72 of the Bengoshi Act, otherwise illegal. *See supra* note 83.

American nationals and companies. Thus, articles I, VII and XXII grant the right to establish an office in Japan, but not the right to provide professional legal services; article VIII gives the right to provide professional legal services to American clients in Japan, but does not grant the right of establishment.

A reasonable good faith solution to the trade issue would view these provisions in light of the intent of the Treaty to encourage mutual trade and recognize that the Treaty allows American lawyers to benefit from all of the above provisions. It is unreasonable to require an American client to bring an American lawyer from the United States for an individual project if there are equally competent American consultants in Japan who can provide professional legal advice. American lawyer-consultants in Japan could give professional legal advice to American clients in Japan, irrespective of the enactment of the comprehensive regulatory scheme required to permit American lawyers to serve Japanese and third-country clients.

If the Japanese Government agreed to grant visas to American lawyers permitting them to open offices as consultants under article VII and to give legal advice to American clients under article VIII, this highly-charged emotional trade dispute climate would cool down. Thereafter, negotiations could continue on the issue of an appropriate regulatory framework which would permit American lawyers to advise Japanese and third-country clients. As the following sections of this article will show, this proposed solution is supported by the negotiating history of the FCN Treaty.[122]

IV. Article I: Treaty Trader and Treaty Investor Visas

The primary purpose of the FCN treaties is to facilitate business.[123] Article I,

[122] The negotiating history consists of 21 sets of minutes of informal meetings between February 25 and May 12, 1952 and one set of minutes of formal discussion between October 15, 1952 and March 11, 1953. All meetings took place in Tokyo at either the United States Embassy or the Japanese Ministry of Foreign Affairs. All minutes were in English and were signed by representatives of both the Japanese and American delegations. In addition, the negotiating history consists of messages between the Tokyo Embassy and the Department of State in Washington concerning the meaning of the standard State Department draft and Japanese requests for changes, starting with U.S. Foreign Serv., Despatch No. 915 from Tokyo, December 7, 1951, which reported exploratory talks between the American and Japanese negotiators.

As to the importance of the negotiating history in interpretation of the FCN treaty, Frank A. Waring, Counselor for Economic Affairs, Office of the United States Political Advisor, Japan, noted: "The record of the preliminary discussions may . . . be the only record to which reference can be made in later years for the purpose of verifying the interpretation intended to be given some passage in the treaty." Memo of Conversation, Discussion on the Draft Treaty of Friendship, Commerce and Navigation between Japan and the United States, 1st Informal Mtg. 2 (Feb. 25, 1952) [hereinafter cited as Memo]. *See infra* note 145.

[123] *See supra* note 107.

paragraph 1 provides for entry into Japan by American nationals for international trade and investment activities and for indefinite stay:

> 1. Nationals of either Party shall be permitted enter the territories of the other Party and to remain therein: (a) for the purpose of carrying on trade between the territories of the two Parties and *engaging in related commercial activities*; (b) for the purpose of developing and directing the operations of an enterprise in which they have invested, or in which they are actively in the process of investing, a substantial amount of capital; and (c) for other purposes subject to the laws relating to the entry and sojourn of aliens.[124]

American trade facilitators fall under category (a) as treaty nationals who will be, with respect to "trade between the territories of the two Parties," "engaging in related commercial activities." "Related commercial activities" means activities related to the carrying on of the international trade between the United States and Japan.[125] Accordingly, American nationals, whether or not they are licensed to practice law in the United States, have the right to enter Japan as treaty traders to engage in trade facilitation and to stay for an indefinite period.[126] In practice, this means that an American national's "status of resi-

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[124] 4 U.S.T. at 2066 (emphasis added). This article was originally article II; the original article I was deleted. *See* Memo, *supra* note 122, at 6-10 (Feb. 25, 1952); Memo of Conversation, Discussion on the Draft Treaty of Friendship, Commerce and Navigation between Japan and the United States 3-4 (Oct. 15, 1952 to Mar. 11, 1953) [hereinafter cited as Memo of Formal Discussions].

[125] Negotiator Robert Adams explained that "related commercial activities" was restricted to activities related to the carrying on of international trade between the United States and Japan and did not mean all activities covered by article VII, paragraph 1 and article VIII, paragraph 1. "The 'related commercial activities' are those which must be carried on as an integral element of the international trade visualized." Memo of Formal Discussions, *supra* note 124, at 5.

[126] "Treaty trader" visas provide for an indefinite period of stay under the Immigration and Naturalization Act, 8 U.S.C. § 1101(a)(15)(E)(i) (1982) and the regulations thereunder. 22 C.F.R. § 41.40 (1985). As FCN negotiator Robert Adams explained: "With this clause, the Treaty, in addition to providing for "treaty traders," would provide for the non-quota entry of so-called "treaty investors" and for their indefinite sojurn so long as they remain in that status." Memo of Formal Discussions, *supra* note 124, at 6.

In the Twentieth Informal Meeting, May 8, 1952, the term "commercial traveler" was distinguished from "treaty merchant":

> Mr. Yukawa requested a definition of the term "commercial traveller" as used in Article XIII, and asked how a commercial traveller differs in status from a treaty merchant.
>
> Mr. Adams replied that a commercial traveller was normally one who was admitted into a country on a temporary visa for a limited period of time. . . .A "treaty trader" [is an individual] to whom the privilege of indefinite sojourn in the United States would be granted for so long as the individual were engaged in trade and related activities between the United States and his country pursuant to a Treaty of Friendship, Commerce and Navigation. . . .Thus, while both the commercial traveller and the treaty trader were non-immigrants under United States' law, the former was admitted only for a short period

dence" under Japanese immigration law should be renewed as long as the American national engages in commercial activities related to international trade such as trade facilitation.[127]

While article I, paragraph 1 allows entry into Japan, it does not have any specific provision allowing treaty traders to open offices in Japan or provide legal advice in Japan, or any provision concerning the applicability of Japanese professional licensing requirements. These issues are addressed by article VII, paragraph 1; article XXII, paragraph 1; and article VIII, paragraph 1 of the Treaty and article 72 of the Japanese Bengoshi Act.

V. National Treatment for All Juridical Entities

As a basic principle, American nationals and companies have the right to engage in all activities related to international trade and investment that Japanese nationals may engage in, pursuant to the national treatment provisions of article VII, paragraph 1, which provides:

> 1. Nationals and companies of either Party shall be accorded national treatment with respect to engaging in all types of commercial, industrial, financial and other business activities within the territories of the other Party, *whether directly by agent or through the medium of any form of lawful juridical entity*. Accordingly, such nationals and companies shall be permitted within such territories: (a) to establish and maintain branches, agencies, offices, factories and other establishments appropriate to the conduct of their business; (b) to organize companies under the general company laws of such other Party, and to acquire majority interests in companies of such other Party; and (c) to control and manage enterprises which they have established or acquired. Moreover, enterprises which they control, whether in the form of individual proprietorships, companies or otherwise, shall, in all that relates to the conduct of the activities thereof, be accorded treatment no less favorable than that accorded like enterprises controlled by na-

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> of time, while the latter could remain in the United States indefinitely as long as his activities were in accordance with the covering FCN Treaty.

Memo, *supra* note 122, 20th Informal Mtg., at 5 (May 8, 1952).

[127] "Status of residence (*zairyu shikaku*) is the term used to describe the visa categories specified in article 4 of the *Shutsunyukoku kanri oyobi nanmin nintei Ho* (Immigration-Control and Refugee-Recognition Act), Cabinet Order 319 of 1951, as amended by Act 75 of 1982. The visa category for aliens who seek to engage in foreign trade, management of business, or capital investment activities in Japan is that found in the Immigration Control Act, art. 4, para. 1, subpara. 5. Article 6(2) of the Shiko Kisoku (Enforcement Regulations) thereunder, Ministry of Justice Order 54, Oct. 28, 1982, requires that an alien seeking this type of visa must have a base in Japan. Extension of the period of stay is governed by article 21 of the Act and article 21 of the regulations. Concerning commercial visas in Japanese immigration law, see generally *Commercial Visas*, in 6 Doing Business in Japan § 5.04[2], at XI 5-13 (Z. Kitagawa ed. 1985).

tionals and companies of such other Party.[128]

The term "national treatment" is defined in article XXII, paragraph 1:

> The term "national treatment" means treatment accorded within the territories of a Party upon terms no less favorable than the treatment accorded therein, in like situations, to nationals, companies, products, vessels or other objects, as the case may be, of such Party.[129]

Article VII, paragraph 1 is the heart of the treaty.[130] It sets forth four principles: (1) *right of establishment*,[131] (2) *national treatment*,[132] (3) *any form of juridical entity*,[133] and (4) *right of control and management*.[134] According to these

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[128] 4 U.S.T. at 2069 (emphasis added).

[129] 4 U.S.T. at 2078-79.

[130] U.S. Foreign Serv., Airgram No. A-453 (Jan. 7, 1952); Memo, *supra* note 122, 4th Informal Mtg., at 3 (Mar. 4, 1952). At that meeting, the Japanese expressed dissatisfaction with the American concept of national treatment. First, they proposed deletion of the term "financial" from the phrase "financial and other activity for profit (business activity)" in the original draft of article VII, paragraph 1. *Id.* at 2-3 (statement of Kenichi Otabe). This objection was later withdrawn. Memo of Formal Discussions, *supra* note 124, at 15. Second, they proposed that the phrase "other activity for profit" be deleted, or that the phrase be qualified so that such activity contribute to the economic rehabilitation of Japan. Memo of Conversation, 4th Informal Mtg., at 5 (statement of Haruki Mori: "Japan should have complete freedom of action in the field of business and financial activities."). While the entire phrase was changed to "financial and other business activity," Memo of Formal Discussions, *supra* note 124, at 15, the Japanese concern that exchange reserves might be depleted by American investors remitting profits to the United States was taken into account in paragraph 6 of the Protocol of the Treaty, 4 U.S.T. at 2082, which states "Either Party may impose restrictions on the introduction of foreign capital as may be necessary to protect its monetary reserves as provided in Article XII, paragraph 2." In light of Mori's comments, Japan's reasons for the Protocol were not simply to protect its balance of payments. *See* D. HENDERSON, FOREIGN ENTERPRISE, *supra* note 42, at 217-18 (Japanese "officialdom has always seen the FIL as primarily a tool for planners and a method for selection induction of technology—with no more foreign managerial participation in business than necessary to get the techniques.").

[131] The relevant language in article VII(1) is "establish and maintain branches, agencies, offices, factories and other establishments appropriate to their conduct of business." 4 U.S.T. at 2069.

[132] The relevant language in article VII(1) is

> Nationals and companies of either Party shall be accorded national treatment with respect to engaging in all types of commercial, industrial, financial and other business activities within the territory of the other Party. . . .Moreover, enterprises which they control, whether in the form of individual proprietorships, companies or otherwise, shall, in all that relates to the conduct of the activities thereof, be accorded treatment no less favorable than that accorded like enterprises of such other Party.

Id.

[133] The relevant language in article VII(1) is "whether directly or by agent or through the medium of any form of lawful juridical entity." *Id.*

[134] The relevant language in article VII(1) is "to organize companies under the general com-

four principles, any American national may establish, control and manage an enterprise to engage in any lawful business activity in Japan that is open to Japanese nationals, on the same conditions, in *any* form of legal entity, whether or not a Japanese national would choose that form of entity.

Article XXII, paragraph 1 determines the scope of the national treatment provision as to American nationals and companies. The provision refers to treatment "in like situations" to nationals and companies of Japan.[135] Article VII provides that enterprises in Japan controlled by American nationals and companies have the right, "in all that relates to the conduct of the activities thereof," to treatment no less favorable than that accorded "like enterprises" controlled by Japanese nationals and companies. To determine whether two enterprises are "like enterprises" or in like situations the test is whether the activity is essentially the same as that permitted to local enterprises. If it is, then there is national treatment with respect to that activity regardless of the form of the enterprise. The organization or structure of an enterprise or the existence of a local equivalent is irrelevant under the article VII, paragraph 1 provision that any form of juridical entity may be chosen. If that were not the case, Japanese trading companies would not have national treatment under the Treaty in the United States since there are no American trading companies which perform all the functions of *sogo shosha*. They are uniquely Japanese institutions.

Thus the activities of American lawyers in Japan, not the form of their establishment, determines the scope of their national treatment. Since Japanese nationals and companies are allowed to be business agents for other companies,[136] so are American lawyers. American lawyers in Japan have the same rights as trading companies to provide trade facilitation services such as information gathering and business advising and consulting. American lawyers employed in-house by a company have the same right to give legal advice to the company as the unlicensed legal staff of a Japanese corporation.[137] Under the treaty American lawyers may not be required to comply with Japanese professional licensing requirements for engaging in activities which are legally engaged in by Japanese non-professionals. There is no room for arguing "well, it looks like a *bengoshi* office, so it must be treated as one" or "they are lawyers in the United States, so they must be regulated as *bengoshi* here."

In summary, article VII, paragraph 1 and article XXII, paragraph 1 give to Americans nationals who may enter Japan under article I, paragraph 1 to en-

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pany laws of such other Party, and to acquire majority interests in companies of such other Party; and. . .to control and manage enterprises which they have established or acquired." *Id.*

[135] The term "in like situations" means "under similar circumstances" or "in similar cases." Memo, *supra* note 122, 21st Informal Mtg., at 2 (May 12, 1952).

[136] *See supra* notes 41-45 and accompanying text.

[137] *See supra* note 42 and accompanying text.

gage in commercial activities related to international trade and investment the right to establish offices in Japan to engage in every activity permitted to Japanese business agents, trading companies, and business consultants. These provisions also grant the right to be treated no differently under Japanese law than Japanese nationals and companies engaged in those activities, even though Japanese and American businesses may be organized into different types of business institutions.

VI. Article VIII: The Right of American Business in Japan to Engage Legal Professionals but not the Right of such Professionals to Practice Law

While article VII provides for the right of establishment, control and management, article VIII provides that American nationals and companies may engage the employees, independent contractors, and professional persons they need to establish an enterprise and effect control and management:

> 1. Nationals and companies of either Party shall be permitted to engage, within the territories of the other Party, accountants and other technical experts, executive personnel, attorneys, agents and other specialists of their choice. Moreover, such nationals and companies shall be permitted to engage accountants and other technical experts regardless of the extent to which they may have qualified for the *practice of a profession* within the territories of such other Party, for the particular purpose of making examinations, audits and technical investigations exclusively for, and rendering reports to, such nationals and companies in connection with the planning and operation of their enterprises, and enterprises in which they have a financial interest, within such territories.
> 2. Nationals of either Party shall not be barred from practicing the *professions* within the territories of the other Party merely by reason of their alienage; but they shall be permitted to engage in *professional* activities therein upon compliance with the requirements regarding qualifications, residence and competence that are applicable to nationals of such other Party.[188]

A. *Right No. 1: The Right to Choose Locally Qualified Professional Persons and Locally-Qualified Professional Persons Regardless of Nationality*

The first of the two rights created by article VIII, paragraph 1 is stated in the first sentence. American nationals and companies have the freedom to "engage" key personnel including "accountants and other technical experts, executive per-

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[188] 4 U.S.T. at 2070 (emphasis added).

sonnel, attorneys, agents, and other specialists of their choice."[139] This provision implements the right of national treatment and right of control and management.

While this freedom of choice provision supersedes immigration and labor law requirements as to the categories specified,[140] it does not supersede professional licensing requirements. Employees and independent contractors must, under this provision, possess any required professional licenses. Thus if an American national is occupationally qualified in Japan, this provision prevents Japan from forbidding an American national or company from hiring or retaining that American national.[141] Whether a professional license is required depends on the specific activity engaged in. On one hand, neither Japanese nor American law has professional licensing requirements for "executive personnel"[142] or

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[139] *Id. See* Memo, *supra* note 122, 5th Informal Mtg., at 2 (Mar. 7, 1952).
The term "engage" applies to both employees and independent contractors. In the negotiations over the identical sentence in the United States-Germany FCN Treaty, Treaty of Friendship, Commerce and Navigation, Oct. 29, 1954, 7 U.S.T. 1839, 1848, T.I.A.S. No. 3062, the Department of State explained that the term was broad enough to allow an American national or company to choose to obtain the necessary services either by hiring employees or by retaining independent persons. Letter from the Office of the United States High Commissioner for Germany to the Federal Ministry of Foreign Affairs of the Federal Republic of Germany 3 (Dec. 15, 1953).

[140] Sumitomo Shoji Am., Inc. v. Avagliano, 457 U.S. at 181 n.6. The negotiating history of the first sentence of article VIII, paragraph 1 of the FCN Treaty with Germany states: "[The first sentence] . . .gives freedom of choice as among persons lawfully present in the country and occupationally qualified under the local law." U.S. Foreign Serv., Despatch No. 2529, at 1-2 (Mar. 18, 1954) (discussions with Germany), *cited in Sumitomo*, 457 U.S. at 181 n.6.

Similarly, during the United States-Japan FCN negotiations:

> Mr. Yukawa. . .asked whether it was understood that those aliens engaged in certain activities, even if employed for the exclusive purpose of a company, such as certified public accountants. . .as well as architects, civil, electrical and mechanical engineers, and other technicians engaged in activities related to public interest or public safety, must comply with qualifications and requirements of technical competence applicable to nationals in the same *professions.*
>
> Mr. Adams replied that it was clearly understood that individuals engaged in the activities mentioned by Mr. Yukawa should under any circumstances comply with local requirements regarding qualifications and competence.

Memo, *supra* note 122, 5th Informal Mtg., at 2 (Mar. 7, 1952) (emphasis added). A 1979 law review article makes the same analysis: "A provision immediately following the employer-choice provision exempts foreign *professionals* from domestic qualification rules only under limited circumstances. By negative implication, *professionals* chosen by the foreign firm normally must meet the same occupational qualifications as employees of domestic firms." Note, *Commercial Treaties and the American Civil Rights Laws: The Case of Japanese Employers*, 31 STAN. L. REV. 947, 954-55 (1979) (emphasis added) (footnote omitted).

[141] Despatch No. 2529, *supra* note 140.

[142] As to the meaning of the term "executive personnel," the negotiating history states:

> In connection with *Article VIII*, Mr. Otabe asked for an explanation of the meaning and

"agents."[143] In contrast, a license is required for "attorneys" (*bengoshi* in the Japanese text of the Treaty)[144] and may be required for "accountants" as well. A license may or may not be required of a "technical expert" or "other specialist" depending on the field. Thus an American national, including an American national licensed to practice law in the United States, who is engaged by an American national or company as an "executive" or as an "agent," may engage in all activities that a Japanese executive or agent may engage in, without a professional license. This provision, however, does not allow an American national or company to be represented by an American attorney in a Japanese court. An American national and company may choose, therefore, any *bengoshi* for representation in court since the term "attorney" means only persons licensed in Japan.

B. Right No. 2: The Right to Obtain the Services of American Legal Professionals for Internal Reports and Examinations Even If Such Persons Are Not Licensed in Japan

The second right granted to American nationals and companies by article VIII, paragraph 1 is the right of American nationals and companies in Japan to engage American professionals for the specific purposes of making examinations and reports to the American national or company for internal management purposes. Although such professionals do not possess the ordinarily required Japanese professional license, they may be employees or independent contractors.

The second sentence of article VIII, paragraph 1 makes it unnecessary even to determine whether professional licensing requirements apply to these services if they are rendered for "internal management purposes." The only inquiry is whether the providers of the services are "experts" or "specialists" in the field or profession in which they are engaged. Article VIII does not grant, however, a general right of establishment to practice a profession.

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scope of the term "executive personnel" in paragraph 1, and further inquired whether this term included employees holding the higher positions in a company.

Mr. Singer replied that this term meant the responsible officials of a company, including, but not limited to, directors and managers, and that it was regarded as covering the higher employees of a company.

Memo, *supra* note 122, 21st Informal Mtg., at 9-10 (May 12, 1952).

[143] In the United States an agent is a person who is appointed by another, his principal, by contract to manage some business to be transacted in the principal's name or on his account, and who has the fiduciary obligation to carry out the business and render an account to the principal. H. REUSCHLEIN & W. GREGORY, AGENCY AND PARTNERSHIP § 2 (1979). The term agent includes independent contractors such as general sales agents, agents under a power-of-attorney, and business agents, such as for entertainers and athletes. *Id.* § 7. The definition of agent under Article 99 of the Japanese Civil Code is similar. *See supra* note 127.

[144] 4 U.S.T. at 2097.

1. The Right to Receive Professional Advice From Employees or Independent Contractors

In the first Japanese comments in the negotiating minutes,[145] the Japanese negotiators requested two changes to the second sentence of paragraph 1. First, they requested that the phrase "on a temporary basis" be inserted after the clause "shall be permitted to engage."[146] This was rejected by the Department of State.[147] Therefore a professional person may be engaged for as long as required. Second, they requested that the phrase "for the exclusive account of their *employers* in connection with the planning. . ." be added.[148] That change was also not accepted, but the word "exclusively" was added in the second sentence.[149] American nationals and companies in Japan may thus obtain examinations, investigations and reports from independent contractors as well as their own employees.[150]

2. The Right to Obtain the Services of American Professionals for Internal Reports and Examinations Even if Such Persons Are Not Licensed in Japan

a. The Professions Clause

Explicit reference to the legal profession in the negotiating history was made only with respect to article VIII, paragraph 2.[151] That history shows that the Japanese negotiators of the FCN Treaty clearly understood that the term "pro-

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[145] Despatch No. 915, *supra* note 122, at 2-3. The negotiating history, preparatory works, and diplomatic correspondence may be used to establish the meaning of a treaty when the meaning is not clear. Arizona v. California, 292 U.S. 341, 359-60 (1934). The Second Restatement of the Foreign Relations Law of the United States, RESTATEMENT (SECOND) OF THE FOREIGN RELATIONS LAW OF THE UNITED STATES § 147(1)(c), (d) (1965) and the Vienna Convention on the Law of Treaties, *opened for signature* May 23, 1969, art. 32, U.N. DOC. A/CONF. 39/27, *reprinted in* 8 I.L.M. (1969), also provide that courts may resort to the negotiating history in interpreting a treaty.

Similarly, Japanese law provides that "[r]eference to the negotiating history of a treaty is necessary to clarify ambiguities in the meaning of treaty language." E. FUKATSU, KOKUSAI HO SORON (GENERAL THEORY OF INTERNATIONAL LAW) 224 (1984); S. KYOZUKA, ZOKU JOYAKUHO NO KENKYU (CONTINUED RESEARCH ON THE LAW OF TREATIES) 276 (1977).

[146] *Id.* at 2.

[147] No further mention of this request is made in the negotiating history and the requested language was not included in the FCN Treaty.

[148] Despatch No. 915, *supra* note 122, at 2; Memo, 5th Informal Mtg., at 1-2 (Mar. 7, 1952).

[149] Memo of Formal Discussions, *supra* note 124, at 20.

[150] *See supra* text accompanying note 139.

[151] *See supra* text accompanying note 138. Article VIII(2) was referred to by the ACCJ as the "professions clause." Telegram No. 2143, *supra* note 51.

fession" includes the legal profession. First, the Japanese negotiators proposed that paragraph 2 be modified to enumerate two professions to be reserved to nationals, port pilots and notaries public.[152] That request was accepted and made part of the Protocol.[153] Therefore, under the terms of paragraph 2, an American national who has met all the applicable Japanese licensing requirements for a profession other than port pilot or notary public cannot be denied the right to practice that profession in Japan solely because of the lack of Japanese citizenship. Probably since the Bengoshi Act does not have an explicit citizenship requirement,[154] no proposal was made to exclude the legal profession from paragraph 2. Second, the Japanese negotiators specifically inquired[155] as to the relationship of paragraph 2, the professions clause, to prohibitions at that time by almost all states on the practice of law and other professions in the United States by Japanese citizens.[156]

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[152] Memo, *supra* note 122, 5th Informal Mtg., at 2-3 (Mar. 7, 1952).

[153] Memo of Formal Discussions, *supra* note 124, at 20. Protocol ¶ 5, 4 U.S.T. at 2082 states, "The provisions of Article VIII, ¶ 2, shall not extend to the professions of notary public and port pilot."

The Japanese did not exclude the legal profession from article VIII, paragraph 2:

> Mr. Adams asked whether the Japanese representatives wished to exclude any other professions from the national treatment provisions of paragraph 2. Receiving a negative reply from Mr. Yukawa, Mr. Adams stated that the Japanese proposal regarding port pilots and notaries public would be submitted to the Department of State for its consideration.

Memo, *supra* note 122, 5th Informal Mtg., at 3 (Mar. 7, 1952).

[154] Notwithstanding the lack of an explicit statutory citizenship requirement, from 1956 to 1977, the Japan Supreme Court General Secretariat recruiting announcements imposed Japanese nationality as a requirement for admission to the Supreme Court Legal and Training Institute. Brown, *supra* note 3, at 447-49; Crabb, *supra* note 3, at 1775; Fukuhara, *Status*, *supra* note 3, at 30-31 n.28; Kosugi, *supra* note 3, at 689-90. The rationale was that because students at the Institute receive salaries from the government, they should be treated as public servants, as to which there is a requirement of Japanese nationality; thereby the Supreme Court incorporated a citizenship requirement into the Bengoshi Act. In 1977, a Korean permanent resident of Japan who had been born, raised, and educated there, and who was a native speaker of Japanese, was admitted to the Institute after receiving much support from *bengoshi*. Crabb, *supra* note 3, at 1775 n.42. Effective January 1, 1978, the Supreme Court revised its admission requirements. While retaining the principle that foreign citizenship may be used as grounds for denial of admission even after being one of the 500 successful applicants out of 25,000 who take the entrance examination, the Supreme Court passed a resolution providing that foreigners may be admitted on a case-by-case basis in an appropriate instance. Kosugi, *supra* note 3, at 690. The above is the only example of a foreign citizen being admitted to the Institute.

[155] Despatch No. 915, *supra* note 122, at 2-3 (emphasis added), states:

> Also in connection with Paragraph 2, the Ministry's representatives questioned whether Japanese in the United States were not in fact barred from certain *professions* by various State laws "merely by reason of their alienage." Further information was requested regarding the practice of law, medicine, and engineering in the various States.

[156] In 1953 most, if not all, states in the United States had citizenship requirements for the practice of law making it impossible for Japanese citizens to qualify as lawyers. Seno, *supra* note

Therefore, since the practice of law was explicitly noted by the Japanese negotiators, since they did not request exclusion of the legal profession as they requested exclusion of two other professions, and since the contemporaneous controversy over the professions clause was primarily concerned with the regulation over the legal profession, it is clear that the word "profession" in article VIII, paragraph 2 includes the legal profession.

b. Legal Professionals for Internal Management Purposes

The interpretation of the term profession to include the legal profession is also borne out by the negotiating history of the second sentence of article VIII, paragraph 1 of the Japanese and German FCN Treaties.[157] The State Depart-

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51, at 18. The prime opponent of the professions clause, Senator Bourke B. Hickenlooper, proposed a reservation to article VIII(2) to prevent the professions clause from superseding those requirements. Hearings, *supra* note 154, at 3. The reservation as adopted by the Senate provides:

> Article VIII, paragraph 2, shall not extend to professions which, because they involve the performance of functions in a public capacity or in the interest of public health and safety, are state-licensed and reserved by statute or constitution exclusively to citizens of the country, and no most-favored-nation clause in the said treaty shall apply to such professions.

4 U.S.T. at 2132.

The American reservation triggered a Japanese reservation not limited to citizenship:

> Japan reserves the right to impose prohibitions or restrictions on nationals of the United States of America with respect to practicing the professions referred to in Article VIII, paragraph 2, to the same extent as States, Territories or possessions of the United States of America, including the District of Columbia, to which such nationals belong impose prohibitions or restrictions on nationals of Japan with respect to practicing such professions.

4 U.S.T. at 2132. Rather than enact a reciprocity-citizenship requirement as proposed by Seno, *supra* note 51, at 16, Japan repealed article 7 of the Bengoshi Act in 1955. *See supra* notes 84-85, 87-88. Viewed narrowly, the repeal only affected Japanese domestic law concerning the licensing of American lawyers to practice the profession of advising Japanese nationals as to American law. It did not affect any American rights under the FCN Treaty. In fact, Japan has allowed American lawyers based outside of Japan to give legal advice when in Japan on short visits on specific matters. *See* Position Paper, *supra* note 22, at 8. The repeal of article 7 thus relegated the long-term status of American lawyers in Japan to that of consultants.

In 1973, state law citizenship requirements for attorneys were held unconstitutional by the United States Supreme Court. *In re* Griffiths, 413 U.S. 717 (1973). Between 1977 and 1984, over 50 Japanese nationals, including 30 *bengoshi*, passed the New York examination and were admitted as attorneys in that state (estimate based on 1984 Martindale-Hubbell Law Directory, The 1984 Nichibenren Kaiin Meibo (Nichibenren Membership Directory), and the author's personal knowledge). As a result of the repeal of article 7 of the Bengoshi Act, there are now only seven American lawyers remaining of the pre-1955 group with offices in Japan. *See supra* note 19.

[157] The second sentence of Article VIII(1) in the U.S.-Japan FCN Treaty reads:

> Moreover, such nationals and companies shall be permitted to engage accountants and other technical experts regardless of the extent to which they may have qualified for the practice of a profession within the territories of such other Party, for the particular purpose

ment interpreted the second sentence of paragraph 1 of the treaty with Japan to be an exception to the requirement for applicable professional licenses:

> The Department assumes that the Japanese understand the difference between this paragraph and paragraph 2. If the technical expert is retained only to make examinations, audits, and technical investigations for, and in connection therewith to "render reports to" his employer, for the "exclusive account" of his employer, he is entitled to perform such a special and transitory job *without being required to possess the relevant professional license* . . . . The purpose of the paragraph is simply to assure the investor the right to have special investigations done by persons who are especially in his confidence for internal management or home office purposes, *without such persons being accused of illegally invading the field of professional practice*. Otherwise, persons who wish to discharge functions considered to be *within the field of the regulated professions* can be required to comply with laws, regulations, and procedures, as stipulated in paragraph 2 [of Article VIII].[158]

Thus, the State Department equated "accountants and other technical experts" with the "regulated professions." Similarly, State Department Despatch No. 2529,[159] which comments on the FCN Treaty with Germany, specifically refers to persons competent in American law as being covered by article VIII, paragraph 1 and therefore being entitled to visas:

> [The second sentence of Article VIII(1)] deals with a special and limited situation, and within its framework goes beyond the first sentence inasmuch as *it waives professional qualifications requirements* in the cases stipulated. These have to do with temporary jobs requiring special skills (e.g. for an American firm,

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> of making examinations, audits and technical investigations exclusively for, and rendering reports to, such nationals and companies in connection with the planning and operation of their enterprises, and enterprises in which they have a financial interest, within such territories.

Treaty of Friendship, Commerce and Navigation, Apr. 2, 1953, United States-Japan, art. VIII, 4 U.S.T. 2063, 2070, T.I.A.S. No. 2863.

The second sentence of Article VIII(1) in the U.S.-Germany Treaty reads:

> Moreover, such nationals and companies shall be permitted to engage accountants and other technical experts regardless of the extent to which they may have qualified for the practice of these professions within the territories of such other Party, for the particular purpose of making for internal purposes examinations, audits and technical investigations for, and rendering reports to, such nationals and companies in connection with the planning and operation of their enterprises, and enterprises in which they have a financial interest, within such territories.

Treaty of Friendship, Commerce and Navigation, Oct. 29, 1954, United States-Federal Republic of Germany, art. VIII, 7 U.S.T. 1839, 1848, T.I.A.S. No. 3062.

[158] U.S. Foreign Serv., Airgram No. 22, at 4-5 (May 7, 1952) (emphasis added).

[159] Despatch No. 2529, *supra* note 140.

> *competence in American law* and accounting methods) for internal management purposes, and no right is created to engage in the general practice of a profession in the host country. *In reference to entry into the country, necessary entry privileges are implied.*[160]

That the second sentence of article VIII, paragraph 1 includes persons competent in American law is also shown by the Memorandum of Conversation of the Twenty-first Informal Meeting:

> With further reference to paragraph 1, Article VIII, Mr. Otabe then asked if there was a clear-cut difference between the words "examinations" and "technical investigations."
>
> Mr. Singer replied that examinations were more general in nature, *and would include inquiries and surveys concerning investment possibilities, general business, financial*, accounting and personnel problems. Technical investigations, on the other hand, were more specific in character, and would include, among other similar studies, those conducted by engineers, production experts, research personnel, laboratory and testing technicians, and other experts with respect to some specific aspect of investment, the establishment of a factory or enterprise or the production of some article.[161]

Conducting inquiries and surveys concerning investment possibilities, general business, and financial problems, while the activities of accountants, are also types of activities that American lawyers specialize in by reason of their legal education, training and experience. These activities overlap the trade facilitation function and legal function of American lawyers.

Furthermore, there is no limit on "reports to" American nationals and companies in Japan as long as they are "in connection with the planning and operation of their enterprises, and enterprises in which they have a financial interest." These reports may take the form of drafts of contracts, court pleadings, and official applications to the Japanese government.[162] American lawyers were as

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[160] *Id.* at 2 (emphasis added).

[161] Memo, *supra* note 122, 21st Informal Mtg., at 10 (May 12, 1952) (emphasis added).

[162] Fukuhara describes the scope of legal matters that may be handled under the second sentence of article VIII(1) by foreign lawyers in Japan without violating the Bengoshi Act:

> The (a) conduct of examinations and legal investigations exclusively in behalf of American nationals and American companies in connection with the planning and operation of the enterprise of an American national or company within Japan or another enterprise within Japan to which an American national or company has advanced funds or from which it derives some other financial benefit, and (b) the rendering of reports thereon to the American national or company concerned. . . .
>
> . . . .
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> . . . [F]oreign lawyers may not go so far as to engage in the external activities of concluding a contract or performing procedures in a court or an administrative agency as

important as business advisors in 1953 as they are today.[163] Since the purpose of the second sentence of article VIII, paragraph 1 is to allow American nationals and companies to have types of examinations done by specialists who are in their confidence, the intent of the treaty is to allow American lawyers, as such specialists, to be engaged to perform "examinations" and make "reports."[164]

There is nothing in the history of the Treaty to suggest that the Japanese negotiators requested exclusion of the legal profession from the special services authorized by the second sentence of article VIII, paragraph 1. Rather, the use of the term profession in both paragraphs 1 and 2 clearly shows their intent to include the legal profession. It is therefore inconceivable, in light of the purpose of the FCN Treaties to expand and facilitate trade with signatory nations, that the United States Department of State intentionally prohibited American nationals and companies from obtaining the advice they need for their enterprises in foreign countries from American legal specialists.

The meaning of the phrase "accountants and other technical experts," therefore, simply means "professionals." Concededly the ordinary meaning of the term "technical expert" (*gijutsusha* in the Japanese text) implies a technician, scientist, engineer or other professional with a scientific background. However, an "accountant" (*kaikeishi*) is not usually considered to be a scientific expert, so the use of the word "other" (*sono ta no*) leaves the meaning of the phrase "accountants and other technical experts," taken by itself, ambiguous.[165] Since

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> the authorized agent of an American national or company.
>
> On the other hand, there is nothing to preclude a foreign lawyer from preparing a report for an American national or company in which he includes as part of the report the proposed draft of a contract or the preparation of a form to be submitted to the court or the government on condition that the actual formal conclusion is carried out later by the American national or company itself or its lawful agent (such as a *bengoshi*).

Fukuhara, *Status*, *supra* note 3, at 34, 35. *See* T. FUKUHARA, THE BENGOSHI ACT, *supra* note 72, at 270. American lawyers may not, of course, violate Code of Professional Responsibility DR 6-101(A)(1), which states that a lawyer shall not handle a legal matter which he knows or should know that he is not competent to handle, without associating with him a lawyer who is competent to handle it. As to Fukuhara's condition that the formal conclusion of a contract must be carried out by a *bengoshi*, Fukuhara seems to overlook the term "agent" in the first sentence of article VIII(1). No *bengoshi* license is required to be an agent or to sign a contract or submit a document to an official agency (except to a court or administrative tribunal, as provided in article 72 of the Bengoshi Act). Under the Japanese Civil or Commercial Codes these activities are open to non-*bengoshi* agents. *See supra* notes 143 and accompanying text.

[163] *See* Moffatt, *supra* note 3, at 13 (quoting in full the June 21, 1984, statement by the ACCJ Board of Governors urging that the U.S. Government press Japan to permit American lawyers to establish offices in Japan); Welty letter, *supra* note 1.

[164] *See* Despatch No. A-22, quoted *supra* text accompanying note 158.

[165] Article 32(a) of the Vienna Convention provides that "[r]ecourse may be had to supplementary means of interpretation. . .when the interpretation. . .leaves the meaning ambiguous or obscure. . . ." *See* art. 32(a), Vienna Convention, *supra* note 145. *See also* Kosugi, *supra* note 3,

the word "profession" also appears in the sentence, "technical expert" cannot be restricted to its ordinary meaning. That would lead to the manifestly absurd or unreasonable result of arbitrarily limiting the types of specialists that a treaty trader may engage, and lead to pointless arguments over whether a particular professional was a "technical expert," which is mentioned in the first and second sentences, or an "other specialist," which is mentioned only in the first sentence, and arguments over "examinations" and "technical investigations."[166] This is a case where a special meaning to the phrase "accountants and other technical experts" ("professionals") was agreed upon by the parties, as shown by the negotiating history.[167] That "accountants and other technical experts" includes all professionals is the only interpretation consistent with the intent of the FCN Treaty to facilitate bilateral trade.

Thus the interpretation of the second sentence of article VIII(1) of the FCN Treaty by its contemporary negotiators to include the legal profession is the only interpretation consistent with the needs of American business in the real world, and is the correct interpretation of this provision.

However, there is another interpretation of the second sentence of article VIII, paragraph 1. That interpretation is advanced by *bengoshi* Keiji Matsumoto, in a 1979 law review article.[168] He argues that American lawyers should not be allowed to open offices to give legal advice to American nationals and companies in Japan. Matsumoto's interpretation is based upon the absence from the second sentence of the term "attorneys" contained in the first sentence:

> The second sentence only provides that nationals and companies of either Party, for the particular purposes specified in the second sentence, may engage "accountants and other technical experts" of their choice regardless of whether they possess professional qualifications. From a contextual interpretation and from the intent of the text which lists "accountants and other technical experts" and "*bengoshi*" next to each other on an equal footing, it is clear that "*bengoshi*" is not included in "accountants and other technical experts." Accordingly, an American *bengoshi* who does not have the qualification of a Japanese *bengoshi* may not, based upon this provision, even within the scope and for the purposes specified in the second sentence, practice the profession of *bengoshi* within Japan for American nationals and companies.[169]

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at 699 (positing that this provision is "awkward and unclear").

[166] *See supra* text accompanying note 161.

[167] This conclusion is in accord with the principle in article 31(4) of the Vienna Convention, *supra* note 145, that "[a] special meaning shall be given to a term if it is established that the parties so intended." This conclusion is also consistent with the practice of both Japan and the United States to issue short-term visas to lawyers and *bengoshi* respectively, which should be taken into account under article 31(3)(c) of the Vienna Convention, *supra* note 145.

[168] *See* Matsumoto, *supra* note 47.

[169] *Id.* at 84.

Matsumoto's analysis is not supported by the negotiating history of the Treaty. First, Matsumoto's use of the phrase "practice the profession of *bengoshi*" confuses the question of whether article VIII allows American nationals and companies in Japan to receive legal advice from American lawyers in Japan with the question of whether article VIII allows American lawyers to open a law office in Japan or to call themselves *bengoshi*. Unlike article VII, paragraph 1, article VIII, paragraph 1 gives no right of establishment of an office in Japan and does not allow American lawyers to refer to themselves as *bengoshi*.[170] Article VIII, paragraph 1 only gives certain rights to American nationals and companies in Japan to receive business, technical and legal services from American professionals.

Second, Matsumoto improperly places emphasis on the status of American lawyers as "attorneys." American licensing requirements for professionals are irrelevant in applying the second sentence of article VIII, paragraph 1 in Japan. What is important is whether the persons to be engaged have specialized knowledge and skills to provide the examinations, reports, and advice needed by the national or company engaging them. Under Matsumoto's interpretation, an American national who has graduated from an American law school and who is not an attorney would be allowed to render advice under the second sentence, but an American national who passed the bar examination would be ineligible. Such a result is manifestly absurd and unreasonable.[171]

The absence of the word "attorneys" in the second sentence does not affect the right of American nationals and companies to obtain legal advice from American lawyers in Japan. Although Matsumoto states that his interpretation is based upon the "intent" of the text, he ignores the word "profession," which appears three times in article VIII, and he offers no explanation of the intent of article VIII, paragraph 1. The inference to be drawn from his arguments is that the language was consciously chosen by the State Department to specifically prevent nationals and companies of one treaty country from consulting with its own legal advisors in the territory of the other treaty country, while allowing

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[170] *See* Airgram No. A-22, *supra* note 158, at 3-4. *Cf.* Despatch No. 2529, *supra* note 140. Matsumoto himself does not object to short trips to Japan by American lawyers:

> In each case, the lawyer coming to Japan on a business trip is concerned with a matter centering on the law of the country involved, and with the necessity of resolving matters entrusted to the lawyer in that country concerning that country, and so it may be said that all of such trips are to attend to such matters. Within these bounds, there is no necessity to consider [such services] as the [engaging in] of the *bengoshi* profession in Japan. (Provided that there would be a problem [if the foreign lawyer] makes a long stay in a hotel and handles matters for the general public).

Matsumoto, *supra* note 47, at 85.

[171] Therefore recourse must be had to the negotiating history of the Treaty, under article 32(b) of the Vienna Convention, *supra* note 145. The negotiating history does not support such a result.

consultation with other professional persons. Another version of this argument is that if the drafters of the treaty had intended to include legal professionals in the second sentence, they would have explicitly said so. That is not a good faith interpretation of the Treaty.[172]

Matsumoto's argument is simply a version of the doubtful principle of statutory construction *expressio unius est exclusio alterius* (expression of one excludes others).[173] However, that principle must not be utilized to defeat the purpose of a statute or treaty, or to override the manifest intent of the drafters of the legislation or treaty.[174] A treaty must be considered as a whole in light of its purpose.[175] In a treaty whose purpose is to encourage mutual trade, and which explicitly provides that nationals and companies of one treaty country may obtain the advice they need from home-country experts and advisors in the supervision of their enterprises in the other treaty country, application of that principle to exclude legal advisors, especially in light of the importance of American legal advisors to American business generally, would tend to defeat that purpose. Therefore application of the principle in this context is improper.[176] The intent and purpose of the Treaty is paramount.

In view of the treaty, continued Japanese Government use of the Nichibenren "Standards"[177] to prohibit American lawyers from advising American clients in Japan therefore conflicts with American rights under the second sentence of article VIII, paragraph 1 of the FCN Treaty. As Fukuhara notes, points 1 and 2 of the summarized standards violate article VIII of the FCN Treaty since the second sentence of article VIII, paragraph 1 allows an American lawyer to make a report to an American client which may include a draft of a contract, court pleading, or government submission.[178] Points 2 and 3 of the summarized Standards[179] also violate that provision of the FCN Treaty since American clients are entitled to engage American lawyers for legal advice, not-

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[172] Such an interpretation must therefore be rejected under article 31(1) of the Vienna Convention, *supra* note 145, which provides that "[a] treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose." The correct interpretation of the provision of the FCN Treaty is under article 31(4) of the Vienna Convention that the drafters agreed on a special meaning to the phrase "accountants and other technical experts." *See supra* text accompanying note 167.

[173] 2A C. SANDS, SUTHERLAND'S STATUTES AND STATUTORY CONSTRUCTION §§ 47.23-.25 (4th ed. 1984).

[174] *Id.*

[175] Vienna Convention, *supra* note 172, article 31(1).

[176] *Id.*

[177] *See supra* notes 58-59, 93 and accompanying text.

[178] *See supra* note 162.

[179] *See supra* note 93.

withstanding any provision in article 72 of the Bengoshi Act.[180]

The conclusion is therefore inescapable that American lawyers, as specialists in law, business, and international trade and investment, may make inquiries, surveys, investigations, examinations and reports concerning investment possibilities, general business, financial, accounting and personnel problems on behalf of American nationals and companies, as either employees or as independent consultants, even if in doing so they render specific legal advice to the American national or company engaging them. Since the right to enter into Japan is implied under article VIII, paragraph 1,[181] and is explicit under article I, paragraph 1,[182] and since treaty traders have the right of indefinite stay,[183] American nationals and companies have the article VIII, paragraph 1 right to employ and retain American lawyers in Japan for specific legal advice related to trade with or investment in Japan even though such lawyers do not possess a Japanese *bengoshi* license.

Finally, there is nothing in the FCN Treaty that says that the American lawyers who render the services authorized by the second sentence of article VIII paragraph 1 must be based outside Japan. Since article 72 of the Bengoshi Act does not prohibit American lawyers who are in Japan as executives (in-house counsel) under the first sentence of article VIII, paragraph 1 from giving legal advice to their company, the only practical benefit of the second sentence is to allow American nationals and companies to engage outside lawyers. It would therefore conflict with the purpose of the FCN Treaty to promote trade to require an American national or company to ignore the presence of American lawyers in Japan as consultants and go to the expense and inconvenience of specially bringing in an American lawyer from the United States for a project. Therefore, the same American lawyers may simultaneously benefit from article VII, paragraph 1 and the second sentence of article VIII, paragraph 1.

3. *No Right To Practice Law*

While American lawyers engaged under the second sentence of article VIII, paragraph 1 may be employees or independent contractors, and have the right of indefinite stay, that provision does not grant them the right to establish an independent legal practice in Japan. Despatch No. 2529 states: "No right is created by the second sentence of Article VIII Paragraph 1 to engage in the general practice of a profession in the host country."[184] Similarly, Despatch No.

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[180] *Cf.* Despatch No. 2529, *supra* note 140.

[181] *See supra* notes 127, 160.

[182] *See supra* notes 124-27 and accompanying text.

[183] *See supra* note 126.

[184] *See supra* text accompanying note 160.

A-22 states: "[P]ersons who wish to discharge functions considered to be within the field of the regulated professions can be required to comply with the applicable licensing laws, regulations, and procedures, as stipulated in paragraph 2 [of article VIII]."[185]

The providing of legal services to American clients by American lawyer/consultants does not constitute the practice of the legal profession in Japan. Such services are not in relation to a legal matter under Fukuhara's narrow analysis of article 72 of the Bengoshi Act[186] and they are incidental to legitimate trade facilitation even under Kosugi's broad reading of article 72.[187] Japan does not have a legitimate regulatory interest in inquiring as to the specific content of advisory services to American clients protected by the treaty by American lawyer/consultants who do not hold themselves out to the general Japanese public as *bengoshi* or as lawyers and who are rendering the same services allowed to be rendered by American lawyers visiting Japan. Also, American lawyers, like Japanese trading companies, company legal departments, and law professors must be presumed to be ethical and law-abiding.[188] The Nichibenren Standards, which presume that American lawyers would violate article 72[189] while ignoring the law-related activities of Japanese, violate the FCN principle of national treatment.

Unquestionably, American lawyers in Japan as consultants may not hold themselves out to the public as engaging in legal activities for which a *bengoshi* or other professional license is required. They cannot call themselves *bengoshi* or their Japanese offices *horitsu jimusho*.[190] They may not represent in writing to the general public in Japan that they provide legal consultations.[191] They may only hold themselves out to the general public as engaging in activities for which no license is required. However, there is nothing prohibiting American lawyers who are consultants in Japan from informing the American public in the United States of their availability in Japan through advertisement in a legal newspaper or directory published in the United States since the activities they

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[185] *See supra* text accompanying note 158.

[186] *See supra* text accompanying notes 77-80.

[187] *See supra* text accompanying note 81.

[188] *See supra* note 162.

[189] *See supra* note 70.

[190] That is prohibited by article 74 of the Bengoshi Act which provides:

> 1. A person who is not a *bengoshi* shall not represent or make publication that he is a *bengoshi* or that his office is a *horitsu jimusho* [law office].
>
> 2. A person who is not a *bengoshi* shall not, for the purpose of receiving profit, represent or make publication that he does legal consultations or does other legal services.

Id. (translation by author). The criminal penalty for violation of article 74 is provided in article 79 (fine of 50,000 yen).

[191] That is also prohibited by article 74. *See supra* note 190.

perform are traditionally provided by lawyers in the United States.[192] The advertisement or directory listing should of course clearly state that the consultant is not licensed to practice law in Japan and indicate the limited nature of the services provided.

Also, since article VIII only gives rights to American nationals and companies, American lawyers may not be engaged to give legal advice to Japanese or third-country nationals or to companies incorporated outside the United States. Subsidiaries incorporated in Japan of companies incorporated in the United States are not companies of the United States within the meaning of article XXII, paragraph 3 of the Treaty.[193] These subsidiaries are Japanese companies and do not have rights under article VIII, paragraph 1.[194] Therefore, American lawyers may not be engaged under the second sentence of article VIII, paragraph 1 by American-owned subsidiaries incorporated in Japan. The United States-incorporated home office or branch of the home office in Japan, however, may under that sentence engage the American lawyer "in connection with the planning and operation" of the subsidiary.[195] And Japanese domestic law does not prohibit the giving of legal advice to a Japanese national or company if the American lawyer is based outside Japan.[196]

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[192] Article 74 of the Bengoshi Act, a criminal statute, has no extraterritorial effect.

[193] Article XXII Paragraph 3 states:

> As used in the present Treaty, the term "companies" means corporations, partnerships, companies and other associations, whether or not with limited liability and whether or not for pecuniary profit. *Companies constituted under the applicable laws and regulations within the territories of either Party shall be deemed companies thereof and shall have their juridical status recognized within the territories of the other Party.*

4 U.S.T. at 2079-80 (emphasis added). In *Sumitomo*, the Supreme Court noted that: "Both the Ministry of Foreign Affairs of Japan and the United States Department of State agree that a United States corporation, even when wholly owned by a Japanese company, is not a company of Japan under the Treaty and is therefore not covered by Article VIII(1)." 457 U.S. at 183.

[194] *Sumitomo*, 457 U.S. at 188. Nonetheless, the Department of State continues to issue "treaty trader" visas under 22 C.F.R. § 41.40 and "treaty investor" visas under 22 C.F.R. § 41.41 to employees from treaty nation countries, including Japan, if the employer is "an organization which is principally owned by a person or persons having the nationality of the treaty country. . . ." 22 C.F.R. § 41.40(a)(2) (1984); 22 C.F.R. § 40.41(a)(3) (1984); C. GORDON & H. ROSENFIELD, IMMIGRATION LAW AND PROCEDURE, 6 Foreign Affairs Manual § 41.40, note 8 states that: "The nationality of a firm is determined for the purposes of section 101(a)(15)(E) by the nationality of those persons who own the principal amount (i.e. more than 50 percent) of the stock of that corporation, *regardless of the place of incorporation.*" *Id.* (emphasis added). In addition, 6 Foreign Affairs Manual § 40.40, note 5 makes 9 Foreign Affairs Manual § 40.40, note 8 applicable to "treaty investors." Thus a Japanese *bengoshi* would be entitled to give legal advice to a Japanese-owned subsidiary incorporated in the United States, but an American lawyer cannot give legal advice to an American-owned subsidiary incorporated in Japan. *See* Shimazaki, *supra* note 3, at 34-36.

[195] *See* FCN Treaty, art. VIII(1), 4 U.S.T. at 2070; Fukuhara, *Status*, *supra* note 3, at 34-35.

[196] *See* Position Paper, *supra* note 22, at 8.

There is also nothing that prohibits American consultants based in Japan from working closely with Japanese *bengoshi* and American lawyers based outside Japan. An American consultant can coordinate with *bengoshi* to provide legal advice to Japanese clients,[197] may allow an American lawyer based outside Japan to use the consultant's offices on a temporary basis, and may even be a partner with an American lawyer in the United States. The firm name in Japan may be similar to the firm name in the United States.[198] There must, however, be a clear separation of business cards and letterheads.[199]

Nichibenren's concern that American lawyer/consultants will not limit their advice to Japanese clients to trade facilitation[200] are unfounded. The possibility of criminal prosecution under article 72 and 74 of the Bengoshi Act and disciplinary action in the lawyer's home jurisdiction for the unauthorized practice of law are sufficient deterrents. American lawyer/consultants need merely to channel their advice to Japanese clients through *bengoshi*. Working together, Japanese *bengoshi* and American lawyers can provide comprehensive legal analysis of all aspects of an international legal problem and better serve the Japanese client with American law needs.

VII. CONCLUSION

An immediate recognition by the Government of Japan that the FCN Treaty and existing Japanese law allow American lawyers to open trade facilitation offices in Japan and allow such consultants to provide legal services to American clients would be a step toward resolving the trade problems between Japan and the United States. It would substantially aid export to and investment in Japan by American business as well as American perception of Japan as an open market. In addition, it would be an important symbol that Japan is willing to accommodate American business institutions although they differ in form from Japanese business institutions[201] and that Japan welcomes the presence of

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[197] Giving legal advice to a *bengoshi* does not violate Bengoshi Act article 72. *See* Position Paper, *supra* note 22, at 8.

[198] Article X of the FCN Treaty protects the use of trade names:

> Nationals and companies of either Party shall be accorded, within the territories of the other Party, national treatment and most-favored-nation treatment with respect to obtaining and maintaining patents of invention, and with respect to rights in trade marks, trade names, trade labels and industrial property of every kind.

4 U.S.T. at 2071.

[199] The letterhead and business cards for the Japan office may not say "attorney-at-law" since that would violate article 74 of the Bengoshi Act. *See supra* note 190.

[200] *See supra* note 70.

[201] "Essential to the future of U.S.-Japan relations is a mutual acceptance of the right to be different." Ogasawara, *Varied Approaches of U.S. Politicians, Japanese Bureaucrats Kindle Friction*, Japan Times, May 13, 1984, at 1, col. 1 (Ogasawara is president of the Japan Times.).

Americans in Japan who are familiar with the Japanese language and culture. By recognizing the FCN Treaty as the code by which commercial relations with the United States should be guided, it will help Japan better understand the United States.

The establishment of an appropriate regulatory framework to enable American lawyers to give legal advice on American law in Japan is consistent with protection of Japanese consumers of legal services. Once American nationals and companies in Japan have access to American lawyers, there will undoubtedly be strong interest expressed by Japanese nationals and companies in receiving immediate access to American lawyers as well. It can be expected that the Japanese government, business, and regulated legal professions, with input from the United States Government, could cooperate to establish an appropriate regulatory framework for the licensing of American lawyers to advise on American law in Japan.

A Comment on *Lawyers as Treaty Traders*

by Hiroshi Itoh**

Richard Kanter presents strong legal arguments concerning the ongoing controversy over whether American lawyers should be allowed to establish their offices in Japan. Primarily based on his extensive analyses of over 3000 pages of recently declassified State Department documents, he argues that American attorneys have a treaty right to perform their legal work as international trade facilitators in Japan. In his view, American attorneys are entitled to enter Japan and stay there indefinitely not only as in-house consultants of American nationals or companies but also as independent trade facilitators. He construes articles I(1), VII(1), and XXII(1) of the United States-Japan Treaty of Friendship, Commerce and Navigation (FCN Treaty) to confer upon American attorneys the right to establish trade facilitation offices to provide business representation and all other unregulated business services such as those provided by Japanese trading companies to their customers. Further, he urges the Japanese government to create a regulatory machinery which would enable American lawyers in Japan to advise American clients in Japan on Japanese laws and Japanese clients on American laws.

Some of Mr. Kanter's major contentions are not very convincing, despite his extensive review of the treaty-making process in question. Mr. Kanter rightly states that the word "attorneys" in the first sentence of article VIII(1) of the FCN Treaty cannot be construed to refer only to Japanese *bengoshi* or attorneys. As he contends, the word should be interpreted to include American attorneys as well so that American nationals or companies in Japan might be able to engage American attorneys for their internal purposes. The negotiating history of the FCN Treaty, however, as presented by Mr. Kanter, does not fully explain why the words "executive personnel, attorneys, agents, and other specialists" were omitted in the second sentence of article VIII(1). Therefore, the Nichibenren (the Japan Federation of Bar Associations) is justified in its assertion that only "accountants and other technical experts," but not attorneys

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should be allowed to render examination, investigations and reports on behalf of American nationals or companies without Japanese licenses.

The history of article VIII(2) which Mr. Kanter relies upon is also not persuasive. This paragraph should be construed to allow American attorneys to practice law in Japan provided they have met the Japanese licensing requirements, as has been the case with a small number of American attorneys who have been licensed to practice law in Japan, as Mr. Kanter notes. Under article VIII(1) and (2), American nationals or companies are entitled to bring American attorneys to Japan as their "executives" or "agents" for special projects related to their international trade and investment activities and engage them for internal purposes that do not require a Japanese *bengoshi* license. A stay of such an attorney in Japan, however, is subject to the length of the special project and is not indefinite.

The national treatment provision in article VII(1) does open a possibility for American attorneys to establish themselves in Japan and stay there for an indefinite period of time, not as retainees of American nationals or companies, but as independent international trade and business consultants for which no *bengoshi* license is required. Article VII(1) does not grant American attorneys the right to practice law in Japan. It recognizes the right to engage in activities designed to facilitate international trade and business to the same extent as Japanese non-*bengoshi* who perform in international trade and business.

The Nichibenren's 1972 *Guidelines Concerning the Provision of the Unauthorized Practice of Law by Foreigners* do not violate article VIII(1) of the FCN Treaty because they do not prevent American attorneys recognized under former article 7 of the Bengoshi Act from practicing American law in Japan. As Mr. Kanter argues, however, the guidelines seem to violate the national treatment provisions of article VII(1) by prohibiting American attorneys from drafting contracts and engaging in other forms of international trade and business facilitation. These activities are open to Japanese nationals, such as employees of trading or manufacturing companies, who perform law-related activities without a *bengoshi* license. The trade facilitation activities of the Japanese non-*bengoshi* may or may not be "other ordinary legal work," within the scope of article 3(1) of the Bengoshi Act but are apparently outside the scope of articles 72 and 74 therein. Thus, Mr. Kanter is correct when he asserts that American attorneys are not prohibited from performing "ordinary legal work" as international trade facilitators unless such legal work is actually a legal "case" or has the potential of becoming one.

As far as the Japanese government is concerned, the question of allowing American attorneys to practice in Japan had for a long time had been purely a legal issue, and the government had left the matter to the Nichibenren. The lawyers' guild had insisted that foreign lawyers pass the same bar examinations as Japanese lawyers. Since it is virtually impossible for foreign attorneys to pass

them, some American attorneys have tied this legal issue to the economic issue of mounting trade deficits and have pushed for "liberalization" of legal services.

Opposition to licensing foreign attorneys in Japan has been rooted in cultural ethnocentrism rather than economic determinism. As Mr. Kanter points out, only about 350 out of the 12,000 Japanese attorneys or *bengoshi* offer international trade facilitation services, and unlicensed employees of Japanese companies perform most legal work in international trade or investment. Therefore, the adverse impact of licensing American attorneys in Japan upon Japanese *bengoshi* would be negligible. To the average Japanese *bengoshi*, American attorneys in Japan who do not have enough knowledge of Japanese law should not be allowed to advise their clients in Japan, either American or Japanese, on Japanese contract and tort law and other legal regulations related to international trade or investment unless they pass the Japanese bar examinations.[1]

The "ordinary legal work" of the United States-Japan trade often requires knowledge of American, Japanese, and international law. American attorneys in Japan who are qualified to give advice on American and international law may not be qualified or licensed to advise on Japanese law. Mr. Kanter does not clearly distinguish in each specific instance the trade facilitation function performed by American attorneys from the strictly legal function of American attorneys in Japan. He seems to imply that American attorneys in Japan should be allowed to perform any legal work involved in international trade facilitation so long as such legal work is not prohibited in the Bengoshi Act. If this is his meaning, such interpretation would go beyond his own main contention that American attorneys should be allowed to enter Japan to conduct the same kind of legal and non-legal work which unlicensed employees of Japanese companies have traditionally been performing.

Finally, the FCN Treaty is not a self-executing treaty. It requires domestic legislation in Japan to implement the rights and obligations agreed upon in this treaty. In this sense, the alleged treaty rights of American attorneys to enter Japan for business purposes depend upon specific legislation by the Japanese Diet. Under strong pressure from the United States government which responded to growing lobbyist activities of a small number of influential American lawyers, the Japanese government began to cave in and asked the Nichibenren to open Japan's door to foreign lawyers by waiving bar exam requirements in certain cases. The Nichibenren may agree to allow American attorneys in Japan to advise American nationals or companies on American laws,

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[1] A similar cultural ethnocentrism manifests itself in the attitude among Japanese education bureaucrats. The Ministry of Education does not recognize a high school diploma from overseas for the purpose of going on to a higher education. A Japanese graduate of an American high school, for instance, must pass an extremely difficult qualifying examination before even applying for entrance examinations to Japanese universities or colleges.

but prohibit them from giving clients, regardless of nationality, any advice on Japanese laws and from employing or forming partnerships with Japanese lawyers. Even this would be a slight opening of the tightly closed door to the Japanese lawyers' guild.

Hawaii's 1985 Corporate Take-over Legislation: Is It Constitutional?

by Michael A. Cane* and Russell A. Taussig**

I. Introduction

General tender offers to security holders have been common in the United States since the turn of the century. It was not until the merger and acquisition boom of the 1960's, however, that such offers began to be commonly made without the consent of incumbent management.[1] The growth of "unfriendly" take-over bids, which has persisted since the 1960's, rocketed upward in the 1980's.[2] This acceleration can be explained by a number of factors not the least of which is the more tolerant attitude toward such acquisitions currently exhibited by the investment community and lawmakers.[3] Other important factors

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[1] *See* Langevoort, *State Tender-Offer Legislation: Interests, Effects, and Political Competency*, 62 CORNELL L. REV. 213, 214 (1977); Note, *The Unsung Death of State Take-over Statutes:* Edgar v. MITE Corp., 24 B.C.L. REV. 1017 (1983).

[2] Hawaiian companies have not been left out of the take-over excitement. *See, e.g., States Give Take-over Targets More Places to Hide*, BUS. WK., Feb. 11, 1985, at 26 (take-over attempt of Castle & Cooke by Minneapolis investor Irwin Jacobs and others). Castle & Cooke also had problems in the recent past from other take-over offerors, as have a number of other Hawaiian companies, including Alexander & Baldwin and International Savings. The repeal of the Hawaii Takeover Bids Act and replacement of it with new legislation in 1985 was an apparent attempt to protect Castle & Cooke which was in the midst of a take-over fight. *See* Block, Barton & Roth, *State Takeover Statutes: "The Second Generation,"* 13 SEC. REG. L.J. 332, 333 (1986).

[3] *See infra* text accompanying notes 96-133. Some commentators have even labeled the Securities and Exchange Commission (SEC) as "pro-take-over." *See, e.g.,* Boehm, *State Interests and Interstate Commerce: A Look at the Theoretical Underpinnings of Take-over Legislation*, 36 WASH. & LEE L. REV. 733, 735 (1979) (The growth of the arbitrage industry, sophisticated offeror strategies, and the current legal climate make a number of large corporations vulnerable to take-over bids.).

include the advent of new bidder weapons,[4] and several "pro-takeover" court decisions.

Perhaps even more important in fueling the current United States take-over activity is the fact that such bids are often very profitable even when technically unsuccessful. Take-over bidders who have been stopped short of taking over their targets have often reaped substantial rewards from their activities by either selling their stock on the open market at an increased price or agreeing with the target company's management to abandon the take-over in exchange for a premium on the shares acquired.[5]

The general pattern of events for a take-over bid is deceptively simple.[6] A bidder makes an offer to current shareholders of a company to buy some or all of their shares, usually for more than the current market price.[7] The bidder generally alleges inefficiencies in the operation and management of the company and announces that existing management will be replaced after the take-over.[8]

In response to the tender offer, management of the target company scrambles for a defensive tactic to repel the invader, and, in a relatively new defensive ploy, state administrative authorities may be petitioned to enforce state laws purportedly enacted to protect shareholders of target companies. The results are not always predictable, but the battle itself is almost certain to be costly.[9] In

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[4] These weapons and counterweapons include such colorfully named maneuvers as Pac Man, White Knight, Shark Repellant, Teddy Bear Pats, Bear Hugs and the Poison Pill. *See* Goldberg, *Regulation of Hostile Tender Offers: A Dissenting View and Recommended Reforms*, 43 MD. L. REV. 225, 237-39 (1984); Prentice, *Target Board Abuse of Defensive Tactics: Can Federal Law Be Mobilized to Overcome the Business Judgment Rule?*, 8 J. CORP. L. 337, 339-43 (1983).

[5] This type of payment is generally referred to as "greenmail." *More Places to Hide*, *supra* note 2, at 26.

[6] For a discussion of the mechanics of a take-over bid, see Fleischer & Mundheim, *Corporate Acquisitions by Tender Offer*, 115 U. PA. L. REV. 317 (1967); Hayes & Taussig, *Tactics of Cash Take-over Bids*, HARV. BUS. REV., Mar.-Apr. 1967, at 135.

[7] This is commonly referred to as a tender offer. The words "tender offer" and "take-over bid" are often used interchangeably. The working definition of a tender offer is a "public offer or solicitation by a company, an individual or a group of persons to purchase during a fixed period of time all or a portion of a class or classes of securities of a publicly held corporation at a specified price or upon specified terms for cash [cash tender offer] and/or securities [exchange offer]." E. ARANOW & H. EINHORN, TENDER OFFERS FOR CORPORATE CONTROL 76 (1973).

[8] *See, e.g., More Places to Hide*, *supra* note 2.

[9] For commentators expressing concern over the costs involved in the tender offer process, *see, e.g.*, Liman, *Has the Tender Movement Gone Too Far?*, 23 N.Y.L. SCH. L. REV. 687, 689 (1978) ("The [take-over] movement is threatening the efficient allocation of economic resources and the social and economic pluralism that has characterized our development."); Note, Corenco v. Schiavone: *The Cash Tender Offeror as Corporate Raider*, 26 ME. L. REV. 93, 103-04 (1974). Management usually claims that the bid is insufficient and that the raiders will damage the company by liquidating its assets, and by alleging that the bid is insufficient. *See id.* For a commentary on how tender offers divert resources away from their highest and best use, see Williams, *Frenzy and Style in the Merger Boom*, N.Y. Times, Jan. 15, 1984, § 3, at 1, col. 3.

addition, arbitrageurs, speculators expecting to make a profit because of the resulting higher stock prices and not bound by federal or state disclosure laws, buy the stock and hold it for resale.[10]

In the middle of take-over battles are federal and state regulators, devising and attempting to apply rules to a very unruly game. Congress set down its rules in a 1968 amendment to the Securities and Exchange Act of 1934, popularly known as the Williams Act.[11] This Act generally requires, among other things, full and fair disclosure by the offeror.[12] State legislatures have also responded, but generally with more restrictive rules.[13] The justification given for this state involvement is the protection of local shareholders; however, many courts find that the true motivation behind most of these statutes is the state's interest in protecting local business from outside intrusion.[14] These relatively new, more restrictive, state laws raise questions of federalism, as well as economic democracy and social justice—issues which promise to be among the most hotly debated topics of the 1980's.[15] Through their delay provisions, the state laws provide incumbent management with a powerful weapon for the defeat of take-over bids.[16]

As a consequence of state take-over legislation, tender offer litigation is on

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[10] *Id.* Arbitrageurs are not bound by disclosure laws unless they fall under relevant definitional sections.

[11] The Williams Act, Pub. L. No. 90-439, 82 Stat. 454 (codified as amended at 15 U.S.C. §§ 78m(d)-(e), 78n(d)-(f) (1982)).

[12] *See* 15 U.S.C. § 78m(d) (1982).

[13] State take-over legislation originated in Virginia in 1968. *See* VA. CODE § 13.1-528 (1985). The Hawaii statute dates from 1974 (HAWAII REV. STAT. ch. 417E); it was repealed in July 1985 when a revision was enacted. Delaware and New York enacted take-over laws in 1976; most of the other states followed thereafter.

[14] *See, e.g.*, Edgar v. MITE Corp., 457 U.S. 624, 637-38 (1982) (Delay is the most potent weapon incumbent management has in tender offer fights.).

[15] *See generally* Gibson, *Fundamental Law for Take-overs*, 39 BUS. LAW. 1551 (1984). *Compare* Boehm, *supra* note 3, at 734-38 (The jurisdictional variations of state take-over statutes may lead to the possibility that the take-over of a single corporation could be subject to regulation by several states. This duplicative and burdensome state interference with essentially a national transaction conflicts with the Williams Act which arguably pre-empts state take-over legislation.) *and* McCauliff, *Federalism and the Constitutionality of State Takeover Statutes*, 67 VA. L. REV. 295, 313 (1981) ("[T]akeovers have become a significant factor in the American economy," raising constitutional issues by the attempt to "resolve legislative policy questions indirectly.") *with* Langevoort, *supra* note 1, at 257 (State tender offer statutes frustrate federal policies and "contravene the Constitution. . . .[O]nly the federal government is politically competent to regulate those takeover bids having a major impact on the national economy.") *and* Wilner & Landy, *The Tender Trap: State Takeover Statutes and Their Constitutionality*, 45 FORDHAM L. REV. 1 (1976) (Under the supremacy clause and the pre-emption doctrine state take-over statutes which directly clash with the Williams Act must give way to the uniform national system of regulating tender offers.).

[16] *See MITE*, 457 U.S. at 635.

the rise.[17] The key question in such litigation is the constitutionality of the state law.[18] The holding in each case unfortunately is applicable only to the particular state act in question. This contributes to the rising tide of litigation by making it necessary to challenge each state act separately.[19]

In the next section, we review the major federal case law concerning state take-over legislation, with particular reference to the constitutional issues involved. Then, in view of the new and unique features of the 1985 Hawaii Corporate Take-over Act and Control Share Acquisitions Act, and of the relative paucity of judicial commentary and dictum regarding similar acts, we analyze, critique, and consider their constitutionality. We conclude with some comments on the direction of state take-over legislation.

II. FEDERAL CONSTITUTIONAL LAW

We start our inquiry into the constitutionality of the Hawaii acts by examining two key provisions of the United States Constitution—the commerce[20] and the supremacy clauses.[21] The commerce clause is the source of most of the federal government's authority over business, and to some extent, a restriction on the states' authority in this area.[22] Under the supremacy clause, properly passed and authorized federal acts are supreme over conflicting state and local laws. These two constitutional provisions are the focal point when courts are faced with challenges to the constitutionality of state take-over acts.[23]

A. *Commerce Clause Restrictions on State Legislation*

The commerce clause gives Congress authority to regulate interstate com-

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[17] *See generally More Places to Hide*, *supra* note 2, at 26 (tender offer litigation in Hawaii and Minnesota).

[18] For articles arguing in favor of the constitutionality of state take-over statutes, see Boehm, *supra* note 3; McCauliff, *supra* note 15. For articles arguing against the constitutionality of state take-over statutes, see Langevoort, *supra* note 1; Wilner & Landy, *supra* note 15.

[19] *See MITE*, 457 U.S. at 643-46. *See also infra* notes 95-133 and accompanying text.

[20] "Congress shall have the power to . . . regulate commerce . . . among the several states. . . ." U.S. CONST. art. I, § 8, cl. 3.

[21] "This Constitution and the laws of the United States which shall be made in pursuance thereof. . .shall be the supreme law of the land. . .anything in the Constitution or law of any state to the contrary not withstanding." U.S. CONST. art. VI, § 2.

[22] Great Atl. & Pac. Tea Co. v. Cottrell, 424 U.S. 366, 370-71 (1976); Great W. United Corp. v. Kidwell, 577 F.2d 1256 (5th Cir. 1978), *rev'd on venue grounds sub nom.* Leroy v. Great W. United Corp., 443 U.S. 173 (1979). *See also* B. FISHER & M. PHILLIPS, THE LEGAL ENVIRONMENT OF BUSINESS 131-33 (1983).

[23] *See, e.g., MITE*, 457 U.S. 624; National City Lines, Inc. v. LLC Corp., 687 F.2d 1122 (8th Cir. 1982); *Kidwell*, 577 F.2d 1256.

merce and activities which "affect" interstate commerce.[24] It has also been the basis for prohibiting state and federal governments from interfering with interstate commerce even if Congress has not enacted legislation in a given area.[25]

Because most business has some "effect" on interstate commerce, the courts have required more than a mere "effect" to invoke the protection of the commerce clause.[26] "Incidental" regulation by state and local legislatures is expected and acceptable, so long as it regulates "even-handedly to effectuate a legitimate local public interest"[27] and does not unduly burden interstate commerce.[28] "Direct" regulation, however, is strictly forbidden.[29]

Courts have utilized a two-part test for dealing with commerce clause challenges to state take-over legislation.[30] The state law is first examined to see whether it causes a direct or incidental restraint on interstate commerce. If it directly regulates or prevents interstate transfers or transactions, it will be held unconstitutional, no matter how strong or substantial the state interest.[31]

Courts look to the extraterritorial effect of the state law to determine whether the effect on interstate commerce is direct. In *Southern Pacific Co. v. Arizona*,[32] the United States Supreme Court struck down an Arizona law when the "practical effect [was]. . .to control [conduct] beyond the boundaries of the State."[33] The Court focused on the extraterritorial effect of the statute, making it clear that attempts by a state to control activities beyond its boundaries are invalid under the commerce clause.

If a court determines that a state law is not a "direct" regulation of interstate commerce, it then applies the second part of the test to determine whether the

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[24] *See, e.g.*, McLain v. Real Estate Bd., 444 U.S. 232, 241 (1980) ("The broad authority of Congress under the Commerce Clause has, of course, long been interpreted to extend beyond activities actually *in* interstate commerce to reach other activities that, while wholly local in nature, nevertheless substantially *affect* interstate commerce.") (emphasis original).

[25] *See MITE*, 457 U.S. at 640; Shaffer v. Heitner, 433 U.S. 186 (1977); Southern Pac. Co. v. Arizona, 325 U.S. 761 (1945); *Kidwell*, 577 F.2d 1256; Empire, Inc. v. Ashcroft, 524 F. Supp. 898 (W.D. Mo. 1981).

[26] *See, e.g., MITE*, 457 U.S. at 640 ("The Commerce Clause, however, permits only *incidental* regulation of interstate commerce by the States; direct regulation is forbidded.") (emphasis original); *Kidwell*, 577 F.2d at 1281 ("[N]ot every exercise of state power with some impact on interstate commerce is invalid.").

[27] *MITE*, 457 U.S. at 640 (quoting Pike v. Bruce Church, Inc., 397 U.S. 137, 142 (1970)).

[28] *See, e.g., id.*; Philadelphia v. New Jersey, 437 U.S. 617, 624 (1978); *Kidwell*, 577 F.2d 1256.

[29] Shafer v. Farmers Grain Co., 268 U.S. 189, 199 (1925).

[30] *See, e.g., National City Lines*, 687 F.2d at 1128; MITE Corp. v. Dixon, 633 F.2d 486, 490 (7th Cir. 1980), *aff'd sub nom.* Edgar v. MITE, 457 U.S. 624 (1982); *Kidwell*, 577 F.2d at 1274. *See also* Kennecott Corp. v. Smith, 507 F. Supp. 1206, 1223 (D.N.J. 1981).

[31] *MITE*, 457 U.S. at 640.

[32] 325 U.S. 761 (1945).

[33] *Id.* at 775.

state has set up its regulation in an even-handed manner to effectuate a legitimate state interest.[34] This requires an inquiry into the reasons for the legislation and an evaluation of the state interest. If the court finds a legitimate state interest, it then applies a balancing test, weighing benefits to the state against burdens placed upon interstate commerce.[35] If the burdens outweigh the benefits, the law is unconstitutional.

Finding, measuring, and weighing the benefits and burdens of a state act is more complicated than determining whether the effect is direct or indirect. It requires consideration of the facts and circumstances of the particular state statute, including, but not limited to (1) the extent of its extraterritorial effects;[36] (2) the harm to interstate activities;[37] (3) the purposes and legitimate interests of the state in passing the legislation;[38] (4) the extent to which the statute actually supports these purposes and interests;[39] and (5) the alternatives available to the state for achieving its legitimate ends.[40]

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[34] *See* authorities cited *supra* note 30. *See also* Philadelphia v. New Jersey, 437 U.S. 617, 624 (1978); Pike v. Bruce Church, Inc., 397 U.S. 137.

[35] *See, e.g., MITE,* 457 U.S. at 643; Mesa Petroleum Co. v. Cities Servs. Co., 715 F.2d 1425 (10th Cir. 1983); Empire, Inc. v. Ashcroft, 524 F. Supp. 898.

[36] In cases involving state take-over laws, this extraterritorial effect is usually measured by the statutory provisions defining the companies. *See, e.g., Ashcroft,* 524 F. Supp. at 904 (regulating corporations incorporated under the state's laws, or with principal executive offices, places of business, or substantial assets within the state).

[37] *See MITE,* 457 U.S. 624 (State take-over laws deprive shareholders of the opportunity to sell their shares, hinder the re-allocation of resources to their highest and best use, and reduce management's incentive to perform well and keep stock prices high.); *Ashcroft,* 524 F. Supp. at 904 (setting forth the argument that state take-over laws disrupt trading on national security markets). The harm to interstate commerce is often measured, in a specific case, by the actual amount of money in the tender offer. *See, e.g., Kidwell,* 577 F.2d at 1284 ("That action [delaying the proposed tender offer] in itself not only had a substantial impact on interstate commerce, it *stopped* over 31 million dollars of interstate commerce.") (emphasis original); *Kennecott,* 507 F. Supp. at 1224. *See also* Note, *The Unsung Death, supra* note 1, at 1034 ("Lower court decisions consistently. . .[rely upon] the dollar value of the tender offer as a barometer of state interference with interstate commerce.").

[38] States usually justify take-over legislation first by claiming it is for the protection of shareholders, then follow with a number of other justifications. *See, e.g., MITE,* 457 U.S. at 644. *See also* Note, *The Unsung Death, supra* note 1, at 1025 (analogy to protection of blue sky laws).

[39] Courts carefully examine whether the statute is tailored to achieve the avowed state interest. In considering Illinois' argument about protecting shareholders, the *MITE* Court noted that a statutory provision which exempted a corporation's tender offer for its own shares was contrary to the avowed purpose. 457 U.S. at 644.

[40] Courts often compare alternatives to determine whether the state has chosen the least restrictive alternative. *See, e.g., Kidwell,* 577 F.2d at 1277.

B. *Supremacy Clause Restrictions on State Take-Over Legislation: The Williams Act*

State statutes which conflict with validly enacted federal laws are unconstitutional under the supremacy clause.[41] Conflicts occur when (1) compliance with both federal and state statutes (or regulations thereunder) is impossible, or (2) a state law is an obstacle to the attainment of the objectives of Congress.[42]

In 1968, Congress enacted the Williams Act as an amendment to the Securities Exchange Act of 1934.[43] The purpose of this Act was to regulate corporate control contests involving cash tender offers.[44] Prior to the Williams Act, a contender for control of a company could circumvent the disclosure requirements of the proxy rules contained in the 1934 Act by making a cash tender offer rather than a proxy solicitation.[45] The Williams Act created requirements for cash tender offers similar to those already in force for proxy battles.[46]

The Williams Act, however, requires the offeror to do more than just file a detailed disclosure with the Securities and Exchange Commission (SEC) and provide copies of this disclosure to the target company and its shareholders.[47] It requires the offeror to give tendering stockholders the right to withdraw their shares during the first seven days of the tender offer and after sixty days if the shares have not yet been purchased.[48] It also requires the offeror to purchase all

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[41] *See, e.g., Kidwell*, 577 F.2d at 1274-75; *Kennecott*, 507 F. Supp. at 1223.

[42] *See, e.g., MITE*, 457 U.S. at 631; Jones v. Rath Packing Co., 430 U.S. 519, 526, *reh'g denied*, 431 U.S. 925 (1977); Florida Lime & Avocado Growers, Inc. v. Paul, 373 U.S. 132, 142-43 (1963). *See also* Burbank v. Lockheed Air Terminal, Inc., 411 U.S. 624 (1973) (possible conflict if Congress intends by its statutory scheme to pre-empt the regulatory area or expressly prohibits state enactments). Section 28(a) of the Securities and Exchange Act of 1934 provides in part: "Nothing in this title shall affect the jurisdiction of the securities commission (or any agency or officer performing like functions) of any state over any security or any person insofar as it does not conflict with the provisions of this title or the rules and regulations thereunder." 15 U.S.C. § 78bb(a) (1982).

[43] 15 U.S.C. §§ 78*l*(i), 78m(d)-(e), 78n(d)-(f) (1982).

[44] H.R. REP. NO. 1711, 90th Cong., 2d Sess. 1, *reprinted in* 1968 U.S. CODE CONG. & AD. NEWS 2811.

[45] *See, e.g.*, Piper v. Chris-Craft Indus., Inc., 430 U.S. 1, 22, *reh'g denied*, 430 U.S. 976 (1977).

[46] *See, e.g., MITE*, 457 U.S. at 633; *Piper*, 430 U.S. at 35; S. REP. NO. 550, 90th Cong., 1st Sess. 3-4 (1967). *See* Langevoort, *supra* note 1, at 214. For a discussion of the legislative history of the Act, see Note, *Cash Tender Offers*, 83 HARV. L. REV. 377 (1969).

[47] 15 U.S.C. § 78n(d)(1) (1982). A disclosure statement must include, among other things, the background and identity of the offeror; the source of the funds he intends to use in making the purchases; the purpose of the purchase, including any plans to liquidate or make major changes in the corporation's structure; and the extent of the offeror's holdings in the target company. *Id.* § 78m(d)(1).

[48] *Id.* § 78n(d)(5).

shares tendered at the same price, and, if the offering price is increased, those shareholders who have already tendered must be paid the higher price.[49]

The Williams Act does not, by its terms, expressly prohibit states from regulating take-overs. Indeed, Congress specifically recognized state regulation over securities in the 1934 Act, "insofar as it does not conflict."[50] It seems to be well accepted that Congress, in drafting the Act, intended to take a neutral stand in battles between incumbent management and the offeror.[51] Although initial proposals more strongly favored management,[52] Congress finally opted for a neutral approach based on full disclosure. Congress intended that shareholders decide whether to tender after being given full and fair disclosure.[53] This is sometimes referred to as the "market" approach to take-over legislation as distinguished from the "fiduciary" approach implicit in many state statutes.[54]

In sum then, there is no question that a conflict between a state take-over statute and the Williams Act would result in the state law being held unconstitutional under the supremacy clause. The question is whether there is a conflict either because an offeror cannot comply with both federal and state statutes or because the state law stands as an obstacle to the accomplishment of congressional objectives.

C. *Court Rulings on Constitutional Challenges to State Take-over Laws*

Offerors have challenged the constitutionality of state take-over acts in a number of recent cases which generally have involved an offeror that has com-

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[49] *Id.* § 78n(d)(7).

[50] Securities Exchange Act of 1934, § 28(a), 15 U.S.C. § 78bb(a) (1982). There is no evidence, however, that Congress was aware of state take-over laws when it enacted the Williams Act, and therefore it probably did not consider such a possibility when passing the Act in 1968. *See MITE*, 457 U.S. at 631 n.6.

[51] This policy of neutrality was reflected in the House Report: "The bill avoids tipping the balance of regulation either in favor of management or in favor of the person making the takeover bid." H.R. REP. NO. 1711, 90th Cong., 2d Sess. 1, *reprinted in* 1968 U.S. CODE CONG. & AD. NEWS 2811, 2813. *See also Piper*, 430 U.S. at 2; S. REP. NO. 550, 90th Cong., 1st Sess. 3 (1967); 113 CONG. REC. 24,664 (1967) (Senator Williams explained "[w]e have taken extreme care to avoid tipping the scales either in favor of management or in favor of the person making the takeover bids.").

[52] The original bill to amend the Securities and Exchange Act of 1934, S. 2731, 89th Cong., 1st Sess. (1965), sought to protect investors by making it difficult for tender offers to succeed. *See Piper*, 430 U.S. at 30. Senate Bill 2731 would have subjected tender offerors to the reporting and short swing profit liability of § 16 of the 1934 Act; it also included advance disclosure requirements and filings. *See* 111 CONG. REC. 28,257-59 (1965).

[53] *MITE*, 457 U.S. at 633-34; *Kidwell*, 577 F.2d at 1268-69.

[54] *See, e.g.*, *National City Lines*, 687 F.2d at 1129; Kennecott Corp. v. Smith, 637 F.2d 181, 188-89 (3d Cir. 1980); *Kidwell*, 577 F.2d at 1268.

plied with federal law but has intentionally not complied with state requirements.[55] Courts handling such cases are generally faced with both pre-emption and commerce clause challenges.[56] In most cases, courts have held state laws unconstitutional and issued injunctions against their enforcement.[57]

The United States Supreme Court faced these issues directly for the first and only time in *Edgar v. MITE Corp.*[58] In *MITE*, following the reasoning of the lower court, the Court held the Illinois take-over statute unconstitutional. Because of a division on the issue of mootness, the Supreme Court did not render a majority opinion on the issue of pre-emption and gave a less than sweeping condemnation of the state law on the commerce clause issue.[59] A closer look at *MITE* and related cases will be helpful in our constitutional analysis of the Hawaii law.

1. Edgar v. MITE Corp.

Early in 1979, after complying with the Williams Act, MITE Corporation made a cash tender offer for all outstanding shares of Chicago Rivet and Machine Company, a publicly held Illinois corporation.[60] MITE, however, did not comply with the Illinois take-over statute. Instead, it brought an action in federal district court asking for a declaratory judgment that the Illinois statute was pre-empted by the Williams Act and/or violated the commerce clause.[61] It also

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[55] *See, e.g.*, *Mesa Petroleum*, 715 F.2d 1425; Bendix Corp. v. Martin-Marietta Corp., 547 F. Supp. 522 (D. Md. 1982); Esmark, Inc. v. Strode, 639 S.W.2d 768 (Ky. 1982).

[56] *See, e.g.*, *MITE*, 457 U.S. 624.

[57] *See, e.g.*, *Mesa Petroleum*, 715 F.2d 1425; Telvest, Inc. v. Bradshaw, 697 F.2d 576 (4th Cir. 1983); Martin-Marietta Corp. v. Bendix Corp., 690 F.2d at 565; *National City Lines*, 687 F.2d at 1133; *Kennecott*, 637 F.2d 181; *Kidwell*, 577 F.2d 1256; APL Ltd. Partnership v. Van Dusen Air, Inc., 622 F. Supp. 1216 (D. Minn. 1985); Icahn v. Blunt, 612 F. Supp. 1400 (W.D. Mo. 1985); Gunter v. AGO Int'l B.V., 533 F. Supp. 86 (N.D. Fla. 1981); Natomas Co. v. Bryan, 512 F. Supp. 191 (D. Nev. 1981); Crane Co. v. Lam, 509 F. Supp. 782 (E.D. Pa. 1981); Brascan Ltd. v. Lassiter, [1981-1982 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 98,247 (E.D. La. Apr. 30, 1979); Dart Indus. v. Conrad, 462 F. Supp. 1 (S.D. Ind. 1978). *But see* Cardiff Acquisitions, Inc. v. Hatch, 751 F.2d 906 (8th Cir. 1984); Agency Rent-A-Car, Inc. v. Connolly, 686 F.2d 1029 (5th Cir. 1982); AMCA Int'l v. Krouse, 482 F. Supp. 929 (S.D. Ohio 1979); City Investing Co. v. Simcox, 476 F. Supp. 112 (S.D. Ind. 1979); Wylain, Inc. v. TRE Corp., 412 A.2d 338 (Del. Ch. 1979). Most of these cases, however, were pre-*MITE* and/or involved distinguishable provisions in the state law.

[58] 457 U.S. 624.

[59] The Court left this question open to an examination of each state law through a balancing of interests test. *Id.* at 643-46. For a broader view of this holding, see Note, *The Unsung Death*, *supra* note 1.

[60] *MITE*, 457 U.S. at 627-28. MITE offered $28 per share to shareholders of Chicago Rivet, approximately $4 over the prevailing market price. *Id.* at 628.

[61] *Id.* at 628. Chicago Rivet responded by bringing suit in Pennsylvania, where it conducted

asked for a preliminary injunction prohibiting the Illinois Secretary of State from enforcing the state law against its tender offer.[62]

The district court held that the Illinois Act was pre-empted by the Williams Act and violated the commerce clause.[63] The court issued a permanent injunction against enforcement of the Act. Shortly after this judgment MITE announced it would forego the take-over.[64] Nonetheless, the case was appealed by the Illinois Secretary of State, first to the United States Court of Appeals for the Seventh Circuit, which affirmed,[65] and then to the United States Supreme Court.

In a divided decision,[66] the Supreme Court affirmed the lower courts and held the Illinois Act unconstitutional.[67] Under a commerce clause balancing test, the court held that the Illinois law excessively burdened interstate commerce in relation to the state interest.[68]

a. *Pre-emption in* MITE

In a portion of his opinion which did not command a majority,[69] Justice White presented an analysis under which the Illinois Act would have been pre-

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most of its business, on the ground that the tender offer violated the Pennsylvania take-over law. PA. CONS. STAT. tit. 70, § 71 (Purdon Supp. 1982-83). When this action failed, it went back to the Illinois Secretary of State, who attempted to apply the Illinois Act. 457 U.S. at 628-29.

[62] 457 U.S. at 629. In an effort to stop the take-over after the preliminary injunction, Chicago Rivet made an offer of $30 per share for its own stock. *Id.* This offer was exempt from application of the Illinois take-over law. ILL. REV. STAT. ch. 121½, ¶ 137.52-9(4) (1979) (repealed 1983).

[63] 457 U.S. at 629.

[64] MITE and Chicago Rivet entered into an agreement whereby MITE could make its tender offer for $31 per share unobstructed by Chicago Rivet if it wanted after reviewing the company's books and records. After doing so, MITE decided to forego its take-over attempt. *Id.* at 629-30.

[65] MITE Corp. v. Dixon, 633 F.2d 486 (7th Cir. 1980), *aff'd sub nom.* Edgar v. MITE Corp., 457 U.S. 624 (1982).

[66] A majority joined in holding the Illinois statute unconstitutional. 457 U.S. at 643. Justices Marshall, Brennan, and Rehnquist dissented on grounds that the case was moot. Justice Powell agreed on the issue of mootness. "In view, however, of the decision of a majority of the Court to reach the merits," he joined in holding the statute unconstitutional. *Id.* at 646.

[67] Chief Justice Burger, and Justices White, Stevens, and O'Connor considered the Illinois law a direct regulation of interstate commerce. Justice Powell joined in holding that the law placed an undue burden on interstate commerce. In addition, Chief Justice Burger and Justices White and Blackmun would have found that the Act was pre-empted. They did not command a majority on this issue. 457 U.S. at 630-34.

[68] *Id.* at 643.

[69] Justice White wrote an opinion, parts I, II, and V-B of which are the opinion of the Court. *Id.* at 626 (affirming the Seventh Circuit); *id.* at 630 (holding the case is not moot); *id.* at 643 (holding statute unconstitutional as a substantial burden on interstate commerce).

empted by the Williams Act. The opinion focused on whether the Illinois Act frustrated the objectives of the Williams Act and concluded that it did.[70]

Justice White observed that the intent of Congress in passing the Williams Act was to protect shareholders through an even-handed approach which avoided favoring either management or bidder.[71] Congress did not intend to handicap offerors; it intended to protect investors by "withholding from management or the bidder any undue advantage that could frustrate the exercise of an informed choice."[72] Each side should be given an opportunity to express its positions fairly and honestly, but the shareholders should make the final decision.[73]

Justice White noted three provisions of the Illinois Act which were inconsistent with this purpose: (1) the pre-notification, waiting period requirement; (2) the hearing and delay section; and (3) the substantive fairness requirement.

The Illinois Act[74] required an offeror to notify the Secretary of State and the target company of its intent to make a tender offer and to disclose all the material terms of the offer twenty business days *before* the offer became effective.[75] This waiting period provided a twenty-day buffer during which the offeror could not proceed, but management could institute plans to ward off the challenge.[76] Justice White concluded that this twenty-day buffer was a powerful defensive tool in the hands of management and that this was "precisely what Congress determined should be avoided."[77] In fact, Justice White noted that a

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[70] *Id.* at 632.

[71] *Id.* at 633 (White, J.) (noting the change from the pro-management provisions of earlier versions of the law to the policy of neutrality in the Act as finally passed). For other decisions where neutrality in the protection of shareholders was noted as the key policy of the Williams Act, see, e.g., *National City Lines*, 687 F.2d at 1129; *Kidwell*, 577 F.2d 1256.

[72] 457 U.S. at 634.

[73] *Id.*

[74] ILL. REV. STAT., ch. 121½, ¶¶ 137.54.E, 137.54.B (1979) (repealed 1983).

[75] Most other states which have such an act also require a waiting period. *See, e.g.*, LA. REV. STAT. ANN. tit. 70, § 73. *See also* Note, *The Unsung Death*, *supra* note 1, at 1062.

[76] As with most of these statutes, a company was not restricted from making a tender offer for its own shares or from instituting other defenses which the offeror could not defend against while the waiting period was in force. *See* Langevoort, *supra* note 1, at 225.

[77] *MITE*, 457 U.S. at 635. SEC Rule 14d-2(b) requires an offeror to commence its offer within five business days of the public announcement of its offer. It has been argued that this is in direct conflict with the longer pre-commencement state filing requirements, and therefore courts have found that the SEC's five-day rule pre-empted this type of requirement because it is impossible to comply with both. *See, e.g.*, *National City Lines*, 687 F.2d at 1130-31; *Ashcroft*, 524 F. Supp. at 903. The definitions in this rule were not available at the outset of the *MITE* controversy, and thus were not used in the determination of the case; however, since 1980 some commentators have argued that all pre-commencement filing requirements are in conflict with this rule. Note, *The Effect of the New SEC Rules on the Constitutionality of State Takeover Statutes*, 8 FORDHAM URB. L.J. 913, 931 (1979-80).

twenty-day requirement in the original Williams Act had been considered unnecessary for the protection of shareholders by the SEC and had been rejected by Congress.[78]

Justice White also observed an inconsistency between the congressional purpose of the Williams Act and the provision of the Illinois Act which gave management the power to delay the commencement of the offer by forcing a hearing before the Secretary of State.[79] The Secretary could call a hearing any time prior to the commencement of the offer with no deadline for completion of the hearing.[80] Moreover, although the statute required a decision within fifteen days of the hearing, this period could be extended without limitation.[81] This gave the Secretary of State power to delay a tender offer indefinitely.[82] This provision was therefore another powerful weapon in the hands of management to forestall a legitimate take-over—contrary to the intent of Congress.

Finally, Justice White pointed to a provision of the Illinois Act which empowered the Secretary to deny registration of an offer if it was found to be "inequitable."[83] By denying shareholders this freedom to make the final decision to accept or reject an offer, the Illinois Act was inconsistent with the intent of Congress.[84]

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[78] *Id.* Congress actually rejected a pre-notification requirement three times before enacting the Williams Act in its present form. *See* 111 CONG. REC. 28,257-59 (1965) (20-day requirement); S. REP. NO. 550, 90th Cong., 1st Sess. 4 (1967) (five-day requirement in 1967); *Hearings on H.R. 4285, S. 3431 and S. 336 Before the Subcomm. on Commerce and Finance of the House Comm. on Interstate and Foreign Commerce*, 91st Cong., 2d Sess. 6-7 (1970) (30-day requirement).

[79] 457 U.S. at 636-39. Under the Illinois Act, management could force the Secretary to call a hearing on the tender offer just by obtaining 10% of the outstanding stock of shareholders living in the state. Until this hearing was concluded, the tender offer could not proceed. *Id.* at 637. Most other state acts contain similar hearing and administrative review provisions. Note, *The Unsung Death*, *supra* note 1, at 1062. *See, e.g.*, KAN. STAT. ANN. § 17-1277 (1981); KY. REV. STAT. ANN. § 292.570 (Baldwin 1981); ME. REV. STAT. ANN. tit. 13, § 804 (West 1981).

[80] 457 U.S. at 637.

[81] *Id.*

[82] *Id.*

[83] *Id.* at 639-40. A number of states have included such substantive review provisions in their take-over statutes. *See, e.g.*, TENN. CODE ANN. § 48-5-104(e) (Supp. 1985).

[84] *MITE*, 457 U.S. at 639-40. It is interesting to observe that two Justices—Powell and Stevens—questioned this reasoning as failing to leave any room for state regulation of tender offers. Because valid state interests may be involved, there should be some room for states to enact requirements beyond those contained in the Williams Act. The legitimate state interests alluded to by these Justices included protection of the local economy from the adverse affects which might occur if a major company moved its corporate headquarters out of the area. *See id.* at 640-47 (Powell, J., concurring).

b. The Commerce Clause and MITE

In addition to its pre-emption problems, Justice White evaluated the Illinois statute in relation to the commerce clause: as a direct regulation of, and undue burden on, interstate commerce. The major problem with the statute was its direct effect on transactions taking place across state lines.[85] The offeror in *MITE* was a Delaware corporation, with principal offices in Connecticut, while the target was an Illinois company with shareholders from around the country—only twenty-seven percent lived in Illinois.[86] The Illinois statute had a direct impact on interstate commerce by affecting the trading of shares across state lines. It not only prevented sales of stock by shareholders living in Illinois; it also barred trading throughout the country.[87]

The Illinois Act applied to shares of any company meeting two of the following three conditions: (1) having principal executive office in Illinois; (2) organized under Illinois law; or (3) having at least ten percent of its stated capital and paid-in surplus in Illinois.[88] Noticeably absent was any residency requirement for the shareholders; the Illinois Act could be applied to shareholders outside the State. Consequently, in the opinion of at least four justices, the Illinois Act constituted a direct regulation of interstate commerce.[89]

Finally, in the only substantive part of the decision supported by a majority of the justices,[90] the Court held that the burden the Act imposed on interstate commerce was excessive in relation to the local interests. The burden arose from the extraterritorial reach of the statute, causing (1) shareholders both inside and outside the state to be deprived of an opportunity to sell their shares at a

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[85] *Id.* at 641. Justice White distinguished state take-over acts from statutorily approved state securities acts (blue sky laws). *Id.*

[86] 457 U.S. at 641-42.

[87] This extraterritorial effect does not occur with blue sky laws since such laws only prohibit the sale of stock to residents of the State. *Id.* at 641. For cases upholding such laws against commerce clause challenges, see, e.g., Merrick v. N.W. Halsey & Co., 242 U.S. 568 (1917); Caldwell v. Sioux Falls Stock Yards Co., 242 U.S. 559 (1917); Hall v. Geiger-Jones Co., 242 U.S. 539 (1917).

[88] ILL. REV. STAT. ch. 121½, ¶ 137.52-10(2) (1979) (repealed 1983). Most state acts provide coverage for corporations which are incorporated within the state, or which have a principal office or substantial assets or do business within the state, or some combination of the above. Langevoort, *supra* note 1, at 219-20; *See, e.g.*, N.Y. BUS. CORP. LAW § 1601(a) (McKinney's Supp. 1986); S.C. CODE ANN. § 35-2-20(5) (Law. Co-op. 1985).

[89] Justice White feared that such regulation, extended extraterritorially by other states, could significantly stifle tender offers throughout the country. The need for national uniformity, therefore, prevented such action by the state. 457 U.S. at 642-43. *Accord* Bendix Corp. v. Martin-Marietta Corp., 548 F. Supp. 522, 532 (D. Md.), *aff'd*, 690 F.2d 558 (6th Cir. 1982); *Ashcroft*, 524 F. Supp. at 904.

[90] 457 U.S. at 630.

premium;[91] (2) the reallocation of economic resources away from their highest and best use;[92] and (3) the disincentive of management to perform well.[93] The Court also found the benefits of the state legislation to be speculative at best.[94] Accordingly, it held that the burdens on interstate commerce outweighed the benefits of the Illinois statute, making it unconstitutional under the commerce clause.

2. *Lower Court Decisions Before and After* MITE

Most federal courts faced with a constitutional challenge to a state take-over statute, both before and after *MITE*, have held the statute unconstitutional.[95] An overview of these cases, along with those few upholding the state law, helps define when state take-over legislation, such as that enacted in Hawaii, is constitutional.

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[91] *Id.* at 643. A tender offer almost always involves an offer which is in excess of current market price; this was the situation in *MITE*. Empirical evidence shows that the market price of the company's stock will generally fall after an unsuccessful bid. *See* Taussig & Hayes, *Cash Take-Overs and Accounting Valuations*, 43 ACCT. REV. 68 (1968).

[92] 457 U.S. at 643 (result would cause inefficiencies in the market place).

[93] *Id.* (noting that management would be less inclined to perform well if it did not fear a possible tender offer). For more on these economic arguments, see generally Fischel, *Efficient Capital Market Theory, the Market for Corporate Control, and the Regulation of Cash Tender Offers*, 57 TEX. L. REV. 1 (1978) (Incumbent managements were free under state take-over statutes and case law governing management accountability to frustrate tender offers with defensive tactics not in the true interests of shareholders.); Jensen, *Takeovers: Folklore and Science*, HARV. BUS. REV., Nov.-Dec. 1984, at 109 (discussion of golden parachutes suggests that additional compensation for top-level management in the event of a take-over may be desirable when they protect stockholders' interests).

[94] In dismissing the state's argument that the Act was merely for the protection of resident security-holders, the Court noted that any such protection, beyond what was provided by the Williams Act, was purely speculative, and that, in any case, the Act went beyond the borders of the state and affected non-residents. *MITE*, 457 U.S. at 644-45. *Accord Kidwell*, 577 F.2d at 1275. This finding is common among courts examining such state acts. *See, e.g.*, *Mesa Petroleum*, 715 F.2d 1425, 1430.

The Court also noted the Act's exemption of tender offers made by a company for its own stock, stating that such an exemption tends to undermine the state's assertion that it is acting for the protection of shareholders. The Court emphasized that the Williams Act provides protection for shareholders quite adequately. In addition, the Court rejected the state's argument that the state legislation was part of its well recognized right to regulate the internal affairs of corporations organized under its laws. This "internal affairs" doctrine was found inapplicable because, as the Court put it, "tender offers contemplate transfers of stock by stockholders to a third party and do not themselves implicate the internal affairs of the target company." 457 U.S. at 644-45. For a more in-depth discussion of this and other justifications used to support state take-over laws, see Note, *The Unsung Death*, *supra* note 1.

[95] *See* authorities cited *supra* note 57.

In *Great Western United Corp. v. Kidwell*,[96] one of the earliest cases to consider a state take-over statute, the Fifth Circuit Court of Appeals struck down the Idaho Take-over Act on the grounds that it was pre-empted by the Williams Act and that it was invalid under the commerce clause. This statute contained pre-commencement filing and hearing requirements similar to those in the Illinois statute analyzed in *MITE*. It also authorized the State Director of Finance to summarily delay the effectiveness of an offer if he determined the registration to be "insufficient."[97] The court stated:

> There is no real dispute that the Idaho statute—like most of the state take-over laws—increases a target company's ability to defeat a tender offer. The Idaho law helps target companies primarily through provisions not found in the Williams Act that give them advance notice of a tender offer and the ability to delay the commencement of an offer, by means such as insisting on a hearing. Most observers of take-over battles agree that time is among the most effective weapons available to a company resisting a tender offer.[98]

After finding that the purposes of the Williams Act were to protect investors through full disclosure and to give them a choice once disclosure was made, the court described the conflict between the statutes as follows:

> Instead of relying upon investor's decisions after full disclosure, Idaho relies upon the business judgement of corporate directors with a fiduciary duty to their shareholders. Idaho's "fiduciary approach" to investor protection may be one way to protect shareholders, but it is an approach Congress rejected.
>
> Idaho's statute is pre-empted, because the market approach to investor protection adopted by Congress and the fiduciary approach adopted by Idaho are incompatible.[99]

Turning to the commerce clause, the Fifth Circuit rejected the district court's finding that Idaho had no legitimate interest in regulating take-overs.[100] The court held that while a state has no legitimate interest in preventing the removal of a business to another state, it did have a legitimate interest in maintaining those corporate managements in its state that were benevolent. "[A] corporation can influence local lifestyles through such means as charitable contributions or civil involvement and the depth of its commitment to issues such as

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[96] 577 F.2d 1256 (5th Cir. 1978), *rev'd on venue grounds sub nom.* Leroy v. Great W. United Corp., 443 U.S. 173 (1979).
[97] 577 F.2d at 1263.
[98] *Id.* at 1278.
[99] *Id.* at 1279.
[100] *Id.* at 1282.

pollution control or job safety. . . ."[101] Moreover, the court pointed out that protecting in-state investors was a legitimate state interest but that protecting out-of-state investors was not.[102]

Before the court weighed these interests against the burden on interstate commerce, it first noted that while at one time courts gave great deference to state regulation involving interstate commerce, more recently, courts have subjected such regulation to a stricter standard:

> Since 1938. . .a more intensive inquiry into the reasonableness of state regulation has evolved. . . .The Court has scrutinized the fit between the state's purpose and its regulation. It has also asked whether alternative means of achieving the purpose would impose fewer burdens on interstate commerce, in a manner similar to "a least restrictive alternative" analysis.[103]

Applying the stricter scrutiny, the court found Idaho's interest to be uncertain, indirect, and disproportionately small compared with the regulation's extraterritorial impact on out-of-state traders and its consequent heavy burden on interstate commerce.[104] The court, therefore, held the Idaho Act unconstitutional under the commerce clause.

A couple of years after *Great Western*, the Third Circuit Court of Appeals, in *Kennecott Corp. v. Smith*,[105] held that the New Jersey Corporation Take-over Bid Disclosure Act conflicted with the Williams Act. The New Jersey Act contained basically the same pre-notification and hearing provisions struck down in *Great Western* and *MITE*.[106] Comparing these provisions with those in the Williams Act, the Third Circuit found that such regulation evidenced a "benevolent bureaucracy" approach to shareholder protection which directly conflicted with the "market" approach contemplated by federal law.[107]

On remand, the district court addressed the commerce clause issue and found that although the New Jersey Act purported to advance local interests which

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[101] *Id.* at 1282-83.

[102] *Id.* at 1283.

[103] *Id.* at 1285 (citations omitted).

[104] The court had earlier pointed out the extraterritorial effect of the state law and potential problems that would be caused if other states also claimed jurisdiction in such cases. *Id.* at 1284. In this case alone, over $31 million in interstate commerce was blocked by state law. *Id.* This dollar amount was sufficient in itself to show a substantial impact on interstate commerce. Courts have often used such a dollar figure as evidence of the burden placed on interstate commerce. *See, e.g., Ashcroft*, 524 F. Supp. at 905 ($23 million of interstate commerce affected); Dart Indus. v. Conrad, 462 F. Supp. at 11 ($215 million of interstate commerce affected).

[105] 637 F.2d 181 (3d Cir. 1980).

[106] Under the New Jersey state law examined in this case, there was a 20-day pre-commencement waiting period, N.J. STAT. ANN. § 49:5-3(a) (West Supp. 1985), and hearing provisions which allowed the state to consider the fairness and equity of the offer. *Id.* § 49:5-4.

[107] *Id.* at 189.

produced only incidental local effects, "the statute's impact on interstate commerce cannot be characterized as incidental."[108] Thus, the district court found it unnecessary to balance burdens against benefits.[109] The court, however, continued:

> If such balancing were required. . .the New Jersey Take-over Law's global and arresting burdens on interstate commerce are clearly excessive in relation to putative local benefits. Assuming that New Jersey can properly protect its citizens who are shareholders of the target firm, the state would still have no interest in the welfare of nonresidents, whom the statute also forbids from transferring their shares.[110]

A notable deviation from the march of cases striking down state take-over acts came two years later in *Agency Rent-A-Car, Inc. v. Connolly.*[111] In *Agency*, the First Circuit Court of Appeals reversed a lower court decision that a disclosure provision of the Massachusetts take-over law conflicted with the Williams Act. The Massachusetts law provided that a holder of five percent or more of a company's stock could not make a tender offer for one year, if, within the previous twelve months, he had purchased any shares (even before reaching five percent) without disclosing his intention to gain control.[112] Agency had violated this provision and was thus subject to the one-year penalty.[113]

The court pointed out that Agency had not challenged the disclosure, filing, or hearing requirements of the statute as had the bidder in *MITE.*[114] The court also distinguished the statute in *Agency* from the statutes considered in *MITE* and the other cases, all of which built delays into every tender offer. The Massachusetts law imposed a delay only when there had been a violation of its provisions. Because this delay could have been avoided by compliance, it was unlike delays allowed by other statutes which occurred whether or not the offeror had complied.[115]

Although the statute imposed a penalty more serious than the penalties available under the Williams Act, the court found that the penalty in the Massachu-

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[108] Kennecott Corp. v. Smith, 507 F. Supp. 1206, 1224 (D.N.J. 1981), *aff'd*, 637 F.2d 181 (3d Cir. 1980).

[109] *Id.*

[110] *Id.*

[111] 686 F.2d 1029 (1st Cir. 1982).

[112] Hawaii has added a penalty provision in its new take-over law substantially identical to this provision. *See* HAWAII REV. STAT. § 417E-9(d) (L.R.B. Comp. 1985).

[113] 686 F.2d at 1032.

[114] *Id.* at 1036.

[115] *Id.* at 1039. Moreover, the First Circuit discounted *MITE* by noting that it was "actually decided by the Court on commerce clause grounds. . .as Justice White's discussion of preemption did not command a majority of the Court." *Id.* at 1034.

setts law was only a sanction and was not an obstacle to the purposes of Congress. If the state could validly regulate an area, as it could the trading of shares, then there should be no problem with its setting out penalties for violations of those regulations.[116]

One day after this decision by the First Circuit, the Eighth Circuit Court of Appeals in *National City Lines, Inc. v. LLC Corps.*[117] struck down the Missouri Take-over Bid Disclosure Act on both pre-emption and commerce clause grounds. The pre-notification and hearing provisions of the Missouri Act were sufficient bases for a finding of a conflict with the Williams Act.[118]

The Eighth Circuit found pre-emption problems with other provisions of the Missouri law, including the withdrawal and pro rata rights of offerees, as well as disclosure requirements.[119] By finding that these provisions, which provided greater protections to offerees than the Williams Act, had been pre-empted, the court appeared to take the position that any deviation from the Williams Act would not be tolerated. In this respect, it may be said that the Eighth Circuit went beyond *MITE*.[120]

Two years later in *Cardiff Acquisitions, Inc. v. Hatch*,[121] however, the Eighth Circuit Court of Appeals showed that not all state regulation of cash tender offers is unconstitutional. In *Cardiff*, the court[122] was faced with the usual commerce clause and pre-emption challenges to the Minnesota Corporate Take-overs Act.[123] The court took a different approach and allowed for deviation from the Williams Act.

The *Cardiff* court began by noting that the opinion of Justice White in *MITE* represented only a plurality except as to the holding that the burdens of the Illinois statute outweighed its benefits.[124] It then distinguished the Illinois

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[116] *Id.* at 1037.

[117] 687 F.2d 1122 (8th Cir. 1982).

[118] *Id.* at 1131.

[119] *Id.* at 1131-32.

[120] Although *MITE* never went so far as to say that all state take-over legislation which deviated from the Williams Act are barred, it has been argued that the plurality position in *MITE* would have that practical effect. *See MITE*, 457 U.S. at 646 (Powell, J., concurring). *See also* Note, *The Unsung Death*, *supra* note 1, at 1044 ("The portion of Justice White's commerce clause opinion finding that there was a direct and unconstitutional interference with interstate commerce mustered a plurality . . . however, the opinion of the Court provided the lower courts with the weapon necessary to destroy the future of state regulation of tender offers within the scope of the Williams Act.").

[121] 751 F.2d 906 (8th Cir. 1984).

[122] The one judge on the panels for both *National City Lines* and *Cardiff* wrote the *Cardiff* opinion.

[123] MINN. STAT. chs. 80B, 302A (Supp. 1985).

[124] 751 F.2d at 909. The court also noted that Justice Powell joined this part of the opinion to create a majority because it left "some room for state regulation of tender offers." *Id.*

Act in *MITE* from the Minnesota law under consideration.[125] The court found four distinctions: (1) The Minnesota Act, unlike the Illinois Act, did not provide for a pre-commencement filing period, or have a substantive review provision.[126] (2) The hearing provision in the Minnesota Act did not give the target company's management the power to force a pre-commencement hearing and so delay the offering. It also placed strict time constraints on the hearing, and restricted it to a determination of full and fair disclosure.[127] (3) The Minnesota Act was restricted to take-overs of corporations in which twenty percent of the shareholders were Minnesota residents and had substantial assets in the state.[128] (4) The Minnesota Act limited any suspension of the offering to Minnesota residents.[129]

The court dismissed the commerce clause claims based on these distinctions, finding, in effect, that the Minnesota statute was not a direct burden on interstate commerce and that any indirect burdens were outweighed by the state's legitimate interest in protecting its shareholders.[130] In balancing the burdens of the state law against its benefits, the Eighth Circuit noted the large number of federal filings each year and the limited resources of the SEC.[131] It pointed out that the use of state facilities would aid in the enforcement of the federal requirement of full disclosure and thus would support congressional goals.

Turning to the pre-emption issue, the court reaffirmed that the Williams Act did not bar a state from regulating take-overs.[132] It ruled that state law would be unconstitutional only when its purposes conflicted with the purposes of the federal law. It then distinguished *National City Lines* and other cases, holding that the Minnesota Act did not conflict with the neutral policy of the Williams Act and was thus constitutional:

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[125] In a passing note, the court distinguished *National City Lines* as decided "on the lack of any significant distinctions between the Illinois Act considered in *MITE* and the Missouri Act at issue [there]." *Id.* at 909 n.2.

[126] *Id.* at 910-11.

[127] *Id.* The Minnesota Act allowed the Commissioner only three days after the filing of a registration statement to suspend the registration and call for a hearing. He then had only 10 calender days to hold the hearing and three calender days thereafter to render his decision. The entire process had to be completed within 19 calender days, which the Court noted was within the 20 business-day minimum offering period specified by federal law and the 15 business-day period for withdrawal rights. The Commissioner was given authority to prescribe different time limits, but the court found nothing to indicate that he had used this authority to delay the offering. *Id.*

[128] *Id.* at 911. This is in contrast to the Illinois statute which could be applied without regard to shareholder residence.

[129] *Id.* at 911. This did away with the extraterritorial effects found to violate interstate commerce protections in *MITE.*

[130] *Id.* at 911.

[131] *Id.* at 912.

[132] *Id.* at 912-13.

> [I]t is constitutionally permissible for the Commissioner to review the adequacy of disclosures. . .so long as he restricts himself to deciding whether sufficient facts have been disclosed to comply with the specific disclosures required by these sections. The Commissioner has no authority to suspend the effectiveness of a tender offer on the ground that the quality of the facts alleged do not satisfy him. He may not require evaluative, judgmental, or overly burdensome or irrelevant disclosures, and he may not pass on the fairness of the offer as disclosed.[133]

In sum, early lower court decisions generally struck down state take-over legislation—largely because they conflicted with federal law and interfered unduly with interstate commerce. *Great Western*, *Kennecott*, and *National City Lines* were typical of such decisions. Subsequently, some state legislatures re-drafted their legislation. They eliminated delay, substantive review, and direct effect on non-residents as well as imposed limited penalties such as the sanction that passed constitutional muster in *Agency*. In *Cardiff*, the Eighth Circuit reviewed such a re-drafting and found it constitutionally sound.

III. CONSTITUTIONAL ISSUES INVOLVING THE 1985 HAWAII CORPORATE TAKE-OVER ACT AND CONTROL SHARE ACQUISITIONS ACT

While other sections of the Hawaii Revised Statutes have some relation to corporate take-overs,[134] this analysis of Hawaii law focuses on chapter 417E and sections 416-171 and 416-172 of the Hawaii Revised Statutes, which contain the newest Hawaii law regarding take-over bids.

A. *Chapter 417E of the Hawaii Revised Statutes*

Chapter 417E was revised in its entirety and became effective as of April 23, 1985.[135] Prior to this revision, the statute included many of the same provisions struck down in other jurisdictions as unconstitutional. Among these provisions were (1) a sixty-day pre-commencement filing requirement;[136] (2) a hear-

[133] *Id.* at 914. The court found that it was constitutionally permissible for the state to require and review disclosures in tender offer situations and that those disclosures need not be exactly the same as federal law. Such disclosures, however, must be limited to those items which are reasonably related to the legitimate purpose of the statute and cannot be for unspecified information. Citing *National City Lines* as controlling, the court therefore found a provision in the law which allowed the Commissioner to require unspecified information unconstitutional. *Id.* at 914 (construing 1984 Minn. Sess. Law Serv. ch. 488, § 80B.03(2), (6)). The Court then evaluated the constitutionality of the Minnesota statute as applied. 751 F.2d at 914-16.

[134] *See, e.g.* HAWAII REV. STAT. ch. 343D (Supp. 1984) (Environmental Disclosure Law); HAWAII REV. STAT. ch. 271 (1976 & Supp. 1984) (Motor Carrier Law).

[135] Act of Apr. 23, 1985, ch. 32, 1985 Hawaii Sess. Laws 47.

[136] HAWAII REV. STAT. § 417E-3(f) (repealed 1985). The 60-day pre-commencement waiting

ing provision with an even longer potential for delay;[137] (3) a substantive review provision;[138] and (4) a disclosure requirement more extensive than federal law with an amorphous provision asking for "such other information as the Commissioner prescribes."[139] Moreover, old chapter 417E, although restricted to only certain types of companies,[140] was unrestricted as to the residency of shareholders.[141]

New chapter 417E makes sweeping changes in the Hawaii law by deleting each of these objectionable provisions. Section 417E-2 still requires registration of take-over offers but now makes the offer effective upon filing with the Commissioner.[142] Required disclosures are substantially the same as those called for in the Minnesota statute approved in *Cardiff*; yet, chapter 417E does not contain those few disclosure provisions which the Eighth Circuit noted as constitutionally objectionable.[143] Additionally, this chapter, with a few exceptions, contains disclosure provisions substantially similar to those in federal law.[144]

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period was the longest of any state statute; it was 40 days longer than the one struck down in *MITE*.

[137] The statute also gave the target company's board of directors the power to force a hearing. *Id.* § 417E-3(f) (1976). *Cf. MITE*, 457 U.S. at 637 (The Court noted with displeasure a provision which allowed incumbent management to force a hearing if it could obtain the cooperation of 10% of shareholders living in the state.).

[138] HAWAII REV. STAT. § 417E-3(g) (repealed 1985). Under this section the Commissioner could deny registration after the hearing if he determined that the bid failed to provide "full and fair" disclosure or was "unfair or inequitable" to the offerees. The Commissioner could also suspend or revoke the effectiveness of any registration for the same reasons.

[139] *Id.* § 417E-3(c) (1976).

[140] The old provisions applied only to corporations incorporated under the laws of Hawaii and doing business in this state ***and*** which were either (1) subject to regulation by the public utilities commission; (2) the owner of more than 1000 acres of real property in any single county; (3) subject to inspection by the bank examiner; or (4) the owner, directly or indirectly, of more than 10% of the voting stock of the foregoing. *Id.* § 417E-1(5) (L.R.B. Comp. 1985).

[141] The original provisions defined an offeree as a person to whom a take-over bid was made and therefore could be applied even in cases where none of the shareholders were residents of the State of Hawaii. *Id.* § 417E-1(4) (1976).

[142] *Id.* § 417E-2(a).

[143] *Compare* HAWAII REV. STAT. § 417E-2(b), (f) (L.R.B. Comp. 1985) (specified information required for registration forms) *with* MINN. STAT. § 80B.03 (Supp. 1985) (Provisions requiring the offeror to disclose such "additional information the commissioner may by rule prescribe" are unconstitutionally vague and may require judgmental data that the commission has no authority to require.). Noticeably absent, however, is any provison giving the commissioner the ability to require additional information.

[144] There are, however, a few deviations from the federal disclosures rules in the Hawaii law. For example, HAWAII REV. STAT. § 417E-2 (3) (L.R.B. Comp. 1985) requires an offeror to report any intention to relocate executive offices out of Hawaii and to report any intention to change policies of employment or materially alter its relations with suppliers, customers or the communities in which it operates. The 1985 Hawaii Corporate Take-over Act further requires the bidder to state proposed *major* changes in corporate structure or management. Under federal law there is

The Commissioner has the power to suspend an offering within three days of filing if the registration does not fully disclose all material information concerning the take-over.[145] If the registration is found to be deficient, the Commissioner must hold a hearing within ten calender days and render a decision three calender days thereafter.[146] The Commissioner can permanently suspend an offer only if he finds that the offeror has failed to make a full and fair disclosure; he cannot suspend an offer because he finds it unfair to offerees.

Futhermore, chapter 417E restricts its applicability to corporations with publicly traded securities which are organized under the laws of the State of Hawaii or which have at least twenty percent of their equity shares held by residents of the state and substantial assets within the state.[147] Moreover, the Act only affects the resident shareholders of these corporations. Thus, by definition, chapter 417E only applies to purchases of securities from Hawaii residents. It does not regulate purchases of securities from individuals living outside the state.

Other provisions of chapter 417E cover fraudulent and deceptive practices,[148] limitations on offerors,[149] and remedies.[150] One additional point of note, how-

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no requirement to disclose an intention to relocate. While 17 C.F.R. § 240.14d-5 (1985) provides for some of the other disclosures, it appears significantly more limited. *See* Susquehanna Corp. v. Pan Am. Sulphur Co., 423 F.2d 1075, 1085-86 (5th Cir. 1970).

Another example is HAWAII REV. STAT. § 417E-2(f)(2) (L.R.B. Comp. 1985) which requires the offeror to disclose the source and amount of funds for the acquisition in blanket form. 17 C.F.R. § 240.14d-3 (1985) is similar but contains an exception to the *public* disclosure of source of funds in filing the Tender Offer Statement on Schedule 14 D-1 (17 C.F.R. § 240.14d-100). Under federal law, if a loan is to be floated from a bank, the name of the bank need not be included in the data open to the public. *Id.* at Item 4(c) (1985). Proponents of the Williams Act wanted to relieve bankers of the pressures that otherwise might be applied to them by incumbent managers. Other differences lie in other sections of the Hawaii law. *See, e.g.*, HAWAII REV. STAT. § 417E-5(d), (g) (L.R.B. Comp. 1985).

[145] HAWAII REV. STAT. § 417E-2(d) (L.R.B. Comp. 1985).

[146] *Id.* § 417E-2(e). The commissioner is limited to a total of 16 calender days by the statute, but he is empowered to prescribe different time limits by rule or order. A substantially similar provision was found to be constitutional in *Cardiff.* 1984 Minn. Sess. Law Serv. ch. 488, § 80B.03(5).

[147] HAWAII REV. STAT. § 417E-1 (L.R.B. Comp. 1985). The definitions used in the Hawaii statute are substantially the same as those used in the Minnesota law and approved in *Cardiff. See* 1984 Minn. Sess. Law Serv. ch. 488, § 80B.03.

[148] HAWAII REV. STAT. § 417E-4 (L.R.B. Comp. 1985).

[149] *Id.* § 417E-5.

[150] *Id.* §§ 417E-8 to -10. Section 417E-8 provides the Commissioner with authority to bring suit for an injunction, among other things, against any person who participates in a take-over bid in violation of the Act. Section 417E-9 adds a potential fine and prison sentence or both for violation of the Act. Section 417E-10(a) gives a civil remedy to offerees whose shares are taken pursuant to a take-over bid which does not comply with the Act or which makes a material misrepresentation or omission of fact. Such an offeree may sue the offeror to recover his shares with dividends or the equivalent of damages with costs and attorneys fees if the offeror no longer

ever, is section 417E-9, which sets out penalties for violations. An offeror who acquires shares in violation of the act is denied his shareholder-voting rights for one year after acquisition of the stock.[151] This section, substantially identical to that approved by the First Circuit in *Agency*, thus provides shareholders with a remedy which goes beyond the Williams Act.[152]

B. *The Hawaii Control Share Acquisitions Act*

When the Hawaii legislature dramatically revised chapter 417E to accommodate constitutional mandates, it also passed the Control Share Acquisitions Act, Hawaii Revised Statutes sections 416-171 and 416-172. This Act is likely to be of greater constitutional concern than chapter 417E because, contrary to the intent of the Williams Act, it sets up obstacles to the acquisition of control of a corporation and because it affects out-of-state shareholders.

Section 416-172 requires an offeror proposing to acquire a specified percentage of the voting shares in a corporation[153] to provide the corporation with a detailed information statement. This statement must include a number of disclosures such as any plans to liquidate, sell assets, or merge. The statute also contains a very inclusive and amorphous requirement that the bidder state "any such other information which would affect the decision of a shareholder with respect to voting on the proposed control share acquisition."[154]

The information statement must be provided to the shareholders of the company who then vote on whether to approve the acquisition. The Act requires that the vote take place within fifty-five days of the shareholders' receipt of the information statement.[155] The offeror must thus wait to consummate the control share acquisition for as long as fifty-five days and can only proceed if the shareholders approve the take-over.[156] Shareholder approval must be by a ma-

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owns the shares.

[151] This makes the shares non-transferable for the one-year period and gives the target company the option to call the shares for redemption. The price of shares redeemed in this manner can either be the purchase price or the book value on the last day of the fiscal quarter ended prior to the date of the call for redemption. HAWAII REV. STAT. § 417E-9(d) (L.R.B. Comp. 1985).

[152] Hawaii's Control Share Acquisitions Act essentially tracks MINN. STAT. § 302A.671 (Supp. 1985). According to the Reporter's Notes to the Minnesota provision, it was passed to deal with the problem of the hostile take-over bid.

[153] The percentage apparently depends on the range of voting power which is necessary in the election of directors. *See* HAWAII REV. STAT. § 416-172(c)(4) (L.R.B. Comp. 1985).

[154] *Id.* § 416-172(c).

[155] *Id.* § 416-172(e).

[156] *Id.* § 416-172(d). The corporation has five days after the information statement is filed to call a special meeting of its shareholders to vote on the proposed acquisition. That meeting must be held within 55 days of the filing by the acquirer. Notice of the meeting must be sent by the corporation within 25 days of filing. *Id.*

jority vote of all shares entitled to vote, excluding those beneficially owned by the acquiring person.[157] Proxies relating to the vote of the shareholders must be solicited separately from the offer to purchase.[158] The purchase itself must be consummated within 180 days of an affirmative vote.[159]

Any violation of this section denies the offeror the right to vote or transfer shares for one year and gives the company the option to call the shares for redemption either at the price at which the shares were acquired or at the book value per share as of the last day of the fiscal quarter ended prior to the date of the call for redemption.[160]

Finally, the Control Share Acquisitions Act, unlike the Corporate Take-over Act, is not limited to shareholders within the state. The only limitation is that the corporation be incorporated in the State of Hawaii with at least 100 shareholders and have its principal place of business or substantial assets in the state.[161]

This brief overview of the Hawaii Corporate Take-over Act and the Control Share Acquisitions Act shows that the Hawaii legislature has completely and dramatically revised corporate take-over legislation. It has attempted to cure the constitutional infirmities in the old law in light of court decisions dealing with similar laws in other states. It has also shifted the responsibility for making the decision about whether the offeror can proceed with the bid from the Commissioner to the majority of the shareholders of a corporation. Two questions about these revisions remain: (1) Has the Hawaii legislature succeeded in drafting legislation which is constitutional? (2) Has the legislation accomplished anything?

C. *Constitutionality of the Hawaii Statutes*

Arguments against new chapter 417E based on contravention of the supremacy clause are hard to come by. Chapter 417E is free of the pre-notification, hearing, and substantive review provisions condemned in other jurisdictions.[162] Hawaii regulators can require hearings but they must be conducted in a timely fashion and are restricted to consideration of full disclosure.[163]

Chapter 417E is now free of the delay and blocking provisions typically found in state take-over statutes held unconstitutional. Management is not pro-

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[157] *Id.* § 416-172(e).
[158] *Id.*
[159] *Id.*
[160] *Id.* § 416-172(b).
[161] *Id.* § 416-171(5).
[162] *See supra* text accompanying notes 95-110.
[163] HAWAII REV. STAT. § 417E-2(e) (L.R.B. Comp. 1985).

tected or put in a preferred position. Consequently, chapter 417E does not appear to conflict with the Williams Act policy of neutrality between offeror and target company.

By contrast, The Control Share Acquisitions Act, while using different means, gives new life to the delay and blocking protections available to incumbent management under previous law. This Act turns a cash tender offer into a two step process: first, disclosure to and approval by shareholders gained in a proxy battle; second, the offer to purchase and the actual consummation of the control share acquisition. The two-step protocol makes it more difficult for an offeror by giving a majority of the shareholders the power to block the minority shareholders' sale of their shares. Moreover, the offer can be delayed beyond the period provided by the Williams Act. In view of these obstacles for a bidder, it can be persuasively argued that the Hawaii law violates the Williams Act policy of neutrality.

Commerce clause problems which occurred in the previous chapter 417E also have been solved by the revisions to the chapter. The direct regulation of interstate commerce, so much a concern of Justice White and the circuit courts, is now absent. By limiting the effectiveness of this chapter to Hawaii residents, the Hawaii legislature has avoided the constitutional problems caused by the extraterritorial effects of other state statutes.[164]

However, the commerce clause problems reappear in sections 416-171 and 416-172. The Control Share Acquisitions Act does not contain any limitation as to the residency of shareholders; it directly restricts the sale of shares by nonresident as well as resident shareholders. This extraterritorial effect is the same as that condemned by the courts in cases involving more typical state take-over statutes.

While the Control Share Acquisitions Act might be distinguished from other take-over statutes on the basis that it involves a shareholder vote rather than an administrative review, the result is the same—the blocking of the transfers of shares owned by non-Hawaii shareholders.[165] Allowing a majority of the share-

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[164] *See MITE*, 457 U.S. at 643.

[165] In APL Ltd. Partnership v. Van Dusen Air, Inc., 622 F. Supp. 1216 (D. Minn. 1985), the district court reviewed the Minnesota Control Share Acquisitions Act, which served as the model for Hawaii's Control Share Acquisitions Act. In striking down the Act on commerce clause grounds, the court first recognized that the Act transferred the power to block the acquisition of a corporation to its shareholders. The court, however, concluded that this transfer produced the same result as when a state official, such as the secretary of state in *MITE*, held that power. If an offeror fails to obtain approval of a majority of the shareholders, the non-resident shareholders willing to sell their shares cannot do so.

In Icahn v. Blunt, 612 F. Supp. at 1415, the district court ruled the Missouri Control Share Acquisitions Act unconstitutional. It succinctly summed up the extraterritorial impact of the Act:

> If Missouri can so directly affect securities trading between non-residents on national exchanges, so too may other states. The interstate sale of securities on national and regional

holders to prevent other non-resident shareholders from selling their stock appears to violate the commerce clause.

D. *Impact of the Changes in the Hawaii Take-over Laws*

If chapter 417E is assumed to be constitutional, one question which remains is whether it provides any practical benefits. Substantively, the Act adds little to the protections already provided by the Williams Act. The disclosure provisions are largely the same, and the administrative review and hearing provisions do little to affect the battle between offeror and target company. Indeed, were this not so, the Act would almost certainly be unconstitutional.

This state take-over act, however, adds an enforcement dimension which may not be available at the federal level. The overburdened SEC in general has not been able to keep up with filings or investigate potential violations,[166] and, according to the head of the American Bar Association Panel on Securities Regulation, has had to retreat from many of its routine functions in the area of take-overs and acquisitions.[167] As a result, the SEC has had to rely increasingly on state agencies to enforce securities regulations in most take-over disputes.[168]

These state regulatory agencies also generally exhibit more interest in those take-over offers that impact on the state economy. State securities regulators are closer to the facts and generally proceed more efficiently than the SEC with the enforcement of take-over regulations in their states. In Hawaii, this extra, more ready, eye of the state, along with the harsh new penalty provisions in the state law,[169] should strengthen enforcement efforts and help ensure full disclosure for Hawaii shareholders without infringing on the goals of Congress or constitutional protections of interstate commerce.[170]

Whether other states will follow the lead of states such as Minnesota and Hawaii in passing revisions similar to new chapter 417E depends on how they balance the burdens of enforcement against the benefits of state involvement.[171]

> securities exchanges would be at the mercy of any state's parochial interests. Therefore, regardless of the local purposes prompting its enactment [the Missouri Control Share Acquisition Statute] is an unconstitutional attempt to assert directly extraterritorial jurisdiction over persons and property.

Id.

[166] Ingersoll, *Inundated Agency: Busy SEC Must Let Many Cases, Filings Go Uninvestigated*, Wall St. J., Dec. 16, 1985, at 1, col. 1.

[167] *Id.*

[168] *Id.*

[169] *See supra* note 149.

[170] This is assuming that the statute is applied in a non-discriminatory constitutional manner. If not, it can be held unconstitutional as applied. *See Cardiff*, 751 F.2d at 914-16 (dictum).

[171] Some states have repealed their take-over statute after having their statute struck down by a federal court. *See, e.g.*, ILL. ANN. STAT. ch. 121½, ¶ 137.51 (Smith-Hurd) (repealed 1983);

The goals and resources of the states are the key considerations. In the end, one can expect an increase in the number of statutes similar to new chapter 417E because states will wish to supplement federal enforcement. However, since these statutes will be constitutional only if they do not vary much from the provisions of the Williams Act, the overall effect of revisions to take-over legislation will be a decrease in independent state regulation of take-overs.[172]

The Control Share Acquisitions Act, on the other hand, initially has a more profound and direct effect on take-overs in Hawaii than new chapter 417E. It protects corporations in Hawaii from hostile take-overs by setting up formidable obstacles in the path of an offeror. The results—protection of incumbent management and direct effect on out-of-state residents—are ones which have been condemned by federal courts as unconstitutional. As a result, the impact of the Control Share Acquisitions Act can only be viewed as temporary; any court called upon to review it will almost surely strike it down as unconstitutional.

IV. Conclusion

The Constitution blocks attempts by state legislatures to pass take-over laws that restrict or delay corporate tender offers. The commerce clause proscribes state provisions that affect out-of-state shareholders. The supremacy clause, in light of the Williams Act, forestalls state laws that attempt to deter shareholders from making their own decisions on take-over bids.

While many state take-over statutes violate the principle of market-based decisions, the Hawaii Corporate Take-over Act avoids this and other constitutional infirmities. It takes a neutral stance between offeror and incumbent management and avoids extra-territorial effects on interstate commerce. The authors thus believe that this Act is constitutional. Although legislation such as the Act adds little to the statutory protections already provided by the Williams Act, it does allow state securities agencies to supplement the enforcement efforts of the more distant federal regulators in Washington.

The Hawaii Control Share Acquisitions Act, on the other hand, directly affects sales of shares outside Hawaii and shows a strong preference for incumbent management. As a result, this Act is likely to be held unconstitutional under both the commerce and supremacy clauses.

UTAH CODE ANN. § 61-4 (repealed 1983). Other states have just left the invalidated laws on the books. *See, e.g.*, DEL. CODE ANN. tit. 8, § 203 (1974); IDAHO CODE §§ 30-1501 to -1513 (1985); LA. REV. STAT. ANN. §§ 51:1500 to :1512 (West Supp. 1985); N.J. STAT. ANN. §§ 49:5-1 to -19 (West Supp. 1985).

[172] Since most statutes presently on the books will probably be held unconstitutional, there will be fewer of these laws and more statutes written along the lines of the Minnesota and Hawaii laws.

The Constitution of the Federated States of Micronesia*

by Alan B. Burdick**

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This article is a survey and analysis of constitutional development in the Federated States of Micronesia. It first describes the social and political context in which the Micronesian Constitutional Convention took place in 1975. The major parts of the article describe the establishment of constitutional government and the interpretation of the Constitution by the Micronesian government during its first seven years.

I. THE SETTING

The Federated States of Micronesia (FSM) comprises one of four self-governing areas in the Trust Territory of the Pacific Islands, the former Japanese Mandated islands of Micronesia.[1] The four areas are the FSM, the Northern Mariana Islands, the Marshall Islands and Palau. Their administration is supervised by the United States, through its Department of the Interior, under the United Nations trusteeship system.[2]

Three of the four areas—the FSM,[3] Palau and the Marshall Islands—are

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[1] During World World II, United States forces advancing across the Pacific captured Micronesia from Japan, which held the area under a League of Nations Mandate. Under U.S. trusteeship, the area became the Trust Territory of the Pacific Islands. D. MCHENRY, MICRONESIA: TRUST BETRAYED 5-8 (1975). The island groups comprising Micronesia are the Northern Mariana Islands, the Marshall Islands, Palau, Ponape (now called Pohnpei), Truk, Yap and Kosrae.

A number of books have been written on recent Micronesian political history. *See* C. HEINE, MICRONESIA AT THE CROSSROADS: A REAPPRAISAL OF THE MICRONESIAN POLITICAL DILEMMA (1974) (an analysis of the problems of unity and future status written by a pro-unity Marshallese political leader); D. MCHENRY, *supra* (a critique of American policy published by the Carnegie Endowment for International Peace); D. NEVIN, THE AMERICAN TOUCH IN MICRONESIA (1977) (a critique of the day-to-day administration of Micronesia carried out by the U.S. Department of the Interior and its agency, the Trust Territory government); H. NUFER, MICRONESIA UNDER AMERICAN RULE (1978); POLITICAL DEVELOPMENT IN MICRONESIA (D. Hughes & S. Lingenfelter eds. 1974) [hereinafter cited as POLITICAL DEVELOPMENT] (largely written by anthropologists with considerable personal experience in Micronesia); 1-3 D. RICHARD, UNITED STATES NAVAL ADMINISTRATION OF THE TRUST TERRITORY OF THE PACIFIC ISLANDS (1957) (official publication of the U.S. Navy); R. VAN CLEVE, THE OFFICE OF TERRITORIAL AFFAIRS (1974) (written by an Interior Department official).

[2] Only the Trust Territory of the Pacific Islands remains of the 11 trusteeships established by the United Nations after World War II. D. MCHENRY, *supra* note 1, at 34. The Trusteeship Agreement for the Former Japanese Mandated Islands, approved by the United Nations Security Council on Apr. 2, 1947, approved by the United States on July 18, 1947, 61 Stat. 397, T.I.A.S. No. 1665, 8 U.N.T.S. 189 [hereinafter cited as Trusteeship Agreement], art. 2, assigns administrative responsibility to the United States. The U.S. Congress has authority to govern territories of the United States. U.S. CONST. art. IV, § 3. Congress delegated administrative authority over the Trust Territory to the President. 48 U.S.C. § 1681(a) (1982). President Truman delegated the authority to the Secretary of the Interior in 1952. *See* Exec. Order No. 10,265, 16 Fed. Reg. 6419 (1951). The Secretary of the Interior delegated administrative authority to the High Commissioner. *See* Secretarial Order No. 2658, 16 Fed. Reg. 9052 (1951).

Pursuant to Secretarial Order No. 3039, the Secretary purports to delegate governing authority within the Trust Territory to the constitutional governments of Micronesia. 44 Fed. Reg. 28,116 (1979). By contrast, the FSM Constitution treats the authority of the FSM government as inherent and sovereign. *See infra* text accompanying notes 77-78.

[3] The FSM stretches 4000 kilometers across the western Pacific between 1° and 12° North of the Equator. OFFICE OF TOURISM, DEP'T OF RESOURCES & DEVELOPMENT, TRUST TERRITORY OF THE PACIFIC ISLANDS, MAPS OF MICRONESIA plate 1 (1970). In the 1980's, the population is about 77,000. The FSM's four states and their approximate populations are: Truk, 39,000; Pohnpei (Ponape), 23,000; Yap, 9000; and Kosrae, 5500. OFFICE OF PLANNING AND STATISTICS, FEDER-

semi-autonomous jurisdictions functioning as constitutional governments under the trusteeship.[4] The constitutions of all three of the governments are designed to be the fundamental law of these jurisdictions during the remaining years of the trusteeship, a period of free association, and during independence if it is ever achieved. Thus, these constitutions, which are already in effect, can be expected to continue in force despite changes in political status.

Palau, the Marshall Islands and FSM have been negotiating with the United States to establish a relationship of free association to commence upon termination of the trusteeship,[5] when each of these governments is to be recognized as fully sovereign.[6] The FSM and the Marshalls ratified the proposed Compact of

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ATED STATES OF MICRONESIA, NATIONAL YEARBOOK OF STATISTICS 4-5 (1981). The population of the Trust Territory as a whole, including the Northern Marianas, is about 145,000. BUREAU OF CENSUS, U.S. DEP'T OF COMMERCE, 1980 CENSUS OF POPULATION, GENERAL POPULATION CHARACTERISTICS, TRUST TERRITORY OF THE PACIFIC ISLANDS 57B-5-6 (1983). The Marianas have about 14,000 (a 1973-census figure); Palau, 12,000; and the Marshalls, 31,000. OFFICE OF PLANNING AND STATISTICS, TRUST TERRITORY OF THE PACIFIC ISLANDS, 3 QUARTERLY BULLETIN OF STATISTICS 1 (1980).

[4] Secretarial Order 3039 recognizes the establishment of constitutional governments. 44 Fed. Reg. 28,116 (1979).

[5] The history of the political status negotiations is discussed in Hanlon & Eperiam, *Federated States of Micronesia: Unifying the Remnants*, in POLITICS IN MICRONESIA 79 (R. Crocombe & A. Ali eds. 1983); Iyechad & Quimby, *Belau: Super-port, Fortress or Identity*, in POLITICS IN MICRONESIA 100 (R. Crocombe & A. Ali eds. 1983); D. MCHENRY, *supra* note 1, *passim*; Smith, *Marshall Islands: Tradition and Dependence*, in POLITICS IN MICRONESIA 55 (R. Crocombe & A. Ali eds. 1983); H.R. REP. NO. 188, pt. 2, 99th Cong., 1st Sess. 9 (1985).

[6] The Preamble to the Compact of Free Association, the document which formalizes the proposed future relationship between the United States and the governments of the Republic of the Marshall Islands and the Federated States of Micronesia, acknowledges the sovereignty of the Micronesian people:

> Recognizing that the peoples of the Trust Territory of the Pacific Islands have and retain their sovereignty and their sovereign right of self-determination and the inherent right to adopt and amend their own Constitutions and forms of government and that the approval of the entry of their respective Governments into this Compact of Free Association by the peoples of the Trust Territory of the Pacific Islands constitutes an exercise of their sovereign right of self determination. . . .

Compact of Free Association Act, 131 CONG. REC. H11,807-28 (daily ed. Dec. 11, 1985). The Compact of Free Association is set forth as § 201 of the Compact of Free Association Act, which is in the form of a Joint Resolution of Congress. The Act purports to impose numerous limitations and reinterpretations of the Compact as well as granting certain additional funds to the Micronesian jurisdictions. *See id.*, tits. I-IV, at H11,807-16, 11,826-28.

United States government officials have stated that the trusteeship will not terminate until all four of the governments in the Trust Territory of the Pacific Islands, including Palau, have completed negotiations on their future status, approved their status in a plebiscite and received Congressional approval. U.S. DEP'T OF STATE, 1978 TRUST TERRITORY OF THE PACIFIC ISLANDS 24 (1978).

Free Association in 1983.[7] In Palau, the proposed Compact received majority support in a 1983 referendum but failed to achieve the three-fourths majority necessary to waive Palau's constitutional prohibition of the introduction of nuclear weapons.[8] Since then, Palau's proposed Compact with the United States has been revised in an attempt to circumvent the prohibition, and it was very recently approved by a vote of 72%.[9] It is not yet clear, however, whether the proposed Compact can pass Palauan constitutional muster and Palau's future relationship with the United States, therefore, remains unclear.

The Northern Mariana Islands are separately administered[10] as they plan to become a "Commonwealth," actually a territory, under United States sovereignty upon termination of the trusteeship.[11] In December, 1985, the United States Congress approved the Compact. Under the terms of the Compact, it will take effect between the United States and the two ratifying areas—the FSM and the Marshall Islands.[12]

II. THE BEGINNINGS OF SELF-GOVERNMENT

During the post-colonial period, the major advances toward self-government in the Trust Territory began with the establishment of the Congress of Micronesia as the legislative body for the entire territory in 1966 after more than twenty years of American administration.[13] The Congress was established by a departmental order of the Secretary of the Interior of the United States.[14] Soon after its establishment, the Congress of Micronesia began to consider terminating the trusteeship.[15]

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[7] A majority of those voting in the FSM approved the Compact of Free Association on June 21, 1983. A majority of the voters approved it in the Marshall Islands on September 7, 1983. *See* S.J. Res. 286, 98th Cong., 2d Sess. 1 (1984); FSM Cong. Res. 78, 3d Cong., 1st Spec. Sess. (1983).

[8] N. MELLER, CONSTITUTIONALISM IN MICRONESIA 336-37 (1985) [hereinafter N. MELLER, CONSTITUTIONALISM]; H.R. REP. NO. 188, pt. 2, 99th Cong., 1st Sess. 8-9 (1985).

[9] *Palau Passes Compact*, Wash. Pac. Rep., Mar. 1, 1986, at 3.

[10] Covenant to Establish a Commonwealth of the Northern Mariana Islands in Political Union with the United States of America, Pub. L. No. 94-241, 90 Stat. 263 (codified at 48 U.S.C. § 1681 (1982)).

[11] See Clark, *Self-Determination and Free Association—Should the United Nations Terminate the Pacific Islands Trust?*, 21 HARV. INT'L L.J. 1 (1980), for a cogent critique of this arrangement under international law. *See also* D. MCHENRY, *supra* note 1, at 129-69.

[12] Compact, *supra* note 6, § 101, at H11,808.

[13] *See* N. MELLER, THE CONGRESS OF MICRONESIA 197-221 (1969) [hereinafter N. MELLER, CONGRESS].

[14] Secretarial Order No. 2882, 29 Fed. Reg. 13,613 (1964), *superseded by* Secretarial Order No. 2918, 34 Fed. Reg. 157 (1969).

[15] C. HEINE, *supra* note 1, at 44-47, 55-71; D. MCHENRY, *supra* note 1, at 88-94; N.

By 1970, the Congress had formulated a policy to seek a political relationship with the United States that would come into effect upon termination of the trusteeship, and the Congress adopted general principles to govern such a relationship.[16] In its view, extreme economic dependence on the United States, and the lack of capital infrastructure and readily exploitable natural resources required either a new political relationship with the United States or prolonged continuation of the trusteeship. The majority ruled out independence as impractical in the near future although it was stated to be the ultimate goal for many of them.[17]

During this same period, the Congress sought to devise a future government that would accommodate the needs of six widely-dispersed districts having distinct languages and cultural traditions and disparate levels of post-contact cultural change while establishing a national government with sovereign powers.[18] The majority of the Congress of Micronesia favored political unity and free association with the United States.

As the political status negotiations continued during the early 1970's, the future relations among the districts became an issue in the negotiations.[19] The United States government's interest in military bases and facilities in three of the six districts[20] affected those districts' attitudes toward unity. The districts that were called upon to grant military-use rights expected major financial rewards. Thus, it was much simpler for the United States to deal individually with the districts having military importance and collectively with the remainder.

The alternative would have been attempting to satisfy all six districts regarding not only their relations with the United States but also their relations with one another. As the discussions regarding compensation for military base rights became more specific, the separatists gained greater support. Their local constituents saw little reason to share the compensation when the burdens of the American military presence would not be shared.[21] Not coincidentally, precisely those three districts in which the United States expressed military interest—the

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MELLER, CONGRESS, *supra* note 13, at 400-03; N. MELLER, CONSTITUTIONALISM, *supra* note 8, at 51-70.

[16] *See* Cong. of Micronesia H.R.J. Res. 87, 3d Cong., 3d Sess. (1970); Cong. of Micronesia H.R.J. Res. 90, 3d Cong., 3d Sess. (1970). *See infra* text accompanying note 79.

[17] D. MCHENRY, *supra* note 1, at 90-92; C. HEINE, *supra* note 1, at 79-84.

[18] D. MCHENRY, *supra* note 1, at 133-38; C. HEINE, *supra* note 1, at 110-17.

[19] C. HEINE, *supra* note 1, at 171-76.

[20] Most of the island of Tinian in the Marianas has been leased for military facilities. D. MCHENRY, *supra* note 1, at 138. The United States has plans for a submarine base at Koror and other bases on Babelthaup in Palau. *See* H.R. REP. NO. 188, pt. 1, 99th Cong., 1st Sess. 6 (1985). The United States has a missile testing range at Kwajalein in the Marshall Islands. D. MCHENRY, *supra* note 1, at 60-62.

[21] N. MELLER, CONSTITUTIONALISM, *supra* note 8, at 71-104.

Marianas, Palau, and the Marshalls—eventually chose to secede.[22]

That the United States might influence the internal organization of Micronesia loomed as a potential permanent intrusion on Micronesian sovereignty. By 1975, the establishment of constitutional government was becoming necessary not simply on its own merits, but it was becoming urgent to ensure that a national polity would be established on the basis of Micronesian decisions. Partly in a race against the complete political disintegration of Micronesia, the Congress enacted a statute calling for a constitutional convention.[23]

III. The Micronesian Constitutional Convention

The Micronesian Constitutional Convention was held in sessions totalling ninety days between July and November 1975.[24] All six districts as then constituted—Ponape,[25] Truk, and Yap, plus the Marianas, Palau, and the Marshall Islands—were represented.[26]

There were sixty delegate seats at the Convention.[27] They represented three types of constituencies—traditional chiefs, members of the Congress, and the public.[28] Six seats were reserved for members of the Congress of Micronesia, one from each district.[29]

Two traditional chiefs from each district, twelve in all, were chosen in district

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[22] Initially, the United States attempted to limit the fragmentation and secession to the Marianas. D. McHenry, *supra* note 1, at 134. However, by the mid-1970's, the United States was resigned to, if not supporting, separatist activity in Palau and the Marshall Islands. In the "Hilo Principles" adopted in April 1978, the United States formally recognized the negotiating delegations of Palau and the Marshall Islands as being legitimate representatives of their districts. Statement of Agreed Principles of Free Association ("Hilo Principles"), in U.S. Dep't of State, 1978 Trust Territory of the Pacific Islands 24-25 (1978).

The United States action was in blatant derogation of the Congress of Micronesia's law establishing the Commission on Future Political Status and Transition (CFPST) as the sole authorized negotiating agency for Micronesia, 2 T.T. Code § 509(4) (1980), but the CFPST and the Congress reluctantly acceded to this action. N. Meller, Constitutionalism, *supra* note 8, at 325.

[23] Constitutional Convention Act, Pub. L. No. 5-60, § 1 (1974).

[24] Journal of The Micronesian Constitutional Convention of 1975 (1976) [hereinafter cited as JMCC].

[25] Ponape's official name was changed to Pohnpei with the adoption of its Constitution in late 1984. National Union, Sept. 30, 1984, at 1, col. 3. Pohnpei is the indigenous name for the major island in the state. *See id.* Until 1976, Kosrae was a part of Ponape and known as Kusaie. It became a separate district in 1976, pursuant to law enacted by the Congress of Micronesia. Pub. L. No. 7-2 (1977) (amending 3 T.T. Code § 1 (1980)). Kosrae is the indigenous name; Kusaie is a western corruption of the name.

[26] JMCC, *supra* note 24, at xxxv.

[27] Constitutional Convention Act, Pub. L. No. 5-60, §§ 2(1), 2(2), 2(3) (1974).

[28] *Id.*

[29] *Id.* § 2(1).

meetings of their peers.[30] The traditional chiefs were originally to be non-voting delegates. However, considerable pressure was put on the Congress to raise their status to voting delegates, and the Congress acquiesced.[31]

The remaining forty-two delegates were chosen by election from districts that generally corresponded to traditional political units.[32] The Mariana Islands had four elected delegates; the Marshall Islands, nine; Palau, five; Ponape, nine; Truk, twelve; and Yap, three.[33] Each elected delegate represented a constituency of approximately 3000 people.

Six of the nine Marianas delegates attended the Convention[34] even though their district's separate political-status negotiations with the United States had already concluded. The Marianas voters had approved their Covenant on June 17, 1975, and the FSM Constitution was never put before them.[35]

Palauans were divided between separatists and those willing to support unity if acceptable terms could be negotiated.[36] Palau's leaders had decided that, if Palau were to be part of a united Micronesia, sovereignty must reside with the constituent states.[37] The Palauan delegates chose to function as a bloc to establish a loose confederation, and they declined leadership positions in the Convention.[38] Important elements of the Constitution that emerged from the Convention reflected the compromises reached between the Palauans and the representatives of Truk, Ponape, and Yap.[39]

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[30] *Id.* § 2(3)(a). For the Marianas, which lacks traditional chiefs, the district administrator and the legislature each appointed one delegate. N. MELLER, CONSTITUTIONALISM, *supra* note 8, at 109. *See* Constitutional Convention Act, Pub. L. No. 5-60, § 2(3)(b) (1974). The traditional chiefs of the Marshalls generally supported the separation movement, N. MELLER, CONSTITUTIONALISM, *supra* note 8, at 93, but two chiefs sympathetic to national unity attended the convention long after it began. The Convention's Resolution No. 20 requested that the Marshalls and the Marianas send traditional leaders to the Constitutional Convention. JMCC, *supra* note 24, at 993-94. In Resolution No. 28, the Convention accepted two Marshallese as "participant-observers." JMCC, *supra* note 24, at 1002. Their ambiguous status was never ultimately resolved.

[31] N. MELLER, CONSTITUTIONALISM, *supra* note 8, at 111-12.

[32] Constitutional Convention Act, Pub. L. No. 5-60, §§ 2(2)(a)-(2)(f) (1974).

[33] *Id.*

[34] The Marianas' delegation was to consist of four members elected from districts, one delegate selected from among the members of the Marianas' delegation to the Congress of Micronesia, and two chosen as additional delegates pursuant to Constitutional Convention Act, Pub. L. No. 5-60, § 2(3)(b) because the Marianas lack traditional leaders. JMCC, *supra* note 24, at 1079. *See supra* note 30. However, one elected delegate and one appointed delegate resigned. JMCC, *supra* note 24, at xxxv. A replacement was chosen for the latter. *Id.* at 940. Of the seven delegates, five signed the Constitution of the Federated States of Micronesia. *Id.* at xxxii.

[35] N. MELLER, CONSTITUTIONALISM, *supra* note 8, at 70 n.19, 74-82.

[36] *Id.* at 93-99.

[37] *Id.* at 176.

[38] JMCC, *supra* note 24, at 28-30, 945-47, 955-56.

[39] SPEC. CONF. COMM. REP. NO. 4 ON RES. 1, JMCC, *supra* note 24, at 940-41. *See* N. MELLER, CONSTITUTIONALISM, *supra* note 8, at 175-91, 199-201, 244, 249, 287-314, 365-67.

By 1975, the majority faction of the Marshalls' leadership had firmly decided on separation and urged their followers to boycott the election of delegates.[40] Consequently, the Marshalls' delegation consisted of nationalists chosen by few voters.[41]

Tosiwo Nakamaya, the President of the Senate of the Congress of Micronesia, was elected President of the Convention at its organization.[42] The Convention established standing committees on structure, functions, civil liberties, public finance and taxation, general provisions, and style and arrangement.[43]

The jurisdiction of two major committees—those on structure and functions—overlapped almost completely, yet their approaches to federalism differed greatly. They brought rival proposals[44] on federalism before the Convention.[45]

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[40] Smith, *supra* note 5, at 58-59; N. MELLER, CONSTITUTIONALISM, *supra* note 8, at 82-93, 144.

[41] Smith, *supra* note 5, at 58-59; N. MELLER, CONSTITUTIONALISM, *supra* note 8, at 89-90, 99.

[42] JMCC, *supra* note 24, at 10.

[43] *Id.* at 14-16. Dr. Norman Meller, a professor of political science at the University of Hawaii, served as the Convention's advisor. His official title was Director of Research and Drafting. *Id.* at xxxix. Dr. Meller describes his role in N. MELLER, CONSTITUTIONALISM, *supra* note 8, at 164-67. The legal staff of the Congress of Micronesia formed part of the Research and Drafting Staff, which assisted the Convention. JMCC, *supra* note 24, at xxxix. The fact that the staff was largely American in citizenship and in the regular employ of the Congress led to some criticism, particularly when scapegoats were being sought. N. MELLER, CONSTITUTIONALISM, *supra* note 8, at 145-46, 218-29; Remarks of Delegate Lazarus Salii, JMCC, *supra* note 24, at 173-74.

[44] In general, the successful proposals for constitutional provisions were generated in committee deliberations, assigned to subcommittees and to legal staff for drafting, and discussed further by the full committees. The committee proposals were then submitted to the Convention. N. MELLER, CONSTITUTIONALISM, *supra* note 8, at 195.

Although convention delegates were authorized to submit their own individual proposals, only four of 163 such proposals were reported out of committee. The four that were reported out of committee included Delegate Proposal 8 (Territorial Limits), Delegate Proposal 29 (Establishing Three Branches of Government and Advisory Council of Traditional Leaders), Delegate Proposal 100 (Palau Delegation Proposal), and Delegate Proposal 120 (Government of United Republics of Micronesia). JMCC, *supra* note 24, at 1035-52. None was formally adopted as part of the text of the Constitution. *See* Status Table of Delegate Proposals, JMCC, *supra* note 24, at 1024-25. However, the delegate proposals undoubtedly had some influence on the committee proposals that were adopted. Chief among these was the Palau Delegation proposal for a loose confederation. Although it was substantially modified, several of its essential provisions were adopted. JMCC, *supra* note 24, at 908. *See supra* note 39.

[45] *Compare* Committee Proposal 24 of the Structure Committee *with* Committee Proposal 21 and Committee Proposal 30 of the Functions Committee. JMCC, *supra* note 24, at 915-35. Committee Proposal 21 deals with allocation of powers between the state and national governments. The substance of its provisions was adopted. *Id.* at 915-17. *See* FSM CONST. arts. IX (Legislature), X (Executive) (FSM Constitution is reprinted at 5 U. HAWAII L. REV. 372 (1983)). Committee Proposal 30 proposed a federal judiciary, similar to that in the United States. JMCC, *supra* note 24, at 933-35. It was nominally rejected. *Id.* at 451. However, it survived virtually intact as Joint Committee Amendment No. 10 to Committee Proposal 24. *Id.* at 925-26. *See*

The Structure Committee proposed that Micronesia be governed by an executive council. The council was to have one member representing each state, and there were to be a bicameral Congress as the legislative body and a unified judicial system, except for local land-claims courts. The proposal would have established a chamber of chiefs in the executive branch of the national government and an active, functional role for the traditional chiefs in their respective states.[46] This proposal was rejected virtually in its entirety.[47]

The Functions Committee proposed a federal system very similar to that created by the United States Constitution.[48] Its proposals generally prevailed. Under those proposals, the executive is led by a President who appoints his own cabinet, there is a unicameral Congress, and a federal judiciary exists separately from the state judiciaries. The entire national government has nominally limited jurisdiction. The states have elected governors and legislatures, and exercise nominally general jurisdiction, as do the state courts. The provisions relating to traditional chiefs merely permit rather than require their formal participation in government.[49]

The fundamental political compromises of the Convention were made as the Convention's majority, representing the central districts that later ratified the Constitution, attempted to accommodate the views of the Palau delegation,[50] while simultaneously preserving the concept of a sovereign national government.[51] These compromises were made by an *ad hoc* Special Committee comprising the district delegation leaders, the President of the Convention, and some committee chairmen.[52] The Special Committee met without staff, that is without Americans observing the Committee's internal deliberations. This was evidently an important factor in promoting the compromises as consonant with the "Micronesian way" of dispute resolution. The decisions of the Special Committee were referred to the standing committees for inclusion in their

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STAND. COMM. REP. NO. 49 ON COMM. PRO. NO. 30, JMCC, *supra* note 24, at 876-80. This modified version of Committee Proposal 30 was adopted. JMCC, *supra* note 24, at 447-50.

[46] JMCC, *supra* note 24, at 918-28. *See also* STAND. COMM. REP. NO. 36, JMCC, *supra* note 24, at 823-61.

[47] *Compare* FSM CONST. art. IX (Legislature), art. X (Executive), art. XI (Judiciary) *with* COMM. PRO. NO. 24, JMCC, *supra* note 24, at 918-28.

[48] *See* STAND. COMM. REP. NO. 33 ON COMM. PRO. NO. 21, JMCC, *supra* note 24, at 813-21 (Legislature and Executive); STAND. COMM. REP. NO. 49 ON COMM. PRO. NO. 30, JMCC, *supra* note 24, at 876-80 (Judiciary).

[49] N. MELLER, CONSTITUTIONALISM, *supra* note 8, at 281.

[50] The Palauan outline of its position is set forth in their petition. JMCC, *supra* note 24, at 955-56; N. MELLER, CONSTITUTIONALISM, *supra* note 8, at 365-67 (The Palauans' comprehensive draft constitution, Delegate Proposal No. 100, is not set forth in either of these sources.).

[51] SPECIAL COMM. REP. NO. 4 ON RES. NO. 1, JMCC, *supra* note 24, at 940-41; N. MELLER, CONSTITUTIONALISM, *supra* note 8, at 175-91, 199-201, 244, 249, 287-314, 365-67.

[52] JMCC, *supra* note 24, at xxxviii.

proposals.[53]

The compromises determined the composition and apportionment of the Congress, the method of electing the President and Vice President, the voting structure in Congress, and the structure of taxation. The compromises required that legislation be approved by a super-majority[54] and that the states receive a large portion of nationally-generated revenues and foreign financial assistance.[55]

The Palauan delegation was sufficiently satisfied with the compromises to sign the Constitution.[56] However, the Constitution was defeated by a narrow margin in Palau.[57] The FSM Constitution was thus shaped in large measure by people who do not live under it.

IV. The Establishment of Constitutional Government

The Constitution was ratified on July 12, 1978, by majority vote in Yap, Pohnpei, Truk, and Kosrae, which had earlier separated from Pohnpei.[58] It was defeated in Palau and the Marshalls.[59] By the terms of the Constitutional Con-

[53] N. Meller, Constitutionalism, *supra* note 8, at 298-304.

[54] The JMCC, *supra* note 24, lacks any explanation of how this change was made. *Compare* Comm. Pro. No. 24, JMCC, *supra* note 24, at 922 (original version requiring passage of bills on simple majority in each of two chambers) *with* Comm. Pro. No. 24, JMCC, *supra* note 24, at 927 (as modified by the Committee on Style and Arrangement requires two-thirds of the individual members of Congress and two-thirds of the state delegations, in a unicameral congress). The modification was apparently done on the informal suggestion of the Special Conference Committee.

[55] Comm. Pro. No. 26, JMCC, *supra* note 24, at 930-31; Comm. Rep. No. 38, JMCC, *supra* note 24, at 863-66. *See also* JMCC, *supra* note 24, at 173-74 (remarks of Lazarus Salii, a member of the Palau Delegation, in which he outlined the Palauan proposal to rebate at least 50% of the national revenues generated from a particular state back to that state).

[56] JMCC, *supra* note 24, at xxxi. *See also* speech of Palau Delegation Chairman Ngirarked, JMCC, *supra* note 24, at 596-97.

[57] *See* Table, *infra* note 59.

[58] *See supra* note 25.

[59] By district, the vote on the Constitution was

	Yes	% Yes	No	% No	Total
Yap	3,359	95	186	5	3,545
Pohnpei	5,970	75	2,020	25	7,990
Truk	9,762	70	4,239	30	14,001
Kosrae	1,118	61	704	39	1,822
FSM Subtotal	20,209	74	7,149	26	27,358
Palau	2,720	45	3,339	55	6,059
Marshalls	3,888	38	6,217	62	10,105
T.T. (less Marianas) total	26,817	62	16,705	38	43,522

vention Act, the Constitution did not take effect in the districts that rejected it.[60]

The Constitution states that its effective date is to be not later than one year after the ratification.[61] This period was to provide time for transition to the new constitutional government.[62] The FSM constitutional government was established on May 10, 1979, following elections in March for the new Congress.[63] However, the contemplated assumption of administrative functions and powers by the new government did not occur within the year after ratification. The transition was delayed for several practical and political reasons.

The location of the capital was one such problem. The capital of the Trust Territory was located on the island of Saipan in the Marianas. In 1975, during the Convention, it was apparent that the Marianas were about to secede. The significantly superior capital infrastructure and telecommunications facilities on Saipan made moving impractical, even though the Congress of Micronesia had passed legislation in August 1976 to make Pohnpei the capital.[64] The Congress moved there in mid-1977,[65] but no other Trust Territory government offices were ever relocated to Pohnpei.

The assumption of governmental functions from the Trust Territory Government was thus impeded by the distance between Pohnpei and Saipan--nearly 2000 kilometers, the inadequate facilities in Pohnpei, and the complications arising as the Trust Territory Government divided its functions, assets, and records among three new governments, rather than transferring them only to one. Only after the new constitutional governments of the FSM and the Marshalls were established in 1979 were government activities relinquished by the Trust Territory in favor of the new governments.

Legal constraints were also imposed on the assumption of governmental functions. Department of Interior Secretarial Order No. 3039 was promulgated, recognizing the new constitutional governments.[66] However, the Order purports to have the Trust Territory Government, which is expected to remain in existence until the termination of the trusteeship, retain a number of powers that

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Cong. of Micronesia, H.R.J. Res. 144, 7th Cong., 2d Spec. Sess. (1978). *See also* N. MELLER, CONSTITUTIONALISM, *supra* note 8, at 345-46 n.45. The Marianas did not vote on the Constitution. *Id.* at 70 n.19, 74-82.

[60] Constitutional Convention Act, Pub. L. No. 5-60, § 11(7).

[61] FSM CONST. art. XVI, § 1.

[62] JMCC, *supra* note 24, at 871.

[63] FSM Interim Cong., S.J. Res. 5 (1979).

[64] Pub. L. No. 6-133 (1976) (codified at 1 FSM CODE § 401 (1982)).

[65] Cong. of Micronesia H.R.J. Res. 63, 7th Cong., 1st Spec. Sess. (1977).

[66] 44 Fed. Reg. 28,116 (1979). The Marianas had already become separately administered. 48 U.S.C. § 1681 (1980); Proclamation No. 4534, 3 C.F.R. §§ 56-57 (1978). This left the Federated States of Micronesia and the other two secessionist districts—Palau and the Marshalls—to form their respective governments.

do not appear necessary under the trusteeship.[67] The Order also implicitly purports to defeat the self-executing character of the FSM Constitution and the constitutions of Palau and the Marshalls. Secretarial Order No. 3039 has provided for a system of transfers of governmental functions and authority by agreement rather than the automatic self-executing devolution contemplated by the Constitutional Convention.[68]

As to some areas of governmental administration, however, the constitutional governments have not been able to acquire control even by agreement. For example, Trust Territory Headquarters has continued to administer important aspects of United States federal programs relating to health care and education, the Trust Territory Social Security system, and the construction of major roads, airfields, and utilities.[69] This retention of power is partly attributable to the partition of the Trust Territory among the three new governments that are in many respects not formally recognized in the United States[70] or in the international community.

The Order also purports to confer on the High Commissioner the power to "suspend," i.e., to veto, legislation of the three constitutional governments that is deemed to be inconsistent with the Order, the Trusteeship Agreement, applicable United States law, or the Bill of Rights of the Trust Territory.[71] The Trust Territory High Court, appointed solely by the Secretary of the Interior to serve at his pleasure,[72] remains in existence even after the establishment of constitutional courts. Taking its cue from the Secretarial Order, the High Court has purported to exercise broad appellate power over the decisions of the constitutional courts.[73]

Despite these delays and legal constraints, the three branches of the constitu-

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[67] For example, the Order purports to give the High Commissioner a veto power over legislation "inconsistent with the provisions of this Order." Secretarial Order No. 3039, § 4b, 44 Fed. Reg. 28,116, 28,117 (1979). The High Court is given "certiorari" review over all cases, regardless of the subject matter. *Id.* § 5b, 44 Fed. Reg. at 28,118.

[68] Manahane v. Federated States of Micronesia, 1 FSM Interim 161, 167-68 n.3 (Tr. Div. Pohnpei 1982); 8 FSM CODE §§ 201-206 (1982).

[69] *See* Hanlon & Eperiam, *supra* note 5, at 91.

[70] Although United States legislation has carefully provided for the separate administration and recognition of the Northern Mariana Islands, *see supra* note 10, very little United States legislation recognizes the separate identity of the new constitutional governments.

[71] Secretarial Order No. 3039, § 4a, 44 Fed. Reg. 28,116, 28,117 (1979).

[72] Secretarial Order No. 2918, 34 Fed. Reg. 157 (1969).

[73] Secretarial Order No. 3039, § 5b, 44 Fed. Reg. 28,116, 28,118 (1979). The High Court's conduct has been sharply criticized in Bowman, *Legitimacy and Scope of Trust Territory High Court Power to Review Decisions of Federated States of Micronesia Supreme Court: The* Otokichy *Cases*, 5 U. HAWAII L. REV. 57 (1983); *"War" in the Micronesian Courts*, PAC. MAG., July-Aug. 1983, at 16-17. *See also In re* Iriarte (II), 1 FSM Interim 255, 267 (Tr. Div. Pohnpei 1983) ("[T]he High Court is an anomalous entity operating on an interim basis within, or adjacent to, a constitutional framework.").

tional government of the Federated States of Micronesia have been established and are actively functioning. The large majority of the administrative powers formerly exercised by the Trust Territory is now exercised by the national and state governments of the Federated States.

V. THE CONSTITUTION: TEXT AND PRACTICE

A. *The Micronesian Nation*

1. *Sovereignty and Supremacy*

The Micronesian Constitutional Convention was held some six years after negotiations had begun with the United States to terminate the trusteeship. Since their beginnings, the negotiations presupposed a political relationship between Micronesia and the United States in the post-trusteeship era on a temporary basis at least.[74] The majority of Micronesian public opinion has long favored a future relationship of free association with the United States in which Micronesian sovereignty and cultural identity would be protected.[75]

Micronesia's political status negotiators had hoped that the Convention would choose a future political status for Micronesia and write the Constitution to conform to that status. However, the Convention chose to leave open the options of both free association and independence.[76]

To accommodate the option of independence, the Constitution can become the fundamental law of an independent nation without the need for amendment.[77] It also sets forth the form of free association that can be established between the FSM and a metropolitan nation such as the United States. It does so by "delegation" to the metropolitan nation of the right to exercise sovereign powers of Micronesia. The Constitution does not recognize that a metropolitan nation would inherently hold such powers.[78]

"Free association" is a term that may describe several types of relations between associated states and metropolitan powers. In 1970, the Congress of Micronesia identified four principles as essential to any future political relationship with a metropolitan nation: (1) sovereignty resides in the people of Micronesia and their government; (2) Micronesians have the right to self-determination and may choose independence or any form of association with any nation; (3)

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[74] D. MCHENRY, *supra* note 1, at 94; C. HEINE, *supra* note 1, at 79-84.

[75] D. MCHENRY, *supra* note 1, at 88-94. An advisory referendum in 1975 confirmed this opinion. N. MELLER, CONSTITUTIONALISM, *supra* note 8, at 66, 70 n.19, and appendix B.

[76] N. MELLER, CONSTITUTIONALISM, *supra* note 8, at 109-10.

[77] *See* FSM CONST. art. II, § 1 (supremacy clause).

[78] FSM CONST. art. IX, § 4.

the people of Micronesia have the right to adopt their constitution and amend it at any time; and (4) free association should be in the form of a revocable compact, terminable unilaterally at any time.[79] Thus began the definition of Micronesian free association.

The Constitution was written to promote these principles.[80] Article II states that the Constitution is the expression of the sovereignty of the people of Micronesia and is the supreme law.[81] After at first vigorously opposing the FSM Constitution as being incompatible with its concept of free association, because of the supremacy clause, the United States accepted this principle in April 1978.[82] The United States negotiators agreed that the Compact of Free Association would be a government-to-government agreement and acknowledged that the Micronesian governments would exercise their constitutional foreign affairs powers during free association subject only to defense limitations. The United States recognized the capacity of Micronesia's future constitutional governments to enter into an agreement of free association and acknowledged that the agreement would be subordinate to their respective constitutions.[83]

Indeed, it is important that the Constitution was designed to come into effect before the termination of the trusteeship. This permits the establishment of a new political relationship with a foreign power to be done under the authority of, and in conformity with, the Constitution. The Constitution's chronological precedence thus helps ensure its supremacy over international agreements.

The referendum on the Constitution with its article on Micronesian sovereignty was therefore an act of self-determination of the most fundamental significance. For the first time in the modern era, Micronesians asserted the existence of their sovereignty and identified its locus. The vote to terminate the trusteeship and to choose among future political relationships is, at least in theory, of lesser juridical significance, although its practical economic and political consequences would be far-reaching.

Under the Compact of Free Association, a number of important governmental functions are to be performed by the United States. In many cases, the United States will continue its former exercise of powers, but on the basis of agreement, rather than on assertion of right. These functions are primarily in the areas of defense, including the authority to review Micronesia's foreign affairs activities that may affect the defense relationship, telecommunications, aviation, and weather services.[84]

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[79] Cong. of Micronesia H.R.J. Res. 87, 3d Cong., 3d Sess. (1970).

[80] *See* STAND. COMM. REP. NO. 16 ON COMM. PRO. NO. 11, JMCC, *supra* note 24, at 784-86.

[81] FSM CONST. art. II, § 1.

[82] N. MELLER, CONSTITUTIONALISM, *supra* note 8, at 317-22.

[83] Statement of Agreed Principles for Free Association ("Hilo Principles"), *supra* note 22, at 24-25. *See* N. MELLER, CONSTITUTIONALISM, *supra* note 8, at 321.

[84] *See generally* Compact, *supra* note 6.

The FSM Constitution states that these governmental powers can be delegated to the United States by treaty.[85] Because these powers are major ones, the Compact had to be submitted to ratification by at least two-thirds of the state legislatures.[86] The FSM Congress ratified the Compact and the requisite three of the four state legislatures approved it by August 1983.[87] The Pohnpei Legislature rejected the Compact, expressing concern that it delegated too much power to the United States.[88]

The Compact of Free Association was also submitted to the FSM electorate and approved in June 1983.[89] Popular ratification is an extra-constitutional requirement imposed by the terms of the Compact itself.[90] The Compact failed

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[85] FSM CONST. art. IX, § 4.

[86] *Id.*

[87] FSM Cong. Res. 78, 3d Cong., 1st Sess. (1983).

[88] *See* STAND. COMM. REP. No. 48, 2d Pohnpei Leg., Reg. Sess. (1983) (on L. Res. No. 144-83) (copy on file at law review office). The Resolution cites among the shortcomings of the Compact:

> substantial and unnecessary danger to our people from nuclear attack or accidental detonation of nuclear weapons which danger may be made possible through distortions in the interpretation of the . . . Compact . . . restraints on the sovereignty of this country for an indeterminate period of time [inadequate recognition of] the potential adverse effects these agreements [the Compact and related documents] may have on the Constitutional balances of authority and responsibility within the Federation . . . .

In other words, the Compact would give the United States too much power over Micronesia and it would enhance FSM national power against the states because most revenues would be from foreign aid passing through the budgetary and auditing control mechanisms of the national government.

[89] FSM Cong. Res. 78, *supra* note 7. By state, the vote on the Compact was

	Yes	% Yes	No	% No	Total
Truk	11,261	95	538	5	11,799
Yap	3,287	94	201	6	3,488
Kosrae	1,325	89	172	11	1,497
Pohnpei	4,248	49	4,437	51	8,685
FSM Total	20,121	79	5,348	21	25,469

National Union, July 15, 1983, at 1, 4, col. 1.

The referendum ballot on the Compact also asked voters to express their preference for an alternative to free association if ratification of the Compact failed. The choices offered were independence and other forms of association with the United States. The results:

	Independence	%	Other	%	Total
Truk	7,252	81	1,655	19	8,907
Yap	1,504	67	732	33	2,236
Kosrae	401	34	793	66	1,194
Pohnpei	4,767	70	2,004	30	6,771
FSM Total	13,924	73	5,184	27	19,108

Id.

[90] Compact, *supra* note 6, § 412, at H11,824.

to achieve majority support in Pohnpei, where the voters expressed a preference for independence.[91]

The Constitution of the Federated States of Micronesia has been designed to accommodate the three most likely eventualities of Micronesia's political status—the interim continuation of the trusteeship, free association, and independence. At the same time, full sovereignty is asserted and the Constitution stands as the supreme law of Micronesia.[92] The steps already taken toward free association have been consonant with the Constitution and have tended to reinforce its legitimacy.

2. *Territory and Jurisdiction*

The Constitution declares that Micronesia shall have an archipelagic territorial regime "unless limited by international treaty obligations assumed by the Federated States of Micronesia, or by its own act."[93] By statute, Micronesia currently asserts jurisdiction over a territorial sea of three nautical miles from island baselines,[94] an exclusive fishery zone in the areas between three and twelve nautical miles of the baselines,[95] and an extended fishery zone from the twelve-mile line to 200 nautical miles from the baselines.[96]

The fishery-zone statute was enacted by the Congress of Micronesia before the advent of constitutional government.[97] Fishing licenses have been sold, at various times, to Japanese, Taiwanese, Korean and American commercial interests.[98] In early 1983, the American Tunaboat Association entered into a regional agreement with the FSM, Palau and Kiribati.[99] Moreover, provisions of the Compact of Free Association recognize the right of the Micronesian governments to exercise jurisdiction over marine resources.[100]

From its inception, however, Micronesia's assertion of a 200-mile fisheries zone has been a source of controversy with the United States and other countries. Although licenses were issued, violations have been frequent, and the American Tunaboat Association refused to renew the licensing agreement,

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[91] *See supra* note 89.

[92] FSM CONST. art. II, § 1.

[93] *Id.* art. I, § 1.

[94] 18 FSM CODE § 102(1) (1982).

[95] *Id.* § 103(1).

[96] *Id.* § 104.

[97] Pub. L. No. 7-71 (1977) (codified at T.T. CODE tit. 52 (1980)).

[98] Personal communications with Michael J. McCoy, Executive Director of the Micronesian Maritime Authority (Jan. 1986).

[99] *Id.*

[100] Compact, *supra* note 6, § 121(b)(1), at H11,816 (§ 121(b)(1)).

which expired on January 1, 1985.[101] The Association has indicated its opposition to the Compact's recognition of the Micronesian fisheries zones.[102] Consequently, when the United States Congress approved the Compact in December 1985, it attached a rider declaring that any fines or confiscations imposed on American boats would be subtracted from aid to the Micronesian government involved.[103] The American and Micronesian governments have apparently agreed to disagree about these provisions.

The United States has refused to permit the FSM (or Palau or the Marshall Islands) to ratify the Convention on the Law of the Sea because of current American opposition to the terms of the Convention. However, the United States has not asserted that the Micronesian governments lack the capacity to ratify it, even during the remaining years of the trusteeship. The FSM is expected to ratify the Convention after the trusteeship is terminated,[104] and the United States appears to have no basis for objection on defense or security grounds and therefore no legal authority to prevent ratification.

3. *Citizenship*

Under the FSM Constitution, Trust Territory citizens "domiciled" in the four districts that ratified the Constitution become citizens of the Federated States of Micronesia as a matter of right.[105] The Constitution states that a "domiciliary" of a district that did not ratify the Constitution may become a citizen only by application to a court of competent jurisdiction within six months after the effective date of the Constitution.[106] The phrase "may become a citizen" was intended to empower the courts "to consider the character and background of each applicant before citizenship is granted."[107]

The Constitution does not define "domicile" and the Constitutional Convention did not provide any definition of its own. Moreover, "domicile" is a very ill-defined term in American law,[108] to which Micronesian law often turns for

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[101] *See generally* National Union, June 30, 1985, at 5, col. 3. Personal communications with Michael J. McCoy, *supra* note 98.

[102] *See* H.R. REP. NO. 188, pt. 1, 99th Cong., 1st Sess. 69-70 (1985).

[103] Compact of Free Association Act, *supra* note 6, § 104(f), at H11,813.

[104] National Union, Feb. 28, 1983, at 4, col. 2.

[105] FSM CONST. art. III, § 1.

[106] *Id.* art. III, §§ 4, 5.

[107] STAND. COMM. REP. NO. 14 ON COMM. PRO. NO. 10, JMCC, *supra* note 24, at 783.

[108] *Compare* Mitchell v. United States, 88 U.S. (21 Wall.) 350, 352 (1875) (where a person lives and has his home is his "domicile" until facts adduced established the contrary) *with* Shaw v. Shaw, 155 W. Va. 712, 187 S.E.2d 124, 127 (1972) ("Domicile is a place a person intends to retain as a permanent residence and go back to ultimately after moving away.").

guidance.[109] Since the advent of the Constitution, this uncertainty has given rise to a very questionable practice of equating a person's ancestry with his domicile. Thus, a number of ethnic Palauans, who had long been residing in Yap and had voted there for many years, were told that they were domiciliaries of Palau and had to apply for FSM citizenship.[110] They filed timely applications conceding the domicile issue. They thereby made their FSM citizenship subject to a discretionary judicial decision, rather than as a matter of right.[111] However, these applications were later approved by the FSM Supreme Court.[112]

The Trust Territory citizenship law has been extremely restrictive; only those persons who are born of two citizen parents or who are born in Micronesia and who do not acquire foreign citizenship at birth are deemed citizens of the Trust Territory by birth.[113] Children born in Micronesia of one citizen parent often acquired the citizenship of the non-citizen parent and thereby are deprived of Trust Territory citizenship even though they are born in the Trust Territory.[114]

The Constitution sets a more liberal standard for FSM citizenship. It is granted to persons born of at least one citizen parent, regardless of place of birth.[115] As permitted by the Constitution,[116] the provision has been applied retroactively to persons born before the effective date of the Constitution.[117]

Dual citizenship is therefore possible. However, the Constitution requires each person having dual citizenship to "register his intent to remain a citizen" of the FSM within three years of the effective date of the Constitution or within three years after his eighteenth birthday, whichever is later.[118] Failure to act causes the individual to lose his Micronesian citizenship and to become a Micronesian "national."[119] "Nationals" are defined as persons who owe permanent allegiance to the state and are entitled to its protections while lacking the full privileges of citizens.[120] One of the privileges that FSM "nationals" evidently

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[109] *See infra* text accompanying notes 322-23.

[110] Personal communication with the Palauans' representatives (1981).

[111] *See supra* text accompanying note 107.

[112] Personal communication with Chief Justice Edward C. King of the Supreme Court of the Federated States of Micronesia (Feb. 1986). The orders granting citizenship are not reported in the FSM Interim Reports.

[113] 53 T.T. CODE § 1 (1980).

[114] For example, under United States law a child born of one United States citizen parent acquires United States citizenship at birth. 8 U.S.C. § 1401 (1982). Therefore, a child born of a United States citizen and a Trust Territory citizen would be a United States citizen and not a Trust Territory citizen.

[115] FSM CONST. art. III, § 2.

[116] *Id.* art. III, § 6.

[117] 7 FSM CODE § 202(2) (1982).

[118] FSM CONST. art. III, § 3.

[119] *Id.*

[120] "The right to vote for or run for elected office in the government, the privilege of appoint-

lack is the right of acquire title to land.[121]

The FSM has a very restrictive policy toward naturalization. The current statutory provisions require an applicant to reside in Micronesia for at least five years immediately before application, to renounce his other citizenship, to have competence in at least one of the indigenous languages of the FSM and to be either the spouse or child of a citizen or to be an FSM national.[122] Even then, the application for citizenship must receive the Congress's "recommendation" by a private bill.[123]

4. *The Possibilities of Secession and Fragmentation*

The Constitution does not expressly address the question of secession from the FSM, which is defined as comprising those districts that ratified the Constitution.[124] Secession was a major issue during the Constitutional Convention.[125] The right of secession, at least within the first few years after ratification of the Constitution, was one of the Palau delegation's demands.[126] However, the resolution which included this demand as a proposed guiding principle of the Convention was ultimately filed.[127]

Early drafts of a committee proposal on national unity would have expressly prohibited secession.[128] This proposal was one of the subjects considered by the Special Committee established to address the concerns of the Palauan delegation.[129] The result was a much weaker provision expressing support of unity, perhaps little more than precatory in effect: "It is the solemn obligation of the national and state governments to uphold the provisions of this Constitution and the principles of unity upon which this Constitution is founded."[130] Nev-

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ment to certain positions, the right to own and sell land, etc. are examples of status distinctions which may be made between nationals and citizens." STAND. COMM. REP. NO. 14 ON COMM. PRO. NO. 10, JMCC, *supra* note 24, at 782. This concept was evidently borrowed from the United States, which has a special quasi-citizenship category for persons also called "nationals." 8 U.S.C. § 1408 (1982).

[121] *See* FSM CONST. art. 13, § 4; *supra* note 120.

[122] 7 FSM CODE § 204 (1982). This naturalization policy maintains the very highly restrictive Trust Territory policy toward naturalization, but it is different in some details. 53 T.T. CODE § 2 (recodified at 7 FSM CODE § 102 (1982)).

[123] 7 FSM CODE § 204 (1982).

[124] FSM CONST. art. I, § 1.

[125] *See* JMCC, *supra* note 24, at 732-33, 764-66, 868-69, 931.

[126] N. MELLER, CONSTITUTIONALISM, *supra* note 8, at 177-81, 184, 302-03.

[127] JMCC, *supra* note 24, at 246, 513. Proposed Convention Resolution No. 1 would have directed the Convention to establish a right of secession. *Id.* at 122.

[128] COMM. PRO. NO. 27, JMCC, *supra* note 24, at 931-32.

[129] N. MELLER, CONSTITUTIONALISM, *supra* note 8, at 303-04.

[130] FSM CONST. art. XIII, § 3.

ertheless, a Palauan delegate conceded that even this provision prohibited the "inalienable right" of secession.[131] Thus, it has been argued, a constitutional amendment would be required to permit a state to secede.[132]

Pohnpei and its Legislature in particular have intermittently raised the issue of secession.[133] The reasons usually advanced for secession are the perceived inequities in the allocation of United States grant funds among the several states and excessive power being asserted by the national government.[134]

To some observers, secessionist sentiment may have been an important factor in Pohnpei's vote against the Compact of Free Association and the Pohnpei Legislature's overwhelming rejection of the Compact. Other observers maintain that Pohnpeians opposed the Compact for the reasons cited by the legislature—that it delegates too much power to the United States.[135] According to these observers, Pohnpeians were not using the vote on the Compact as an indirect protest against continued unity.

Another explanation for the Pohnpeians' secessionist sentiment is usually not publicly mentioned. It is their fear that many Trukese may migrate to Pohnpei.[136] Of all the states, Pohnpei has the highest per-capita income, it has relatively valuable natural resources, a low ratio of population to land mass,[137]

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[131] JMCC, *supra* note 24, at 764-65.

[132] Personal communications with former staff members of the Constitutional Convention (1979).

[133] Hanlon & Eperiam, *supra* note 5, at 93-94; numerous personal communications with various Pohnpeian leaders.

[134] *See* the Pohnpei State Legislature's criticism of the Compact, *supra* note 88. *See also* N. MELLER, CONSTITUTIONALISM, *supra* note 8, at 337, 351 n.89.

[135] N. MELLER, CONSTITUTIONALISM, *supra* note 8, at 337, 351 n.89.

[136] Hanlon & Eperiam, *supra* note 5, at 88.

[137] The respective populations, land areas, and population densities of the Trust Territory jurisdictions are

	Population	Land Area (sq. mile)	Density (per sq. mile)
Kosrae	5,522	42.3	131
Pohnpei	23,485	133.4	176
Truk	38,648	49.2	786
Yap	9,319	45.9	203
FSM Total	76,974	270.8	284

OFFICE OF PLANNING AND STATISTICS, FEDERATED STATUTES OF MICRONESIA, NATIONAL YEARBOOK OF STATISTICS 4-5 (1981).

Marshall Islands	31,045	69.8	445
Palau	12,173	190.7	64
N. Mariana Islands	14,333*	184.5	80

* 1973 population

and a large portion of Pohnpei's land is in the public domain.[138] By contrast, Truk has the largest population and the highest population density of all the FSM states.[139] Because Pohnpei is the national capital and is geographically close to Truk, a high level of immigration from Truk is possible.[140]

Another type of secession has also attracted some popular support in the recent past. Various island groups have sought to become separate administrative districts or, since the advent of the Constitution, separate states. Kosrae became a separate district pursuant to a Congress of Micronesia law separating it from Pohnpei.[141] This occurred in 1976 before the advent of constitutional government.[142]

Kosrae's separation from Pohnpei was asserted as a precedent to justify the secession of the Faichuk Islands, in the Western part of the Truk Lagoon, from the remainder of the state of Truk.[143] The Constitution does not explicitly create a process for fragmentation or amalgamation of existing states after the effective date of the Constitution, but it does require the consent of a state's legislature before its boundaries may be changed.[144] The Truk Legislature endorsed the separation of Faichuk, giving impetus to a Congressional bill to establish Faichuk as a separate state.[145] The bill passed the Congress in mid-1981 during a special session held in Truk as large numbers of Faichuk people observed the proceedings. The President vetoed the bill despite considerable personal political risk to him as a Trukese.[146]

Several factors contributed to the failure of the Faichuk secession. One relates to geography. The Faichuk people had argued that, with some 9,000 people, Faichuk would form a state larger in population than Kosrae. The Faichuk

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OFFICE OF PLANNING AND STATISTICS, TRUST TERRITORY OF THE PACIFIC ISLANDS, 3 QUARTERLY BULLETIN OF STATISTICS 1 (1980).

[138] Fischer, *Contemporary Ponape Island Land Tenure*, in LAND TENURE PATTERNS, TRUST TERRITORY OF THE PACIFIC ISLANDS 117 (J. de Young ed. 1958).

[139] *See* Table, *supra* note 137.

[140] Hanlon & Eperiam, *supra* note 5, at 93.

[141] Pub. L. No. 5-77 (1974) (codified at 3 T.T. CODE § 1(7) (1980)).

[142] It has been said that Kosrae's secession from Pohnpei was allowed to ensure ratification of the Constitution. By the terms of the Micronesian Constitutional Convention Act, the Constitution would not have been ratified at all unless a majority of the districts which voted on it ratified it. Constitutional Convention Act, Pub. L. No. 5-60, § 11(7) (1974). Of the five districts that were to vote on the Constitution, two districts—Palau and the Marshalls—were likely to vote against it. By making Kosrae a sixth district, the chances of approval were enhanced. Promoters of the Constitution thus supported Kosrae's separate status. Hanlon & Eperiam, *supra* note 5, at 88. Ironically, Kosrae's percentage of approval was the lowest of the four districts that approved the Constitution. *See supra* note 59.

[143] J. OF 2D CONG., Spec. Sess. 84 (1981) (statement of Sen. Refalopei).

[144] FSM CONST. art. I, § 2.

[145] National Union, Aug. 15, 1981, at 1, col. 1.

[146] Hanlon & Eperiam, *supra* note 5, at 92-93.

Islands, however, are located only about twenty kilometers from the state capital of Truk at Moen, while Kosrae is some 600 kilometers from Pohnpei Island, the capital of Pohnpei.[147] If Faichuk were to secede from Truk, it would form a small enclave surrounded by the remainder of the state of Truk. In addition, the people of Faichuk also share linguistic and family ties with the remainder of Truk Lagoon.[148] By contrast, Kosrae is linguistically and culturally distinct.[149]

A second explanation is economic. Although Faichuk is located near the government center at Moen, it has had virtually no commercial economic activity and very little in governmental services. Supporters of the legislation asserted that separate statehood would bring major economic development to Faichuk.[150] Their argument was correct but not for the reasons they stated. As a state, Faichuk would have become a distinct statistical unit in the many governmental reports made each year. Faichuk's lack of development and the level of welfare would probably have attracted the attention of the United States Congress and administration, and the United Nations Trusteeship Council, as well as others. The embarrassing statistics would need to be addressed. However, opponents noted that the anticipated forms of economic development were merely the establishment of more governmental infrastructure, schools, and hospitals rather than productive economic activity.[151] The construction, maintenance, and staffing of these facilities would have imposed a severe drain on the already limited budgetary resources of the FSM.

The third main reason that Faichuk's proposed secession failed is political. It engendered vehement opposition in Pohnpei and Yap. There was fear that creation of a second Trukese state would enhance Trukese political power within the federation.[152] Because Truk's population already constitutes more than half of the FSM total, the other states fear domination by Truk.[153]

With the failure of Pohnpei to secede from the FSM and the failure of Faichuk to become a separate state within the FSM, the delicate political balance within the Federated States appears to have stabilized, but some secessionist sentiment persists.[154] In the next year or two, the trusteeship will be terminated and free association will begin, or some serious impediment to these events will arise, signalling a potentially perpetual continuation of the trusteeship.[155] Any of these events may revive secessionist activity.

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[147] MAPS OF MICRONESIA, *supra* note 3, at plate 6.

[148] *See* J. FISCHER, THE EASTERN CAROLINES 7-8 (1957).

[149] *Id.* at 7.

[150] Hanlon & Eperiam, *supra* note 5, at 92.

[151] *Id.*

[152] *Id.* at 93.

[153] *Id. See* Table, *supra* note 137.

[154] N. MELLER, CONSTITUTIONALISM, *supra* note 8, at 352-53 n.103.

[155] Over the past several years, the Soviet Union has been building a record of objections in

B. *The National and State Governments*

1. *Separation of Powers and Federalism*

The Constitution establishes a federal system of government modeled after that of the United States in many essential respects. The national government is composed of three separate branches, each having theoretically equal powers.[156] The specific characteristics of each branch also reflect the American model.[157]The Constitution provides for a division of powers on a federal model between the national and state governments.[158] The states have general powers which are, in theory, broader than the powers of the national government. The Convention record reflects that the framers knew from the outset that the proper balance would be achieved only with difficulty:

> We intend that the language of this article [granting national legislative powers] be strictly and narrowly construed . . . . Your Committee does not wish [the FSM Supreme] court to distort the meaning of the language of this article by using it to excessively and unduly expand the power of the Central Government. Nor does your Committee intend that the general grant of power be ignored, with the effect of denying to the Central Government the power necessary to deal with problems which are national in scope. In situations where no express provision applies, the highest court of the land must interpret, and in doing so, must maintain a very delicate balance.[159]

The national government has only those powers expressly granted by the Constitution and those inherently national powers which are beyond the capacity of the states to exercise.[160] The Convention recognized that the national government would have the ultimate word:

> Your Committee feels that flexibility must be built into the Constitution if the

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the U.N. Trusteeship Council to the free assocation status proposal for the FSM, Palau and the Marshalls, and the proposed commonwealth status for the Mariana Islands. The Soviet Union may veto the trusteeship's termination in the U.N. Security Council, particularly since the U.S. State Department stated in 1980 its view that, to be legally effective, termination of this trusteeship must be approved by the Security Council. Statement by the Permanent Mission of the Union of Soviet Socialist Republics to the United Nations, 35 U.N. GAOR Annex at 1-2, U.N. Doc. A/35/113/S/13817 (1980).

[156] *See* FSM CONST. art. IX (legislative branch); art. X (executive branch); art. XI (judicial branch).

[157] *Id.*

[158] *See* FSM CONST. art. VII, §§ 1, 2; art. VIII, §§ 1, 2; STAND. COMM. REP. NO. 33 ON COMM. PRO. NO. 21, JMCC, *supra* note 24, at 813-17.

[159] STAND. COMM. REP. NO. 33 ON COMM. PRO. NO. 21, JMCC, *supra* note 24, at 817.

[160] FSM CONST. art. VIII, §§ 1, 2.

> system of government we are establishing is to succeed, and that the wise course is to rely on the discretion of the national legislature and national chief executive, tempered by the restraints of the Constitution and the Supreme Court, in deciding whether a power being exercised by the national government is truly national in character.[161]

Most of the national government's express powers are enumerated in the legislative article of the Constitution.[162] The most important of these powers include control over foreign affairs;[163] national defense;[164] immigration, naturalization, and citizenship;[165] banking, foreign and interstate commerce, insurance, commercial paper and securities,[166] issuance of currency;[167] and regulation of navigation and shipping.[168]

The list is more explicit and detailed than that in the United States Constitution. In the United States, many important areas of economic regulation and social legislation have fallen under federal control as a result of expansive New Deal-era interpretations of United States federal power to provide for the general welfare and to regulate interstate commerce. By making detailed express grants of authority to the national government, the FSM Constitution makes such expansive interpretation unnecessary.

The Constitution allows the state and national governments to exercise concurrent jurisdiction over education and health care,[169] and to establish social security and public welfare systems.[170] The Functions Committee delineated the sharing of responsibilities for health and welfare:

> Your Committee feels that the basic responsibility for providing health care and education should rest with the states. However, the national government should be empowered to promote education and health care, to appropriate funds for that purpose and to establish certain standards . . . . In addition, the national government should have the primary responsibility to coordinate education in Micronesia and to conduct higher education.[171]

The FSM Congress presumably has the power to delineate state and national

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[161] STAND. COMM. REP. NO. 33 ON COMM. PRO. NO. 22, JMCC, *supra* note 24, at 817.
[162] FSM CONST. art. IX, § 2.
[163] *Id.* art. IX, § 2(b).
[164] *Id.* art. IX, § 2(a).
[165] *Id.* art. IX, § 2(c).
[166] *Id.* art. IX, § 2(g).
[167] *Id.* art. IX, § 2(f).
[168] *Id.* art. IX, § 2(h).
[169] *Id.* art. IX, § 3(c).
[170] *Id.* art. IX, § 3(d).
[171] STAND. COMM. REP. NO. 33 ON COMM. PRO. NO. 21, JMCC, *supra* note 24, at 820.

jurisdiction in these areas if conflicts arise.[172] During the first several years of constitutional government, however, the Congress has not established a major policy-making role in these areas for the national government.

Through the combination of express powers, inherently national powers and concurrent powers, the Constitution provides the basis for a very strong central government if the Congress and executive both wish to assert national powers at the expense of the states. Concerns about economic and administrative efficiency reinforce tendencies toward centralization. Opposite tendencies are nurtured by concerns among some state officials and members of Congress about the size of the national government's executive branch, and by a desire to provide greater local power and more employment for local constituents by increasing the power and size of the state governments.[173] Because of these tendencies, the constitutional powers allocated to the national government have not always been retained in practice.

The next several sections of this article will describe the three branches of the national government and the relations between the national and state governments. This survey indicates that the states have received greater control or financial benefits in areas nominally reserved to the national government and that, within the national government, the Congress has held powers that seemingly belong to the executive.

2. *The National Congress*

The Congress of the Federated States of Micronesia is the national legislature.[174] It is a unicameral body, but the Constitution permits a Chamber of Chiefs to be created as the second house.[175]

As in the United States two hundred years ago,[176] the Constitutional Convention sought to establish an acceptable balance between equal representation on the basis of population and equal representation of the states as diverse political entities. In Micronesia, the diversity extends to culture and language.

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[172] This would appear to be an appropriate exercise of power beyond that which a state can perform. *See* FSM CONST. art. VIII, § 1; STAND. COMM. REP. NO. 33 ON COMM. PRO. NO. 21, JMCC, *supra* note 24, at 816.

[173] *See* Hanlon & Eperiam, *supra* note 5, at 92.

[174] FSM CONST. art. IX, § 1.

[175] *Id.* art. V, § 3. It is extremely unlikely that such a chamber will be established. *See* N. MELLER, CONSTITUTIONALISM, *supra* note 8, at 272-74.

[176] In the United States this balance was effected by a compromise in which two houses of Congress were created. In the Senate, two senators represent each state and are elected for six-year terms, one-third being elected every two years. U.S. CONST. art. I, § 3. In the House of Representatives, each state has at least one member elected for two-year terms, but it is otherwise apportioned strictly on the basis of population. U.S. CONST. art. I, § 2.

Micronesia followed the American concept of having some legislators elected as representatives of co-equal states and some elected on the basis of population, but placed them together in a unicameral Congress. The Congress has one member from each state elected at large every four years and one or more members from each state elected every two years from districts apportioned according to population.[177] All members are popularly and directly elected.[178] The four-year members are ordinarily all elected simultaneously. Under the preliminary apportionment set forth in the Constitution, Yap and Kosrae each have two members, Pohnpei has four, and Truk has six.[179] These figures include the members elected to four-year terms.

Each state may, but need not, set aside one of its two-year seats for a traditional leader.[180] None has chosen to do so. This failure may partly be explained by the reduction in the number of congressional seats during the transition from the former Congress of Micronesia to the new Congress.[181] If the number of seats is significantly increased after the next census, it is conceivable that a seat will be set aside for a traditional leader in Yap, but it is highly unlikely that any of the other states will do the same.[182]

The legislative process also reflects the compromise between representation of states and of population. Bills are passed on first reading by a two-thirds majority of the members voting individually.[183] On second reading, passage requires the affirmative vote of two-thirds of the state delegations.[184] If legislation is vetoed by the President, it may be passed over the veto by a vote of three-fourths of the state delegations.[185]

Congress also has the power to impeach the President, Vice President, and Supreme Court justices for treason or corruption by a two-thirds vote of the members.[186] The Supreme Court has the power to review the impeachment of the President or the Vice President, and a special tribunal is established to

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[177] *Id.*

[178] FSM CONST. art. IX, § 8.

[179] *See id.* art. XV, § 6.

[180] *Id.* art. IX, § 11.

[181] The last apportionment of the Congress of Micronesia before the advent of constitutional government was, in the House of Representatives, Kosrae, one; Pohnpei, four; Truk, seven; and Yap, two. Each of the four districts also had two senators, for a total of 22 members. Secretarial Order No. 2918, pt. III, § 5(b), 34 Fed. Reg. 157 (1969), as amended Mar. 24, 1976. Under the FSM Constitution, this total was reduced to fourteen. FSM CONST. art. XV, § 6.

[182] Yap is the only state that has provided a governmental role for its traditional leaders. *See infra* notes 293-95 and accompanying text.

[183] FSM CONST. art. IX, § 20.

[184] *Id.*

[185] *Id.* art. IX, § 2(q).

[186] *Id.* art. IX, § 7.

review the impeachment of a Supreme Court justice.[187]

Since Congress, in theory, functions separately from the executive, members of Congress may not serve as cabinet members or hold any other public office.[188] This prohibition is, however, being habitually violated.[189]

3. *The National Executive*

a. *Election*

The President and Vice President, who must be from different states,[190] are chosen from among the four-year members of Congress.[191] Several circumstances combined to make election of the President and Vice President by direct popular election undesirable in the minds of the delegates to the Constitutional Convention.[192] These include the lack of nationwide political parties; the lack of political parties on the state level, where there are no formal parties but many alliances; the fact that candidates are usually chosen on the basis of regional and kinship ties rather than political issues; the linguistic and cultural dissimilarities of the states from one another; and the lack of any experience with interdistrict elections in the past.[193] Perhaps the most significant factor was a fear that direct election would promote regional prejudices.[194]

The method chosen tends to lessen the possibility that a President will be elected solely because the single largest state has overwhelming electoral power. However, nothing ensures against a single state dominating the presidential election if it acquires a sufficiently large number of Congressional seats. Truk's population already exceeds that of the other three states combined.

The President and Vice President are elected by Congress at the first session following the quadrennial elections.[195] Their seats are declared vacant and new elections are held to fill those seats for the balance of the four-year terms.[196]

To be re-elected, the President and Vice President must, like prime ministers

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[187] *Id.*

[188] *Id.* art. IX, § 13.

[189] *See infra* note 222 and accompanying text.

[190] *Id.* art. X, § 5.

[191] *Id.* art. X, § 4.

[192] *See generally* STAND. COMM. REP. NO. 33 ON COMM. PRO. NO. 21, JMCC, *supra* note 24, at 813; STAND. COMM. REP. NO. 36 ON COMM. PRO. NO. 24, JMCC, *supra* note 24, at 825-26; Hanlon & Eperiam, *supra* note 5, at 89; N. MELLER, CONSTITUTIONALISM, *supra* note 8, at 296.

[193] *See* N. MELLER, CONSTITUTIONALISM, *supra* note 8, at 8-12.

[194] Hanlon & Eperiam, *supra* note 5, at 89. Mr. Eperiam was a delegate to the Constitutional Convention from Pohnpei. JMCC, *supra* note 24, at xxxv.

[195] FSM CONST. art. X, § 1.

[196] *Id.* art. X, § 5.

in a parliamentary system, be re-elected from their local constituencies. They must either persuade their replacements in the four-year seats to stand aside or must campaign against them to regain their congressional seats only to relinquish them if they are re-elected to the Presidency or Vice Presidency.[197]

b. The Exercise and Limits of Executive Powers

The President's powers and duties include supervision of governmental administration;[198] nomination of ambassadors, justices of the national courts, and cabinet members, subject to the approval of the Congress in each instance;[199] and preparation of the annual budget.[200]

Some important executive functions are performed by agencies that are not exclusively under the control of the executive branch. Authority has been shared not merely with the FSM Congress[201] but also with the state governments,[202] and, with the Trust Territory High Commissioner.[203] Much of this sharing may have been anticipated by the framers of the Constitution, although some of the arrangements appear to represent a lingering reluctance of former holders of power to entrust it to the national executive as provided for by the Constitution.

Where the states exercise authority in the national realm, and where members of Congress exercise executive functions, Micronesians have made major

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[197] In 1979, Tosiwo Nakayama, the former President of the Constitutional Convention and President of the Senate in the Congress of Micronesia, was elected President of the Federated States of Micronesia. Hanlon & Eperiam, *supra* note 5, at 89. Petrus Tun, formerly a Senator from Yap, was elected Vice President. *Id.* President Nakayama was re-elected to the Congress and then to the Presidency in 1983. National Union, May 15, 1983, at 1, col. 1. Vice President Tun chose not to seek re-election to the Congress, and he was replaced as Vice President by Bailey Olter, Senator from Pohnpei. *Id.*

[198] FSM CONST. art. X, §§ 1, 2(a), 2(b), 3.

[199] *Id.* art. X, § 2(d).

[200] *Id.* art. XII, § 2(a).

[201] *See infra* discussion of the Micronesian Maritime Authority (MMA), the Commission on Future Political Status and Transition (CFPST), Delegation to the United Nations Law of the Sea Conference, and other agencies, at text accompanying note 222.

[202] Among the FSM national government agencies having members chosen by the states are:

1. The CFPST, *see infra* text accompanying notes 214-17.

2. The FSM Telecommunications Corporation, which owns and operates the telecommunications system in the FSM. 21 FSM CODE § 203 (1982).

3. The FSM Board of Education, which, among its other duties, assists the national government "in formulating and defining educational objectives and policies . . . ." 40 FSM CODE §§ 123, 127 (1982).

4. The FSM National Fisheries Corporation, which is authorized to engage in virtually all commercial activities relating to fishing and fisheries. Pub. L. No. 3-14, § 6 (1983).

[203] *See infra* notes 205-13 and accompanying text.

departures in practice from the American model. Both of these types of arrangements are very much in accordance with Micronesian models of decision-making, which are based on consensus and appear to reflect their preference notwithstanding the constraints in the Constitution they adopted. The agencies operating under such arrangements are at the forefront of Micronesian economic and political development. While these power-sharing arrangements may promote harmony in a possibly fragile federation, they do not usually foster radical innovation.

As in the United States, semi-autonomous agencies have been established to exercise executive powers in the field of economic development. In the FSM, these agencies emerged during the era of the Congress of Micronesia when it was the sole branch of government chosen in any manner by the people of Micronesia. The Congress believed, with much justification, that the Trust Territory executive was unlikely to stimulate productive economic development in Micronesia.[204] Accordingly, the Congress by statute established semi-autonomous agencies to perform essentially executive functions of the Trust Territory government.

Among these agencies was the Micronesian Maritime Authority (MMA), the body established to administer Micronesia's fisheries zone. The MMA was established as a Trust Territory-wide agency charged with negotiating foreign fishing agreements and enforcing Micronesia's fisheries zone.[205] Now, as an independent agency of the FSM, the MMA has continued these functions, negotiating fisheries agreements with representatives of the Japanese, Taiwanese, Korean and American tuna industries.[206] It is assisted by the FSM government, which, unlike the Trust Territory before it, vigorously asserts the FSM's fisheries rights as a major source of revenues.[207]

Another agency established during the pre-Constitutional era was the Micronesia Development Bank. It managed the Trust Territory Economic Development Loan Fund funded by the United States Congress.[208] With the fragmentation of Micronesia into four jurisdictions, the Loan Fund was divided. The Federated States Development Bank (FSDB) was established to administer the FSM's share as well as such additional funds that might come from local and

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[204] *See* Hanlon & Eperiam, *supra* note 5, at 86-87; D. McHENRY, *supra* note 1, at 91.

[205] Pub. L. No. 7-71 (1977) (codified at T.T. CODE, tit. 52 (1980)). At that time, four members of the MMA were appointed by the High Commissioner (without the advice and consent of the Congress of Micronesia), four were appointed jointly by the Speaker of the House of Representatives and the President of the Senate, and the ninth member was appointed jointly by the High Commissioner and the presiding officers of the Congress. See 24 FSM CODE § 301(1) (1982), *amended by* Pub.L. No. 3-10 (1983) for the present selection process.

[206] Hanlon & Eperiam, *supra* note 5, at 95.

[207] *Id.*

[208] 29 T.T. CODE, ch. 1. (1980).

other foreign sources.[209]

Both the MMA and the Development Bank administer matters about which the United States Congress has been acutely sensitive. As to the MMA, Micronesia's enforcement of a 200-mile fisheries zone for tuna is inconsistent with United States government policy. The Congress of Micronesia legislation establishing the agency in the pre-constitutional era allowed the High Commissioner to appoint nearly half of the MMA Board.[210] It was believed that the presence of the High Commissioner's appointees would help mollify the United States government's sensitivity toward the 200-mile fisheries zone which the MMA was committed to enforce.

On the advent of constitutional government, the FSM government deemed it expedient to allow the Trust Territory High Commissioner to continue to have appointees on the MMA governing board.[211] In 1983, the composition of the MMA was changed, eliminating the High Commissioner's appointees and reducing the membership from nine to seven. Apparently, the FSM government considered the situation sufficiently safe to remove the High Commissioner from the appointive process.[212] However, the FSM government has considered it appropriate to continue having Trust Territory officials on the governing board of the Development Bank, to encourage the United States Congress to make additional appropriations to it.[213]

The negotiation of a new political status and planning for the transition to constitutional government have been central concerns of Micronesian political development for over a decade. Until the mid-1970's, the Congress of Micronesia kept both functions to itself. To gain support for both the Constitution and proposed future status arrangements, the Congress established an agency, the Commission on Future Political Status and Transition (CFPST), in 1976, half of whose membership was chosen by the district legislatures.[214]

After the advent of constitutional government, the CFPST continued to negotiate with the United States. This arrangement probably can be considered constitutionally permissible because the Commission lacks power to make binding agreements on behalf of the FSM.[215] Conflicts between the CFPST, which engages in foreign affairs activities outside the executive branch,[216] and the executive branch have been avoided because a single person has served as the

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[209] 30 FSM CODE §§ 101-106 (1982).

[210] Pub. L. No. 7-71 (1977) (codified at 52 T.T. CODE, ch. 5 (1980)).

[211] Pub. L. No. 1-34 (1979) (codified at 24 FSM CODE § 301(1) (1982)).

[212] Pub. L. No. 3-10 (1983) (amending 24 FSM CODE § 301 (1982)).

[213] Therefore, the High Commissioner continues to appoint two of the Board's seven members. 30 FSM CODE § 107 (1982).

[214] Pub. L. No. 6-87 (1976) (codified at 8 FSM CODE § 103(2) (1982)).

[215] *See* 8 FSM CODE § 108 (1982).

[216] *Id.* § 108(2).

Chairman of the Commission since 1976 and also as Secretary of External Affairs since the establishment of that office in 1979.[217]

Other national government agencies have state representatives on their governing boards. These include the Coconut Development Authority,[218] the Telecommunications Corporation,[219] the Foreign Investment Board,[220] and the Banking Board.[221]

During the pre-Constitutional era, members of the Congress of Micronesia sat on the boards of a number of agencies performing executive tasks. These included the MMA, the CFPST, and the Delegation to the United Nations Law of the Sea Conference.[222] Since the beginning of constitutional government, members of the FSM Congress have continued to perform these functions in apparent violation of the constitutional prohibition against dual office-holding. These arrangements may be challenged in the future.

Just as there have been structural limitations on the authority of the national executive brought about by shared power of appointment, there have also been limitations on its functions because of the continuation of the trusteeship during the first years of the FSM's experience with constitutional government. As could be expected, the FSM has been constrained in its foreign affairs activities. It has had to receive United States Department of State approval for aid agreements and regional fisheries agreements.[223]

In other areas, the FSM's exercise of its executive authority has been delayed for technical reasons. For example, the FSM began to operate international satellite telecommunications in 1982, but the United States is expected to continue to control administration of the FSM's radio frequencies throughout the trusteeship and in at least the early years of Free Association.[224] And it was not until July 1984 that the FSM inaugurated its independent postal service.[225] The United States dollar remains the legal tender,[226] and it would continue as the legal tender under Free Association.[227]

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[217] This official is Andon Amaraich, a former senator in the Congress of Micronesia from Truk.

[218] 22 FSM CODE § 203 (1982).

[219] 21 FSM CODE § 209 (1982).

[220] 33 FSM CODE § 206 (1982).

[221] 29 FSM CODE § 201 (1982).

[222] 10 FSM CODE § 302(1) (1982).

[223] During the author's tenure as Staff Counsel to the CFPST, the U.S. Department of State sent a policy memorandum to the constitutional governments of the FSM, the Marshall Islands and Palau, setting forth these requirements.

[224] *See* Compact, *supra* note 6, § 131, at H11,817.

[225] *See* Pub. L. No. 3-13, § 2 (1983).

[226] 57 FSM CODE § 101 (1982).

[227] Compact, *supra* note 6, § 251, at H11,822.

c. *Emergency Powers*

The Constitution provides the President with emergency powers "if required to preserve public peace, health or safety, at a time of extreme emergency caused by civil disturbance, natural disaster, or immediate threat of war, or insurrection."[228] Civil rights may be suspended, and the declaration of emergency and actions taken under it are exempt from "judicial interference" for a period of thirty days after its first issuance.[229]

The Congress is required to convene within thirty days of the declaration of emergency to consider its revocation, amendment, or extension.[230] Unless the Congress extends the period, it expires no later than thirty days after the initial declaration.[231]

4. *The FSM Judiciary*

a. *The Supreme Court*

The judicial power of the Federated States of Micronesia resides in the Supreme Court and such other national courts as may be established by statute.[232] At the present time, the Supreme Court is the only national court.[233] There are currently only two justices on the Supreme Court, the Chief Justice and a single associate justice.[234] An amendment to the Judiciary Act in 1983 authorizes the appointment of a total of five associate Justices,[235] the maximum complement allowed by the Constitution,[236] but no new nominations have yet been made.[237]

The Constitution requires that the Supreme Court have both trial and appellate divisions.[238] At least three justices must hear an appeal, and the trial justice is excluded from the appellate panel.[239] Thus, judges from other courts have

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[228] FSM CONST. art. X, § 9(a).

[229] *Id.* art. X, § 9(b).

[230] *Id.* art. X, § 9(c).

[231] *Id.*

[232] *Id.* art. XI, § 1.

[233] Judiciary Act of 1979, 4 FSM CODE § 101 (1982) (*reprinted at* 5 U. HAWAII L. REV. 384 (1983)).

[234] *See* Turcott, *Jurisdiction: The Beginnings of the Federated States of Micronesia Supreme Court*, 5 U. HAWAII L. REV. 361, 363-64 (1983). The Judiciary Act of 1979 originally authorized the appointment of only one Associate Justice in addition to the Chief Justice. 4 FSM CODE § 103 (1982).

[235] Pub. L. No. 3-3 (1983) (amending 4 FSM CODE § 103 (1982)).

[236] FSM CONST. art. XI, § 2.

[237] Personal communication with Chief Justice Edward C. King, *supra* note 112.

[238] FSM CONST. art. XI, § 2.

[239] *Id.* art. XI, § 2.

been assigned by the Chief Justice to serve as temporary justices.[240] Such assignments have been accepted by judges and justices of the United States federal courts, the Palau Supreme Court, the Guam and Northern Marianas courts, and the FSM state courts.[241]

The Constitution provides that the qualifications of the Supreme Court justices and other national court judges are to be set by statute.[242] The Constitution thus permits the appointment of expatriates and persons who are not law school graduates, while allowing Congress the opportunity to modify the requirements for new appointments at a later date.

At present, Supreme Court justices must be at least thirty years old, and be either a graduate of an accredited law school and admitted to practice in any jurisdiction, or "be a person of equivalent and extraordinary legal ability obtained through at least five years experience practicing law."[243] Supreme Court justices serve life terms.[244]

The Chief Justice[245] is the chief administrator of the national courts.[246] He has very broad powers to make rules governing judicial procedure and evidence, the assignment of judges, and the admission and discipline of attorneys.[247]

The Congress is required to provide financial assistance to the state judiciar-

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[240] *See id.* art. XI, § 9(b) (authorizing the Chief Justice to "give special assignments to retired Supreme Court justices and judges of State and other courts"); 4 FSM CODE § 104 (1982) (governing the appointment of temporary justices).

[241] These judges have included Dorothy W. Nelson of the U.S. Court of Appeals for the Ninth Circuit and Samuel P. King of the U.S. District Court for the District of Hawaii in Jonas v. Trial Div. of Federated States of Micronesia Supreme Court, 1 FSM Interim 322 (App. Div. Pohnpei 1983); Mamoru Nakamura, Chief Justice of the Palau Supreme Court, and Herbert D. Soll, Judge, Commonwealth Trial Court, Northern Mariana Islands, in Laion v. Federated States of Micronesia, 1 FSM Interim 503 (App. Div. Truk 1983), and other cases; Alfred Laureta of the U.S. District Court for the Northern Mariana Islands, in Alaphonso v. Federated States of Micronesia, 1 FSM Interim 209 (App. Div. Truk 1982); and Janet Weeks of the Superior Court of Guam and Soukitchy Fritz of the Truk District Court, in Federated States of Micronesia v. Otokichy, 1 FSM Interim 183 (App. Div. Truk 1982).

[242] FSM CONST. art. XI, § 5.

[243] 4 FSM CODE § 107(1) (1982).

[244] The Constitution states that the justices "serve during good behavior." FSM CONST. art. XI, § 3. This same phrase is contained in Committee Proposal No. 30, which was eventually adopted by the Constitutional Convention. *See supra* note 48 and accompanying text. The Committee Report on this Proposal states, "To assure independence of the judiciary, your Committee is recommending that judges serve for life." STAND. COMM. REP. NO. 49, JMCC, *supra* note 24, at 876-78.

[245] Edward C. King is the Chief Justice. He and Associate Justice Benson are expatriates. Turcott, *supra* note 234, at 363-64.

[246] This broad administrative power has not been fully recognized by the executive branch or the Congress, and conflicts have resulted. *See id.* at 365-69.

[247] FSM CONST. art. XI, § 9.

ies.[248] State judiciaries have been established and are functioning in all states.[249] Their establishment was much delayed for several reasons including state politics. In addition, the Trust Territory High Court imposed requirements for certification beyond those set forth in Secretarial Order No. 3039.[250]

b. Jurisdiction of the National and State Courts

The Constitution provides separately for the exclusive, original jurisdiction of the Supreme Court and the jurisdiction of the other national courts.[251] The original and exclusive jurisdiction of the Supreme Court extends to "cases affecting officials of foreign governments, disputes between states, admiralty or maritime cases, and in which the national government is a party except where an interest in land is at issue."[252] The Supreme Court also currently exercises the jurisdiction of all the national courts because there are no inferior national courts.[253]

In earlier drafts of the Constitution, the national and state courts were to have concurrent jurisdiction over a wide range of cases. Both national and state courts were to hear cases "arising under" the Constitution, national law and treaties and cases involving disputes between domestic parties and foreign citizens or governments and disputes between parties of diverse state citizenship.[254] National law was to prescribe the actual allocation of the various types of cases between the state and national courts.[255]

This allocation of jurisdiction was radically altered by an amendment made

[248] *Id.* art. XI, § 10.

[249] *See* National Union, Mar. 15, 1985, at 6, col. 1.

[250] *See* correspondence among the Solicitor's Office of the Department of the Interior, the Trust Territory High Court, the FSM Supreme Court and the Governor of Pohnpei (on file at law review office).

[251] The jurisdiction of the FSM Supreme Court over matters set forth in FSM CONST. art. XI, § 6(a) is original and exclusive. The Supreme Court has original, non-exclusive jurisdiction over diversity and national-question matters set forth in § 6(b). If an inferior national court is established, the allocation of original jurisdiction over the § 6(b) matters would be set by statute. *Id.* § 6(c).

[252] *Id.* § 6(a).

[253] Because the FSM Supreme Court is currently the sole national court, its jurisdiction is broadly similar to the jurisdiction of U.S. federal courts over cases involving federal questions and parties of diverse citizenship. *Compare* FSM CONST. art. XI, § 6 *with* 28 U.S.C. § 1251 (original jurisdiction of U.S. Supreme Court), § 1330 (federal district court jurisdiction over actions against foreign states), § 1331 (district court federal-question jurisdiction), § 1332 (district court diversity jurisdiction), *and* § 1333 (1982) (district court admiralty and maritime jurisdiction).

[254] COMM. PRO. NO. 30, § 7(b), JMCC, *supra* note 24, at 934-35. These matters are set forth in what is now § 6(b) of art. XI.

[255] *See* COMM. PRO. NO. 30, § 7(b), JMCC, *supra* note 24, at 935; STAND. COMM. REP. NO. 49, JMCC, *supra* note 24, at 879.

on the floor of the Constitutional Convention. The amendment removed concurrent state-court jurisdiction over diversity and national-law matters, making such cases subject to the exclusive jurisdiction of the Supreme Court and such other national courts as may exist.[256]

The Supreme Court thus appears to have exclusive jurisdiction as against the state courts in all diversity cases. The FSM Supreme Court has recognized that its diversity jurisdiction allows it to hear land cases.[257] However, the court has not yet declared whether national court diversity jurisdiction is exclusive as against the state courts.

Violations of national rights by any party also appear to give rise to national court jurisdiction even in the absence of diversity of citizenship. The Constitution's Declaration of Rights[258] apparently applies to state and local govern-

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[256] FSM CONST. art. XI, § 6(b). The amendment was offered on the floor of the Convention by Delegate Toribiong. JMCC, *supra* note 24, at 492-95. The apparent intent of the amendment was to give national courts exclusive jurisdiction—as against state courts—over national-law matters:

> [T]hese cases may be assigned to different courts depending upon the laws which may be enacted in the future [pursuant to art. XI, § 6(c)]—and [the purpose of this amendment is] to remove state and local courts from handling cases arising under this Constitution, treaties and national law because if you allow them to handle those cases we will have a mess on our hands.

JMCC, *supra* note 24, at 492.

However, the jurisdictional language of the amended provision, § 6(b), applies identically to diversity cases. If § 6(b) *precludes* state-court jurisdiction in national-law matters, as Delegate Toribiong, an attorney, clearly intended, then it equally *precludes* state-court jurisdiction in diversity matters, even cases involving land.

Two days after Mr. Toribiong offered the amendment, he stated, "[T]he Article on Judiciary . . . says that the federal courts shall have no jurisdiction at all over land matters." JMCC, *supra* note 24, at 542. Mr. Toribiong was evidently not considering the possibility that a land case might involve parties of diverse citizenships. Indeed, even before he introduced the amendment, Mr. Toribiong noted that the national courts could consider land cases involving issues of national constitutional rights. *Id.* at 449.

[257] *In re* Nahnsen, 1 FSM Interim 97, 100-06 (Tr. Div. Pohnpei 1982).

> The conclusion that the powers to regulate probate, inheritance and land matters are powers of states, rather than the national government, of course does not suggest that this court is without jurisdiction to preside over proceedings involving the exercise of those powers. The constitution emphasized "powers" in delegating authority to the legislative and executive branches. FSM Const. Art. IX, Sect. 2 and Art. X, Sect. 2. The allocation of judicial authority is made on the basis of jurisdiction, generally without regard to whether state, or national, "powers" will be at issue.
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> . . . .
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> Thus, our finding that the issues between these parties concern matters within the legislative powers of states to regulate does not indicate that this court is without jurisdiction to decide the issues.

Id. at 108, 109.

[258] FSM CONST. art. IV.

ments,[259] and the National Criminal Code has a civil rights provision applicable to any person.[260] This makes Supreme Court jurisdiction over land cases

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[259] There is no statement in the text of the Constitution or in the Convention record expressly stating that the Declaration of Rights shall apply to state and local governmental actions. However, there are no statements to the opposite effect, and there are strong implications throughout the Constitution and the Convention record that the Declaration does apply beyond the national government. Three examples are:

1. The Committee Report on the Declaration of Rights is replete with references to U.S. Supreme Court cases nullifying state laws that violated the U.S. Bill of Rights. STAND. COMM. REP. NO. 23 ON COMM. PRO. NO. 14, JMCC, *supra* note 24, at 793-804. These cases generally follow the U.S. Constitutional doctrine that much of the U.S. Bill of Rights was "incorporated" into the fourteenth amendment and thus made applicable to state action. *See generally* Benton v. Maryland, 395 U.S. 784 (1969). This case articulates the doctrine:

> Our recent cases have thoroughly rejected the . . . notion that basic constitutional rights can be denied by the States as long as the totality of the circumstances does not disclose a denial of "fundamental fairness." Once it is decided that a particular Bill of Rights guarantee is "fundamental to the American scheme of justice". . . the same constitutional standards apply against both the State and Federal Governments.

Id. at 795 (citations omitted). *Benton* was among the U.S. cases cited in the committee report regarding double jeopardy. JMCC, *supra* note 24, at 798.

2. Under FSM CONST. art. V, § 2, statutes may be enacted that infringe on the rights protected by the Declaration of Rights if such statutes are to protect "the traditions of the people of the Federated States of Micronesia." Such statutes would be local, rather than national. *See* STAND. COMM. REP. NO. 33 ON COMM. PRO. NO. 21, JMCC, *supra* note 24, at 814; comments of Delegate Ngiraked, JMCC, *supra* note 24, at 650.

Such statutes are subject to challenge as violations of the Declaration of Rights. FSM CONST. art. V, § 2. If statutes infringing on constitutionally protected rights can be challenged although they purport to protect local traditions, it seems all the more logical that statutes lacking such a justification are subject to constitutional challenge. Such challenges would be heard exclusively in the national courts because they involve interpretation of the Constitution. FSM CONST. art. XI, § 6(b). *See supra* note 256 and accompanying text.

3. Delegate Johnson Toribiong noted, without objection by other delegates, that the national courts would hear cases alleging that state agencies violated national constitutional rights. JMCC, *supra* note 24, at 449.

[260] 11 FSM CODE § 701 (1982):

> (1) *Deprivation of rights.* A person commits an offense if, whether or not acting under color of law, he deprives another of, or injures, oppresses, threatens, or intimidates another in the free exercise or enjoyment of, or because of his having so exercised any right, privilege, or immunity secured to him by the Constitution or laws of the Federated States of Micronesia, the laws of the Trust Territory of the Pacific Islands, or the Constitution or laws of the United States of America which are applicable to the Federated States of Micronesia.
>
> (2) *Penalty.* A person convicted under this section shall be punished by imprisonment for not more than one year.
>
> (3) *Civil liability.* A person who deprives another of any right or privilege protected under this section shall be civilly liable to the party injured in an action at law, suit in equity, or other proper proceeding for redress, without regard to whether a criminal case has been brought or conviction obtained. In an action brought under this section, the court may

possible where violations of national rights are asserted.[261] For example, a state land inheritance law might be challenged as violating the Constitution's equal protection guarantee.[262]

The floor amendment removing the state courts' proposed concurrent jurisdiction over national law issues has created apparent anomalies in the Constitution's text. Article XI section 8 provides that a "substantial question" of national law appearing in a case in state or local court is to be certified to the appellate division of the Supreme Court. The appellate division may decide the particular issue or the entire case or remand it for further proceedings.[263] Similarly, the appellate division may also review cases decided in state courts if they "require interpretation" of the Constitution, national law, or treaties.[264] Both of these provisions appear to have been mooted by the floor amendment because such cases are exclusively under national court jurisdiction.[265]

An interesting Micronesian twist on the concept of federalism is a provision stating that "if a state constitution permits, the appellate division of the Supreme Court may review other cases on appeal" from the state courts even though no issue of national law or diversity is present.[266] No cases have yet

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award costs and reasonable attorney's fees to the prevailing party.

[261] Delegate Toribiong expressly recognized that a person could assert a national constitutional right in a national court in a land case. JMCC, *supra* note 24, at 449.

[262] Pohnpei's inheritance law relating to land on Pohnpei Island favored the eldest male child of a landowner. *See* Fischer, *supra* note 138, at 83-96. In 1978 Pohnpei's law was amended to provide for equal inheritance rights of all children. Pohnpei Pub. L. No. 4L-155-78 (1978).

[263] FSM CONST. art. XI, § 8.

[264] *Id.* art. XI, § 7.

[265] Sections 7 and 8 were drafted as part of Committee Proposal No. 30 at least as early as October 25, 1975. JMCC, *supra* note 24, at 933-35. Neither section was amended to conform to the floor amendment which completely deprives state courts of jurisdiction in any cases involving interpretation of the Constitution or national law. *See supra* text accompanying note 256.

In this writer's analysis, section 8 in its entirety and section 7 in part were rendered meaningless by the amendment. State and local courts simply lack jurisdiction over any case involving a "substantial question" of national law. This is particularly apparent because cases "arising under" the FSM Constitution or national laws are "cases involving the enforcement of a right protected or created by the national constitution, national law or a treaty and cases involving the construction or interpretation of the national constitution, national law or a treaty." STAND. COMM. REP. NO. 49 ON COMM. PRO. NO. 30, JMCC, *supra* note 24, at 879. Thus, if a national question arises in a state-court case, it evidently must be removed to a national court. Compare United States case law, which interprets "arising under" far more restrictively. Skelly Oil Co. v. Phillips Petroleum Co., 339 U.S. 667, 672 (1950).

The FSM Supreme Court has recognized this problem, but has refrained from declaring what, if any, residual meaning section 8 has. Ponape Chamber of Commerce v. Nett Mun. Gov't, 1 FSM Interim 389, 393-94 n.1 (Tr. Div. Pohnpei 1984).

[266] *Id.* The Kosrae State Constitution expressly permits such appeals. KOSRAE CONST. art. VI, § 6. The Pohnpei and Yap Constitutions are silent on this issue. *See* POHNPEI CONST. art. X, §§ 1-11; YAP CONST. art. VII, §§ 1-7 (copies on file in law review office).

arisen under this provision.

Another twist goes in the opposite direction. The Supreme Court's original and exclusive jurisdiction includes "cases in which the national government is a party except where an interest in land is at issue."[267] It is not at all clear who has jurisdiction when the national government is a party and an interest in land is at issue. The Committee Report is silent on this question.[268]

The Convention may have originally intended such cases to be under the concurrent jurisdiction of the national and state courts.[269] If so, the Supreme Court would exercise such jurisdiction on a de facto exclusive basis, at least if an issue of national law is present. This is because the state courts were excluded from concurrent jurisdiction over such cases, and there are no other national courts.[270]

Perhaps, however, the Convention expected the state courts to have exclusive jurisdiction over such cases to protect local citizens from a potentially hostile national government aided by its own court. Such fears were based on unhappy experiences with the Trust Territory government and its courts.[271] As with the related issue of eminent domain,[272] the Convention records provide no definitive answer.

In sum, the national-law and diversity bases for jurisdiction are potentially very broad. Moreover, unlike the American model, this jurisdiction is exclusive.[273]

This broad jurisdiction may be tempered in practice. As to diversity matters, there is likely to be national-court deference to state decisional law. In a 1982 case, the Supreme Court declared that it had jurisdiction over probate cases where the claimants have diverse citizenship even though the cases may involve land.[274] The court, however, invited the Trust Territory District Court for Pohnpei (the Pohnpei Supreme Court had not yet been established) to state its views on the validity of certain wills and on the effect of the Pohnpei inheritance laws as they applied to the case.[275] The Supreme Court can be expected to increase its referral of questions of substantive state law since the establishment of the state courts.

The American concept of judicial review of legislative and administrative acts

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[267] FSM CONST. art. XI, § 6(a).

[268] *See* STAND. COMM. REP. NO. 49 ON COMM. PRO. NO. 30, JMCC, *supra* note 24, at 879.

[269] *See supra* notes 254-65 and accompanying text.

[270] *Id.*

[271] *See infra* notes 404-28 and accompanying text.

[272] *See infra* notes 437-44 and accompanying text.

[273] The United States Constitution, by contrast, merely permits federal courts to exercise such jurisdiction. U.S. CONST. art. III, § 2.

[274] *In re* Nahnsen, 1 FSM Interim 97, 101-09 (Tr. Div. Pohnpei 1982). *See supra* note 257.

[275] 1 FSM Interim at 111-12.

is implied, but not expressly affirmed, in the Micronesian Constitution.[276] The FSM Supreme Court has held certain national administrative acts unconstitutional. These have primarily been police searches and seizures.[277] The court has not held any national legislative act unconstitutional but it has declared its authority to do so.[278] Similarly, as of this writing, no state legislative act has been held unconstitutional. However, the FSM Supreme Court held that a municipal ordinance taxing imports of goods across the state's docks, which are located within the municipality, violated the Pohnpei state charter. Interestingly, the court refrained from ruling on the plaintiff's allegations that the ordinance violated the FSM Constitution. Instead, the court held that it had pendent jurisdiction over the state-law claim and ruled on it.[279]

The FSM Supreme Court has also held state administrative acts to be unconstitutional. In *Etpison v. Perman*,[280] the court held that the Pohnpei State Public Lands Authority had violated the FSM Constitution's guarantee of procedural due-process rights. A person occupying a parcel of government-held land, claiming to be the successor to the leaseholder, was not given personal notice of the agency's plan to renew the lease of a rival claimant.[281] The court vacated the Authority's action and remanded the dispute to it.[282]

5. *Traditional Chiefs and Law in National and State Government*

The traditional cultures of the Federated States of Micronesia are highly diverse.[283] The nature and amount of post-contact cultural transformation also differs among the island groups.[284] Land tenure,[285] family law, and the exis-

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[276] The concept of judicial review of legislation is recognized in FSM CONST. art. V, § 2. See discussion *supra* at note 259. In American practice, courts can hold legislation and administrative acts null and void if the acts are found violative of the Constitution. Marbury v. Madison, 5 U.S. (1 Cranch) 137 (1803).

[277] *See, e.g.*, Federated States of Micronesia v. George, 1 FSM Interim 449, 460 (Tr. Div. Kosrae 1984).

[278] Suldan v. Federated States of Micronesia (II), 1 FSM Interim 339, 342-50 (Tr. Div. Pohnpei 1983).

[279] Ponape Chamber of Commerce v. Nett Mun. Gov't, 1 FSM Interim 389, 403 (Tr. Div. Pohnpei 1984). The author was an attorney for the plaintiff in that case. *Id.* at 389.

[280] 1 FSM Interim 405, 427-28 (Tr. Div. Pohnpei 1984).

[281] The court relied heavily on Mullane v. Central Hanover Bank & Trust Co., 339 U.S. 306, 315 (1950).

[282] Etpison v. Perman, 1 FSM Interim at 429-32.

[283] Mason, *Unity and Disunity in Micronesia: Internal Problems and Future Status*, in POLITICAL DEVELOPMENT, *supra* note 1, at 225-44; N. MELLER, CONGRESS, *supra* note 13, at 3-4; N. MELLER, CONSTITUTIONALISM, *supra* note 8, at 8-12. "To make one nation of many islands, we respect the diversity of our cultures. Our differences enrich us." FSM CONST. preamble.

[284] *See generally* F. HEZEL, THE FIRST TAINT OF CIVILIZATION: A HISTORY OF THE CAROLINE

tence and survival of chiefly hierarchies all vary widely.[286] At each stage of transition toward a democratically elected legislative system under the trusteeship, the governmental positions and functions of the traditional chiefs have been diminished and largely eliminated[287] except in Yap.[288] Similarly, the legislatures and the courts were, consciously or otherwise, reducing the role of traditional law as they adopted, in court decisions[289] and legislation,[290] rules of law patterned after American practice.

The FSM Constitution provides both the state and national governments the means to reverse the waning of traditional laws and the powers of chiefs. However, the Constitution in no way mandates such a reversal.[291]

a. Traditional Chiefs

The Constitution provides that traditional chiefs may be given "formal or functional roles at any level of government."[292] At the state level, only Yap has

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AND MARSHALL ISLANDS IN PRE-COLONIAL DAYS, 1521-1885 (1983). *See also* C. HEINE, *supra* note 1, at 10-14.

[285] *See generally* LAND TENURE PATTERNS, TRUST TERRITORY OF THE PACIFIC ISLANDS (J. de Young ed. 1958).

[286] Hughes & Lingenfelter, *General Introduction*, in POLITICAL DEVELOPMENT, *supra* note 1, at 7-19.

[287] *See generally* POLITICAL DEVELOPMENT, *supra* note 1, especially at 20-21, 31-33. N. MELLER, CONGRESS, *supra* note 13, at 120-31. *See also* C. HEINE, *supra* note 1, at 30-39 on the waning of tradition in general.

[288] *See infra* text accompanying note 294.

[289] An example from Pohnpei: Early Trust Territory High Court decisions recognized Pohnpei's complex system of family land ownership under a senior man, *e.g.*, Kilara v. Alexander, 1 T.T.R. 3 (Tr. Div. Pohnpei 1951); Pelitin v. Lorenso, 1 T.T.R. 307 (Tr. Div. Pohnpei 1957); Opispo v. Mesileng, 4 T.T.R. 80 (Tr. Div. Pohnpei 1968). The latter case holds that a state law could not deprive junior interest holders of their rights even though it expressly purported to abolish these rights. More recent cases implicitly treat adverse land claims as competition for fee-simple rights of individuals without any reference to junior interests, *e.g.*, Hadley v. Hadley, 7 T.T.R. 164 (Tr. Div. Pohnpei 1975) (suit between two brothers: no discussion of whether one had use rights under the other); Long v. Susumu, 7 T.T.R. 286 (Tr. Div. Pohnpei 1976) (similar).

[290] Another example from Pohnpei: Pohnpei formerly had a system of land inheritance in which land was to be passed from one senior man to the senior man in the next generation to hold on behalf of the entire family. Fischer, *supra* note 138, at 87-96. In 1978, the legislature adopted a system of inheritance in which each child of the owner inherits an equal undivided interest. Pohnpei Pub. L. No. 4L-155-78 (1978). The change was due, in no small part, to the increasing inequities of a situation in which senior men were in practice acting as virtually fee-simple-absolute owners, ignoring junior rights.

[291] *See* N. MELLER, CONSTITUTIONALISM, *supra* note 8, at 281.

[292] FSM CONST. art. V, § 1.

given its traditional chiefs a formal governmental role.[293] The Yap Constitution provides for two councils of traditional chiefs, one composed of chiefs from the Yap Islands proper and the other from the outer islands.[294] These councils have the power to veto legislation that concerns custom and traditions.[295]

Pohnpei also considered giving traditional chiefs governmental authority on the state level. During the Pohnpei State Constitutional Convention of 1983-84, there was much debate on the topic. However, the proposals were eventually dropped because of apparent public opposition.[296]

On the national level, the Constitution permits a legislative role for the traditional chiefs. "The Congress may establish, when needed, a Chamber of Chiefs."[297] No movement for such a chamber is evident. The diversity of cultures and languages, the lack of any modern or traditional precedent for government of large areas by councils of chiefs (except in Yap),[298] and the traditional chiefs' relative lack of skill in the modern processes of legislation and administration[299] appear to be the main reasons that they have not been given these powers.

b. Traditional Law

Legislation—ordinarily at the state or local level[300]—may incorporate customary law or attempt to protect custom.[301] If a court finds such legislation to conflict with the Declaration of Rights, "protection of Micronesian tradition shall be considered a compelling social purpose warranting such governmental

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[293] Of the four state charters which preceded the state constitutions, only Yap's provided for a council of traditional chiefs. *See* 3 T.T. CODE ch. 3 (Truk), ch. 4 (Yap), ch. 5 (Kosrae), ch. 6 (Pohnpei) (1980). Neither the Pohnpei nor Kosrae Constitutions provide governmental roles for traditional chiefs. *See infra* note 296.

[294] YAP CONST. art. II, § 1. The outer islands are linguistically and culturally tied to Truk although politically they have long been part of the "Yap empire." Hughes & Lingenfelter, *General Introduction*, in POLITICAL DEVELOPMENT, *supra* note 1, at 9-11.

[295] YAP CONST. art. V, §§ 16-17.

[296] This writer served as legal counsel to the Pohnpei Constitutional Convention during several months of its deliberations in 1983 and 1984. These proposals included establishment of a council of chiefs having power to review legislation (as in Yap), giving the chiefs control over public lands, and proposals that the chiefs have formal roles at governmental functions.

[297] FSM CONST. art. V, § 3.

[298] N. MELLER, CONGRESS, *supra* note 13, at 120-31.

[299] *Id. See* Hughes, *Obstacles to the Integration of the District Legislature into Ponapean Society*, in POLITICAL DEVELOPMENT, *supra* note 1, at 94-98.

[300] STAND. COMM. REP. NO. 33 ON COMM. PRO. NO. 21, JMCC, *supra* note 24, at 814. *See also supra* note 259; *infra* note 304.

[301] FSM CONST. art. V, § 2.

action."[302] This provision may appear to require all such legislation to be upheld and the right to be infringed, but the Convention record is unclear.[303]

Although the Convention record indicates that only the state or local levels were to enact legislation protecting custom,[304] to some extent at least national legislation must be consonant with tradition. For example, Congress is to define major crimes "having due regard for local custom and tradition."[305] The National Criminal Code provides that custom may be asserted in criminal trials and in sentencing.[306]

In FSM Supreme Court cases, custom has played an important role in determining matters of privilege[307] and sentencing in criminal cases. Examples of sentences influenced by custom are restitution and service to the victim.[308] The FSM Supreme Court has actively encouraged practitioners to raise issues relating to custom, and the court has appointed a number of elders to act as formal advisors to the court on matters of custom in their respective cultures.[309]

The FSM Supreme Court has, however, rejected arguments that a criminal prosecution should be dismissed simply because the victim has forgiven his

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[302] *Id.*

[303] The Committee on Style and Arrangement "adopted certain particular principles of style" of which the first was a clear distinction between "may" (used "to indicate a delegation of power") and "shall" (used "where a command was intended"). STAND. COMM. REP. NO. 67 ON DRAFT CONSTITUTION FOR THE FEDERATED STATES OF MICRONESIA, JMCC, *supra* note 24, at 891-92. Thus, seemingly, the "compelling purpose" would require infringement of the right. *Cf.* Korematsu v. United States, 323 U.S. 214 (1944), employing similar language to reach a similar result. However, the Style Committee reported that "the meaning appears to be that the courts are commanded to take custom and tradition into account." STAND. COMM. REP. NO. 44 ON BILL OF RIGHTS, JMCC, *supra* note 24, at 874. Adding to the ambiguity of the Convention record was the floor debate in which this question was raised but left unanswered. JMCC, *supra* note 24, at 648-51.

[304] The Convention apparently contemplated that protection of custom was a matter exclusively reserved to the states. STAND. COMM. REP. NO. 33 ON COMM. PRO. NO. 21, JMCC, *supra* note 24, at 814. *See also* JMCC, *supra* note 24, at 394, 618, 650, 773-74.

[305] FSM CONST. art. IX, § 2(p).

[306] 11 FSM CODE §§ 108, 1002-03 (1982).

[307] Federated States of Micronesia v. Boaz (I), 1 FSM Interim 22, 27 (Tr. Div. Pohnpei 1981) (claim of privileged entry into building rejected). *Cf.* Federated States of Micronesia v. Ruben, 1 FSM Interim 34, 40-42 (Tr. Div. Truk 1981) (defendant acquitted of assault charges because of self-defense; court rejected prosecution argument that the victim—the brother-in-law of defendant—had a privilege to break into defendant's house at night while drunk).

[308] 11 FSM CODE §§ 1002(6), 1003 (1982). *See, e.g.*, Federated States of Micronesia v. Boaz, Crim. No. 1981-502 (Tr. Div. Pohnpei Oct. 21, 1981) (unreported), providing for imprisonment for 75 days or, at the option of the defendant, an alternative sentence requiring the defendant to repair the house that he damaged while burglarizing it.

[309] Supreme Court of the Federated States of Micronesia, General Court Order No. 1982-1 (Feb. 3, 1982) (Appointment of Assessors Under the Judiciary Act) (on file at law review office). *See* Turcott, *supra* note 234, at 366-67.

assailant in a traditional ceremony of reconciliation.[310] The court found that customary law places less emphasis on individual guilt than does modern law and that customary forgiveness ceremonies attempt "to prevent further violence and conflict, to soothe wounded feelings, and to ease the intense emotions of those most directly involved."[311] By contrast, the court found that the constitutional legal system focuses simultaneously on the individual defendant and "the more generalized interests of the larger society to preserve order and respect for the law."[312]

c. Judicial Guidance

A constitutional requirement to honor custom is contained in the judicial guidance provision, which states that "court decisions shall be consistent with this Constitution, Micronesian customs and traditions, and the social and geographical configuration of Micronesia."[313] This requirement applies to holdover Trust Territory courts[314] and the new state and local courts,[315] as well as FSM national courts. The provision is intended to substitute Micronesian custom and Micronesian concepts of justice (if they conflict with American common law) as the source of law in the absence of statute.[316]

Although existing law already required such reference to custom,[317] relatively

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[310] Federated States of Micronesia v. Mudong, 1 FSM Interim 135, 140 (Tr. Div. Pohnpei 1982).

[311] *Id.* at 145.

[312] *Id.*

[313] FSM CONST. art. XI, § 11.

[314] *See In re* Iriarte (II), 1 FSM Interim 255, 268 (Tr. Div. Pohnpei 1983). "The Trust Territory High Court, in its interim role within the constitutional government of the Federated States of Micronesia . . . must promote constitutional self-government as a primary duty. It therefore may not act in a manner contrary to the Constitution of the Federated States of Micronesia . . . ." In another case, the Trust Territory High Court disagreed, asserting that it, rather than the FSM Supreme Court, was the ultimate arbiter of the law in Micronesia. The Trust Territory High Court's position has been vigorously criticized in Bowman, *supra* note 73, and in *"War" in the Micronesian Courts*, *supra* note 73.

[315] STAND. COMM. REP. NO. 34 ON COMM. PRO. NO. 22, JMCC, *supra* note 24, at 821-22.

[316] *Id.*

[317] The customs of the inhabitants of the Trust Territory not in conflict with the laws of the Trust Territory shall be preserved. The recognized customary law of the various parts of the Trust Territory shall have the full force and effect of law so far as such customary law is not in conflict with the laws mentioned in section 101 of this chapter.

1 T.T. CODE § 102 (1980). Section 101 established the following hierarchy of law in Micronesia:

(1) The trusteeship agreement;

(2) Such laws of the United States as shall, by their own force, be in effect in the Trust Territory, including the executive orders of the President and orders of the Secretary of the Interior;

little had been done to give it effect. For example, a number of Trust Territory High Court cases held that custom would, like facts, have to be pleaded and proved, and the court tended to find such pleadings and proof insufficient: "When there is a dispute as to the existence or effect of a local custom, the party relying upon it must prove it by evidence satisfactory to the court."[318] However, "[i]f a local custom is firmly established and widely known, this court will take judicial notice of it."[319] Trust Territory High Court decisions have held that "public policy" may forbid the enforcement of a custom. "This court can perceive no persuasive reason for upholding a custom which closes the mouth of a family member knowing of commission of a felony by another family member, under pain of forfeiture . . . ."[320] By contrast, the judicial guidance provision of the FSM Constitution makes custom the public policy of Micronesia.

Trust Territory law had established the common law of the United States, as set forth in the *Restatements* of the American Law Institute, as a residual source of law in the absence of written law or customary law.[321] The FSM Supreme Court has held that American common law can be used as a source of law, but only if it is in conformity with the judicial guidance provision.[322] The court stated, "Of course, this Court can and should consider the *Restatement* and reasoning of courts in the United States and other jurisdictions in arriving at its own decisions."[323] Quoting an earlier decision, the court stated, "What is clear from the Constitution, however, is that we are not to consider ourselves bound by those decisions and must not fall into the error of adopting the reasoning of those decisions without independently considering suitability of that reasoning for the Federated States of Micronesia."[324]

The judicial guidance provision is of potentially immense importance because it frees the courts from constraints that would be imposed by rigid adherence to the *Restatements*. Thus, the FSM Supreme Court has held that it may depart

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(3) Laws of the Trust Territory and amendments thereto;

(4) District orders promulgated by the district administrators of the Trust Territory;

(5) The acts of legislative bodies convened under charter from the High Commissioner when these acts are approved by the High Commissioner or otherwise become law; and

(6) Duly enacted municipal ordinances.

Thus, under Trust Territory law, custom was near the bottom of the hierarchy, just above American common law. *See infra* text accompanying note 321.

[318] Ngirmekur v. Municipality of Airai, 7 T.T.R. 477, 483 (Tr. Div. Palau 1976).

[319] Lajutok v. Kabua, 3 T.T.R. 630, 634 (App. Div. Marshall Is. 1968).

[320] Yangilemau v. Mahoburimalei, 1 T.T.R. 429, 433 (Tr. Div. Palau 1958).

[321] 1 T.T. CODE § 103 (1980).

[322] Rauzi v. Federated States of Micronesia, 2 FSM Interim 8 (Tr. Div. Pohnpei 1985).

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

[324] *Id.* at 15 (quoting Alaphonso v. Federated States of Micronesia, 1 FSM Interim 209, 212 (App. Div. Truk 1982)).

from the *Restatement*'s rule of contributory negligence[325] and adopt a rule of comparative negligence.[326] This freedom from strict adherence to the *Restatement* or any other body of foreign law gives the FSM courts the power of most other common-law courts to decide cases on the basis of the reasoning and experience, and sense of justice, of its own society.[327] This freedom extends far beyond matters as to which customs and traditions have developed.[328]

6. *Federalism—Criminal Law*

a. Legislation

Under the Constitution, criminal law is subject to ultimate national control.[329] The Constitution directs that the Congress shall define major crimes and prescribe penalties, having due regard for local custom and tradition, leaving to the states jurisdiction over minor crimes.[330]

Under the National Criminal Code, the distinction between major and minor crimes is determined by the maximum punishment.[331] The Congress thus equated punishment with the severity of the offense.[332] The Congress has set the boundary between major and minor crimes somewhat above the traditional common-law distinction between felonies and misdemeanors.[333] Crimes carrying imprisonment penalties of three years or longer are deemed major and therefore national crimes.[334] The states are free to define as offenses any criminal acts not incorporated in the National Criminal Code but may only impose imprisonment penalties of less than three years.

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[325] RESTATEMENT (SECOND) OF TORTS §§ 463-496 (1965).

[326] Ray v. Electrical Contracting Corp., 2 FSM Interim 21, 23 n.1 (App. Div. Truk 1985) (citing Rauzi v. Federated States of Micronesia, 2 FSM Interim 8 (Tr. Div. Pohnpei 1985)). In *Ray*, the defendants were held liable in the wrongful death of two young children because of the defendants' reckless conduct. Thus the case fell into an exception to the rule that contributory negligence defeats recovery.

[327] *Cf.* POHNPEI CONST. art. X, § 11: "Judicial Policy. The decisions of all courts and adjudicatory bodies shall be consistent with this Constitution and the concepts of justice of the people of Pohnpei."

[328] *See, e.g.*, Rauzi v. Federated States of Micronesia, 2 FSM Interim at 13-17 (involving the common law definition of "employee").

[329] FSM CONST. art. IX, § 2(p).

[330] *Id.*

[331] 11 FSM CODE §§ 104(6), 902 (1982).

[332] *Cf.* STAND. COMM. REP. NO. 33 ON COMM. PRO. NO. 21, JMCC, *supra* note 24, at 819.

[333] *Compare* 11 FSM CODE § 104(1) *with* § 104(6) *and* § 902 (1982).

[334] 11 FSM CODE § 104(6) (1982). "An attempt to commit a major crime is also a major crime." *Id.* A similar definition is at 11 FSM CODE § 902 (1982). This second definition also includes as major crimes theft offenses where the value of the property or services is $1000 or more.

The most important and controversial element of the FSM's constitutional treatment of criminal law is that national crimes need not have a national nexus. The implications of this scheme were not fully analyzed during the Constitutional Convention and this has led to some disagreement.[335] Many at the state level perceived the scheme established by the National Criminal Code as an unwarranted arrogation of power by the national government. The critics argued that crimes lacking a national nexus should be governed by state law even though they may be very serious crimes.[336] This argument is consistent with the Constitution's general concept of federalism, but it lacks support in either the text of the Constitution or the Convention record.[337]

b. Administration

Even though the National Criminal Code asserts great potential national power, the administration of law enforcement has largely been delegated to the states by agreements. Thus, state police investigate criminal cases and apprehend suspects, and state attorneys prosecute them on behalf of the national attorney general, but the prosecutions are in the FSM Supreme Court. This scheme of delegation was adopted as a matter of policy and practicality, rather than because of any constitutional mandate. If there had been no delegation, separate national and state police forces would have been needed in each state.

National law authorizes such agreements but requires that the President maintain final legal and administrative authority over criminal law enforcement.[338] The national government's residual authority may help state officials avoid difficulties in cases having political implications.

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[335] See STAND. COMM. REP. NO. 299, 3d Cong., 4th Sess., Nov. 5, 1984, in which a majority of the Congress's judiciary committee endorsed a bill proposing to remove from the National Criminal Code all crimes lacking a national nexus, except homicide.

[336] This argument was made at early conferences of state and national officials and their staffs in 1979 and 1980. The author participated in these conferences.

[337] There is no indication in the Committee Report that national crimes must have a national nexus:

> Your Committee feels that a rational clear-cut distinction between the authority of the national government and that of the state governments ought to be made in the area of criminal law and that the distinction ought to be based on the severity of the crime. Your Committee also feels that the national government ought to take local custom into consideration in legislation regarding crimes. Your Committee has therefore provided that the national government should have authority over major crimes, should be empowered to distinguish between 'major' and 'minor' crimes and that in enacting such legislation should take local custom into account.

STAND. COMM. REP. NO. 33 ON COMM. PRO. NO. 21, JMCC, *supra* note 24, at 819.

[338] 12 FSM CODE § 1203 (1982).

c. *Adjudication*

An obvious question raised by this system is the national courts' jurisdiction over lesser offenses that often occur during the commission of major crimes. For example, a person committing burglary (a major national-law crime) may well commit criminal trespass and larceny (both minor state-law crimes).

The national courts probably have inherent power to adjudicate lesser-included offenses when they hear the major accusations.[339] However, the FSM Supreme Court has not yet expressly declared that it has such jurisdiction, and lesser offenses have been adjudicated in the local courts even when a major crime is involved.[340]

In practice, the lesser-included offenses are being adjudicated in the state courts. Apparently, no one has yet been convicted in both state court and the national Supreme Court for offenses based on the same criminal act. It is not clear whether such multiple convictions would violate the constitutional prohibition of double jeopardy[341] although American standards indicate that they would not.[342]

d. *Possible Changes*

On the whole, this system appeared to work satisfactorily and, probably for this reason, early criticism of the demarcation in the National Criminal Code between major and minor crimes subsided. In 1984, however, legislation was introduced in the FSM Congress to remove national jurisdiction over virtually all crimes except homicides.[343] The legislation came close to being enacted, and the support it received indicates that the ultimate resolution of this very important issue is not yet clear.

If most crimes come to be adjudicated at the state level, a latent problem may well manifest itself. At present, most state judges lack law-school educa-

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[339] In Ponape Chamber of Commerce v. Nett Mun. Gov't, 1 FSM Interim 389 (Tr. Div. Pohnpei 1984), the court exercised pendent jurisdiction over a state-law claim in a civil action challenging a municipal ordinance as violating the FSM Constitution.

[340] Indeed, in a trial-division case, Associate Justice Benson on his own motion held that the FSM Supreme Court lacked ancillary jurisdiction over a lesser-included larceny count (a minor state-law crime) in a prosecution for burglary (a major national-law crime). Federated States of Micronesia v. Hartman, 1 FSM Interim 43 (Tr. Div. Truk 1981).

[341] FSM CONST. art. IV, § 7.

[342] *See* Blockburger v. United States, 284 U.S. 299 (1932) (holding that a person may be convicted of two or more offenses arising out of a single act if each statutory provision requires proof of a fact not essential to the other provision). This would be the situation as to lesser-included offenses.

[343] Bill No. 3-215 (introduced May 18, 1984). *See supra* note 335.

tion. This situation will probably continue for another decade. If state judges are to decide felony cases, criminal defendants could establish a routine practice of challenging the competence of state-court judges to rule on their pleadings.[344] The Supreme Court would then be faced with a difficult choice. If it rejects these claims, it may possibly deny the accused their rights guaranteed under the FSM Constitution. If it upholds the claims, it would create a major source of friction between the national and state courts.[345]

A second problem is that, even if the states had law-school trained judges, an accused who asserted a defense based on a right protected by the FSM Constitution would appear to have a case "arising under" the FSM Constitution. The reason is the broad FSM concept of "arising under."[346] The case might have to be removed to an FSM national court.[347]

7. *Federalism—Marine Resources*

Exploitation of the living and non-living resources of the sea is at present one

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[344] For a discussion of the educational background of the judges, see Turcott, *supra* note 234, at 367-69. In North v. Russell, 427 U.S. 328 (1976), the U.S. Supreme Court, by a vote of 5 to 2, held that a person may be tried by a non-attorney judge in a criminal case and be given a jail sentence, provided that he has the right to trial de novo before an attorney judge. U.S. states such as California have held the U.S. constitutional standard to be insufficient. The California Supreme Court held in Gordon v. Justice Court, 12 Cal. 3d 323, 525 P.2d 72, 115 Cal. Rptr. 632 (1974), *cert. denied*, 420 U.S. 938 (1975), that an accused is entitled to a law-school trained judge whenever the offense is punishable by a jail sentence of any duration.

[345] The FSM Supreme Court could adopt the U.S. standard or a different one. There is, of course, no rule of logic that a law-school trained judge will always understand claims of constitutional rights and uphold them, and that a judge who lacks law school training will never understand such claims and will thus fail to uphold them. However, training of some sort—in law school, legal practice, or judicial seminars—would in most instances seem essential for judicial understanding of constitutional rights. The Convention almost certainly did not contemplate that all judges at all levels would be law-school trained because of the small number of Micronesian graduates of law schools. *See* Turcott, *supra* note 234, at 367-69. Thus the FSM Supreme Court could hold that the judicial guidance provision, FSM CONST. art. XI, § 11, anticipates a less rigorous standard. The argument could be made that an accused is better served by a judge who understands the culture of the accused even though he might not fully understand his constitutional rights. This argument is undercut by the presence of advisors on custom in the Supreme Court. *See supra* note 309. *Cf.* 4 FSM CODE § 107(2) (1982) (requirement that an FSM Supreme Court justice "be a graduate from an accredited law school and be admitted to practice in any jurisdiction, or be a person of equivalent and extraordinary legal ability obtained through at least five years of experience practicing law.").

[346] *See supra* note 265.

[347] It can be argued that the right of appeal and possible trial de novo before law-school trained judges would remove the due process problem. *See* North v. Russell, 427 U.S. 328 (1976). This argument, however, has been cogently criticized in Gordon v. Justice Court, 12 Cal. 3d 323, 525 P.2d 72, 115 Cal. Rptr. 632 (1974), *cert. denied*, 420 U.S. 938 (1975).

of Micronesia's greatest internal sources of economic wealth.[348] Micronesia has very little land mass, few roads, and barely adequate utilities.[349] Its labor force largely lacks industrial skills and, given the large infusion of American aid, it lacks compelling incentives to learn and use them.[350]

As a result of these factors, the allocation of administrative authority over the sea and the right to revenues from it were important issues at the Constitutional Convention.[351] The Constitution gives the national government paramount legal authority over marine resources. The national government regulates the ownership, exploration, and exploitation of natural resources in the ocean space twelve miles beyond the island baselines.[352] The national government may retain all revenues from fishing and other exploitation of marine resources except for half of the net revenues derived from ocean-floor minerals, the other half to be paid to the affected states.[353] Since the beginning, however, the only revenues of the Micronesian Maritime Authority have been from foreign fishing agreements.[354]

Although the national government could have retained marine-resource revenues for its own use, the FSM Congress has appropriated most of the funds for local projects in the states.[355] Congress has apportioned the fisheries revenues, which along with the income tax revenues are the largest source of funds that the Congress is legally free to appropriate,[356] as the members of Congress deem best, subject to Presidential veto.[357]

8. *Federalism—Taxation and the Distribution of Aid and Revenues*

a. *Import and Income Tax Revenues*

The Constitution permits the national government to impose only two types of general taxes—import taxes and income taxes.[358] These are, however, at pre-

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[348] "Most economic studies look to tourism and Micronesia's potential for [military] bases as its major immediate assets. These studies also cite fishing as a major asset, but see little prospect that the Micronesians themselves will be able to exploit these resources." D. McHENRY, *supra* note 1, at 8. *See also* N. MELLER, CONSTITUTIONALISM, *supra* note 8, at 23.

[349] D. McHENRY, *supra* note 1, at 7-15; N. MELLER, CONSTITUTIONALISM, *supra* note 8, at 8-19.

[350] *See* N. MELLER, CONSTITUTIONALISM, *supra* note 8, at 14-20.

[351] *See* STAND. COMM. REP. NO. 33 ON COMM. PRO. NO. 21, JMCC, *supra* note 24, at 819.

[352] FSM CONST. art. IX, § 2(m).

[353] *Id.* art. IX, § 6.

[354] Personal communication with Michael J. McCoy, *supra* note 98.

[355] *Id. See also* Hanlon & Eperiam, *supra* note 5, at 95.

[356] *See* FSM CONST. art. IX, §§ 2(d), (e).

[357] Political considerations have been paramount in the allocation of these funds, and the executive branch has not attempted to impose its views.

[358] FSM CONST. art. IX, § 5.

sent the greatest sources of internal revenue in Micronesia.[359] Taxes on ownership or transfer of land rights are non-existent except for some taxation of rental housing. Since rights in land are virtually the only valuable material asset held by most Micronesians living in a semi-subsistence economy, such taxes would be extremely unpopular and it is highly unlikely that they will be introduced in the foreseeable future.

The Constitution requires the national government to share its tax revenues with the states. At least half of all national tax revenues must be paid into the treasury of the state in which they were collected.[360] Those funds may then be appropriated by the respective state legislatures.

Although the Congress has not increased the percentage of revenues to be given over to the state treasuries, it has made additional appropriations to the state and municipal governments for public works projects and other grants-in-aid. This procedure of appropriation, rather than increasing the percentage of revenues shared with the states, permits the members of Congress to retain greater control over expenditures within their respective states, enhancing their local political power.

b. Distribution of Foreign Aid to the States

The Constitution requires, in general, that foreign financial assistance be distributed in equal shares, one share for each state and one share for the national government.[361] However, "where a particular distribution is required by the terms or special nature of the assistance," that distribution will prevail.[362]

Currently, United States grant funds are considered funds of a "special nature" because United States congressional committees specify how the funds are to be spent. After the termination of the trusteeship, the United States and other sources of external aid can be expected to require specific patterns of distribution to promote effective use of the granted funds or materials. For example, the grant from the United States government under the Compact of Free Association, which would be the most important such assistance, expressly provides that this assistance will be divided into something other than five equal shares.[363] "To take into account the special nature of the assistance, to be provided under [several sections of the Compact], the division of these amounts among the national and state governments of the Federated States of Micronesia

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[359] Sales taxes and taxes on luxuries are comparatively low. *See generally* 77 T.T. CODE §§ 3, 53, 101 (1980). These taxes are now within the states' jurisdiction.

[360] FSM CONST. art. IX, § 5.

[361] *Id.* art. XII, § 1(b).

[362] *Id.*

[363] Compact, *supra* note 6, § 211(a)(2), at H11, 821.

shall be certified to the Government of the United States by the Government of the Federated States of Mirconesia."[364] Similarly, the Japanese government has provided material assistance, such as construction and fisheries equipment, which has also been distributed in accordance with pre-arranged formulas.[365]

These aid funds are intended to address identified needs, and the FSM national government acts to some extent as a broker, seeking to assure each state a "fair" share of available funds. Since the fair share envisaged by the sources providing the grant is infrequently an "equal share," the Constitution's nominally general rule of equal-share distribution will rarely, if ever, be invoked.

9. *Declaration of Rights*

a. *American Sources*

Article IV of the FSM Constitution closely parallels the United States constitutional amendments that relate to human rights.[366] The Micronesian Declaration of Rights is somewhat more detailed. In the United States, constitutional rights originally were protections only against federal actions. After a long period of development, most of these protections are now enforceable against state actions.[367] In Micronesia, such an evolution probably will not be needed as it

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[364] *Id.*

[365] *See* National Union, Mar. 30, 1985, at 1, col. 3.

[366] *See generally* STAND. COMM. REP. NO. 23 ON COMM. PRO. NO. 14, relying on numerous American cases and other authorities to describe the rights. JMCC, *supra* note 24, at 793-803. The FSM Supreme Court has noted on several occasions the close connection between the U.S. Bill of Rights and the Micronesia Declaration of Rights. *See, e.g.*, Federated States of Micronesia v. Tipen, 1 FSM Interim 79, 83-85 (Tr. Div. Pohnpei 1982); Tosie v. Tosie, 1 FSM Interim 149, 153-55 (Tr. Div. Kosrae 1982).

[367] In the United States, the federal constitution's guarantees have been imposed on state-government action by United States Supreme Court decisions. *E.g.*, Chicago, B. & Quincy R.R. v. Chicago, 166 U.S. 226 (1897) (fifth amendment right to just compensation); Fiske v. Kansas, 274 U.S. 380 (1927) (first amendment rights of freedom of speech, press, and religion); *In re* Oliver, 333 U.S. 257 (1948) (sixth amendment right to public trial); Mapp v. Ohio, 367 U.S. 643 (1961) (fourth amendment right to be free from unreasonable searches and seizures and to have any evidence illegally seized excluded from trial); Gideon v. Wainwright, 372 U.S. 335 (1963) (sixth amendment right to counsel); Malloy v. Hogan, 378 U.S. 1 (1964) (fifth amendment freedom from compelled self-incrimination); Pointer v. Texas, 380 U.S. 400 (1965) (sixth amendment right to confrontation of opposing witnesses); Klopfer v. North Carolina, 386 U.S. 213 (1967) (sixth amendment right to speedy trial); Washington v. Texas, 388 U.S. 14 (1967) (sixth amendment right to compulsory process for obtaining witnesses); Duncan v. Louisiana, 391 U.S. 145 (1968) (sixth amendment right to jury trial); Benton v. Maryland, 395 U.S. 784 (1969) (fifth amendment prohibition of double jeopardy). These decisions hold that most federal guarantees are applicable to state action because of the fourteenth amendment of the United States Constitution, which prohibits state infringement of rights which are contrary to due process

appears understood that Micronesia's constitutional protections apply to the states and local governments as well as the national government.[368]

b. Freedom of Expression and Religion

Specific Micronesian constitutional guarantees include freedom of expression, peaceable assembly, association, petition,[369] and exercise of religion.[370] Establishment of religion is prohibited except that assistance may be provided to parochial schools for non-religious purposes.[371]

The provisions on freedom of expression and religion caused much controversy. The Convention delegates expressed much concern that these provisions would permit open, public criticism of traditional leaders, contrary to established custom;[372] the display of pornographic materials, again contrary to custom;[373] and proselytizing by new religious groups, threatening established balances of power in local communities.[374]

c. Equal Protection of the Laws

The Constitution provides in two places for equal protection of the laws.[375] Article IV, section 3 states that "a person may not . . . be denied equal protection of the laws." This statement is clearly derived from the fourteenth amendment to the United States Constitution.[376] Article IV, section 4 then provides an enumeration of classifications as to which equal protection is guaranteed: "Equal protection of the laws may not be denied or impaired on account of sex, race, ancestry, national origin, language, or social status."

This enumeration bears a close resemblance to that contained in article 2 of the Universal Declaration of Human Rights.[377] It also parallels in some re-

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of law. *See* U.S. CONST. amend. XIV, § 1.

[368] N. MELLER, CONSTITUTIONALISM, *supra* note 8, at 245. *See supra* note 259 and accompanying text.

[369] FSM CONST. art. IV, § 1.

[370] *Id.* art. IV, § 2.

[371] *Id.*

[372] JMCC, *supra* note 24, at 615-21; N. MELLER, CONSTITUTIONALISM, *supra* note 8, at 207.

[373] JMCC, *supra* note 24, at 617-20.

[374] *See* N. MELLER, CONSTITUTIONALISM, *supra* note 8, at 245-46. The Pohnpei and Kosrae Constitutions both lack protections of freedom of religion for this reason.

[375] FSM CONST. art. IV, §§ 3, 4.

[376] STAND. COMM. REP. NO. 23 ON COMM. PRO. NO. 14, JMCC, *supra* note 24, at 796-97.

[377] Article 2 of the Universal Declaration of Human Rights states, "Everyone is entitled to all the rights and freedoms set forth in the Declaration, without distinction of any kind, such as race, colour, sex, language, religion, political or other opinion, national or social origin, property, birth or other status." G.A. Res. 217A, art. 2, U.N. Doc. A/810, at 71 (1948), *reprinted in* DEP'T OF

spects, but not in others, a list that might be compiled of "inherently suspect" classifications as defined by the United States Supreme Court in interpreting the American equal-protection clause.[378] However, two differences are worth noting. In the United States, gender classification is not held to be inherently suspect,[379] while legislative and administrative discrimination against aliens is inherently suspect.[380]

Citizenship is not enumerated in article IV, section 4 as one of the classes as to which people are entitled to equal protection. Thus, discrimination against aliens and non-citizen nationals is perhaps the major area in which the Micronesian Constitution appears to provide a lesser standard of protection than does United States constitutional practice.[381]

It thus appears that discrimination against aliens and non-citizen nationals is subject to the less strict standard of "rational basis" as contrasted to the "close judicial scrutiny" directed toward inherently suspect classifications. Historically, Micronesia has allowed a great deal of discrimination against non-citizens. The Trusteeship Agreement allows the administering authority to take measures to protect the lands and resources of Micronesians.[382] Micronesian laws and administrative rules have been and remain replete with measures protecting Micronesians from open competition with non-citizens in the ownership and use of land,[383] business activity,[384] employment,[385] and access to governmental

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PUBLIC INFORMATION, UNITED NATIONS, EVERYONE'S UNITED NATIONS 412-13 (9th ed. 1979).

[378] *See* McLaughlin v. Florida, 379 U.S. 184 (1964). American courts subject an "inherently suspect" classification to "close judicial scrutiny" and will nullify governmental action based on such criteria unless the government can prove that a "compelling governmental interest" is advanced by the classification. Korematsu v. United States, 323 U.S. 214 (1944).

The Micronesian Constitutional Convention intended its enumeration to set forth the classifications that Micronesia would consider inherently suspect. STAND. COMM. REP. NO. 23 ON COMM. PRO. NO. 14, JMCC, *supra* note 24, at 797.

[379] *E.g.*, Reed v. Reed, 404 U.S. 71 (1971).

[380] *E.g.*, Graham v. Richardson, 403 U.S. 365 (1971).

[381] However, Professor Meller states that, "With but one exclusion, the Bill of Rights incorporated into the constitution applies to all persons, whether or not citizens. The exception is the freedom to travel and migrate, which refers only to citizens." N. MELLER, CONSTITUTIONALISM, *supra* note 8, at 247.

[382] Trusteeship Agreement, *supra* note 2, at art. 6(2).

[383] The Trust Territory Code authorized the High Commissioner to "restrict or forbid the acquisition of interests in real property and in business enterprises by persons who are not citizens of the Trust Territory." 1 T.T. CODE § 13 (1980). Acquisition of title to real property was prohibited. 57 T.T. CODE § 201 (1980). By administrative order, non-citizens could acquire leaseholds in excess of one year only by permission of the High Commissioner.

[384] Trust Territory Foreign Investors Business Permit Act, 33 T.T. CODE §§ 1-19 (1980), *superseded by* FSM Foreign Investment Act, 32 FSM CODE §§ 201-232 (1982).

[385] Trust Territory Protection of Resident Workers Act, 49 T.T. CODE §§ 51-57 (1980), *superseded by* 51 FSM CODE §§ 111-168 (1982).

services.[386]

It therefore seems that the Constitutional Convention expected to continue these practices by requiring that discrimination against non-citizens need only have a "rational basis." No compelling interest, such as that required to justify discrimination involving an inherently suspect classification,[387] need be advanced.[388]

Moreover, the enumerated protection against discrimination on the basis of "national origin" does not appear to apply to aliens. It seems to be intended to guarantee only that naturalized citizens be accorded rights equal to those accorded to persons who acquire their citizenship at birth.

d. Rights of the Criminally Accused

Freedom from unreasonable search and seizure and freedom from invasion of privacy are guaranteed.[389] The FSM Supreme Court, using American Supreme Court decisions as a guide, has found certain police practices to violate this right.[390] For example, it held that a holdover Trust Territory statute forbids materials obtained in an unreasonable search from being used as evidence in a criminal prosecution.[391] More recently, the FSM Supreme Court has adopted the "exclusionary rule" as a constitutional right even in the absence of a statutory protection.[392]

American law is also followed in requiring that warrants must be issued on probable cause supported by affidavit particularly describing the place to be searched and the persons or things to be seized.[393] Similarly, as in the United States,[394] the writ of habeas corpus may not be suspended unless the suspension

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[386] For example, government-sponsored educational services are intended primarily for the benefit of Micronesian citizens. *See* 41 T.T. CODE § 2 (education), § 152 (College of Micronesia) (1980).

[387] *See, e.g.*, Korematsu v. United States, 323 U.S. 214, 216 (1944).

[388] Under either standard, the Micronesian government probably could demonstrate that such protections are necessary to protect a small, poor, and relatively uneducated population, with minimal resources, from competition by wealthy and aggressive outsiders. The protection of their resources and cultural identity forms the basis of Micronesia's negotiating principles for free association. *See supra* text accompanying note 79.

[389] FSM CONST. art. IV, § 5.

[390] Federated States of Micronesia v. George, 1 FSM Interim 449, 457 (Tr. Div. Kosrae 1984).

[391] Federated States of Micronesia v. Tipen, 1 FSM Interim 79, 93-94 (Tr. Div. Pohnpei 1982).

[392] Federated States of Micronesia v. George, 1 FSM Interim 449, 457 (Tr. Div. Kosrae 1984).

[393] FSM CONST. art. IV, § 5.

[394] U.S. CONST. art. I, § 9, cl. 2.

is required for public safety in cases of rebellion or invasion.[395]

The constitutional rights of the accused expressly include the right to have a speedy and public trial, to be informed of the nature of the accusation, to have counsel, to be confronted with the witnesses against him, and to compel attendance of witnesses in his behalf.[396] Other rights of the accused include protection from compelled self-incrimination and double jeopardy "for the same offense."[397] These protections are all restatements of American constitutional provisions.[398]

American decisional law requires that defense counsel be supplied free to indigents.[399] The Micronesian Constitution states that the national government recognizes the people's right to legal services "and shall take every step reasonable and necessary to provide these services."[400] At the advent of constitutional government, the national government became responsible for the provision of free public-defender services,[401] which have been given to virtually every criminal defendant.[402]

10. *Land Law*

The Constitution generally contemplates that issues relating to land will be governed by state law.[403] Especially in the earlier days of the Convention, the general view was to deprive the national government of any control over land and to disqualify the national courts from hearing any land cases. This general policy emerged as a deeply-felt reaction to the very serious conflicts between Micronesians and the Trust Territory Government over land issues. However, as the Convention progressed, some exceptions to the policy were acknowledged.

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[395] FSM CONST. art. IV, § 8.

[396] *Id.* art. IV, § 6.

[397] *Id.* art. IV, § 7. *See supra* notes 339-42 and accompanying text.

[398] U.S. CONST. amend. VI.

[399] Gideon v. Wainwright, 372 U.S. 335 (1963); Argersinger v. Hamlin, 407 U.S. 25 (1972).

[400] FSM CONST. art. XIII, § 1.

[401] 2 FSM CODE § 204(6) (1982) provides that there shall be an Office of the Public Defender.

[402] This was also the practice under the Trust Territory government. *See* Trust Territory v. Poll, 3 T.T.R. 387, 396 (Tr. Div. Pohnpei 1968) (requiring appointment of counsel without charge to represent indigent defendants).

[403] STAND. COMM. REP. NO. 33 ON COMM. PRO. NO. 21, JMCC, *supra* note 24, at 814 states, "The powers which your Committee contemplate would be reserved to the states include Personal Property Law, Land Law, Legislation Regarding Protection of Local Custom."

a. Government Administration of "Public" Lands

The Japanese government and several Japanese companies had extensive land holdings during the Mandate,[404] often wrongfully acquired from Micronesian individuals and kinship groups through forced sales, falsification of land records, and other improper means.[405] These properties were confiscated by the United States Naval Administration in Micronesia after World War II,[406] and the confiscation was ratified by the Treaty of Peace between the United States and Japan.[407] The Trust Territory government held these lands as "public" lands.[408] In its early days, the Trust Territory government recognized that the Japanese had wrongfully acquired much land, and established a policy to return it to its owners.[409] However, the government rarely implemented the policy except when forced to do so by court order.[410]

When the Micronesian Legal Services Corporation sought to force the Trust Territory government to implement the policy by arguing that the government was acting as a trustee pursuant to the Trusteeship Agreement, the Trust Territory High Court held that the government was free to ignore the policy.[411]

For reasons such as these, the Convention endeavored to prohibit the FSM national government from having the powers that would allow it to continue the practices of the Trust Territory government.[412] There was much sentiment in the Convention to preclude the national government from having eminent domain power[413] and its courts from having jurisdiction over cases involving land, even—indeed, especially—when the national government was a party.[414]

b. Court Jurisdiction over Land

The Constitution appears to carefully exclude the national courts from jurisdiction over land cases. The drafters evidently intended that state courts would

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[404] *See generally* LAND TENURE PATTERNS, *supra* note 285. *See infra* cases cited at note 410.

[405] *See generally* LAND TENURE PATTERNS, *supra* note 285.

[406] *See* 3 D. RICHARD, *supra* note 1, at 500-06.

[407] Administration Agreement Under Article III of the Security Treaty Between the United States and Japan, Feb. 28, 1952, arts. II-IV, 3 U.S.T. 3341-44, T.I.A.S. No. 2492.

[408] 67 T.T. CODE §§ 1-2 (1980).

[409] Office of the Deputy High Comm'r, Trust Territory of the Pacific Islands, Trust Territory Policy Letter P-1 (Dec. 29, 1947) (Land Policy) (on file in law review office).

[410] *See, e.g.*, Santos v. Trust Territory, 1 T.T.R. 463 (Tr. Div. Palau 1958); Tamael v. Trust Territory, 1 T.T.R. 520 (Tr. Div. Palau 1958).

[411] Ogarto v. Johnston, Civ. App. No. 219 (T.T. App. Div. Oct. 5, 1979) (not reported).

[412] *See* N. MELLER, CONSTITUTIONALISM, *supra* note 8. *See also infra* discussion at note 427, at 59-60; D. MCHENRY, *supra* note 1, at 112-116.

[413] *See, e.g.*, the comments of Delegate Fichita Bossy, JMCC, *supra* note 24, at 136-37.

[414] FSM CONST. art. XI, § 6(a). *See supra* text accompanying notes 267-72.

have jurisdiction over any land cases even though they might "arise under" national law or involve diversity of citizenship.[415] For example, the chairman of the Functions Committee stated, "The national level of our future government will not have jurisdiction over land matters."[416]

The exclusion of the national courts from jurisdiction over land cases was evidently a response to the policies of the Trust Territory High Court, an agency of the United States Secretary of the Interior. The Trust Territory High Court was established by the Secretary of the Interior,[417] who appoints the judges of that court.[418] Their appointment was never made subject to the advice and consent power of the Congress of Micronesia. They have no fixed terms of office and their tenure has always been treated as being at the pleasure of the Secretary.[419]

Before the advent of constitutional government, the High Court had exclusive jurisdiction over land matters,[420] except for the jurisdiction it shared with the Land Commission.[421] But the Land Commission itself was an agency of the same department of the Trust Territory government that was disputing citizens' land claims against the government.[422] Thus, all land disputes between citizens and the government were being adjudicated in prima facie hostile fora.

In its decisions, the High Court imported such doctrines as sovereign immunity;[423] the "prior wrongs doctrine," which holds that the trusteeship administration is not required to redress the wrongful acts of prior administrations, such as land takings;[424] and, by asserting the equitable doctrine of laches, a judicially imposed refusal to hear cases brought to court after delay[425] even though for many years Micronesians lacked access to competent legal counsel.[426]

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[415] *See supra* notes 257-62 and accompanying text.

[416] Statement of Delegate Hirosi Ismael, Oct. 28, 1975, JMCC, *supra* note 24, at 448. This statement preceded the amendment of what is now art. XI, § 6(b), on Nov. 4, 1975, JMCC, *supra* note 24, at 492-93. *See supra* note 256. Delegate Ismael's conclusion was reinforced by the report of the Convention's Functions Committee on the proposal that ultimately became art. IX, § 2, enumerating the powers of the national government. The report states that "the power and legislative authority . . . reserved to the states" includes land law. STAND. COMM. REP. NO. 33 ON COMM. PRO. NO. 21, JMCC, *supra* note 24, at 814.

[417] Secretarial Order No. 2658, 16 Fed. Reg. 9052 (1951).

[418] *Id.*

[419] Bowman, *supra* note 73, at 66.

[420] 5 T.T. CODE § 53 (1980).

[421] 67 T.T. CODE §§ 101-120 (1980).

[422] The Land Commission was a division of the Trust Territory Department of Lands and Surveys. *Id.* § 102. The head of that department was responsible for administering the "public lands" of the Trust Territory. *Id.* §§ 51-52.

[423] Alig v. Trust Territory, 3 T.T.R. 603 (App. Div. Marianas 1967).

[424] Wasisang v. Trust Territory, 1 T.T.R. 14 (Tr. Div. Palau 1952).

[425] Crisostimo v. Trust Territory, 7 T.T.R. 34 (Tr. Div. Marianas 1974).

[426] "Because of the well recognized fact that there is a great scarcity of lawyers in the Trust

The Convention's displeasure with the Trust Territory High Court's policies was reflected in early drafts of the judicial guidance provision, which expressly stated that High Court decisions should not have *stare decisis* effect.[427] Although the draft was later modified, it appears clear that the Convention was directly rejecting doctrines used by the High Court to avoid returning wrongfully-taken lands to their owners.

The Convention thus reflected profound distrust of non-local authority over land. Apparently, the delegates were unwilling to trust FSM national courts even though their judges would be chosen by Micronesians. Ironically, however, by including specific provisions in the Constitution regarding land, the Convention created areas of exclusive jurisdiction for the national courts.[428]

c. *Alien Land Ownership*

The Constitution prohibits non-citizens and corporations not wholly owned by citizens from acquiring title to land or waters in Micronesia.[429] By implication, the prohibition does not extend to leaseholds or other forms of use or power over land. Where aliens had previously acquired title to land, they may retain title, but title can only be inherited or acquired by citizens.[430]

Foreign land ownership is not at present a serious problem in Micronesia. Because the Trust Territory government for over thirty years, by statute, forbade the acquisition of title by non-citizens,[431] little land is currently owned by them. At present, the few remaining foreign-owned lands belong to Catholic and Protestant entities and the descendants of a trading family. However, the constitutional prohibition is important to guard against future acquisitions.

d. *"Indefinite Use Rights" Prohibition*

In all four of the FSM states, a peculiar problem arose in the mid-1950's. The Trust Territory Government took control of hundreds of parcels of land under documents purporting to give the government use rights of indefinite

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territory up to this time . . . ." *In re* Matagolai, 6 T.T.R. 577, 581 (App. Div. Marianas 1974).

[427] JMCC, *supra* note 24, at 419-21; STAND. COMM. REP. NO. 34 ON COMM. PRO. NO. 22, JMCC, *supra* note 24, at 821-22, 917. *See also supra* text accompanying notes 317-20.

[428] *See supra* notes 251-57 and accompanying text.

[429] FSM CONST. art. XIII, § 4. This prohibition may have been intended to apply against non-citizen nationals as well. *See supra* note 120.

[430] The prohibition is against acquisition of title, not retention of title previously acquired. STAND. COMM. REP. NO. 42 ON COMM. PRO. NO. 28, JMCC, *supra* note 24, at 870. *See also* statement of the Chairman of the General Provisions Committee (Petrus Tun), JMCC, *supra* note 24, at 414.

[431] 57 T.T. CODE § 201 (1980).

duration. The owners had expected the lands to be returned within reasonable periods of time, but by the mid-1970's the Trust Territory government was asserting that its rights were equivalent to fee-simple interests.[432]

The Micronesian Constitution states that such agreements may not be made in the future. Agreements existing when the Constitution became effective on May 10, 1979 were void on May 10, 1984 unless they were re-negotiated.[433] Where the national government is a party, as it would be in those instances in which it inherits the rights of the Trust Territory government, or where the United States government is a party, it is the duty of the national government to initiate negotiations for new use agreements.[434] The United States Congress has appropriated several million dollars for renegotiation of these use rights.[435]

In the future, one potentially serious problem could arise regarding use rights. Under traditional concepts of land tenure, the holders of senior rights in land often grant use rights of an indefinite term to their junior relatives. The constitutional provision was apparently not intended to prohibit such arrangements although they are not free of abuses.[436] Instead, the Convention was addressing a specific, narrow problem arising where the land user had originally represented that its use of land would be for a finite period of time, but later asserted virtually fee-simple rights, depriving the owner of his expectation of a reversion.

e. Eminent Domain

The national government's eminent domain power was among the most con-

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[432] *See generally* STAND. COMM. REP. NO. 32 ON COMM. PRO. NO. 20, JMCC, *supra* note 24, at 812. *See also* JMCC, *supra* note 24, at 136-37, 416-18. The Congress established a study group on indefinite land-use rights. 8 FSM CODE §§ 501-505 (1982). *See also* N. MELLER, CONSTITUTIONALISM, *supra* note 8, at 202-03, 305, 313-14 n.51.

[433] FSM CONST. art. XIII, § 5.

[434] *Id.* § 6.

[435] *Request for FY 1980 Supplemental Appropriations, Trust Territory of the Pacific Islands: Hearings Before the Subcomm. on the Dep't of the Interior and Related Agencies of the House Comm. on Appropriations*, 96th Cong., 2d Sess. 330-33 (1980). *See also* Compact, *supra* note 6, § 105(n), at H11,815.

[436] Use-right holders might be evicted after having substantially improved a parcel of land. *See* J. FISCHER, *supra* note 148, at 127. Under American law, equitable principles would be available to the use-right holder. It is unclear whether state courts would apply such principles to grant redress or simply hold that such abuses are permissible under custom and therefore not subject to legal redress. Conversely, a use-right holder might assert that he received an outright grant. Since the large majority of such transactions have been oral, the passage of a generation or two may make it exceedingly difficult for the true owner to reassert his title pursuant to the intent of the original agreement.

troversial issues before the Constitutional Convention.[437] A compromise proposal was drafted to reserve the eminent domain power to the state governments, and to allow them to determine, by law, whether to delegate that authority to the national government.[438] Members of the Convention who adamantly opposed eminent domain succeeded in defeating the proposal.[439] The Micronesian Constitution omits any provision such as that in the United States Constitution's fifth amendment that states, "nor shall private property be taken for public use, without just compensation."[440] The omission may imply that eminent domain power, even as limited by due-process guarantees, is not to be inferred.

In refusing to include a provision on eminent domain, the members of the Convention chose to ignore arguments that constitutional silence might be interpreted as implying that the national government would have eminent domain power since it may well be an inherent power of government.[441] In fact, the Constitution is not necessarily completely silent on eminent domain. In oblique and negative language, the Declaration of Rights states that "a person may not be denied life, liberty or property without due process of law."[442] The provision, which is an almost literal copy of a provision of the fifth amendment to the United States Constitution,[443] may imply that property can be taken as long as due process is observed.

These conflicting interpretations have not been resolved by judicial interpretation because eminent domain has not yet arisen as a problem. Given the extreme sensitivity with which the question has been addressed, and indeed shunted aside, it seems very likely to be avoided in the foreseeable future as well.[444]

11. Environmental Protection

The Constitution lacks a comprehensive statement of policy on environmental protection apparently because of the expectation that the states would have pri-

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[437] *See* N. MELLER, CONSTITUTIONALISM, *supra* note 8, at 267-71.

[438] *See* COMM. PRO. NO. 3 (as redrafted), JMCC, *supra* note 24, at 232-35.

[439] JMCC, *supra* note 24, at 235, 543-44.

[440] U.S. CONST. amend. V.

[441] JMCC, *supra* note 24, at 233, 544.

[442] FSM CONST. art. IV, § 3.

[443] U.S. CONST. amend. V.

[444] The FSM national government has acquired approximately 50 hectares for the national capital site by negotiation with the Pohnpei State Public Lands Authority. *See* National Union, Jan. 30, 1985, at 1, col. 2. It has made similar isolated acquisitions of properties used for telecommunications, postal, and other national functions. In short, the national government appears so far to have satisfied its land needs without resort to eminent domain.

mary responsibility for this subject.[445] However, article XIII, section 2 of the Constitution is a rather forceful declaration on toxic substances:

> Radioactive, toxic chemical, or other harmful substances may not be tested, stored, used, or disposed of within the jurisdiction of the Federated States of Micronesia without the express approval of the national government of the Federated States of Micronesia.[446]

By its terms, the provision applies to everyone, including state and local governments as well as the private sector. Most importantly, it applies to any foreign government acting within the jurisdiction of Micronesia. This would include the United States and its defense activities during free association or any other time.[447]

Although permission is to be granted to the United States, effective on the advent of free association, it is to be limited to activities deemed essential to the defense responsibility, and subject to numerous restrictive safeguards.[448] Disposal is to occur only in a few situations, and the permission granted is not intended as a generalized license for dumping of toxic wastes in the waters, or on the islands, of Micronesia.[449]

VI. CONCLUSION

The Constitution of the Federated States of Micronesia affirms the sovereignty of the Micronesian nation, in both its foreign and domestic affairs, and the supremacy of the Constitution over international agreements, including future political relationships with the United States. Its adoption has arrested the further political fragmentation of the Trust Territory of the Pacific Islands. Disagreements and resentments persist, particularly in Pohnpei and Faichuk, but secession and fragmentation appear, at least for the present, to have become politically and practically impossible.

Despite cynical predictions that the federation would never be established,[450] the Federated States government has been largely successful in assuming many of the governmental functions previously exercised by Trust Territory government, and in allocating functions and responsibilities between the national and state governments. Although the trusteeship continues and the full exercise of

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[445] *See* STAND. COMM. REP. NO. 33 ON COMM. PRO. NO. 21, JMCC, *supra* note 24, at 814.

[446] FSM CONST. art. XIII, § 2.

[447] *See* N. MELLER, CONSTITUTIONALISM, *supra* note 8, at 305.

[448] *See* Armstrong, *Strategic Underpinnings of the Legal Regime of Free Association: The Negotiations for the Future Political Status of Micronesia*, 7 BROOKLYN J. INT'L L. 179, 184 n.12 (1981).

[449] *Id.*

[450] *See* Hanlon & Eperiam, *supra* note 5, at 87-88.

sovereign powers is not yet possible, constitutional government of the Federated States of Micronesia has begun.

The post-trusteeship future will test the strengths of the Federated States of Micronesia and its Constitution. The early successes, although not unlimited, give hope that the Constitution will fulfill its purpose in creating a nation responsive to the aspirations of its citizens.

The Formulation of Labor Policy and the Legal Regulation of Employment in Hong Kong and the People's Republic of China: Identifying an Emerging Agenda for 1997

The principal purpose of labour law . . . is to regulate, to support and to restrain the power of management and the power of organised labour.[1]

I. Introduction

After a century and a half of British colonial rule, the People's Republic of China (PRC) will resume the exercise of sovereignty over Hong Kong on July 1, 1997.[2] The PRC government maintains that Hong Kong will be allowed to

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[1] KAHN-FREUND'S LABOUR AND THE LAW 15 (P. Davies & M. Freedland 3d ed. 1983).

[2] China first ceded the small island of Hong Kong to the British in 1841. The Opium War resulted in the Treaty of Nanking, the first in a series of "unequal treaties" that forced China to surrender territory to the United Kingdom. Nineteen years later, in the Convention of Peking, the British acquired Kowloon, a peninsula on the southern tip of mainland China. These two colonial acquisitions were ceded by China to the British in perpetuity. In 1898, the British obtained a 99-year lease for the portion of the mainland above Kowloon, known as the New Territories. This lease is due to expire in 1997. For a general overview of these treaties, see P. WESLEY-SMITH, UNEQUAL TREATY, 1898-1997: CHINA, GREAT BRITAIN AND HONG KONG'S NEW TERRITORIES (1980); Dicks, *Treaty, Grant, Usage or Sufferance? Some Legal Aspects of the Status of Hong Kong*, 95 CHINA Q. 446-51 (1983); Comment, *The Legal Implications of the Sino-British Treaties Regarding Hong Kong*, 4 LOY. L.A. INT'L & COMP. L.J. 111 (1981).

On March 10, 1972, Huang Hua, China's then representative to the United Nations, addressed a letter to the United Nations Special Committee on Colonialism:

> The questions of Hong Kong and Macao belong to the category of questions resulting from the series of unequal treaties which the imperialists imposed on China. Hong Kong and Macao are part of the Chinese territory occupied by the British and Portuguese authorities. The settlement of the questions of Hong Kong and Macao is entirely within China's sovereign right and do not at all fall under the ordinary category of colonial territories. Consequently they should not be included in the list of colonial territories covered by the declaration on the granting of independence to colonial countries and people. With

preserve its present political and capitalist economic system as well as its wide range of freedoms for fifty years after the 1997 reversion.[3] It is an unprecedented event in modern history for a sovereign country to recover ceded territory through the process of negotiation with the colonial government and to agree to grant status quo "autonomy" to the former colony despite its distinct and opposing political, social and economic system.[4]

The recent Joint Declaration between Britain and China, on the question of Hong Kong, unequivocally returns all of Hong Kong, Kowloon and the New Territories[5] to the sovereign power of the PRC upon termination of the lease on the New Territories.[6] The Sino-British Joint Declaration presents guidelines for the administrative transition of Hong Kong, which will cease to be a Crown Colony of Britain and become a special administrative region[7] of the PRC in

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> regard to the questions of Hong Kong and Macao, the Chinese government has consistently held that they should be settled in an appropriate way when conditions are ripe. . . .

Letter from Huang Hua to the United Nations (Mar. 10, 1972), *reprinted in* N. MINERS, THE GOVERNMENT AND POLITICS OF HONG KONG 19-20 (1981).

[3] Joint Declaration of the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of the People's Republic of China on the Question of Hong Kong, para. 3(12), 23 I.L.M. 1366, 1372 (1984) [hereinafter cited as Joint Declaration].

[4] This is also the first time that Britain has agreed to restore sovereignty over a colonial possession to its original owner instead of granting the colony independence. Davies, *Initialled, Sealed and Delivered*, FAR E. ECON. REV., Oct. 4, 1984, at 12.

[5] Throughout the years, Hong Kong island, Kowloon and the New Territories have been treated collectively as "Hong Kong." For all practical purposes, any resolution of Hong Kong must cover all three areas. Even if China were to exercise control strictly over the leased area (the New Territories), Hong Kong and Kowloon would have an extremely difficult time with a separate and independent existence. In 1983, nearly one-half of Hong Kong's food supply came from China. Hong Kong is also dependent on China for a large portion of her water supply, as well as petroleum. *See* A. RABUSHKA, HONG KONG: A STUDY IN ECONOMIC FREEDOM (1979); Youngson, *Introduction* to CHINA AND HONG KONG: THE ECONOMIC NEXUS 8 (A. Youngson ed. 1983) [hereinafter cited as ECONOMIC NEXUS]. For these reasons, Hong Kong Island, Kowloon Peninsula, and the New Territories are economically inseparable. Furthermore, British involvement in and the resulting colonial administration over this area underscore this economic and political reality.

[6] The Sino-British Joint Declaration on the Question of Hong Kong was signed by Prime Minister Margaret Thatcher and Premier Zhao Ziyang on December 19, 1984. For an excellent discussion of the history and negotiations involved and the complete text of the agreement, see Joint Declaration, *supra* note 3, at 1366. *See also* Davies, *supra* note 4, at 12-15; Comment, *Legal Aspects of the Sino-British Draft Agreement on the Future of Hong Kong*, 20 TEX. INT'L L.J. 167 (1985); Note, *Joint Declaration of the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of the People's Republic of China on the Question of Hong Kong*, 26 HARV. INT'L L.J. 249 (1985). Aspects of the Joint Declaration which affect labor formulation will be summarized in Section IV of this comment.

[7] Clarke, *Hong Kong Under the Chinese Constitution*, 14 HONG KONG L.J. 71 (1984). Article 31 of the Constitution of the People's Republic of China provides: "[T]he state may, where

1997. Although the PRC contends that there will be "one country and two systems,"[8] it appears that there is some degree of convergence between the two and it remains to be seen whether Hong Kong and the PRC will be able to function totally independent of each other.[9]

The agenda for Hong Kong and the PRC during this transition period will be one of maintaining economic prosperity for both systems. An important factor behind the success of Hong Kong as an international industrial, trade and financial center lies in the legal regulation of employment and the formulation of labor policy existing in Hong Kong. This comment examines the two distinct labor systems of the PRC and Hong Kong, and the possibilities for convergence. Current economic and labor reform in the PRC points to the leadership's emphasis on increasing overall economic prosperity. The maintenance of Hong Kong's system of labor relations, meanwhile, is vital for the future stability of Hong Kong.

As a crown colony, Hong Kong has essentially followed a British model of labor management.[10] Hong Kong's system of industrial relations is based on a

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necessary, establish special administrative regions. The system to be instituted in special administrative regions shall be prescribed by law enacted by the National People's Congress according to specific conditions." CONSTITUTION OF THE PEOPLE'S REPUBLIC OF CHINA, *reprinted in* 2 COMMERCIAL, BUSINESS AND TRADE LAWS: PEOPLE'S REPUBLIC OF CHINA (Oceana) Booklet 16 (O. Nee, Jr. ed. Aug. 1985) [hereinafter cited as PRC CONST.].

[8] Speech by Deng Xiaoping, at Third Plenary Session of the Central Advisory Commission (Oct. 22, 1984). *'One Country, Two Systems' Born of Reality*, BEIJING REV., Feb. 4, 1985, at 15. *See also Deng Xiaoping on Hong Kong Issue*, BEIJING REV., July 23, 1984, at 16.

[9] As early as 1960, the Central Committee of the Communist Party of China stressed in a directive that Hong Kong should be utilized in the interest of China's long-term planning goals. *See* J. CHENG, HONG KONG: IN SEARCH OF A FUTURE 45 (1984). Professor Cheng described the relationship between China and Hong Kong in this manner:

> The late Premier, Zhou Enlai, who was instrumental in the development of the Four Modernizations programme, perceived that Hong Kong could play an integral part in promoting China's economic modernization. In order to support Hong Kong's economic development, he announced that all provinces in China had a responsibility to help provide supplies to the territory, thus highlighting the mutually advantageous relationship between Hong Kong and the mainland. . . .As a free port and a growing market, as well as an international financial centre, Hong Kong is a major source of profits to China. One estimate placed Beijing's total earnings on current account from Hong Kong in 1982 in the region of US$ 6.5 billion to US$ 7 billion. China also views Hong Kong as a source of information and, in some ways, an example for China in pursuing its Four Modernizations programme.

Id. See generally Ma, How to Use the Hong Kong Economy to Serve the Acceleration of China's Four Modernizations, Economic Studies Reference Materials (Mar. 1979), *reprinted in* J. CHENG, *supra*, at 58-67; ECONOMIC NEXUS, *supra* note 5; Howe, *Growth, Public Policy and Hong Kong's Economic Relationship with China*, 95 CHINA Q. 512, 529-33 (1983).

[10] Chen, *The Economic Setting*, in THE BUSINESS ENVIRONMENT IN HONG KONG 3 (D. Lethbridge ed. 1984).

modified version of laissez faire[11] known as "positive non-interventionism."[12] The Hong Kong government views the relationship between the worker and the employer as one of equal bargaining power, with government regulating only when it feels necessary. The underlying governmental philosophy is that the economy operates most efficiently when market forces are allowed to control the employment relationship.[13] As a result, the Hong Kong government has traditionally played a minimal role in the support of employment legislation. There appears to be a movement, however, toward governmental intervention to provide a greater statutory floor of rights for the working class.[14]

The PRC provides an interesting contrast to the development of labor law in Hong Kong. Since the founding of the PRC in 1949, industrial relations have been transformed into a highly centralized system, whereby the government has played a major role in employment regulation, as well as in formulating management policies and the production plans of individual factories.[15] Recent reforms, however, indicate a trend toward decentralization of this power and giving greater management power directly to the state enterprises in controlling the relationship between employer and worker.[16] One of the most important of the "Four Modernizations"[17] is industrial modernization. Labor-management re-

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[11] The theory of laissez faire is that government should intervene as minimally as possible in the direction of economic affairs. Economic efficiency for the state is achieved by allowing market forces to prevail. *See* V. SIT, S. WONG & T. KIANG, SMALL SCALE INDUSTRY IN A LAISSEZ-FAIRE ECONOMY: A HONG KONG CASE STUDY 64-65 (1980).

[12] Ng, *The Formulation of Labour Policy in Hong Kong*, 13 HONG KONG L.J. 174, 174-75 (1983).

[13] Sir Philip Haddon-Cave, Chief Secretary of Hong Kong, has expressed the government's policy in this manner:

> The Hong Kong Government's attitude to the economy, which is a consequence of the environment in which the economy operates, is frequently but inadequately described as being based on the philosophy of laissez-faire. . . .So it is preferable to describe our attitude to the economy as one of positive non-interventionism: this involves taking the view that, in the great majority of circumstances it is futile and damaging to the growth rate of the economy for attempts to be made to plan the allocation of resources available to the private sector and to frustrate the operation of market forces which, in an open economy, are difficult enough to predict, let alone to control.

Haddon-Cave, *The Making of Some Aspects of Public Policy in Hong Kong*, in THE BUSINESS ENVIRONMENT IN HONG KONG at xiv (D. Lethbridge ed. 1984).

[14] For example, in the past decade, there were over 150 regulations or ordinances enacted to provide for higher standards in the safety, health and welfare of workers. GOVERNMENT INFORMATION SERVICES, HONG KONG REPORT 1985, at 106 (1985) [hereinafter cited as HONG KONG REPORT].

[15] R. TUNG, CHINESE INDUSTRIAL SOCIETY AFTER MAO 158 (1982).

[16] *See generally id.* at 157-76.

[17] The formulation of the present program of Four Modernizations began in 1977 at the Eleventh National Congress. The Four Modernizations is a state plan which emphasizes the development of industry, agriculture, defense, and science and technology. Through the Four Modern-

form plays a significant role in stimulating economic efficiency and encouraging foreign investment.

Given these two distinct labor systems, the 1997 Sino-Hong Kong reunion lends itself to a fascinating comparative analysis on the respective evolution, present status and future of labor law for the PRC and Hong Kong. Interesting questions are presented when a highly industrialized capitalist government, such as Hong Kong, is "annexed" to a developing socialist country such as China. The focus of this paper will be on some of the labor law issues underlying the unification of Hong Kong and the PRC. Section II is an overview of the historical development and the general characteristics of Hong Kong labor law. This section examines the tripartite relationship of government, employer and employee, with particular emphasis on government's increasing role as "protector" of the working class. The labor system is viewed in the context of this tripartite relationship and the formulation of labor legislation. Section III outlines the general characteristics of labor law in the PRC with special emphasis placed on the current labor-management reforms. Finally, Section IV will identify some of the labor issues and problems confronting the new Sino-Hong Kong unification.

II. Labor Law in Hong Kong

A. *Historical Development*

Hong Kong was acquired by the British from China through a series of three treaties.[18] The British captured Hong Kong for the purpose of maintaining trade with China and Hong Kong served as a free port during this early period. In 1911, the Republic of China was founded and the first trade unions appeared in Hong Kong in the form of craft guilds. Although unions were subject to strict control in China,[19] they enjoyed greater freedom in Hong Kong. Prior to World War I, relations between employers and employees in both Hong Kong and China were relatively peaceful.[20]

In 1919, after the First World War, Hong Kong experienced considerable

izations the PRC hopes to raise the annual per capita income of its people to US$ 1000 by the year 2000. To illustrate the high goals set by this program, compare the per capita income for 1979, which was US$ 253. *See* Yu, *U.S.$ 1,000 by the Year 2000*, Beijing Rev., Oct. 27, 1980, at 16. In other words, the PRC government hopes to quadruple the per capita income level over only a 20-year period. For a more detailed introduction to the Four Modernizations, see R. Tung, *supra* note 15, at 35-48.

[18] *See supra* note 2 and accompanying text.

[19] In 1913, unions were eventually banned in China. *See* K. Chan, Labour Movement in Hong Kong 2 (1980).

[20] *Id.*

unrest.[21] This was due in part to the disasterous results of the Paris Peace Conference transferring to Japan the portion of Shantung Province originally "leased" to Germany and subsequently led to the "May Fourth Movement" in China.[22] During this period, the working class entered the political arena as an independent force for the first time in China, with the first large-scale strikes by students and laborers. The disturbances in China extended into Hong Kong. In 1920, Hong Kong mechanics staged a strike, followed by similar strikes by other trades in the following year.[23] Because these strikes led to pay increases, the Chinese Seamen's Union in Hong Kong, with support by twelve other unions, struck in 1922. The roughly 120,000 workers involved were supported financially by the Canton province of China. The strike effectively paralyzed the Colonial trading post and finally settled on the union's terms. The mainland Chinese rallied behind the strike in Hong Kong and saw the settlement as a victory in their fight against imperialism.[24]

During the period of the early 1920's, both political parties in China, the Nationalists (Kuomintang) and the Chinese Communist Party worked together, as they understood the importance of mass worker support in unifying China.[25] In their attempts to strengthen China and consolidate territory, this two-party coalition sought to instigate labor unrest in the crown colony. Beginning in mid-1925, a large-scale strike and boycott ran for sixteen months and almost succeeded in closing Hong Kong as a trading port. Due to the overt political objectives of the mainland Chinese to disrupt life in Hong Kong, the colonial government enacted the Illegal Strikes and Lockouts Ordinance of 1927.[26] This

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[21] This included strikes, riots and demonstrations. *Id. See also* T. CHOW, THE MAY FOURTH MOVEMENT 117-70 (1960); F. SCHURMANN & O. SCHELL, REPUBLICAN CHINA 116-17 (1967).

[22] China had hoped that the postwar settlement of the Peace Conference would return the Japanese-held German concessions in Shangtung Province to China. Instead it officially transferred Germany's concessions to Japan. *See* T. CHOW, *supra* note 21, at 92-116. For a historical analysis of the May Fourth Movement and a discussion of the role that the first large-scale strikes and demonstrations by workers and students had on influencing the Peking government in its foreign and domestic policies, see *id.* at 145-70.

[23] K. CHAN, *supra* note 19, at 2; Lethbridge & Ng, *The Business Environment and Employment*, in THE BUSINESS ENVIRONMENT IN HONG KONG 78 (D. Lethbridge ed. 1984).

[24] K. HO, A HISTORY OF THE MODERN CHINESE REVOLUTION 51-57 (1959), *reprinted in* F. SCHURMANN & O. SCHELL, *supra* note 21, at 117-22. *See also* K. CHAN, *supra* note 19, at 2.

[25] Dr. Sun Yat Sen, founder of the Nationalist party, not only repealed the Chinese laws against trade unions in 1921, but actively sought labor support. In the same year, the Communist Party of China was established. The Communist Party included a Labor Secretariat whose duties were to organize industrial trade unions. *See* Lethbridge & Ng, *supra* note 23, at 78; F. SCHURMANN & O. SCHELL, *supra* note 21, at 116-17.

[26] Lethbridge & Ng, *supra* note 23, at 79. The Illegal Strikes and Lockouts Ordinance was modeled after the British Trade Disputes and Trade Unions Act of 1927. This legislation was designed "to suppress the illegal activities of unions rather than to encourage their legal ones." H.R. BUTTERS, REPORT ON LABOUR AND LABOURING CONDITIONS IN HONG KONG ¶ 113 (1939),

ordinance prohibited strikes or lockouts for foreign political purposes, as well as the foreign control of any Hong Kong union.

The union movement in Hong Kong suffered another setback during the late 1920's when the world-wide depression sent floods of immigrants from China into Hong Kong. The labor force in Hong Kong was plentiful and, as a result, union activities suffered.[27] The development of industry later brought Hong Kong out of the depression in the 1930's. With the advent of the Sino-Japanese War in 1937, the ban on unions in China was lifted the following year, and the British Government began to encourage the growth of trade unions in Hong Kong. In the same year, the colonial government appointed the first labor officer to Hong Kong. All union activity came to a halt in 1941, however, with the Japanese occupation of Hong Kong.[28]

The Japanese occupation ended at the close of the Second World War, and there was an acute shortage of labor in Hong Kong. This shifted the bargaining power in favor of the Hong Kong workers and encouraged union activity. For example, a series of labor disputes in all the major utility companies occurred in 1946.[29] The strong union position weakened, however, with another huge influx of laborers fleeing from the civil war in China.[30] The struggle between the Nationalists and the Communists spilled over into Hong Kong, causing fragmentation and rivalry among unions as both the Kuomintang and the Chinese Communist Party organized workers in Hong Kong.[31] In 1948, the Hong Kong colonial government passed the Trade Unions and Trade Disputes Ordinance, which required trade union registration. This ordinance solidified the fragmentation because unions had to align themselves either with the Communist Hong Kong Federation of Trade Unions or the Nationalist Hong Kong and Kowloon Trades Union Council. To this date the labor movement is split over this political and ideological line.[32]

The civil war in China, furthermore, indirectly contributed to Hong Kong's industrialization during the early 1950's. In 1949, the civil war ended in the Chinese Communist Party's favor and the People's Republic of China was formally established. Once again, mainland Chinese refugees flowed into Hong

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cited in J. ENGLAND & J. REAR, INDUSTRIAL RELATIONS AND LAW IN HONG KONG 130 (1981).

[27] K. CHAN, *supra* note 19, at 3.

[28] *Id. See also* Lethbridge & Ng, *supra* note 23, at 79-80.

[29] K. CHAN, *supra* note 19, at 3.

[30] After the Japanese occupation, the population had declined by over one million in 1941, to an estimated 600,000 in 1945. *See* Lethbridge & Ng, *supra* note 23, at 79. "The influx of returnees and refugees from China swelled the population of Hong Kong from 600,000 in 1945 to over 2 million in 1953, and provided an almost unlimited supply of labour in relation to the employment available." R. HSIA & L. CHAU, INDUSTRIALISM, EMPLOYMENT AND INCOME DISTRIBUTION: A CASE STUDY OF HONG KONG 11 (1978).

[31] K. CHAN, *supra* note 19, at 4.

[32] Lethbridge & Ng, *supra* note 23, at 80-81.

Kong, but this time bringing with them capital and skilled labor, as well as entrepreneurial and technical expertise.[33] The decline of Hong Kong's traditional role as a free port added to the industrialization movement. Hong Kong's status as an agent for China's foreign trade was abruptly terminated when the new communist government closed its trade door to the West. In addition, a 1951 United Nations trade embargo against China during the Korean War sharply curtailed Hong Kong's China trade.[34]

Between 1947 and 1978, Hong Kong experienced a rapid growth of industrial undertakings and factory employment. During this thirty-one year period the number of recorded manufacturing establishments increased forty-fold, with employment increasing fifteen-fold.[35] This surge of industrialization caused labor shortages in the late 1950's. However, mainland Chinese refugees immediately alleviated those shortages by crossing the then open border between Canton and Hong Kong.[36]

Increased industrialization led to greater concern for labor legislation. Since 1842, Hong Kong's economic and industrial relations had been governed under a laissez faire approach—achieving economic efficiency and prosperity by letting market forces prevail over state planning. Government did not intervene in the employment relationship. Protective labor legislation was rare and minimal. The handful of ordinances actually passed in the early 1900's dealt principally with basic minimum health and safety provisions.[37]

After the Kowloon Disturbances of 1966[38] and the confrontations of 1967[39] the government paid greater attention to appropriate protection of Hong Kong workers against exploitation.[40] In the absence of strong trade unions, the legislature responded in 1968 by passing a program of thirty-three ordinances to es-

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[33] R. HSIA & L. CHAU, *supra* note 30, at 11.

[34] Chen, *supra* note 10, at 3.

[35] J. ENGLAND & J. REAR, *supra* note 26, at 36.

[36] Howe, *supra* note 9, at 530. The Census and Statistical Department of Hong Kong recorded unemployment in 1961 at only 1.7%. J. ENGLAND & J. REAR, *supra* note 26, at 37.

[37] J. ENGLAND & J. REAR, *supra* note 26, at 201-03.

[38] In April 1966, a five cent increase in the fare of one of the ferry companies prompted the Kowloon Disturbances. Prior to Hong Kong's underwater subway system between Kowloon and Hong Kong Island, ferries were the only way of commuting for work and business. This was not, however, a typical labor dispute. A Commission of Inquiry at that time determined that the underlying cause of the dispute was the need to improve the social environment and working conditions of Hong Kong. D. BONAVIA, HONG KONG 1997, at 33-34 (1985), and K. CHAN, *supra* note 19, at 4.

[39] In May 1966, the radical extremism of the "Great Proletarian Cultural Revolution" in China flowed over the Canton border and into Hong Kong. There were strikes and violent riots and confrontations that disrupted life in Hong Kong. *See* D. BONAVIA, *supra* note 38, at 33-46.

[40] J. ENGLAND & J. REAR, *supra* note 26, at 203. *See also* Ng & Levin, *Editors' Introduction* to CONTEMPORARY ISSUES IN HONG KONG LABOR RELATIONS 17 (S. Ng & D. Levin eds. 1983).

tablish minimum standards regarding employment terms and conditions.[41] The centerpiece of this program was the Employment Ordinance,[42] which governs the terms of employment for all employees under a contract of employment. It provides for rest days,[43] statutory holidays,[44] sick leave,[45] severance payments,[46] and also guarantees the right to join and take part in the activities of a trade union.[47] This was the beginning of a trend for greater labor protection provided by government legislation.[48]

B. *General Characteristics of Hong Kong Labor Law*

1. *Governmental Machinery for Labor Policy Formulation*

The governmental institutions in Hong Kong are typical of a British Crown Colony, and very little has changed since the colony was first established.[49] Recent developments following the Sino-British Joint Declaration, however, have introduced elected representatives for the first time in the Legislative Council.[50]

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[41] J. ENGLAND & J. REAR, *supra* note 26, at 203.

[42] LAWS OF HONG KONG, EMPLOYMENT ORDINANCE ch. 57 (1984). *See also* HONG KONG LABOUR DEP'T, A CONCISE GUIDE TO THE EMPLOYMENT ORDINANCE (1984).

[43] LAWS OF HONG KONG, EMPLOYMENT ORDINANCE ch. 57, §§ 17-20 (1984).

[44] *Id.* §§ 39-41.

[45] *Id.* §§ 33-38.

[46] *Id.* §§ 31A-Q.

[47] *Id.* §§ 21A-C.

[48] In the decade following, 137 items of labor legislation have been enacted. GOVERNMENTAL INFORMATION SERVICES, HONG KONG REPORT 1978, at 38 (1979). *See also* S. Ng, Labour Legislation in Hong Kong: Past, Present and Future, in Hong Kong and 1997: Strategies for the Future 4 (1984) [hereinafter cited as Labour Legislation].

[49] J. ENGLAND & J. REAR, *supra* note 26, at 6. The establishment of the Hong Kong government is similar to that of other British acquired territories. After each of the treaties between China and Britain in 1842, 1860 and 1898, the Queen issued an Order in Council to officially take possession of the territory. The Orders in Council define the territorial boundaries and the extent of jurisdiction of the executive and legislative branches. There are two documents which form the constitution of Hong Kong. They are the Letters Patent and the Royal Instructions. The Letters Patent establishes the framework of the administration of Hong Kong by creating the office of the Governor, and the Executive and Legislative Councils. The power of the Governor is outlined with respect to legislation, grants of land, and the appointment and tenure of judges and other public officers. The Royal Instructions cover the composition, powers and procedures of the Executive and Legislative Councils. For an in-depth analysis of the constitutional basis of Hong Kong, see N. MINERS, *supra* note 2, at 63-75.

[50] *See* WHITE PAPER: THE FURTHER DEVELOPMENT OF REPRESENTATIVE GOVERNMENT IN HONG KONG (Nov. 1984), *reprinted in* D. BONAVIA, *supra* note 38, at 210. This change was implemented by special elections held for these positions in September 1985. The Legislative Council is now composed of 12 members elected by an electoral college, 12 members elected by functional constituencies, 22 appointed by the Governor and 10 official members. *See also* Lau, *One Small*

The primary function of the Legislative Council is to enact legislation. Before a Legislative Council bill can become law, the Governor must sign the bill. The Executive Council[51] has the authority to make regulations and considers all principal legislation before it is introduced to the Legislative Council. The Executive Council is the equivalent of the Governor's cabinet and is still presently controlled entirely by British "expatriates." It appears that the PRC hopes to retain policy making power in Hong Kong through its reserved right to appoint members of the Executive Council and the Governor.[52]

a. Department of Labour

The Department of Labour[53] initiates the introduction of labor legislation in the Legislative Council and is also responsible for its enforcement.[54] This department has been the primary contributing force behind the present labor leg-

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Step for Voters, FAR E. ECON. REV., Sept. 5, 1985, at 36; *LegCo Election Countdown*, HONG KONG COUNTDOWN: PERSPECTIVES ON CHANGE 4 (Sept. 4, 1985) (Asia Information Services Newsletter).

[51] The Executive Council functions as the Governor's cabinet, advising the Governor on policy. The Executive Council consists of 12 appointed members, 10 unofficial and two official members, as well as four ex-officio members, which include the Chief Secretary, the Commander of British Forces, the Financial Secretary and the Attorney General. HONG KONG REPORT, *supra* note 14, at 53.

[52] For a thorough discussion of Hong Kong's governmental organs and its changing role in policy making, see Hook, *The Government of Hong Kong: Change Within Tradition*, 95 CHINA Q. 491 (1983).

[53] The Department was created in 1947 as the office of the Commissioner for Labour, who is the principal advisor to the colonial government on matters of labor and employment. The Department consists of 16 divisions which oversee almost every aspect of labor policy. The major divisions include the Labour Relations Service, the Employment Services Division, the Labour Inspectorate, the Factory Inspectorate, an Apprenticeship Inspectorate, the Training Council Division, the Industrial Health Division, and the Employees, Compensation Division. Ng & Levin, *supra* note 40, at 25-26. Since 1984, the Labour Inspectorate of the Department is also responsible for enforcing the provisions of the Employees Compensation Ordinance.

[54] During 1984, "there were 7,140 prosecutions for breach of ordinances and their regulations administered by the Labour Department. Fines totalling HK$ 7,883,530 (US$ 985,441) were imposed." HONG KONG REPORT, *supra* note 14, at 107. This administrative agency is further responsible for ensuring that Hong Kong international labor conventions are observed. As a dependent territory of the United Kingdom, and as a future special administrative region of China, Hong Kong is not a member of the International Labor Organization, which is an agency of the United Nations. Hong Kong, therefore, does not ratify international labor conventions, which attempt to set minimum international labor standards. As of December 1984, Hong Kong has applied a total of 49 conventions: 30 conventions in full and 19 with modifications. *See id.* For a summary of the international labor conventions adopted by the Hong Kong government, see J. ENGLAND & J. REAR, *supra* note 26, at 383-405. *Compare with* INTERNATIONAL LABOUR ORGANISATION, INTERNATIONAL LABOUR CONVENTIONS AND RECOMMENDATIONS (1982).

islation movement.[55] The Labour Department also plays an active role in the day-to-day resolution of grievances and trade disputes. The Labour Relations Service of the Labour Department serves as a conciliation board for processing claims before they may be heard before the Labour Tribunal. Although the department only offers voluntary conciliation, the sheer volume of grievance claims and trade disputes settled indicates its success as an institutional dispute resolution mechanism.[56] It is no surprise that the department has been growing at a rapid rate to accommodate its increasingly active role in industrial labor relations.

b. Labour Tribunal

The 1972 Labour Tribunal Ordinance created a special tribunal with exclusive jurisdiction to adjudicate monetary claims arising from individual contracts of employment.[57] The purpose of this special tribunal is to provide an accessible, informal, fast and inexpensive grievance resolution process. This is accomplished by keeping costs to a minimum, excluding lawyers, and waiving formal rules of evidence.[58]

Labor grievances first must be filed with the Labour Relations Service of the Labour Department. Only after conciliation has been attempted and fails may the parties' claims be heard before the Labour Tribunal.[59] The Labour Tribunal has decreased the courts' role as a source of labor law by effectively relegating the Hong Kong courts to only special appeal procedures.[60] The Tribunal, however, does not publish its cases and hence its judgments have no precedential

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[55] Ng & Levin, *supra* note 40, at 25-26.

[56] *Id.* at 26.

[57] LAWS OF HONG KONG, LABOUR TRIBUNAL ORDINANCE ch. 25 (1982). The Labour Tribunal is not equivalent to a labor court. Labor courts traditionally have jurisdiction over labor interests and rights, while the tribunal is strictly limited to statutory rights provided by the Employment Ordinance. Causes of action are further restricted to monetary claims. For example, a claim for wrongful dismissal for participating in union activities would not be entertained as a legal concern under §§ 21(B) and (C) of the Employment Ordinance, Protection Against Anti-Union Discrimination, and only wages may be awarded as damages. For those labor rights not specified in the Employment Ordinance or individual contract, the only recourse is through the Labour Relations Service of the Labour Department. RESEARCH & INFORMATION CENTRE, HONG KONG & KOWLOON TRADES UNION COUNCIL, THE HONG KONG LABOUR TRIBUNAL 2-3 (1982).

[58] R. RIBEIRO, THE LAW AND PRACTICE OF THE HONG KONG LABOUR TRIBUNAL 1-2 (1978).

[59] The Labour Tribunal Ordinance establishes that conciliation must be attempted before the Tribunal may hear the claim. LAWS OF HONG KONG, LABOUR TRIBUNAL ORDINANCE ch. 25, § 15 (1982).

[60] During 1984, the Tribunal heard 3888 cases involving both employees and employers as claimants, and more than HK$ 15 million (US$ 1.8 million) in damages were awarded. HONG KONG REPORT, *supra* note 14, at 110.

value. For the great majority of the cases, the Tribunal is the final forum.[61]

2. *Trade Unions*

The classic Western theory of trade unions is that workers need to collectively organize in order to improve their working conditions.[62] The purpose of unions, therefore, is to counterbalance the unequal bargaining power of management over the workers. Trade unions in Hong Kong, however, fail to serve this purpose. The present status of Hong Kong trade unions is largely weak and fragmented.[63]

Trade unions in Hong Kong are generally ineffective for a variety of reasons. Hong Kong unions are basically political organizations, and as a consequence many workers are deterred from involvement.[64] Unions are either politically aligned with the Chinese Communist Party or the Kuomintang.[65] Fragmented unions can also be attributed to the traditional governmental policy of non-

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[61] Of the more than 2000 claims filed annually in the 1970's, only 30-40 claimants appealed. Of these only about a dozen appeals were actually accepted in District Court. R. RIBEIRO, *supra* note 58, at 2. *See also* Ribeiro, *Transfers from the Labour Tribunal and Procedural Problems in the Supreme Court*, 5 HONG KONG L.J. 212 (1975). Ribeiro concludes:

> The Labour Tribunal Ordinance's jurisdictional provisions cast their net over a very wide area so as to cover all money claims arising out of all employment contract disputes, with no monetary ceiling. At the same time, all the other provisions basically aim at setting up what is essentially a small-claims labour court. The wide jurisdictional provisions therefore made it inevitable that large claims quite unsuited to the Tribunal would (and will continue to) come before it. Use of the transfer procedure and difficulties concerning the proper functional relationship between the Tribunal and the ordinary courts were (and continue to be) equally inevitably likely to occur.

Id. at 230-31.

[62] *See* KAHN-FREUND'S LABOUR AND THE LAW, *supra* note 1, at 271; A. REES, THE ECONOMICS OF TRADE UNIONS 25-27 (1977).

[63] J. ENGLAND & J. REAR, *supra* note 26, at 140.

[64] Although there has been a steady growth in union membership, the majority of workers do not belong to trade unions. Only 20% to 25% of the employees actually belong to trade unions. *Id.* at 147. *See also* H. TURNER, THE LAST COLONY: BUT WHOSE? A STUDY OF THE LABOUR MOVEMENT, LABOUR MARKET AND LABOUR UNIONS IN HONG KONG 17-18 (1980); Ng & Levin, *supra* note 40, at 1; *Independent Unions Plan Neutral Federation*, ASIAN LAB. MONITOR, May 1984, at 19.

[65] Trade unions in Hong Kong must be registered under the TRADE UNIONS ORDINANCE ch. 332. The Hong Kong Federation of Trade Unions supports the policies of the PRC, and has 73 affiliated unions with about 168,280 members. There are also 17 associated unions with a membership of 19,680 which are friendly towards the Federation of Trade Unions. The Hong Kong and Kowloon Trades Union Council supports the policies of the government of Taiwan. It has 71 affiliated unions with a membership of roughly 35,700, and seven associated unions with some 810 members. The remaining 216 unions are politically independent and have a membership of about 127,350. HONG KONG REPORT, *supra* note 14, at 109.

intervention. Unions with any real power are perceived to be a threat to the economic planning system. For example, the Hong Kong government refuses to impose direct control on private wages,[66] and thus has prevented the trade unions from having the negotiating power to do so.

3. *Labor Legislation*

There are five main sources of existing Hong Kong labor law: common law, rules of equity, ordinances, subordinate legislation and customary law.[67] Current Hong Kong labor law is rooted in English employment contract law. Hong Kong workers, however, rely on a system of statutory rights enforced by the government, instead of relying on collective bargaining reinforced by industrial action as British workers do in the United Kingdom.[68] In recent years, the Hong Kong government has intervened in the employment relationship to equalize the balance of bargaining power, primarily through legislation limiting the freedom of contract and imposing minimum employment terms and conditions.[69]

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[66] *See* A. RABUSHKA, *supra* note 5, at 75; Ng, *The Formulation of Labour Policy in Hong Kong*, 13 HONG KONG L.J. 174, 175 (1983).

[67] Section 11 of annex I to the Joint Declaration provides that these five sources of existing law will be preserved after the establishment of the Hong Kong Special Administrative Region.

[68] J. ENGLAND & J. REAR, *supra* note 26, at 196. The right of collective bargaining is rarely invoked by Hong Kong trade unions. There is a lack of bargaining power on the part of the labor movement in establishing formal bilateral relations with employers. Less than five percent of the labor force is covered by formal collective agreements. *Id.* at 162. The most comprehensive written agreement is one signed following a 1973 dispute by the Cable and Wireless Company employees. This agreement is mainly concerned with recognition and general pay adjustment procedures, however, and does not incorporate a detailed grievance procedure. H. TURNER, *supra* note 64, at 17-18. Turner states that:

> It is clear that compared to other countries at a similar level of industrialisation or development, and where the formation of trade unions is not greatly inhibited by law or by political conditions, the membership of unions among Hong Kong employees is low, and formal collective bargaining, or analogous processes involving organised employee participation, is little developed.

Id. at 33.

[69] In the decade from 1974 to 1984, there were a total of 152 regulations or ordinances enacted to provide for higher standards in the safety, health and welfare of workers. GOVERNMENT INFORMATION SERVICE, HONG KONG REPORT 1985, at 106 (1985). See also Thurley, *The Role of Labour Administration in Industrial Society*, in CONTEMPORARY ISSUES IN HONG KONG LABOUR RELATIONS (Ng & Levin eds. 1983), for an essay on the causes and consequences of the growing intervention by government in private sector employment relations. This shift of policy to one of positive non-intervention has been explained in this manner:

> In the first place, it epitomizes an official response to increasingly widespread local aspirations for a better quality of life, as signalled by the 1966-67 upheavals and the generalized social protest that ensued. Secondly, the reforms could also be intended as an answer to

There are presently four major ordinances which are enforced by the Labour Department. The 1968 Employment Ordinance is the primary and most comprehensive source of labor protection for Hong Kong workers.[70] The Factories and Industrial Undertakings Ordinance of 1955 covers industrial safety regulations.[71] The Employee's Compensation Ordinance (formerly Workmen's Compensation Ordinance) provides compensation for work related injuries.[72] In 1975, the Labour Relations Ordinance was passed to provide for improved labor-management relations and procedures for the settlement of trade disputes.[73] All of these ordinances have been amended through the years.[74]

> social critics overseas (notable, the lobby of British trade unionists) and as measure to harmonize local labour standards with international labour conventions and comparable provisions in neighboring countries. Thirdly, these legislative moves probably also reflect a mild paternalistic consciousness on the part of the governing elite of the need for social and labour reforms.

Ng, *Industrial Relations and Voluntarism: The Hong Kong Dilemma*, 121 INT'L LAB. REV. 751 (Nov.-Dec. 1982). Hong Kong, however, does not have a statutory minimum wage rate. This is one area which the government has chosen to leave to the market forces of supply and demand. HONG KONG REPORT, *supra* note 14, at 107. Furthermore, there is no guaranteed statutory right to strike in Hong Kong. Workers have the freedom to strike and take industrial action; however, the law affords them no protection for the consequences of their actions. This "freedom" has left them "severely limited by criminal law and virtually unprotected by the civil law." J. ENGLAND & J. REAR, *supra* note 26, at 340. For example, in a study on the Labour Tribunal, a sample of unpublished cases seems to indicate that the tribunal disapproves of workers who initiate strikes and other industrial action. *See* R. RIBEIRO, *supra* note 58, at 59.

[70] LAWS OF HONG KONG, EMPLOYMENT ORDINANCE ch. 57 (1984). *See also* notes 42-47 and accompanying text.

[71] LAWS OF HONG KONG, FACTORIES AND INDUSTRIAL UNDERTAKINGS ORDINANCE ch. 59 (1983).

[72] Pursuant to this ordinance, every employer is required to provide an insurance policy to compensate employees or their dependants for injury or death arising out of accidents in the course of employment. LAWS OF HONG KONG, EMPLOYEES' COMPENSATION ORDINANCE ch. 282, § 40 (1983).

[73] LAWS OF HONG KONG, LABOUR RELATIONS ORDINANCE ch. 55 (1975). The Ordinance has a three-stage settlement process: ordinary conciliation, special conciliation and action by the Governor-in-Council. Ordinary conciliation is invoked by the Commissioner of Labour, typically appointing a conciliation officer to assist the parties in reaching settlement of the trade dispute. *Id.* § 3. Special conciliation is basically a second attempt to resolve the dispute by another officer. *Id.* § 5. Both stages of ordinary and special conciliation are voluntary. However, if either party in dispute refuses conciliation, then the Governor-in-Council may invoke discretionary power to force arbitration, boards of inquiry, or compulsory "cooling off" periods, and no industrial action by unions may be taken. *Id.* § 11. "In 1984, 147 trade disputes were handled by. . .conciliation. . .provided by the Labour Relations Service of the Labour Department." HONG KONG REPORT, *supra* note 14, at 109.

[74] For example, the Employment Ordinance originally addressed only three areas: the duration and termination of contracts, wages, and employment agencies. Since then, the ordinance has been built upon by the addition of provisions dealing with maternity leave, rest days, holidays with pay, annual paid leave, sickness allowances, severance payments, wages of sub-contractors'

Because the Labour Tribunal, the primary judicial body that deals with labor matters, does not publish its cases, the development of Hong Kong common law on labor issues has been limited. Therefore, English common law and rules of equity are generally controlling law in the Hong Kong district courts.[75]

III. Labor Law in the People's Republic of China

A. *Historical Development*

The role of labor law in the PRC is historically intertwined with the country's political development. Modern labor law in the PRC may be traced back to the "May Fourth Movement" in 1919.[76] The introduction of Marxist-Leninist ideas in the workers' movement that followed was instrumental in the founding of the Chinese Communist Party in 1921.[77] From 1923 to 1927, the Kuomintang[78] and the Chinese Communist Party worked together to mobilize the labor force in hopes of unifying China. The Chinese Communist Party took the lead in 1921 to develop a national workers' movement by creating the China Trade Union Secretariat to organize industrial trade unions.[79] The Nationalist Government in the same year repealed the Chinese laws banning trade unions.[80] It was not until 1926, however, that the Nationalist leaders officially recognized trade unions.[81] The Chinese Communist Party meanwhile, had convened the First All-China Trade Union Congress in 1922 and established the All-China Federation of Trade Unions in 1925.[82]

The civil war between the Nationalist and the Chinese Communist Party hindered the labor movement from 1927 to 1949. In 1927, the Kuomintang slaughtered communist leaders in Shanghai, forcing the All-China Federation of Trade Unions and the Chinese Communist Party underground.[83] It was not

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employees, and protection against anti-union discrimination. J. ENGLAND & J. REAR, *supra* note 26, at 205.

[75] *See supra* notes 57-61 and accompanying text. *See also* Wesley-Smith, *The Effect of Pre-1843 Acts of Parliament in Hong Kong*, 14 HONG KONG L.J. 142 (1984); Wesley-Smith, *English Practice and Procedure in Hong Kong*, 9 HONG KONG L.J. 255 (1979).

[76] The working class entered the political arena as an independent force for the first time. *See supra* notes 21-23 and accompanying text.

[77] F. SCHURMANN & O. SCHELL, *supra* note 21, at 87-88.

[78] The Kuomintang was the official government at that time, after the overthrow of the Manchu Dynasty in 1911. *Id.* at 3.

[79] R. TUNG, *supra* note 15, at 155.

[80] Lethbridge & Ng, *supra* note 23, at 78.

[81] F. FANG, CHINESE LABOUR 68-69 (1931).

[82] L. LEE, THE STRUCTURE OF THE TRADE UNION SYSTEM IN CHINA 8 (1984).

[83] For a detailed recounting of the "Shanghai Coup," see F. SCHURMANN & O. SCHELL, *supra* note 21, at 104-15.

until the Chinese Communist Party gained control in 1949 that the All-China Federation of Trade Unions was restored.[84] In the following year, the then Central People's Government Council (provisional national government) passed the Trade Union Law of the PRC which systematized the trade union structure in China.[85] The Trade Union Law established the right for workers to organize and join trade unions, elect representatives and negotiate labor agreements with the management.[86]

Following the Soviet model, the PRC initiated a socialist transformation of industry, whereby the private ownership of enterprises was nationalized by the state.[87] In addition, cooperative enterprises replaced private trade and farmland was collectively organized into "people's communes."[88] During this period of socialist transformation, only two types of ownership were permitted, state or collective enterprises.[89] Collective enterprises during this period were disfavored as remnants of capitalism. The anti-capitalist sentiment provided the impetus to nationalize industry into state-owned enterprises.[90]

The first constitution ratified by the new PRC government in 1954 established the framework for the orderly administration of justice and labor relations.[91] The political events of the next two decades had a profound effect on the labor movement as well as the rule of law in the PRC. Tragic events led to

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[84] *See* L. LEE, *supra* note 82, at 3.

[85] *Id.* at 9.

[86] Trade Union Law of the People's Republic of China arts. 1, 2, 5, 6 (1950), *reprinted in* SELECTED LEGAL DOCUMENTS OF THE PEOPLE'S REPUBLIC OF CHINA 301-10 (J. Wang ed. 1976).

[87] During the critical building period from 1949 through the First Five Year Plan (1953-57), the new PRC government was heavily influenced by the Soviet system due in part to its reliance on Soviet aid. As a result, the PRC adopted the Soviet model of planning and managing the economy. Chinese planning was highly centralized. Prices and production targets were set by party officials in Beijing. Individual factories were regulated by state agencies as to how much to produce, and total production was turned over to the state for distribution. R. TUNG, *supra* note 15, at 155-58. Recently there have been attempts to decentralize governmental control. *See* M. XUE, CURRENT ECONOMIC PROBLEMS IN CHINA 109-38 (1982).

[88] *See* C. ULLERICH, RURAL EMPLOYMENT AND MANPOWER PROBLEMS IN CHINA 42-56 (1979); M. XUE, *supra* note 87, at 37-47. Recent reform has begun to dismantle the people's communes and make them only administrative units, experimenting in profit incentives and contract responsibility systems as a means to increase productivity. These reforms have been highly successful in the countryside. G. CHOW, THE CHINESE ECONOMY 46-49 (1985).

[89] State-owned enterprises represent "[o]wnership by the whole people. . .under which the state owns the means of production on behalf of all the working people." Collective-ownership represents "public ownership under which the means of production are owned collectively by the working people in the enterprises and communes." Wei, *1979: More Than 7 Million People Employed*, BEIJING REV., Feb. 11, 1980, at 14.

[90] R. TUNG, *supra* note 15, at 54.

[91] Weng, *Some Key Aspects of the 1982 Draft Constitution of the People's Republic of China*, 91 CHINA Q. 493 (1982).

the "hundred flowers" and anti-rightist campaigns in 1957.[92] During the six-week campaign of free speech for all, union leaders criticized the subordination of union concerns to those of the Chinese Communist Party. The union response was so overwhelming that, in retaliation, the Chinese Communist Party relieved many union leaders and cadres and sent them to production lines for reform through physical labor.[93]

These roadblocks to the development of the labor movement were further exacerbated by the "Great Leap Forward" in 1958 which caused economic chaos and famine.[94] The leadership of the PRC set highly ambitious growth targets, and ignored economic realities. In order to achieve these goals, it was necessary to mobilize the workers and farmers in masses. This was provided for by a dual structure in trade union organization. The All-China Federation of Trade Unions was decentralized along national and regional lines and worked independent of each other.[95]

In 1966, Chairman Mao launched the "Great Proletarian Cultural Revolution."[96] During this period, the radical elements pushed the "mass line"—the

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[92] What started as a clever political slogan by Chairman Mao—"Let a hundred flowers bloom and a hundred schools of thoughts contend"—ended in a movement that hurt hundreds of thousands of intellectuals, including the legal specialists. This movement had a profound effect on the legal system that was just beginning to emerge: "The majority of legal specialists were removed from legal work, and thereafter the legal bureaucracy was staffed largely by new cadres. The codification commissions stopped working, and no more was heard about drafting of legal codes." V. LI, LAW WITHOUT LAWYERS 30-31 (1978).

[93] L. LEE, *supra* note 82, at 51-53.

[94] D. Patel, One Country-Two Systems: Prospects for Hong Kong's Economy under Chinese Sovereignty, in Hong Kong and 1997: Strategies for the Future 12-13 (1984). Patel summarized the Great Leap campaign in the following manner:

> The great leap resulted in a massive waste of effort and unbalanced development. Excessive mobilization of farmers to undertake grandiose public works projects diverted attention from agricultural output and led to serious food shortages. At the same time rural areas suffered extensive disruption with the creation of "people's communes," which abolished individual rights to ownership of land and livestock. . . .[T]here was such chaos and confusion that economic statistics ceased to be published in 1959. Within a year or so, the leap was abandoned; the great leap forward ended as a short leap into the dark.

Id.

[95] Hearn, *W(h)ither the Trade Unions in China?*, 19 J. INDUS. REL. 158, 164 (1977).

[96] The result was nearly a decade of social and political anarchy that set China back not only in industrial relations, but in almost every area imaginable. Although the Cultural Revolution corresponded with the second and third five-year plans, political goals outweighed any economic or planning objectives behind the campaign. A common theme that ties this period together is one of radical extremism. The Cultural Revolution was used mainly as a political tool by Chairman Mao to strengthen the communist party and condemn political opponents as "capitalist" enemies of the state. On a deeper level, the revolution was a national issue of what kind of socialism the PRC should have. For a detailed analysis of the Cultural Revolution, see J. CHESNEAUX, CHINA: THE PEOPLE'S REPUBLIC, 1949-1976, at 138-200 (1979). *See also* Chen, *The*

rejection of a society of order and conservatism. As a result, fundamental leadership structures and institutions were dismantled. Trade unions and workers' congresses were effectively suspended. Workers' congresses were relegated to serving political ends, such as political education and propaganda.[97]

Upon resuming leadership in 1977 Deng Xiaoping[98] pushed to re-institute the workers' congress system, after the long period of inactivity.[99] In 1978, during the Ninth National Congress of Trade Unions, Deng stressed the need to give workers more control in enterprise management:

> Workshop directors, section chiefs and group heads in every enterprise must in the future be elected by the workers in the unit. Major issues in the enterprise should be discussed by the workers' congresses or general membership meetings, at which leading cadres of the enterprise must listen to the worker's views and accept their criticism and supervision.[100]

Enterprises were quick to implement these changes in labor management[101] and the 1982 constitution formally re-established the workers' congress system.[102]

B. *General Characteristics of PRC Labor Law*

The 1982 constitution recognized the importance of labor and the key role the working class plays in economic development of the country. Article 1 provides the fundamental tenet of the constitution: "The People's Republic of

Developing Legal System in China, 13 HONG KONG L.J. 291-92 (1983).

[97] Lewis & Ottley, *China's Developing Labor Law*, 59 WASH. U.L.Q. 1165, 1181 (1982). *See also* C. BETTELHEIM, CULTURAL REVOLUTION AND INDUSTRIAL ORGANIZATION IN CHINA 104-28 (1974); Kang, *China's Trade Unions*, BEIJING REV., June 8, 1979, at 10-11.

[98] The current legal drive began to take shape at the Eleventh Party Congress of the People's National Congress when Deng Xiaoping was reinstated to all his previous party positions. The Eleventh Party Congress also renounced the political movements of the past two decades and emphasized the need for economic development. In 1978, the Third Plenum of the Eleventh Central Committee made a commitment to establish a functioning legal system. Since 1978 more than 300 laws and regulations, most of them economic, have been promulgated. U.S. DEP'T OF STATE, BACKGROUND NOTES: CHINA 5 (1983). *See also* Chen, *supra* note 96, at 292-96.

[99] *See supra* notes 93-97 and accompanying text.

[100] Foreign Broadcast Information Service—China (FBIS-CHI), Oct. 12, 1978, at E-6 (microfiche).

[101] Factory workers would be able to elect their own leaders to represent them in their workers' congresses. "Elected" workers' congresses had expanded powers in making their own decisions for enterprise management. *See* Tian, *Democracy in Factories*, BEIJING REV., Sept. 1, 1980, at 19; Zhang, *How Chinese Workers Exercise Their Democratic Rights*, BEIJING REV., Oct. 4, 1982, at 18; Zhou, *An Important Step Towards Democratic Management*, BEIJING REV., Sept. 7, 1981, at 14.

[102] PRC CONST. arts. 16-17, *supra* note 7.

China is a socialist state of the people's democratic dictatorship led by the working class and based on the alliance of workers and peasants." The socialist economic system is elaborated in Article 6 as "socialist public ownership of the means of production" through state ownership by the "whole people," and by "collective ownership by the working people." Article 42 further establishes the right and duty to work, while Article 43 states that the working people have the right to rest.[103]

1. *Governmental Machinery for Labor Policy Formulation*

The power to make labor law in the PRC rests principally with three governmental authorities: the Standing Committee of the National People's Congress, the Central Committee of the Communist Party of China and the State Council. The constitution provides that the National People's Congress is the legislative branch,[104] and the State Council is the executive branch of the state.[105] The political reality, however, is that the State Council is subordinate to the Chinese Communist Party.[106] The Chinese Communist Party makes nearly all major decisions in the form of broad principles or policy guidelines, which the State Council must follow in issuing regulations for their implementation.

2. *Workers' Congresses*

A workers' congress is a committee made up of workers and management, and is the basic form of enterprise management. These workers' congresses make decisions on every management aspect of the enterprise, including production plans, budgets, labor protection, and bonuses.[107] The administrative arm of the workers' congress is the trade union committee, which handles the day-to-day functions of the congress.[108] Article 7 of the Trade Union Law provides that the duty of trade unions is to protect the interests of workers, exercise supervision over management to ensure that labor protection, labor insurance, wage standards and safety measures are carried out.[109]

Article 16 of the 1982 constitution stipulates the role that workers have in

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[103] *Id.* arts. 42-43.

[104] *Id.* art. 58.

[105] *Id.* art. 85.

[106] P. WIK, HOW TO DO BUSINESS WITH THE PEOPLE'S REPUBLIC OF CHINA 111-12 (1984).

[107] Kang, *supra* note 97, at 9; *Some Questions on China's Trade Unions*, BEIJING REV., May 5, 1980, at 25; Zhang, *supra* note 101, at 19-22.

[108] Kang, *supra* note 107, at 13. *See also* the Provisional Regulations Concerning Congresses of Workers and Staff Members in State-Owned Industrial Enterprises, *reprinted in* BEIJING REV., Sept. 7, 1981, at 16.

[109] Trade Union Law art. 7, *supra* note 86.

enterprise management: "State enterprises practice democratic management through congresses of workers and staff and in other ways in accordance with the law."[110] Article 17 further provides that: "Collective economic organizations practice democratic management in accordance with the law, with the entire body of their workers electing or removing their managerial personnel and deciding on major issues concerning operation and management."[111]

There exist, however, contradictions as to the extent of the worker's rights in pushing for labor reforms through the use of workers' congresses. For example, the freedom to strike guarantee which was provided for in the 1978 constitution[112] was removed entirely from the 1982 constitution.[113] Article 45 from the earlier constitution guaranteed: "the freedom to strike, and [citizens] have the right to speak out freely, air their views fully, hold great debates." This has been reduced to "freedom of speech, the press, assembly, association, procession and demonstration" in Article 34 of the 1982 constitution. Considering the actual conditions of present-day China, the current list of freedoms cannot arguably cover the material omission of the freedom to strike. This again emphasizes the state priority of stability and economic advancement over a strong workers' movement.[114]

3. *Labor Legislation*

Self-management for state enterprises is the most significant development in domestic labor policy for the PRC during the 1980's.[115] The Chinese Communist Party recognized the over-concentration of bureaucratic control by the state as a major cause of China's economic problems.[116] The current decentralization movement involves the transfer of administrative power over state enterprises from central national to the provincial level.[117] No longer is the State Council solely responsible for setting planning targets, and the delegation of authority

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[110] PRC CONST. art. 16, *supra* note 7.

[111] *Id.* art. 17.

[112] CONST. OF THE PEOPLE'S REPUBLIC OF CHINA art. 45 (1978), *reprinted in* 2 SELECTED LEGAL DOCUMENTS OF THE PEOPLE'S REPUBLIC OF CHINA 125, 164 (J. Wang ed. 1979).

[113] PRC CONST. art. 34, *supra* note 7.

[114] Weng points to overriding the policy of stability and speculated that the right to strike was omitted due to the lessons of Poland's Solidarity movement. Weng, *supra* note 91, at 504.

[115] *See also Domestic Labor Policy*, E. ASIAN EXECUTIVE REP., Mar. 1981, at 6.

[116] DECISION OF THE CENTRAL COMMITTEE OF THE COMMUNIST PARTY OF CHINA ON REFORM OF THE ECONOMIC STRUCTURE, *reprinted in* BEIJING REV., Oct. 29, 1984, at i-xvi [hereinafter cited as CENTRAL COMMITTEE DECISION].

[117] The PRC's decentralization must be distinguished from that practiced in the Soviet Union. Soviet decentralization involves the shifting of administrative power to the managers rather than the workers. C. BETTELHEIM, *supra* note 97, at 50.

from higher to lower administrative levels is more informal and indirect.[118] This decentralization of power—partial dismantling of the state planning system—will mean that functions previously handled by the state will be controlled at the individual factory level.

The PRC's recent rejoining of the International Labor Organization is a good indication that the government of the PRC supports minimum labor standards and benefits. In 1983, after a thirty-four year absence, the PRC resumed an active role in the International Labor Organization.[119] Current labor legislation in the PRC, meanwhile, classifies workers as those in domestic enterprises, and those in foreign joint ventures or special economic zones. Workers involved with foreign related enterprises generally have greater privileges and benefits than do workers in domestic enterprises.[120]

These experimental programs represent an emerging national policy and make the PRC's labor system resemble a more Western model of economic planning and labor relations.[121] The new "responsibility system" increases work productivity by providing a system of incentives for efficient performance and penalties for poor work. Since the socialist transformation of industry in China, profits from industry went directly to the state. Now with the new labor reforms, enterprises are allowed to keep the excess of contract production to be used for the benefit of the workers.[122]

Greater power is placed in state enterprise workers by allowing collective con-

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[118] T. RAWSKI, CHINA'S TRANSITION TO INDUSTRIALISM 110 (1980). *See also* Comment, *Reflections on the Modern Chinese Legal System*, 59 WASH. U.L.Q. 1221, 1229 (1982).

[119] The PRC was a founding member of the International Labor Organization (ILO) and has reoccupied its permanent seat on the ILO governing body. *China Resumes Active Role in ILO*, ASIAN LAB. MONITOR, Dec. 1983, at 13.

[120] *See* Horsley, *Notes on New Customs Rules and Joint Venture Labor Management Rules*, E. ASIAN EXECUTIVE REP., June 1984, at 13; *New Regulations For Foreign Companies in Guangdong SEZ's*, E. ASIAN EXECUTIVE REP., Mar. 1982, at 6.

[121] *See* T. RAWSKI, *supra* note 118, at 7; Comment, *Reflections on the Modern Chinese Legal System*, *supra* note 118, at 1228. Current PRC leadership has recognized that centralized planning is not as effective as once thought. Added to this problem was the fact that the planning system was placed in the control of cadres who were chosen for their political and ideological fervor and were poorly educated to manage complex economic issues. *See* V. LI, *supra* note 92, at 22-24. Under Deng Xiaoping's command, government leaders have transformed Mao's ideological purity and revolutionary socialism into a policy of pragmatism. Ideological and political obstacles have given way to primary objectives of economic growth and higher levels of consumption. Van Ness, *Three Lines in Chinese Foreign Relations, 1950-1983: The Development Imperative*, in THREE VISIONS OF CHINESE SOCIALISM 118-25 (D. Solinger ed. 1984).

[122] Tentative Measures Concerning the Sharing of Profits in State-owned Industrial Enterprises (1980), *reprinted in* COMMERCIAL LAWS & BUSINESS REGULATIONS OF THE PEOPLE'S REPUBLIC OF CHINA 8 (V. Sit ed. 1983) [hereinafter cited as COMMERCIAL LAWS]. *See also* A. BHALLA, ECONOMIC TRANSITION IN HUNAN AND SOUTHERN CHINA 43-51 (1984); R. TUNG, *supra* note 15, at 158-60.

trol over the enterprise, such as setting production plans including the right to hire and dismiss managers.[123] The national eight-grade wage structure has been modified,[124] and state enterprises have also been allowed to hire workers on a contract basis for a fixed period.[125] Furthermore, in March of 1984, the State Council issued a regulation that terminated traditional job inheritance.[126] This is an attempt to break the traditional "iron rice bowl"[127] system of lifetime job security. While lifetime job security appears to be an ideal labor benefit, many workers are discouraged by the lack of upward mobility and frozen wages.

Although the constitution and subsequent laws and regulations recognize the importance of labor reform for the economic development of the country, many of the PRC's more progressive reforms have been limited to special economic zones[128] and joint ventures.[129] A critical component of these experiments was reform in labor management for special economic zones and joint ventures.[130]

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[123] Provisional Regulations Concerning Congresses of Workers and Staff Members in State-Owned Industrial Enterprises, *supra* note 108.

[124] Workers are paid "dividend wages" on the basis of "more pay for more work," work attitude and responsibility, and their technical level. *See* Provisional Procedures for the Implementation of the System of Fixed Wages Plus Dividend Wages in State Catering and Service Enterprises (1981), *reprinted in* COMMERCIAL LAWS, *supra* note 122, at 543. *See also* Shirk, *Recent Chinese Labour Policies and the Transformation of the Industrial Organization in China*, 88 CHINA Q. 275 (1981).

[125] Joint Publications Research Service (JPRS), 78044 (May 1, 1981) at 1-4 (microfiche). State enterprises may now contract with workers, defining the terms and conditions of employment such as wages, benefits and termination. Under this system, enterprises are allowed to dismiss workers whose performance is unsatisfactory.

[126] For example, more than 4000 young people have been removed from the jobs they inherited from their parents in Guizhou Province. *Plan to End Inherited Jobs Hits Resistance*, ASIAN LAB. MONITOR, May 1984, at 17.

[127] "Iron rice bowls" refers to jobs in state enterprises with guaranteed security against dismissal and demotion. M. XUE, *supra* note 87, at 54. *See also* A. BHALLA, *supra* note 122, at 51-55.

[128] In 1980, special economic zones were established to aid in promoting foreign trade and investment. Regulations on Special Economic Zones in Guangdong Province, *reprinted in* COMMERCIAL LAWS, *supra* note 122, at 341. Special economic zones are modeled after free-trade zones of Europe and the foreign trade zones of the United States. A special economic zone is an area where enterprises enjoy preferential treatment in operations, such as lower tax rates, use of land, materials and labor resources. Currently there are four cities in which special economic zones are located: Shenzhen, Zhuhai and Shantou in Guangdong Province, and Xiamen in Fujian Province. *See* Nishitateno, *China's Special Economic Zones: Experimental Units for Economic Reform*, 32 INT'L & COMP. L.Q. 175-78 (1983).

[129] In 1979 the Joint Venture law was enacted. The Law of the People's Republic of China on Joint Ventures Using Chinese and Foreign Investment, *reprinted in* COMMERCIAL LAWS, *supra* note 122, at 326. The joint venture law was designed to promote foreign trade and attract foreign investment as well as to finance and facilitate technological acquisition and modernization. *See* Reynolds, *The Joint Venture Law of the People's Republic of China*, 14 INT'L LAW. 31 (1980); Rich, *Joint Ventures in China: The Legal Challenge*, 15 INT'L LAW. 183, 186-87 (1981).

[130] In 1980, the Regulations on Labour Management in Joint Ventures using Chinese and

Subsequent labor management regulations establish useful and detailed information on a number of issues, such as recruitment, probationary employment, dismissal and severance pay, disciplinary measures, rewards, wage standards, the administration of labor insurance and welfare funds, and the handling of industrial accidents.[131] These regulations help to clarify the respective roles of labor-management, the trade unions and governmental labor departments.[132] Most of these new laws, however, are limited to joint ventures and special economic zones.

IV. An Emerging Agenda

The Sino-British Joint Declaration[133] helps to establish that the current

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Foreign Investment were promulgated. COMMERCIAL LAWS, *supra* note 122, at 331. In 1981, the Interim Provisions for Labour and Wage Management in Enterprises in the Special Economic Zones in Guangdong Province were enacted. *Id.* at 344.

[131] *See supra* note 130. *See also* Horsley, *supra* note 120, at 13.

[132] The two provisions establish the key importance of the labor contract. Article 2 of the Regulations on Labour Management in Joint Ventures using Chinese and Foreign Investment stipulates:

> Matters pertaining to employment, dismissal and resignation of the workers and staff members, tasks of production and other work, wages and awards and punishment, working time and vacation, labour insurance and welfare, labour protection and labour discipline in joint ventures shall be stipulated in the labour contracts signed.

COMMERCIAL LAWS, *supra* note 122, at 331.

The role of venture trade unions is also found in article 2: "A labour contract shall be signed collectively by the joint venture and the venture's union organization." This provision vests considerable power in the joint venture trade unions when dealing with contract negotiations. The last component of article 2 establishes the supervisory role of the labour management department of the government by holding that "after a labour contract is signed, it must be submitted to the labour management department. . .for approval." There are similar provisions in the Interim Provisions for Labour and Wage Management in Enterprises in the Special Economic Zones of Guangdong Province, COMMERCIAL LAWS, *supra* note 122, at 344.

[133] The Joint Declaration is composed of a main agreement, three annexes and a short memorandum. The main agreement enumerates the 12 basic policy points the PRC has promised to abide by. The central body is annex one, which elaborates on the 12 basic policy points introduced in the main agreement. Annex one, therefore, covers all the main aspects of political, social and economic life, including guarantees of human rights, freedoms and the general way of life. The second annex covers the function and composition of the Sino-British Joint Liaison Group. The Joint Liaison Group is an advisory body which will assist the Special Administrative Region in maintaining its economy and establishing procedures for a smooth transition. The third annex deals with the question of land leases in Hong Kong and essentially guarantees the continuing right of Hong Kong residents to hold land to the year 2047. The agreement ends with a memorandum which addresses the question of nationality and passports. The PRC will not honor dual nationalities; therefore, all Hong Kong Chinese compatriots must become Chinese nationals. *See supra* notes 3-7 and accompanying text.

Hong Kong system of labor policy formulation will remain status quo. The most significant changes to be implemented are featured in the first section of annex one. First, the special administrative region will be directly under the authority of the Central People's Government of the PRC. The special administrative region will enjoy a high degree of autonomy, except in foreign and defense matters. The first section further stipulates that the capitalist system shall remain unchanged for fifty years and that socialist policies will not be practiced in the Hong Kong special administrative region. Second, the Hong Kong special administrative region will be vested with executive, legislative, and independent judicial power, including that of final adjudication. Third, the government, judiciary, and the legislature will be composed of local inhabitants. The PRC, however, will retain some control through the power to appoint the chief executive (governor) and all top level officials (secretaries). Checks and balances will be provided by the legislature and the rule of law. The executive authorities must abide by the law and shall be accountable to the Legislative Council, which will be an elective representative body.

Section II of annex one of the Joint Declaration maintains Hong Kong's legal system.[134] The third section of annex one deals with the system of appointment and removal of judicial officers.[135] The fourth section of the first annex maintains the public service, as well as the merit system.[136] Section XIII of annex

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[134] Section II provides:

> After the establishment of the Hong Kong Special Administrative Region, the laws previously in force in Hong Kong (i.e. the common law, rules of equity, ordinances, subordinate legislation and customary law) shall be maintained, save for any that contravene the Basic Law and subject to any amendment by the Hong Kong Special Administrative Region legislature.
>
> The legislative power of the Hong Kong Special Administrative Region shall be vested in the legislature of the Hong Kong Special Administrative Region. The legislature may on its own authority enact laws in accordance with the provisions of the Basic Law and legal procedures, and report them to the Standing Committee of the National People's Congress for the record.

JOINT DECLARATION, *supra* note 3, at 1373.

[135] Section III of annex one covers the system of appointment and removal of judicial officers. The chief executive (appointed by the PRC government) shall appoint and remove judges. While this would seem like direct control by the PRC over the judiciary, the section holds that the chief executive must act according to recommendations of an independent commission composed of local judges, attorneys and various other eminent people. Furthermore, judges of the highest rank may only be appointed and removed with the endorsement of the Special Administrative Region legislature. *Id.* § III, at 1373-74.

[136] Section IV of the first annex maintains the public sector, as well as the merit system:

> After the establishment of the Hong Kong Special Administrative Region, public servants previously serving in Hong Kong in all government departments, including the police department, and members of the judiciary may all remain in employment and continue their service no less favorable than before. . . .
>
> The appointment and promotion of public servants shall be on the basis of qualifica-

one furthermore explicitly provides that these rights and freedoms shall be preserved: "freedom. . .to form and join trade unions. . .of strike. . .of choice of occupation. . . ." All labor organs and existing labor laws, therefore, should be maintained.

These basic policies and annexes will be included in Hong Kong's charter of self-rule power and will form the Basic Law, which is intended to be the constitutional document for Hong Kong.[137] The Basic Law will be issued and approved by the National People's Congress of the central government of the PRC.

Due to the influence of both "transferor" and "transferee" countries, a comparative analysis of both the PRC and Hong Kong should help to identify an emerging agenda for the future formulation of labor law in each of the two distinct systems. Britain and China have both played significant roles in the development of industrial relations in Hong Kong. Britain as the ruling colonial government has had a direct impact on Hong Kong's labor policy formulation. China's role, although indirect, has nevertheless contributed to the development of Hong Kong's present labor system.[138]

Most critics point to the difference in ideology between the two systems as the major obstacle for successful reunification. There are two principal administrative differences between Chinese socialism and Hong Kong's capitalism. The first is the difference in the planning system and the relationship between state and enterprise. The second difference is in the incentive system used to divide the benefits of production. The PRC's socialist system is based on a centralized

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> tions, experience and ability. Hong Kong's previous system of recruitment, employment, assessment, discipline, training and management for the public service. . .shall. . .be maintained.

Id. § IV, at 1374.

[137] The Basic Law can be best understood by comparing it to the "home rule" power of local governmental units in the United States. In the United States the national government is a government of granted powers pursuant to the specific powers enumerated by the Constitution. All other powers remain within the exclusive power of the units forming the federation, which are the states. U.S. CONST. arts. I-III, amend. X. In most states there exists a third tier of the system which involves the granting of "home rule" power from the states to local governmental units, such as cities, counties or municipalities. Home rule means the power of self-government within the prescribed constitutional or statutory limits. *See* D. MANDELKER, D. NETSCH, & P. SALSICH, STATE AND LOCAL GOVERNMENT IN A FEDERAL SYSTEM 101-05 (1983). In this respect, Hong Kong is akin to a home rule local government unit. The Basic Law is much like a constitutional charter. Every power that Hong Kong asserts must therefore be derived from the Basic Law. Herein lies the importance of the Basic Law.

[138] Political struggle in the PRC has created Hong Kong's "refugee labour pool, prejudiced its efforts towards social reform, divided the trade unions, produced tension which have endangered public order and led to curbs on industrial conflict and political activity by unions, and simultaneously threatened the termination of colonial rule and stifled all moves towards independence." J. ENGLAND & J. REAR, *supra* note 26, at 25.

planning system that attempts to control every aspect of labor and the economy, while Hong Kong's capitalist system is a highly decentralized planning system that maintains a policy of governmental non-intervention in labor management and economic planning.

The PRC and Hong Kong, however, have similarities in how they approach labor administration. Both systems resemble a "state organized labour control" planning model.[139] This model points to a "paternalistic" attitude towards state administration and a weak enterprise consciousness among workers. In Hong Kong, the colonial government provides a statutory framework of labor relations, and trade unions are kept weak and fragmented. In the PRC, the Chinese Communist Party manipulates the scope of management-worker freedoms and rights.

This state paternalism also dictates the extent to which an activist trade union movement develops. A common denominator in Hong Kong and the PRC is that strong trade unions have traditionally been sacrificed in return for political expediency and now for greater economic growth.[140] Trade unions in Hong Kong have not been afforded the same type of rights and legal immunities as in Britain.[141] Meanwhile, trade unions and workers' congresses in the PRC have been subordinate to the policies of the Chinese Communist Party.[142]

The major problem inherent in this model of state organized labor control is the conflict between the state and private sector management regarding the ba-

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[139] Thurley, *supra* note 69, at 111-19.

[140] *CRIA Group Analyses Far East, Caribbean Development Models in Conference Report*, 2 INT'L TRADE REP. (BNA) 212 (Feb. 6, 1985).

[141] The role of trade unions helps to explain the British government's success in Hong Kong and its labor problems in Britain. Professor Rowley argues that "labor-market turbulence on the scale witnessed in Britain over the past twenty-five years is primarily the consequence of a system of legal immunities for trade unions, trade-union officials, and individual trade-union members unprecedented in the Western world." Rowley, *Toward a Political Economy of British Labor Law*, 51 U. CHI. L. REV. 1135, 1135 (1984).

[142] L. LEE, *supra* note 82, at 75-77. The socialist theory is that all use of the means of production in the PRC is in the exclusive domain of the state in order to achieve economic goals. Glos, *The Theory and Practice of Soviet International Law*, 16 INT'L LAW. 279, 296 (1982). Professor Glos argues that the Marxist principle "to each according to his work" is meaningless in the PRC: "[t]he means of production and the labor of the Chinese people do not serve the fulfillment of the historic mission of the working class—the liberation of society—but on the contrary are used toward the total enslavement of the working class." *Id.* The trade union's role as a "transmission belt" between the Chinese Communist Party and the mass workers had been used to transmit Party policy down to the masses only, and any feedback up from the masses was severely limited. Lewis & Ottley, *supra* note 97, at 1175. *See also supra* notes 93-97 and accompanying text. This was particularly evident during the periods of the Great Leap Forward when trade unions' administrative functions were transferred to the Chinese Communist Party, and the Cultural Revolution when unions were used as a forum for political education.

sic objectives of labor administration.[143] In other words, when the state labor administrators define their role to include not only regulation, but also responsibility and control for the overall development of labor administration, the simple result is that private sector labor management is restricted. This is the conflict which is hindering the development of private sector labor management in Hong Kong and the collective enterprises in the PRC.

Recent developments in both the PRC and Hong Kong indicate that this model of labor administration is slowly changing. Hong Kong is undergoing a gradual transition to representative government.[144] Trade unions have been designated a "functional constituency,"[145] and have been guaranteed two seats on the elected portion of the Legislative Council. Thus, the effective role of trade unions as political pressure groups is likely to be enhanced in the writing of labor legislation.[146] Key reforms in the PRC include policies to decentralize and separate government from enterprise management functions and to establish forms of economic responsibility systems and implement the principle of "distribution according to work."[147] As means to utilize the market mechanism in a socialist economy, Chinese writers have recommended the free choice of jobs within limits, placing employment on a competitive basis, and allowing supply and demand to solve labor problems.[148] These policies suggest that the Chinese model of labor management will become increasingly like that of Hong Kong.

Professor Clark Kerr postulates that all industrialized and industrializing societies have a basic tendency towards convergence despite their differences in cultures, institutions and actual experiences.[149] Kerr's convergence thesis focuses on

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[143] Thurley, *supra* note 69, at 118.

[144] *See* Miners, Alternative Governmental Structures for a Future Self-Governing Hong Kong, in Hong Kong and 1997: Strategies for the Future (1984); *supra* note 50 and accompanying text.

[145] Functional constituencies were established to assure proper elected representation of the economic and professional sectors of Hong Kong society. There are nine functional constituencies (commercial, industrial, financial, labor, social services, education, legal, medical, and engineers and associated professions) that will return an overall total of 12 unofficial members to the Legislative Council. The commercial, industrial and labor constituencies will each return two unofficial members to the Legislative Council. *See* WHITE PAPER, *supra* note 50, at 209-24.

[146] Labour Legislation, *supra* note 48, at 12. Professor Ng concludes: "Thus, for the union movement which is increasingly politicised under the officially sponsored 'democratisation' movement, the method of 'legal enactment' may eventually become a more viable and crucial means of conceiving industrial relations norms." *Id.*

[147] *See* CENTRAL COMMITTEE DECISION, *supra* note 116. On October 20, 1984, the Twelfth Central Committee of the Communist Party at its Third Plenary Session officially recognized this policy by adopting the Decision of the Central Committee of the Communist Party of China on Reform of the Economic Structure. This document declares the need to reform and restructure the entire national economy.

[148] *See* Liu & Zhao, *Relationship Between Planning and the Market Under Socialism* (1979), *reprinted in* ECONOMIC REFORM IN THE PEOPLE'S REPUBLIC OF CHINA (G. Wang ed. 1982).

[149] *See generally* C. KERR, THE FUTURE OF INDUSTRIAL SOCIETIES (1983); C. KERR, J. DUNLOP,

the process of industrialization as the primary imperative of every developing nation.[150] This synthesis between socialism and capitalism arguably began some time ago in both China and Hong Kong.[151] The PRC is now committed to this objective with its economic reforms known as "market socialism" and which appear to emulate Hong Kong's model of economic management.[152] The PRC leadership understands that development will only come through industrialization.[153] With the PRC's emphasis on workers' congresses and labor management reform, Deng Xiaoping is pushing the policy that industrial workers are at the "vanguard" of this movement. Furthermore, business relationships in the form of trade and direct investments have been steadily increasing between China and Hong Kong.[154]

F. HARBISON & C. MYERS, INDUSTRIALISM AND INDUSTRIAL MAN (1964).

[150] This convergence thesis was further qualified in Thurley, *supra* note 69, at 112. Thurley asserted that it is impossible to cope with the range of differences in labor administration using only one model as a norm. Instead he advocated four models of labor administration: professional personnel management (United Kingdom), industrial relations corporatism (United States), welfare corporatism (Japan), and a state organized labor control model (Hong Kong). *See supra* note 139 and accompanying text.

[151] In fact, as early as 1978, Beazer had predicted:

> Thus, the political changes in China and the development of its own economy along lines more nearly approaching a price- and profit-oriented system, coupled with the evolution of government spending patterns in Hong Kong, are likely to result in a situation in twenty years in which the two countries' economies resemble each other much more closely than they do now.

W. BEAZER, THE COMMERCIAL FUTURE OF HONG KONG 151 (1978). More recently, Patel concluded:

> The principal thrust behind this is the recognition that incentives, profits, taxes, and economic efficiency are not repugnant to socialism in China. And in Hong Kong there is the recognition of the need of greater political and social commitment in the direction of the economy without violating the operation of market forces.

D. Patel, *supra* note 94, at 11.

[152] *See* CENTRAL COMMITTEE DECISION, *supra* note 116; Lee & Bonavia, *Socialist Balancing Act*, FAR E. ECON. REV., Oct. 10, 1985, at 36.

[153] See *supra* note 17 and accompanying text for a discussion of the Four Modernizations.

[154] *See generally* ECONOMIC NEXUS, *supra* note 5; Howe, *supra* note 9, at 529-30. For instance, officials in the Shenzhen special economic zone have signed contracts with Hong Kong companies to develop industrial estates. Shenzhen officials are willing to experiment with management and depart from traditional policy by placing management power in the Hong Kong based partner. *Executive Briefing*, E. ASIAN EXECUTIVE REP., July 1982, at 1. The apparent motivation is to increase production by the more efficient and competitive means that characterize Hong Kong industry. Another example of influence on the PRC is a Hong Kong firm established by the PRC to handle its trademark and patent registrations. Foreign companies may now apply for Chinese trademarks and patents to this company in Hong Kong, which will act as their agent. Leung, *PRC Forms Hong Kong Firm to Handle its Trademark and Patent Registrations*, E. ASIAN EXECUTIVE REP., July 1984, at 10.

Culturally, the Chinese have a distaste for confrontational litigation[155] and, therefore, judicial avenues are rarely used in either Hong Kong[156] or the PRC[157] to resolve labor disputes. China and Hong Kong both have similar approaches to handling labor disputes, relying heavily on governmental administrative intervention in labor dispute resolution, especially the use of conciliation, mediation and arbitration. This is another area where the two labor systems do not necessarily conflict.

Finally, the PRC's resumption of an active role in the International Labor Organization is also a good indication that the PRC supports basic minimum labor standards and protections.[158] The question is how will the PRC represent Hong Kong in the International Labor Organization? Hong Kong is a dependent territory of the United Kingdom until 1997 and therefore was not a member of the International Labor Organization and did not participate directly in its matters. Britain will no longer be responsible for Hong Kong in the International Labor Organization after 1997 and the PRC will represent Hong Kong's concerns at International Labor Organization conferences. It remains to be seen to what extent the PRC government will push for higher labor standards in Hong Kong and the PRC.[159]

If the PRC can resolve the status of Hong Kong ideologically within its party leadership and continue to raise living standards in the PRC, there will be greater experimentation to emulate Hong Kong in the PRC. It is possible that rather than trying to change the economic system of Hong Kong to reflect existing PRC policy, there will be a move toward making the PRC system more like that of Hong Kong. Given the radical shifts of planning policy in the past, the "one country, two systems" policy presents two basic alternatives for the PRC leadership: accelerate the pace of reforms in China or retreat back to Marxist socialism.[160] Based on the rate of current economic reforms and the

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[155] V. Li, *supra* note 92.

[156] Although the Labor Tribunal in Hong Kong has increasingly been utilized as a forum for dispute resolution, the nature of the tribunal represents administrative arbitration more than traditional judicial adjudication. *See supra* notes 56-60 and accompanying text.

[157] In the PRC, the People's Courts do not fit into the Anglo-American model of impartial tribunals for the adjudication of disputes, but rather are agencies for the implementation of state and Party policies. Lubman, *Emerging Functions of Formal Legal Institutions in China's Modernization*, 2 China L. Rep. 195, 245-46 (1983).

[158] *See supra* notes 119-20 and accompanying text.

[159] The new Hong Kong Special Administrative Region might demand participation at the International Labor Organization conferences, in view of the disparity between Hong Kong and PRC application of International Labour Conventions.

[160] *See* D. Patel, *supra* note 94, at 2-3. Patel argues that only the process of convergence can guarantee the successful co-existence of one country and two systems. *Id. See also* notes 149-51 and accompanying text.

move away from orthodox Marxist ideology,[161] it is arguable that the pace of reforms in the PRC will continue and that Hong Kong will be emulated as a model of economic and labor management.[162]

Robert Wai Fung

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[161] *See* Dittmer, *Recent Developments: The 12th Congress of the Communist Party of China*, 93 CHINA Q. 108 (1983):

> The response of the 12th Congress to this sense of ideological and moral lapse has been two-faceted: on the one hand, there has been some movement on the theoretical level towards a redefinition of the role of the ideological superstructure in its relationship to the material base of society; and on a political level, a rectification campaign has been proclaimed. To be sure, the central theoretical thrust of the Deng Xiaoping regime remains pragmatic, making culture/ideology a function of economics.

Id. at 119. *See also* Bonavia, *The Marx Brothers*, FAR E. ECON. REV., Dec. 20, 1984, at 38; Lee & Bonavia, *supra* note 152, at 36. In the *People's Daily* on December 7, 1984, the Chinese Communist Party organ stated in a leading article:

> Marx died 101 years ago, and his works were written more than a century ago. Some were simply conjecture at that time, and later underwent tremendous changes. Some of the conjectures were not necessarily alright. There were many things that Marx and Engels, even Lenin, had no experience of. We cannot expect the works of Marx and Lenin in their day to solve the problems of today. This is something we have to bear in mind during our study.

People's Daily, Dec. 7, 1984, *reprinted in* Bonavia, *supra*, at 39. This article, however, was amended later to read: "We cannot expect the works of Marx and Lenin in their day to solve *all* the problems of today." *Id.* at 38 (emphasis original).

[162] Wilson, *How Hong Kong May Come to Terms with Communism*, 133 BANKER 27-28 (1983).

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I. INTRODUCTION

Hawaii's water law is unique; its origins lie in ancient Hawaiian customs.[1] Early Hawaiians developed extensive rules to allocate the indispensable freshwater resource for irrigation and domestic uses.[2] As land and water resources transferred from Hawaiian to western ownership,[3] the ancient Hawaiian cus-

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[1] For summaries of water rights in Hawaii, see generally W. HUTCHINS, THE HAWAIIAN SYSTEM OF WATER RIGHTS (1946) [hereinafter cited as HUTCHINS I]; W. HUTCHINS, WATER RIGHTS LAWS IN THE NINETEEN WESTERN STATES (1979) [hereinafter cited as HUTCHINS II]; NATIONAL WATER COMMISSION, A SUMMARY-DIGEST OF STATE WATER LAWS 243 (R. Dewsnup & D. Jensen eds. 1973); DEP'T OF BUDGET & FINANCE, STATE OF HAWAII, LAND AND WATER RESOURCE MANAGEMENT IN HAWAII 141 (1979) (J. Van Dyke, Team Leader).

[2] For historical background on ancient Hawaiian water customs, see generally E. HANDY & E. HANDY, NATIVE PLANTERS IN OLD HAWAII: THEIR LIFE, LORE, AND ENVIRONMENT 56-67 (1972); Nakuina, *Ancient Hawaiian Water Rights*, in THRUM'S HAWAIIAN ANNUAL 79 (1894); Perry, *A Brief History of Hawaiian Water Rights*, in THRUM'S HAWAIIAN ANNUAL 90 (1913).

[3] The concept of fee simple ownership was not part of the ancient Hawaiian land system. Rather, a complex tenure system comparable to the feudal system of medieval Europe prevailed.

toms carried over into the western system of laws. Hawaii's pre-statehood courts relied on these customs in deciding water rights disputes.

By the time Hawaii became a state in 1959, its courts had developed an extensive body of case law on water rights.[4] However, the case law and early Hawaiian customs applied primarily to surface water, not to groundwater.[5] Although surface water and groundwater are components of a single hydrological system,[6] the water laws of all other states have historically treated these two types of freshwater differently.[7] Despite the uniqueness of Hawaii's law compared to other states, the legal distinction between surface water and groundwater also applies in Hawaii. The reason is unusual, but simple—early Hawaiians and western settlers did not know groundwater existed.[8] Thus, there

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With the counsel of western advisors, King Kamehameha III divided land titles among the chiefs, the crown, and the government. This historic land division, which began in 1848, is called the Great Mahele. The creation of formalized procedures for the sale of government lands and the granting of the right to own land in Hawaii to aliens completed the transformation to the western land system. *See generally* J. CHINEN, THE GREAT MAHELE: HAWAII'S LAND DIVISION OF 1848 (1958); Levy, *Native Hawaiian Land Rights*, 63 CALIF. L. REV. 848 (1975).

[4] Major water rights cases decided by the Territorial Supreme Court include: Territory v. Gay, 31 Hawaii 376 (1930) (surplus surface water rights), *aff'd*, 52 F.2d 356 (9th Cir.), *cert. denied*, 284 U.S. 677 (1931); Carter v. Territory, 24 Hawaii 47 (1917) (surplus surface water rights); Hawaiian Commercial & Sugar Co. v. Wailuku Sugar Co., 15 Hawaii 675 (1904) (surplus surface water rights); Wong Leong v. Irwin, 10 Hawaii 265 (1896) (appurtenant water rights); Lonoaea v. Wailuku Sugar Co., 9 Hawaii 651 (1895) (prescriptive water rights); Peck v. Bailey, 8 Hawaii 658 (1867) (appurtenant water rights). The first water rights case decided by the supreme court since Hawaii became a state was McBryde Sugar Co. v. Robinson, 54 Hawaii 174, 504 P.2d 1330 (appurtenant, prescriptive, and surplus surface water rights), *aff'd on rehearing*, 55 Hawaii 260, 517 P.2d 26 (1973), *appeal dismissed and cert. denied*, 417 U.S. 962 (1974).

[5] Groundwater is "water occupying all the voids within a geologic stratum." Excluded from this category are surface waters such as streams, springs, and lakes, as well as subsurface water in the unsaturated zone. The voids in the unsaturated zone (also called the "zone of aeration") are filled with air and water. The zone of aeration is located above the saturated groundwater zone and extends upward to the surface. D. TODD, GROUNDWATER HYDROLOGY 1 (2d ed. 1980).

[6] Groundwater constitutes one portion of the earth's water circulatory system known as the hydrologic cycle. *Id.* at 13. *See also infra* notes 44-53 and accompanying text.

[7] *See infra* notes 197-200 and accompanying text.

[8] The first artesian well in this Territory, then Kingdom, was dug in the late seventies of the last century. The ancient Hawaiians had none and knew nothing of them and therefore had no customs, rules or regulations concerning their use or their ownership. . . . With reference to surface water, the ancient Hawaiians did have custom, rules and regulations amounting to law. . . .

Territory v. Gay, 31 Hawaii at 403.

During the Hawaiian Islands' first 1000 years of human occupation, groundwater was unknown. The early Hawaiians and western settlers relied almost exclusively on streams and springs. These surface water sources were easily contaminated, required extensive transport infrastructure, and the supply fluctuated widely depending on rainfall. Although the Hawaiians dug shallow wells near the shoreline to skim brackish water, these water sources were marginal in quality and

was no ancient Hawaiian custom relating to groundwater.

Groundwater is superior to surface water in quality and reliability.[9] As a result, groundwater has become an increasingly important factor in Hawaii's economic growth since its discovery in 1879.[10] Its abundance in the early years, however, postponed any need to develop groundwater law—only one case reached the territorial supreme court.[11] As competition for groundwater mounted during the post-war and post-statehood economic booms, water rights conflicts spurred the enactment of groundwater legislation.[12] These statutes erected a framework to regulate groundwater users without first laying the foundation. To this day it is uncertain who is entitled to use groundwater. Yet, considerable groundwater investment continues, albeit based on untested legal

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quantity. *See* Cox, *Groundwater Technology in Hawai'i*, in GROUNDWATER IN HAWAI'I: A CENTURY OF PROGRESS 15 (F. Fujimura & W. Chang eds. 1981). A ranchowner named James Campbell discovered groundwater in 1879. After drilling for three months and for over 200 feet in the arid Ewa plains of Oahu, his crew encountered flowing artesian groundwater. *See* Cox, *A Century of Water in Hawai'i*, in GROUNDWATER IN HAWAI'I: A CENTURY OF PROGRESS 51 (F. Fujimura & W. Chang eds. 1981), at 51.

[9] The quality of Hawaii's groundwater has been hailed as:

> [T]he purest water known to man, totally free, with minor exceptions, of the chemical additives so common in most other cities. . . . The natural purity of the ground water supply is the result of an amazingly efficient filtering action of soil and rock as rain water percolates slowly downward to the water table.

Katz, *Honolulu's Unique Water System*, PARADISE PAC., Nov. 1960, at 63.

Besides the filtering action of the sediments, another reason for the exceptional quality of groundwater is the oxidation that occurs in the zone of aeration. Oxidation destroys or renders harmless much of the organic matter that is carried with the infiltrating water. G. MACDONALD, A. ABBOTT & F. PETERSON, VOLCANOES IN THE SEA 231 (2d ed. 1983) [hereinafter cited as MACDONALD].

Regarding reliability:

> Except for perennial streams which drain high rainfall areas along windward slopes and coasts, and spring-fed streams in mountainous areas, streamflow generally is unreliable as a source of year-round water supply. Therefore, stream water is used primarily for agricultural purposes, and even then extensive ditch and tunnel systems are required to collect and convey the water from wet mountainous areas to irrigated fields at lower elevations. Groundwater provides a more constant and dependable source of water, and is used for most domestic and municipal water suppliers in the Hawaiian Islands.

Id. at 201-02.

[10] In 1975, groundwater comprised nearly 46% of all water used in Hawaii, and 90% of all water used for domestic purposes. MACDONALD, *supra* note 9, at 229. In comparison to nationwide water use, Hawaii ranks second to California in terms of intensity of groundwater use (groundwater production rate per area). D. TODD, *supra* note 5, at 13.

[11] City Mill v. Honolulu Sewer & Water Comm'n, 30 Hawaii 912 (1929). *See infra* notes 226-34 and accompanying text.

[12] HAWAII REV. STAT. ch. 177 (1976) (originally enacted as Ground Water Use Act of 1959, ch. 274, 1959 Hawaii Sess. Laws 303; completely reenacted in ch. 122, 1961 Hawaii Sess. Laws 135). *See infra* notes 239-49 and accompanying text.

assumptions.[13]

Hawaii voters ratified a constitutional amendment in 1978 that provides the means to determine groundwater rights through a comprehensive water code.[14] Other recent developments include two Hawaii Supreme Court cases dealing primarily with surface water rights but with ramifications for groundwater law: the *Reppun*[15] case addressed the relationship between surface water and groundwater, and the *McBryde*[16] case addressed state ownership of water resources.

This comment describes the status of Hawaii's groundwater and provides suggestions for change. Section II identifies the major issues that should be addressed by groundwater laws. Groundwater issues in Hawaii differ from those in the mainland states, a caveat to drafters considering adoption of groundwater doctrines from other states. Groundwater issues also differ from surface water issues, a factor to consider before attempting to integrate groundwater and surface water laws. Section III identifies the legal elements of groundwater rights—who is entitled to use groundwater, how much, and what rules have been developed to resolve conflicts. The section also surveys various common law and statutory approaches from other states to discover how these elements have been addressed elsewhere. Section IV compares Hawaii's groundwater laws to the doctrines developed in other states. Section V recommends changes in Hawaii's groundwater laws and Section VI concludes the comment.

II. Groundwater Issues in Hawaii

Groundwater issues fall into three categories: (1) supply management, (2) conflict management, and (3) demand management. Supply management refers to the physical limits of the groundwater resource and the consequences if demand exceeds these limits. Conflict management refers to the resolution of the competing claims among groundwater users, surface water users, and overlying landowners. Such conflicts arise from the location of a well, rather than from the supply status of the groundwater resource. Demand management refers to the allocation of the limited groundwater resource to the "highest and best uses," those uses in the public's best interest.

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[13] The rights to non-artesian groundwater are especially uncertain. In City Mill v. Honolulu Sewer & Water Comm'n, 30 Hawaii 912, the court adopted the correlative rights doctrine; however, the holding was limited to artesian groundwater. *See infra* notes 226-28 and accompanying text.

[14] Hawaii Const. art. XI, § 7 ("Water Resources"). *See infra* note 223 and accompanying text.

[15] Reppun v. Board of Water Supply, 65 Hawaii 531, 656 P.2d 57 (1982), *cert. denied*, 105 S. Ct. 2016 (1985). *See infra* notes 263-67 and accompanying text.

[16] McBryde Sugar Co. v. Robinson, 54 Hawaii 174, 504 P.2d 1330. *See infra* notes 230-32 and accompanying text.

A. *Supply Management*

Hawaii is blessed with an abundant groundwater supply because of its mountainous topography and porous geology.[17] The mountains deflect moist tradewinds upward, causing the wind-borne water vapor to cool, condense, and fall as rain. Because of the mountains, the rainfall over the islands is three times greater than the rainfall over the open ocean.[18] The porous volcanic rocks allow a high percentage of the rainfall to percolate and accumulate underground, rather than to flow on the surface and discharge into the ocean.[19]

Abundant as it may be, the groundwater supply is exhaustible. Groundwater supply is a dynamic relationship between two factors: input from rainfall (called "recharge") and outflow from natural leakage or wells.[20] Several problems

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[17] For background information on Hawaii's hydrogeology, see generally GROUNDWATER IN HAWAI'I: A CENTURY OF PROGRESS (F. Fujimura & W. Chang eds. 1981); HUTCHINS I, *supra* note 1, at 144-63, especially 145 n.5; MACDONALD, *supra* note 9, at 229-59; J. MINK & S. SUMIDA, AQUIFER CLASSIFICATION, STATE OF HAWAII (Water Resources Research Center, Univ. of Hawaii, Technical Rep. No. 75, 1984); K. TAKASAKI, SUMMARY APPRAISALS OF THE NATION'S GROUND-WATER RESOURCES—HAWAII REGION (U.S.G.S. Professional Paper No. 813-M, 1978).

[18] "Open-ocean rainfall near the Hawaiian Islands is about 25 inches per year compared with an average of about 70 inches on land. The islands, by their presence, thus increase the open-ocean rainfall by 45 inches per year or by 5,000 billion gallons (14 billion gallons per day)." SUMMARY APPRAISALS, *supra* note 17, at 5.

[19] On the mainland United States, as on most continental regions in the world, surface runoff generally is much greater than groundwater recharge, often by a factor of several times. . . . [F]or most of the Hawaiian islands, groundwater recharge and surface runoff are roughly the same. . . . [T]his is due to the very high average permeability of Hawaiian volcanic rocks and soils.

> Basalts, in general, comprise some of the most permeable formations on earth, and those in the Hawaiian islands are especially permeable due to their youth and, most important, to the small thickness of individual lava flows.

MACDONALD, *supra* note 9, at 230.

Groundwater movement is controlled by the geologic formation. Geologic formations that have sufficiently high porosity and permeability to yield water readily to wells are called aquifers. Porosity, the percent of pore space in a given rock or soil volume, measures storage capacity. Permeability, the ease with which a fluid flows through rock or soil material due to the connectivity of the pores, determines how rapidly water flows through subsurface materials. Volcanic rocks in Hawaii generally have moderate porosities (on the order of 10% to 30%), and exceedingly high permeabilities, and thus are among the best aquifers in the world. *Id.* at 232.

[20] Groundwater discharges naturally into stream beds, springs, or the ocean. *Id.* at 199. To illustrate the relationship between groundwater outflow and recharge, imagine beneath a faucet, a cup of water with a hole midway in the side. The water in the cup represents groundwater, the hole represents natural leakage, and water from a faucet represents rainfall. If the rate of input from the faucet equals the rate of outflow leaking from the hole, the water level stays constant. However, if the flow from the faucet is reduced, the water level in the cup drops since the outflow rate from the hole exceeds the input rate. This is what happens when a drought occurs.

If a straw is added to represent a well, the outflow increases depending on how hard and how

(called "overdraft problems") result when the outflow exceeds recharge. Other supply problems include temporary shortages during droughts and wasteful water development practices.

1. *Overdraft Problems*

Overdraft occurs when the outflow rate from wells and natural leakage exceeds the recharge rate from rainfall. Fortunately, the recharge rate in Hawaii is high compared to some parts of the mainland.[21] When the recharge rate is negligible, overdraft is unavoidable and the groundwater is said to be "mined."[22] In comparison, the management objective for recharged groundwater resources is to avoid overdraft. By limiting withdrawal so that it does not exceed recharge, the groundwater resource becomes available indefinitely. The withdrawal limit is called the "sustainable yield" or "safe yield." The determination of the sustainable yield is complex and usually requires computer-based hydrological modeling.[23]

If withdrawal exceeds sustainable yield, the resulting overdraft problems differ depending on the type of groundwater. In Hawaii, there are basically three types of groundwater: basal groundwater, dike-impounded groundwater, and

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frequently the observer sucks from the straw. If the total outflow from the straw and the hole exceeds the recharge rate from the faucet, the water level drops to a point below the bottom of the straw. If one desires to keep sucking water from the straw, the straw needs to be lowered until eventually the straw rests on the bottom of the cup. Similarly, a well would have to be deepened if the groundwater level is lowered, and the well-owner would incur additional costs to drill and pump the extra distance to the surface.

The straw and cup analogy illustrates three issues related to groundwater supply. First, several problems result when the outflow rate exceeds recharge—these are called the overdraft problems. Second, temporary shortages occur during droughts. Third, the "straw" itself could be defective causing wasteful leakages.

[21] Recharge in Hawaii is exceptional. *See supra* note 19. The Ogallala aquifer, which underlies six states and is probably the largest aquifer in the western United States, is an example of an aquifer that receives negligible recharge. Bittinger, *Ogallala Ground Water*, in GROUNDWATER: ALLOCATION-DEVELOPMENT-POLLUTION 1 (1983) (seminar proceedings published by the University of Colorado School of Law).

[22] The issues involved with groundwater mining include determining the rate of depletion and who should pay the increased pumping and drilling costs as the groundwater level drops. *See generally* Aiken, *Ground Water Mining Law and Policy*, 53 U. COLO. L. REV. 505 (1982). The term "mining" is often used interchangeably with "overdraft." One commentator suggests using the term "mining" to refer to areas with poor recharge. 1 WATERS AND WATER RIGHTS § 52.2(C), at 332 (R. Clark ed. 1967).

[23] *See generally* Mink, *Determination of Sustainable Yields in Basal Aquifers of Hawai'i*, in GROUNDWATER IN HAWAI'I: A CENTURY OF PROGRESS 101-16 (F. Fujimura & W. Chang eds. 1981).

perched groundwater.[24]

Basal groundwater is the most abundant groundwater source. As the freshwater from rainfall seeps downward, it accumulates and floats on denser salt water that has seeped in from the ocean.[25] Overdraft of basal groundwater causes the freshwater lens to contract. As the lens contracts, the boundary between freshwater and salt water recedes inland and the groundwater level drops. Consequently, wells drilled near the coast experience increased salinity as the freshwater boundary recedes inward; inland wells must be deepened to reach the lowered groundwater levels.[26]

Dike-impounded groundwater and perched groundwater do not float on salt water and, hence, are not threatened by the problems of reduced storage capacity and salinization that affect basal groundwater. Dike-impounded groundwater is stored behind volcanic dikes, relatively impermeable lava that cooled under pressure in vertical fissures. The dikes form compartments. To tap the groundwater that accumulates in these compartments, horizontal tunnels puncture the dikes. Perched groundwater is stored above sea level by relatively impermeable ash or clay layers. Perched groundwater is tapped primarily by tunnels. Overdraft of dike-impounded groundwater[27] or of perched groundwater[28] causes the water level to drop below the level of the tunnel.

Overdraft problems raise two legal issues: (1) whether and to what extent

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[24] *See generally supra* note 17.

[25] Freshwater floating on salt water presses down on the salt water. How far the salt water is pushed down depends on the relative densities of fresh and salt water. Results of mass balance calculations, using normal densities of 1.0 grams per cubic centimeter for freshwater and 1.025 grams per cubic centimeter for salt water, indicate that every meter of freshwater above sea level is balanced by an additional 40 meters of freshwater below sea level. Since the interior portion of the islands receive greater rainfall, the layer of freshwater is thicker in the central part of the island. As a result, the basal groundwater body has the form of a biconvex lens. A Dutch scientist, Baden-Ghyben, and a German named Herzberg independently discovered the principle of fresh groundwater flotation on salt water. The basal groundwater body is commonly referred to as the Ghyben-Herzberg lens, or basal lens. MACDONALD, *supra* note 9, at 234.

[26] *See, e.g.*, R. DALE, LAND USE AND ITS EFFECTS ON THE BASAL WATER SUPPLY, PEARL HARBOR AREA, OAHU, HAWAII, 1931-1965 (U.S.G.S. Hydrologic Atlas No. HA-267, 1967) (documents the overdraft problems resulting from excessive pumpage from the Pearl Harbor aquifer).

The process of saline encroachment may be practically irreversible. "It appears that any movement of the zone of transition causes it to widen. Thus the center of the zone may return to a former position after equal and alternate movements, but the [weakly saline] edge of the zone . . . will not retract as readily as it advances." Wentworth, *Factors in the Behavior of Ground Water in a Ghyben-Herzberg System*, 1 PAC. SCI. 172, 181 (1947).

[27] *See generally* K. TAKASAKI, EVALUATION OF MAJOR DIKE-IMPOUNDED GROUND-WATER RESERVOIRS, ISLAND OF OAHU (U.S.G.S. Open-File Rep. No. 81-1119, 1981).

[28] Perched groundwater is the least significant of the three types of groundwater. "The areal extent of perching beds and structures usually is quite limited, hence storage in these aquifers is small and the flow from perched aquifers tends to be relatively unstable." MACDONALD, *supra* note 9, at 237.

government may curtail withdrawal rates from existing private wells without paying compensation, and (2) whether government may prohibit additional new wells.[29] An ancillary issue is the method for determining sustainable yield.[30]

2. *Temporary Shortages Due to Droughts*

Sustainable yield is based on normal rainfall. During droughts, however, drastic withdrawal reductions are necessary to avoid overdraft problems. Because of the emergency nature of droughts, there is less question of government's power to curtail pumping and impose moratoria on new wells. The more controversial issue is how government determines when a drought occurs and what controls are necessary.[31]

3. *Wasteful Water Development Practices*

When an impermeable rock or soil layer overlies a groundwater aquifer, the confined groundwater becomes pressurized.[32] Confined groundwater is commonly called "artesian" groundwater. If the pressure is great enough, artesian water will flow to the surface without pumping when tapped by a well. Because free-flowing artesian wells waste water if left uncapped, government in Hawaii regulated such wells as early as 1884.[33] Regulation was later expanded to non-artesian wells when government realized that improper design could cause underground leakage and contamination.[34]

Tunneling for dike-impounded groundwater in Hawaii began in the early 1900's and continues to be refined.[35] Studies have shown that tunneling into the dikes reduces the storage capacity of these natural reservoirs.[36] Hydrologists

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[29] *See infra* notes 146-56 and accompanying text (constitutional rights). *See also infra* notes 168-82 and accompanying text (overdraft law in other states); notes 245-50 and accompanying text (overdraft law in Hawaii).

[30] > [T]he sustainable yield for a given aquifer is not constant, and often is difficult to assess accurately. In fact, even after more than 100 years of development, the sustainable yield of the Pearl Harbor-Honolulu aquifer is still not precisely known, and the best estimates of its magnitude vary by about 10 to 15 percent.

MACDONALD, *supra* note 9, at 242.

[31] *See infra* notes 173 & 180 and accompanying text (law in other states); notes 251-52 and accompanying text (law in Hawaii).

[32] *See* MACDONALD, *supra* note 9, at 232.

[33] *See infra* note 214 and accompanying text.

[34] *See infra* note 215 and accompanying text.

[35] EVALUATION, *supra* note 27, at 4-8.

[36] *See generally* G. HIRASHIMA, TUNNELS AND DIKES OF THE KOOLAU RANGE, OAHU, HAWAII, AND THEIR EFFECT ON STORAGE DEPLETION AND MOVEMENT OF GROUND WATER 117-34

have developed a method called "bulkheading" to control leakage from the tunnel, and thereby restore some of the storage capacity.[37] To date, bulkheading has not been a precaution imposed by regulation.[38]

The legal issue regarding the regulation of wasteful practices is whether government may restrict private property rights by imposing controls, such as bulkheading, on the design and construction of new or modified wells.[39] These regulations are ministerial; the government must approve the applicant's proposal if the applicant meets all design and construction specifications.[40]

B. *Conflict Management*

Groundwater withdrawal may cause unintentional conflicts between groundwater users, between groundwater users and surface water users, and between groundwater users and overlying landowners. The conflicts arise because groundwater is not confined by property boundaries and is interconnected with surface water. Although these conflicts occur more frequently as the sustainable yield is reached, the conflicts depend more on the location of the well rather than the status of the regional groundwater supply.

(U.S.G.S. Water-Supply Paper No. 1999-M, 1971); Mink, *Flow Hydraulics in Dike Tunnels in Hawaii*, in EVALUATION OF MAJOR DIKE-IMPOUNDED GROUND-WATER RESERVOIRS, ISLAND OF OAHU (U.S.G.S. Open-File Rep. No. 81-1119, 1981), *supra* note 27.

[37] A significant part of the reduction in storage by tunneling could be restored by constructing bulkheads at the controlling dikes. [Bulkheading is the construction of a damlike structure at the point of insertion of a tunnel into a dike.] Bulkheads have been installed in several tunnels, but only the one in a tunnel in Waihee is effective in restoring water to its pretunnel level. Bulkheads in other tunnels in Oahu were not constructed at dikes that originally stored the most water; hence, they are only partly effective in the restoration of storage. The locations of dikes that control the most water can best be determined at the time of tunneling. If tunneling information is not available and storage is depleted, gain flow between dikes, determined by measurements, should indicate the best sites for bulkheads. Bulkheads are most effective where single dikes control large quantities of water and where the contrast in permeability between lava flows and dikes is great. . . . The restoration of significant amounts of storage above these tunnels would be invaluable. Optimum use of these tunnels would be to store water during the wet winter months for use during the dry summer months. . . .

SUMMARY APPRAISALS, *supra* note 17, at 24.

[38] *See infra* note 257 and accompanying text.

[39] Some states consider the property right in water to include the right to waste. *See infra* note 96.

[40] *See infra* note 115.

1. *Groundwater User vs. Groundwater User*

The pumping of groundwater creates a "cone of depression" in the groundwater level surrounding the well.[41] The width of the "cone" depends on the pumping rate, the depth of the well, and the flowrate of the groundwater. When a well owner drills a new well too closely to an existing well so that the respective "cones" overlap, the flow from the first well is reduced. This conflict is called "well interference." It is possible to predict and prevent such interference conflicts with hydraulic formulas.[42] However, the cost and reliability of such calculations depend on the availability of permeability data and the extent of localized variation in geological conditions.

Once the conflict occurs, there are several possible mitigating measures: increase the depth of one of the wells, reduce the pumping rate, or stagger the pumping times from each well. The legal issue is who should bear the burden of the additional costs or inconvenience—the existing or the new well-owner.[43]

2. *Groundwater User vs. Surface Water User*

Groundwater leaks naturally as surface flow, e.g., streamflow and springs. Streams fed by groundwater usually flow year-round. During the dry summer season, the groundwater leakage comprises nearly one hundred percent of the streamflow.[44] Without this groundwater leakage, surface water users would be without water during the critical summer months. In addition, perennial streams are habitats for native stream fauna that require a continuous passage from the stream headwaters to the sea throughout the year.[45] After development of groundwater from dike-impounded or perched sources, the groundwater that would normally leak into the streams is diverted by tunnels or wells.[46] The resulting streamflow reduction interferes not only with surface water rights, but also with environmental values associated with maintaining

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[41] *See generally* D. TODD, *supra* note 5, at 115-52. For a simplified explanation of well hydraulics, see Crosby, *A Layman's Guide to Groundwater Hydrology*, in F. TRELEASE, CASES AND MATERIALS ON WATER LAW: RESOURCE USE AND ENVIRONMENTAL PROTECTION 460-61 (2d ed. 1974).

[42] *See* D. TODD, *supra* note 5, at 147-49.

[43] *See infra* notes 183-96 and accompanying text (law in other states); notes 258-61 and accompanying text (law in Hawaii).

[44] *See* MACDONALD, *supra* note 9, at 242-45.

[45] *See generally* A. TIMBOL & J. MACIOLEK, STREAM CHANNEL MODIFICATION IN HAWAII, PART A: STATEWIDE INVENTORY OF STREAMS, HABITAT FACTORS AND ASSOCIATED BIOTA (U.S. Fish & Wildlife Service Rep. No. FWS/OBS-78/16, 1978).

[46] *See, e.g.*, G. HIRASHIMA, INFLUENCE OF WATER-DEVELOPMENT TUNNELS ON STREAMFLOW-RELATIONS IN HAIKU-KAHULUU AREA, OAHU, HAWAII (Dep't Land & Nat. Resources, Div. of Water & Land Dev. Circular No. C21, 1963).

minimum streamflows.[47] The protection of minimum streamflow has gained increasing attention in the laws of several states, including Hawaii.[48]

Coastal springs occur in Hawaii usually as a result of leakage from basal groundwater.[49] Maintaining these springflows is one factor to consider in determining the sustainable yield for basal groundwater. It is entirely possible to set a sustainable yield that equilibrates with the recharge rate, yet allows the groundwater level to drop enough to reduce or eliminate flow from certain springs.[50]

Streams and springs are surface water sources with a system of water rights that is separate from groundwater rights.[51] Therefore, in all of these conflicts between groundwater users and surface water users, the legal issue is which right should prevail—the groundwater or the surface water right.[52] The surface water right usually has seniority over the groundwater right. On the other hand, the groundwater use is usually more important to the general public since groundwater is the primary drinking water source. Techniques to integrate groundwater and surface water rights are called "conjunctive uses."[53]

3. *Groundwater User vs. Overlying Landowner*

When groundwater is withdrawn from sedimentary formations, the ground

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[47] *See generally* WILSON OKAMOTO & ASSOCIATES, INC., INSTREAM USE STUDY: WINDWARD OAHU (Dep't Land & Nat. Resources, Div. of Water & Land Dev. Rep. No. R68, 1983) (identifies various instream values and methods of assessing minimum flow requirements).

[48] *See, e.g.*, HAWAII REV. STAT. ch. 176D (Supp. 1984) (instream use protection).

[49] *See* MACDONALD, *supra* note 9, at 235-36.

[50] The sustainable yield determines the equilibrium groundwater level (or "head"). Spring flow is a function of the groundwater level. A drop in groundwater level reduces spring discharge. *See* J. MINK, STATE OF THE GROUNDWATER RESOURCES OF SOUTHERN OAHU 41-44 (1980) (available at City & County of Honolulu Mun. Library).

[51] *See infra* notes 197-200 and accompanying text.

[52] *See infra* notes 197-207 and accompanying text (law in other states); *see also infra* notes 262-67 and accompanying text (law in Hawaii).

[53] "Conjunctive use" is an ambiguous term. One meaning of the term refers to the underground storage of surface water supplies. *See* Robie, *Water Management of the Future: A Groundwater Storage Program for the California State Water Project*, 11 PAC. L.J. 41, 42 n.2 (1979). Another meaning refers to the legal integration of physically related ground and surface water. *See* Hillhouse, *Integrating Ground and Surface Water Use in an Appropriation State*, 20 ROCKY MTN. MIN. L. INST. 691, 692 (1975). Trelease, a noted water rights lawyer, uses the term generically to refer to both underground storage and legal integration of surface and groundwater rights. He defines conjunctive use as "the name applied to several different practices and processes employed to coordinate the use of ground and surface waters in order to get the maximum economic benefits from both resources." Trelease, *Conjunctive Use of Groundwater and Surface Water*, 27B ROCKY MTN. MIN. L. INST. 1853, 1854 (1982). For discussion of conjunctive use techniques, see *infra* notes 197-207 and accompanying text.

may subside as the sediment compacts.[54] Subsidence may cause damage to any structures constructed on or buried in the affected land area. Unlike the mainland, groundwater in Hawaii is usually withdrawn from rock formations rather than from sedimentary formations.[55] However, the growing demand for groundwater should someday economically justify the development of the sedimentary groundwater sources.

The legal issue involves a clash between the legal right of the well owner to withdraw groundwater, and the legal right of the neighboring landowner to unimpeded use of his property.[56] Although subsidence may not be a problem in Hawaii currently, the groundwater user's liability will be addressed in anticipation of future problems.[57]

C. Demand Management

Demand for groundwater is limited by supply. When demand equals supply, as defined by the sustainable yield, the granting of additional groundwater rights may cause irreparable harm. New demands for more productive uses must then be accommodated by some mechanism to transfer rights from existing uses to new uses. Groundwater demand management generally involves the allocation of groundwater to those uses from which society receives the greatest benefits. These preferred uses are called synonymously the "highest and best uses,"[58] "beneficial uses,"[59] or "reasonable-beneficial uses."[60] There are ba-

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[54] *See* D. TODD, *supra* note 5, at 253-61.

[55] In the past, groundwater from the sedimentary aquifers has not been extensively developed, primarily because of two factors. The storage capacity and permeability of the sediments is small compared with that of basaltic lava aquifers, and hence groundwater has always been easier to develop from the lavas than from sedimentary aquifers. Furthermore, the coastal plain sedimentary aquifers are close to the sea, and thus much of the water in these deposits tends to be brackish. In future years, however, many of the more promising sedimentary aquifers, especially those occupying stream valleys along the windward coast of Oahu, probably will be developed to satisfy increasing demands for fresh water supplies.

MACDONALD, *supra* note 9, at 236.

[56] *See infra* notes 208-12 and accompanying text (law in other states).

[57] *See infra* notes 268-69 and accompanying text (law in Hawaii).

[58] Economists use the term "highest and best use" to refer to a use in which the marginal value product is greater than the marginal factor cost. *See generally* Levi, *Highest and Best Use: An Economic Goal for Water Law*, 34 MO. L. REV. 165 (1969).

[59] "Beneficial use" is a fundamental concept in prior appropriation doctrine; it refers to a requirement that the water use be nonwasteful and consistent with the best interests of the people. Legislatures promulgate "beneficial uses" through statutory lists of uses; courts determine a "beneficial use" as a question of fact in the absence of a statutory list. Trelease, *The Concept of Reasonable Beneficial Use in the Law of Surface Streams*, 12 WYO. L.J. 1 (1957). *See also* Trelease, *Preferences to the Use of Water*, 27 ROCKY MTN. L. REV. 133 (1955). For further discussion on the prior appropriation doctrine, see *infra* notes 101-05 and accompanying text.

sically two approaches to determine the highest and best use—the market system approach and the administrative approach.[61]

1. Market System vs. Administrative System

The market system allows private decisionmakers, motivated by profit, to determine the highest and best use through prices.[62] Theoretically, when there is a willing buyer and a willing seller with each attempting to maximize gains, at least one person may be better off and no person is worse off as a result of the transaction.[63] The market system may not, however, be equitable since it allocates an indispensable resource, potable water, to those most able to pay. Moreover, the prices established through the market system may not account for third-party costs.[64]

The administrative system allocates water through the political process.[65] The legislature delegates authority to an administrator who allocates groundwater in

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[60] "Reasonable-beneficial use" is a concept that merges "reasonable use" principles from the riparian doctrine with the "beneficial use" principles from the prior appropriation doctrine. The "beneficial use" approach tags a particular use as beneficial or not beneficial without regard as to whether another use may be more beneficial. The "reasonable use" approach considers the relative benefits of competing users. Thus, the "reasonable-beneficial use" standard refers to a use that is efficient and economic with respect to the use itself and is reasonable in relation to other uses and the public interest. The "reasonable-beneficial use" concept is a common law modification of the prior appropriation standard and is also the adopted standard in the Model Water Code. Maloney, Capehart & Hoofman, *Florida's "Reasonable Beneficial" Water Use Standard: Have East and West Met?*, 31 U. FLA. L. REV. 253 (1979). The Model Water Code proposes a statewide limited-duration permit system for surface and groundwater. F. MALONEY, R. AUSNESS & J. MORRIS, A MODEL WATER CODE WITH COMMENTARY 170-73 (1972) [hereinafter cited as MODEL WATER CODE]. Florida is the only state to adopt the Model Water Code. The draft water code introduced in the 1985 Hawaii Legislature was based on the Model Water Code. *See infra* note 225.

[61] For an overview of the alternative allocation systems, see generally 1 WATERS AND WATER RIGHTS, *supra* note 22, §§ 60-63, at 397-430.

[62] The use of prices to measure "benefit" applies only to "private goods," as distinguished from "public goods." Private goods can be allocated in the market because costs can be directly tied to benefits. On the other hand, public goods cannot be allocated through the market because an individual derives benefits regardless of whether he pays for them (e.g., national defense, police protection). Accordingly, water is a private good. Johnson, *An Optimal State Water Law: Fixed Water Rights and Flexible Market Prices*, 57 VA. L. REV. 345, 347-50 (1971).

[63] Economists call this optimum distribution of benefits achieved by an efficient market system the "Pareto optimum." Several conditions are necessary in order to achieve this ideal, efficient market. In actuality, markets are notoriously imperfect. *Id.* at 350-54.

[64] For criticism of the market system, see generally MODEL WATER CODE, *supra* note 60, at 75-81; Note, *A Proposal for a Regulated Market of Water Rights in Iowa*, 65 IOWA L. REV. 979, 989-95 (1980).

[65] *See generally* Ausness, *Water Use Permits in a Riparian State, Problems and Proposals*, 66 KY. L.J. 191 (1977).

accordance with statutory guidelines. The guidelines often include a list of preferred uses.[66] Commentators criticize this administrative system as economically stifling since bureaucratic "red tape" and uncertainty discourage investments. In addition, the fixed list of preferred uses does not accommodate changing conditions.[67]

Increasingly, states allocate groundwater through a permit system.[68] The permit system may incorporate a market system approach,[69] an administrative approach,[70] or some combination of the two.[71] In weighing the alternative approaches, legislators should consider two factors—security and flexibility. Security refers to the assurance that an investor will not lose a groundwater right before realizing a fair return. A permit provides this security by allocating a fixed quantity upon which the permit holder may rely, by defining the permit holder's legal rights as protection against other groundwater and surface water users, and by establishing the duration of the permit to allow the permit holder to plan ahead.[72]

Flexibility refers to the ability to shift uses to more "beneficial" uses as conditions change. Here, market system proponents and administrative system proponents differ on the optimal duration of a permit. Market system proponents advocate perpetual-duration permits.[73] Once issued, the permit transfers among willing buyers and sellers with minimal government intervention. Administrative system proponents advocate limited-duration permits.[74] The duration may be uniform for all uses or may vary according to the amortization rate of particular uses.[75] The shorter the duration, the greater the flexibility for government to shift the use to more "beneficial" uses. On the other hand, investors feel less secure with shorter duration permits since there is uncertainty whether the state will renew the permit.

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[66] *See, e.g.*, HAWAII REV. STAT. § 177-2(1) (1976); S.D. CODIFIED LAWS ANN. § 46-1-5 (1983); TEX. WATER CODE ANN. §§ 11.023(a) & 11.024 (Vernon Supp. 1986).

[67] For criticism of the administrative system, see generally Trelease, *The Model Water Code, the Wise Administrator and the Goddam Bureaucrat*, 14 NAT. RES. J. 207 (1974) [hereinafter cited as *Wise Administrator*].

[68] *See infra* notes 101-16 and accompanying text.

[69] *See, e.g.*, ALASKA STAT. §§ 46.15.010 to -.270 (1982).

[70] *See, e.g.*, FLA. STAT. § 373 (1970 & Supp. 1985); IOWA CODE ANN. § 455B.261-.274 (West Supp. 1985).

[71] *See, e.g.*, Note, *A Proposal*, *supra* note 64.

[72] *See* MODEL WATER CODE, *supra* note 60, at 158.

[73] *See, e.g.*, *Wise Administrator*, *supra* note 67.

[74] *See, e.g.*, MODEL WATER CODE, *supra* note 60.

[75] The National Water Commission has suggested variable term permits that would last for a period sufficient to amortize the water user's investment. Under the commission's proposal, permits might last up to 60 years depending on the nature of the business. NATIONAL WATER COMMISSION, WATER POLICIES FOR THE FUTURE 286-87 (1973).

2. *Appropriate System for Groundwater Management*

Generally, surface water is more amenable to private decisionmaking through a market system, but groundwater requires more centralized government control. The pivotal differences between surface water and groundwater characteristics include:[76]

(1) State of knowledge—Surface water is easily observed and studied. Because groundwater cannot be seen, the extent and movement of groundwater can be inferred, but not known with complete certainty.[77] Hence, while the ramifications of surface water use are predictable, unforeseen impacts may occur with groundwater use. Centralized control is necessary to monitor the groundwater resource.

(2) Rate of movement—Streamflow is measured in feet per second; groundwater flow is measured in feet per day.[78] The actions of co-users of a stream, therefore, have a more immediate effect on each other than co-users of a particular groundwater source. Thus, while conflicts between stream users may be easily resolved, the complexity of groundwater conflicts may require government intervention.

(3) Flow variability—Streamflow fluctuates in response to rainfall. In contrast, groundwater stores the rainfall in large underground reservoirs and is available even after months of drought. As a more reliable water source,[79] groundwater has high public value.

(4) Water quality—Groundwater quality is generally superior to surface water quality; the filtering effect of sediments and rock purifies groundwater.[80] Notwithstanding the recent concern with pesticide contamination,[81] groundwater treatment generally is unnecessary in Hawaii.[82] This exceptional water

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[76] *See generally* Haase, *The Interrelationship of Ground and Surface Water: An Enigma to Western Water Law*, 10 Sw.-Nev. L. Rev. 2069, 2083-84 (1978).

[77] The uncertainty regarding sustainable yield is an example. *See supra* note 30.

[78] Even though the permeability of most Hawaiian volcanic rocks is very high, the rate at which groundwater flows is generally very low and averages only a few meters per day. This is because the difference in groundwater elevations is very low, in some cases as low as 0.2 meter per kilometer of flow.

Macdonald, *supra* note 9, at 232.

[79] *See supra* note 9.

[80] *Id.*

[81] For an updated assessment of the pesticide contamination problem, see generally L. Lau, Subsurface Water Quality: Organic Chemical Contamination of O'ahu Groundwater (Water Resources Research Center, Univ. of Hawaii, Special Rep. No. 7.0:85, 1985).

[82] In general, good quality water is available in Hawaii's major basal, dike-impounded, and perched water bodies. All ground water developed for public and domestic purposes are [sic] chemically suitable for use without treatment. No significant levels of organic contaminants, pesticides, or toxic chemicals have been detected. . . .The physical quality of ground water is excellent. It is usually free of color and contains little or no turbidity.

quality has high public value.

(5) Existence of a market—Water users can construct inexpensive systems to divert streamflow but face substantial or prohibitive cost to drill even a small well. Thus, a market exists for surface water rights since many users can compete to use streamflow. In contrast, very few users can afford to drill a well. Most people in Hawaii rely on municipal water systems for domestic water.[83]

(6) Effect of excessive consumption—Total consumption of a stream does not result in permanent physical damage; the stream regains its flow with the next rainfall. In contrast, overdraft of the basal groundwater resource could disrupt and shrink the basal lens, with the possible irreversible loss and forced reliance on expensive desalinization technology.[84]

D. *Other Issues*

Two other issues are important on the mainland but not applicable to Hawaii. The first issue involves the power of states to regulate groundwater export across state boundaries. This is a federal constitutional issue involving the Commerce Clause.[85] As an island state, Hawaii does not have interstate trade in

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> The pH values range between 6.8 and 8.4 units. No offensive taste or odor has been found in potable ground water supplies. Incidence of bacterial contamination in ground water is low.

DEP'T OF LAND & NAT. RESOURCES, STATE OF HAWAII, STATE WATER RESOURCES DEVELOPMENT PLAN III-18 (1980).

[83] The estimated population served by private water systems is as follows: 21,268 on Oahu (about 2% of the Oahu population); 2,978 on Hawaii (about 3% of the Big Island population); 3,504 on Maui (about 6% of the Maui population); 2,300 on Molokai (about 36% of the Molokai population); 2,800 on Lanai (100% of the Lanai population); and 2,570 on Kauai (about 6% of the Kauai population). S & S ENGINEERS, INC., INTERIM DRINKING WATER STUDY: PRIVATE WATER SYSTEMS, STATE OF HAWAII (1978) (available at the Dep't of Health, State of Hawaii).

[84] *See supra* note 26.

[85] In Sporhase v. Nebraska *ex rel.* Douglas, 458 U.S. 941 (1982), the Court held unconstitutional a Nebraska statute that prohibited the export of groundwater to land located in neighboring Colorado. The defendants owned contiguous tracts of land in Nebraska and Colorado and used groundwater pumped from a Nebraska well to irrigate Colorado fields. The defendants did not apply for a permit to transport groundwater across state borders as required under a Nebraska statute. Nebraska conditioned interstate transport of groundwater on reciprocity, i.e., the recipient state must allow its groundwater to be exported into Nebraska. Colorado law forbade export of groundwater. The defendants challenged the constitutionality of the reciprocity requirement.

The Court concluded that groundwater was an article of interstate commerce and was subject to the federal commerce power. Because this was not an area of commerce Congress had regulated, preemption was not an issue. The Court applied a balancing test to determine whether the state legislation violated the commerce clause, weighing the local interests against the burden imposed on interstate commerce. The Court found that while much of the statute advanced a legitimate interest of water conservation, Nebraska did not satisfactorily establish a relationship

groundwater.

The second issue involves the rights to surface water imported and stored underground. This issue is applicable primarily in California where cities import immense quantities of surface water from remote rural areas to replenish the groundwater supply and compensate for overdraft.[86] If Hawaii ever begins to practice artificial recharge using storm effluent or wastewater, the rights to the augmented groundwater supply may become important.[87]

III. Legal Framework to Address Groundwater Issues

Courts developed legal doctrines for groundwater at a time when very little was known about the groundwater resource.[88] As the issues related to groundwater use have become more clearly defined, courts and legislatures have modified these early doctrines. Changes in the law, however, often raise constitutional issues since property owners may be divested of previously protected rights.

A. *Alternative Groundwater Doctrines*

1. *Common Law Doctrines*

Early court decisions classified groundwater into two categories.[89] If groundwater flowed in a defined channel, the courts called it an "underground stream" and applied the principles of surface water law.[90] The courts called all other

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between the reciprocity clause and the local objectives of water conservation. The case was therefore remanded for a determination of whether the clause should be severed to salvage the statute.

[86] *See generally Conjunctive Use*, *supra* note 53, at 1880-84.

[87] Several studies have proposed the use of stormwater runoff, irrigation water, or sewage effluent as artificial recharge in Hawaii. *See, e.g.*, Summary Appraisal, *supra* note 17, at 24.

[88] "The laws of [groundwater's] existence and progress, while there, are not uniform, and cannot be known or regulated. It rises to great heights, and moves collaterally, by influences beyond our apprehension. These influences are . . . secret, changeable and uncontrollable. . . ." Roath v. Driscoll, 20 Conn. 532, 540 (1850).

[89] For an overview of common law doctrines, see generally Ausness, *supra* note 65, at 207-14; Hanks & Hanks, *The Law of Water in New Jersey: Groundwater*, 24 Rutgers L. Rev. 621, 630-48 (1970); 1 Waters & Water Rights, *supra* note 22, § 17 at 71-74.

[90] *See, e.g.*, Gagnon v. French Lick Springs Hotel Co., 163 Ind. 687, 72 N.E. 849 (1904); Evans v. City of Seattle, 182 Wash. 450, 47 P.2d 984 (1935). Because underground streams are unusual, the party alleging the existence of one has a difficult burden of proof. *See, e.g.*, Safranek v. Town of Limon, 123 Colo. 330, 228 P.2d 975 (1951); Ryan v. Quinla, 45 Mont. 521, 124 P. 512, 516 (1912). Some courts even held that the location of the underground stream had to be reasonably ascertainable from the surface without excavation. *See, e.g.*, Hayes v. Adams, 109 Or. 51, 218 P. 933, 935 (1923); Collins v. Charters Valley Gas Co., 131 Pa. 143, 18 A. 1012 (1890). *Contra*, Maricopa County Mun. Conservation Dist. No. 1 v. Southwest Cotton Co., 39

types of groundwater "percolating groundwater."[91]

For percolating groundwater, the courts developed three alternative doctrines: the English or absolute ownership doctrine,[92] the American or reasonable use doctrine,[93] and the correlative rights doctrine.[94] All three doctrines treat percolating groundwater as part of the land and grant an overlying landowner the exclusive right to the underlying groundwater.[95] The basic distinction among

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Ariz. 65, 4 P.2d 369, 377 (1931), *modified in other respects*, 39 Ariz. 367, 7 P.2d 254 (1932).

[91] Percolating waters "ooze, seep or filter through the soil beneath the surface, without a defined channel." Clinchfield Coal Corp. v. Compton, 148 Va. 437, 439, 139 S.E. 308, 311 (1927). Courts presume groundwater to be percolating rather than flowing in an underground stream unless a party presents sufficient evidence to prove the existence of the underground stream with a relatively high degree of certainty. Some states have abandoned the underground stream category and hold all groundwater to be percolating. *See Water Use Permits*, *supra* note 65, at 208 n.114 (citing Hinton v. Little, 50 Idaho 371, 296 P. 582, 583 (1931); KAN. STAT. §§ 82a-702 to -703 (1969); N.D. CENT. CODE § 61-01-01 (1960); OR. REV. STAT. § 537.515(3) (1973)).

[92] The absolute ownership doctrine was followed in many states in the nineteenth century. *See Water Use Permits*, *supra* note 65, at 210 n.124 (citing Roath v. Driscoll, 20 Conn. 533 (1850); Saddler v. Lee, 66 Ga. 45 (1879); Kinnaird v. Standard Oil Co., 89 Ky. 468, 12 S.W. 937 (1890); Wilson v. City of New Bedford, 108 Mass. 261 (1871); Chase v. Silverstone, 62 Mo. 175 (1873); Haldeman v. Bruckhart, 45 Pa. 514 (1863)). Texas is one of the few states that continues to adhere to the absolute ownership doctrine. City of Corpus Christi v. Pleasonton, 154 Tex. 289, 276 S.W.2d 798 (1955). Texas modified the doctrine somewhat in Friendswood Dev. Co. v. Smith-Southwest Indus., 576 S.W.2d 21 (Tex. 1978). *See infra* note 211 and accompanying text.

[93] Arizona, Nebraska, and Oklahoma have adopted the reasonable use doctrine. Bristor v. Cheatham, 75 Ariz. 227, 255 P.2d 173 (1953); Prather v. Eisenmann, 200 Neb. 1, 261 N.W.2d 766 (1978); Canada v. City of Shawnee, 179 Okla. 53, 64 P.2d 694 (1937). All three states have enacted groundwater legislation that significantly modifies, but does not completely displace, the reasonable use doctrine. ARIZ. REV. STAT. ANN. §§ 45-401 to -637 (Supp. 1985); NEB. REV. STAT. §§ 46-656 to -674 (1943) (1984); OKLA. STAT. ANN. tit. 82 §§ 1020.1-.22 (Supp. 1985). For a discussion of the effect of such legislation on the reasonable use doctrine, see generally Aiken, *Nebraska Ground Water Law and Administration*, 59 NEB. L. REV. 917 (1980); Jensen, *The Allocation of Percolating Water Under the Oklahoma Ground Water Law of 1972*, 14 TULSA L.J. 437 (1979); Note, *The Right to Use Groundwater in Arizona After* Chino Valley II *and* Cherry v. Steiner, 25 ARIZ. L. REV. 473 (1983).

[94] California and Hawaii have adopted the correlative rights doctrine. Katz v. Walkinshaw, 141 Cal. 116, 74 P. 766 (1903); City Mill v. Honolulu Sewer & Water Comm'n, 30 Hawaii 912 (1929). New Jersey has adopted a combination of the reasonable use and correlative rights doctrines. *See* Hanks & Hanks, *supra* note 89, at 654-57. Some commentators also include Arkansas, Delaware, Minnesota, and Tennessee as correlative rights states. F. MALONEY, S. PLAGER & F. BALDWIN, WATER LAW AND ADMINISTRATION: THE FLORIDA EXPERIENCE 54.2(b)(3) (1968). *But see* Hanks & Hanks, *supra* note 89, at 643 n.95 (contending that the Minnesota and Tennessee cases do not support the correlative rights doctrine).

[95] *See, e.g.*, Roath v. Driscoll, 20 Conn. at 540:

> Water combined with the earth, or passing through it, by percolation or by filtration, or chemical attraction, has no distinctive character of ownership from the earth itself. . . .Water, whether moving or motionless in the earth, is not, in the eye of the law,

the three doctrines lies in the overlying owner's rights regarding the type and place of use of groundwater. Under the absolute ownership doctrine, the overlying landowner has the right to use the groundwater for any type of use and may also transport the water to lands that do not overlie the groundwater aquifer.[96]

Under the reasonable use doctrine, the rights of overlying landowners differ depending on the place of use. Landowners who use the groundwater on the overlying land are entitled to use an unlimited quantity, provided that the use is "reasonable."[97] The rights of landowners who transport water to non-overly-

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distinct from the earth.

See also Nebraska Ground Water, *supra* note 93, at 923 ("The absolute ownership, reasonable use, and correlative rights doctrines all share the major premise that the right to use ground water is based on owning land overlying the ground water reservoir.").

[96] The absolute ownership doctrine originated in Acton v. Blundell, 152 Eng. Rep. 1223 (Ex. Ch. 1843):

> [T]hat the person who owns the surface may dig therein, and apply all that is there found to his own purposes at his free will and pleasure and that if in the exercise of such right, he intercepts or drains off the water collected from underground springs in his neighbour's well, this inconvenience to his neighbour falls within the description of damnum absque injuria, which cannot become the ground of an action.

Id. at 1235.

Two policy reasons underlie this doctrine. First, since very little was known about groundwater, the courts felt that no rational body of rules could be applied. *See supra* note 88. Second, the doctrine favors municipal water suppliers and other large users who have the strongest and deepest pumps. *See* Hanks & Hanks, *supra* note 89, at 632. The limitations apply only to the right to waste and the right to harm a neighbor maliciously. One state has recognized the user's absolute right to the groundwater even when the use is wasteful. City of Corpus Christi v. Pleasonton, 154 Tex. 289, 276 S.W.2d 798 (1955). One commentator observed:

> Corpus Christi bought land overlying an artesian basin. It drilled wells flowing 10 million gallons per day, flowed the water into a river where 63 to 74 percent of the water was lost to evaporation and seepage and took the remainder into its municipal system 118 miles away—all with court sanction and despite a statute prohibiting the waste of artesian water.

Hanks & Hanks, *supra* note 89, at 633 n.40.

One early court went so far as to recognize a user's right to waste the groundwater for the express purpose of harming a neighbor. Huber v. Merkel, 117 Wis. 355, 94 N.W. 354 (1903), *overruled by* State v. Michels Pipeline Constr., Inc., 63 Wis. 2d 278, 217 N.W.2d 339 (1974). *See* Comment, *The Law of Underground Water: A Half Century of* Huber v. Merkel, 1953 WIS. L. REV. 491.

[97] Wasteful or malicious uses are unreasonable per se and may be enjoined even though the plaintiff suffered no actual damage. *Water Use Permits*, *supra* note 65, at 211 n.129 (citing Barclay v. Abraham, 121 Iowa 69, 96 N.W. 1080 (1903); Stillwater Water Co. v. Farmer, 89 Minn. 58, 93 N.W. 907 (1903)). This author believes that the "reasonable use" doctrine for groundwater is not comparable with the riparian reasonable use doctrine for surface water. Under the reasonable use doctrine for groundwater, "reasonable" is a limitation on absolute ownership doctrine and proscribes transporting groundwater to the injury of overlying landowners. Under the riparian doctrine, "reasonable" is a criterion used to allocate the available supply among competing riparians. For differing points of view on the comparability of the two doctrines, compare Harnsberger, *Nebraska Ground Water Problems*, 42 NEB. L. REV. 721 (1963) (fundamental dis-

ing lands are subordinate to the overlying users' rights. Thus, an overlying user may enjoin a transporter, regardless of the reasonableness of the transporter's use.[98]

Similar to the reasonable use doctrine, the correlative rights doctrine also distinguishes between overlying users and transporters. Unlike the reasonable use doctrine, the correlative rights doctrine adds a further distinction between "shortage" and "surplus" conditions. During "surplus" conditions, transporters acquire appropriative rights in the surplus amount,[99] as contrasted with the unclear rights between transporters under the reasonable use doctrine. During "shortages," overlying users are entitled to a proportionate share;[100] transporters get nothing.

2. *Statutory Permit Systems*

Most western states have statutorily adopted the prior appropriation doctrine.[101] Unlike the common law doctrines, the prior appropriation doctrine

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tinction in use of the term between the two doctrines) with J. SAX, WATER LAW, PLANNING AND POLICY 462 (1968) (use of the term indistinguishable between the two doctrines). Whether a difference exists is significant for riparian states that desire to integrate surface and groundwater laws with a unified standard. Hanks & Hanks, *supra* note 89, at 637.

[98] *See Water Use Permits*, *supra* note 65, at 211 n.132 (citing Schenk v. City of Ann Arbor, 196 Mich. 75, 163 N.W. 109 (1917); Erickson v. Crookston Waterworks Power & Light Co., 100 Minn. 481, 111 N.W. 391 (1907); Rouse v. City of Kinston, 188 N.C. 1, 123 S.E. 482 (1924); Canada v. City of Shawnee, 179 Okla. 53, 64 P.2d 694, 697 (1937)).

[99] Katz v. Walkinshaw, 141 Cal. 116, 136, 74 P. 776, 772 (1903). *See, e.g.*, City of San Bernardino v. City of Riverside, 186 Cal. 7, 198 P. 784 (1921). *See also* Hanks & Hanks, *supra* note 89, at 640.

[100] Katz v. Walkinshaw, 141 Cal. at 136, 74 P. at 772. The court implied that proration should be based on the size of the overlying land. This method has problems:

> In an agricultural context it may make sense to apportion according to the area of the overlying land. If A uses more water per acre for his crops than B, and assuming other factors are equal, it can be said that the excess of A's use over B's is due to inefficiency, and should therefore be held to be a nonbeneficial use. In an industrial context, however, no necessary connection exists between the area of the overlying land and the amount of water which may be put to beneficial use on the overlying land. Here it makes more sense to apportion the shortage on the basis of previous beneficial use rather than acreage.

Hanks & Hanks, *supra* note 89, at 640.

No proration is possible under the reasonable use or absolute ownership doctrines. *See, e.g.*, *Canada*, 179 Okla. at 55, 64 P.2d at 696. One commentator suggests two reasons to justify the Oklahoma court's rejection of apportionment: lack of factual information to administer such a rule, and diminution of the public welfare through interference with valuable water uses. Jensen, *supra* note 93, at 453-55.

[101] All of the western states that have accepted the prior appropriation doctrine for surface water have applied the doctrine to groundwater. 5 WATERS & WATER RIGHTS, § 441, at 414 n.27 (R. Clark ed. 1967 & Supp. 1978).

does not automatically grant any groundwater rights to the overlying landowner. Instead, the groundwater right is available to anyone who uses the groundwater for a "beneficial use."[102] The water may be transported to non-overlying lands.[103] Administrators or the courts resolve conflicts according to priority; the first in time is first in right.[104] To acquire the groundwater right, a beneficial groundwater user must apply to the state for a permit.[105]

Besides the prior appropriation permit system, a second type of statutory permit system adopted by some states is the "critical area permit system."[106] Unlike the prior appropriation permit system, the critical area permit system does not establish groundwater rights. Instead, the critical area statute regulates pre-existing groundwater rights that have been established through common law.[107] Regulation of private groundwater rights under a state's police power is limited to "critical areas," those areas experiencing or threatened by overdraft problems.[108] Common law groundwater rights remain unaffected in non-critical areas.[109]

A third type of statutory permit system is the "comprehensive water use

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[102] For an overview of the prior appropriation doctrine, see generally 1 HUTCHINS II, *supra* note 1. For a definition of "beneficial use" and its distinction from "reasonable-beneficial use," see *supra* notes 59 & 60.

[103] *See* 1 HUTCHINS II, *supra* note 1, at 517-22.

[104] *See id.* at 569.

[105] In all the appropriation states except Idaho, the permit system is the exclusive means to acquire a valid appropriative right. Application is made to a state administrator, usually the state engineer. Acceptance of the application establishes the priority; the right is "perfected" (completed) when water is ultimately used. The permit usually specifies the quantity of water, time of use, place of use, purpose of use, and place of diversion. In Idaho, the appropriative right may be perfected either by a permit or by withdrawing the water and applying it to a beneficial use. *Id.* at 312-48.

[106] *See* 2 *id.* at 659-64 (summary description of critical area statutes of western states); Ausness, *Water Rights Legislation in the East: A Program for Reform*, 24 WM. & MARY L. REV. 547 (1983) (summary descriptions of water laws of fourteen eastern states, of which five (Indiana, Mississippi, North Carolina, South Carolina, and Virginia) have critical area statutes for groundwater).

[107] *See, e.g.*, Jarvis v. State Land Dep't, 104 Ariz. 527, 456 P.2d 385 (1969) (reasonable use doctrine not displaced by critical area statute). *See also* 5 WATERS AND WATER RIGHTS, *supra* note 22, § 442.5, at 431-33 (emphasizing the regulatory nature of Hawaii's critical area statutes, as distinguished from establishing rights in groundwater).

[108] *See, e.g.*, HAWAII REV. STAT. § 177-2(3) (1976):

> "Designated ground-water area" means an area in which the board finds that the ground water must be regulated and protected for its best utilization, conservation, and protection in order to prevent threat of exhaustion, depletion, waste, pollution, or deterioration by salt encroachment or an area in which the board finds that the ground water must be regulated and protected in order to protect the ground water resources from exhaustion, depletion, waste, pollution, or deterioration by salt encroachment.

[109] *See supra* note 107.

permit system."[110] The comprehensive permit system subjects surface and groundwater rights to a single, statewide permit system. Florida and Iowa regulate pre-existing common law rights statewide through limited-duration permits.[111] Alaska has a perpetual permit system that establishes and regulates water rights under the prior appropriation doctrine.[112]

A fourth type of groundwater statute, commonly called a "well-drilling statute," regulates the design and construction of wells.[113] The purposes of this statute are two-fold: to prevent waste and contamination caused by defective design and construction practices, and to collect information on hydrogeology and the amount of groundwater usage.[114] Unlike the comprehensive or critical area permit systems, the typical well-drilling statute does not dictate whether a well may or may not be drilled to prevent overdraft; instead, a well permit must be issued if the applicant has met all the specified design and construction criteria.[115] Most states have enacted well-drilling statutes, regardless of whether they recognize common law or prior appropriation groundwater rights.[116]

B. *Nature of the Property Right in Groundwater*

Groundwater law is part of property law. The nature of the property right,

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[110] Hanks & Hanks, *supra* note 89, at 649; *Water Use Permits*, *supra* note 65, at 222.

[111] IOWA CODE ANN. § 455B.265 (West Supp. 1985); FLA. STAT. ANN. § 373.236 (West 1974). *See generally* Hines, *A Decade of Experience Under the Iowa Water Permit System*, (pts. 1 & 2), 7 NAT. RESOURCES J. 499 (1967), 8 NAT. RESOURCES J. 23 (1968).

[112] ALASKA STAT. §§ 46.15.010-.270 (1982). *See generally* Trelease, *Alaska's New Water Use Act*, 2 LAND & WATER L. REV. 1 (1967).

[113] *See, e.g.*, HAWAII REV. STAT. ch. 178 (1976).

[114] Design and construction requirements to prevent waste and contamination include well-casing specifications, sealing abandoned wells, installation of check valves, and inspection of work. Registration of all wells, requirements for well-drilling logs and for submission of periodic flow reports produce information vital to the determination of sustainable yields. *See* HAWAII REV. STAT. ch. 178 (1976). The well-drilling logs, for instance, contain data on water levels and on geologic materials encountered at various depths. *Id.*

[115] *See, e.g.*, City Mill v. Honolulu Sewer & Water Comm'n, 30 Hawaii 912 (1929) (court struck down an amendment to the well-drilling statute that attempted to authorize discretionary denial). In analyzing the *City Mill* decision, one commentator stated:

> There is no present authorization to deny a permit so long as the applicant is ready to comply with these requirements. . . . [T]he police power of the Territory extended to the imposition of reasonable regulations for the boring and the maintenance of private artesian wells . . . but that it did not extend to the prohibiting of an individual landowner from drilling an artesian well on his own land while at the same time permitting unrestrained operation and use of existing wells.

HUTCHINS I, *supra* note 1, at 203-04.

[116] Burke & Kulasza, *Artesian Power! How to Prepare for the Coming Groundwater Revolution*, 28 ROCKY MTN. MIN. L. INST. 1345, 1379-80 (1983).

however, has vexed courts and legislatures. On one hand, groundwater is part of the land; the landowner may absolutely own the groundwater within the property boundaries. On the other hand, groundwater migrates across property boundaries and the amount fluctuates; no one can own the groundwater, just as one can own the streambed but not the flowing stream. In this respect, a holder of a groundwater right may only possess the right to use groundwater, called a usufructuary right,[117] but is unable to physically own groundwater in its flowing natural state.

The difference between an absolute ownership right and a usufructuary right is significant in two respects. Unlike absolute ownership, where a landowner has the freedom to use the property with very limited restrictions, a usufructuary right is a system of rules that qualifies the user's right in relation to other users and the available supply of water.[118] Besides the degree of restrictions, another significant difference is the ease in which the groundwater laws may be changed as knowledge about the groundwater resource increases. The United States Constitution affords greater protection to absolute ownership rights than to usufructuary rights.[119]

1. *Nature of Common Law Groundwater Rights*

Common law groundwater rights are acquired through landownership.[120] Two possible theories support the notion that groundwater rights are an incident of landownership. One theory, based on the doctrine that a landowner owns everything from the heavens to the center of the earth (*cujus est solum, ejus est usque ad inferos*), considers groundwater as inseparable from the land.[121] According to this theory, the landowner possesses a property right in the groundwater by the mere fact of landownership; it does not matter whether the

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[117] The "usufructory right" is the right of enjoying anything in which one has no property, of enjoying a thing the property of which is vested in another, and of drawing of the same all the profit, utility, and advantage which it may produce provided that it is done without altering the substance of the thing or of using and enjoying and receiving the profits of property which belongs to another.

Kelly v. Lansford, 572 S.W.2d 369, 372 (Tex. Civ. App. 1978).

[118] Under the prior appropriation doctrine, the state establishes the rules to acquire the usufructuary right. These rules ensure that the use is not wasteful and does not interfere with existing users. *See supra* note 105. Under the correlative rights doctrine, overlying owners have equal rights during shortages. *See supra* note 100.

[119] *See infra* notes 147-56 and accompanying text.

[120] *See supra* note 95.

[121] "The English rule seems to be rested at bottom upon the maxim, 'cujus est solum, ejus est usque ad coelum et ad inferos.' " Meeker v. East Orange, 77 N.J.L. 623, 636, 74 A. 379, 384 (1909).

landowner has actually drilled for the groundwater.[122] The second theory, based on Roman civil law and applied to such natural resources as wild animals, considers groundwater to be the property of no one (*res nullius*),[123] freely accessible to all citizens, and reduced to ownership only upon capture. Under this theory, the landowner possesses an inchoate right to the groundwater that does not vest until the groundwater is actually "captured" by drilling.[124] In most jurisdictions, it is unclear which theory applies.

Although the correlative rights doctrine considers the groundwater as an incident of landownership, this doctrine also recognizes the flowing, ephemeral qualities of groundwater. Hence, the landowner's share is subject to apportionment during shortages. Because of this restriction, correlative rights doctrines are more like usufructuary rights than absolute property rights.[125]

A second theory, with roots in Roman civil law, lends additional support to the concept of usufructuary rights as legislatively preferable to absolute ownership. This second theory treats a natural resource as the common property of everyone (*res communes*).[126] Certain natural resources are so important to all citizens that they should be reserved for the whole populace. A variant of this public ownership theory is that the state, in its sovereign capacity, is the representative of the public to enforce the public interests (*publici juris*).[127] Under the *res communes* theory, it is unclear whether the public has a private right to prevent infringement of the public interest.[128] Under the *publici juris* theory,

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[122] *See supra* note 95.

[123] It is also a rather strange, not to say paradoxical property right: In the course of "oozing" or "creeping" along, it keeps changing "absolute owners." In other words, it would have made equally good sense to say that percolating groundwaters belong to no one until they have actually been captured and brought to the surface.

Hanks & Hanks, *supra* note 89, at 641 n.84.

> [S]ince a landowner has no rights against an adjoining landowner who also withdraws ground water, it is somewhat misleading to say that he owns "absolutely" the percolating water under his land. Instead it would seem that the landowner does not really own the water until he has reduced it to actual possession. The property right involved is the landowner's exclusive right of access to the ground water through his land, rather than ownership of the underground water itself.

Water Use Permits, *supra* note 65, at 210 (footnotes omitted).

For the distinction between *res nullius* and other forms of ownership, such as *res communes*, *res publicae*, and *publici juris*, see Trelease, *Government Ownership and Trusteeship of Water*, 45 CALIF. L. REV. 638 (1957).

[124] *See, e.g.*, Town of Chino Valley v. City of Prescott, 131 Ariz. 78, 638 P.2d 1324, 1328 (1981), *appeal dismissed*, 457 U.S. 1101 (1982).

[125] *See* Hanks & Hanks, *supra* note 89, at 640-43; *Water Use Permits*, *supra* note 65, at 214.

[126] *See Government Ownership*, *supra* note 123, at 640.

[127] *Id.*

[128] *Id. See also*, Sax, *The Public Trust Doctrine in Natural Resource Law: Effective Judicial Intervention*, 68 MICH. L. REV. 471 (1970).

the state is entrusted with the responsibility to protect and enhance the public's interests.[129] The *publici juris* theory is commonly referred to as the "public trust doctrine."

Courts are still sketching a state's fiduciary duties under the public trust doctrine.[130] The state's accountability in the protection of the groundwater resource, however, makes the *publici juris* theory preferable to *res communes*. The California Supreme Court, in *National Audubon Society v. Superior Court of Alpine County*,[131] recently set forth several important principles relating to the duties of the state as trustee. First of all, the state has an affirmative duty to "exercise continued supervision over the trust."[132] Accordingly, the state not only has an affirmative duty to consider public trust values in the planning and allocation of water resources,[133] but also to "reconsider allocation decisions even though those decisions were made after due consideration of their effect on the public trust."[134] In other words, "the state is not confined by past allocation decisions which may be incorrect in light of current knowledge or inconsistent with current needs."[135] Consequently, "parties acquiring rights in trust property generally hold those rights subject to the trust, and can assert no vested right to use those rights in a manner harmful to the trust."[136] If government violates any of these duties, citizens can bring suit for a breach of fiduciary duty.[137]

The state does not own the groundwater in a proprietary sense (*res publi-*

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[129] Likewise the state is not the owner of the domestic water of the state in the sense that it has absolute power and dominion over it to the exclusion of the rights of those who have the beneficial interest therein. The title is an equitable one residing in the water users of the state. The state as an entity is the holder of the legal title as trustee for the benefit of the people of the state, all of whom in the last analysis, are the water users of the state. . . . As trustee, the state and its agencies . . . are bound faithfully to administer that trust and are answerable to the courts, in the exercise of their traditional powers in equity, for the proper discharge of their stewardship.

Ivanhoe Irrigation Dist. v. All Parties, 47 Cal. 2d 597, 625, 306 P.2d 824, 840-41 (1957), *rev'd sub nom.* Ivanhoe Irrigation Dist. v. McCracken, 357 U.S. 275 (1958) (*McCracken* overruled by California v. United States, 438 U.S. 645 (1978)).

[130] The public trust doctrine carried over to American law from English common law and Roman civil law. For a history of its origins in American law, see Shively v. Bowlby, 152 U.S. 1 (1894). Confusion has arisen over the nature of the government's fiduciary duties, the resources subject to the trust, and the public purposes protected by the trust. *See generally* Sax, *supra* note 128.

[131] 33 Cal. 3d 419, 658 P.2d 709, 189 Cal. Rptr. 346, *cert. denied*, 464 U.S. 977 (1983).

[132] *Id.* at 437, 658 P.2d at 721, 189 Cal. Rptr. at 358.

[133] *Id.* at 441, 658 P.2d at 728, 189 Cal. Rptr. at 364.

[134] *Id.* at 447, 658 P.2d at 728, 189 Cal. Rptr. at 365.

[135] *Id.*

[136] *Id.* at 437, 658 P.2d at 721, 189 Cal. Rptr. at 358.

[137] *See* Ivanhoe Irrigation Dist. v. All Parties, 47 Cal. 2d 597, 306 P.2d 824.

cae)[138] under either the *res communes* or *publici juris* theories. Therefore, the state does not have the power to alienate title to these rights to the detriment of the public interest.[139]

2. *Nature of Prior Appropriation Groundwater Rights*

Under the prior appropriation doctrine, a landowner does not automatically acquire any rights to groundwater. Instead, the groundwater right is available to anyone who uses the groundwater for a "beneficial use." Two possible theories support the prior appropriation doctrine. One theory, similar to the common law doctrines, is *res nullius*—that no one owns the groundwater until it is "captured."[140] Thus, the first person who puts the groundwater to a beneficial use is vested with the groundwater right.

An alternative theory is that the groundwater is publicly owned with private usufructuary rights issued by the state through a permit system.[141] Many prior appropriation states have a statutory or a constitutional provision that declares public ownership in the groundwater resource. The variations include "property of the state,"[142] "property of the people,"[143] "property of the public,"[144] and "dedicating all waters to the use of the people."[145] These statements, however,

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[138] State-owned automobiles or the state capitol building are examples of proprietary state ownership. *See Government Ownership, supra* note 123, at 640.

[139] The public trust doctrine permits the state to grant the use of such waters to private parties.

> [B]ut that is a very different doctrine from the one which would sanction the abdication of the general control of the State over lands under the navigable waters of an entire harbor or bay, or of a sea or lake. Such abdication is not consistent with the exercise of that trust which requires the government of the State to preserve such waters for the use of the public. . . . The control of the State for the purposes of the trust can never be lost, except as to such parcels as are used in promoting the interests of the public therein, or can be disposed of without any substantial impairment of the public interest in the lands and waters remaining.

Illinois Cent. R.R. v. Illinois, 146 U.S. 387, 452 (1892).

[140] *See* 1 HUTCHINS II, *supra* note 1, at 140-42.

[141] *Id.*

[142] *Government Ownership, supra* note 123, at 642 (citing MONT. CONST. art. III, § 15; N.D. CONST. § 210; WYO. CONST. art. 8, § 1; IDAHO CODE § 42-101 (1948); TEX. REV. CIV. STAT. art. 7467 (Vernon 1948).

[143] *Government Ownership, supra* note 123, at 642 (citing CAL. WATER CODE § 102).

[144] *Government Ownership, supra* note 123, at 642 (citing COLO. CONST. art. XVI, § 5; N.M. CONST. art. XVI, § 2; ARIZ. REV. STAT. § 45-101 (1956); NEB. REV. STAT. § 46-202 (1952); NEV. COMP. LAWS § 7890 (1929); OR. REV. STAT. § 537.110 (1953); S.D. CODE § 61.0101 (1939); UTAH CODE ANN. § 73-1-1 (1953); WASH. REV. CODE § 90.04.020 (1951)).

[145] *Government Ownership, supra* note 123, at 642 (citing KAN. STAT. ANN. § 82a-702 (1949)).

do not clearly distinguish between *res communes*, *publici juris*, or *res publicae*.

3. *Constitutional Implications*

Federal and state constitutions protect property rights from any "taking" by government without just compensation.[146] Government may indirectly "take" property through overly restrictive regulations[147] or through drastic changes of property laws.[148] To be a "taking," the right must first be considered "property" within the meaning of the constitution.[149] Secondly, the government's action must so deprive the owner of certain rights that, in effect, the government has "taken" the property without compensating the owner.[150]

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[146] U.S. CONST. amend. V: "No person shall . . . be deprived of . . . property without due process of law." The U.S. Supreme Court has held that due process requires the payment of just compensation when the government takes private property. Chicago, B. & Q. R.R. v. Chicago, 166 U.S. 226 (1897). The fifth amendment is applicable to states through the fourteenth amendment. Most states have equivalent state constitutional protection. *See, e.g.*, HAWAII CONST. art. I, § 4.

[147] *See* Pennsylvania Coal Co. v. Mahon, 260 U.S. 395 (1922). The applicability of the fifth amendment to police power regulations is still debated. *See generally* F. BOSSELMAN, D. CALLIES & J. BANTA, THE TAKING ISSUE (1973).

[148] *See, e.g.*, Robinson v. Ariyoshi, 441 F. Supp. 559 (D. Hawaii 1977) (Courts can "take" property when its decision overrules prior cases and applies the "new" rule retroactively), *aff'd*, 753 F.2d 1468 (9th Cir. 1985). For an opposing point of view, see generally Chang, *Unraveling* Robinson v. Ariyoshi*: Can Courts "Take" Property?*, 2 U. HAWAII L. REV. 57 (1979).

[149] Only a very few legal terms have a broader scope than "property." *See* Lauer, *The Riparian Rights as Property*, in WATER RESOURCES AND THE LAW 131 (1958). "Any concept which may include things so diverse in their nature as a shoelace and a share of preferred corporate stock must necessarily be difficult of precise definition." *Id.* at 140. The judiciary determines

> whether the interest in question warrant[s] protection, based upon judicial experience and personal insight into American constitutionalism and the present needs of the public. If the conclusion is in favor of protection, then the questioned interest is awarded the exalted denomination of "property" and on that basis defended against legislative action. As Hamilton and Till point out, "It is incorrect to say that the judiciary protected property; rather they called that property to which they accorded protection."

Id. at 142.

[150] Courts have developed several tests to determine whether the government action rises to a "taking": diminution in value, *see, e.g.*, Pennsylvania Coal Co. v. Mahon, 260 U.S. 393 (1922); overriding public interest, *see, e.g.*, Miller v. Schoene, 276 U.S. 272 (1928); and balancing individual burden against public benefit, *see, e.g.*, Penn Cent. Transp. Co. v. City of New York, 438 U.S. 104 (1978). For discussion on "taking" in the water rights context, see generally W. KLOOS, N. AIPA & W. CHANG, WATER RIGHTS, WATER REGULATION, AND THE "TAKING ISSUE" IN HAWAI'I (Water Resources Research Center, Univ. of Hawaii, Technical Rep. No. 150, 1983); Kyl, *The 1980 Arizona Groundwater Management Act: From Inception to Current Constitutional Challenge*, 53 U. COLO. L. REV. 471 (1982); Looney, *Modification of Arkansas Water Law: Issues and Alternatives*, 38 ARK. L. REV. 221 (1984); O'Connell, *Iowa's New Water Statute—The Constitutionality of Regulating Existing Uses of Water*, 47 IOWA L. REV. 549 (1962); Scurlock, *Consti-*

Under the absolute ownership and reasonable use doctrines, groundwater rights are definitely "property" within the meaning of the constitution.[151] The critical question is how this property right vests. Under one theory, the groundwater right vests upon mere ownership of the land.[152] Under the *res nullius* theory, however, the right vests only upon "capture" of the groundwater.[153] Once a court determines a groundwater right to have vested, the court applies "taking" tests to determine whether the government's action is unconstitutional.

If the groundwater right is a usufructuary right—which may be the case under the correlative rights or prior appropriations doctrines—government action is usually not a "taking" for two alternative reasons. First, a court may consider a usufructuary right not to be "property," since the owner possesses only use rights but no physical ownership of the groundwater.[154] If the right is not "property," it cannot be "taken." Alternatively, the court may consider the state to be the owner of the groundwater under the *res communes, publici juris*, or *res publicae* theories, or by outright declaration in the state constitution or a statute. If the state is the actual owner, the state cannot "take" from itself.[155]

On the other hand, courts may consider the system of rules that comprise the usufructuary right to be "property" within the meaning of the constitution.[156]

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tutionality of Water Rights Regulation, 1 KAN. L. REV. 125 (1953).

[151] *See supra* note 125.

[152] *See supra* notes 121-22 and accompanying text.

[153] *See supra* notes 123-24 and accompanying text.

[154] *See, e.g.*, Williams v. City of Wichita, 190 Kan. 317, 374 P.2d 578 (1962), *appeal dismissed and cert. denied*, 375 U.S. 7 (1963) (discussed in 11 KAN. L. REV. 558 (1963)).

[155] *See, e.g.*, State *ex rel.* Erickson v. McLean, 62 N.M. 264, 308 P.2d 983 (1957); Wyoming Hereford Ranch v. Hammon Packing Co., 33 Wyo. 14, 236 P. 764 (1925).

[156] One commentator raises the possibility of a system of rules being "property," but rejects the notion:

> Although the simple right to the use of water may be a property right, there remains the substantial problem of whether the elaborate legal doctrine which the courts have formulated to govern the enjoyment of the usufructuary right can itself be described as property. Almost without exception, the courts have given very little indication of whether these particularized rules of use can be denominated "property.". . .
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> . . . The goal in making rules to govern water use is therefore twofold: enabling the water to be put to its maximum beneficial use and insuring that the equal right of each person in the use of the water is protected. . . .
>
> . . . As such, [the rules] are not property in themselves; they are merely judicially-adopted guides for ascertaining the extent of the usufructuary right of each person who has access to a watercourse. These rules are created for the purpose of safeguarding property and do not in themselves rise to the status of property merely by virtue of their adoption. . . .
>
> . . . [However], they cannot be freely abolished either in whole or in part, without at least raising the problem of whether the abolition impairs property in that the remaining rules of use fail to give equal or just protection to the usufructuary right.

Any change in the rules, therefore, would require a "taking" analysis.

C. *Elements of the Groundwater Right*

A groundwater right, whether it be a vested property right or a usufructuary right, is a bundle of rights and obligations.[157] The elements of a groundwater right evolve as courts and legislatures develop rules to resolve various groundwater issues. Three major elements, which correspond to the categories of issues discussed in section II, are as follows:

(1) Acquisition and transfer. Who has the right to access the groundwater resource, i.e., drill a well or tunnel? Can this right be transferred for profit? The issues related to demand management apply: whether a market system or a permit system more effectively determines the "highest and best use" for the limited groundwater resource.[158]

(2) Measure of the right. How much groundwater may the user withdraw? The issues related to supply management apply: whether and to what extent the state must impose withdrawal limits to prevent overdraft, reduce allocations during temporary drought shortages, and regulate wasteful design and construction practices.[159]

(3) Rights and liabilities. What rules resolve conflicts between groundwater users, between groundwater and surface water users, and between groundwater users and overlying landowners? The issues related to conflict management apply: which of the competing parties should bear the burden of additional costs, inconveniences, or complete restraint.[160]

1. *Acquisition and Transfer of Groundwater Rights*

Under the common law doctrines, groundwater rights are acquired and transferred through landownership.[161] However, in states where statutory permit systems overlay the common law doctrines, the groundwater permit does not automatically transfer without approval from the state.[162] The state normally approves the transfer when the place and type of use of groundwater remains

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Lauer, *supra* note 149, at 209.

[157] *See generally* Snare, *The Concept of Property*, 9 AM. PHIL. Q. 200 (1972) (analyzing the concept of property as a complex of six rights and obligations: right of use, right of exclusion, right of transfer, punishment rules, damage rules, and liability rules).

[158] *See supra* notes 62-84 and accompanying text.

[159] *See supra* notes 17-40 and accompanying text.

[160] *See supra* notes 41-57 and accompanying text.

[161] *See supra* note 95 and accompanying text.

[162] *See, e.g.*, HAWAII REV. STAT. § 177-20(b) (1976).

unchanged. Besides private transfers by the landowner through a land sale, the state may also transfer a permit to another landowner upon the permit's expiration[163] or upon paying compensation.[164]

Under the prior appropriation doctrine, the groundwater right is acquired through a permit that evidences a beneficial use of the groundwater. The groundwater right is severable from the land and may be transferred separately.[165] In most prior appropriation states, groundwater rights are transferred through the market system.[166] "Pseudo-market" systems, where the state actively participates in the initial distribution of the rights and oversees subsequent transfers, have been proposed but not implemented to date.[167]

2. *Measure of Groundwater Rights*

Under the absolute ownership doctrine, there is no limit on the amount of groundwater that may be withdrawn. In the absence of statutory controls, a landowner is entitled to deplete the groundwater supply to the detriment of neighboring landowners.[168] Early cases went so far as to hold that a landowner has the right to waste groundwater, thereby striking down a well-drilling statute as unconstitutional.[169] In short, the absolute ownership doctrine is inadequate to address issues involving overdraft, droughts, and wasteful practices.

The reasonable use and correlative rights doctrines control wasteful practices by restricting groundwater use to "reasonable uses."[170] However, this standard does not provide definite guidelines for landowners.

The reasonable use doctrine indirectly prevents overdraft by restricting the place of use. On the one hand, a landowner is entitled to an unlimited quantity to satisfy a "reasonable use."[171] On the other hand, the quantity is in fact limited by a further restriction that the groundwater may be used only on the overlying land; it may not be sold and transported elsewhere if inadequate water is available for the overlying landowners.[172] Once a landowner limits the groundwater use to the overlying land for a "reasonable use," there is no further

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[163] *See, e.g., id.* § 177-28(b).

[164] *See, e.g., id.* § 177-27(3).

[165] *See* 1 HUTCHINS II, *supra* note 1, at 476-77.

[166] The best example is Alaska's water rights system. *See supra* note 112.

[167] *See, e.g.,* Johnson, *supra* note 62; Note, *A Proposal, supra* note 64; *Water Use Permit, supra* note 65, at 262-64.

[168] *See supra* note 96.

[169] *Id.*

[170] *See supra* note 97.

[171] *Id.*

[172] *See supra* note 98 and accompanying text.

restriction that may be imposed during droughts to reduce consumption.[173]

The correlative rights doctrine improves upon the reasonable use doctrine by providing remedies for shortages. The shortages may be temporary (caused by droughts), or permanent (caused by overdraft).[174] During shortages, landowners are entitled only to a proportionate share of the available supply.[175] Furthermore, the correlative rights doctrine loosens the "place of use" restriction by allowing transporters to obtain appropriative rights, provided no other overlying landowner is harmed.[176]

"Critical area" and "comprehensive" permit statutes address the shortcomings of the common law doctrines in the prevention of overdraft and allocation during drought conditions. During temporary drought shortages, the statutes authorize the permit agency to undertake emergency measures. Typically, the state administrator has broad discretion to apportion, rotate, limit, or prohibit water uses based on a classification of uses rather than on the basis of priority in time.[177] To prevent overdraft, the state is authorized to limit existing uses and to prohibit new wells.[178]

Permit systems improve upon the correlative rights doctrine in three ways.[179] First, the state can take measures to address potential overdraft before the condition occurs, in contrast to the post-overdraft litigation process under the correlative rights doctrine. Second, the state can regulate all the users of a particular groundwater basin, in contrast to the court's limited jurisdiction over the parties of the suit. Finally, expert hydrologists or engineers make the decisions, rather than a judge with no background in hydrogeology.

Unlike the common law doctrines, the prior appropriation doctrine allocates a fixed quantity of groundwater.[180] During shortages caused by drought or over-

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[173] *See supra* note 100.

[174] *See, e.g.*, City of Pasadena v. City of Alhambra, 33 Cal. 2d 908, 207 P.2d 17 (1948) (all pumpers required to reduce pumping proportionately so that only the safe yield withdrawn from the basin), *cert. denied*, 339 U.S. 937 (1950) (*Pasadena* overruled in Los Angeles v. San Fernando, 14 Cal. 3d 199, 537 P.2d 1250, 123 Cal. Rptr. 1 (1975)).

[175] *See supra* note 100 and accompanying text.

[176] *See supra* note 99 and accompanying text.

[177] *See, e.g.*, HAWAII REV. STAT. §§ 177-33, -34 (1976); MODEL WATER CODE, *supra* note 60, at § 2.09. *But see Wise Administrator*, *supra* note 67, at 216 (criticizes the breadth of administrative discretion without more specific guidelines).

[178] *See, e.g.*, HAWAII REV. STAT. § 177-22 (1976 & Supp. 1984); MODEL WATER CODE, *supra* note 60, at §§ 2.02 & 1.07(6). Statutes that deny permission to drill a well in order to prevent overdraft have been upheld. *See, e.g.*, Cherry v. Steiner, 543 F. Supp. 1270, 1277-78 (D. Ariz. 1982), *aff'd*, 716 F.2d 687 (9th Cir. 1983), *cert. denied*, 466 U.S. 931 (1984); Southwest Eng'g Co. v. Ernst, 79 Ariz. 403, 291 P.2d 764 (1955); F. Arthur Stone & Sons v. Gibson, 230 Kan. 224, 630 P.2d 1164 (1981).

[179] *See* MODEL WATER CODE, *supra* note 60, at 78-79.

[180] *See supra* note 105.

draft, the groundwater is allocated according to seniority.[181] Junior users must cease pumping to allow the senior users to receive their full allocation. Wasteful practices are prohibited by conditioning the groundwater right upon using the water for a "beneficial" use.[182]

3. *Rights and Liabilities of Groundwater Users*

a. *Groundwater User vs. Groundwater User*

Under the absolute ownership doctrine, a landowner is not liable for well interference.[183] Conversely, a landowner has no protections from lower water levels resulting from well interference.[184]

Under the reasonable use and correlative rights doctrines, liability depends on whether the user is an overlying landowner or a transporter to non-overlying lands.[185] Both doctrines protect an overlying owner against a transporter.[186] In conflicts between two transporters, the remedies differ. Under the reasonable use doctrine, courts allow the biggest pump to prevail.[187] Under the correlative rights doctrine, as applied in California, the courts protect the prior appropriator.[188] In conflicts involving two overlying landowners, the law is unclear. Using the test of "reasonableness," a few courts have exercised their equity powers to apportion the costs among the competing well owners.[189]

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[181] *See supra* note 104.

[182] *See supra* note 102.

[183] *See supra* note 96 and accompanying text.

[184] [The absolute doctrine's] distinctive feature is the proposition that no property rights exist in such water except while they remain in the soil of the landowner; that he has no right either to have them continue to pass into his land, as they would under natural conditions, or to prevent them from being drawn out of his land by an interference with natural conditions on neighboring land. Such right as he has is therefore one which he cannot protect or enforce by a resort to legal means, and one which he cannot depend on to continue permanently or for any definite period.

Katz v. Walkinshaw, 141 Cal. 116, 133, 74 P. 766, 771 (1903).

[185] *See* Hanks & Hanks, *supra* note 89, at 640.

[186] *See, e.g.*, Katz v. Walkinshaw, 141 Cal. at 133, 74 P. at 771 (correlative rights doctrine); Forbell v. City of New York, 164 N.Y. 522, 58 N.E. 644 (1900) (reasonable use doctrine).

[187] Merrick Water Co. v. City of Brooklyn, 32 A.D. 454, 53 N.Y.S. 10 (1898), *aff'd mem.*, 160 N.Y. 657, 55 N.E. 1097 (1899). Both plaintiff and defendant sold water for use off the overlying land. The court stated, "If one gets more than the other, we think there can be no more ground of complaint than would exist if both sought to improve their own land and one secured more than the other, or one was damaged and the other was not." 32 A.D. at 456, 53 N.Y.S. at 12.

[188] Katz v. Walkinshaw, 141 Cal. at 133, 74 P. at 771.

[189] For correlative rights doctrine, see, e.g., City of Lodi v. East Bay Mun. Util. Dist., 7 Cal. 2d 316, 60 P.2d 439 (1936); Burr v. Maclay Rancho Water Co., 154 Cal. 428, 98 P. 260

Under the prior appropriation doctrine, early court decisions held the junior well owner liable for any interference with a senior well owner, suggesting that the senior user's means of diversion—that is, the depth of the well and the size of the pump—was a property right.[190] Thus, a senior owner of a shallow well could prevent the use of groundwater by a junior well owner even if adequate quantities of groundwater were available at greater depths. Some courts limited this protection to "preferred" uses, as defined by statute.[191] In either case, the prior or preferred appropriator enjoyed an absolute right to the historical means of diversion without regard to its reasonableness.

Recognizing that an absolute property right in the means of diversion is contrary to the policy of maximum beneficial use of groundwater, courts today protect a senior owner's right only to the extent the senior owner maintained reasonable pumping depths.[192] In economic terms, this means the senior owner pays the costs to deepen his well up to the reasonable diversion depth,[193] and

(1908). For reasonable use doctrine, see, e.g., MacArtor v. Graylyn Crest III Swim Club, Inc., 41 Del. Ch. 26, 187 A.2d 417 (1963). For a discussion on the "reasonableness" test, see *infra* note 193.

[190] *See, e.g.*, Pima Farms v. Procter, 30 Ariz. 96, 245 P. 369 (1926) (Arizona abandoned the property approach in favor of the rule of reasonable diversion in Bristor v. Cheatham, 75 Ariz. 227, 155 P.2d 173 (1953)); Hehl v. Hubbell, 132 Colo. 96, 285 P.2d 593 (1955) (Colorado has since adopted the economic reach rule in City of Colorado Springs v. Bender, 148 Colo. 458, 366 P.2d 552 (1961)); Noh v. Stoner, 53 Idaho 651, 26 P.2d 1112 (1933) (*Noh* overruled in Baker v. Ore-Ida Foods, Inc., 95 Idaho 575, 513 P.2d 627 (1973) (adoption of reasonable diversion rule)); Current Creek Irrigation Co. v. Andrews, 9 Utah 2d 324, 344 P.2d 528 (1959) (construing UTAH CODE ANN. § 73-3-23 (1953) (*Current Creek* overruled in Wayman v. Murray City Corp., 23 Utah 2d 97, 458 P.2d 861 (1969)).

[191] *See, e.g.*, Prather v. Eisenmann, 200 Neb. 1, 261 N.W.2d 766 (1978) (construing NEB. REV. STAT. § 46-613 (R.R.S. 1943)). *See generally* Comment, *Protection Unlimited: A Preferred User's Right to Means of Groundwater Diversion in Nebraska*, 62 NEB. L. REV. 270 (1983).

[192] *See, e.g.*, Baker v. Ore-Ida Foods, Inc., 95 Idaho 575, 584, 513 P.2d 627, 636 (1973) (Holders of senior appropriative rights may occasionally be forced to "accept some modifications in their rights in order to achieve the goal of full economic deelopment."); Wayman v. Murray City Corp., 23 Utah 2d 97, 458 P.2d 861 (1969) (Although a conflict existed between the policy to maximize benefits of water usage and the vested right of a prior appropriator, the court balanced the competing interests in a manner best suited to the development of the state's water law.).

[193] Courts developed four alternative tests to determine the reasonable diversion depth. The "economic reach" test weighs the financial resources of the respective parties. The more the junior party is financially able to bear the costs, the greater the proportion of the costs a court allocates to the junior party. The outcome of the economic reach test may hinge on such arbitrary factors as the capital reserves or choice of bookkeeping system of the well owners. *See, e.g.*, City of Colorado Springs v. Bender, 148 Colo. 458, 366 P.2d 552 (1961).

Two more objective tests are (1) splitting the increased diversion costs equally among those affected, *see, e.g.*, MacArtor v. Graylyn Crest III Swim Club, Inc., 41 Del. Ch. 26, 187 A.2d 417 (1963), and (2) setting a water level in the aquifer at some point above the sustainable yield, *see, e.g.*, Current Creek Irrigation Co. v. Andrews, 9 Utah 2d 324, 344 P.2d 528 (1959) (Crockett,

the junior owner pays for any additional cost beyond the reasonable pumping depth necessary to restore water to the senior owner. If the senior owner's pumping depth is reasonable, the junior well owner shoulders the entire cost of restoring water to the senior.

Instead of relying entirely on courts to resolve well-interference conflicts, some states prevent such conflicts through well-drilling statutes.[194] There are basically two statutory approaches to well-interference minimization. The simpler approach imposes minimum distance requirements between wells.[195] This approach is unsatisfactory since localized geological conditions are not taken into account. Moreover, certain landowners may be completely precluded from drilling a well if the statutory spacing requirements exceed the dimensions of the lot.

A more favorable approach incorporates the reasonable diversion doctrine.[196] The applicant first conducts a well-interference analysis. Upon a finding of probable interference, the administrator makes a finding on the reasonableness of the existing well owner's means of diversion. If the means of diversion is reasonable, the administrator may deny the application or conditionally approve the junior owner's application by limiting the depth of the well, size of the pump, or the permissible amount of water that may be withdrawn. If the means of diversion is not reasonable, then the administrator approves the application and prohibits the senior owner from enjoining the junior owner unless the senior owner im-

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J., dissenting).

A fourth test is the approach of the RESTATEMENT (SECOND) OF TORTS § 850A(c)-(i) (1979). The Restatement (Second) of Torts integrates the other three tests by including them in a list of several factors that a court should consider in balancing the equities on a case-by-case basis. These factors include purpose of the use; economic value; social value; extent and amount of harm caused; practicality of avoiding the harm; practicality of adjusting the quantity of water used by each user; protection of existing values of water uses, land, investments, and enterprises; and justice of requiring the user causing harm to bear the loss. *See generally Protection Unlimited, supra* note 191.

[194] *Protection Unlimited, supra* note 191, at 302 n.225 (citing COLO. REV. STAT. § 37-90-137 (Supp. 1979); MONT. CODE ANN. § 89-2918 (1977); NEV. REV. STAT. § 534.110(7) (1979); N.M. STAT. ANN. § 72-12-3(E) (1978); OR. REV. STAT. §§ 537.620(3), .620(4), .622 (1981); WASH. REV. CODE ANN. §§ 90.44.030, .040, .090 (1962); WYO. STAT. § 41-3-932(c) (1977)). Hawaii also has a well-interference provision. HAWAII REV. STAT. § 177-25(2) (1976). *See infra* notes 258-59 and accompanying text.

[195] Burke & Kulasza, *supra* note 116, at 1380 (citing COLO. REV. STAT. § 37-90-137(2) (1973) (minimum distance of 600 feet apart); NEB. REV. STAT. §§ 46-609, -651 (1978) (distinguishes between small wells, which may be located 600 feet apart, and large wells, which must be located 1000 feet apart)).

[196] *Protection Unlimited, supra* note 191, at 303 n.226 (citing IDAHO CODE § 42-226 (1977); NEV. REV. STAT. § 534.110(3)-(4) (1979); S.D. CODIFIED LAWS ANN. § 46-6-6.1 (Supp. 1982) (exempts low-capacity wells from potentially expensive analytical requirements); WASH. REV. CODE ANN. § 90.44.070 (1962); WYO. STAT. § 41-3-933 (1977)).

proves his well to a reasonable depth.

b. Groundwater User vs. Surface Water User

Under common law, a groundwater user would be liable to a surface water user only if the court found the groundwater to be an "underground stream" that flowed into the surface stream. The extent of the groundwater user's liability would depend on surface water law.[197] For example, under riparian surface water law, the groundwater user would be limited to an amount necessary for a "reasonable use." Under prior appropriation surface water law, the groundwater user would be enjoined from further use if the groundwater right was junior in time to the surface water right.

Because early courts considered percolating groundwater as part of the land rather than as part of an interconnected hydrological system,[198] a user of percolating groundwater was not liable for any interference with surface water rights.[199] More recently, courts have recognized the interrelation between groundwater and surface water without resorting to the fiction of an underground stream.[200]

Courts in prior appropriation states have also faced difficulties integrating groundwater and surface water rights.[201] If the courts adhere to a strict seniority

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[197] *See* Pima Farms Co. v. Proctor, 30 Ariz. 96, 245 P. 369 (1926); Verdugo Canyon Water Co. v. Verdugo, 152 Cal. 655, 93 P. 1021 (1908). *See also supra* note 90.

[198] *See supra* note 95.

[199] *See, e.g.*, Pecos County Water Control & Improvement Dist. v. Williams, 271 S.W.2d 503 (Tex. Civ. App. 1954) (court allowed landowner to drill wells and tap the source of large springs that supplied several ninety-year-old surface water appropriations).

[200] City of Los Angeles v. Hunter, 156 Cal. 603, 105 P. 755 (1909), exemplifies the "fiction" of an underground stream.

> [T]he court had a case involving the San Fernando Valley where farmers were pumping so much that they threatened to destroy the Los Angeles River, which was wholly owned by the city under its "pueblo rights." The groundwater had no bed and banks—it lay in a basin covering the whole valley floor. By use of an outrageous fiction—that the groundwater beneath the San Fernando Valley was an "underground lake"—the percolating property of the valley residents became the legal as well as the factual source of the Los Angeles River. The court's hydrologic theories were laughable; its water law destroyed all distinctions between percolating water and underground streams, but the result was the one it desired.

Conjunctive Use, *supra* note 53, at 1856-57.

The California court later abandoned the fiction and simply held that percolating groundwater that fed a stream was part of the stream. Hudson v. Dailey, 156 Cal. 617, 105 P. 748 (1909). *See also* Reppun v. Board of Water Supply, 65 Hawaii 531, 656 P.2d 57 (1982) (discussed *infra* at notes 263-67 and accompanying text).

[201] *See generally Conjunctive Use*, *supra* note 53; Haase, *supra* note 76; Harrison & Sandstrom, *The Groundwater-Surface Water Conflict and Recent Colorado Water Legislation*, 43 U. COLO. L.

system, then surface water rights will usually have priority over groundwater rights. This creates a dilemma between the policy to protect vested rights and the policy to promote maximum beneficial use of the total water resource.[202]

Three methods have been developed, primarily by the Colorado legislature,[203] to resolve this dilemma. These methods differ in cost allocation between the vested surface water right user and the junior groundwater right user.

(1) Requiring the surface water user to follow the source. Under this method, the surface water user has a right both to the surface water and to the groundwater.[204] Therefore, if the surface water flow is reduced by a junior groundwater user, the surface water user is obliged to "follow the source" and develop his own wells to tap the groundwater that flows toward the stream. The senior surface water user, therefore, shoulders the cost to restore the reduced flow.

(2) Providing substituted water sources. Under this method, the junior groundwater user compensates the senior surface water user by providing water from a substituted source.[205] The senior surface water user is obliged to accept the substituted source if the quantity and quality of the water meet the senior user's requirements. The water quality of the substituted supply need only be appropriate for the senior owner's use and not necessarily of comparable quality to his historical water supply. This method allocates the cost of restoring the senior user's surface flow to the junior groundwater user.

(3) Developing augmentation plans. An augmentation plan is a detailed program, usually on a regional scale, that utilizes a combination of devices to maxi-

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REV. 1 (1971); Hillhouse, *supra* note 53.

[202] *See, e.g.*, Fellhauer v. People, 167 Colo. 320, 447 P.2d 986 (1968):

> These decisions are concerned primarily with the respective priorities of *vested rights* which have been established. It is implicit in these constitutional provisions that, along with *vested rights*, there shall be *maximum utilization* of the water of this state. As administration of water approaches its second century the curtain is opening upon the new drama of *maximum utilization* and how constitutionally that doctrine can be integrated into the law of *vested rights*. We have known for a long time that the doctrine was lurking in the backstage shadows as a result of the accepted, though oft violated, principle that the right to water does not give the right to waste it.

Id. at 335-36, 447 P.2d at 993 (emphasis in original).

[203] COLO. REV. STAT. §§ 37-92-102 et seq. (1973 & Supp. 1985).

[204] Colorado has the only statute that expressly recognizes one water right to both surface and groundwater sources. COLO. REV. STAT. § 37-92-102(2)(c) (1973) (water right determination and administration). New Mexico judicially recognized this common right to both sources in Templeton v. Pecos Valley Artesian Conservancy Dist., 65 N.M. 59, 332 P.2d 465 (1958). *See Conjunctive Use*, *supra* note 53, at 1862; Hillhouse, *supra* note 53, at 707-09.

[205] Examples of substituted sources include by-passing some of the pumped groundwater into the stream that supplies the surface water user, constructing reservoirs, importing water from other areas, or even transporting treated wastewater to the senior user's place of use. *See Conjunctive Use*, *supra* note 53, at 1863-66; Hillhouse, *supra* note 53, at 709-10.

mize beneficial use of the water resources.[206] Because of its complexity and broad-ranging effect, the state engineer must initially approve the plan, with final review and approval by the court.[207]

c. *Groundwater User vs. Overlying Landowner*

Conflicts arise between a groundwater user and an overlying landowner when groundwater withdrawal causes subsidence.[208] On one hand, a landowner has the right to use the groundwater underlying the property. On the other hand, the damaged landowner has the property right to subjacent support and also a right in tort law to be protected from the negligent acts of others.[209]

Early court decisions under the absolute ownership doctrine recognized the landowner's unlimited right to withdraw groundwater, and thereby allowed no cause of action for subsidence.[210] This immunity from liability, however, has been modified and courts now recognize a cause of action founded on negligence.[211] The Restatement (Second) of Torts extends even more protection to the overlying landowner. Rather than requiring proof of negligence, the Restatement extends strict liability for subsidence damage caused by groundwater removal.[212]

The preceding overview of the development of groundwater law forms the backdrop for an examination of the status of groundwater law in Hawaii and the need for change.

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[206] COLO. REV. STAT. § 37-92-103(9) (1973 & Supp. 1985) (upheld in Cache la Poudre Water Users Ass'n v. Glacier View Meadows, 191 Colo. 53, 550 P.2d 288 (1976) (A real estate developer proposed to drill wells to supply a residential subdivision. The wells would have depleted a surface water supply. The court upheld the real estate developer's plan to supply surface users with alternative sources, and denied surface water users' challenge that the augmentation plan was a taking of a property right.)). For a discussion of alternative management techniques, see Harrison & Sandstrom, *supra* note 201, at 137-48. These techniques include developing new sources, pooling water resources, exchanging water sources, and providing substitute water supplies. *See also Conjunctive Use*, *supra* note 53, at 1865-66; Hillhouse, *supra* note 53, at 710-12, 718-20.

[207] COLO. REV. STAT. § 37-92-304 (1973 & Supp. 1985). *See* Weibert v. Rothe Bros., 200 Colo. 310, 618 P.2d 1367 (1980) (court reversed too-hasty approval of plan by the water judge for lack of proof that adequate amounts of replacement water would be provided at the needed times).

[208] *See supra* note 54 and accompanying text.

[209] For a discussion of liability based on property law, see Muskatell v. City of Seattle, 10 Wash. 2d 221, 116 P.2d 363 (1941). For a discussion of liability based on negligence, see Garner v. Town of Milton, 346 Mass. 617, 195 N.E.2d 65 (1964). *See generally* Morris, *Subsidence: An Emerging Area of the Law*, 22 ARIZ. L. REV. 891 (1981).

[210] *See, e.g.*, Acton v. Blundell, 152 Eng. Rep. 1223 (Ex. Ch. 1843).

[211] *See, e.g.*, Friendswood Dev. Co. v. Smith-Southwest Indus., 576 S.W.2d 21 (Tex. 1978).

[212] RESTATEMENT (SECOND) OF TORTS § 818 (1979).

IV. STATUS OF GROUNDWATER LAW IN HAWAII

Groundwater law has not received as much attention in Hawaii as it has on the mainland. Groundwater's relative abundance in the past and the willingness of major groundwater users to resolve conflicts among themselves rather than litigate obviated legislative or judical refinements in the law. Today, there are over 2600 wells or tunnels statewide that withdraw about 280,000 million gallons of groundwater per year for agricultural, domestic, and industrial uses.[213] Intensified conflicts are imminent.

A. *History of Groundwater Management In Hawaii*

Regulation of wasteful practices began in Hawaii as early as 1884.[214] Originally, the law regulated only artesian wells. The legislature amended the law in 1970 to apply to all wells.[215] The legislature first attempted to limit withdrawals from an area threatened by overdraft in 1927.[216] In 1930, the Territory of Hawaii Supreme Court struck down the first attempt to regulate groundwater withdrawals as an unconstitutional "taking" of private property in *City Mill v. Honolulu Sewer and Water Commission.*[217]

Faced with increasing threats of overdraft, the legislature passed a "critical area" statute in 1959.[218] The 1959 act differed from the unconstitutional 1929 act in two ways. First, the legislature limited the applicability of the permit system to "critical areas," as determined through clear statutory criteria and

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[213] R. NAKAHARA, WATER USE IN HAWAII: 1980 (U.S.G.S. Rep. No. R71, 1984).

[214] REV. LAWS HAWAII ch. 269 (1915). The history of Hawaii's water law is summarized in Chang, *Management and Control of Oahu's Groundwater Resources*, in GROUNDWATER IN HAWAI'I: A CENTURY OF PROGRESS 31-50 (F. Fujimura & W. Chang eds. 1981).

[215] Act Relating to Artesian Wells, ch. 123, 1970 Hawaii Sess. Laws 239 (codified as HAWAII REV. STAT. ch. 178 (1976)).

[216] Permit for new wells. From and after the passage of this Act, it shall be unlawful for any person to sink, bore, drill or drive any new artesian well in said district of Honolulu, or to reopen any artesian well which has been unused for two years or more, except under and pursuant to the terms and conditions of a permit therefor from the commission. . . . If, in the opinion of the commission, the proposed work would threaten the safety of the water of the artesian area or basin which would be drawn upon by such well, by lowering its level or increasing the salt content of any existing well or wells, the application therefor may be denied. . . .

Act to Provide Proper Conservation, Development, Use and Control of Water Resources Available for District of Honolulu, ch. 222, 1927 Hawaii Sess. Laws 27.

[217] 30 Hawaii 912 (1930).

[218] HAWAII REV. STAT. §§ 177-1 to -35 (1976) (originally enacted as Ground Water Use Act of 1959, ch. 274, 1959 Hawaii Sess. Laws 303; completely reenacted as Ground Water Use Act, ch. 122, 1961 Hawaii Sess. Laws 135).

public hearings.[219] Second, unlike the 1929 act, existing uses were controlled, not just proposed uses.[220]

The state did not designate the first "critical area" until 1979, after a prolonged drought and recommendations by a governor-appointed Hawaii Water Commission.[221] Today, nearly half of the island of Oahu is designated as a critical area. Other parts of the state are under consideration for designation.[222]

In 1978, Hawaii voters ratified a constitutional amendment that obligates the state "to protect, control and regulate the use of Hawaii's water resources for the benefit of the people."[223] The amendment also mandates the legislature to establish a water resources agency which will be responsible for setting overall water policies.

In 1982, the legislature established the Advisory Study Commission on Water Resources to draft a state water code.[224] The commission presented the draft code to the legislature in 1985. The 1985 Hawaii Senate passed the water code bill, but the bill never emerged from committee in the House.[225] Pres-

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[219] HAWAII REV. STAT. § 177-5 (1976).

[220] *Id.* § 177-16.

[221] STATE WATER COMMISSION, HAWAII'S WATER RESOURCES: DIRECTIONS FOR THE FUTURE (1979).

[222] Designated critical areas on Oahu include the Pearl Harbor, Wahiawa, and Waialua groundwater basins. Other areas under consideration include Kahuku (Oahu); Lahaina, Waiehu, Wailuku (Maui); Poipu, Kekaha (Kauai). STATE WATER RESOURCES DEVELOPMENT PLAN, *supra* note 82, at 48.

[223] The State has an obligation to protect, control and regulate the use of Hawaii's water resources for the benefit of its people.

> The legislature shall provide for a water resources agency which, as provided by law, shall set overall water conservation, quality and use policies; define beneficial and reasonable uses; protect ground and surface water resources, watersheds and natural stream environments; establish criteria for water use priorities while assuring appurtenant rights and existing correlative and riparian uses and establish procedures for regulating all uses of Hawaii's water resources.

HAWAII CONST. art. XI, § 7 ("Water Resources").

[224] Act Relating to a Water Commission and Formulation of a State Water Code, ch. 170, 1982 Hawaii Sess. Laws 290. The Advisory Study Commission consisted of the directors of various state departments, the chief executive of each county board or department of water supply, and five appointees of the President of the Hawaii Senate and of the Speaker of the Hawaii House of Representatives. The appointees of the president and the speaker include two members of the general public, one representative of major water users, one member of the Hawaii Farm Bureau Federation, and one representative of major landowners. *Id.*

[225] ADVISORY STUDY COMMISSION ON WATER RESOURCES, REPORT TO THE THIRTEENTH HAWAII LEG. (1985). The commission proposed a comprehensive permit system based on the Model Water Code. The draft water code S.B. No. 564 was in the 1985 Hawaii Legislature. *See* 1985 SEN. J. 941. The Senate Economic Development Committee amended the bill to apply only to "critical areas" and reported the bill out of committee as SEN. STAND. COMM. REP. No. 228, 13th Hawaii Leg., Reg. Sess., 1985 SEN. J. 218. Subsequently, the bill passed out of the Senate Ways

ently, the commission and the legislature are preparing alternative drafts.

B. *Analysis of Hawaii's Groundwater Laws*

1. *Acquisition and Transfer of Groundwater Rights*

Uncertainty pervades Hawaii's groundwater law. In the only definitive statement regarding acquisition and transfer of groundwater rights, the Territory of Hawaii Supreme Court, in *City Mill*, adopted the correlative rights doctrine.[226] The court, however, limited its holding to artesian groundwater.[227] Although the court's rationale in *City Mill* could be extended to non-artesian groundwater,[228] no case law or statute has directly addressed the point.

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and Means Committee with additional amendments. SEN. STAND. COMM. REP. No. 656, 13th Hawaii Leg., Reg. Sess., 1985 SEN. J. 389. The bill crossed over to the House, but never emerged from the House Committee on Water, Land Use Development and Hawaiian Affairs. *See* 1985 HOUSE J. 443.

[226] If a person or other entity should purchase all of a large tract of land under which an artesian basin exists, it would be easy to take the view, we think, that that owner of the land would be the sole owner of the water underneath it. If two persons or other entities should purchase each a half of that tract it would seem to be equally fair and rational to regard the two owners of the land as owners in equal shares of all of the waters. Why not, upon the same reasoning, regard all the owners of all of the many portions of such an area as co-owners of the waters of the basin? We think that they should be so regarded and that this is the view that most nearly effectuates justice and coincides with early concepts of the law as to the ownership of the soil and all within it. Their rights are correlative.

City Mill, 30 Hawaii at 924-25.

Several other early cases involving groundwater related to what water passed with a lease and did not address the nature of the property right in groundwater. *See* Richards v. Ontai, 20 Hawaii 335, 340-42 (1910); Richards v. Ontai, 19 Hawaii 451, 453-54 (1909) (These two cases between the same parties litigated the measure of water granted by lease and the method by which water should be furnished to the lessor.); *see also* Tsunoda v. Young Sun Kow, 23 Hawaii 660 (1917) (question of whether the surplus water from an artesian well passed by a lease of the land on which the well was located; the decision turned on the construction of the lease in light of the intent of the parties); HUTCHINS I, *supra* note 1, at 178. Other early cases addressed "underground streams," *see infra* note 229, and one case commented on tunnel water, Hawaiian Commercial & Sugar Co. v. Wailuku Sugar Co., 15 Hawaii 675, 680, 691-92 (1904) (ownership of tunnel water developed on respondent's land not contested; court acknowledged ownership) (dicta).

[227] In our opinion section 5 of Act 222, L. 1927, in so far as it seeks to authorize the Honolulu sewer and water commission to wholly deprive any co-owner of the waters of the basin under consideration, without due compensation, of his share in the *artesian* waters of that basin, violates the provisions of the Constitution and is invalid.

City Mill, 30 Hawaii at 947 (emphasis added).

[228] While it is true that the court was considering only artesian water, the court quoted, with approval, language from water law authorities and from the cases which would support the view that in Hawaii correlative rights exist between the adjoining or neighboring

The correlative rights doctrine applies to "percolating" groundwater. Early Hawaii court decisions recognized "underground streams" but never articulated the rules for this type of groundwater; several litigants tried unsuccessfully to prove that groundwater flowed in a known and defined channel.[229]

In short, Hawaii's law classifies groundwater into three categories—artesian percolating groundwater, non-artesian percolating groundwater, and underground streams. The rules for non-artesian groundwater and underground streams are unclear or nonexistent.

To create further uncertainty, a recent surface water case, *McBryde v. Robinson*,[230] muddled the current validity of the *City Mill* holding. In *McBryde*, the Hawaii Supreme Court declared all surface waters to be the property of the state.[231] This decision overruled a line of pre-statehood cases that found surface water rights to be privately owned. These early cases, according to the *McBryde* court, erroneously interpreted certain key statutes that governed the transfer of

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> owners of land in underground percolating water as well as in artesian basins; in other words, that the doctrine of correlative rights will not be given a restricted application to artesian water only.

Cades, *Hawaiian System of Water Rights*, 59 J. AM. WATER WORKS A. 925, 925 (1967).

[229] Palolo Land & Improvement Co. v. Territory, 18 Hawaii 30 (1906) (court rejected contention that flow that disappeared in a stream on higher lands fed a lower spring; no proof that the water flowed in a definite underground stream); Wong Leong v. Irwin, 10 Hawaii 265, 270 (1896) (court rejected contention that seepage from taro irrigation fed a spring since it could not be proven that the water flowed in an underground stream); Davis v. Afong, 5 Hawaii 216, 222-24 (1884) (involved the rights to water flowing from a spring into an irrigation ditch; no known and defined underground stream was found). *See* HUTCHINS I, *supra* note 1, at 166-71.

[230] McBryde Sugar Co. v. Robinson, 54 Hawaii 174, 504 P.2d 1330.

[231] The *McBryde* opinion was not clear regarding whether state ownership was in a proprietary sense (*res publicae*) or in the public trust (*publici juris*). The Hawaii Supreme Court later clarified, in response to certified questions from the Ninth Circuit Court of Appeals, that it meant public trust.

> The *McBryde* opinion, however, did not supplant the konohikis with the State as the owner of surplus waters in the sense that the State is now free to do as it pleases with the waters of our lands. In *McBryde*, *supra* we indeed held that at the time of the introduction of fee simple ownership to these islands the king reserved the ownership of all surface waters. 54 Haw. at 187, 504 P.2d at 1339. But we believe that by this reservation, a public trust was imposed upon all the waters of the kingdom. That is, we find the public interest in the waters of the kingdom was understood to necessitate a retention of authority and the imposition of a concomitant duty to maintain the purity and flow of our waters for future generations and to assure that the waters of our land are put to reasonable and beneficial uses. This is not ownership in the corporeal sense where the State may do with the property as it pleases; rather, we comprehend the nature of the State's ownership as a retention of such authority to assure the continued existence and beneficial application of the resource for the common good.

Robinson v. Ariyoshi, 65 Hawaii 641, 673-74, 658 P.2d 287, 310 (1982) (certified questions from the United States Court of Appeals for the Ninth Circuit).

land and water rights from the Hawaiian king to the chiefs and commoners.[232]

There is a convincing argument that all groundwater should also be declared the property of the state. It appears that the *City Mill* court erred in its reasoning. In holding that artesian groundwater rights were privately owned by the landowner, the court reasoned that groundwater was not expressly reserved to the Hawaiian government when land titles passed from the King to private hands (the Great Mahele).[233] The language of the Great Mahele expressly reserved other subsurface resources, such as minerals and metallic mines. The reasoning of the *City Mill* court overlooked a crucial fact—no one knew that groundwater existed at the time of the transfer.[234] If the existence of groundwater had been known, arguably it would either have been expressly reserved to the state or at least incorporated in the same statutes interpreted in the *McBryde* decision.

The *City Mill* decision persists as law. If the legislature or the judiciary change the law, the new law would probably not apply to landowners whose groundwater rights have vested.[235] There are no definitive tests to determine

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[232] Principles Adopted by the Board of Commissioners to Quiet Land Titles, in Their Adjudication of Claims Presented to Them, ch. 1847, 1846 Hawaii Sess. Laws 85, *reprinted in* 2 REV. LAWS HAWAII §§ 2120-52 (1925), *also reprinted in* THE FUNDAMENTAL LAW OF HAWAII 140 (L. Thurston ed. 1904). These principles limited the number of rights the King of Hawaii could surrender in the Great Mahele. One of the rights not surrendered included the "usufruct of lands for the common good." Construing this language, the Hawaii Supreme Court in *McBryde* found that "the right to water is one of the most important usufruct of lands." 54 Hawaii at 186, 504 P.2d at 1338.

[233] While the Territory of Hawaii, in so far [sic] as it may be the owner of any piece or pieces of land over an artesian basin, has the same rights in the artesian waters which a private owner of the same pieces of land would have, no reason occurs to us which would sustain the view that the Territory is, or that its predecessors were, the owners of all artesian waters in the Territory. Prior to 1845 the King was the sole owner, because he was the owner of all of the land in the islands under the system and conceptions then prevailing. When in the late [18]40's and thereafter the system was voluntarily abandoned by the King and was radically changed and land tenures became vested in individuals, the ownership of the subterranean waters which were a part of land passed, as a part of the lands themselves, from the King to the individuals. With the issuance of land commissions awards, confirmed thereafter by royal patents, the ownership of the King ceased and the ownership of individuals began. *In the transaction "all mineral or metallic mines" were reserved to the Hawaiian government, but there was no reservation whatever of the subterranean waters.* If the doctrine of correlative rights is the correct one, as we think it is, it has been so since the establishment of titles in individuals and that conception of the law cannot now be altered simply because there is danger, if there is, of the salt content of the artesian basins being increased to the degree that the waters will not be potable.

City Mill, 30 Hawaii at 934 (emphasis added).

[234] Groundwater was discovered in Hawaii in 1879, *see supra* note 8, over 30 years after the Great Mahele of 1848.

[235] The parties concede that the State of Hawaii has the sovereign power to change its laws

what constitutes a vested right. Courts could find that no vested rights exist for groundwater since Hawaii law has always been uncertain.[236] Landowners overlying artesian groundwater would have the best claim for vested rights. Even then the result could depend on whether the groundwater was actually used for a beneficial purpose prior to the new law; landowners who had not drilled or whose use was not considered "beneficial" would not possess a vested right.[237] Landowners overlying non-artesian groundwater or "underground streams" would have a tenuous vested rights claim since no prior law directly addressed such rights. The result could depend on the court's willingness to protect investments based upon an estoppel theory, whether it be the state's passive "acceptance" of such investments or some other reason.[238]

The critical area statute creates further uncertainty regarding the acquisition and transfer of groundwater rights in designated critical areas. The source of confusion is the function of the permit. The permit does not create rights in groundwater. Instead, the permit regulates pre-existing groundwater rights established under common law.[239] One major limitation on the common law rights is that the landowner no longer has an automatic right to use the groundwater in designated critical areas. To drill a new well, the landowner must ob-

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from time to time as its legislature may see fit, and may, by changing its laws, radically change the definitions of property rights and the manner in which property rights can be controlled or transferred.

The state may also change its laws by judicial decision as well as by legislative action. Insofar as judicial changes in the law operate prospectively to affect property rights vesting after the law is changed, no specific federal question is presented by the state's choice of implement in changing state law. *See Hughes v. Washington*, 389 U.S. 290, 295 . . . (1967) (Stewart, J., concurring).

. . . New law, however, cannot divest rights that were vested before the court announced the new law. *See Hughes*, 389 U.S. at 295-98.

Robinson v. Ariyoshi, 753 F.2d 1468, 1474 (9th Cir. 1985).

[236] *See, e.g.*, Cherry v. Steiner, 543 F. Supp. 1270, 1277-78 (D. Ariz. 1982), *aff'd*, 716 F.2d 687 (9th Cir. 1983), *cert. denied*, 466 U.S. 931 (1984) (The federal courts rejected the argument that the Arizona Supreme Court destroyed property rights by working an unpredictable change in state law. Since state law had never been clear regarding groundwater ownership, there could be no radical departure from prior law.).

[237] This is the *res nullius* theory of ownership. *See supra* notes 127-28 and accompanying text.

[238] The equitable estoppel and vested rights doctrines are closely related, but distinct doctrines. "Equitable estoppel focuses on whether it would be inequitable to allow the government to repudiate its prior conduct; vested rights focuses on whether a landowner has acquired a real property right which cannot be taken away by subsequent government regulation." Tom, *Development Rights in Hawaii*, 6 U. HAWAII L. REV. 437, 443 (1984). "Estoppel has three basic elements: (1) a showing of good faith; (2) reliance by the property owner on some act or omission of the government; and (3) a substantial change in position as a result of such reliance." *Id.*

In *Robinson*, the Ninth Circuit Court of Appeals seems to have based its opinion on the estoppel doctrine. *See* Robinson v. Ariyoshi, 753 F.2d 1468 (9th Cir. 1985).

[239] *See* 3 HUTCHINS II, *supra* note 1, at 716.

tain a permit.[240] Furthermore, the state may terminate the permit upon certain conditions, including nonuse of the allocated amount, violation of the statute or permit conditions, or the existence of a more "beneficial" use.[241]

An unresolved question is whether a landowner may sell an unexpired permit apart from the sale of the overlying land. *City Mill* could be interpreted to prohibit such transfers of a "critical area" permit apart from the land. First of all, correlative groundwater rights are not severable from the land and cannot be sold without transferring title to the land.[242] Second, even if groundwater rights could be sold apart from the land, the *City Mill* court stated, "when there is not sufficient water for all [i.e., designated critical area], each [overlying landowner] will be limited to a reasonable share of the water."[243] The permit represents an administrative allocation of the landowner's "reasonable share." If the landowner no longer needs the amount allocated such that he would be willing to sell, then that portion subject to sale is no longer "reasonable." Since the landowner has no rights to an unreasonable share, arguably those rights revert to the collective ownership of the overlying landowners for reallocation by the public agency. This line of analysis would prohibit transfer of a permit or of the water itself for profit.[244]

2. *Measure of Groundwater Rights*

Hawaii's groundwater laws limit the amount of groundwater use to prevent overdraft, allocate groundwater during drought shortages, and prevent wasteful practices.

a. *Overdraft Prevention*

The critical area statute addresses overdraft problems. The state may designate "critical areas" those areas already experiencing overdraft problems or threatened by overdraft.[245] Indicators of overdraft problems include withdrawal rates in excess of recharge rates, declining groundwater levels, and increasing salinity.[246]

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[240] HAWAII REV. STAT. §§ 177-15, -19 (1976).

[241] *Id.* § 177-29.

[242] *City Mill*, 30 Hawaii at 934 ("[O]wnership of the subterranean waters which were a part of the land passed, as a part of the lands themselves. . . .").

[243] *Id.* at 923.

[244] For an opposing point of view, see Honolulu Corp. Council, *HECO Waiau Water Tunnel*, (Memo. 83-32) (June 15, 1983) (supporting the sale of the permit apart from the land) (available at City & County of Honolulu Mun. Library).

[245] HAWAII REV. STAT. § 177-5(5) (1976).

[246] *Id.*

The state allocates a fixed amount of groundwater to existing and new users. Existing users are entitled to the amount used for beneficial purposes within five years prior to the effective date of the designation.[247] The allocation to new users depends on whether groundwater is available in excess of the sustainable yield, whether the use is beneficial, and whether the new well will interfere with existing wells.[248] The statute permits transport of groundwater to non-overlying lands; however, special approval is required to supply or sell groundwater to another person.[249]

In non-critical areas, the groundwater right is measured according to the correlative rights doctrine. Accordingly, the landowner is limited to "reasonable uses" and a proportionate share during shortages. Also, the landowner may transport groundwater to non-overlying lands, provided other landowners are not harmed.[250]

b. Allocation During Temporary Drought Shortages

The critical area statute authorizes the state to implement emergency measures during periods of water shortage.[251] The state's emergency power extends to non-designated areas as well as designated critical areas.

The emergency measures include forbidding new uses or modification of existing uses. Furthermore, the state may apportion, limit, or rotate existing uses. The degree of restriction depends on the type of water use and seniority. Domestic, municipal, and military uses have priority over other uses. Within the same class of use, the use initiated prior in time has preference.

In addition to state regulation, the Revised Charter of the City and County of Honolulu authorizes regulation of all wells, including private and federal wells, during shortages.[252] Restrictions become more drastic as the water shortage progresses through three specified levels—caution low water condition, alert low water condition, and critical low water condition. At the first level, the county conducts a public awareness program and appeals for voluntary conservation. At the second level, the county may impose mandatory restrictions, such as limiting the time and quantity of water used for lawn irrigation, upon its own consumers and upon private wells. In addition, the county may establish water allotments to its own consumers and to private wells. At the third level,

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[247] *Id.* § 177-15.
[248] *Id.* § 177-22.
[249] *Id.* § 177-20.
[250] *See supra* note 99 and accompanying text.
[251] HAWAII REV. STAT. § 177-34 (1976).
[252] Board of Water Supply, City & County of Honolulu, Rules & Regulations §§ 3-318 to -322 (1980).

the mandatory use restrictions broaden from lawn and ground cover irrigation to include plant and garden irrigation, washing cars and other vehicles, filling swimming pools and other types of ponds, washing sidewalks and other hard-surfaced areas, operating fountains, and serving water to restaurant customers. In addition, the water allotments to the county's consumers and to private wells decrease. At the third level, the county may also establish special rates and charges to induce its consumers to conserve more water.

c. Wasteful Practices Regulation

The well-drilling statute regulates all types of groundwater development, including wells, tunnels, shafts, and other methods.[253] The statute applies in critical and non-critical areas. Thus, in critical areas, a landowner must obtain both a groundwater use permit and a well-drilling permit.

The City and County of Honolulu also regulates well-drilling.[254] To avoid duplication, the county regulations exempt all existing and new wells in critical areas;[255] the state defers to the county in non-critical areas.[256] Another problem with the county regulations is the county's exclusion of tunnels that tap dike-impounded groundwater,[257] a provision that may be self-serving since the county is the primary developer of this type of groundwater.

3. Rights and Liabilities of Groundwater Users

a. Groundwater User vs. Groundwater User

Under the critical area statute, the state must consider potential well-interference conflicts before granting a groundwater use permit.[258] If there is potential conflict, the state may either deny the permit or issue the permit on the condition the permittee "furnish to the person whose use is interfered with water equal in quantity and comparable in quality to that lost by reason of the

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[253] HAWAII REV. STAT. § 178-1 (1976).

[254] Board of Water Supply, City & County of Honolulu, Rules & Regulations §§ 3-305 to -317 (1980).

[255] *Id.* § 3-323 ("Exemption of Private Wells Within Designated Groundwater Control Areas").

[256] HAWAII REV. STAT. § 178-11 (1976).

[257] "The Manager may exclude high-level tunnels from the provisions of this section if it is specifically determined in each case that wastage of water therefrom cannot be reasonably corrected." Board of Water Supply, City & County of Honolulu, Rules & Regulations § 3-313 (1980). *See supra* notes 35-38 and accompanying text.

[258] HAWAII REV. STAT. § 177-25(2) (1976).

interference."[259]

Since the statute does not consider whether the senior user's means of diversion is reasonable, a senior user's shallow well could prevent the withdrawal of groundwater available at lower depths, or shift to the junior user the full cost of restoring water to the senior. The law in prior appropriation jurisdictions protects a senior user only to the extent the well is a "reasonable diversion."[260]

The aforementioned well-interference restrictions do not apply in non-critical areas since the state's well-drilling statute does not contain any provisions to prevent such conflicts. Controls in non-critical areas, therefore, depend on county regulations. The City and County of Honolulu well-drilling regulation does contain well-interference provisions. This regulation simply authorizes the county to deny the permit if there is potential conflict.[261] Unlike the critical area statute, there is no express provision for conditional approval if the applicant is willing to restore water to the affected owner. Similarly to the critical area statute, the county regulation protects the senior user regardless of whether the senior well is a "reasonable diversion."

b. Groundwater User vs. Surface Water User

In early Hawaii cases, the court did not protect a surface water user from interference unless the groundwater was an "underground stream."[262] Recently, the Hawaii Supreme Court, in *Reppun v. Board of Water Supply*,[263] discarded that antiquated notion and recognized the interrelation between surface water and groundwater, regardless of whether the groundwater flowed in a defined channel or was "percolating."[264]

Reppun involved a conflict between taro farmers, who relied on streamflow to irrigate their crop, and the county water agency, who had tunneled into various dike compartments. As the county increased withdrawal of dike-impounded groundwater, the streamflow diminished. The county, anticipating this impact,

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[259] *Id.* § 177-26.

[260] *See supra* notes 192-93 and accompanying text.

[261] Board of Water Supply, City & County of Honolulu, Rules & Regulations § 3-306(4)(d) (1980).

[262] *See supra* note 229 and accompanying text.

[263] 65 Hawaii 531, 656 P.2d 57 (1982).

[264] We agree that the law must recognize that 'all waters are part of a natural watercourse, whether visible or not, constituting a part of the whole body of moving water.' *City of Colorado Springs v. Bender*, 148 Colo. 458, 461, 366 P.2d 552 (1961). We therefore hold that where surface water and groundwater can be demonstrated to be physically interrelated as parts of a single system, established surface water rights may be protected against diversions that injure those rights, whether the diversion involves surface water or groundwater. *See* Restat. Torts 2d 858.

Id. at 555, 656 P.2d at 73.

had purchased the surface water rights. The taro farmers relied on the *McBryde* decision, which held that riparian landowners were entitled to the "natural flow" of the stream.[265] The court avoided the water sale contracts and upheld the surface water rights.

While *Reppun* is commendable for recognizing the hydrological interconnection between surface and groundwater, in one sense it is inconsistent with the conjunctive use policies being developed in other states.[266] In these states, the surface water user must first "follow the source" of the streamflow by digging his own wells before the groundwater user can be held liable. Alternatively, the groundwater user may supply the surface water user with a substituted water source of appropriate quantity and quality. In *Reppun*, the groundwater user had no right whatsoever to reduce streamflow, even though the groundwater user had purchased the surface water rights.[267]

From another perspective, *Reppun* does not necessarily conflict with the conjunctive use policies; rather, it adds an important limitation. The "substituted source" and "augmentation plan" alternatives would be entirely consistent with Reppun if such measures maintain the streamflow. However, the "follow the source" alternative would not be acceptable since the streamflow would be reduced. The importance of maintaining the streamflow is to protect certain instream values, one of which the court recognized as taro irrigation. Further clarification by statute or case law is necessary to specify other instream values and at what point, if any, it would be acceptable for the groundwater user to reduce streamflow.

c. *Groundwater User vs. Overlying Landowner*

The critical area statute holds the groundwater user strictly liable for subsidence damages.[268] This rule is consistent with the Restatement (Second) of Torts.[269]

In non-critical areas, liability would probably depend on a court's interpretation of the correlative rights doctrine. The court would likely hold the groundwater user liable for negligence. Alternatively, the court could accept the Restatement's imposition of strict liability and thereby establish a uniform rule for critical and non-critical areas.

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[265] *Id.* at 545, 656 P.2d at 72 (court modified the "natural flow" theory in favor of the "reasonable use" theory of the riparian rights doctrine).

[266] *See supra* notes 203-07 and accompanying text.

[267] *See* W. CHANG & J. MONCUR, *Reppun v. Board of Water Supply*: PROPERTY RIGHTS, ECONOMIC EFFICIENCY AND ENSURING MINIMUM STREAMFLOW STANDARDS (Water Resources Research Center, Univ. of Hawaii, Technical Rep. No. 165, 1984).

[268] HAWAII REV. STAT. § 177-31 (1976).

[269] *See supra* note 212 and accompanying text.

The preceding analysis identified some of the gaps and uncertainties in Hawaii's groundwater laws. The current effort to develop a comprehensive water code is a long-awaited opportunity to restructure Hawaii's groundwater laws.

V. Suggested Changes to Hawaii's Groundwater Law

The suggested changes in this section recognize the need to update Hawaii's groundwater laws to comport with modern scientific knowledge, to favor uses that have high and invariant water quality requirements, to balance vested rights principles with a more flexible policy that allows maximum beneficial use of the water resources, to coordinate groundwater laws at various levels of government, and to harmonize groundwater law with other laws, such as land use controls. The three groundwater rights elements—acquisition and transfer, measurement, and rights and liabilities—frame the suggested changes.

A. *Acquisition and Transfer of Groundwater Rights*

The legislature should declare the groundwater in Hawaii to be in the public trust and allocate groundwater rights according to a statewide permit system.

1. *Rationale for the Public Trust Declaration*

The public trust is a form of state ownership. Unlike the *res commune* or *res publicae* forms of state ownership, the state has specific fiduciary duties under the public trust doctrine (*juris publici*).[270]

The public trust doctrine allows the state greater constitutional flexibility to restrict groundwater use and otherwise change groundwater law. Extensive restrictions are necessary since individual private decisionmaking is usually unable to analyze and predict the complex ramifications of groundwater use. The state, which has regional modelling and data collection capabilities, could condition groundwater uses to prevent overdraft and avoid conflicts among groundwater users, surface water users, and overlying landowners. Because knowledge of this complex resource is continually improving, groundwater laws should be mutable to keep pace with the increasing knowledge.

Declaration of the public trust would be easier for groundwater than for surface water. Surface water rights have been extensively litigated in Hawaii, in contrast to the single case relating to groundwater rights. Because of the pervading uncertainty regarding groundwater rights, claims to vested groundwater

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[270] *See supra* notes 127-37 and accompanying text.

rights are tenuous.[271] Hawaii could institute a dual system of water rights—a market system for surface water rights and an administrative system for groundwater rights. Such a system may encourage non-domestic private users to favor surface water sources, thus reserving the high quality groundwater for domestic uses.

2. *Statewide Permit System*

The common law requirements of landownership as a condition to use groundwater should be abandoned. Instead, the permit should be available to anyone able to use the groundwater for a reasonable-beneficial use. The permit should also allow transport to non-overlying lands, in recognition of Hawaii's need to transport water from the wetter windward side of the islands to the drier leeward side.

The state should issue a perpetual permit to each county, and limited-duration permits to other users. The county is the primary supplier of domestic water. Groundwater is the best source for domestic uses; all other water sources, such as streams or desalinization of brackish water, require expensive treatment. Since it is unlikely that the state will ever need to shift the use of groundwater from the county's domestic use to another use, the limited-duration permit does not make sense for the county. In comparison, agricultural uses can tolerate a wide range of water quality. Limited-duration permits issued for agricultural uses enable the state to shift the groundwater use to uses that demand higher water quality.

The perpetual permit issued to the county would also result in a closer coordination of land use and groundwater laws. Under the current critical area permit system, the groundwater use on a particular land parcel in a critical area can change from agricultural use to urban use without the issuance of a groundwater use permit. This "loophole" occurs when the county rezones land from county agricultural district to urban district; the developer is able to hook-up to the county system without drilling a new well.

By issuing a perpetual permit to the county, the county would determine the "highest and best" use for groundwater through land use controls.[272] In evaluating any proposed land use change, the county must ensure that the rezoning conforms to county land use development plans.[273] The development plans project the type of land uses and associated population over the next twenty years.[274] Based on these projections, the county water department projects the

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[271] *See supra* notes 226-38 and accompanying text.

[272] *See generally* D. CALLIES, REGULATING PARADISE: LAND USE CONTROLS IN HAWAII (1984).

[273] *See, e.g.*, HONOLULU, HAWAII, REV. CHARTER § 5-412(3) (1973).

[274] *See, e.g.*, *id.* § 5-409.

amount of water that will be required, where it must be distributed, how many additional new sources need to be developed, and where these sources might be located.[275] Since the county water systems rely primarily on groundwater to serve almost all urban development,[276] the urban designations on the development plan implicitly allocate groundwater to domestic uses.

To ensure that county planners consider the groundwater supply in land use decisions, the water code should require county planners to consult with the state to determine the sustainable yield limits before amending county development plans.[277] The county should also provide incentives to land developers to develop water conservation plans.[278]

Water, however, is just one factor weighed in a land use decision.[279] Even when abundant groundwater is available to accommodate the proposed use, there may be other overriding policies, such as susceptibility to natural hazards,

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[275] *See, e.g.*, BOARD OF WATER SUPPLY, CITY & COUNTY OF HONOLULU, OAHU WATER PLAN (1984).

[276] *See supra* note 83.

[277] The Honolulu charter presently requires planners to consult with the county board of water supply when formulating or amending development plans. HONOLULU, HAWAII, REV. CHARTER § 5-410 (1973). This consultation requirement should be extended to include the state water agency. For a discussion of the coordination of water and land use planning, see generally Ashton & Bayer, *Water Supply and Urban Growth Planning: A Partnership*, 19 WATER RESOURCES BULL. 779 (1983); Hole, *Water Resources and Growth Management in South Florida*, 108 J. WATER RESOURCE PLAN. & MGMT. 286 (1982); Lord, *Municipal Water Supply Restrictions as Urban Growth Constraints*, 19 WATER RESOURCES BULL. 131 (1983); Pizor, Nieswand & Hordon, *A Quantitative Approach to Determining Land Use Densities from Water Supply and Quality*, 18 J. ENVTL. MGMT. 49 (1984); Rea, *Drought in Florida: Nature's Response to "Comprehensive" Planning*, 57 FLA. B.J. 266 (1983); White, *Water As a Tool in Land Use Control: Legal Considerations*, 20 ROCKY MTN. MIN. L. INST. 671 (1975); Wilson, *A Land Use Policy Based on Water Supply*, 19 WATER RESOURCES BULL. 937 (1983).

[278] *See generally* W. SANDERS & C. THUROW, WATER CONSERVATION IN RESIDENTIAL DEVELOPMENT: LAND USE TECHNIQUES (Am. Planning Ass'n, Planning Advisory Serv. Rep. No. 373, 1982) (suggests reducing the size of lawns, landscaping with drought-tolerant plants, and using water-saving devices such as pressurized toilet tanks and flow control devices for faucets and showers).

[279] *See, e.g.*, HAWAII REV. STAT. § 205-17 (Supp. 1984) (decisionmaker must consider factors such as natural habitats, historical resources, agricultural resources, fiscal impact, employment opportunities, housing opportunities). Water has on occassion been the single constraining factor, resulting in development moratoria, e.g., Poipu (Kauai) and Lahaina (Maui). When the proposed development conforms with all requirements, except for inadequate water supplies, the county supplier has a duty to augment its supplies and rescind the moratorium as soon as possible. *See generally* Vranesh, *Water Planning for Municipalities*, 24 ROCKY MTN. MIN. L. INST. 865, 886-89 (1978) (constitutionality of using public utilities to control growth); White, *supra* note 277, at 675-79 (constitutionality of using public utilities to control growth); Note, *The Thirst for Population Control: Water Hookup Moratoria and the Duty to Augment Supply*, 27 HASTINGS L.J. 753 (1976) (If there were no duty to augment supply, water distributors could impose indefinite water hookup moratoria and effectively veto development plans formulated by legislative bodies.).

preservation of prime agricultural land, or excessive costs to provide public facilities and services. In those situations, the land use decisionmaker should deny the development plan amendment or rezoning. This denial in turn implicitly denies the water use permit application depite the fact that the proposed water use may qualify as "reasonable and beneficial" according to water law.

Under the perpetual permit, the county would be subject to the sustainable yield, overdraft, waste, and conflict management powers of the state. However, the county would maintain control over groundwater allocation among competing land uses within the withdrawal limits imposed by the state permit.

B. *Measure of Groundwater Rights*

1. *Overdraft Prevention*

Under the suggested statewide permit system, the state would allocate a fixed quantity of groundwater to all existing and new uses. By subjecting all wells to the permit requirements, rather than just wells in critical areas, the state would have an inventory of all wells; this would simplify monitoring withdrawals and estimating the sustainable yield.

The total allocations within a particular groundwater basin should not exceed the sustainable yield. Since the methodology for determining sustainable yield is still evolving, the permit should clearly set forth the state's power to periodically adjust allocations in order to conform with revised sustainable yield estimates.[280] There should be no vested right in the fixed quantity allocation.[281]

2. *Allocation During Temporary Drought Shortages*

During emergency shortages, personal survival water uses have priority over other uses. Since the county is the primary supplier of domestic water, water levels in the county system should trigger emergency measures.[282] Therefore, the legislature should explicitly delegate authority to the counties to regulate private wells during emergency shortages.

Since the county is both a supplier and a regulator, the county's regulations

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[280] *See, e.g.*, OKLA. STAT. tit. 82, § 1020.6 (Supp. 1985) (The water board may revise maximum annual yield determination; however, this provision is eviscerated by a restriction that prevents the board from decreasing the allocation. If the original estimates of safe yield were too high, the restriction would mean that the basin would be depleted faster than had originally been contemplated.); Jensen, *supra* note 93, at 467.

[281] *See supra* notes 154-55 and accompanying text.

[282] Delegation to the county should be conditioned on the county's capability. The Board of Water Supply, City & County of Honolulu, is highly capable. It has a sophisticated computer system that sounds an alarm when any of its wells drops to a critical level.

could conceivably favor the county's consumers over the private wells. For example, if the county lacks a conservation program, emergency shortages would occur more frequently despite conservation efforts on the part of private well owners. Furthermore, the county's emergency measures could impose stringent restrictions on private non-domestic users while allowing domestic users to use water for non-essential purposes, such as watering lawns. The City and County of Honolulu's regulations alleviate this potential conflict of interest by establishing an ongoing conservation program.[283] In addition, that county's emergency measures restrict certain non-essential classes of domestic uses, such as lawn irrigation, washing cars, and filling swimming pools.[284]

3. *Wasteful Practices Regulation*

The state should have exclusive jurisdiction to administer the well-drilling statute; the legislature should repeal any delegation of authority to the counties.[285] The state could then consolidate data collection and expertise at one governmental level. Groundwater is a complex resource; its management requires engineering specialists and computer-based modeling of complete hydrological systems.

C. *Rights and Liabilities of Groundwater Users*

1. *Groundwater User vs. Groundwater User*

Well-interference conflicts occur in non-critical as well as critical areas. Thus, the legislature should authorize the state to regulate well-interference conflicts on a statewide basis, rather than only in critical areas. Furthermore, the statute should incorporate the "reasonable diversion" doctrine.[286]

2. *Groundwater User vs. Surface Water User*

The legislature should adopt conjunctive use policies that allow a groundwater user to restore water to the surface water user from alternative sources.[287] However, the legislature should not allow the groundwater user to reduce

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[283] *See* OAHU WATER PLAN, *supra* note 275.

[284] *See supra* note 252 and accompanying text.

[285] The well-drilling statute contains a provision that permits counties to regulate wells. HAWAII REV. STAT. § 178-11 (1976).

[286] *See supra* notes 192-93, 196 and accompanying text.

[287] *See supra* notes 203-07 and accompanying text.

streamflow below a specified minimum threshold.[288]

3. *Groundwater User vs. Overlying Landowner*

The legislature should extend the strict liability provisions in the critical area statute to non-critical areas.[289] The preceding suggestions differ significantly from the Model Water Code.[290]

VI. CONCLUSION

Surface water law is based on ancient Hawaiian customs. In contrast, groundwater law has no basis in ancient Hawaiian customs; the early Hawaiians were unaware of the groundwater resource. In the absence of pre-existing customary or statutory law for groundwater, the courts and legislature have a clean slate to fashion a system of groundwater rights. Only one case has reached the state supreme court involving groundwater rights. In *City Mill*, the court adopted the correlative rights doctrine. The court limited its holding to artesian groundwater; rights in non-artesian groundwater are still uncertain. The two groundwater statutes that currently exist—a well-drilling statute and a critical area statute—are regulatory in nature, and thus do not establish or clarify property rights in groundwater. The paucity of case law involving groundwater rights contrasts with the extensive surface water litigation in Hawaii.

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[288] *See supra* notes 266-67 and accompanying text.

[289] *See supra* notes 268-69 and accompanying text.

[290] Suggestions in this comment differ from the Model Water Code in the following respects:

(1) Permit duration: The Model Water Code recommends limited-duration permits for all uses. This comment suggests a perpetual permit for the counties and limited-duration permits for other users.

(2) Landownership as a condition to apply for a permit: The Model Water Code is not clear whether the common law landownership requirement is abandoned in favor of the prior appropriation theory of severing landownership from groundwater rights. This comment makes it clear that the prior appropriation theory of severance should be adopted.

(3) Conflict management provisions: The Model Water Code does not address any of the conflict situations between groundwater users, surface water users, and overlying landowners. This comment makes specific suggestions.

(4) "Reasonable-beneficial use" standard: This comment favors the Model Water Code's "reasonable-beneficial use" standard over the prior appropriation "beneficial use" standard. However, this comment also suggests that county land use decisionmakers should properly consider other growth management and environmental factors that a water administrator would not normally consider under the "reasonable-beneficial use" standard. The drought provisions suggested in this comment, however, are comparable to those in the Model Water Code.

Given the present uncertainty with groundwater rights, the legislature and courts can refuse to recognize that any of the current groundwater users have vested rights. Thus, the state has an opportunity to establish a comprehensive new system of rules for groundwater without threat of serious constitutional challenges.

This comment suggests a groundwater management system based on declaring groundwater to be in the public trust. The public trust accomplishes two purposes. First, a public trust makes the state accountable in the management of the groundwater resource in the public interest. Second, because the state is the legal "owner" of the groundwater resource, it has the flexibility to change the groundwater laws without subsequent constitutional challenges. The flexibility to change the law is important to keep pace with improving knowledge of groundwater hydrology and management techniques.

The state should allocate usufructuary rights through a statewide permit system. The permit should have a perpetual duration for the counties and a limited duration for other users. The counties are the primary suppliers of domestic water. The counties regulate the demand for domestic water through land use controls by granting or denying requests for rezoning non-urban districts to urban. Since the maintenance of domestic water supplies is crucial during drought shortages, the counties should be responsible for county-wide emergency measures. The counties can minimize vulnerability to shortages by incorporating conservation incentives in their land use control system.

Since the four counties have varying technical expertise, the state should be responsible for management functions that require sophisticated modeling and analyses. The state should be responsible for setting the sustainable yield, allocating fixed quantities to the county and private well owners in accordance with the sustainable yield estimates, regulating well design and construction practices, and monitoring all wells in the state. Furthermore, the state should be responsible for preventing and resolving conflicts among groundwater users, surface water users, and overlying landowners. Conflicts between groundwater users should be resolved on the basis of the "reasonable diversion" doctrine. Conflicts between groundwater and surface water users should be resolved by utilizing conjunctive use devices. The groundwater user should be strictly liable for subsidence damages to an overlying landowner.

Although Hawaii's hydrogeology differs from the mainland, many of the management techniques being developed on the mainland are applicable in Hawaii. The greatest challenge in developing an effective statewide groundwater management system will lie in how well the groundwater regulations integrate with land use regulations.

Roy R. Takemoto

Leyson v. Steuermann: Is There Plain Error in Hawaii's Doctrine of Informed Consent?

I. Introduction

Informed consent to receive medical treatment represents a developing and controversial area of the law,[1] paralleling the growth of medical malpractice litigation over the past two decades. With medical malpractice and personal injury cases increasingly before the courts,[2] a clearly defined informed consent law is imperative.

In *Leyson v. Steuermann*,[3] the Hawaii Intermediate Court of Appeals (ICA) addressed the doctrine of informed consent in Hawaii. The court based its opinion on procedural grounds[4] and therefore did not reach the substantive issue of

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[1] One commentator has observed that:

> Since its birth about two decades ago, the doctrine of informed consent has spawned untold controversy in the courts, among legal scholars, and within the medical profession. Although often condemned by the medical profession as a myth and a fiction . . . generally it is favorably received by legal scholars. The doctrine promotes significant individual rights, and many practicing lawyers regard it well. . . .

Meisel, *Informed Consent: Who Decides For Whom?*, in MEDICAL ETHICS AND THE LAW 197, 197 (M.D. Hiller, ed. 1981) (footnotes omitted).

[2] "The social climate in this country has created the concept that litigation is an appropriate method for patients to express dissatisfaction with the health delivered by their physician." Johnson, *An Overview of Informed Consent: Majority and Minority Rules*, in LEGAL MEDICINE WITH SPECIAL REFERENCE TO DIAGNOSTIC IMAGING 281 (A.E. James, ed. 1980). The author notes that this view that "every unpleasant occurrence of life must be compensated" combined with the weakening of legal defenses (such as assumption of risk) and certain immunities, and the increase in consumer rights have had an effect on the rise in patient litigation. *Id.*

[3] 6 Hawaii App. ____, 705 P.2d 37 (1985).

[4] *Id.* at ____, 705 P.2d at 40. In addressing the procedural questions, the ICA held that: 1) Leyson could not raise the issue that certain remarks in Steuermann's opening statement not objected to and certain testimony objected to on other grounds were an improper appeal to the prejudices and sympathies of the jury. 2) The trial court did not err in denying Leyson permission to obtain the jury foreman's affidavit to determine if one juror dominated jury deliberations and that the jury found Steuermann not negligent for a legally inappropriate reason. 3) The special jury verdict was not manifestly against the weight of the evidence. 4) By failing to object at trial, Leyson could not preserve the point for appeal that the jury instructions on informed consent were in error. 5) A miscarriage of justice would not occur if HAWAII R. CIV. P. 51(e) were applied

informed consent.[5] In strong and deliberate dicta, however, the court did examine the status of Hawaii's doctrine and found conflict between the Hawaii case law[6] and existing legislation.[7] The *Leyson* court proposed changes to Hawaii's standards of informed consent by setting out a modified objective standard of causation[8] and urging a patient-oriented standard of disclosure.

Section III of this note provides a brief examination of the procedural issues involved. In Section IV, the note then focuses on the doctrine of informed consent, first by surveying the development of the doctrine nationally and then by focusing on informed consent as applied in Hawaii. Section V analyzes the court's treatment of informed consent. Finally, Section VI of this note examines the impact of the *Leyson* decision. This section discusses the decision's potential effect on the quality of health care and on medical malpractice litigation.

II. FACTS

Over a period of several years, defendant Dr. Nicholas Steuermann treated plaintiff Cresencio Leyson for psoriasis[9] by prescribing corticosteroids.[10] During this same period, Leyson also received medical treatment from other practitioners[11] who prescribed similar drugs, although sometimes in "appreciably larger doses."[12] After many years of this drug therapy, Leyson experienced hip, joint,

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strictly and plain error was not applicable. The ICA also stated that the issue of whether the jury instructions based on informed consent were correct did not have to be reached. *See infra* notes 59-73 and accompanying text.

[5] 6 Hawaii App. at ____, 705 P.2d at 44-48. The substantive issue was whether the jury instructions correctly stated the law regarding informed consent.

[6] Nishi v. Hartwell, 52 Hawaii 188, 473 P.2d 116 (1970) is Hawaii's seminal case on informed consent. See also Frey v. Goebert, 52 Hawaii 308, 474 P.2d 537 (1970), decided shortly after *Nishi*, which briefly mentioned the issue of informed consent.

[7] HAWAII REV. STAT. § 671-3 (Supp. 1984).

[8] 6 Hawaii App. at ____ n.10, 705 P.2d at 47 n.10.

[9] *Id.* at ____, 705 P.2d at 40-41. Crescencio Leyson was Dr. Nicholas Steuermann's patient during two different periods, from June 1970 to November 1971, and from December 1975 to May 1977. Psoriasis is a chronic skin disorder characterized by thickening of the outer layers of the skin. R. MARKS, PSORIASIS: A GUIDE TO ONE OF THE COMMONEST SKIN DISEASES 96 (1981). Psoriasis is often treated with corticosteroid drugs. Various side effects are associated with corticosteroids. *See infra* notes 10, 12-13.

[10] 6 Hawaii App. at ____, 705 P.2d at 40-41. Physicians commonly prescribe corticosteroids, anti-inflammatory drugs, for psoriasis. R. MARKS, *supra* note 9, at 57, 62-63.

[11] 6 Hawaii App. at ____, 705 P.2d at 41. After his initial treatment under Dr. Steuermann, Leyson saw three other practitioners for the same condition. After his second period of treatment by Steuermann, Leyson saw two other practitioners. *Id.*

[12] *Id.* Leyson received doses of 60-180 milligrams of corticosteroids per day from another practitioner. Steuermann had previously prescribed similar corticosteroids at 40-60 milligrams. *Id.*

and shoulder problems and developed cataracts.[13]

Leyson thereafter initiated an action against Dr. Steuermann. He contended that Dr. Steuermann failed to fully inform him about the inherent risks of corticosteroid treatment.[14] Leyson requested the trial judge to instruct the jury that a physician has a duty to "reasonably inform the patient as to the potential risk."[15]

The Third Circuit Court rejected Leyson's proposed instructions and gave Dr. Steuermann's requested instruction that the physician's duty to inform should be determined by the standards of the medical community.[16] The jury found Dr. Steuermann not negligent in the care and treatment of Leyson.[17]

On appeal, Leyson alleged that the trial court erred when it improperly instructed the jury on informed consent.[18] The ICA disagreed with Leyson and

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[13] *Id.* Corticosteroids and related drugs do have various adverse side effects over prolonged use, such as cataracts and bone problems, two of Leyson's ailments. J. LONG, THE ESSENTIAL GUIDE TO PRESCRIPTION DRUGS 531 (1977). *See generally* PHYSICIAN'S DESK REFERENCE (J. Angel, ed. 1983); E. STERN, PRESCRIPTION DRUGS AND THEIR SIDE EFFECTS (1981).

[14] 6 Hawaii App. at ____, 705 P.2d at 41. Leyson said that Steuermann did not warn him of any side effects of the drug treatment during his first period of treatment. There is conflicting evidence as to whether Steuermann informed Leyson during the second period of treatment.

[15] *Id.* at ____, 705 P.2d at 47. Leyson requested three other instructions which were not given. *See infra* note 60 and accompanying text. The instructions the trial court gave reflected the inconclusiveness of the case law and legislation on informed consent in Hawaii. *See infra* text accompanying notes 151-68. Leyson's requested instructions used a subjective patient standard. *See infra* notes 60, 107-09 and accompanying text. Leyson eventually agreed to the instructions as given. *See infra* note 64 and accompanying text.

[16] 6 Hawaii App. at ____, 705 P.2d at 48. *See infra* notes 60, 89, 91 and accompanying text.

[17] 6 Hawaii App. at ____, 705 P.2d at 42. The trial court used plaintiff's special verdict form which asked the jury only one all inclusive question as to liability: "Was Dr. Steuermann negligent in the care or treatment of Cresencio Leyson?" Ten jurors responded "no" and two jurors "yes." *Id.*

[18] *Id.* at ____, ____, 705 P.2d at 42, 43. Leyson argued three procedural points on appeal. First, Leyson contended that certain testimony appealed to the prejudices and sympathies of the jurors. This testimony concerned the interruption of Dr. Steuermann's medical career by his imprisonment in a Nazi concentration camp. *Id.* at ____, 705 P.2d at 41-42.

As to Leyson's first point, the ICA held that the issue was barred on appeal because of Leyson's failure to object to the remarks in defendant's opening statement and objecting on the wrong grounds for the testimony in question, failure to ask for a curative instruction, and failure to request a mistrial. Furthermore, the court found that any impropriety of the remarks was not so fundamental or prejudicial as to cause a gross injustice if a new trial was not granted. *Id.*

Leyson's second point was that the lower court erred in denying permission to obtain the jury foreman's affidavit. Leyson's attorney, in his own affidavit, alleged that one person dominated the jury deliberations, and that this particular juror may have reacted to the testimony concerning Steuermann's internment in a Nazi concentration camp. However, in Leyson's counsel's affidavit, the jury foreman stated that the larger doses of corticosteroids prescribed by other physicians influenced his decision and that "it was unfair to find Dr. Steuermann negligent alone." *Id.* at

unanimously affirmed the lower court's decision.[19]

III. PLAIN ERROR: APPEALING THE JURY INSTRUCTIONS

Jury instructions serve the purpose of informing the jury of the applicable law.[20] The instructions must be relevant under the evidence, correctly state the law, and stand independent of other instructions given by the court.[21] As such, the instructions should clearly direct the jury in reaching a fair and just verdict.[22]

A party who disagrees with those instructions may object at trial and appeal to a higher court.[23] In reviewing the instructions, the appellate court examines the record to determine whether the appealing party objected to the instructions in a timely and specific manner. Even if the appellate court finds these require-

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____, 705 P.2d at 42. *See supra* note 4.

The court summarily disposed of Leyson's motion for the jury foreman's affidavit by citing the Hawaii Rules of Evidence:

> Upon an inquiry into the validity of a verdict . . . a juror may not testify concerning the effect of anything upon his . . . mind or emotions as influencing him to assent to or dissent from the verdict . . . or concerning his mental processes in connection therewith. Nor may his affidavit or evidence of any statement by him indicating an effect of this kind be received.

HAWAII R. EVID. 606(b), *quoted in* 6 Hawaii App. at ____, 705 P.2d at 43.

Hypothetically, a more interesting result could follow the court's terse treatment in affirming the lower court's denial of plaintiff's motion to obtain the jury foreman's affidavit. Had the plaintiff's argument been framed such that the particular juror's domination over the deliberations could be considered an *act* rather than an emotion or thought, perhaps the affidavit might be allowed under HAWAII R. EVID. 606(b). The rule otherwise precludes inquiries into the minds and emotions of the jurors.

Third, Leyson contended that the jury's verdict fell against the weight of the evidence. The ICA, using the abuse of discretion standard, dismissed this claim because "the trial judge did not clearly abuse his discretion when he denied the motion [for a new trial]." 6 Hawaii App. at ____, 705 P.2d at 44.

[19] 6 Hawaii App. at ____, 705 P.2d at 44, 48. Additionally, the court dismissed Steuermann's frivolous appeal argument without comment. *Id.* at 48.

[20] Tittle v. Hurlbutt, 53 Hawaii 526, 530, 497 P.2d 1354, 1357 (1972) (refusal to give repetitious jury instructions upheld in medical malpractice action).

[21] 6 Hawaii App. at ____, 705 P.2d at 47 (citing Sherry v. Asing, 56 Hawaii 135, 144, 531 P.2d 648, 655 (1975)).

[22] 9 C. WRIGHT & A. MILLER, FEDERAL PRACTICE AND PROCEDURE: CIVIL § 2558, at 668 (1971).

In a practical sense, both parties want the jury instructions to best reflect their own positions. An attorney can potentially achieve this in several ways. For example, an attorney can submit proposed instructions to the court. An attorney can also object to or agree with the instructions requested by the opposition. Yet, the trial judge ultimately decides which instructions to give.

[23] HAWAII R. CIV. P. 51(e). *See infra* note 25 and accompanying text.

ments were not met, the court has the discretion to review the instructions under the doctrine of plain error.[24]

Rule 51(e) of the Hawaii Rules of Civil Procedure provides that a party may not allege error concerning jury instructions unless the objection is made *before* the jury begins its deliberations.[25] The rule further states that the objection must be accompanied by specific grounds.[26] If a party fails to meet these conditions, the court may consider the right to object waived and bar a claim of error on appeal.[27]

A. *Development of Plain Error in Hawaii*

An exception to a literal interpretation of this procedural rule lies in the judicial doctrine of "plain error."[28] Plain error allows an appellate court to re-

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[24] 6 Hawaii App. at ____, 705 P.2d at 48 (citing C. WRIGHT & A. MILLER, *supra* note 22, § 2558, at 668).

[25] Hawaii Rules of Civil Procedure, in relevant part, state that "[n]o party may assign as error the giving or the refusal to give, or the modification of, an instruction . . . unless he objects thereto *before* the jury retires to consider its verdict. . . ." HAWAII R. CIV. P. 51(e) (emphasis added).

[26] *Id.*

[27] 6 Hawaii App. at ____, 705 P.2d at 48 (citing C. WRIGHT & A. MILLER, *supra* note 22, § 2558, at 668).

[28] C. WRIGHT, THE LAW OF FEDERAL COURTS 630 (4th ed. 1983). Although federal courts have construed strictly Rule 51(e) of the Federal Rules of Civil Procedure, a growing number have recently applied the plain error rule and reversed. *See* Rodrigues v. Dixilyn Corp., 620 F.2d 537 (5th Cir. 1980) (plain error found despite no objection at trial to a jury instruction that contributory negligence served as a defense to an action of strict liability), *cert. denied*, 449 U.S. 1113 (1981); MacEdward v. Northern Elec. Co., 595 F.2d 105 (2d Cir. 1979) (plain error found where a breach of employment case went to the jury without an instruction on the defense of statute of frauds or promissory estoppel); Choy v. Bouchelle, 436 F.2d 319 (3d Cir. 1970) (plain error found where jury instructions omitted legal guidelines to the relevant factual situation); Pritchard v. Liggett & Myers Tobacco Co., 350 F.2d 479 (3d Cir. 1965) (plain error found in a breach of warranty action where counsel failed to protect properly the interest of the client by a timely objection to the jury instructions), *cert. denied*, 382 U.S. 987 (1966), *amended* 370 F.2d 95 (3d Cir. 1966), *cert. denied*, 386 U.S. 1009 (1967).

The application of plain error might appear inconsistent with the actual wording of Rule 51(e). Professor Wright points out that it "burdens the appellate courts with having to review afterthought claims of error, which counsel parade forward under the banner of plain error." C. WRIGHT, *supra*, at 630. Plain error should be reserved for those cases where "the error has seriously affected the fairness, integrity, or public reputation of judicial proceedings." *Id. Cf.* Liner v. J.B. Talley & Co., 618 F.2d 327 (1980) (no plain error found in breach of employer's warranty action), *reh'g denied*, 623 F.2d 711 (5th Cir. 1980); Cohen v. Franchard Corp., 478 F.2d 115 (2d Cir.) (no plain error in a class action for damages for purchase of shares in a limited partnership where there was no substantial miscarriage of justice), *cert. denied*, 414 U.S. 857 (1973); Sowrizal v. Hughes, 333 F.2d 829 (3d Cir. 1964) (no plain error in personal injury case

view a claim of serious error in the jury instructions, even if proper objections were not made at trial.[29] The application of plain error serves to prevent a "miscarriage of justice."[30]

In the seminal case of *Struzik v. City & County of Honolulu*,[31] the Hawaii Supreme Court signaled its willingness to construe liberally Hawaii Rule of Civil Procedure 51(e). The court held that a trial court "has the power to depart from a literal application of a rule when such action is necessary to prevent a miscarriage of justice."[32] In *Struzik*, a pedestrian fell and injured herself on a city sidewalk.[33] The pedestrian then filed an action against the city and the abutting land owner for failure to maintain that portion of the sidewalk in a safe condition.[34] The trial court instructed the jury on a land owner's duty to maintain the public sidewalk,[35] but omitted the fact that the duty rests primarily with the city or state.[36] On appeal by the defendant, the Hawaii Supreme Court found that the instructions may have misled the jury to believe that the landowner owed the pedestrian the duty of care.[37] The court found defendant's

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where jury instruction did not cause a miscarriage of justice).

Only the Ninth Circuit continues to apply the rule literally and "den[ies] that there is any power to reverse for plain error in an unobjected-to instruction in a civil case." C. WRIGHT & A. MILLER, *supra* note 22, § 2558, at 674-75. As the court observed, "Whatever the rule may be elsewhere, in this circuit the plain error rule may not be utilized in civil appeals to obtain a review of the instructions given or refused." Bertrand v. South Pac. Co., 282 F.2d 569, 572 (9th Cir.) (allegedly erroneous jury instructions and jury instructions not given in an employee action for damages not reviewable under plain error), *cert. denied*, 365 U.S. 816 (1960). *See also* Bock v. United States, 375 F.2d 479, 480 (9th Cir. 1967) (court refused to review jury instructions not given under plain error where ground asserted was not raised in trial court in highway condemnation case); Crespo v. Fireman's Fund Indem. Co., 318 F.2d 174, 175 (9th Cir. 1963) (court refused to review allegedly erroneous jury instructions in an action by a judgment creditor of insured to recover where there was a failure to object at trial; court held that there would be no reversal necessary even if the instruction was erroneous); Hargrave v. Wellman, 276 F.2d 948, 950 (9th Cir. 1960) (court refused to review jury instructions not given in a personal injury action where FED. R. CIV. P. 51 was not complied with by a failure to object at trial).

[29] 6 Hawaii App. at ___, 705 P.2d at 48 (citing C. WRIGHT & A. MILLER, *supra* note 22, § 2558, at 672). *See also* C. WRIGHT, *supra* note 28, at 630.

[30] Struzik v. City & County of Honolulu, 50 Hawaii 241, 246, 437 P.2d 880, 884 (1968) (new trial granted where jury instructions misled jurors about homeowner's duty of care in maintaining a public sidewalk).

[31] 50 Hawaii 241, 437 P.2d 880 (1968).

[32] *Id.* at 246, 437 P.2d at 884.

[33] *Id.* at 242, 437 P.2d at 882.

[34] *Id.*

[35] *Id.* at 246-48, 437 P.2d at 884-85.

[36] *Id.*

[37] The Hawaii Supreme Court stated that an objection under Rule 51(e) should incorporate language "*sufficiently specific* to direct the attention of the court to the issue it sought to raise." S & W Crane Serv., Inc. v. Dependents of Berard, 53 Hawaii 161, 163-64, 489 P.2d 419, 421

objections to the instructions insufficient, but granted a new trial to prevent a miscarriage of justice against the land owner.[38]

In a 1978 case, *Turner v. Willis*,[39] the Hawaii Supreme Court extended this liberal concept further. The court applied the plain error rule despite a *complete* failure to object to the jury instructions at trial.[40] In *Turner*, a pedestrian sustained injuries when allegedly hit by a pipe protruding from a truck, the only passing vehicle in the area.[41] The court instructed the jury on res ipsa loquitur, stating that the proximate cause of the accident resulted from the defendant's negligence.[42] On appeal, the defendants maintained that the instruction was erroneous because res ispa loquitur permits, but does not compel, an inference of negligence.[43] The supreme court agreed and found the jury instructions given on res ipsa loquitur "misleading, clearly erroneous, and harmful."[44] The court reversed the lower court's decision even assuming no objection whatsoever had been made at trial.[45] The implicit message of *Turner* was that the court would review instructions under plain error if those instructions manifestly cause an unfair or prejudicial result.

The following year, the Hawaii Supreme Court refined its requirement for the review of jury instructions even further. In *In re Lorenzo*,[46] the court stated that on review, the question is not whether the jury instructions "were *technically correct* but whether appellant could have suffered *prejudice* on their account."[47] In *Lorenzo*, a widow, in an action against the executor of her husband's estate, claimed her dower interest in the estate.[48] On appeal by the widow, the supreme court found the instructions that her desertion of her husband was justified "resulted in prejudice to the appellant,"[49] thus requiring a reversal.[50]

(1971) (emphasis added) (quoting Pierro v. Carnegie-Illinois Steel Corp., 186 F.2d 75, 78 (3d Cir. 1950)). Thus, the court attempted to clarify under what conditions it would review jury instructions under plain error.

[38] 50 Hawaii at 248, 437 P.2d at 885.

[39] 59 Hawaii 319, 582 P.2d 710 (1978).

[40] *Id.* at 324, 582 P.2d at 714.

[41] *Id.* at 320-21, 582 P.2d at 712-13.

[42] *Id.* at 322-23, 582 P.2d at 713.

[43] *Id.* at 323, 582 P.2d at 713.

[44] *Id.* at 323, 326, 582 P.2d at 713, 715. The Hawaii Supreme Court went beyond the sufficiently specific test of *Crane* by eliminating the need to bring the court's attention to the error.

[45] *Id.* at 324-26, 582 P.2d at 714-15.

[46] 61 Hawaii 236, 602 P.2d 521 (1979).

[47] *Id.* at 244, 602 P.2d at 528 (emphasis added).

[48] The lower court barred the widow's interest. *Id.* at 237-38, 602 P.2d at 524.

[49] *Id.* at 252, 602 P.2d at 532. The Hawaii Supreme Court also found one of the instructions to be misleading as well. *Id.* at 249, 602 P.2d at 530.

[50] *Id.* at 252, 602 P.2d at 532.

The Hawaii Supreme Court has generously interpreted Rule 51(e) and considered plain error where the error has harmed or prejudiced the outcome of the case.[51] While neither the ICA nor the Hawaii Supreme Court has specifically defined plain error,[52] review generally has been limited to those cases where "it is shown that substantial rights of the defendant may have been affected."[53]

While the ICA has acknowledged the supreme court's position,[54] it has granted plain error less often, adhering to a more literal interpretation of Rule 51(e).[55] For example, in *Guaschino v. Eucalyptus, Inc.*,[56] a case involving breach of a lease agreement, the defendant-lessors alleged error in the lower court's

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[51] In Gelber v. Sheraton-Hawaii Corp., 49 Hawaii 327, 417 P.2d 638 (1966), the Hawaii Supreme Court noted that "[i]n jury trials . . . an erroneous instruction is presumptively harmful and is 'ground for reversal unless it affirmatively appears from the whole record that it was not prejudicial.' " *Id.* at 330-31, 417 P.2d at 640. *See generally* Chung v. Kaonohi Center Co., 62 Hawaii 594, 618 P.2d 283 (1980) (breach of contract action where jurors advised to disregard prejudicial testimony as to wife's miscarriage; no plain error found); City & County of Honolulu v. Bennett, 57 Hawaii 195, 552 P.2d 1380 (1976) (court held that, in a land action, where there was no indication if jury relied on erroneous jury instruction on adverse possession, reversal was necessary); Greene v. Texeira, 54 Hawaii 231, 505 P.2d 1169 (1973) (court willing to find plain error where interpretion of statute of great public import). *See also* the discussion of *Struzik, supra* notes 33-37 and accompanying text; *Turner, supra* notes 39-45 and accompanying text; *Lorenzo, supra* notes 46-50 and accompanying text.

[52] Ironically, as the ICA once put it, plain error could be found in cases where there "are errors in the jury instructions" or, in criminal cases, where "substantial rights of the defendant may have been affected." State v. Casipe, 5 Hawaii App. 210, ——, 686 P.2d 28, 36 (1984).

[53] *Id. See also* State v. Brezee, 66 Hawaii 162, 657 P.2d 1044 (1983) (no plain error where failure to request an instruction reviewed due to substantial rights in criminal case); State v. McNulty, 60 Hawaii 259, 588 P.2d 438 (1978) (no plain error in omission of burden of proof instruction in criminal case); State v. Tyrrell, 60 Hawaii 17, 586 P.2d 1028 (1978) (plain error found where substantial rights affected by instructing in error about the burden of proof of self-defense); State v. Chong, 3 Hawaii App. 246, 649 P.2d 1112 (1982) (no plain error in giving a limiting instruction for criminal case); State v. Liuafi, 1 Hawaii App. 625, 623 P.2d 1271 (1981) (plain error found on one charge, failure to render aid, in an attempted murder case because of conflicting instruction).

[54] Guaschino v. Eucalyptus, Inc., 3 Hawaii App. 632, 644, 658 P.2d 888, 897 (1983).

[55] Johnson v. Robert's Hawaii Tour, Inc., 4 Hawaii App. 175, 664 P.2d 262 (1983) (no plain error found where jury instruction not objected to and instruction as a whole not prejudicial, insufficient, erroneous, inconsistent, or misleading); Tanuvasa v. City & County of Honolulu, 2 Hawaii App. 102, 626 P.2d 1175 (1981) (no plain error in failure to instruct in an action for damages); *In re* Coleman, 1 Hawaii App. 136, 615 P.2d 760 (1980) (contested will action in which there was no plain error in failure to instruct jury where evidence did not support an instruction and where instruction was given by agreement).

[56] 3 Hawaii App. 632, 658 P.2d 888 (1983). *See also* State v. Halemanu, 3 Hawaii App. 300, 650 P.2d 587 (1982) (criminal case where error in jury instructions defining a dangerous instrument was not prejudicial as a whole; no plain error was found); State v. Corpuz, 3 Hawaii App. 206, 646 P.2d 598 (1982) (criminal case where instruction that the defendant had the burden of proof on a defense of duress was not objected to at trial but correctly stated the law and was agreed to; no prejudice, so no plain error was found).

refusal to give an instruction on the defense of duress.[57] The ICA noted defendant's failure to object at trial and reasoned without elaboration that the evidence did not require such an instruction, as the record indicated no plain error.[58]

B. The Leyson *Court's Reasoning*

Leyson argued on appeal that the jury instructions were improper.[59] Leyson had requested additional instructions which by agreement were not given.[60] The instructions that were given by the court, in pertinent part, read:

> What a doctor should tell his patient before starting treatment must be established by the testimony of doctors. [Defendant's Requested Instuction 3, given as modified by agreement.]
>
> If you find from the evidence that a [sic] defendant failed in his duty to reasonably inform the patient as to the potential risk and as to the possible alternative modes of treatment, you should find him to be liable for negligence in this respect. [Plaintiff's Requested Instruction 20, given by agreement.][61]

The ICA recognized a distinct difference between the instructions given and those requested by Leyson. On the one hand, the instructions given by the court

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[57] 3 Hawaii App. at 644, 658 P.2d at 897.

[58] *Id.*

[59] 6 Hawaii App. at ____, 705 P.2d at 47-48.

[60] *Id.* The instructions requested, but not given were:

PLAINTIFFS' REQUESTED INSTRUCTION NO. 13. The doctrine of informed consent requires first, that the physician know of all adverse side effects inherent in a proposed course of treatment that a reasonably careful and skillful physician in good standing would know about. The failure to know of such side effects is negligence.

PLAINTIFFS' REQUESTED INSTRUCTION NO. 14. Second, the physician has a duty to disclose to his patient all relevant information which the patient needs to make an informed choice as to whether he will accept or forego the proposed treatment. The physician must inform the patient, in lay terms, of all material risks of the treatment, the recognized alternative forms of treatment, the risks, if any, of the alternative forms of treatment, and the risks, if any, of no treatment at all. The failure of the physician to inform his patient as I have just instructed you may be negligence.

PLAINTIFFS' REQUESTED INSTRUCTION NO. 15. The amount of information that must be disclosed is that which the physician knows or should know would be regarded by a reasonable person in the patient's position when deciding whether to accept or forego the proposed course of treatment. In other words, the patient is entitled to all relevant information necessary for him to make an informed choice. Further, if the physician knows or should know of a patient's unique concerns or lack of familiarity with medical problems, this may require even greater disclosure by the doctor.

Id.

[61] *Id.* at ____, 705 P.2d at 47-48.

provided a standard of disclosure where the doctor decided what information a patient needed.[62] The instructions requested by Leyson but not given by the court, on the other hand, provided that disclosure should entail what a reasonable person in the patient's position would need.[63] Since Leyson had agreed to the instructions as given,[64] however, the court held that it did not need to analyze the apparent conflict and determine which instruction correctly stated the law.[65]

The *Leyson* court went on to consider the application of plain error in a two step analysis.[66] In the first step of the analysis, the court noted that Leyson did not object to the jury instructions at trial and that under Rule 51(e), failure to object in a timely manner barred Leyson from raising the issue of incorrect jury instructions on appeal.[67] Leyson's failure to act, therefore, did not meet the "timely" requirement of Rule 51(e). Under a literal interpretation of Rule 51(e), Leyson would automatically lose on appeal.

However, the court acknowledged that pursuant to *Struzik*,[68] it had discretion to apply the plain error rule and "depart from a strict enforcement of Rule 51(e) . . . when such action is necessary to prevent a miscarriage of justice."[69] In the second step of its analysis, the court determined whether an unjust result would occur if it strictly applied Rule 51(e).[70] In doing so, the court placed great emphasis on the deliberateness[71] of Leyson's actions. Leyson not only failed to object to the instructions at trial as a possible mistake or oversight, but he acted with purpose by actually agreeing to the instructions. The court, in support of its conclusion, observed that "Leyson's counsel was not certain that [the instruction given] was wrong and [he] was so convinced that he would win even if [the instruction] was given that he decided not to object to it."[72] There-

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[62] *Id.* at ___, 705 P.2d at 48.

[63] *Id.* at ___, 705 P.2d at 47-48.

[64] *Id.* at ___, 705 P.2d at 48.

[65] *Id.*

[66] *Id.*

[67] *Id.*

[68] *Id.* Struzik v. City & County of Honolulu, 50 Hawaii at 246, 437 P.2d at 884.

[69] 6 Hawaii App. at ___, 705 P.2d at 48. In discussing Leyson's counsel's behavior, the ICA observed that neither HAWAII R. CIV. P. 60(b)(6) (excusable neglect) nor Rule 51(e) (plain error) serves "the purpose of relieving a party from the free, calculated and deliberate choices he has made." *Id.* at ___, 705 P.2d at 48 (citing 11 C. WRIGHT & A. MILLER, FEDERAL PRACTICE AND PROCEDURE: CIVIL § 2864, at 214 (1973)).

Hawaii Rules of Civil Procedure, governing relief from judgment or order, state in relevant part: "On motion and upon such terms as are just, the court may relieve a party . . . from a final judgment, order, or proceeding for . . . mistake, inadvertance, or excusable neglect." HAWAII R. CIV. P. 60.

[70] 6 Hawaii App. at ___, 705 P.2d at 48.

[71] *Id.*

[72] *Id.*

fore, the *Leyson* court concluded no plain error existed.[73]

C. *Analysis of the Court's Reasoning*

In rejecting the application of plain error in *Leyson*, the ICA expressly considered Leyson's deliberate choice not to object to the jury instructions.[74] In particular, the court noted the confidence of Leyson's attorney that he would win the case.[75] There was no oversight or mistake involved. Thus, the holding of *Leyson* is well-supported on the basis that Leyson's counsel did appear to act purposely in not objecting to the jury instructions. Relief under plain error should be an extraordinary measure to prevent injustice from occurring.[76] Use of such relief as a calculated decision of counsel could be considered an abuse of the doctrine.

The ICA, however, may have been influenced by other factors as well. The propriety of Steuermann as the defendant might have significantly influenced the eventual outcome in *Leyson*. Given the fact that other treating physicians prescribed greater doses of the same drug, the court might have considered that Leyson had a tenuous case against Steuermann from the start.[77] Even the jury foreman stated that it was "unfair to find Steuermann negligent alone."[78] A jury likely would have been reluctant to find a defendant-physician such as Steuermann responsible for the patient's injuries, eliminating the causal link and thus ruling out any possibility of the application of plain error. Leyson's rights would not have been prejudiced under this analysis. Such an error could have been considered harmless.[79] The holding of *Leyson* could be entirely justified on

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[73] *Id.*

[74] *Id.* It may have appeared to the court that Leyson's counsel had "gambl[ed] on the outcome of the jury's deliberations while secretly preserving the error to be raised on a motion for a new trial in the event of an unfavorable verdict." Weathers v. Kaiser Found. Hosps., 5 Cal. 3d 98, 103, 485 P.2d 1132, 1135, 95 Cal. Rptr. 516, 519 (1971). Earlier in the opinion, the *Leyson* court cited *Weathers* in its discussion of plain error. 6 Hawaii App. at ____, 705 P.2d at 43. *See supra* note 51.

[75] 6 Hawaii App. at ____, 705 P.2d at 48.

[76] C. WRIGHT, *supra* note 28, at 630.

[77] *See supra* note 12. Theoretically, Steuermann would be jointly and severally liable with the other defendants unless the negligence of the other defendants, so much greater than his, was deemed a supervening cause. *See* Espaniola v. Cawdrey-Mars Joint Venture, 68 Hawaii ____, 707 P.2d 365 (1985); Mckenna v. Volkswagenwerk Aktiengesellschaft, 57 Hawaii 460, 558 P.2d 1018 (1977).

[78] 6 Hawaii App. at ____, 705 P.2d at 42. *See supra* notes 11-12 and accompanying text.

[79] *See supra* note 69. Another analogy the court could have made was to harmless error. HAWAII R. CIV. P. 61 states that an error or defect in the proceeding that affects the substantial rights of the parties must not be ignored. The court could have decided that Leyson's right to recover was not harmed by error in procedure, such as the failure to object to the jury instructions.

the basis that Steuermann alone did not necessarily represent the appropriate defendant.

Additionally, the court's decision not to review the jury instructions may have been influenced by the ambiguity between the common law and existing legislation.[80] Arguably, the jury instructions adequately reflected the status of the law. Therefore, the instructions given by the lower court did not call for review. While the instructions may have been inconsistent, they were not necessarily wrong. If the law had clearly provided for a standard different from the jury instructions given by the lower court, perhaps the ICA would have analyzed the instructions under plain error.

Finally, the ICA historically tends to construe Rule 51(e) narrowly. As evidenced by its decision in *Guaschino*,[81] the ICA has acknowledged that the Hawaii Supreme Court takes a more liberal position in applying plain error.[82] The ICA's general reluctance to apply plain error might have had some influence in the *Leyson* decision.

IV. INFORMED CONSENT

Informed consent requires that a physician fully disclose to a patient the type of risks and alternatives to a proposed treatment.[83] The concept of informed consent represents the patient's right to self-determination,[84] and therefore ex-

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[80] 6 Hawaii App. at ——, 705 P.2d at 48.

[81] 3 Hawaii App. 632, 658 P.2d 888 (1983). *See supra* notes 11-12, 51 and accompanying text.

[82] 3 Hawaii App. at 644, 658 P.2d at 897.

[83] Salgo v. Leland Stanford Jr. Univ. Bd. of Trustees, 154 Cal. App. 2d 560, 578, 317 P.2d 170, 181 (1957). A physician who fails to disclose risk information is liable for that failure even if the patient is injured from a properly conducted treatment, if the patient would not have undergone the treatment had he known of the risks involved. The doctrine of informed consent is concerned with the disclosure of risk information to the patient by the physician. Negligent treatment is a separate area of medical malpractice law. *See* W. KEETON, D. DOBBS, R. KEETON & D. OWEN, PROSSER AND KEETON ON THE LAW OF TORTS § 32, at 190 (5th ed. 1984) [hereinafter cited as PROSSER & KEETON ON TORTS]; Recent Development, *Medical Malpractice: A Subjective Approach to Informed Consent in Oklahoma*, 15 TULSA L.J. 665, 667 (1980) [hereinafter cited as Recent Development, *Oklahoma Malpractice*]. *See generally* Plante, *An Analysis of "Informed Consent,"* 36 FORDHAM L. REV. 639 (1967-1968).

[84] In Schloendorff v. Society of N.Y. Hosp., 211 N.Y. 125, 129, 105 N.E. 92, 93 (1914), Justice Cardozo stated, "Every human being of adult years and sound mind has a right to determine what shall be done with his own body." This frequently-quoted passage from Justice Cardozo's opinion "crystallized the newly emerging view by explicitly acknowledging the individual's right to control his body with integrity and decide upon the propriety of a particular treatment plan." Comment, *A Modified Informed Consent Standard for Massachusetts*, 17 SUFFOLK U.L. REV., 243, 247 n.15 (1983) [hereinafter cited as Comment, *Modified Standard*]. The above quote from Justice Cardozo is also cited in Leyson v. Steuermann, 6 Hawaii App. at ——, —— n.10, 705

ists only where the patient is afforded the right to make an intelligent and rational decision whether to undergo treatment.[85] Courts generally address two main principles of the informed consent doctrine: disclosure[86] and causation.[87]

There are, however, exceptions to informed consent, and courts will look to see if any of the exceptions apply.[88] The exceptions are fairly well-accepted, but

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P.2d at 44, 47 n.10. *See also* Canterbury v. Spence, 464 F.2d 772, 780 (D.C. Cir. 1972), *cert. denied*, 409 U.S. 1064 (1973); D. LOUISELL & H. WILLIAMS, MEDICAL MALPRACTICE at ¶ 22.02 (1984); Katz, *Informed Consent—A Fairy Tale? Law's Vision*, 39 U. PITT. L. REV. 137, 145 (1977); Trichter & Lewis, *Informed Consent: The Three Tests and a Modest Proposal for the Reality of the Patient as an Individual*, 21 S. TEX. L.J. 155, 156, 168 (1981); Comment, *Texas Adopts an Objective Standard of Medical Disclosure: "Is There a Reasonable Layperson in the House?,"* 15 TEX. TECH. L. REV. 389, 391 n.10 (1984) [hereinafter cited as Comment, *Texas Standard*]; Recent Development, *Oklahoma Malpractice*, *supra* note 83, at 666 n.6.

[85] The *Canterbury* court noted:

> True consent to what happens to one's self is the informed exercise of a choice, and that entails an opportunity to evaluate knowledgeably the options available and the risks attendant upon each. The average patient has little or no understanding of the medical arts, and ordinarily has only his physician to whom he can look for enlightenment with which to reach an intelligent decision. From these almost axiomatic considerations springs the need, and in turn the requirement, of a reasonable divulgence by physician to patient to make such a decision possible.

Canterbury v. Spence, 464 F.2d at 780. *See also* Katz, *supra* note 84, at 148; Comment, *Texas Standard*, *supra* note 84, at 392.

[86] *See infra* notes 90-98 and accompanying text.

[87] *See infra* notes 99-109 and accompanying text.

[88] Although there is no national consensus regarding the standard for disclosure, courts generally agree on the exceptions to the physician's duty to disclose. Emergencies, therapeutic privilege, waiver and incompetency are the exceptions to informed consent.

The emergency exception applies when the patient is incapacitated and cannot make a decision. The therapeutic privilege applies when informing the patient of the material risks of treatment would be detrimental to his or her health or interests. A waiver to informed consent would apply where the patient voluntarily gives up the right to be informed or relinquishes this right to another, perhaps the physician. The incompetency exception is related to the emergency exception. Hawaii law covers the incompetency exception in a statute, HAWAII REV. STAT. § 560:5-312(a)(3) (1976) and HAWAII REV. STAT. § 671-3(a) (Supp. 1984). Incompetency may encompass intoxication, severe mental retardation, senility, severe mental illness or the inability to make a decision. Meisel, *supra* note 1, at 207-11.

Another exception sometimes considered is when the patient knows of the risk or when the risk is common. Meisel, *The Expansion of Liability for Medical Accidents: From Negligence to Strict Liability by Way of Informed Consent*, 56 NEB. L. REV. 51, 93-94 (1977) [hereinafter cited as Meisel, *Expansion, Informed Consent*]. *See generally* Nishi v. Hartwell, 52 Hawaii 188, 473 P.2d 116 (1970) (leading Hawaii case in which the possible hazard of paralysis in a diagnostic cardiac procedure was not revealed to an apprehensive, hypertensive patient; therapeutic exception applied); Andrews, *Informed Consent Statutes and the Decisionmaking Process*, 5 J. LEGAL MED. 163, 178 (1984); Meisel, *The "Exceptions" to Informed Consent Doctrine: Striking a Balance Between Competing Values in Medical Decisionmaking*, 1979 WIS. L. REV. 413, 434-88 [hereinafter cited as Meisel, *Exceptions, Informed Consent*]; Perdue, *The Law of Texas Medical Malpractice*, 11

the principles of disclosure and causation serve as a source of great debate.[89]

A. *Principles of Disclosure and Causation*

1. *Disclosure*

Generally, disclosure means that a physician inform a patient of: 1) the nature of the condition, 2) the nature of the suggested treatment, 3) the likelihood of success, 4) alternatives to the suggested treatment, and 5) the inherent risks involved.[90] While there is general agreement among the jurisdictions as to the elements of disclosure,[91] disagreement exists as to the appropriate standards for disclosure.[92]

Courts use one of two basic standards to determine the physician's duty to disclose risks: 1) the professional standard,[93] and 2) the patient standard.[94] The

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HOUS. L. REV. 2, 11 (1974); Trichter & Lewis, *supra* note 84, at 156-59.

[89] As the *Canterbury* court stated in regard to the standards of disclosure, "there is, nonetheless, disagreement between the courts and commentators." Canterbury v. Spence, 464 F.2d at 779. *See also* Meisel, *supra* note 1, at 201.

[90] Natanson v. Kline, 186 Kan. 393, 410, 350 P.2d 1093, 1106, *reh'g denied*, 187 Kan. 186, 354 P.2d 670 (1960). *See also* Meisel, *supra* note 1, at 201.

[91] Courts in various jurisdictions agree that physicians need not disclose every risk to the patient. *See, e.g.*, Salgo v. Leland Stanford Jr. Univ. Bd. of Trustees, 154 Cal. App. 2d 560, 317 P.2d 170 (1957); Nishi v. Hartwell, 52 Hawaii 188, 473 P.2d 116 (1970); Natanson v. Kline, 186 Kan. 393, 350 P.2d 1093, *reh'g denied*, 187 Kan. 186, 354 P.2d 670 (1960). *See generally* Meisel, *supra* note 1, at 200; Comment, *Texas Standard*, *supra* note 84, at 392.

Most courts do not interpret full disclosure literally because the physician's knowledge may be too complex for the patient, full disclosure would be impractical, and some of the information is plainly irrelevant. *See, e.g.*, Cobbs v. Grant, 8 Cal. 3d 229, 502 P.2d 1, 104 Cal. Rptr. 505 (1972); Salgo v. Leland Stanford Jr. Univ. Bd. of Trustees, 154 Cal. App. 2d 560, 317 P.2d 170 (1957); Woods v. Brumlop, 71 N.M. 221, 377 P.2d 520 (1962).

[92] One court has found liability for injury due to a physician's failure to disclose to the patient the alternatives to treatment. Truman v. Thomas, 27 Cal. 3d 285, 611 P.2d 902, 165 Cal. Rptr. 308 (1980) (failure to inform of risks of *not* taking Pap test). *See also supra* note 89 and accompanying text.

[93] Currently, a majority of jurisdictions follow the professional standard. Comment, *Modified Standard*, *supra* note 84, at 299. *See, e.g.*, Reidisser v. Nelson, 111 Ariz. 542, 534 P.2d 1052 (1975) (standard of disclosure measured by the usual practices of the medical profession in the locality in case where hysterectomy surgery caused uterovaginal fistula); Natanson v. Kline, 186 Kan. 393, 350 P.2d 1093 (professional standard of care used where mastectomy patient suffered injury from cobalt radiation treatment; radiologist not held liable as proximate cause of injuries under negligence theory of informed consent), *reh'g denied*, 187 Kan. 186, 354 P.2d 670 (1960); Woolley v. Henderson, 418 A.2d 1123 (Me. 1980) (standard of disclosure is that of a reasonable medical practitioner in that branch of medicine under similar circumstances where back surgery unsuccessful).

This standard favors the notion that physicians know what is best for a patient. As one com-

professional standard applies accepted medical practice as its standard for disclosure. Under this standard, the physician need not disclose the risk unless a reasonable physician would do so.[95]

In contrast, the patient standard requires the physician to disclose information a patient would find significant in making the decision to receive treatment. Courts which adopt the patient standard emphasize what the patient needs to know to make an informed decision, rather than what the medical community thinks the patient should be told.[96]

The patient standard of disclosure has two variations: the objective and the subjective. The objective standard requires the physician to disclose those risks which a reasonably prudent person would find material in deciding whether to undergo treatment.[97] The subjective standard requires the physician to disclose fully information that the individual patient would find material.[98] Under the

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mentator stated: "[T]he majority position . . . favors the paternalistic belief that the doctor knows best and that good medicine must therefore be good law." Trichter & Lewis, *supra* note 84, at 162. An alternative view of the professional standard is that "[i]t reflects the belief that medical issues are too complex for a patient to understand and the high esteem society generally accords physicians." A. ROSOFF, INFORMED CONSENT: A GUIDE TO HEALTH CARE PROVIDERS 34-35 (1981), *cited in* Comment, *Modified Standard*, *supra* note 84, at 249 n.22.

Jurisdictions that subscribe to the professional standard do not permit accepted, low-quality medical practice to serve as the standard. *See, e.g.*, Helling v. Carey, 83 Wash. 2d 514, 519 P.2d 981 (1974) (ophthalmologist liable where simple glaucoma test was not given although it was accepted medical practice not to routinely give the test).

[94] The patient-oriented standards are gaining in acceptance. Comment, *Modified Standard*, *supra* note 84, at 250. *See, e.g.*, Canterbury v. Spence, 464 F.2d 772 (D.C. Cir. 1972) (duty to disclose based on standard of reasonable person in patient's position where patient paralyzed after spinal surgery), *cert. denied*, 409 U.S. 1064 (1973); Cobbs v. Grant, 8 Cal. 3d 229, 502 P.2d 1, 104 Cal. Rptr. 505 (1972) (a patient, suffering complications following ulcer surgery, only could have made the decision to receive treatment if he had had adequate information); Scaria v. St. Paul Fire & Marine Ins. Co., 68 Wis. 2d 1, 227 N.W. 2d 647 (1975) (standard of disclosure measured by what other physicians would disclose held inadequate to provide patient information).

At some point, patient-oriented standards may become the majority rule because of their recognition of individual rights. Of the two patient standards, the objective standard has received wider acceptance than the subjective one. One commentator observed that "most minority courts have chosen an objective test." Recent Development, *Malpractice: Doctrine of Informed Consent Adopted*, 33 OKLA. L. REV. 197, 199 (1980) [hereinafter cited as Recent Development, *Doctrine Adopted*]. Only a minority of the jurisdictions accept the subjective standard. Trichter & Lewis, *supra* note 84, at 160-61. *See also* Seidelson, *Medical Malpractice: Informed Consent Cases in "Full Disclosure" Jurisdictions*, 14 DUQ. L. REV. 309, 311-12 (1976).

[95] D. LOUISELL & H. WILLIAMS, *supra* note 84, ¶ 22.15.

[96] Canterbury v. Spence, 464 F.2d at 783. *See generally* D. LOUISELL & H. WILLIAMS, *supra* note 84, ¶ 22.08.

[97] Comment, *Texas Standard*, *supra* note 84, at 294-95. *See also* Canterbury v. Spence, 464 F.2d at 786-87.

[98] Scott v. Bradford, 606 P.2d 554 (Okla. 1979). In this case, the patient suffered

subjective patient standard, the need for material information is judged from the perspective of the actual person, not from a hypothetical reasonable person.

2. *Causation*

Causation is an important factor in establishing the claim of informed consent because jurisdictions treat informed consent claims as causes of actions in negligence.[99] As in most negligence actions,[100] a causal relationship must exist between the lack of disclosure and the damage or injury to the patient.[101] Even if a patient demonstrates lack of disclosure, absent a showing of causation, the physician will not be held liable for failing to obtain an informed consent.[102] One court observed that causation was shown when "adequate disclosure could reasonably be expected to have caused that person to decline the treatment because of the kind of risk or danger that resulted in harm."[103]

Courts do differ, however, regarding the appropriate standard. There are two generally accepted standards of causation: the objective patient standard and the subjective patient standard.

Under the objective patient standard,[104] causation will be established if a

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vesicovaginal fistula after a hysterectomy. She claimed she would have foregone surgery had she known of the risks. Under a reasonable person approach, the Oklahoma Supreme Court found that "a patient's right of self-determination is *irrevocably lost*. This basic right to know and decide is the reason for the full-disclosure rule. Accordingly, we decline to jeopardize this right by the imposition of the 'reasonable man' standard." *Id.* at 559. The scope of disclosure was measured in *Scott* by the patient's need to know of all the material risks.

[99] The California Supreme Court found that a suit challenging informed consent may be brought under one of two causes of action: battery or negligence. A battery consists of any unconsented touching; the touching need not cause harm. Cobbs v. Grant, 8 Cal. 3d 229, 240, 502 P.2d 1, 7, 104 Cal. Rptr. 505, 512 (1972). The trend, however, is to treat inadequate disclosure cases as actions in negligence.

[100] PROSSER & KEETON ON TORTS, *supra* note 83, § 32, at 189-90. The doctrine of informed consent has developed in two rather distinct stages. Early cases were concerned with the total lack of consent for treatment and were actions in battery for unconsented touchings of or trespasses on the patient's body. *See* Mohr v. Williams, 95 Minn. 261, 104 N.W. 12 (1905) (battery held where physician operated on more diseased left ear although consent obtained for right ear only). *See also* PROSSER & KEETON ON TORTS, *supra* note 83, § 18, at 118-19.

Later cases have been more concerned with the "informed" nature of the consent. Physicians have been held liable under a negligence theory for injuries occuring during treatment that the patients have "consented" to undergo. In these types of cases, liability has been based on the fact that a patient had not been "informed" of the risks and alternatives to treatment. *Id. See also* D. LOUISELL & H. WILLIAMS, *supra* note 84, ¶ 22.02.

[101] Canterbury v. Spence, 464 F.2d at 790.

[102] D. LOUISELL & H. WILLIAMS, *supra* note 84, ¶ 22.11.

[103] Canterbury v. Spence, 464 F.2d at 791.

[104] *Id.* at 790-91. *See also* Meisel, *Expansion, Informed Consent*, *supra* note 88, at 110 n.169.

reasonable person would have declined treatment after disclosure of the material risks involved.[105] The physician is less subject to the patient's reliance on hindsight or disillusionment following unsuccessful treatment;[106] only if the reasonable person would have declined treatment would the physician be liable. No deference is given to the credibility of the particular patient.

Under the subjective patient standard,[107] causation exists when a *particular patient* would have foregone treatment had he or she been fully informed.[108] This standard gives great deference to the credibility of the patient.[109]

B. *Historical Developments of the Doctrine of Informed Consent*

1. *Emergence of the Doctrine*

The term "informed consent" first appeared in the 1957 case of *Salgo v. Leland Stanford Jr. University Board of Trustees.*[110] The California District Court of Appeals held that a physician subjects himself to liability if he "withholds any facts which are necessary to form the basis of an intelligent consent."[111] However, the court limited duty to inform to the physician's discretion to withhold information for the patient's mental and emotional condition.[112] While it appeared to set a subjective standard, the court ultimately determined the dis-

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[105] *See generally* Shetter v. Rochelle, 2 Ariz. App. 358, 409 P.2d 74 (1965), *modified*, 2 Ariz. App. 607, 411 P.2d 45 (1967); Scott v. Bradford, 606 P.2d 554 (Okla. 1979); Wilkinson v. Vesey, 110 R.I. 606, 295 A.2d 676 (1972). Courts generally agree that a physician need not disclose every risk which could materialize during a particular course of treatment. Comment, *Texas Standard, supra* note 80, at 392.

In *Canterbury*, 464 F.2d at 786-87, the court noted that the information to be disclosed must be *material*, stating that "the test for determining whether a particular peril must be divulged is its *materiality* to the patient's decision: all risks potentially affecting the decision must be unmasked." *Id.* (footnote omitted) (emphasis added). The court further refined its definition of a material risk: "A risk is thus material when a reasonable person, in what the physician knows or should know to be the patient's position would be likely to attach significance to the risk or cluster of risks in deciding whether or not to forego the proposed therapy." *Id.* at 787 (quoting Waltz & Schueneman, *Informed Consent to Therapy*, 64 Nw. U.L. REV. 628, 640 (1970)).

[106] Canterbury v. Spence, 464 F.2d at 786-87. *See also* Cobbs v. Grant, 8 Cal. 3d 229, 245, 502 P.2d 1, 11, 104 Cal. Rptr. 505, 515 (1972).

[107] Comment, *Texas Standard, supra* note 84, at 395.

[108] *See supra* note 98 and accompanying text.

[109] Wilkinson v. Vesey, 110 R.I. at 625, 295 A.2d at 688.

[110] 154 Cal. App. 2d 560, 317 P.2d 170 (1957) (patient paralyzed following diagnostic aortography).

[111] *Id.* at 578, 317 P.2d at 181.

[112] *Id.* at 578, 317 P.2d at 180. The language of *Salgo* formed the basis of the therapeutic exception relied on in *Nishi.*

closure decision from the perspective of the physician.[113]

Three years after *Salgo*, the Kansas Supreme Court decided *Natanson v. Kline*.[114] This medical malpractice case established the lack of informed consent as a failure to disclose risk information.[115] However, the standard of disclosure used in this case was the professional standard, developed from the language of *Salgo*, which became the generally accepted one used in informed consent cases throughout the country.[116] *Natanson* also represented one of the first cases to apply a negligence theory to informed consent rather than battery.[117]

The professional standard prevailed until the 1972 landmark case of *Canterbury v. Spence*.[118] In this case, the plaintiff-patient suffered partial paralysis as the result of back surgery and subsequent hospital care.[119] The doctor did not inform Canterbury of the risk of paralysis inherent in the procedure he planned to perform.[120] Canterbury appealed a directed verdict for the surgeon and hospital.[121] The appellate court reversed in favor of the plaintiff on the ground that

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[113] As one commentator observed about the "new" doctrine of informed consent:

> This was a startling piece of work. The [*Salgo*] court, on the one hand, posited a new duty of minimum disclosure for physicians, framed in language which strongly suggests that mere breach of the duty vitiates consent . . . without regard to whether plaintiffs would have declined the operation if the missing information had been provided. Yet, on the other hand, the court stated that, unlike the traditional disclosure for consent—what the doctor is going to do—this new duty to inform is not absolute, but subject to physician's discretion.
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> . . . Yet the court sensed the immense difficulty in stating [what facts must be disclosed] . . . thus it bowed to the "discretion" and experience of the medical profession. The law was left in profound confusion.

Katz, *supra* note 84, at 150.

[114] 186 Kan. 393, 350 P.2d 1093, *reh'g denied*, 187 Kan. 186, 354 P.2d 670 (1960).

[115] 186 Kan. at 408, 409, 350 P.2d at 1103, 1105. *Natanson* lent new terminology to the tort resulting from inadequate disclosure.

[116] A commentator on the professional standard observed that this standard bows to the traditional stronghold of the medical community. Katz, *supra* note 84, at 140, 148, 150. The author stated, "Yet judges were hesitant to intrude on medical practices. . . . Indeed, disclosure and consent, except in the most rudimentary fashion, are obligations alien to medical practice." *Id.* at 148.

By allowing doctors to determine what patients should know about the risks of medical treatment, the professional standard promotes physician paternalism and, in a sense, negates the patient's right to self-determination. Trichter & Lewis, *supra* note 84, at 162. Furthermore, it may be difficult for the patient to prove non-compliance with the accepted medical practice due to physicians' reticence to testify against each other. The standard, determined by the medical community, of which the defendant is a part, then becomes an inherently subjective one and difficult for the patient to overcome at trial. *See* Comment, *Texas Standard*, *supra* note 84, at 401-02.

[117] 186 Kan. at 401-02, 350 P.2d at 1100. *See also supra* note 100 and accompanying text.

[118] 464 F.2d 772 (D.C. Cir. 1972), *cert. denied*, 409 U.S. 1064 (1973).

[119] 464 F.2d at 776-78.

[120] *Id.* at 776-77.

[121] *Id.* at 776, 778.

there was a factual question regarding the physician's failure to disclose the material risks of treatment.[122]

In a comprehensive opinion, the *Canterbury* court refused to adopt the professional standard of duty to disclose and instead announced a new standard: the objective patient.[123] This standard, which weighs the informational needs of a reasonable, prudent person in the patient's position, supported the preservation of a patient's right to self-determination.[124]

The decision in *Canterbury* allowed the jury to decide if there was informed consent without requiring expert testimony on whether a physician failed to comply with accepted medical standards for disclosure.[125] Even though the standard announced in *Canterbury* gave patients more freedom to decide what happens to them, the court eased the burden on defendant-physicians to project the patients' level of understanding and to disclose *every* risk imaginable.[126]

As to the standard of causation, the *Canterbury* court applied the objective standard. The court expressed doubt about the patient's ability to ignore hindsight after the medical procedure,[127] even though the court espoused patient rights for a standard of disclosure. The court reasoned that the patient's response in the exploration of causality at the trial *after* the injury "hardly represent[ed] more than a guess, perhaps tinged by the circumstance that the uncommunicated hazard has in fact materialized."[128] One commentator observed that *Canterbury*'s objective test of causation "denie[d] *individuals* their right to forego treatment for personal reasons which the *average* person might not consider important."[129]

In 1979, the Oklahoma Supreme Court, in *Scott v. Bradford*,[130] refused to adopt the objective standard of causation announced by *Canterbury* and developed a subjective standard advocating patients' right to self-determination. In *Scott*, the plaintiff-patient alleged that if complications following a hysterectomy had been disclosed, she would not have undergone the surgery. The *Scott* court held in the patient's favor by adopting a subjective standard where both the failure to disclose and causation were assessed from the perspective of the *par-*

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[122] The issue of disclosure was raised along with questions of negligence in the performance of the surgery and post-surgical care. *Id.* at 779.

[123] *See supra* notes 93-98 and accompanying text.

[124] 464 F.2d at 786.

[125] Andrews, *supra* note 88, at 176.

[126] Comment, *Texas Standard*, *supra* note 84, at 398.

[127] *Canterbury*, 464 F.2d at 790-91.

[128] *Id.*

[129] Comment, *Texas Standard*, *supra* note 84, at 398 (emphasis added). The author noted that "because the decision of whether to undergo treatment is a uniquely personal decision, self-determination is denied when the materiality issue is left to jurors to decide by their standards." *Id.*

[130] 606 P.2d 554 (Okla. 1979).

ticular patient.[131] Under the *Scott* standard, if the patient considered the failure to disclose material, then causation *automatically* existed.[132] With the adoption of this subjective standard, the Oklahoma Supreme Court acknowledged the shortcoming of the objective standard in order to protect the autonomy of the individual patient.[133]

2. *Informed Consent in Hawaii*

The doctrine of informed consent was first introduced into Hawaii law through the seminal case of *Nishi v. Hartwell*[134] in 1970. In this case, Drs. Hartwell and Scully performed diagnostic surgery upon Paul Nishi, a dentist, to investigate a possible aneurysm.[135] Nishi's wife had signed a consent form.[136] Following the diagnostic procedure,[137] Nishi experienced paralysis. Although both physicians were aware of the inherent danger of paralysis associated with this type of surgery, neither disclosed the risk to Nishi.[138]

The court set out what appeared to be a subjective patient standard of disclosure.[139] Citing *Salgo*, the court stated that the physician's duty is to disclose "all relevant information concerning a proposed treatment, including the collateral hazards"[140] so that the patient can make an intelligent decision based on the information.

In actuality, however, the court adopted a professional standard of disclosure, where the physicians would not be held liable for their failure to inform fully the patient of the risks of surgery. In the opinion, the court stated that the

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[131] *Id.* at 559. Proponents of the subjective patient standard maintain that the standard gives a patient more control over his or her own destiny. Recent Development, *Oklahoma Malpractice*, *supra* note 83, at 677. On the other hand, critics of the standard have said it places too great a burden on the physician to guess what the patient needs to know. Comment, *Texas Standard*, *supra* note 84, at 396. In addition, the patient might say at trial that, had the additional information been disclosed, he or she would not have consented to the treatment; this exposes the physician to patient hindsight. Waltz & Schueneman, *supra* note 105, at 629. Thus, the clear advantage rests with the patient under the subjective approach.

[132] *See supra* note 98.

[133] Trichter & Lewis, *supra* note 84, at 163.

[134] 52 Hawaii 188, 473 P.2d 116 (1970). *Nishi* is Hawaii's leading case on informed consent. *See also* Frey v. Goebert, 52 Hawaii 308, 309, 474 P.2d 537, 537-38 (1970) (a medical malpractice case which briefly addressed the issue of informed consent, but ruled the evidence did not support the plaintiff's claim).

[135] 52 Hawaii at 190, 473 P.2d at 119.

[136] *Id.* at 190, 473 P.2d at 118.

[137] *Id.*

[138] *Id.* at 190, 473 P.2d at 119.

[139] *Id.* at 191, 473 P.2d at 119. The court's decision paralleled the reasoning of *Salgo*.

[140] *Id.* (citing Salgo v. Leland Stanford Jr. Univ. Bd. of Trustees, 154 Cal. App. 2d 560, 317 P.2d 170 (1957)).

physician's liability in a malpractice action was determined "by reference to medical standards."[141] This contradicted the court's apparent adoption of a patient standard, but followed the same course as the *Salgo* decision in adopting a professional standard of disclosure. While the opinion appeared ambiguous, *Nishi* is often cited as a professional standard of disclosure case.[142]

Whether the supreme court intended to apply a professional or a patient standard of disclosure, the court found that the exception of the therapeutic privilege applied, and thus held in favor of the defendant-doctors.[143] Accepting the doctors' testimony that "full disclosure would not be in Dr. Nishi's best medical interest in view of [his] psychological condition,"[144] the court found the omission to fall clearly within the exception to informed consent.

In 1976, the Hawaii State Legislature responded to the increase of medical malpractice suits[145] and enacted legislation relating to medical torts.[146] The statute provided that in an action involving lack of informed consent, the health care provider could introduce evidence that he or she complied with certain standards for informed consent established by the Board of Medical Examiners.[147] To meet that end, the statute required that the Board develop standards

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[141] 52 Hawaii at 195, 473 P.2d at 121. The court added, however, that the physician had the authority and discretion to withhold information which might be detrimental "to the patient's total care and best interest." *Id.* at 191, 473 P.2d at 119 (citing Salgo v. Leland Stanford Jr. Univ. Bd. of Trustees, 154 Cal. App. 2d at 578, 317 P.2d at 181). By so stating, the court adopted the therapeutic privilege to the rule of disclosure. This privilege has been criticized for providing a loophole for the physician. The burden on the patient is increased as physicians may not want to testify against each other. *See infra* note 205 and accompanying text. The *Nishi* court was also criticized for allowing the defendants to serve as expert witnesses on the standard of care.

[142] D. LOUISELL & H. WILLIAMS, *supra* note 84, ¶ 22.06.

[143] 52 Hawaii at 191, 473 P.2d at 119.

[144] *Id.* at 194, 473 P.2d at 120.

[145] The increase of medical malpractice cases nationally in the 1970's gave rise to legislatures enacting bills to alleviate the situation. By 1980, 24 states had enacted informed consent legislation (Alaska, Delaware, Florida, Hawaii, Idaho, Iowa, Kentucky, Louisiana, Maine, Nebraska, Nevada, New Hampshire, New York, North Carolina, North Dakota, Ohio, Oregon, Pennsylvania, Rhode Island, Tennessee, Texas, Utah, Vermont, and Washington). Only one state, Georgia, has rejected informed consent legislation. Meisel, *supra* note 1, at 197-98. *See also* PROSSER & KEETON ON TORTS, *supra* note 83, at 192-93.

Hawaii represents one of only eight states that remain "silent on the standard of disclosure." Andrews, *supra* note 88, at 179. Furthermore, Hawaii and Texas are the only two states that direct an administrative agency to create informed consent standards (and forms) for health care providers. In describing the task given to the local Board of Medical Examiners, one commentator noted that both Hawaii and Texas allow standards developed by these agencies to be challenged by either the patient or the physician but "neither specifies the grounds upon which such a challenge can be made." Andrews, *supra* note 88, at 179-80.

[146] HAWAII REV. STAT. ch. 671 (1976).

[147] *Id.*

"designed to reasonably inform and to be understandable by a patient."[148]

In 1983, the legislature amended the statute, incorporating verbatim the general disclosure requirements announced by the Board.[149] The current statute calls for standards to reasonably inform a patient of:

(1) The condition being treated;
(2) The nature and character of the proposed treatment or surgical procedure;
(3) The anticipated results;
(4) The recognized possible alternative forms of treatment; and
(5) The recognized serious possible risks, complications, and anticipated benefits involved in the treatment or surgical procedure, and in the recognized possible alternative forms of treatment, including non-treatment. . . .[150]

Although these provisions provide guidelines for informed consent, the statute fails to denote whether the professional or patient standard of disclosure applies.[151] As a result of this omission, physicians are unsure of how much they need to tell their patient and from whose viewpoint. Litigators stand equally unsure of how to prove liability under the statute.

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[148] The Health and Judiciary Committees of the State House of Representatives remarked about the bill amending the law:

> [T]he range of procedures subject to consent . . . was so large that the Board [of Medical Examiners] found it impossible to develop standards for each procedure. Your Committees agree that this task may be too large for the Board, but remain convinced that there are some procedures which are so controversial . . . that they should receive special attention. . . .
>
> Accordingly, your Committees have amended S.B. No. 236, S.D. 1 to require the Board to develop standards for informed consent, insofar as practicable, commencing with mastectomies.

H.R. STAND. COMM. REP. NO. 823, 11th Hawaii Leg., Reg. Sess., 1983 HOUSE J. 1219-20.

The standards for mastectomies have been issued in response to HAWAII REV. STAT. § 671-3(c) and are presently the only ones that the Board of Medical Examiners has developed. The directive was published in J. HAWAII MED. A., Mar. 1984, at 63. However, the guidelines for breast cancer are somewhat ambiguous in that the requirements of HAWAII REV. STAT. § 671-3 (b)(1), (b)(3), and (b)(5) (the information on the condition being treated, the anticipated results, and the risks of non-treatment respectively) are omitted.

[149] The amended statute, which incorporated the Board's general guidelines, called for the Board of Medical Examiners to develop specific standards of informed consent for mastectomies. HAWAII REV. STAT. § 671-3 (Supp. 1984). *See supra* note 148.

[150] HAWAII REV. STAT. § 671-3 (Supp. 1984).

[151] *See supra* note 145 and accompanying text.

V. AN ANALYSIS OF THE *Leyson* COURT'S TREATMENT OF INFORMED CONSENT

In *Leyson v. Steuermann*, the ICA examined the doctrine of informed consent, focusing on the standards of disclosure and causation. Although this discussion was merely dicta, the court's adoption of a modified objective standard of causation represents the most recent pronouncement on informed consent by an appellate court in Hawaii.

The *Leyson* court first considered the standard of disclosure. In doing so, the court reviewed *Nishi v. Hartwell*.[152] The ICA found *Nishi* internally contradictory.[153] According to the ICA's interpretation, *Nishi* recognized the duty of a physician to disclose "to his patient all relevant information covering a proposed treatment, including the collateral hazards."[154] Yet, the *Nishi* court seemed to adopt the professional standard by referring to the "relevant medical standard" of disclosure[155] and allowing the exception of therapeutic privilege.[156]

Despite this apparent inconsistency, the ICA conceded that *Nishi* stood for the professional standard. The *Leyson* court, however, criticized the professional standard for its failure to recognize the patient's right to self-determination.[157]

The ICA then reviewed the relevant statutory provisions governing informed consent.[158] The court found no clarification,[159] noting that the statute applied a different duty than *Nishi*, by imposing on the physician a duty to disclose "the probable risks and effects of the proposed treatment or surgical procedure."[160] Further, the court could not determine whether the legislature intended the statute to supplant the ambiguity of *Nishi* or to explain it.[161]

The *Leyson* court may have misinterpreted *Nishi v. Hartwell* by stating that its standard of disclosure was unclear.[162] Although some language in *Nishi* does support a patient's right to self-determination, commentators tend to agree that

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[152] 52 Hawaii 188, 473 P.2d 116 (1970). *Nishi* is also often cited for two other principles: for establishment of a therapeutic privilege (*see supra* notes 88, 141) and for allowing the defendants to serve as the expert witnesses for the plaintiff (*see infra* note 164). D. LOUISELL & H. WILLIAMS, *supra* note 84, ¶ 22.27.

[153] 6 Hawaii App. at ___, 705 P.2d at 44.

[154] 52 Hawaii at 191, 473 P.2d at 119.

[155] *Id.* at 195, 473 P.2d at 121.

[156] *Id.*

[157] 6 Hawaii App. at ___, 705 P.2d at 44, 47.

[158] *Id.* at ___, 705 P.2d at 45-46.

[159] *Id.*

[160] HAWAII REV. STAT. § 671-3 (Supp. 1984).

[161] 6 Hawaii App. at ___, 705 P.2d at 45-46. The *Leyson* court stated that "[i]t is not clear . . . whether the legislature's intent was to supplant *Nishi*'s ambiguously defined duty of disclosure." *Id.*

[162] *Id.* at ___, 705 P.2d at 44.

Nishi supports a professional standard of disclosure.[163] Indeed, at the time the court decided *Nishi*, the professional standard was the only applicable standard in informed consent cases.[164]

The court's analysis of the informed consent legislation appears to be sound. The statute states that fulfillment of the general guidelines[165] can be used for prima facie evidence of informed consent.[166] Interestingly, however, the statute does not articulate any particular *standard* of disclosure, namely, whether disclosure should entail the perspective of the doctor, the actual patient or the reasonable patient. Arguably, the statute *implies* a patient standard by its incorporation of patient-favorable language.

As the ICA noted, the legislative history does not reveal whether the guidelines were designed to supplant the standard in *Nishi*.[167] Nor does the legislative history shed light on which standard of disclosure the lawmakers intended to prevail.[168] In other words, the standard of disclosure for informed consent in the current legislation is unclear.

The *Leyson* court did propose a totally new standard of causation.[169] In its opinion, the court emphasized the various perspectives of causation,[170] including the perspective of the actual patient,[171] a reasonable person in the patient's

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[163] D. LOUISELL & H. WILLIAMS, *supra* note 84, ¶ 22.27.

[164] *See supra* notes 110-18 and accompanying text. *Nishi*, viewed in its historical context, seems to set forth only a professional standard. In 1970, no other standard existed. *Canterbury*, setting forth one of the first patient-oriented standards, was decided in 1972, two years after *Nishi*. Additionally, Justice Abe's dissent in *Nishi* gives the impression that the court indeed endorsed a professional standard. He stated:

> [E]ven under the negligence theory, the burden of proof on the issue of non-disclosure should be on the physicians and they should be required to prove by testimony of disinterested expert witness that under established standard of medical practice they were justified in not fully disclosing to Dr. Nishi the collateral hazards attendant.

52 Hawaii at 210, 473 P.2d at 128.

Justice Abe did not dissent from the professional standard used in *Nishi*. Rather, he objected to the court's switching the nature of the suit from plaintiff's battery theory to a court-imposed theory of negligence. In addition, Justice Abe objected to the defendant-physicians' self-serving expert testimonies. *Id.* at 207, 473 P.2d at 127. He felt that the burden of proof for non-disclosure should not fall totally on the plaintiff because of physicians' reticence to testify against one another and that defendant-physicians should shoulder the burden of proving by expert testimony that they did not have a duty to inform Nishi of the potential hazards.

[165] HAWAII REV. STAT. § 671-3. *See supra* note 148-50 and accompanying text.

[166] HAWAII REV. STAT. § 671-3.

[167] *See supra* note 161 and accompanying text.

[168] *See supra* notes 145, 151 and accompanying text.

[169] 6 Hawaii App. at ___ n.10, 705 P.2d at 47 n.10.

[170] *Id.* The court found "[t]here is disagreement whether this question [of causation] should be examined from the viewpoint of Leyson, a reasonable person in Leyson's position, an ordinary person in Leyson's position, or some other viewpoint." *Id.*

[171] Scott v. Bradford, 606 P.2d 554 (Okla. 1979). *See supra* notes 130-32 and accompanying

position,[172] and other "viewpoints" as well.[173] After setting forth these perspectives, the ICA opted for a rather innovative causation standard[174] "that determines the question from the viewpoint of the *actual* patient acting *rationally* and *reasonably*."[175] The court coined this standard the modified objective standard of causation.

This new standard of causation closely resembles the subjective standard adopted by the Oklahoma Supreme Court in *Scott*, because of the recognition of patient rights. By using the term "actual patient,"[176] the new standard represents a split from the trend of authority.[177]

The *Leyson* court did not discuss, however, the facts of *Leyson* with respect to causation. The court apparently arrived at this modified objective standard of causation simply by merging its support for the patient's right to self-determination with its concern for the physician's difficulty in second-guessing the patient's hypothetical reaction to full disclosure.[178]

Although the court adopted a standard of causation,[179] the court failed to articulate clearly a standard of disclosure. This may have been due to the necessary deference to the Hawaii Supreme Court's decision in *Nishi*. Even though the ICA expressed concern for the rights of a patient to determine what happens to him or her, the court declined the opportunity to clarify a standard of disclosure which would stand consistent with its causation standard. By announcing a modified objective patient standard of causation and by providing a discussion favoring a patient's right to self-determination,[180] however, the *Leyson* court seemed to endorse an objective patient standard of disclosure.

Had the ICA been able to apply these objective patient-oriented standards, the result may have been different. The inquiry would have centered on the disclosure to Leyson, instead of whether Dr. Steuermann acted according to the norms of the medical community. If the jury felt that this disclosure, or lack of it, would have caused a reasonable person to forgo the treatment and that the

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text.

[172] Canterbury v. Spence, 464 F.2d 772 (D.C. Cir. 1972), *cert. denied*, 409 U.S. 1064 (1973).

[173] 6 Hawaii App. at ___ n.10, 705 P.2d at 47 n.10.

[174] *See supra* notes 99-109 and accompanying text.

[175] 6 Hawaii App. at ___ n.10, 705 P.2d at 47 n.10.

[176] *Id.*

[177] *See supra* notes 100-05 and accompanying text.

[178] 6 Hawaii App. at ___ n.10, 705 P.2d at 47 n.10. The court noted: "Moreover, we recognize that what a reasonable and competent physician thinks his patient should be told is not necessarily what the patient would find significant in making his decision. *Since it never happened, however, it is impossible to determine what Leyson would have done had he been properly informed.*" *Id.* (emphasis added).

[179] *Id.*

[180] *Id.* at ___, ___ n.10, 705 P.2d at 44, 47 n.10.

treatment caused Leyson's injuries, the jury probably would have reached a different result.

VI. IMPACT

A. *The Procedural Aspect-Jury- Instructions*

Although the holding of *Leyson* does not add to existing Hawaii case law on procedure,[181] it reaffirms an important point. To preserve errors on appeal, attorneys must raise timely and specific objections at trial.[182] If attorneys deliberately agree to unfavorable jury instructions, the ICA will reject the plain error rule.[183] Thus, attorneys who gamble with jury verdicts may deny their clients a fair trial either by not objecting in a timely and appropriate manner or by assuming clients will win regardless of the attorneys' actions.[184]

B. *The Substantive Issue—Informed Consent*

In strong and persuasive dicta, the *Leyson* court analyzed the doctrine of informed consent.[185] The court did not articulate a standard of disclosure, but did propose a modified objective standard of causation.[186]

Although the ICA's proposed causation standard manifests in dicta, it is important in several respects. The ICA's modified objective patient standard of causation implies the court's support for a patient-oriented standard of disclosure and the opinion alerts the community to this.

The *Leyson* opinion also reaffirms the original purpose of the informed consent doctrine, namely, to recognize the right of the individual to decide for himself what should happen to his body.[187] Affording the individual the right to self-determination lessens the traditional prerogative of physicians to set their own legal standards. The professional standard of disclosure is arguably a narrow one, bowing to the traditional stronghold of the medical community in setting its own legal standards.[188] As the *Canterbury* court aptly noted,

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[181] D. LOUISELL & H. WILLIAMS, *supra* note 84, ¶ 22.11.

[182] 6 Hawaii App. at ____, 705 P.2d at 48.

[183] *See supra* notes 51-53, 69, 74, 79.

[184] As a precautionary measure and as a rule of thumb, attorneys should preserve the record for appeal by careful adherence to the procedural rules. Further, the ICA implied that deliberate agreement to jury instructions, as a ploy to activate plain error on appeal, will likely preclude such an action. *See supra* notes 67-73 and accompanying text.

[185] 6 Hawaii App. at ____, 705 P.2d at 44-48.

[186] *Id.* at ____ n.10, 705 P.2d at 47 n.10.

[187] Canterbury v. Spence, 464 F.2d at 781.

[188] Katz, *supra* note 84, at 150.

"[r]espect for the patient's right to self-determination on particular therapy demands a standard set by law *for* physicians rather than one which physicians may or may not impose upon themselves."[189]

With the foundation of *Leyson*'s more patient favorable standards of informed consent, other ramifications come to the forefront. Some of these are what the disclosure should entail, the extension of informed consent to nonsurgical treatment cases, what effect *Leyson* will have on litigation, and the effects on health care.

1. *The Scope of the* Leyson *Decision*

a. Disclosure

In *Leyson*, the ICA did not specify what "disclosure" actually entails. Most courts agree that practical necessity precludes full disclosure[190] and require that the physician only disclose reasonably material risks to the patient.[191] Courts do not agree, however, from whose viewpoint these risks are considered material:[192] the physician's or the patient's. In Hawaii, the prevailing standard is the professional standard which applies the physician's viewpoint.[193]

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[189] 464 F.2d at 784 (footnotes omitted) (emphasis added).

[190] In discussing the difficulty of full disclosure, the *Canterbury* court stated:

> The courts have frequently confronted this problem [the scope of disclosure] but no uniform standard defining the adequacy of the divulgence emerges from the decisions. Some have said *"full" disclosure, a norm we are unwilling to adopt literally*. It seems obviously prohibitive and unrealistic to expect physicians to discuss with their patients every risk of proposed treatment—no matter how small or remote—and generally unnecessary from the patient's viewpoint as well. Indeed, the cases speaking in terms of "full" disclosure appear to envision something less than total disclosure, leaving unanswered the question of just how much.

Id. at 786. (footnotes omitted) (emphasis added).

One commentator noted that:

> Although the informed consent cases often speak in terms of requiring full disclosure, they also acknowledge that the physician is not obliged to tell the patient everything that is medically known . . . about the procedure. There are several reasons for this. First, some of what the physician knows is too complex to be communicated meaningfully to the layperson . . . . However if one chooses to do so, simple language must be used . . . . [T]he courts . . . have concluded that *practical considerations preclude giving the patient all information about a particular procedure*. Finally, some of the information that could be disclosed is irrelevant . . . to the patient's decisionmaking process and therefore need not be disclosed.

Meisel, *supra* note 1, at 201-02 (emphasis added).

[191] *Canterbury*, 464 F.2d at 787.

[192] *See supra* note 89 and accompanying text.

[193] *See supra* note 164 and accompanying text.

Additionally, the ICA did not specify the quality of the disclosure to the patient. Clearly, "patient comprehension serves as the keystone of true and viable informed consent."[194] Since Hawaii's population includes diverse cultures and languages,[195] physicians should be aware that language barriers could exist. Physicians, therefore, must ensure effective consent, i.e., that the patient actually *comprehends* the information presented by the physician. Arguably, unless the patient actually consented to the procedure, consent would not be effective, intelligent, and rational.[196] If the quality of disclosure becomes embodied in statute, health care providers will need to consider additional measures. The employment of interpretive services may be necessary to ensure effective comprehension of disclosure to make an informed consent.

b. Causation

If Hawaii were to adopt the specific standard of causation that the *Leyson* court set forth, Hawaii would stand unique among the jurisdictions.[197] Most jurisdictions follow either the subjective (actual patient) or objective (reasonably prudent patient) standards of causation.[198] The ICA's proposed standard finds a middle ground between these two standards: the actual patient acting rationally and reasonably.[199] This innovation combines the underlying rationale of informed consent—protection of the patient's individual rights—with the reasonableness requirement that eases the burden of guess work and patient hindsight on the physician.[200]

While the *Leyson* court did not define "rationally" and "reasonably" in its hybrid standard, one can suppose that the court intended the generally accepted meaning of the "reasonably prudent person" standard which the courts use in negligence cases. Future litigation will certainly shape the boundaries of "reasonable" and "rational actions" by the actual patient to determine causation. It

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[194] Note, *Medical Malpractice: Towards a Viable Disclosure Standard for Informed Consent*, 32 OKLA. L. REV. 868, 888 (1979).

[195] Results of the 1980 census in Hawaii revealed the following population breakdown: 26.3% Causasian, 23.5% Japanese, 17.9% part-Hawaiian, 11.2% Filipino, 9.4% mixed races (other than Hawaiian), 5.1% Chinese, 1.0% Hawaiian, 1.2% Samoan, 1.3% Korean, 1.3% Black, 0.7% Puerto Rican and 1.2% unknown or other. Additionally, 16.4% of the entire population of the state is foreign born. ATLAS OF HAWAII 112-13 (1983).

[196] *See supra* note 85 and accompanying text.

[197] A modified objective standard would resemble the minority subjective standard of causation promulgated by Scott v. Bradford, 606 P.2d 554 (Okla. 1979), which staunchly advocated patient rights. *See supra* notes 130-32 and accompanying text.

[198] *See supra* notes 99-109 and accompanying text.

[199] 6 Hawaii App. at ___ n.10, 705 P.2d at 47 n.10.

[200] Waltz & Schueneman, *supra* note 105, at 640. *See* Canterbury v. Spence, 464 F.2d at 786-87; Cobbs v. Grant, 8 Cal. 3d 229, 245, 502 P.2d 1, 11, 104 Cal. Rptr. 505, 515 (1972).

is likely that juries will allow recovery where the patient appears credible and the injury is severe.

c. *Extension of Informed Consent to Drug Treatment*

Drug treatment, like surgery, should implicate the patient's right to determine what happens to his or her body. This is particularly true since injuries resulting from non-surgical treatment might be just as material and devastating as those involving surgical procedures.[201] Therefore, informed consent should be required in drug treatment as well.

Yet, informed consent cases usually involve surgical treatment. The ICA's concern with informed consent in *Leyson*, a drug treatment case, demonstrates the court's willingness to extend the doctrine of informed consent to other areas of health care, including drug therapy.[202]

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[201] "[I]nformed consent does not apply only to surgical procedures. . . . If a drug puts a patient at risk, the patient should be so informed." For example, in Sharpe v. Pugh, 270 N.C. 598, 155 S.E.2d 108 (1967), the court found a physician liable because he prescribed Chloromycetin for the plaintiff's child without warning that aplastic anemia could result as a side-effect. A corollary to this rule requires drug companies to fully inform physicians of adverse side effects of their products. G. ANNAS, L. GLANTZ, & B. KATZ, THE RIGHTS OF DOCTORS, NURSES AND ALLIED HEALTH PROFESSIONALS 76 (1981) (footnotes omitted).

[202] The cases most frequently discussed for informed consent involve surgical procedures. *See* Canterbury v. Spence, 464 F.2d 772, 780 (D.C. Cir. 1972) (back surgery), *cert. denied*, 409 U.S. 1064 (1973); Reidisser v. Nelson, 111 Ariz. 542, 534 P.2d 1052 (1975) (hysterectomy); Cobbs v. Grant, 8 Cal. 3d 229, 502 P.2d 1, 104 Cal. Rptr. 505 (1972) (ulcer surgery); Salgo v. Leland Stanford Jr. Univ. Bd. of Trustees, 154 Cal. App. 2d 560, 317 P.2d 170 (1957) (aortography); Nishi v. Hartwell, 52 Hawaii 188, 473 P.2d 116 (1970) (aortography); Woolley v. Henderson, 418 A.2d 1123 (Me. 1980) (back surgery); Scott v. Bradford, 606 P.2d 554 (Okla. 1979) (hysterectomy).

For examples of cases involving drug treatment and informed consent, see, e.g., Niblack v. United States, 438 F. Supp. 383 (D. Colo. 1977) (cortisone-related injury where physician not liable as patient probably would not have rejected the treatment); Hamilton v. Hardy, 37 Colo. App. 375, 549 P.2d 1099 (1976) (case involving use of the drug Ovulen); Calabrese v. Trenton State College, 162 N.J. Super. 145, 392 A.2d 600 (1978) (case involving rabies shots), *aff'd*, 82 N.J. 321, 413 A.2d 315 (1980); Koury v. Follo, 272 N.C. 366, 158 S.E.2d 548 (1968) (case involving use of the drug Strep-Combiotic); Sharpe v. Pugh, 270 N.C. 598, 155 S.E.2d 108 (1967) (case involving use of Chloromycetin); Mueller v. Mueller, 88 S.D. 446, 221 N.W.2d 39 (1974) (cortisone-related injury); Marsh v. Arnold, 446 S.W.2d 949 (Tex. Civ. App. 1969) (use of the drug Kantrex).

See also Natanson v. Kline, 186 Kan. 393, 350 P.2d 1093 (informed consent issue in use of radiation treatment), *reh'g denied*, 187 Kan. 186, 354 P.2d 670 (1960) (*supra* notes 114-17 and accompanying text). Pennsylvania does not apply informed consent to therapeutic procedures. *See* Malloy v. Shanahan, 280 Pa. Super. 440, 421 A.2d 803 (1980).

2. *Effects on Litigation*

Adoption of patient-oriented standards of disclosure and causation would represent a significant departure from the former professional standard. Such a change would surely enhance a patient's chances of prevailing at trial since he or she would have an easier burden of proof.[203] By applying this standard, courts will no longer require expert testimony to prove the standard of disclosure. Such testimony only would be necessary to explain technical medical terms or procedures.[204]

Moreover, the patient would not have to face the "community of silence,"[205] where physicians stand reticent to testify against their colleagues. Instead, the patient's own testimony that his or her doctor did not provide full and adequate disclosure of a material risk would be sufficient.[206]

This standard would not serve as an advantage to physicians.[207] Consequently, physicians will argue that *Leyson* rests on procedural grounds and the suggested standard of causation lies merely in dicta. Further, physicians will contend that the *Leyson* court misinterpreted *Nishi*.[208] While the ICA maintained the standard of disclosure adopted in *Nishi* was ambiguous, physicians will argue that the *Nishi* court actually offered a professional standard of disclosure.[209]

In the short run, therefore, the number of informed consent suits could increase[210] because of the eased trial burden for the patient. Concomitantly, the obligation on the physician would increase. Moreover, where the physician may have "underdisclosed" risk information before the adoption of a patient-oriented standard, he or she might "overdisclose" in the future to satisfy the patient's need to know.[211]

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[203] As one author states, "[s]ome commentators have expressed the fear that patients [would] be unable to prevail in the professional standard jurisdictions because of the requirement of expert medical evidence to prove negligence." Comment, *Texas Standard*, *supra* note 84, at 401 (footnotes omitted).

[204] D. LOUISELL & H. WILLIAMS, *supra* note 84, ¶ 22.09. *See also* Canterbury v. Spence, 464 F.2d at 792.

[205] D. LOUISELL & H. WILLIAMS, *supra* note 84, ¶ 22.11.

[206] Canterbury v. Spence, 464 F.2d at 792; D. LOUISELL & H. WILLIAMS, *supra* note 84, ¶ 22.09. Query whether this would raise evidentiary hearsay problems. *See* HAWAII R. EVID. 801.

[207] *See also* Comment, *Texas Standard*, *supra* note 84, at 401.

[208] *See supra* notes 162-64 and accompanying text.

[209] *See supra* note 164 and accompanying text.

[210] *See generally* Meisel, *Expansion, Informed Consent*, *supra* note 88; Curran, *Malpractice Insurance: A Genuine National Crisis*, 292 NEW ENG. J. MED. 1223 (1975).

[211] Time spent by a physician in providing full disclosure might cause the negative effect of additional doctor fees. However, physicians could offset this cost if insurance rates and litigation costs eventually drop. *See infra* note 224 and accompanying text.

The long-term effect of a patient-oriented standard would probably result in a decrease in the amount of informed consent litigation. This is so because a requirement of disclosure from the patient's viewpoint would probably improve the communcation between the physician and patient, thus improving overall physician-patient relations and diminishing the possibility of dissatisfaction and ensuing litigation.[212] Additionally, the physician, by fulfilling the disclosure requirement, will make himself less susceptible to a lawsuit.[213] Frivolous claims would not hold up with conclusive proof of disclosure of relevant, material risks.[214] As one court stated, "the more communication . . . the less litigation."[215] The better informed patient will have greater confidence in the physician and will therefore be less likely to bring an action against him.

3. *Health Care Advancements*

The adoption of a patient-oriented standard of disclosure would improve communication between the physician and the patient.[216] Increased communication would reduce the chance of misunderstanding and strengthen the relationship between the physician and patient.[217] The patient would become a better informed health consumer and learn more about his own medical situation.[218] The patient also would be able to ask better questions or feel freer to seek a second opinion.[219] Moreover, a patient who is aware of the course of a proposed treatment recovers more quickly.[220]

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[212] Trichter & Lewis, *supra* note 84, at 165.

[213] *Id.*

[214] *Id.* at 167.

[215] Wilkinson v. Vesey, 110 R.I. 606, 629, 295 A.2d 676, 690 (1972).

[216] Andrews, *supra* note 88, at 165; Trichter & Lewis, *supra* note 84, at 165.

[217] Trichter & Lewis, *supra* note 84, at 165-66. The court in *Wilkinson* summarized the benefits of informed consent on the patient-physician relationship:

> Besides being good medicine, good humanity, good public relations, and good medicolegal defense, [the duty to inform] has a therapeutic value all its own. The informed and consenting patient, aware of the risk, is not so shocked should the risk turn up in his case and, if patient-physician rapport is high, is much less likely to sue his doctor in the first instance.

Wilkinson v. Vesey, 110 R.I. at 629, 295 A.2d at 690 (citing G. MORRIS & A. MORITZ, DOCTOR AND PATIENT AND THE LAW (5th ed. 1971)).

[218] Trichter & Lewis, *supra* note 84, at 165-66.

[219] *Id.*

[220] Studies show that disclosure of information actually benefits the patient's adjustment to the procedure. I. JANIS & L. MANN, DECISION MAKING: A PSYCHOLOGICAL ANALYSIS OF CONFLICT, CHOICE, AND COMMITMENT 367-404 (1977). The authors concluded that the benefits of disclosure also included an "emotional inoculation," where the patient is made aware of the potential crisis before it occurs. This advance information allows the patient to emotionally anticipate and prepare for the impending event. *Id.* at 389. *See also* Andrews, *supra* note 88, at 165-68; Trichter

With a better informed consumer population, the delivery of health care should improve. Full disclosure will cause the physician to review his own treatment decisions with more precision and avoid his own judgment biases.[221] Full disclosure would also open up a "dialogue" between the physician and the patient, leading to a freer flow of important information.[222] Indeed, full disclosure could improve the physician's overall decision-making process. In addition, the more aware patient could decline treatment that was unnecessary, inappropriate, or "one advocated more for the benefit of the practitioner than the patient."[223]

If litigation would decrease and the quality of health care would increase under the *Leyson* standards, the effects will be beneficial for both patients and physicians. Patients would find greater satisfaction with the quality of their health care as well as enjoy the opportunity to participate in its selection. Decreased litigation might also have a beneficial effect on the physician's insurance rates.[224]

Adopting the patient-oriented standards suggested by *Leyson* would bring Hawaii's doctrine of informed consent in line with its original purpose of preserving the patient's right to determine what happens to his or her body.[225] The development of case law nationally[226] acknowledges this right; the case law also demonstrates less deference to the physician's role in the patient's decision to undergo treatment.[227] If Hawaii adopts the proposed *Leyson* standards, the Hawaii courts would join the trend of authority.[228]

& Lewis, *supra* note 84, at 166.

[221] Andrews, *supra* note 88, at 170-71. In regard to improvements in medicine, one author noted that "[e]ven drug companies would be forced to reduce the risks of their medications, make fuller disclosures, and promote more research in the areas of curative and preventive medicine." Trichter & Lewis, *supra* note 84, at 167-68 (footnote omitted).

[222] Andrews, *supra* note 88, at 170-71.

[223] *Id.* at 169.

[224] Interview with Professor Richard S. Miller, William S. Richardson School of Law, University of Hawaii (Jan. 14, 1986).

[225] The adoption of informed consent might affect other professions as well. By analogy, informed consent could have an impact on the legal profession. For example, attorneys are required to inform a client of the reasonable alternatives in a legal matter. The HAWAII CODE PROF. RESP. EC 7-8 (1981) states, "A lawyer should exert his best efforts to insure that decisions of his client are made only after his client has been informed of the relevant considerations. . . . A lawyer should advise his client of the possible effect of each legal alternative." EC 7-11 states, "The responsibilities of a lawyer may vary according to the intelligence, experience, mental condition or age of a client, or the nature of a particular proceeding." *See also* PROSSER & KEETON ON TORTS, *supra* note 83, § 32, at 189 n.52.

[226] Meisel, *supra* note 1, at 200.

[227] Katz, *supra* note 84, at 140, 143; Trichter & Lewis, *supra* note 84, at 162.

[228] As Justice Abe stated in his dissent in *Nishi*, "This court has indicated its willingness to pioneer new case laws to bring about justice and fairness and to meet the needs of changing

VII. Conclusion

Hawaii's courts and legislature need to look seriously at the doctrine of informed consent. As one commentator aptly put it:

> Informed consent is an ethical command. It has deep and strong roots in the individualistic tradition of the English common law. Informed consent reflects one of our highest ethical values—individual autonomy; it implicates strong emotional needs both for control over our own lives and for dependence upon others; and it deals with a subject of fundamental importance, our health. It is little wonder it is a source of so much conflict, confusion, and strongly held positions.[229]

In *Leyson v. Steuermann*, the ICA addressed the doctrine of informed consent. Although the decision rested on procedural grounds,[230] the court provided a lengthy discussion of informed consent. Specifically, the court opted for a modified objective standard of causation[231] and thereby inferred its preference for the patient standard of disclosure. In its analysis, the court found both the existing legislation and Hawaii case law ambiguous.[232]

Indeed, Hawaii's doctrine of informed consent urgently requires clarification. *Leyson* serves as the first step in this process. It will be interesting to see whether Hawaii courts will continue with the progressive trend and adopt patient-oriented standards of disclosure and causation of informed consent when next faced with the issue.

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time." 52 Hawaii at 211, 473 P.2d at 128 (footnote omitted).

The Hawaii Supreme Court has produced progressive law, especially in the area of torts: Rodrigues v. State, 52 Hawaii 156, 472 P.2d 509 (1970) (recovery for serious mental harm caused by property damage); Leong v. Takasaki, 55 Hawaii 398, 520 P.2d 758 (1974) (recovery for mental distress where boy saw step-grandmother struck and killed despite no physical injury to him); Campbell v. Animal Quarantine Station, 63 Hawaii 557, 632 P.2d 1066 (1981) (recovery for mental distress where family pet died due to defendant's negligent care). Two cases which represent the Hawaii Supreme Court's prodivity to pioneer the law are Dold v. Outrigger Hotel, 54 Hawaii 18, 501 P.2d 368 (1972) (recovery in contract action allowed due to spoiled vacation plans) and Chung v. Kaonohi Center Co., 62 Hawaii 594, 618 P.2d 283 (1983) (punitive damages awarded for willful breach of contract).

[229] Meisel, *supra* note 1, at 198.

[230] *See supra* notes 18-19, 59-73 and accompanying text.

[231] 6 Hawaii App. at ___ n.10, 705 P.2d at 47 n.10.

[232] *Id.* at ___, 705 P.2d at 44.

Hawaii Surface Water Law: An Analysis of *Robinson v. Ariyoshi*

I. Introduction

Robinson v. Ariyoshi[1] (*Robinson III*), a critical link in the development of surface water law[2] in Hawaii, represents the latest controversy between the State of Hawaii and private property owners regarding the ownership, diversion and use of surface water from the Hanapepe River on the island of Kauai.[3] *Robinson III*

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[1] 753 F.2d 1468 (9th Cir. 1985) (*Robinson III*).

[2] Surface water in this note will refer to water that occurs in natural and artificial watercourses and as storm and freshet water as opposed to groundwater or artesian water. For a discussion of groundwater law in Hawaii, *see* Comment, *Groundwater Rights in Hawaii: Status and Suggested Change*, 8 U. HAWAII L. REV. 517 (1986).

Hawaiian surface water law terminology includes: appurtenant water, prescriptive water, normal surplus water, and storm and freshet surplus water. *See generally* DEP'T OF BUDGET & FINANCE, STATE OF HAWAII, LAND AND WATER RESOURCE MANAGEMENT IN HAWAII 177-81, 185-87 (1979) (J. Van Dyke, Team Leader) [hereinafter cited as WATER RESOURCE MANAGEMENT]; 2 W. HUTCHINS, WATER RIGHTS IN THE NINETEEN WESTERN STATES 172-89 (1974); 1 WATERS AND WATER RIGHTS (R. Clark ed. 1967).

[3] Kauai is an island with a central mountainous area. It has rainfall of 400 to 500 inches per year that decreases towards the perimeter of the island. Territory v. Gay, 52 F.2d 356, 357 (9th Cir.) (*Territory II*), *cert. denied*, 284 U.S. 677 (1931). The mountainous rainfall feeds the watersheds of two streams, the Manuahi and the Koula. The two streams meet approximately half-way to the sea to form the Hanapepe River which then flows over increasingly dry land. *Id.*

The Robinsons succeeded in interest to the water rights for the Koula and Manuahi streams through property transfers after the the Great Mahele by purchasing property consisting of the ilianas of Manuahi and Koula. WATER RESOURCE MANAGEMENT, *supra* note 2, at 195. These ilianas were parts of the ahupuaa of Hanapepe which originally was part of King Kamehameha III's crown lands. Territory v. Gay, 26 Hawaii 382, 384 (1922).

Robinsons' predecessors and their lessees have diverted water from the Hanapepe River since 1891. *Territory II*, 52 F.2d at 356. Current diversions upriver have now made the river almost dry at its mouth. McBryde v. Robinson, 54 Hawaii 174, 177, 504 P.2d 1330, 1334 (1973) (*McBryde I*).

McBryde Sugar Co. now owns the southeast portion of the Hanapepe Valley and the state controls the southwest portion. WATER RESOURCE MANAGEMENT, *supra* note 2, at 197. The parties have been litigating the superiority of their surface water rights for over 60 years.

was an appeal to the Ninth Circuit Court of Appeals by the state.[4] The state opposed enforcement of an injunction imposed by the federal district court[5] that banned state officials from interfering with the Robinsons'[6] existing water diversion systems. The state also opposed the federal ruling invalidating state ownership of surface waters in Hawaii and the riparian water regime[7] as announced by the Hawaii Supreme Court in *McBryde Sugar Co. v. Robinson* (*McBryde I*).[8]

In *Robinson III*, the Ninth Circuit Court of Appeals dealt with both procedural and substantive issues of whether the state supreme court can properly divest property interests under the fifth and fourteenth amendments of the United States Constitution[9] by changing the existing water regime. The court held that while the state is empowered to change the balance of public and private water rights, it could only take vested surface water rights through eminent domain.[10]

This note will focus primarily on the substantive aspects of the shift in surface water rights from the traditional water law system as it developed under

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[4] The state has filed a petition for certiorari to the U.S. Supreme Court. *See* 54 U.S.L.W. 3170 (Sept. 24, 1985).

[5] Robinson v. Ariyoshi, 441 F. Supp. 559 (D. Hawaii 1977) (*Robinson I*).

[6] Plaintiffs-Appellees, successors in interest to Gay & Robinson Company, included the trustees under the will of Aylmer F. Robinson, Helen M. Robinson, Individually and as Executrix, Estate of Lester B. Robinson, and Bruce B. Robinson and Keith P. Robinson. Defendants-Appellants were the State of Hawaii, McBryde Sugar Co., Olokele Sugar Co., and other small landowners. *See id.*

[7] Riparian rights are:

> [T]he right to use water. . .without prejudicing the riparian rights of others and the right to the natural flow of the stream without substantial diminution and in the shape and size given it by nature. . . .[T]he riparian right appertains only to land adjoining a natural watercourse for its use.

McBryde I, 54 Hawaii at 198, 504 P.2d at 1344.

The doctrine of riparianism was first declared in Carter v. Territory, 24 Hawaii 47 (1917), but this was later overruled in favor of "traditional Hawaiian water law" in Territory v. Gay, 31 Hawaii 376 (1930) (*Territory I*). In *McBryde I*, 54 Hawaii 174, 504 P.2d 1330, the court reinstated the riparian doctrine for Hawaii's surface water. *See infra* note 33 and accompanying text. *Robinson I* enjoined state ownership of surface water and the shift to riparianism as Hawaii's water regime declared in *McBryde I*. *Robinson III*, 753 F.2d at 1471.

[8] 54 Hawaii 174, 504 P.2d 1330, *aff'd on rehearing*, 55 Hawaii 260, 517 P.2d 26 (1973) (*McBryde II*), *appeal dismissed and cert. denied*, 417 U.S. 962 (1974) (*McBryde III*). *McBryde I* gave the state a claim to the surface water of the Hanapepe River on Kauai by overruling *Territory I*, 31 Hawaii 376 (1930), which held that the Gay & Robinson Co. owned the "normal surplus water" and had the right to divert water for use outside the Hanapepe drainage area.

[9] U.S. CONST. amend. V provides in part: "No person shall be. . .deprived of life, liberty, or property, without due process of law, nor shall private property be taken for public use without just compensation." U.S. CONST. amend. XIV, § 1 provides in part: "[N]or shall any State deprive any person of life, liberty, or property, without due process of law."

[10] 753 F.2d at 1475.

the ancient Hawaiians[11] to the riparian doctrine of water law as announced by *McBryde I* and as modified by the *Robinson* cases. This note will also discuss the impact of this controversial shift as it affects the state's attempts to reconcile the traditional Hawaiian relationship to water with modern needs.

II. History and Facts

A. *Ancient Hawaiian Surface Water Rights*

As an island people, ancient Hawaiians valued land and fresh water. In response to finite resources, the Hawaiian kings developed the konohiki system of property distribution to allocate control and use of the island resources. The king, who controlled[12] all land and water, granted units of land, or ahupuaas, to his chiefs, or konohikis, under a hierarchical land tenure system.[13] Each konohiki could then allocate various parts of the ahupuaa to his subjects in the form of ilianas, or ilis. In addition, the king could allocate a portion of one konohiki's ahupuaa to another konohiki forming an ili kupono (an independent ili) within that ahupuaa.[14]

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[11] Hawaiian land and property terms are explained in Territory v. Bishop Trust Co., 41 Hawaii 358, 361-62 (1956). For a discussion of ancient Hawaiian property and water law, see generally W. Hutchins, *supra* note 2; Waters and Water Rights, *supra* note 2.

Some commentators have argued that what had been characterized as ancient Hawaiian law was really a misunderstanding of ancient Hawaiian water rights and principles of "ownership" by jurists and legal scholars who attempted to describe the Hawaiian system in western legal terms. *See, e.g.*, Water Resource Management, *supra* note 2, at 176-77.

[12] Ancient sovereign control over water has been described as:

> [T]he King was the sole owner of the water as he was [with] the rest of the land and could do with either or both as he pleased. In later years, the rule seems to have been for him not to dispossess tenants of their lands except for cause and to that extent, perhaps, he would not have deprived cultivators of the water to which their lands were by usage entitled. But no limitation, as far as we can learn, ever existed or was supposed to exist to his power to use the surplus waters as he saw fit.

Hawaiian Commercial & Sugar Co. v. Wailuku Sugar Co., 15 Hawaii 675, 680 (1904). Some commentators have stated that the king's interest in the land and water of Hawaii was not a vested or personal right but a right as trustee, deriving from divine authority. *See, e.g.*, Water Resource Management, *supra* note 2, at 148 (citing E. Handy & E. Handy, Native Planters in Old Hawaii 63 (1972)).

[13] The Hawaiians were not bound to the land or to the chief of the village in the way people were under the European feudal system. The tenants of an ahupuaa were responsible for tending the land and creating and maintaining water courses for irrigation to that land; however, they were free to leave. Water Resource Management, *supra* note 2, at 148.

[14] The Hawaii Supreme Court has explained the significance of and difference between an ahupuaa and ili and an ili kupono:

> [E]rroneous opinions have sometimes prevailed as to what are "Ahupuaas" and "Ilis."
>
> An Ahupuaa has been called the "unit" of land in this country; but is by no means a

The water rights associated with the ahupuaa were clearly under the control of the konohiki of the ahupuaa.[15] The konohiki was responsible for the allocation of water, which was primarily used for taro cultivation.[16] The konohiki was required to provide access to water for drinking and for other domestic uses by the tenants who worked the land.[17]

If the watershed was located within an ili kupono, then the konohiki of that ili kupono controlled the water; if the watershed was located outside an ili kupono, then the konohiki of the ahupuaa controlled the water.[18] In any ahupuaa which the king retained, but within which he granted an ili kupono, he was presumed to have retained control over all of the water.[19]

> measure of area, for Ahupuaas vary exceedingly as to size. Many Ahupuaas are divided into Ilis; other Ahupuaas have no Ilis in them. . . .
>
> There are two kinds of Ilis. One, the Ili of the Ahupuaa, [is] a mere subdivision of the Ahupuaa for the convenience of the chief holding the Ahupuaa. . . .The Konohikis of such Ilianas. . .brought their revenues to the chief holding the Ahupuaa.
>
> The other class were the "Ili Kupono". . . .These were independent of the Ahupuaa [and the Chief of the Ili Kupono did not have to] pay general tribute [to the Ahupuaa].
>
> In some cases these Ilianas are very numerous, absorbing the larger part of the Ahupuaas. . . .
>
> The Ilis in question in this suit are not distinctly named "Ili Kuponos," this name not being preserved in the mahele; but all the Ilis that were recognized and treated in the mahele and awarded by the Commission were undoubtedly "Ili Kuponos." This name was dropped, for, when separated from the Ahupuaa by mahele and subsequent award, its necessity was gone. All other Ilis went with the Ahupuaa in which they were situated, and were not further distinguished.

Harris v. Carter, 6 Hawaii 195, 206-07 (1877).

[15] In Reppun v. Board of Water Supply, 65 Hawaii 531, 656 P.2d 57 (1982), the court described the native system of water allocation:

> Perhaps the essential feature of the ancient water system was that water was guaranteed to those natives who needed it, provided they helped in the construction of the irrigation system. . . .Beneficial use of water by the [tenants] were also essential to the continued delivery of water. . . .[A] "spirit of mutual dependence and helpfulness prevailed, alike among the high and low, with respect to the use of water."

Id. at 540, 656 P.2d at 64 (quoting WATER RESOURCE MANAGEMENT, *supra* note 2, at 141).

A contrary view was expressed by the court in the *Territory* cases and by legal scholars and commentators who characterized the water as having been owned absolutely by the king and distributed to the konohikis to allocate the water for the king. Land owners were believed to also own the right to divert and use water. *Territory I*, 31 Hawaii 376.

[16] *See infra* note 31.

[17] Access to drinking water was assured to lower konohikis and their tenants. Access to running water has been codified in HAWAII REV. STAT. § 7-1 (1976). It was this provision that served as the basis for riparianism in later case law. *See infra* note 47 and accompanying text.

[18] *See Territory I*, 31 Hawaii at 381-82.

[19] *McBryde I*, 54 Hawaii at 184, 504 P.2d at 1337. In *Robinson I*, essentially, the court noted that *McBryde I* allowed the state to step into the position of the king, controlling all the water in the area of the original ahupuaa of Hanapepe. *Robinson I*, 441 F. Supp. at 565.

B. Modern Water Rights

Western contact brought increasing pressures to provide for private ownership. In 1848, King Kamehameha III significantly changed the property system of Hawaii. When he undertook the Great Mahele,[20] private property was created for the first time in Hawaii.[21] Ultimately, the crown lands given to the government became property of the Territory of Hawaii.[22]

Surface water litigation in the late 1800's centered on the uncertain water rights associated with the new land grants under the Great Mahele. In 1867 the first water law case in Hawaii, *Peck v. Bailey*,[23] established the concept of appurtenant water rights, based on the court's interpretation of the ancient konohiki system. The *Peck* court held that an appurtenant landholder could divert and use that volume of water that historically had been diverted under the native konohiki system.[24] The *Peck* court further held that landholders within an ahupuaa were entitled to use the water running through their respective lands.[25] The owner of the lower ili was entitled to the amount of water previously diverted "by immemorial usage" as an easement appurtenant.[26]

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[20] "The term *mahele* means to divide or apportion. . . .[T]he Great Mahele of 1848. . .accomplished the division of the undivided interest in land between the King on one hand and the chief and konohikis on the other." *McBryde I*, 54 Hawaii at 182 n.5, 504 P.2d at 1336 n.5. *See generally* J. CHINEN, THE GREAT MAHELE: HAWAII'S LAND DIVISION OF 1848 (1958).

[21] In the Great Mahele, land was distributed to the king and his family, the landlords (konohikis and chiefs), and the tenants. The chiefs who had previously held lands released their lands to the king, who then redistributed them, reserving some land for his personal estate (crown lands). After a grant, the new owner applied to the newly-formed Land Commission for conversion to a formal award and allodial title upon payment of a commutation. The king then divided his retained personal lands, giving the larger portion to the government for public use, and keeping a smaller portion for his own estate. Harris v. Carter, 6 Hawaii at 198, 200-01.

[22] Organic Act § 73 (3), Act of Apr. 30, 1900, ch. 339, 31 Stat. 141. The Admission Act provided that the state succeeded to the title of the territory's public lands. Act of Mar. 18, 1959, Pub. L. No. 86-3, § 5(a), 73 Stat. 4.

[23] 8 Hawaii 658 (1867) (Downriver sugar mill operators claimed that defendants were diverting more water from an illegal dam than allowed under the native Hawaiian water system.).

[24] *Id.* at 672.

[25] *Id.* at 671. The *Peck* court discussed riparianism but concluded that appurtenant rights allowed the diversion of more water according to the needs of the parties.

[26] *Id.* at 661. In addition, the court held "[w]hen a party has the right of water, he can use it for any purpose, although different from the original use, and in a different place, if the change does not effect iujuriously [sic] the rights of others." *Id.* at 666.

Harris v. Carter, 6 Hawaii 195 (1877), held that property rights associated with an ahupuaa granted under the Great Mahele were not superior to the property rights of an ili kupono granted within the confines of that ahupuaa. A grant of an undesignated ili was, in essence, an independent ili kupono unless specifically designated otherwise. In addition, lands retained by King Kamehameha III as crown lands did not require commutation to the Land Commission because they were rights vested in him as sovereign. *Id.* at 206-07.

In the 1917 case of *Carter v. Territory*,[27] the Hawaii Supreme Court changed the water regime of Hawaii from the appurtenant doctrine to the doctrine of riparianism.[28] *Carter* held that riparianism would be binding on the use of surface water where water flowed from a private land owner's ahupuaa to the territory's ahupuaa.[29] The court held that upper riparian owners must follow the "proportional diminution"[30] principle in times of relative drought to allow

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Hawaiian Commercial & Sugar Co. v. Wailuku Sugar Co., 15 Hawaii 675 (1904), dealt with rights to water from the Wailuku River on Maui. The plaintiff claimed the defendant was diverting illegal amounts of water to irrigate dry, or kula, land some distance away thereby reducing the amount that was available. The court held that plaintiff had appurtenant rights established by historic usage and that the defendants could not divert all surplus water and transport it to kula land. *Id.* at 698-99.

[27] 24 Hawaii 47 (1917).

[28] Appurtenant use is not the same as riparian use. Riparian water rights include the right to use flowing water on land adjoining natural watercourses without prejudicing the riparian rights of others downstream, or the right of others to the natural flow of the watercourse without substantial diminution and in the shape and size given it by nature. *McBryde I*, 54 Hawaii at 199, 504 P.2d at 1344. Appurtenant rights were differentiated from riparian rights by the *Peck* court as follows: "A riparian proprietor has a qualified property in the soil to the thread of the stream, with all the privileges annexed thereto by law. . . *.If the rights of these parties were limited to those of riparian proprietors, they would be much less than they are.*" *Peck*, 8 Hawaii at 670 (emphasis added).

[29] The *Carter* court held that the doctrine of prior appropriation, used almost exclusively in the western United States, had no realistic application to Hawaii. The common foundation of this doctrine is the requirement of beneficial use. The right to use can be lost if the user does not continue beneficial use or if water is not used over a period of time. Under the Hawaiian system, while the water rights were tied to the land in which the water originates, there was always an amount available for downstream users either by need or by prescriptive right.

Additionally, *Carter* held that even without specific mention, water rights passed with the land in the grant. 24 Hawaii at 58. The court noted that:

> By the deed, the water courses were conveyed and [included] a right to the water accustomed to flow in them. The same principle applies to all the lands conveyed by the King, or awarded by the land commission. If any of the lands were entitled to water by immemorial usage, this right was included in the conveyance as an appurtenance. An easement appurtenant to land will pass by a grant of the land without mention being made of the easement or the appurtenance.

Id. (quoting Peck v. Bailey, 8 Hawaii 658, 661 (1867)).

Carter further held that:

> [T]he Territory is the *owner* of all the waters. . .to the extent of the ordinary or normal flow; that the Territory lawfully maintains the dam and pipe system whereby it diverts water from the stream. . .that the [landowner] is entitled to the surplus normal flow, if any, after all domestic requirements are satisfied, for artificial purposes to the extent of the quantity to which the lands owned by him were entitled for such purposes by custom at the time the lands first passed into private ownership, whatever that quantity was. . . .

24 Hawaii at 70-71 (emphasis added).

[30] Proportional diminution is the theory that provides landowners with a rule to deal with drought and diminishing flow by allowing a proportional decrease in all diversions. *Id.* at 61.

downstream users access to water.[31]

Litigation over the property rights in the Hanapepe River Basin began twelve years later in *Territory v. Gay (Territory)*.[32] The court held that Gay & Robinson owned the ili of Koula because the mahele to Gay & Robinson's predecessor was procedurally proper as prescribed by the Minister of the Interior of the Territory.[33] The court also held that the ili of Koula owned by Gay & Robinson was an independent ili kupono and not an inferior part of the ahupuaa controlled by the territory.[34]

After Gay & Robinson established ownership of the upper part of the ahupuaa of Hanapepe, the problem of who controlled the water flowing in the Hanapepe River arose. Gay & Robinson, as upper riparian landholders, diverted increasing volumes of water from the river; the territory, which controlled the down river land, was faced with diminishing water resources.

The substantive water rights to the Hanapepe River Basin were adjudicated eight years later in *Territory v. Gay (Territory I)*.[35] The territory claimed, as successor to the king's crown land of the ahupuaa of Hanapepe, that it was entitled to all the surplus waters in the Hanapepe River.[36]

The *Territory I* court limited *Carter*.[37] The court held that normal surplus water belonged to the owner of the land from which the water originated and could be diverted by the owner.[38] Gay & Robinson's right to divert water from the stream was restricted only by the amount of water allocated to downstream users by virtue of their appurtenant and prescriptive water rights.[39] *Territory I* established that Gay & Robinson's rights to normal surplus water were not inferior to those of the territory because Gay & Robinson's ili kupono was

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[31] Traditionally, in times of drought, the konohiki had the ability to determine which users had the right to divert and use water for cultivation and which did not. *Id.* at 61-62.

[32] 26 Hawaii 382 (1922).

[33] *See id.* at 385.

[34] *Id.* at 393.

[35] 31 Hawaii 376 (1930).

[36] *Id.* at 381. The territory claimed under two alternate theories of ownership: (1) the ilis of Koula and Manuahi were inferior to the ahupuaa of Hanapepe and the territory, as the owner of the ahupuaa, was the owner of all of the surplus waters of the Hanapepe stream, and (2) if the ilis of Koula and Manuahi were not inferior to the ahupuaa of Hanapepe they were not superior and therefore, under the ruling in *Carter*, the surplus water should be divided proportionately. The territory also claimed that because there were no arable lands in the upper ilis which needed irrigation and there were arid arable lands in the lower part of the ahupuaa of Hanapepe requiring water, the territory should be entitled to all surplus water. *Id.* at 381-82.

[37] Chief Justice Berry would have overruled *Carter*, however, he did not command a majority on this point. Justice Parsons did not join in "that part of the opinion . . . for the sole reason that such disapproval is not necessary to a determination of the issues before us." *Id.* at 404 (Parsons, J., dissenting in part). *See* WATER RESOURCE MANAGEMENT, supra note 2, at 189-91.

[38] *Territory I*, 31 Hawaii at 388.

[39] *Id.* at 395-96.

independent and of equal legal stature to the territory's ahupuaa.[40] In 1931, the Ninth Circuit Court of Appeals affirmed *Territory I* noting that water rights are properly adjudicated by state courts that are familiar with local customs and laws.[41]

Thus, the water rights of Gay & Robinson and their lessees had withstood challenges in both the territorial and federal courts. The normal surplus water rights were owned by Gay & Robinson and other land holders who had gained appurtenant water rights. McBryde Sugar Company and Gay & Robinson believed their rights to divert and consume "normal surplus water" of the Hanapepe River were confirmed.[42] Subsequently, they developed agricultural irrigation systems worth millions of dollars in the Hanapepe River basin.[43]

Upon Hawaii's annexation in 1898, the land grants from the king to his subjects and their successors became personal property recognized and protected by the state.[44] This presumably included the associated water rights as determined by the territorial and federal courts.

In 1973, the Hawaii Supreme Court overruled *Territory I* in *McBryde I*[45] and held that the doctrine of riparian water rights[46] controlled the use of water in the Hanapepe River Basin based on section 7-1 of the Hawaii Revised Statutes and its historic roots.[47] The court determined that there could be no such classi-

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[40] *Id.* at 380-82.

[41] *Territory II*, 52 F.2d 356, 359 (upholding *Territory I* on the basis that the state water law was very technical and complex and ruled by local custom and tradition).

The territory brought an equity action in the First Territory Circuit to enjoin Gay & Robinson from diverting water and maintaining a dam that restricted the flow of water to downstream owners. *See Territory v. Gay*, 32 Hawaii 404 (1932) (*Territory III*). The First Circuit determined it did not have jurisdiction because of forum non conveniens. It was "inequitable and oppressive" in terms of cost of litigation and transportation for some of the parties who lived on Kauai because the First Circuit was in Honolulu. *Id.* at 414.

[42] The water rights in force until the *McBryde* litigation included the ability to divert, use, and consume water.

[43] As of December 31, 1972, McBryde alone had invested $11,863,392.43 in capital irrigation improvements to their sugar plantation. *Robinson I*, 441 F. Supp. at 574.

[44] *See supra* note 22.

[45] 54 Hawaii 174, 504 P.2d 1330. At this time, Gay & Robinson and McBryde Sugar Co. were the major users of the water from the Hanapepe River. The controvery started in 1949 when Gay & Robinson installed a large ditch and tunnel system which allowed them to divert substantially greater quantities of water than before. By the time of the *McBryde* litigation, Gay & Robinson was diverting so much water from the Hanapepe River that McBryde was unable to maintain their diversion levels. *McBryde II*, 55 Hawaii at 263-65, 517 P.2d at 28-29 (Levinson, J., dissenting). The trial court determined the quantities of water each party could divert based on a formula for appurtenant rights. The trial court also found that McBryde was entitled to prescriptive water rights, but a prescriptive right cannot be held against the state. *McBryde I*, 54 Hawaii at 198, 504 P.2d at 1344-45.

[46] *See supra* note 7.

[47] HAWAII REV. STAT. § 7-1 (1976) provides in pertinent part:

fication as normal surplus water because riparian owners had only reasonable and beneficial use of water.[48] In addition, the *McBryde I* court held that nonriparian landholders had *no* rights to divert water.[49]

This adversely affected Gay & Robinson as they had been diverting water and transferring it to nonriparian lands. Under *McBryde I*, they had only the right to use the water in the Hanapepe River on their riparian land and had no superior water diversion rights to downstream users.[50]

In addition, the *McBryde I* court held the state to be the owner of all the water in the Hanapepe River.[51] The court declared that a private landholder

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> [The people] shall. . .have a right to drinking water, and running water, and the right of way. The springs of water, running water. . .shall be free to all, on all lands granted in fee simple; provided that this shall not be applicable to wells and watercourses, which individuals have made for their own use.

The *McBryde I* court based its decision on several factors. (1) Appurtenant rights recognized by *Territory I* were essentially riparian rights. 54 Hawaii at 191, 504 P.2d at 1341. The *Territory I* court stated, "Water for domestic purposes on a lower ahupuaa is in any event assured under Hawaiian law." 31 Hawaii at 395. (2) The codification of appurtenant rights in the "Enactment of Further Principles" was a "statutory enactment of the doctrine of riparian rights recognized as part of the common law by the English and Massachusetts courts." 54 Hawaii at 197, 504 P.2d at 1344. This was an act from 1850 of the Hawaiian Kingdom which provided:

> The people also shall have a right to drinking water, and running water, and the right of way. The springs of water, and running water, and roads shall be free to all, should they need them, on all lands granted in fee simple: Provided, that this shall not be applicable to wells and water courses which individuals have made for their own use.

Act of Aug. 6, 1850, L. 1850, § 7, 1850 Hawaii Sess. Laws 202, 203-04, *compiled in* REV. LAWS HAWAII, Appendix at 2141, 2142 (1925).

[48] Under the riparian doctrine, upper riparian land holders have only the right to reasonable and beneficial use of water which is not detrimental to downstream users. The concept of beneficial use means that a riparian land holder may use whatever volume he needs even if it diminishes the flow of the river or stream. The riparian user can only take water from the river or stream for artificial purposes (*e.g.*, use resulting in profit) if it does not impede the flow or injure downstream riparian users. "Beneficial use is. . .involved in the distinction between natural and artificial uses. . . .[I]f a riparian's use of water on his own land is patently not beneficial, his use is not reasonable as against other riparians whose use is clearly beneficial." 1 WATERS AND WATER RIGHTS, *supra* note 2, § 19.1.

[49] 54 Hawaii at 198, 504 P.2d at 1344.

[50] *Id.* Interbasin transfer is a large problem under the riparian doctrine where demand exceeds supply. For a discussion of riparianism and interbasin transfer, see Abrams, *Interbasin Transfer in a Riparian Jurisdiction*, 24 WM. & MARY L. REV. 591 (1983).

[51] 54 Hawaii at 187, 504 P.2d at 1339. The *McBryde I* court based its decision to give ownership of the flowing waters to the state on language in the Land Commission Principles. *Id.* at 186-87, 504 P.2d at 1338-39. The Land Commission Principles were established by the Land Commission to quiet private land titles after the Great Mahele. The *McBryde I* court focused on the Land Commission mandate to "encourage. . .and to enforce the usufruct of land for the common good." *Id.* at 186, 504 P.2d at 1338. The court noted, "We believe that the right to water is one of the most important usufruct of lands. . .reserved for the people of Hawaii and for their common good in all of the land grants," *id.*, and the Land Commission Act "was very

cannot maintain a prescriptive right against the state.[52] The *McBryde I* court did not apply its findings to existing diversions leaving the water diversion rights of the Robinsons uncertain.[53]

Believing their vested property rights were taken by the *McBryde I* decision in violation of the fifth and fourteenth amendments, McBryde Sugar Company and Gay & Robinson filed a motion for rehearing. The Hawaii Supreme Court denied the rehearing, summarily refusing to consider the constitutional questions.[54] Two justices dissented in *McBryde II*, noting that section 7-1 of the Hawaii Revised Statutes did not adopt the common law doctrine of riparianism[55] and that the state did not have title to all water in the Hanapepe River.[56]

Successors to Gay & Robinson filed suit in federal district court to enjoin the state from enforcing the judgment in *McBryde I*. The Robinsons and other landowners claimed the holding of *McBryde I* was an unconstitutional violation of the fifth and fourteenth amendments. The Robinsons and other landowners argued that the Hawaii Supreme Court did not adequately consider the constitutionality[57] of the "taking" of their vested water rights by the dramatic change in the water law and that condemnation and just compensation were required.

In 1977, the federal district court granted a permanent injunction against the state. In *Robinson v. Ariyoshi* (*Robinson I*),[58] the court invalidated state owner-

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similar to. . .common law rules. . .that no one may acquire property to running water. . .*that flowing water was publici juris*; and that it was the common property to be used by all who had a right of access to it. . . ." *Id.* at 187, 504 P.2d at 1339 (emphasis original).

[52] *Id.* at 198, 504 P.2d at 1344-45.

[53] *See* Robinson v. Ariyoshi, 65 Hawaii 641, 666, 658 P.2d 287, 305 (1982) (*Robinson II*) ("[W]e understand *McBryde* to be silent on the actual application of the rights delineated therein to existing diversions.").

[54] 55 Hawaii 260, 517 P.2d 26. The Hawaii Supreme Court limited the issues for *McBryde II* and directed the parties to submit supplementary briefs that considered:

> (1) Whether HRS § 7-1 was material to the determination of the water rights of the parties, and (2) whether owners of parcels of land in the Hanapepe Valley, who were entitled to appurtenant water rights for taro raising at the time of the Mahele or the Land Commission Award, were entitled to apply appurtenant water rights to parcels of land other than that to which the court found the right was appurtenant.

Id. at 261, 517 P.2d at 27.

[55] The dissent in *McBryde II* did not agree with the majority holding that HAWAII REV. STAT. § 7-1 provides the rationale for riparianism in Hawaii. The dissent theory focused on policy, statutory construction, analysis of Hawaiian usage and judicial precedent. *McBryde II*, 55 Hawaii at 284-98, 517 P.2d at 39-47.

[56] In dissent, Justice Levinson noted that the Land Commission Act did not allow a state claim of ownership because "if all 'usufructs' of land were retained by the king, then nothing but bare legal title was passed by the Mahele and subsequent Land Commission Awards." 55 Hawaii at 270, 517 P.2d at 32. In addition, ownership of water should be based on Hawaiian custom and previous state court decisions. *Id.*

[57] *See supra* note 56 and accompanying text.

[58] 441 F. Supp. 559 (D. Hawaii 1977).

ship of surface water and riparianism.[59] The court thus implied that the appurtenant water rights system, as set forth in the *Territory* cases, was the appropriate water law doctine for Hawaii.

The state appealed to the Ninth Circuit Court of Appeals, claiming that the substantive water rights of the parties had already been adjudicated by the Hawaii Supreme Court. The state also appealed the injunction issued by *Robinson I*, claiming that the riparian doctrine did not effect a taking of vested property rights.[60]

The Ninth Circuit certified six questions to the Hawaii Supreme Court.[61] In 1982, the Hawaii Supreme Court responded in *Robinson v. Ariyoshi* (*Robinson II*).[62] The underlying premise of the court's responses was the doctrine of riparianism.[63] The court re-emphasized that the shift to the riparian system did not effect a taking of vested property rights.[64] By the time of *Robinson III*, water law in Hawaii had evolved dramatically from the ancient to the riparian system.

III. Analysis of Court Opinion

The Ninth Circuit Court of Appeals faced difficult procedural and substantive questions in *Robinson III*. The procedural issue was whether a federal court had jurisdiction to adjudicate state water rights.[65] The substantive water law

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[59] *Id.* at 586.

[60] The state also argued that this was an improper horizontal appeal and that the Ninth Circuit lacked jurisdiction. *See infra* note 66. *See generally* Chang, *Unraveling* Robinson v. Ariyoshi: *Can the Courts "Take" Property?*, 2 U. Hawaii L. Rev. 57 (1979).

[61] *Robinson II*, 65 Hawaii 641, 658 P.2d 287 (1982).

[62] The Ninth Circuit asked, "Does [*McBryde I*] preclude any or all appellees from bringing an action in state court alleging that their property was taken without compensation in violation of the Fifth Amendment of the United States Constitution?" *Id.* at 657-58, 658 P.2d at 300. The Hawaii Supreme Court responded that the Robinsons and other landowners would not be precluded from bringing an action "to enjoin the cessation of particular diversions." *Id.* at 666, 658 P.2d at 305.

The Ninth Circuit also asked, "Until [*McBryde I*] was decided had the question of who owned surplus water been a settled question in Hawaii law?" *Id.* at 667, 658 P.2d at 305. The Hawaii court responded that "even in the original *McBryde* action, the parties implicitly conceded that, far from being settled, the law governing surplus water was in a state of flux and confusion and that the court had both the power and the duty to reassess and resolve the situation." *Id.* at 673, 658 P.2d at 309-10.

[63] *Id.* at 676-77, 658 P.2d at 311-12. *Cf. Reppun*, 65 Hawaii at 564, 656 P.2d at 78 (The state could not divert water obtained by purchase from other landowners in a way that was injurious to reasonable and beneficial riparian use.).

[64] *Robinson II*, 65 Hawaii at 659-60, 656 P.2d at 301-02.

[65] The state argued that (1) there was no case or controversy because the state had not acted to induce the Robinsons to cease or change their existing water diversions, (2) the Hawaii Supreme Court, as the proper arbiter of state property rights had previously defined the ownership of the

issue was whether the state, by suddenly changing the water law system, effected a taking of a vested property right.[66] More specifically, the issue was whether the Robinsons' water rights had vested, and if they had, whether those rights were taken by the *McBryde I* decision.[67]

A. *Vesting and Ownership of Water Rights*

The *Robinson III* court held that the Robinsons' water rights had vested.[68] The court based its decision on several factors.[69]

1. *Property Interests*

The *Robinson III* court acknowledged the Robinsons' substantial property interests: The Robinsons' water rights "which as private property had been bought, sold and leased freely, and which had been the subject of state and local taxation as well as condemnation for ditch rights-of-way."[70] The court thus implied that the Robinsons had private ownership of water rights.

The state disputed the Robinsons' private ownership of water rights.[71] The state argued that *McBryde I* correctly characterized the Robinsons' water diver-

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water in the Hanapepe River in *McBryde I*, and (3) any remaining federal questions following the *McBryde* cases have been precluded by the res judicata effect of the United States Supreme Court denial of both appellate review and certiorari in *McBryde III*. 753 F.2d at 1471.

The court held that a case or controversy did exist as "the litigation history of the past half century, together with the language of *McBryde I* and *II*, constitutes a sufficient cloud upon the title of the plaintiffs so as to interfere substantially with the financing of improvements or any potential sale of their lands." *Id.*

In addition, the court held that res judicata was not a bar because the Hawaii Supreme Court had refused to hear the Robinsons' federal question claims. Thus, the due process claims were unlitigated. *Id.* at 1471-73.

Controversy has surrounded the jurisdiction issue. The state argued that the federal suit was an impermissable "horizontal appeal" or collateral attack on the Hawaii Supreme Court's *McBryde I* and *McBryde II* decisions. For a discussion of this issue, see W. CHANG, THE ENFORCEMENT OF CONSISTENCY IN HAWAIIAN WATER RIGHTS: AN INTRODUCTION TO *Robinson v. Ariyoshi*, (Office of Water Research and Technology Technical Paper No. 120, 1978); Chang, *Unraveling* Robinson v. Ariyoshi, *supra* note 60.

[66] 753 F.2d at 1473.

[67] In addition, the appeal considered the injunction placed on the state by the district court. *Id.* at 1474-75.

[68] *Id.* at 1474.

[69] *Id.* at 1473.

[70] *Id.* For a discussion of water as a property interest, see generally 1 WATERS AND WATER RIGHTS, *supra* note 2, § 53.

[71] The state based its argument on the *publici juris* doctrine of *McBryde I*. Addendum to Appellants' Reply Brief at 7-8, Robinson v. Ariyoshi, 753 F.2d 1468 (9th Cir. 1985).

sions not as a "private property" right but as a usufructuary right,[72] incident to owning property riparian to the Hanapepe River.[73] Based on this theory, the Robinsons originally had, if anything, only a very limited property right.[74]

The major difference between the *Robinson* and the *McBryde* cases was the characterization of "ownership"[75] of water. It could be argued that *McBryde I* held that the state should have an ownership interest giving it the right to regulate *the use* of water for the public benefit but no right as a sovereign "owner" of the Hanapepe River. The *Robinson I* court noted, however, that the "government has bought and paid for privately owned surface water and all branches of the Hawaiian government have consistently dealt with surface water however owned or acquired by the government in all respects and in the same manner as private persons."[76] This could explain why the *Robinson* courts have been skeptical of the state's interest in the water of the Hanapepe River and have been unwilling to accept the state's *publici juris* interpretation of surface water in Hawaii.[77] This would also explain why the *Robinson III* court upheld the finding that *if the state acted to enforce McBryde I*, by asserting a superior claim or restricting diversions, it would constitute a taking of the Robinsons' water rights.[78] In lifting the injunction against the state, the *Robinson III* court implied that the state was the owner of all *unallocated* surface water in Hawaii.[79]

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[72] A usufructuary right under the riparian system is the right to *use* water not an ownership interest. 1 WATERS AND WATER RIGHTS, *supra* note 2, § 16.1.

[73] *See supra* note 71.

[74] *See* W. KLOOS, N. AIPA & W. CHANG, WATER RIGHTS, WATER REGULATION, AND THE "TAKING ISSUE" IN HAWAI'I 19 (Water Resources Research Center, Univ. of Hawaii, Technical Rep. No. 150, 1983) (thesis offered that (1) "all water rights, including both ancient Hawaiian and common law rights, are rights to *use* water, not rights of ownership in water," and (2) "[a]n individual's property is found in the use rights that apply to him, not in his physical ownership of water as a commodity.") (emphasis original).

[75] There are different types of state "ownership" of water rights, *publici juris* and *res publicae*. Trelease, *Government Ownership and Trusteeship of Water*, 45 CALIF. L. REV. 638, 640-41 (1957). Private usufructuary rights can attach to surface water by the doctrine of *publici juris*, i.e., water belonging to the public. *Id.* at 641. The state in *Robinson III* contended that surface water in Hawaii was controlled by the state in a *publici juris* sense. Addendum to Appellants' Reply Brief, *supra* note 71.

Res publicae is a sovereign proprietary right. As applied to water rights, a state owns the water in its sovereign capacity for the common benefit of all people. Trelease, *supra*, at 640-41. The significance of this is under what theory the state was to "own" the water of the Hanapepe River in *McBryde I*.

[76] 441 F. Supp. at 577.

[77] Standing alone, the *McBryde I* holding that the state owned the water in trust for the public does not conflict with the Robinsons' continuing ability to *divert* water. It conflicts with the Robinsons' *ownership* of the water.

[78] *Robinson III*, 753 F.2d at 1474.

[79] Since the *Robinson III* court held that the state could change the system of water rights in

2. *Previous Decisions*

Reliance by the Robinsons on previous adjudication of water rights was an important factor that the *Robinson III* court used in concluding that the Robinsons' water rights had vested.[80] By summarily holding that the Robinsons' rights vested after *Territory I*,[81] the *Robinson III* court avoided a discussion of the doctrinal tension which exists between the *Territory* and *McBryde* cases. Under the *Territory* cases, water rights passed with the property. The *Territory* courts noted that under the ancient konohiki system, the upper riparian owner possessed the right to use the water as he pleased.[82] Since the water rights were determined by the location of the property, such rights were deemed to have been attached to the property. Therefore, when title to the land was granted under the Great Mahele, the water rights which were attached to that property also passed to the new owner.[83]

The *McBryde* court, however, did not accept the *Territory* courts' view of water law history. The court held that under the ancient system, flowing water was considered "common property to be used by *all* who had a right of access to it."[84] Therefore, it was inconceivable that riparian owners could claim a private ownership right to the water.[85] At the most, the riparian owner had only a right to use the water in a manner that would not be detrimental to other riparian owners.[86]

When the *Robinson III* court held that the Robinsons' rights vested after *Territory I*, it implicitly affirmed the *Territory* cases. The court should have taken the opportunity to discuss why the *Territory* courts' views were more "accurate" than the *McBryde* court's. Instead, the court left the water law doc-

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Hawaii, one could conclude the court adopted the *publici juris* ownership theory from *McBryde I*. Also, even with the injunction lifted, the change in water rights is not immediately threatening to existing landowners' diversions because any state attempt to restrict existing rights would constitute a taking.

[80] 753 F.2d at 1474. Unfortunately, the *Robinson III* court gave no authority for reliance as a factor to recognize a vested water right. Although previous recognition by the state could also be grounds for estoppel, the issues of reliance and previous recognition by the state are not necessary to establish a constitutional claim that property rights may have been taken, especially since the court had decided that previous adjudication established the Robinsons' water rights. Reliance and previous recognition would be more important factors if the court had not found the Robinsons' rights as vesting *de jure*.

[81] *Id.*

[82] *See Territory I*, 31 Hawaii at 393-94. The water rights were limited to ensure access to drinking water and for other domestic uses for the tenants. *See supra* note 17 and accompanying text.

[83] *See Territory II*, 52 F.2d at 357-58.

[84] *McBryde I*, 54 Hawaii at 187, 504 P.2d at 1339 (emphasis added).

[85] *Id.* at 186, 504 P.2d at 1339.

[86] *Id.* at 197-98, 504 P.2d at 1344.

trine in disarray because although it implicitly affirmed the *Territory* cases, it also affirmed *McBryde*, "with respect to real property rights created in Hawaii after the [*McBryde I*] decision became final."[87]

B. The District Court Injunction

In *Robinson III*, both plaintiffs and defendants conceded that the state had the power to change the substantive property law.[88] The Hawaii Supreme Court was, therefore, acting within the authority granted by the state constitution when it announced that the doctrine of riparianism would control and the state was the owner of the surface water in Hawaii.[89] Such a change in the law, however, could be prospective only.[90]

Because the state has yet to interfere with the Robinsons' water diversions or irrigation systems, the court concluded that the injunction granted in *Robinson I* "may have been premature."[91] By vacating the injunction, the *Robinson III* court implied that a judicial declaration standing alone, even if adverse to the Robinsons' property interests, was not equivalent to a taking by the state. Also, it is implicit in the *Robinson III* holding that water rights that have vested before 1973 are superior to the riparian rights that are now in force.

IV. IMPACT

Water rights in Hawaii following *Robinson III* are a mixture of two systems.[92] Questions that remain include (1) under what circumstances water rights may be relinquished, lost, extinguished or waived, (2) whether the water rights are transferrable between parties, and (3) superiority of water rights between appurtenant and riparian users.[93] The continuing problem of interbasin transfer of water, the diversion of water to nonriparian land, will need resolution as large tracts of nonriparian agriculture land need water as the appurtenant system declines.[94]

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[87] 753 F.2d at 1474.

[88] *Id.* at 1474.

[89] *Id.*

[90] *Id.* The court relied on Hughes v. Washington, 389 U.S. 290, 294 (1967) (Stewart, J., concurring) (If a state law changes unpredictably, a taking has occurred.).

[91] 753 F.2d at 1474.

[92] Other "mixed" water regimes exist in the United States, most commonly mixing riparian and prior appropriation doctrines. 1 WATERS AND WATER RIGHTS, *supra* note 2, § 18.2(B)(4), at 82.

[93] For example, will a riparian user be able to restrain an appurtenant diversion that would deprive him of customary flow that may be beneficial to his land?

[94] *See supra* note 50.

After *Robinson III*, if the state wishes to acquire water rights to the Hanapepe river, it will have to do so through the power of eminent domain.[95] The issue of public purpose in condemnation proceedings has recently been considered in *Hawaii Housing Authority v. Midkiff*,[96] where the fifth amendment's public purpose doctrine was broadened considerably in upholding the Hawaii Land Reform Act.[97] Much of the public benefit doctrine utilized in *Midkiff*, the breaking up of large monopolistic land holdings in Hawaii in favor of more equitable distribution, could be applicable to water rights issues. The legislature would need to determine whether the public utility of riparian stream flow is more critical than the existing private diversions, taking into account that the sugar cane industry is heavily subsidized and diminishing in importance for the island economy.

V. CONCLUSION

Robinson III is another chapter in the long and unique history of surface water rights in the Hanapepe Valley of Kauai. It is most significant because of the controversy over the Hawaii Supreme Court's reversal of over sixty years of substantive water law in *McBryde I*. While the federal court paid deference to the *McBryde* determinations of water rights of the parties on a prospective basis, it held that any attempt by the state to claim the rights to water that have vested in private parties will constitute a taking under the fifth and fourteenth amendments that will require the state to condemn the property for public use and pay just compensation.

Jennifer Cook Clark

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[95] 753 F.2d at 1474. *See* 4 WATERS AND WATER RIGHTS, *supra* note 2, § 300 (defining eminent domain as the state's right to take private property for public use).

[96] 104 S. Ct. 2321 (1984) (determining whether the state adhered to the public benefit doctrine by condemning large landholder estates for transfer upon just compensation to private parties).

[97] The *Midkiff* court held that the public use clause of the fifth amendment is upheld if the state legislature "could have believed" that the statute would promote its objective of a public use. *Id.* at 2330. *See generally* Callies, *A Requiem for Public Purpose:* Hawaii Housing Authority v. Midkiff, 1985 INST. ON PLAN. ZONING & EMINENT DOMAIN 8-1.

In re Maldonado: The Stacking of No-Fault Benefits on Workers' Compensation Benefits for the Same Loss

I. INTRODUCTION

In the case of *In re Maldonado*,[1] the Hawaii Supreme Court considered the issue of whether an injured employee may recover monthly earnings loss benefits[2] from his employer's no-fault insurer in addition to workers' compensation benefits which exceed the maximum monthly earnings loss limit prescribed by Hawaii's no-fault statute.[3] In reversing the Hawaii Intermediate Court of Ap-

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[1] 67 Hawaii 347, 687 P.2d 1 (1984). A five-person court (Lum, C.J.; Nakamura, Padgett, and Hayashi, J.J.; and Moon, Circuit Judge, sitting in place of Wakatsuki, J. who was disqualified) heard the case upon certiorari.

[2] Hawaii's no-fault statute defines "monthly earnings" as:

(A) In the case of a regularly employed person, one-twelfth of the average annual earnings before state and federal income taxes at the time of injury or death;

(B) In the case of a person regularly self-employed, one-twelfth of the average annual earnings before state and federal income taxes at the time of injury or death;

(C) In the case of an unemployed person or a person not regularly employed or self-employed, one-twelfth of the anticipated annual compensation before state and federal income taxes of such person paid from the time such person would reasonably have been expected to be regularly employed.

HAWAII REV. STAT. § 294-2(7) (1976).

[3] HAWAII REV. STAT. ch. 294 (1976). The no-fault statute limited the amount of monthly earnings as follows:

§294-2 Definitions. As used in this chapter:

. . . .

(10) "No-fault benefits" with respect to any accidental harm shall be subject to an aggregate limit of $15,000 per person or his survivor and means:

. . . .

(C) Monthly earnings loss measured by an amount equal to the lesser of:

(i) $800 per month, or

(ii) The monthly earnings for the period during which the accidental harm results in the inability to engage in available and appropriate gainful activity.

Id. § 294-2(10)(C). (The monthly earnings loss ceiling recently has been raised to $900. *Id.* §

peals (ICA),[4] the Hawaii Supreme Court[5] held that no-fault wage loss benefits may be "stacked"[6] on workers' compensation benefits for the same loss in order to compensate fully an injured accident victim.

This note will focus on *Maldonado* in light of the legislative history of the no-fault law, case law in Hawaii and in other jurisdictions, and underlying policy considerations. The discussion will conclude with an examination of the implications of the *Maldonado* decision and the legislative response to the case.

II. FACTS

On August 26, 1980, Petitioner Ruperto Maldonado was injured while operating an MTL, Inc. bus on North King Street in Honolulu.[7] Due to the severity of his injuries, Maldonado was unable to return to work.[8] Maldonado received $931.66 per month in workers' compensation wage benefits.[9] At the time of

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294-2(10)(C)(i) (L.R.B. Comp. 1985)).

[4] *In re* Maldonado, 5 Hawaii App. 185, 683 P.2d 394 (1984). In Hawaii, the Intermediate Court of Appeals (ICA) hears cases by assignment from the supreme court. HAWAII REV. STAT. § 641-1 (Supp. 1984).

[5] In a 3-2 decision, Chief Justice Lum and Justice Hayashi joined Justice Padgett in the majority opinion. 67 Hawaii at ____, 687 P.2d at 2. Circuit Judge Moon joined Justice Nakamura in the dissenting opinion. *Id.* at ____, 687 P.2d at 4.

[6] "Stacking" refers to the accumulation of benefits from different insurance policies for the same loss. *See* Allstate Ins. Co. v. Morgan, 59 Hawaii 44, 575 P.2d 477 (1978). More specifically, one commentator defined stacking as follows:

> "Stacking," sometimes referred to as "pyramiding," occurs when an insured is permitted to recover under multiple insurance coverages. It has been described as follows:
>
> > The stacking or pyramiding of coverages usually denotes the availability of more than one policy to the same insured. The effect of allowing dual [uninsured motorist] recovery is to permit stacking. "Stacking" where permitted, makes more than one policy fully available to the injured party without proration between the companies held liable. The word "stacking" as used in the argot of the insurance industry, implies and is intended to be used when one policy's limit is "stacked" on top of another and possibly a third is "stacked" on top of the second. The claim is not paid by slicing through the stack like a piece of wedding cake but is paid by first using one layer, then another, and so on.

Comment, *When Enough Isn't Enough: Supplementing Uninsured Motorist Coverage in Pennsylvania*, 54 TEMP. L.Q. 281, 282 (1981) (quoting P. PRETZEL, UNINSURED MOTORISTS, 87-88 (1972)).

[7] 67 Hawaii at ____, 687 P.2d at 2.

[8] *Id.*

[9] *Id.* The ICA noted that "[i]n case of total or partial disability of an employee, the Workers' Compensation Law, Hawaii Revised Statutes (HRS) Chapter 386 (1976 & Supp. 1983) provides for weekly income benefits equal to a certain percentage of the employee's 'average weekly wages.' *See* HRS §§ 386-31 & -32 (1976 & Supp. 1984)." 5 Hawaii App. at 186 n.1, 683 P.2d at 396 n.1. In this case, Maldonado's monthly workers' compensation benefits approximated 61% of his prior monthly wages.

the injury, Maldonado's monthly salary was $1534.[10] Thus, he incurred an actual monthly wage loss of $602.34.[11]

Maldonado filed a claim for $602.34 with Transport Indemnity Company, the no-fault insurer of MTL.[12] Transport Indemnity denied his claim.[13] The insurer based its denial upon Hawaii Revised Statutes section 294-5(b),[14] which the insurer construed to exempt it from paying any wage loss benefits to Maldonado since he was receiving workers' compensation benefits in excess of $800 per month.[15]

Maldonado subsequently requested a review by the Motor Vehicle Insurance Division of the Department of Regulatory Agencies.[16] The hearings officer found that Transport Indemnity's denial was improper.[17] The Insurance Commissioner rejected the recommendation of the hearings officer and ruled in favor of Transport Indemnity.[18] On appeal, the First Circuit Court and the ICA affirmed the Commissioner's action.[19] The Hawaii Supreme Court granted certio-

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[10] 67 Hawaii at ___, 687 P.2d at 2.

[11] *Id.*

[12] *Id.*

[13] *Id.*

[14] *Id.* At the time of the accident, the applicable statutory language provided that:

> All no-fault benefits shall be paid secondarily and net of any benefits a person is entitled to receive because of accidental harm from social security laws and workers' compensation laws; provided that this section shall be inapplicable to benefits payable to a surviving spouse and any surviving dependent as provided under Section 294-4. If the person does not collect such benefits under such laws by reason of the contest of his right to so collect by the person or organization responsible for payment thereof, the injured person, if otherwise eligible, shall, nevertheless, be entitled to receive no-fault benefits and upon payment thereof the no-fault insurer shall be subrogated to the injured person's right to collect such benefits.

HAWAII REV. STAT. § 294-5(b) (Supp. 1979), *quoted in* 67 Hawaii at ___, 687 P.2d at 203.

[15] 67 Hawaii at ___, 687 P.2d at 2. See *supra* note 3 for the applicable statutory provision.

[16] The legislature changed the name of the Department of Regulatory Agencies to the Department of Commerce and Consumer Affairs. HAWAII REV. STAT. § 26-9 (Supp. 1982). The Insurance Division is the agency charged with the administration of Hawaii's no-fault insurance law. *Id.* §§ 294-2, 431-31(1) (1976).

[17] 67 Hawaii at ___, 687 P.2d at 2. For the text of the Hearings Officer's Findings of Fact, Conclusions of Law and Recommended Order, see *In re* Maldonado, 82-1 HAWAII L. REP. 820319 (1982).

[18] 67 Hawaii at ___, 687 P.2d at 2. For the text of the Commissioner's Final Decision and Order, see *In re* Maldonado, 82-1 HAWAII L. REP. 820311 (1982).

[19] 67 Hawaii at ___, 687 P.2d at 2. Maldonado appealed the Commissioner's Order pursuant to HAWAII REV. STAT. §§ 431-68, -69 (1976). The scope of judicial review for administrative decisions is as follows:

> Upon review of the record the court may affirm the decision of the agency or remand the case with instructions for further proceedings; or it may reverse or modify the decision and order if the substantial rights of the petitioners may have been prejudiced because the administrative findings, conclusions, decisions or orders are:

rari on appeal and reversed the ICA decision.[20]

III. Background

A. *Legal Context of No-Fault and Workers' Compensation in Hawaii*

The no-fault system began as an alternative to the tort system of liability.[21] Accident victims, insurers, and attorneys were frustrated with long drawn-out litigation and high administrative costs inherent in motor vehicle accident liability cases.[22] Although insurance companies usually bore the losses, they frequently passed the high costs to the consumer in the form of high insurance premiums.[23] Moreover, one-fourth of all accident victims received no compensation whatsoever.[24]

The workers' compensation laws were also enacted as an alternative to the tort system.[25] Injured employees who experienced work related injuries found

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(1) In violation of constitutional or statutory provisions; or
(2) In excess of the statutory authority or jurisdiction of the agency; or
(3) Made upon unlawful procedure; or
(4) Affected by other error of law; or
(5) Clearly erroneous in view of the reliable, probative, and substantial evidence on the whole record; or
(6) Arbitrary, or capricious, or characterized by abuse of discretion or clearly unwarranted exercise of discretion.

Id. § 91-14.

In *Maldonado*, both the supreme court and the ICA based their determinations on Hawaii Rev. Stat. § 91-14(g)(4). 67 Hawaii at ____, 687 P.2d at 4; 5 Hawaii App. at 188, 683 P.2d at 397. Hawaii Rev. Stat. ch. 91 is commonly referred to as the Hawaii Administrative Procedure Act. 5 Hawaii App. at 188 n.4, 683 P.2d at 397 n.4. For a summary of judicial review of administrative decisions in Hawaii, see Note, *Outdoor Circle v. Harold K. L. Castle Trust Estate: Judicial Review of Administrative Decisions*, 7 U. Hawaii L. Rev. 449 (1985). *See also* Outdoor Circle v. Harold K. L. Castle Trust Estate, 4 Hawaii App. 633, 675 P.2d 784 (1983), *cert. denied*, 67 Hawaii 1, 677 P.2d 965 (1984).

[20] 67 Hawaii at ____, 687 P.2d at 2.

[21] *See generally* W. Keeton, D. Dobbs, R. Keeton & D. Owen, Prosser and Keeton on the Law of Torts § 84 (5th ed. 1984) [hereinafter cited as Prosser and Keeton on Torts]; Yee, *Tradition and the Political Process: The Evolution of No Fault Legislation in the State of Hawaii*, 10 Forum 870 (1975).

[22] Yee, *supra* note 21, at 871.

[23] *Id.* For example, prior to no-fault insurance in 1971 only 40 cents out of every dollar paid in motor vehicle insurance premiums actually were paid as benefits to claimants. Twenty-three cents went to sales and overhead costs of insurance; 18 cents went to litigation expenses and 14 cents went to claim adjusting expenses. *Id.*

[24] *Id.*

[25] For a concise overview of workers' compensation laws, see generally Prosser and Keeton on Torts, *supra* note 21, § 80.

that the requirement of proving causation made tort recovery difficult.[26]

In response to these difficulties, the Hawaii legislature followed a national trend and adopted laws designed to reduce insurance premiums and administrative costs. In 1963, the legislature re-enacted the forerunner of the present workers' compensation statute.[27] Under the current statute, employees injured in work-related activities accepted a smaller recovery (usually about two-thirds of wages)[28] than the usual tort awards in exchange for a presumption that injuries were caused by the work environment or conditions. Claims were paid from a state-administered fund which required contributions from virtually all employers.[29]

In 1973 and 1974, the legislature enacted a law requiring no-fault insurance for all motorists.[30] The major purposes of the statute were (1) to create a system of reparations for accidental harm and loss arising from motor vehicle accidents, (2) to compensate damages without regard to fault, and (3) to limit tort liability for these accidents.[31] However, no-fault benefits were subject to an aggregate limit of $15,000, and a claimant could recover no more than $800 per month from the no-fault insurer for lost wages due to an automobile-related injury.[32] The no-fault statute also sought to prevent duplication of benefits by prohibit-

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[26] *Id.*

[27] HAWAII REV. STAT. ch. 386 (1976). Workers' compensation was originally adopted by the Territorial Legislature in 1915. REV. LAWS HAWAII ch. 209 (1925). The workers' compensation statute was completely revised and re-enacted in 1963. Act of May 31, 1963, ch. 116, 1963 Hawaii Sess. Laws 103. For a summary of the original purposes behind workers' compensation in Hawaii, see Kamanu v. E.E. Black Ltd., 41 Hawaii 442 (1956).

[28] HAWAII REV. STAT. §§ 386-31, -32 (1976 & Supp. 1984).

[29] *Id.* § 386-151 (1976).

[30] Act of May 31, 1973, ch. 203, 1973 Hawaii Sess. Laws 381; Act of June 6, 1974, ch. 168, 1974 Hawaii Sess. Laws 317 (codified at HAWAII REV. STAT. ch. 294). For a history of no-fault legislation in Hawaii and other jurisdictions, see generally, 8D J. APPLEMAN, INSURANCE LAW AND PRACTICE §§ 5151-5155 (1981 & Supp. 1983); M. WOODRUFF, J. FONSECA, & A. SQUILLANTE, AUTOMOBILE INSURANCE AND NO-FAULT LAW § 18 (1974 & Supp. 1984).

[31] HAWAII REV. STAT. § 294-1 (1976). The conference committee report stated the five goals underlying the no-fault law:

(1) Provide for a speedy, adequate and equitable reparation for those injured or otherwise victimized;
(2) Provide for the stabilization and reduction of motor vehicle liability insurance premium rates;
(3) Provide for insurance coverage for all who require it, at a cost within the reach of every licensed driver;
(4) Provide for a compulsory insurance system;
(5) Provide for adequate regulatory control. . . .

H.R. CONF. COMM. REP. NO. 13, 7th Hawaii Leg., Reg. Sess., 1973 HOUSE J. 1219.

[32] HAWAII REV. STAT. § 294-2(10)(C) (1976). See *supra* note 3 for the text of the statute. The statute also requires an insurer to provide for optional additional coverages under a no-fault insurance policy. HAWAII REV. STAT. § 294-11 (1976 & Supp. 1984).

ing recovery from more than one insurer for the same accident.[33] The statute provided that no-fault benefits were to be paid "secondarily and net of any benefits" received from other sources, including workers' compensation.[34]

In certain situations, however, the no-fault system provided inadequate relief to injured claimants.[35] In an effort to provide meaningful compensation to injured parties, Hawaii courts began to allow the "stacking" or "pyramiding" of insurance policies in order to increase no-fault benefits.[36] For example, in *Mizoguchi v. State Farm Mutual Automobile Insurance Co.*,[37] an insured's surviving spouse, in her capacity as personal representative, sought survivor's loss benefits in addition to work-loss benefits under her decedent husband's no-fault

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[33] The applicable statute provides in pertinent part that "[n]o person shall recover no-fault benefits from more than one insurer for accidental harm as a result of the same accident." HAWAII REV. STAT. § 294-5(d) (1976).

[34] Prior to 1977, § 294-5(b) provided that "[a]ll no-fault benefits shall be paid secondarily and net of any benefits a person receives because of the accidental harm from social security laws, workers' compensation laws, or public assistance laws." *Id.* § 294-5(b). In 1977 and 1978, the legislature amended § 294-5(b) by deleting the reference to public assistance laws. The purpose of the amendment was "to insure that Hawaii law will not be in conflict with federal regulations requiring that Medicaid and other federally funded public assistance programs to be a secondary source of resource to other sources." H.R. CONF. COMM. REP. NO. 39, 9th Hawaii Leg., Reg. Sess., 1977 HOUSE J. 1262.

[35] For example, Maldonado received only $931.66 in workers' compensation monthly wage loss benefits. If he were limited to this remedy, his annual income would not exceed $11,179.92. Conversely, if he was limited to a no-fault claim as his remedy, his annual income would not exceed $9,600.00.

[36] See *supra* note 6 for a definition of "stacking." The Hawaii Supreme Court first began "stacking" of uninsured motorist policies. *See* HAWAII REV. STAT. §§ 287-7, 431-35(a), 431-448 (1976). The first case to allow stacking, Walton v. State Farm Mut. Auto. Ins. Co., 55 Hawaii 326, 518 P.2d 1399 (1974), involved an uninsured motorist provision containing an "other insurance" clause. The clause provided that the plaintiff would be covered only to the extent that the policy limit exceeds applicable coverage under other insurance policies. The court held that under HAWAII REV. STAT. §§ 287-7 and 431-448, the other insurance clause was void to the extent that it limited benefits to less than actual damages. The court thus indicated that the "stacking" of coverages from the same policy was permissible as long as total benefits did not exceed actual damages.

Four years later, in Allstate Ins. Co. v. Morgan, 59 Hawaii 44, 575 P.2d 477 (1978), the court held that under §§ 287-7 and 431-448, a driver whose father's uninsured motorist coverage extended to more than one motor vehicle could "stack" the benefits of each vehicle covered under the policy for an injury not involving the covered vehicles. *See also* Estate of Calibuso v. Pacific Ins. Co., 62 Hawaii 424, 616 P.2d 1357 (1980) (unrelated injured passengers may recover under uninsured motorist coverage for all three cars of the driver); American Ins. Co. v. Takahashi, 59 Hawaii 59, 575 P.2d 881, *reh'g denied per curiam*, 59 Hawaii 102, 577 P.2d 780 (1978) (An injured party can recover on two uninsured motorist policies when he is injured in a third independently owned and insured motor vehicle. An insurer cannot reduce its liability by implementing a "limits of liability" clause into the policy.).

[37] 66 Hawaii 373, 663 P.2d 1071 (1983).

policy. The court held that under a no-fault insurance policy, survivors of a deceased insured were entitled to both survivor's loss benefits and provable work-loss benefits up to the increased aggregate limits of additional coverage.[38] The court found that the statutory amount of coverage was a minimum limit which insured were allowed to exceed, and that work-loss benefits did not duplicate survivor's loss benefits under the no-fault system.[39]

In *Yamaguchi v. State Farm Mutual Automobile Insurance Co.*,[40] the estate and survivors of an insured passenger claimed no-fault benefits under two separate policies covering automobiles not involved in the fatal accident. The Ninth Circuit Court of Appeals held that Hawaii law places no limitation either on the number of policies[41] under which the estate and survivors of an eligible insured could recover no-fault benefits or on the dollar amount recoverable under no-fault.[42]

These cases illustrate that prior to *Maldonado*, the Hawaii Supreme Court and the Ninth Circuit Court of Appeals had taken a liberal view in allowing the "stacking" of no-fault insurance coverages in order to achieve better compensation for accident-related injuries. However, they also left open the question of whether an injured claimant could stack benefits of two different compensation systems.

Subsequent to *Maldonado*, the ICA has disallowed the stacking of no-fault benefits. In *Rana v. Bishop Insurance of Hawaii, Inc.*,[43] an injured person sought to recover his entire monthly wage loss of $2000 by "stacking" no-fault monthly earnings loss coverages from one no-fault policy covering seven automobiles.[44] The ICA held that Hawaii's no-fault law precludes "stacking" of no-fault basic insurance coverages where the injured insured had a single policy

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[38] *Id.* at 381, 663 P.2d at 1076. *Cf.* Hudson v. Uwekoolani, 65 Hawaii 468, 653 P.2d 783 (1982) (If the deceased would have been entitled to work-loss benefits had he lived and been permanently incapacitated, his estate should be entitled to receive the same benefits if he died.).

[39] 66 Hawaii at 377-78, 663 P.2d at 1074-75. Hawaii's no-fault statute requires insurers to provide additional coverages at the option of the insured. *See* HAWAII REV. STAT. § 294-11 (1976 & Supp. 1982).

[40] 706 F.2d 940 (9th Cir. 1983).

[41] *Id.* at 948-49. The court held that Hawaii's no-fault law prohibits "benefit stacking" (i.e., duplicative benefits from more than one insurer) but does not prohibit "policy stacking." *Id. See supra* note 33 and accompanying text. *See also* First Ins. Co. of Hawaii, Ltd. v. Jackson, 67 Hawaii 165, 681 P.2d 569 (1984) (the burden of proving that a claimant's tort recovery duplicated no-fault benefits already paid to the claimant was upon the insurer).

[42] 706 F.2d at 952-53.

[43] ___ Hawaii App. ___, 713 P.2d 1363, *aff'd*, ___ Hawaii ___, 713 P.2d 1363 (1985).

[44] ___ Hawaii App. at ___, 713 P.2d at 1366. Rana's theory was that "the 'stacking' of no-fault basic coverage of $800 earnings loss benefits per vehicle under the policy was permitted and that the 'stacked' aggregate limit would be seven vehicles times $15,000 or $105,000." *Id.*

covering several vehicles.[45] The ICA further held that the analogy between the no-fault and uninsured motorist laws was faulty because the underlying statutes were enacted for different purposes.[46] The ICA disagreed with the Ninth Circuit's holding in *Yamaguchi*[47] and factually distinguished *Mizoguchi*.[48] Significantly, the ICA also admitted to an error in its earlier *Maldonado* opinion[49] where it had stated that stacking of no-fault policies is permitted under the no-fault law.[50] In short, *Rana* severely limited the applicability of the "stacking"

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[45] *Id.* at ___, 713 P.2d at 1369. The court found that:

> The legislative history of the No-Fault Law evinces a legislative concern to reduce and stabilize automobile insurance costs prevailing prior to its enactment and to provide and maintain reasonable premium rates for no-fault basic coverage. We discern therefrom a legislative intent to prohibit stacking which indubitably will lead to higher premiums for no-fault basic coverage. We therefore conclude that HRS §§ 294-2(10) and -3(c) precludes the stacking of no-fault basic insurance policies and coverages. To permit stacking would be contrary to an objective the legislature sought to achieve.

Id.

[46] *Id.* at ___, 713 P.2d at 1370-71. The ICA adopted the rationale of Kirsch v. Nationwide Ins. Co., 532 F. Supp. 766, 768 (W.D. Pa. 1982). Since uninsured motorist coverage is intended to assure recovery to accident victims where a negligent tortfeasor is unable to pay a judgment award, there is no statutory maximum to the amount of possible recovery. On the other hand, no-fault laws provide for a specific amount of possible recovery to accident victims regardless of fault. Thus, no-fault places a statutory ceiling on the amount of recovery available to an accident victim. ___ Hawaii App. at ___, 713 P.2d at 1370-71. The ICA further held that while no-fault insurance is compulsory, uninsured motorist insurance may be rejected. *Id.* at ___, 713 P.2d at 1371.

[47] *Id.* at ___, 713 P.2d at 1369-70. The ICA boldly stated that it was not bound by a federal court's interpretation of state law. The ICA reasoned that state courts are "the final arbiters" of issues involving state law. *Id.* The court also noted that in *Mizoguchi*, the Hawaii Supreme Court had reserved opinion on the specific issue raised in *Yamaguchi*. *Id.* at ___ n.7, 713 P.2d at 1370 n.7.

[48] *Id.* at ___, 713 P.2d at 1370. Labeling Rana's reliance on *Mizoguchi* as "misplaced," the ICA emphasized that *Mizoguchi* involved the applicability of optional additional no-fault coverages as provided by HAWAII REV. STAT. § 294-11(a)(3) (1976). Rana, in contrast, had tried to stack the benefits from the compulsory basic no-fault coverages on several vehicles that he owned. ___ Hawaii App. at ___, 713 P.2d at 1370.

[49] 5 Hawaii App. at 192, 683 P.2d at 400.

[50] The ICA commented on its *Maldonado* decision in *Rana*:

> Unfortunately, our use of the term "stacking" in *Maldonado* was loose and indiscriminate. There, the construction of HRS § 294-5(b) was involved, and we and the parties involved in the appeal characterized the issue as being whether the "stacking" of no-fault and workers' compensation insurance policies was permissible. We looked at the results achieved in *Yamaguchi* and *Mizoguchi*, which permitted the "stacking" of optional additional no-fault policy or coverage upon a no-fault basic policy or coverage, and improvidently made a general statement that our No-Fault Law permitted "stacking" of no-fault policies in *Maldonado*. Since stacking of two or more no-fault basic policies or coverages was not involved in *Maldonado*, that statement is *obiter dictum* and not binding.

___ Hawaii App. at ___, 713 P.2d at 1369.

doctrine under Hawaii's no-fault law.

B. *Relationship of No-Fault and Workers' Compensation in Other Jurisdictions*

No-fault legislation has been enacted in twenty-four states.[51] All fifty states have adopted workers' compensation laws.[52] Most work loss laws permit no-fault insurers to offset[53] workers' compensation benefits to avoid duplication of benefits.[54] In doing so, "the cost of no-fault is kept lower than if both the workers' compensation and no-fault insurance were reimbursing the victim one dollar to cover a victim's single dollar of loss."[55]

In states where workers' compensation may be applied in a traffic accident involving an employee, the exclusivity doctrine[56] of workers' compensation bars

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[51] 4C L. FRUMER & M. FRIEDMAN, PERSONAL INJURY ACTIONS, DEFENSES, DAMAGES, INSURANCE § 1.02(4) (1985). *See generally* UNIF. MOTOR VEHICLE ACCIDENT REPARATIONS ACT, 14 U.L.A. 41 (1972).

[52] PROSSER AND KEETON ON TORTS, *supra* note 21, § 80.

[53] "The noun 'offset' is defined as a contrary claim or demand by which a given claim may be lessened or cancelled; and the verb 'offset' means to balance; to cancel the contrary claims or sums; to counteract." Lalime v. Desbiens, 115 Vt. 165, 168, 55 A.2d 121, 123 (1947). The majority of cases address the issue of whether workers' compensation benefits can be "offset" against no-fault benefits for the same loss as opposed to whether they can be "stacked." For purposes of this analysis, the issue of "stacking" may be treated as the converse of the issue of "offsetting."

[54] Comment, *New York No-Fault Automobile Insurance: Work Loss Benefit Computations—A Comparative Analysis*, 5 PACE L. REV. 111 (1984) [hereinafter cited as *Work Loss Benefit Computations*]. The following statutes allow workers' compensation offsets or stacking: COLO. REV. STAT. § 10-4-707(5) (Supp. 1985); CONN. GEN. STAT. ANN. § 38-333(c) (West Supp. 1985); D.C. CODE ANN. § 35-2110(b)(2) (Supp. 1985); FLA. STAT. ANN. § 627.736(4)(d)(3) (West 1984); GA. CODE ANN. § 33-34-8 (1982); HAWAII REV. STAT. § 294-5(b) (Supp. 1985); KAN. STAT. ANN. § 40-3110(a) (1981); KY. REV. STAT. ANN. § 304.39-120 (Baldwin Supp. 1985); MD. ANN. CODE art. 48A, § 543(d) (1979); MASS. GEN. LAWS ANN. ch. 90, § 34A (West 1969); MICH. COMP. LAWS ANN. § 500.3109(1) (West 1983); MINN. STAT. ANN. § 65B.61(1) (West Supp. 1985); N.Y. INS. LAW § 671(2)(b) (McKinney Supp. 1983-1984); N.D. CENT. CODE § 26.1-41-13(1)(b) (Supp. 1985); OR. REV. STAT. § 743.810(2) (Supp. 1985); S.C. CODE ANN. § 56-11-150(D) (Law Co-op 1977); UTAH CODE ANN. § 31-41-7(3) (Supp. 1985).

Much of the pertinent statutory language is similar to the UNIF. MOTOR VEHICLE ACCIDENT REPARATIONS ACT which provides: "All benefits or advantages a person receives or is entitled to receive because of the injury from social security, workmen's compensation, and any other state required temporary, non-occupational disability insurance are subtracted in calculating net loss." UNIF. MOTOR VEHICLE ACCIDENT REPARATIONS ACT § 11, 14 U.L.A. 41, 78 (1972). *See also id.* Commissioner's comment, at 78-80.

[55] *Work Loss Benefit Computations*, *supra* note 54, at 140.

[56] The exclusivity doctrine of workers' compensation asserts that, when an injured employee is covered by a workers' compensation act, the statutory remedy is the sole remedy and that recovery against the employer is barred at common law. PROSSER AND KEETON ON TORTS, *supra* note 21, § 80. Workers' compensation is recognized to be in the nature of a compromise, by which a worker accepts limited compensation, usually less than a jury estimate for damages, in return for

any recovery of benefits from the employer's no-fault insurer, despite statutory language which allows workers' compensation benefits to offset no-fault benefits.[57] Courts which have upheld the exclusivity doctrine based their decisions upon the premise that the no-fault laws had no application to employers who already were obligated to their employees under workers' compensation.[58] No-fault has neither changed that statutory obligation nor increased the employer's burden to pay compensation for a favored class of employees who qualify for both no-fault and workers' compensation benefits.[59]

Other state courts hold that the no-fault and workers' compensation systems are to be given equal dignity. An employee, these courts hold, is not precluded from recovering no-fault insurance benefits when he is entitled to receive workers' compensation benefits.[60] These jurisdictions may be divided into two cate-

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extended liability in the employer and the assurance that he will be paid. *Id.* A vast majority of courts have held that conduct that falls short of an intent to harm will not allow an employee to overcome the exclusivity provision. *Id. See also* Birnbaum & Wrubel, *Workers' Compensation and the Employer's Immunity Shield: Recent Exceptions to Exclusivity*, 5 J. PROD. LIAB. 119 (1982).

[57] *See, e.g.*, Flaherty v. Traveler's Ins. Co., 369 Mass. 482, 340 N.E.2d 888 (1976) (Legislative enactment of no-fault did not signal a retreat of the exclusive remedy doctrine.); I.M.L. Freight v. Ottosen, 538 P.2d 296 (Utah 1975) (Allowing the recovery of no-fault benefits in addition to workers' compensation would favor one type of employees.).

Although workers' compensation is the exclusive remedy against the employer, recovery from the employee's no-fault policy has been allowed. *See, e.g.*, Georgia Farm Bureau Mut. Ins. Co. v. Fireman's Fund Ins. Co., 161 Ga. App. 276, 288 S.E.2d 263 (1982) (An employee receiving workers' compensation is precluded from his employer's no-fault but is not barred from his own.); Motley v. State Farm Mut. Ins. Co., 502 Pa. 335, 466 A.2d 609 (1983) (Employee may receive up to statutory limit under own policy for work loss under Pennsylvania No-Fault Act for losses not compensated under workers' compensation.).

[58] *See, e.g.*, Georgia Farm Bureau Mut. Ins. Co. v. Fireman's Fund Ins. Co., 161 Ga. App. at 277, 288 S.E.2d at 264; I.M.L. Freight v. Ottosen, 538 P.2d at 297.

[59] *See, e.g.*, Georgia Farm Bureau Mut. Ins. Co. v. Fireman's Fund Ins. Co., 161 Ga. App. at 277, 288 S.E.2d at 264; I.M.L. Freight v. Ottosen, 538 P.2d at 297. These cases imply that an employer need not have no-fault insurance since employees may not recover under the employer's no-fault coverage. The exclusivity doctrine, however, applies only to the employer-employee relationship. The exclusivity doctrine does not prevent pedestrians and bicyclists from recovering no-fault benefits. *See* GA. CODE ANN. § 33-34-7(a)(3) (Supp. 1985); UTAH CODE ANN. § 31-41-7(1)(b) (Supp. 1983). Therefore, it is advisable for employers in these states to maintain no-fault coverage.

[60] *See, e.g.*, Mathis v. Interstate Motor Sys., 408 Mich. 164, 289 N.W.2d 708 (1981) (Employees injured while operating motor vehicles within course and scope of employment are entitled to recover both workers' compensation and no-fault benefits subject to statutory subtraction of workers' compensation from no-fault benefits.); Ryder Truck Lines v. Maiorano, 44 N.Y.2d 364, 376 N.E.2d 1311, 405 N.Y.S.2d 666 (1978) (Nothing in no-fault legislation suggested that an employee injured while operating a motor vehicle within the course and scope of employment was precluded from receiving no-fault benefits in addition to workers' compensation benefits.) The court in *Ryder Truck Lines* considered the fact that both the workers' compensation and no-fault programs were self-standing and independently available. 44 N.Y.2d at 364, 376

gories: "stacking" jurisdictions and "offset" jurisdictions.[61]

The "stacking" jurisdictions generally hold that the sum recovered through workers' compensation does not reduce the policy limits of the no-fault coverage.[62] These jurisdictions either (1) subtract available benefits or advantages (like workers' compensation) from the total economic loss accrued to calculate "net loss," then allow the recovery of the "net loss" up to the no-fault statutory limits;[63] or (2) allow the stacking of all available benefits outright.[64] Courts which have allowed stacking have justified their conclusions by referring to a particular state's statute,[65] or by noting public policy reasons.[66] Stacking results in a fuller recovery for injured persons who qualify for both workers' compensation and no-fault benefits.

On the other hand, "offset" jurisdictions allow the subtraction of workers' compensation benefits from the maximum statutorily allowed by a state's no-fault law.[67] One state court cited the purpose of the state's workers' compensation act, which is to put a limited amount of money in the hands of an injured individual, to justify offsetting.[68] Another court referred to state statutes and legislative history, which limit recovery from workers' compensation and no-fault to the no-fault statutory maximum, to permit offsetting.[69]

In order to recover no-fault benefits in an "offset" jurisdiction, the workers'

N.E.2d at 1312, 405 N.Y.S.2d at 666.

[61] *See supra* note 53 and accompanying text.

[62] *See, e.g.*, O'Bar v. M.F.A. Mut. Ins. Co., 275 Ark. 247, 628 S.W.2d 561 (1982) (A clause which reduced no-fault accidental death benefits by the amount of workers' compensation benefits received held to be void against public policy since accidental death benefits are like life insurance and life insurance is treated differently from medical and income disability benefits so far as double coverage is concerned.); Comeau v. Safeco Ins. Co., 356 So. 2d 790 (Fla. 1978) (No-fault personal injury protection benefits to be paid primarily and supplemental to workers' compensation benefits received until either the injured party has been fully compensated or until the statutory maximum has been reached.); United States Fidelity & Guar. Co. v. Smith, 580 S.W.2d 216 (Ky. 1979) (No-fault insurer was liable for payment of benefits up to policy limit for widow's net economic loss after a 15% tax advantage and all collateral benefits have been subtracted from total loss.).

[63] *United States Fidelity & Guar.*, 580 S.W.2d at 219-20.

[64] *O'Bar*, 275 Ark. at 249, 628 S.W.2d at 562; *Comeau*, 356 So. 2d at 794.

[65] *Comeau*, 356 So. 2d at 792-94; *United States Fidelity & Guar.*, 580 S.W.2d at 218-19.

[66] *O'Bar*, 275 Ark. at 249, 628 S.W.2d at 562.

[67] *See, e.g.*, Smelser v. Criterion Ins. Co., 293 Md. 384, 444 A.2d 1024 (1982) (Mechanic injured by a customer's car driven by a fellow employee was not entitled to receive no-fault benefits under customer's policy in addition to workers' compensation since the workers' compensation benefits received were in excess of the no-fault statutory limit.); Featherly v. A.A.A. Ins. Co., 119 Mich. App. 132, 326 N.W.2d 390 (1982) (Total benefits payable are determined by a 15% tax adjustment on actual loss up to no-fault statutory limit; amount of no-fault benefits due from insurer is equal to the difference between total benefits payable and workers' compensation.).

[68] *Smelser*, 293 Md. at 393, 444 A.2d at 1029.

[69] *Featherly*, 119 Mich. App. at 137, 326 N.W.2d at 392.

compensation award must be less than the no-fault statutory ceiling. If the workers' compensation award is greater than the no-fault statutory maximum, then the situation becomes analogous to the situation in exclusivity doctrine cases: workers' compensation becomes the only remedy available.

Courts which have "stacked" or "offset" earnings loss benefits largely have based their decisions on the particular state's no-fault law.[70] Those cases cannot be used to interpret Hawaii Revised Statutes section 294-5(b),[71] which was at issue in *Maldonado*, but are helpful in the analysis of policy considerations behind "stacking" and "offsetting."

IV. Analysis

The permissibility of "stacking" no-fault benefits on workers' compensation benefits was a question of first impression for the Hawaii Supreme Court. Con-

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[70] In Comeau v. Safeco Ins. Co., 356 So. 2d 790 (Fla. 1978), the Florida Supreme Court applied the Florida no-fault statute to permit the "stacking" of no-fault benefits on workers' compensation benefits. The statute provided, in pertinent part: "Benefits due from an insurer. . .shall be primary, except that benefits received under any workmen's compensation law shall be credited against the benefits [due from the insurer]. . . ." FLA. STAT. ANN. § 627.736(4) (1976). Similarly, in United States Fidelity & Guar. Co. v. Smith, 580 S.W.2d 216 (Ky. 1979), the Kentucky Supreme Court construed Kentucky law to allow "stacking." The Kentucky no-fault law provided that "[a]ll benefits or advantages a person receives or is entitled to receive because of injury from social security and workmen's compensation are subtracted in calculating net loss." KY. REV. STAT. § 309.39-120(1) (1974). *Comeau* and *United States Fidelity & Guar. Co.* are illustrative of the proposition that the "stacking" of benefits does not constitute a windfall to the insured party.

On the other hand, Smelser v. Criterion Ins. Co., 293 Md. 384, 444 A.2d 1024 (1982), and Featherly v. A.A.A. Ins. Co., 119 Mich. App. 132, 326 N.W.2d 390 (1982), are two cases that have interpreted state laws to "offset" the amount of no-fault benefits payable by the no-fault insurer of the employer by the amount of workers' compensation benefits received by the claimant. *Smelser* and *Featherly* have upheld the proposition that "stacking" benefits from both no-fault and workers' compensation constitutes a windfall to the insured and should not be permitted.

In *Smelser*, the Maryland Supreme Court interpreted the Maryland no-fault law, which provided that "[b]enefits payable under [no-fault]. . .shall be reduced to the extent that the recipient has recovered benefits under workmen's compensation laws of any state or the federal government." MD. ANN. CODE art. 48A, § 543(d) (1957, 1979 Repl. Vol.). The Michigan Supreme Court in *Featherly* applied the Michigan no-fault statute, which provided: "Benefits provided or required to be provided under the laws of any state or the federal government shall be subtracted from the personal protection insurance benefits otherwise payable for the injury." MICH. COMP. LAWS ANN. § 500.3109(1) (West 1983).

The ICA determined that cases from these other jurisdictions were largely dependent upon each state's particular no-fault legislation. *Maldonado*, 5 Hawaii App. at 189, 683 P.2d at 398.

[71] See *supra* note 14 for the text of the statute in effect at the time of Maldonado's injury.

fronted with apparently unambiguous statutory language[72] and a seemingly well-reasoned ICA opinion,[73] the court construed the language and framework of the no-fault statute and concluded that an injured employee should be entitled to no-fault benefits in addition to workers' compensation benefits for loss of wages. This section will discuss the court's rationale in holding for Maldonado and the dissenting opinion's criticism of the court's holding.

From the outset, the Hawaii Supreme Court treated the *Maldonado* issue as one of law.[74] Specifically, the court saw the dispositive issue as the practical meaning of the word "net" as employed by the statute.[75] Transport Indemnity's position was that since Maldonaldo received $931.66 in workers' compensation benefits, that amount should be subtracted from the statutory limit of $800.00 for monthly earnings loss benefits leaving a "net" loss of zero.[76] Thus, in Transport Indemnity's view, Maldonaldo was entitled to nothing.[77] The Insurance Commissioner adopted this view in denying Maldonado's claim,[78] and both the First Circuit Court[79] and the ICA[80] affirmed this interpretation. However, the Hawaii Supreme Court rejected this view in favor of the recommendation of the assigned hearings officer that Maldonaldo's claim be granted.[81]

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[72] HAWAII REV. STAT. § 294-5(b) (Supp. 1979).

[73] 5 Hawaii App. 185, 683 P.2d 394.

[74] 67 Hawaii at ___, 687 P.2d at 2. The court phrased the issue as: "Is the amount of wages, which the petitioner actually lost each month, that is the difference between his wages and his worker's compensation disability benefits, the same loss as that for which the worker's disability benefits were paid?" *Id.* at ___, 687 P.2d at 3. As a "pure question of statutory interpretation," the disposition of the case was governed by HAWAII REV. STAT. § 91-14(g)(4) (1976). 67 Hawaii at ___, 687 P.2d at 4.

Perhaps the most "visible" aspect of *Maldonado* is the absence of any cited cases in the Hawaii Supreme Court's opinion. Presumably, the court felt that the unique nature of Hawaii's no-fault law destroyed the applicability of cases from other jurisdictions. Thus, Justice Padgett wrote an opinion based on legislative mandate. Nevertheless, at least some of the cases could have provided persuasive authority, for they also were decided on the basis of policy considerations common to many jurisdictions.

[75] 67 Hawaii at ___, 687 P.2d at 2. See *supra* note 14 for the applicable statutory language. The court saw "net" as emphasizing the "secondary" nature of no-fault benefits to workers' compensation benefits. In contrast, the ICA viewed "net" as having a distinct meaning in that it indicated that workers' compensation benefits were to be subtracted from the maximum limit under the no-fault statute. 5 Hawaii App. at 190-91, 683 P.2d at 398-99. Otherwise, in the ICA's view, "net" would become superfluous in violation of "a cardinal rule of statutory construction." *Id.*

[76] 67 Hawaii at ___, 687 P.2d at 2. In other words, Maldonado's workers' compensation benefits left him with a "profit" of $131.66 as opposed to a "net loss."

[77] *Id.*

[78] *Id.*

[79] *Id.*

[80] *Id.*

[81] *Id.* at ___, 687 P.2d at 3.

The threshold question in *Maldonado* was whether the "secondarily and net" provision of section 294-5(b) evidenced a clear legislative intent to bar Maldonado's claim against Transport Indemnity. The court referred to the definition of no-fault benefits[82] and emphasized that Maldonado suffered a loss of $602.34, even after the workers' compensation benefits of $931.66 were subtracted from his actual monthly wages of $1,534.00.[83] After assuming that the $15,000 aggregate limit had not been reached,[84] the court reasoned that since workers' compensation benefits were already paid primarily, the net loss of $602.34 could be paid secondarily without violating the statutory language.[85]

In contrast, the dissent viewed the Commissioner's decision as consistent with the clear language and history of section 294-5(b).[86] Labelling the court's interpretation a "tortured reading" of the statute,[87] the dissent emphasized that the "secondarily and net" language of section 294-5(b) unambiguously militated against the court's logic, thus mandating the denial of Maldonado's claim.[88]

To the extent that the language clearly precluded "stacking" of no-fault and workers' compensation benefits, the court arguably need not have looked at the legislative history of the no-fault statute.[89] Had the statute provided that no-fault benefits be paid "secondarily" rather than "secondarily and net" of workers' compensation benefits, it would have been more reasonable for the court to hold in favor of Maldonado. As the dissent stated, the court's construction of "net" loss as synonymous with "secondary" loss rendered the word "net" superfluous.[90] The court evidently rejected the ICA's statement that to hold for Maldonado would violate the rule that construction of a statute should avoid rendering a term meaningless.[91]

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[82] *Id.* See *supra* note 3 for the text of HAWAII REV. STAT. § 294(10)(C)(i) (1976).

[83] 67 Hawaii at ____, 687 P.2d at 3.

[84] *Id* at ____, 687 P.2d at 3-4.

[85] *Id.* In reaching this conclusion, the court construed "net" as synonymous with "secondary."

[86] *Id.* at ____, 687 P.2d at 4 (Nakamura, J., dissenting). Circuit Judge Moon joined Justice Nakamura in the dissenting opinion. Justice Nakamura, while an attorney, represented labor unions on various workers' compensation issues. Critics note an irony that Justice Nakamura, a presumed expert, wrote the minority opinion. See Smith, *"Stacked" Benefits Case May Raise Cost of Insurance*, Sunday Honolulu Star-Bull. & Advertiser, Jan. 6, 1985, at F8, col. 1, for a journalistic discussion of *Maldonado*.

[87] 67 Hawaii at ____, 687 P.2d at 5.

[88] *Id.* See *supra* note 14 for the text of HAWAII REV. STAT. § 294-5(b) (Supp. 1979).

[89] *See, e.g.*, Hawaii Pub. Employment Relations Bd. v. U.P.W., Local 646, 66 Hawaii 461, 667 P.2d 783 (1983) (The fundamental objective of a court in construing statutory language is to ascertain and give effect to the intention of the legislature, which is obtained primarily from the language contained in the statute itself.).

[90] 67 Hawaii at ____, 687 P.2d at 5. *See generally* 2A SUTHERLAND STATUTORY CONSTRUCTION § 46.06 (N. Singer 4th ed. 1984 & Supp. 1985) [hereinafter cited as SUTHERLAND].

[91] The ICA quoted a "cardinal rule of statutory construction" which stated that "a statute

A pivotal issue is posed by the court's choice of extrinsic sources for legislative intent. The hearings officer had noted a 1980 Senate Standing Committee Report as indicative of the original legislative intent.[92] The ICA instead referred to 1973 and 1974 Conference Committee Reports as more appropriate sources for the legislative history of section 294-5(b).[93]

The Hawaii Supreme Court noted that the language at issue in *Maldonado* was part of the originally enacted legislation and that the 1974 and 1980 committee reports dealt with later amendments which did not change that language. The court instead chose to confine its analysis to the 1973 report and to other sections of the statute rather than the subsequent legislative history. Thus, the court held that denial of benefits to Maldonado would have been contrary to the tenor of sections 294-3(a)[94] and 294-2(10)(c)(i).[95] To the extent that section 294-3(a) established a clear right to no-fault benefits, Maldonado had a right to such benefits notwithstanding the benefits he received from workers' compensation. Given this right, Maldonado was entitled to actual wage loss benefits up to the $800.00 per month maximum established in section 294-2(10)(c)(i). In this regard, Maldonado should have been compensated for his "actual" wage loss of $602.34 in order to satisfy the legislative intent.

The court held that since the right to no-fault benefits permeated the entire no-fault act, any reasonable construction of section 294-5(b) could not deny benefits to Maldonado. Therefore, "secondary" and "net" were synonymous and

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ought upon the whole be so construed that if it can be prevented no clause, sentence, or word shall be superfluous, void or insignificant." 5 Hawaii App. at 191, 683 P.2d at 399.

[92] 67 Hawaii at ___, 687 P.2d at 3. The 1980 report provided in pertinent part that: "If the amount, if any, the claimant actually lost during a monthly period is equal to or less than the amount of applicable coverage, it is our intent that the no-fault carrier is required to pay for such monthly earnings loss." SEN. STAND. COMM. REP. NO. 983, 8th Hawaii Leg., Reg. Sess., 1980 SEN. J. 1502, *quoted in* 67 Hawaii at ___, 687 P.2d at 3.

[93] 67 Hawaii at ___, 687 P.2d at 3. The 1974 report provided that "all benefits a victim may receive from. . .workmen's compensation. . .shall be deducted from no-fault benefits which are due." H.R. CONF. COMM. REP. NO. 27, 7th Hawaii Leg., Reg. Sess., 1974 HOUSE J. 867, *quoted in* 67 Hawaii at ___, 687 P.2d at 3. The 1973 report, in comparison, provided that "the amount paid would be reduced by any benefit from other sources paid to cover the same loss." H.R. CONF. COMM. REP. NO. 13, 7th Hawaii Leg., Reg. Sess., 1973 HOUSE J. 1221, *quoted in* 67 Hawaii at ___, 687 P.2d at 3. Both of these reports were cited in the ICA opinion as well. 5 Hawaii App. at 190, 683 P.2d at 398.

[94] That statute provided in part that "[i]f the accident causing accidental harm occurs in the State, every person insured under this chapter, and his survivors, suffering loss from accidental harm arising out of the operation, maintenance or use of a motor vehicle has a right to no-fault benefits." HAWAII REV. STAT. § 294-3(a) (1976), *quoted in* 67 Hawaii at ___, 687 P.2d at 3. The court evidently felt that the "right" to no-fault benefits was inherent as well as statutory. In the court's view, since the provision dealt with "priority" of the source of payments, it was irrelevant to the "rights" issue. 67 Hawaii at ___, 687 P.2d at 4.

[95] 67 Hawaii at ___, 687 P.2d at 3. For the text of the applicable statute, see *supra* note 3.

referred to the priority of payments and not whether benefits were actually payable.[96] This holding suggests that courts must presume that benefits are payable as a matter of course in construing section 294-5(b). The absence of such a presumption, in the Hawaii Supreme Court's view, would be contrary to the language and framework of the entire no-fault act.

The dissent, however, questioned the relevancy of these other sections in interpreting section 294-5(b). The dissent stated that section 294-3(a) merely established a general rule which was subject to limitations (such as section 294-5(b)) and that section 294-2(10)(c)(i) merely provided a maximum limit of $800 for monthly wage loss benefits.[97] Under this interpretation, Maldonado's "actual" wage loss should not be calculated as the difference between his prior monthly earnings and the workers' compensation benefits he received. In the dissent's view, the no-fault benefit payable would be the excess of the $800 wage loss maximum over the workers' compensation benefits received. Since Maldonado's workers' compensation benefits exceeded this maximum, he did not have a loss under the no-fault act.

The court probably was reasonable in excluding the 1980 report as inappropriate authority for the resolution of the "stacking" issue. The dissent reinforced this point by noting that the 1980 report dealt with a partial earnings situation. Since Maldonado did not receive any earnings while disabled, he did not come within the purview of the 1980 report.[98]

The court's rejection of the 1974 report, however, seems to raise significant difficulties. The Hawaii Motor Vehicle Accident Reparations Act did not become effective until after the 1974 legislative session. The original legislative history of Hawaii's no-fault law arguably encompassed both of the 1973 and 1974 legislative sessions. Perhaps the court should not have limited itself to the 1973 report, but should have looked at the 1974 report to clarify the meaning of the 1973 report. Moreover, this legislative history may have helped to clarify the apparent conflict between the right to benefits enunciated in section 294-3(a) and the "secondary and net" provision of section 294-5(b). Indeed, the pattern of amendments to section 294-5(b) suggests that Maldonado's situation was an exception to the general primacy of no-fault benefits.[99]

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[96] 67 Hawaii at ___, 687 P.2d at 4.

[97] *Id.* at ___, 687 P.2d at 5.

[98] *Id.* at ___, 687 P.2d at 5-6. The dissent pointed out that the 1980 report referred to HAWAII REV. STAT. § 294-2(10)(C)(iii) (1976) which was not at issue in this case. *Id. See supra* note 92.

[99] *See supra* note 34. The common thread to the collateral sources designated as primary to no-fault benefits seems to be that they were financed by the employer. The legislature's reluctance to delete workers' compensation benefits from this category arguably indicates an intent to substitute workers' compensation benefits for no-fault benefits whenever possible.

It should also be noted that Justice Wakatsuki was a member of the legislature when the no-

The Insurance Commissioner had relied on the subrogation provision of section 294-5(b) in denying Maldonado's claim.[100] The court demonstrated that this reliance was misplaced by showing how the no-fault insurer could pay the maximum monthly limit of $800 if the workers' compensation carrier failed to pay benefits.[101] By subrogation to the $931.66 per month claim against MTL, Transport Indemnity would actually pay $197.66 more than if it would have to pay under Maldonado's claim of $602.34 for each month of disability.[102] The court declared that allowing Maldonado's claim "does no violence to any part or word of the statute" and held in favor of Maldonado.[103]

Finally, the court addressed the standard of review of an administrative ruling.[104] In reversing the ICA, the Hawaii Supreme Court appears to have adopted a de novo or right/wrong standard of review for secondary appeals of administrative decisions.[105] The existence of legal error outweighed the need for deference to the Insurance Commissioner's interpretation of section 294-5(b).[106] In order to establish the existence of that error, however, the court adopted the interpretation of a hearings officer who was arguably less qualified, less experienced, and therefore less likely to possess the expertise of the Insurance Commissioner. While the court was not required to give total deference to the Commissioner, the court's rationale seems contradictory in that it may undermine the credibility of the administrative process.

The dissent concluded its attack with a policy argument: Due to the tax-free

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fault law was enacted. Therefore, he may have been in a better position to ascertain the original legislative intent. Given that he affirmed the Insurance Commissioner's opinion at the circuit court level, the dissenting opinion's rationale seems more persuasive.

[100] 67 Hawaii at ___, 687 P.2d at 4. The second sentence provided that:

> If the person does not collect such benefits under such laws by reason of the contest of his right to so collect by the person or organization responsible for payment thereof, the injured person, if otherwise eligible, shall, nevertheless, be entitled to receive no-fault benefits and upon payment thereof the no-fault insurer shall be subrogated to the injured person's right to collect such benefits.

HAWAII REV. STAT. § 294-5(b) (Supp. 1979).

[101] 67 Hawaii at ___, 687 P.2d at 4.

[102] *Id.*

[103] *Id.*

[104] *Id.* The ICA had relied on the doctrine that an appellate court interpreting a statute must give due deference to the interpretation given it by the agency charged with its interpretation. 5 Hawaii App. at 193, 683 P.2d at 400. However, the supreme court felt that this doctrine was outweighed because under the statute prescribing the standard of review, the Insurance Commissioner had committed an error of law sufficient for reversal, in that her decision was "contrary to the language and framework of the no-fault statute." 67 Hawaii at ___, 687 P.2d at 4. See *supra* note 19 for the text of HAWAII REV. STAT. § 91-14(g) (1976), which outlines the scope of judicial review of administrative decisions.

[105] 67 Hawaii at ___, 687 P.2d at 4. *See generally* SUTHERLAND, *supra* note 90, § 49.05.

[106] 67 Hawaii at ___, 687 P.2d at 4.

status of his aggregrate benefits, Maldonado actually profited from his injury.[107] Apparently, the court felt that it was better for Maldonado to obtain a windfall than to relieve Transport Indemnity of its contractual (and statutory) obligation to pay benefits to injured accident victims. It should be noted that Maldonado's no-fault coverage was provided by MTL. Not only did Maldonado receive duplicative benefits, MTL was subjected to double liability since it paid the premiums for both the workers' compensation and no-fault insurance coverages. In this respect, *Maldonado* is distinguishable from cases in which the insured tried to stack benefits from his own no-fault coverage.[108]

In evaluating the court's rationale, it should be emphasized that Hawaii's no-fault law was intended to provide "speedy, adequate, and equitable reparation" for injured claimants.[109] If the no-fault act was intended to provide full recovery, then the court's rationale would be much more persuasive. Adequate reparation, however, does not necessitate full recovery. Therefore, the court's assertion that the Insurance Commissioner's decision was contrary to the clear language and framework of the no-fault law seems questionable. The no-fault act created a trade-off whereby potential plaintiffs sacrificed tort recovery in exchange for a less stringent burden of proof. It, therefore, seems inequitable to allow an injured claimant full tax-free recovery without imposing on him the burden of proof associated with personal injury lawsuits.

Neither the court nor the dissent dealt with the exclusivity provision of the workers' compensation statute.[110] Although the issue was not raised on appeal, it could have been argued that section 386-5 of the Hawaii Revised Statutes bars no-fault recovery once workers' compensation benefits have been received.

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[107] *Id.* at ___, 687 P.2d at 6.

[108] H.R. CONF. COMM. REP. NO. 13, 7th Hawaii Leg., Reg. Sess., 1973 HOUSE J. 1219.

[109] *See supra* note 31 and accompanying text.

[110] Hawaii's workers' compensation statute provides:

> The rights and remedies herein granted to an employee or his dependents on account of a work injury suffered by him shall exclude all other liability of the employer to the employee, his legal representative, spouse, dependents, next of kin, or anyone else entitled to recover damages from the employer, at common law or otherwise, on account of the injury.

HAWAII REV. STAT. § 386-5 (1976).

The validity of an argument that § 386-5 bars Maldonado's claim turns on whether no-fault benefits are analogous to the tort liability of an employer to an injured employee. Given that no-fault insurance was created as a substitute for tort liability, it might have been possible for Transport Indemnity to raise the defense of exclusivity. On the other hand, the language of § 294-5(b) arguably suggests that workers' compensation is not exclusive. *See supra* note 14. Moreover, the case law indicates that the exclusive remedy doctrine is by no means absolute. *See, e.g.*, Espaniola v. Cawdrey Mars Joint Venture, 68 Hawaii ___, 707 P.2d 365 (1985) (post-*Maldonado* case holding that, notwithstanding § 386-5, an employer covered by the workers' compensation law can still be liable to a third party if he assumes liability under an indemnity agreement).

If no-fault benefits constituted liability of MTL to Maldonado on account of his injury, section 386-5 might have barred him from seeking benefits from Transport Indemnity.

Finally, if Maldonado's workers' compensation benefits were inadequate, it appears illogical for the court to attempt to correct such a defect by no-fault judicial doctrine. Perhaps it would have been more sensible for the legislature to amend the workers' compensation benefit schedules, rather than for the courts to stretch the statutory language of the no-fault law in order to achieve a just result. The legislature is better equipped than the courts to decide such a broad issue.

In summary, the Hawaii Supreme Court held that where an employee was injured in a work-related automobile accident and partially compensated for lost wages by workers' compensation, the amount not paid and actually lost by the employee is his monthly earnings loss for purposes of Hawaii's no-fault law.[111] Confined to its facts, *Maldonado* seems to reach a reasonable result in allowing the "stacking" of no-fault and workers' compensation benefits in order to grant an injured employee a fuller recovery.

The court's rationale, however, seems to conflict with statutory provisions.[112] Moreover, the court's assertion that the Insurance Commissioner's interpretation was contrary to the clear language and framework of the no-fault law is not persuasive. Finally, the tax-free status of no-fault benefits is troubling in that it seems to create a windfall that may encourage malingering. The next section will explore the Hawaii State Legislature's response to the *Maldonado* decision.

V. IMPACT

In re Maldonado allows any person injured in a motor vehicle accident in the course and scope of employment to "stack" no-fault work loss benefits on workers' compensation. The court's decision to permit "stacking" has been met with displeasure in the Hawaii legislature. In 1985, the legislature amended section

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[111] 67 Hawaii at ____, 687 P.2d at 2. In other words, if an injured insured recovered more than $800 in workers' compensation benefits, that person could also recover up to $800 from his no-fault insurer as long as his recovery did not exceed his prior actual monthly wage loss.

[112] *Maldonado* may also be inconsistent with the administration of the no-fault statute. HAWAII REV. STAT. § 294-6(a) (1976) allows an injured claimant under certain conditions to bring a tort action when his no-fault remedies have been exhausted. The Insurance Commissioner has stated that for the purposes of tolling the statute of limitations, a claimant may receive "no-fault" benefits under workers' compensation laws. *See, e.g.*, Letter from David T. Ishikawa, Motor Vehicle Insurance Commissioner, to William C. Chikasuye, Attorney-at-Law (May 27, 1980), *reprinted in* 80-1 HAWAII L. REP. 800285 (1980) (concerning workers' compensation payments as no-fault benefits).

294-5(b)[113] of the Hawaii Revised Statutes as a direct result of *Maldonado*.[114]

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[113] The Act provided that:

SECTION 1. The purpose of this Act is to clarify the intent of the legislature that no-fault wage loss benefits should not be paid in addition to workers' compensation lost earnings benefits if the no-fault wage loss maximum has been paid.

SECTION 2. Section 294-5, Hawaii Revised Statutes, is amended by amending subsection (b) to read as follows:

(b) All no-fault benefits shall be paid secondarily and net of any benefits a person is entitled to receive because of the accidental harm from workers' compensation laws; *provided that the total amount a person is entitled to receive for monthly earnings loss under this chapter shall be limited to the amount set out in section 294-2(10) (c) or the amount of any applicable coverage under section 294-11, without any deduction of any amount received as compensation for lost earnings under any workers' compensation law provided; that the aggregate of the payments from both sources shall not exceed eighty per cent of the person's monthly earnings as monthly earnings are defined in section 294-2(7). . . .*

SECTION 3. New statutory material is underscored.

Act of April 30, 1985, ch. 56, 1985 Hawaii Sess. Laws 88 (codified at HAWAII REV. STAT. § 294-5(b) (L.R.B. Comp. 1985)).

[114] The Committee Report stated in pertinent part:

The purpose of this bill is to revise Section 294-5, Hawaii Revised Statutes, to limit a claimant's wage loss benefits from both workers' compensation and no-fault insurance sources to the maximum of such benefits available under a claimant's no-fault insurance policy.

This bill attempts to remedy the recent Hawaii Supreme Court decision in *Maldonado v. Transport Indemnity* . . .[sic]

Your Committee, upon further consideration has amended the bill by providing that the aggregate of payments from both sources shall not exceed 80 percent of the person's monthly earnings, as suggested by the Department [of Commerce and Consumer Affairs].

H.R. STAND. COMM. REP. NO. 850, 13th Hawaii Leg., Reg. Sess., 1985 HOUSE J. 1401.

Maldonado is not the first no-fault case to spark reactionary legislation. In Joshua v. MTL, Inc., 65 Hawaii 623, 656 P.2d 736 (1982), an uninsured motorist was injured when his automobile, which was stopped, was struck by an MTL bus. The uninsured motorist argued that certain provisions of the no-fault law (HAWAII REV. STAT. §§ 294-6(a)(2), -36(b) (1976)) were unconstitutional as a denial of equal protection to persons ineligible for no-fault benefits. Section 294-6(a)(2) abolished tort liability until medical-rehabilitative threshold had been reached. Under § 294-36, uninsured motorists had to file a tort action within two years of the accident, and insured motorists had a statute of limitations of two years after the last payment of insurance benefits. The Hawaii Supreme Court held § 294-6(a)(2) to be unconstitutional since there was no rational basis for barring uninsured motorists from bringing tort actions against negligent drivers of insured vehicles while permitting insured motorists to do so. Section 294-36(b) was held to deny equal protection since negligent operators of insured vehicles had a longer statute of limitations than an uninsured motorist suffering the same loss. *Cf.* McAulton v. Goldstrin, 66 Hawaii 14, 656 P.2d 96 (1982) (An uninsured motorist was awarded damages even though his losses did not equal the threshold amount in light of Joshua v. MTL, Inc.).

The 1983 legislature responded with an amendment designed to resolve a paradox created by *Joshua* and *McAulton*:

A constant problem in the no-fault system is the minority which consistently refuses to

The amended statute limits the aggregate amount recoverable from workers' compensation and no-fault insurance to eighty percent of a person's earnings loss.[115] No-fault insurance payments remain secondary to workers' compensation.[116]

The eighty percent cap instituted by the legislature aligns Hawaii with Kentucky, which allows the stacking of no-fault benefits on workers' compensation up to a percentage of a claimant's wage loss.[117] Before section 294-5(b) was amended, an injured employee could receive more than his after-tax earnings.[118] There was a strong incentive to malinger.[119] The eighty percent figure of the amended statute, however, prevents a tax windfall, thus reducing the likelihood of malingering.[120]

> obtain the motor vehicle insurance coverage required under the law. The legislature has taken more than one approach to encourage full compliance with the law. . . .
>
> In recent times the Hawaii supreme court, however, eroded one of the most important elements of our no-fault system, the mandatory insurance coverage of all who choose to exercise the privilege of driving. The court's decision in *Joshua v. MTL, Inc.*. . .misread the intent of the legislature. . . .
>
> The result of the *Joshua* and *McAulton* decisions is that the no-fault law is interpreted to provide law violators faster and easier access to the judicial system than law abiding citizens have. These decisions fly in the face of justice and public policy. By rewarding noncompliance, these decisions may well be the first step in what could lead ultimately to the destruction of the no-fault system. . . .
>
> Accordingly, the purpose of this Act is to expressly restate, reiterate, and clarify the intent of the legislature in enacting sections 294-6(a) and 294-36(b). . . .

Act of June 9, 1983, ch. 245, 1983 Hawaii Sess. Laws 518, 520-21. The amendment was codified in HAWAII REV. STAT. §§ 294-6(a) & 294-36(b) (Supp. 1984). In Washington v. Fireman's Fund Ins. Co., ____ Hawaii ____, 708 P.2d 129 (1985), the court held that Act 245 effectively supersedes both *Joshua* and *McAulton*.

[115] HAWAII REV. STAT. § 294-5(b) (L.R.B Comp. 1985).

[116] *Id.*

[117] *See* United States Fidelity & Guar. Co. v. Smith, 580 So. 2d 216 (Ky. 1979).

[118] Due to the nontaxable nature of no-fault and workers' compensation benefits, Maldonado, in recovering his gross monthly wages, received more than his after-tax take-home pay.

[119] This argument is somewhat tempered by the fact that employees collecting workers' compensation benefits neither collect overtime pay nor obtain raises. Smith, *supra* note 86, at F8, col. 3.

[120] The prevention of malingering is a constitutionally permissible purpose, and the eighty percent cap appears to be rationally related to that purpose in light of Richardson v. Belcher, 404 U.S. 78 (1971). In *Richardson*, the United States Supreme Court held that the mandatory reduction of social security benefits to account for the receipt of workers' compensation benefits under § 224 of the Social Security Act did not violate the due process clause of the fifth and fourteenth amendments. *Id.* at 84. The Court found that Congress sought to prevent the recovery of duplicative benefits, to prevent malingering, and to give precedence to state compensation schemes. *Id.* at 83. The Court held that these goals were legitimate and rationally related to the classification created by § 224, which limited total state and federal benefit recovery to eighty percent of a person's earnings prior to the disability. *Id.* at 83-84.

Prior to the passage of the amendment, some commentators suggested that *Maldonado* would spark an increase in insurance rates due to the possibility of more claimants.[121] Companies employing large numbers of drivers would be hardest hit by sharp rises in insurance costs.[122] The amendment struck a compromise between the interests of employers and those of the injured employees by balancing the need for low insurance costs and for adequate compensation.[123]

The new statute, however, appears to have a disproportionate effect on the poor. Individuals in the lower tax brackets usually do not lose twenty percent of their earnings to income taxes.[124] Therefore the low wage earner would recover less than his after-tax take home pay.

An alternative to the eighty percent cap would be to calculate net earnings loss on a case-by-case basis. Under this method, each claimant's net earnings loss would be calculated by subtracting applicable federal and state income taxes from the person's gross income before the injury. Although administrative costs in the area of claim settlement will undoubtedly increase due to additional paperwork, the calculation of net earnings loss will provide compensation that approximates a person's income before the injury.

A second alternative involves a progressive percentage cap that would vary depending upon a person's gross income. For example, a person who has monthly earnings of $1000 could have a ninety percent cap, whereas a person who earns $2000 per month could have a cap set at eighty percent. The calculation of recoverable earnings loss will be based on a rate schedule set by the legislature. The administrative costs of this alternative should be less than the first, since a single rate schedule is involved, and factors like dependency are not

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[121] Smith, *supra* note 86, at F8, col. 1. A 1985 study submitted to the Insurance Commissioner noted that:

> Carriers sense a continuing erosion of the claim settlement climate as a result of judicial decisions. Two instances mentioned by almost everyone interviewed were the Muldanado [sic] case, where the coordination between automobile insurance wage loss benefits under PIP coverage and workers compensation insurance benefits was interpreted to the detriment of insurance carriers, and cases involving the "stacking" of uninsured motorists limits where the total coverage allowed was based on the UM limits multiplied by the number of vehicles. Both of these decisions involve areas where the previous pricing assumed a certain interpretation of the coverage that has been significantly altered at the judicial level.

Dep't of Commerce & Consumer Affairs, Review of Hawaii No-Fault Law 26 (Jan. 1985).

[122] Smith, *supra* note 86, at F8, col. 1.

[123] For example, assuming that Maldonado is covered by the new law, he would be entitled to a maximum of 80% of $1534.00 or $1227.20, considerably more than the $931.66 under workers' compensation alone. Transport Indemnity would be required to pay benefits of only $295.54 ($1227.20 - $931.66), considerably less than the $602.34 under the Hawaii Supreme Court's opinion in *Maldonado*.

[124] *See* I.R.C. § 1 (West Supp. 1984).

taken into account. The greatest drawback to the second alternative is the cost that will be incurred in the research and implementation of the rate schedule by the legislature.

A third alternative would be to retain section 294-5(b) as an offset provision. Recovery would be limited to after-tax earnings prior to the injury, subject to the no-fault statutory ceiling.[125] Additionally, the no-fault statutory maximum as provided by section 294-2(10)(C)(i) should be raised to $1400 per month.[126] By offsetting recovery after taxes are calculated, tax windfalls will be avoided, and fair compensation will be provided. Raising the monthly earnings loss ceiling to $1400 will insure adequate compensation for persons who qualify for both workers' compensation and no-fault benefits, and for persons whose exclusive remedy is no-fault.[127] Another feature of this alternative is that employees injured within the scope of employment essentially would be treated in a manner similar to non-driving employees.[128] Drawbacks to this alternative include an increase in administrative costs to implement this on a case-by-case basis, and a recovery limited to $1400 per month.

VI. CONCLUSION

In re Maldonado, a case of first impression in Hawaii, interpreted Hawaii Revised Statutes section 294-5(b) to permit "stacking" no-fault earnings loss benefits on workers' compensation benefits. *Maldonado* represents a judicial admission that the no-fault and workers' compensation laws were individually inadequate in providing compensation to an injured person.

In response to *Maldonado*, the Hawaii legislature amended section 294-5(b) in 1985. The amendment limited the holding of *Maldonado* by setting an eighty percent cap on wage loss benefits recoverable from no-fault and workers' compensation. The amendment appears to balance the interests of the injured employee, which is to have adequate compensation, and the interests of the employer, which is to keep the price of insurance premiums down.

The amendment may also be seen as a message from the legislature to the

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[125] *See* Featherly v. A.A.A. Ins. Co., 119 Mich. App. 132, 326 N.W.2d 390 (1982) (interprets Michigan offset statute).

[126] The statutory maximum has been $800 per month since the Hawaii no-fault law was first enacted. It has recently been raised to $900 per month. HAWAII REV. STAT. § 294-2(10)(C)(i) (L.R.B. Comp. 1985).

[127] The statutory maximum in Michigan is $1475. *Featherly*, 119 Mich. App. at 135, 326 N.W.2d at 391.

[128] *E.g.*, I.M.L. Freight v. Ottosen, 538 P.2d 296, 297 (Utah 1975).

courts to be conservative in the area of no-fault "stacking."[129] Whether the concept of "stacking" will be extended will be determined in the future.

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Ward F.N. Fujimoto

[129] After the legislature amended section 294-5(b), the ICA has disallowed the stacking of no-fault benefits in Rana v. Bishop Ins. Co., ___ Hawaii App. ___, 713 P.2d 1363, *aff'd*, ___ Hawaii ___, 713 P.2d 1363 (1985). For a discussion of *Rana*, see *supra* text accompanying notes 43-50.

State v. Tanaka: How Reasonable Is an Expectation of Privacy in Trash?

I. INTRODUCTION

In *State v. Tanaka*,[1] the Hawaii Supreme Court faced the question of whether the police may search and seize trash contained in opaque trash bags without a warrant.[2] The court held that the defendants had a reasonable expectation of privacy in their trash, and therefore the warrantless search and seizure of their trash was prohibited by the Hawaii Constitution.[3]

This conclusion differs from the conclusion reached by most jurisdictions that have considered the same question.[4] The Hawaii Supreme Court based its decision on prior Hawaii case law and on a broad interpretation of the language of the Hawaii Constitution.[5] This recent development analyzes the decision reached by the Hawaii Supreme Court in *State v. Tanaka*, compares it with the decisions reached by other jurisidictions which have examined the constitutionality of a trash search, and examines its potential impact.

II. FACTS OF *State v. Tanaka*

State v. Tanaka is a consolidation of three cases.[6] In the first case,[7] a confidential informant told a police officer that he had, upon invitation by defendants Tanaka and Bal, met them at their work place at Granger Pacific to place bets on football games.[8]

At 1:00 a.m., after business hours, the officers entered the private parking area next to the service entrance of Granger Pacific without a search warrant and

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[1] 67 Hawaii ____, 701 P.2d 1274 (1985).

[2] *Id.* at ____, 701 P.2d at 1274 (Cases consolidated were *State v. Tanaka*, *State v. Takamiya*, and *State v. Kahoohalahala*.).

[3] *Id.*

[4] *See infra* Section IV.

[5] *See infra* note 28.

[6] 67 Hawaii at ____, 701 P.2d at 1274.

[7] The first case hereinafter will be referred to as the *Tanaka* case.

[8] Appellee's Answering Brief at 3 (Tanaka).

searched the Granger Pacific dumpster for evidence of illegal gambling activity.[9] According to the defendants the dumpster was located in an enclosed and fenced area not open to the general public.[10]

Because the seized evidence was contained in an opaque plastic bag tied with a wire binding, the contents were not visible without untying the bag.[11] There was no sign indicating that access to Granger Pacific premises was restricted. The company's trash had been commingled with the trash from the other tenants who also used the dumpster.[12] Based on the evidence obtained from the trash search, the police obtained a warrant to search the interior of the Granger Pacific premises. The search revealed gambling documents.[13]

In the second case,[14] a confidential informant told an officer that betting slips could be obtained from persons at Maui Beverage and Supplies. In addition, the police had observed a person whom they believed to be a gambling runner go into Maui Beverage.[15] Between November 11, 1981, and December 15, 1981, officers entered the premises of Maui Beverage on several occasions to search its trash dumpster, which was located about thirty-five feet from the building and approximately forty to fifty feet from the public roadway.[16]

Although a sign posted on the premises read, "Warning: Private Property, Keep Out, Violators Will Be Prosecuted," the officers did not obtain consent to enter the premises or to search the dumpster.[17] During these searches, which occurred between the hours of 11:00 p.m. and 2:00 a.m., the officers opened the dumpster, removed closed boxes and opaque plastic trashbags, opened them, and inspected the contents.[18] Based on evidence obtained from these trash searches the officers obtained a warrant to search Takamiya's residence and business premises.[19] The search revealed gambling documents.[20]

In the third case,[21] a police officer received information from an anonymous caller that Kahoohalahala was involved in bookmaking schemes.[22] The Kahoohalahalas lived on Maui in a single story house with a garage extending

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[9] Appellant's Opening Brief at 3 (Tanaka).

[10] *Id.*

[11] *Id.*

[12] Appellee's Answering Brief at 9 (Tanaka).

[13] State v. Tanaka, 67 Hawaii at ____, 701 P.2d at 1275.

[14] The second case hereinafter will be referred to as the *Takamiya* case.

[15] Appellee's Answering Brief at 6 (Takamiya).

[16] Two other companies were also situated on the premises—Tanikai, Inc. and Fred L. Waldron, Ltd. Appellant's Opening Brief at 3 (Takamiya).

[17] *Id.* at 3-4.

[18] *Id.* at 4.

[19] *Id.* at 5.

[20] State v. Tanaka, 67 Hawaii at ____, 701 P.2d at 1275.

[21] The third case hereinafter will be referred to as the *Kahoohalahala* case.

[22] Appellee's Answering Brief at 10 (Kahoohalahala).

in front.[23] A trash can was located in front of the garage.[24]

The police conducted a surveillance of the home to "observe when the trash. . .would be moved from the garage to the roadway."[25] After the trash can was moved to the roadway, an officer seized it.[26] A search warrant, based on the contents of the can, led to police seizing gambling records.[27]

III. ANALYSIS

The threshold issue in *Tanaka* was whether a "search" had taken place within the meaning of the Hawaii Constitution[28] when the officers entered the defendants' property and examined the contents of the trash bags.[29] The court began its analysis by examining whether the defendants had a reasonable expectation of privacy in the property examined by the officers. If so, the police would have had to obtain a warrant before they could search.[30]

The reasonable expectation of privacy test has two parts.[31] The first looks to see if the defendant has an actual expectation of privacy.[32] The Hawaii Supreme Court addressed this issue in *State v. Ching*.[33] *Ching* involved an inventory search of a lost pouch. As part of the search, a police officer opened an opaque metal cylinder which had been in the pouch and found cocaine.[34] The court held that the defendant had demonstrated an actual expectation of privacy by placing the cocaine in an opaque, metal container with a screw-on cap.[35]

Similarly, in each of the fact situations presented in *State v. Tanaka*, the evidence in question was contained in opaque, closed trash containers. Furthermore, Tanaka and Takamiya testified that they had an expectation of privacy in

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[23] *Id.*

[24] *Id.*

[25] *Id.*

[26] *Id.*

[27] State v. Tanaka, 67 Hawaii at ___, 701 P.2d at 1276.

[28] The applicable section of the Hawaii Constitution reads: "The right of the people to be secure in their persons, houses, papers and effects against unreasonable searches, seizures, and invasions of privacy shall not be violated. . . ." HAWAII CONST. art. I, § 7. Although the Hawaii Constitution specifically states a right to privacy, the Hawaii Supreme Court has interpreted that provision to be similar to the right to privacy guaranteed under the federal Constitution. State v. Mueller, 66 Hawaii 616, 630, 671 P.2d 1351, 1360 (1983).

[29] *Tanaka*, 67 Hawaii at ___, 701 P.2d at 1276.

[30] *Id.* at ___, 701 P.2d at 1276-77. The officers must obtain a search warrant before they can search the property unless exigent circumstances are present. *Id.*

[31] *Id.* at ___, 701 P.2d at 1276.

[32] *Id.*

[33] 67 Hawaii 107, 678 P.2d 1088 (1984).

[34] *Id.* at 108, 678 P.2d at 1090-91.

[35] *Id.* at 110, 678 P.2d at 1092.

their trash bags.[36] On this basis, the court held that the defendants did have an actual expectation of privacy in their trash.[37]

The second part of the test requires that the defendant's expectation of privacy be one that society recognizes.[38] The *Tanaka* court observed that the federal appellate courts that have considered the constitutionality of trash searches have held that "under the Fourth Amendment of the U.S. Constitution, society is not prepared to recognize expectations of privacy in garbage."[39] In its interpretation of the Hawaii Constitution, however, the court did recognize a societal expectation of privacy in trash.[40]

In deciding this issue, the court considered the usual items found in a person's garbage.[41] Because these items can reveal so much about a person's activities, associations, and beliefs, the court held that the expectation of privacy that people have in their trash is reasonable. The court found that it was "exactly this type of overbroad governmental intrusion that article I, § 7 of the Hawaii Constitution was intended to prevent."[42]

IV. Commentary

Other jurisdictions that have examined the constitutionality[43] of trash

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[36] State v. Tanaka, 67 Hawaii at ___, 701 P.2d at 1276.

[37] *Id.*

[38] *Id.*

[39] *Id.* at ___, 701 P.2d at 1276.

[40] In State v. Kaluna, 55 Hawaii 361, 369, 520 P.2d 51, 58 (1974), the Hawaii Supreme Court declared itself as the "final" and "unreviewable" authority in interpreting the Hawaii Constitution. As such, the court can "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.*

[41] These items include "business records, bills, correspondence, magazines, [and] tax records." 67 Hawaii at ___, 701 P.2d at 1276-77.

[42] *Id.* at ___, 701 P.2d at 1277.

[43] For courts that have found no reasonable expectation of privacy in trash, see, e.g., United States v. Michaels, 726 F.2d 1307 (8th Cir.) (no expectation of privacy in trash after the trash has been intermingled with the trash of others in an apartment trash dumpster), *cert. denied*, 105 S. Ct. 92 (1984); United States v. Kramer, 711 F.2d 789 (7th Cir.) (A person who wants to keep things private must either keep it or destroy it before putting it in the trash.), *cert. denied*, 464 U.S. 962 (1983); United States v. Vahalik, 606 F.2d 99 (5th Cir. 1979) (The act of placing the trash out for collection is abandonment.), *cert. denied*, 444 U.S. 1081 (1980); United States v. Crowell, 586 F.2d 1020 (4th Cir. 1978) (Absent special arrangements for the removal of trash inviolate, the placing of trash for collection is abandonment.), *cert. denied*, 440 U.S. 959 (1979); United States v. Dzialak, 441 F.2d 212 (2d Cir. 1971) (property abandoned between the sidewalk and the street in front of the defendant's home); United States v. Minker, 312 F.2d 632 (3d Cir. 1962) (trash abandoned in an apartment's dumpster located on the apartment's property, but outside the building, is outside a constitutionally protected area); Smith v. State, 510

searches have applied either different tests from the test applied by the *Tanaka* court, or the same test in a slightly different manner. The Hawaii Supreme Court rejected the other approaches choosing to apply the reasonable expectation of privacy test.[44]

A. *Abandonment Test*

Some courts have used an abandonment test to determine the constitutionality of the trash search.[45] Under this test, the issue is "whether the defendant has, in discarding the property, relinquished the expectation of privacy with respect to the property so that neither search nor seizure is within the proscriptions of the fourth amendment."[46] Thus, abandonment depends upon the intent of the defendant.[47]

Although courts applying an abandonment test agree that the defendant's intent is determinative, they disagree as to what actions indicate the intent to

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P.2d 793 (Alaska) (no actual expectation of privacy), *cert. denied*, 414 U.S. 1086 (1973); Stone v. State, 402 So. 2d 1330 (Fla. Dist. Ct. App. 1981) (Trash is abandoned unless special arrangements are made for removal of the trash without it being opened or examined.); People v. Huddleston, 38 Ill. App. 3d 277, 347 N.E.2d 76 (1976) (Location of the trash is significant in determining whether there was an intention to abandon. Trash on curbside is abandoned.); State v. Oquist, 327 N.W.2d 587 (Minn. 1982) (No reasonable expectation of privacy exists in trash bag located near the garbage can and seized without the deputies trespassing on defendant's property.); Commonwealth v. Minton, 288 Pa. Super. 381, 432 A.2d 212 (1981) (Placing trash out for collection is abandonment.).

For courts that found an expectation of privacy in trash, see, e.g., Work v. United States, 243 F.2d 660 (D.C. Cir. 1957) (Trash on the curtilage of a house was not abandoned.); People v. Krivda, 5 Cal. 3d 357, 486 P.2d 1262, 96 Cal. Rptr. 62 (1971) (Defendant has a reasonable expectation of privacy in his trash until the trash is commingled with the trash of others and loses its identity.); Ball v. State, 57 Wis. 2d 653, 205 N.W.2d 353 (1973) (Defendant must undertake an act that shows his intention to abandon the property, such as putting the trash in plain view outside the curtilage of his home.).

[44] 67 Hawaii at ____, 701 P.2d at 1276.

[45] For courts that have used the abandonment concept to determine constitutionality of trash searches, see, e.g., United States v. Vahalik, 606 F.2d 99 (5th Cir. 1979); United States v. Crowell, 586 F.2d 1020 (4th Cir. 1978); United States v. Shelby, 573 F.2d 971 (7th Cir.), *cert. denied*, 439 U.S. 841 (1978); United States v. Minker, 312 F.2d 632 (3d Cir. 1962); People v. Krivda, 5 Cal. 3d 357, 486 P.2d 1262, 96 Cal. Rptr. 62 (1971); Stone v. State, 402 So. 2d 1330 (Fla. Dist. Ct. App. 1981); People v. Huddleston, 38 Ill. App. 3d 277, 347 N.E.2d 76 (1976); Ball v. State, 57 Wis. 2d 653, 205 N.W.2d 353 (1973).

[46] State v. Oquist, 327 N.W.2d 587, 590 (Minn. 1982). Abandonment used in a constitutional context differs from abandonment as used in the law of property. Under the law of property, the court asks whether "the owner has voluntarily, intentionally, and unconditionally relinquished his interest in the property so that another, having acquired possession, may successfully assert his superior interest." *Id.*

[47] United States v. Minker, 312 F.2d 632, 634 (3d Cir. 1962).

abandon.[48] In *Commonwealth v. Minton*,[49] the Superior Court of Pennsylvania admitted evidence obtained from the warrantless search of a large plastic trash bag seized from the curbside of the defendant's residence.[50] The court held that "placing trash for collection is an act of abandonment which terminates any fourth amendment protection."[51] In contrast, the Supreme Court of California determined in *People v. Krivda*[52] that placing trash barrels at the curb for pick-up by refuse collectors does not necessarily indicate an intent to abandon the trash.[53] Arguably, the defendant's act of placing the trash on the curbside for collection indicates only an intent to comply with local ordinances that require residents to place their trash barrels at the curb to be taken away.[54]

Courts have also found the location of the trash to be an important fact in determining the defendant's intent to abandon the trash.[55] In *State v. Schultz*,[56] the Florida District Court of Appeals stated that "the location of the trash is a significant factor in determining whether defendant has abandoned the trash. . . .Some locations give rise to a greater and more reasonable expectation of privacy than others."[57] Thus trash placed at the rear of the defendant's home, a garage or carport might not be abandoned, but trash placed on the swale area would be considered abandoned.[58] In *United States v. Harruff*,[59] a Michigan district court, however, rejected the importance of location in determining an intent to abandon:

> [W]here a thing is does not determine the question; rather it is the intent of the

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[48] *Compare* People v. Huddleston, 38 Ill. App. 3d 277, 347 N.E.2d 76 (1976) (The location of the trash is a significant factor in determining whether defendant has abandoned the trash.) *and* Commonwealth v. Minton, 288 Pa. Super. 381, 432 A.2d 212 (1981) (Placing of trash in the garbage cans at the time and place for collection by public employees signifies abandonment.) *with* United States v. Harruff, 352 F. Supp. 224 (D. Mich. 1972) (The location of an item does not determine whether it was abandoned.) *and* People v. Krivda, 5 Cal. 3d 357, 486 P.2d 1262, 96 Cal. Rptr. 62 (1971) (Defendants' placement of trash near sidewalk was not necessarily indicative of any intent other than to comply with local ordinances governing the disposal of trash. Thus it does not indicate an intent to abandon.).

[49] 288 Pa. Super. 381, 432 A.2d 212 (1981).

[50] *Id.*

[51] *Id.* at 391, 432 A.2d at 217.

[52] 5 Cal. 3d 357, 486 P.2d 1262, 96 Cal. Rptr. 62 (1971).

[53] *Id.* at 366 n.7, 486 P.2d at 1268 n.7, 96 Cal. Rptr. at 68 n.7.

[54] *Id.*

[55] State v. Schultz, 388 So. 2d 1326 (Fla. Dist. Ct. App. 1980) (Trash deposited on the swale was abandoned.); People v. Huddleston, 38 Ill. App. 3d 277, 347 N.E.2d 76 (1976) (Trash at curbside was abandoned.).

[56] 388 So. 2d 1326 (Fla. Dist. Ct. App. 1980).

[57] *Id.* at 1329.

[58] *Id.*

[59] 352 F. Supp. 224 (D. Mich. 1972).

> person that is determinative for if the actor's intention is to abandon a piece of property, its location would not matter. . . .[I]t might be abandoned in a private place or private in a public place.[60]

Because the defendant placed his trash in an apartment complex-community trash container the court found that he had reason to be aware of public scrutiny of his trash. Under these circumstances the court found that the defendant could not have an intent to keep his trash private. Thus the court found that the defendant had abandoned his trash.[61]

Another test of abandonment is to find an act that transforms a revocable decision to abandon the property to an irrevocable one. The Wisconsin Supreme Court has found such a transformation where the defendant either vacates the premises or in some way places the property in the public view.[62]

Had the Hawaii Supreme Court adopted the abandonment test, the result in *Tanaka* might have been slightly different. The court could have found that Tanaka abandoned his trash when it was thrown in a dumpster used by other parties. Although the dumpster was located on private property, there was no sign on the premises to discourage trespassers. The record is unclear as to whether the general public had access to the dumpster.[63] If they did, this situation would be similar to *Harruff*[64] where the Michigan court found that the defendant did not have a reasonable expectation.

Takamiya appears to have a stronger argument because there was a "no trespassing" sign posted on the premises.[65] Such a sign could manifest an intent to preserve privacy in the contents of the dumpster although the circumstances might indicate that the sign was not, in itself, sufficient basis for a privacy expectation.

As applied to Kahoohalahala, the abandonment test would not have a clear cut result. Under the approach of *Minton*,[66] placing the trash out for collection would constitute abandonment. Under the California Supreme Court's approach in *People v. Krivda*,[67] the Kahoohalahala's trash might not have been found to be abandoned because the act of placing the trash on the curbside to be picked up by refuse collectors did not indicate abandonment.[68] The specific location of the trash would be an important factor in a determination of an intent to aban-

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[60] *Id.* at 226 (construing *Katz v. United States*, 389 U.S. 347 (1967)).

[61] 352 F. Supp. 226 (D. Mich. 1972).

[62] Ball v. State, 57 Wis. 2d 653, 662, 205 N.W.2d 353, 357 (1973).

[63] Appellee's Answering Brief at 9 (Tanaka).

[64] 352 F. Supp. 224 (D. Mich. 1972).

[65] Appellant's Opening Brief at 3 (Takamiya).

[66] 288 Pa. Super. at 391, 432 A.2d at 217 (1981).

[67] 5 Cal. 3d 357, 486 P.2d 1262, 96 Cal. Rptr. 62 (1971).

[68] *Id.* at 366 n.7, 486 P.2d at 1268 n.7, 96 Cal. Rptr. at 68 n.7.

don. By placing it on the curbside of the property, it is arguable that the Kahoohalahalas abandoned their trash.

B. Other Dispositions

Some courts have applied a curtilage test to determine whether constitutional protections apply to expectations of privacy in trash. Curtilage defines an area surrounding a person's dwelling which is considered to be included within the constitutional protection of the dwelling.[69] Thus, anything located on the curtilage is protected from unreasonable searches and seizures in the same way as a residence would be protected.[70] A number of factors determine whether a certain area is within the curtilage of a person's dwelling, including how close the area is to the dwelling and whether it is within an enclosure surrounding the dwelling.[71] Thus a dumpster which is located in a "wholly open area accessible to all of the tenants, their guests, and invited and uninvited visitors, [and which] is fully visible, unlocked, unfenced, and unrestricted in its use by any posted sign" is outside the protected area.[72]

Tanaka had placed his trash in a dumpster located on private property in an enclosed and fenced area not open to the general public.[73] Therefore an argument could have been made that the trash was located within the curtilage of the building and hence was protected from search and seizure. Similarly, Takamiya placed his trash in a dumpster located thirty-five feet from the building and approximately forty to fifty feet from the public roadway.[74] This could be considered to be within the curtilage of the building. By contrast, in the *Kahoohalahala* case, the trash that had been moved to the roadway would probably be considered outside the curtilage of the dwelling.[75] Thus the police would have been permitted to search the Kahoohalahala's trash without a search warrant.

The reasonable expectation of privacy test results in a more predictable body of law than the curtilage test. Determining whether a particular area is within the curtilage would have to be made on a case-by-case basis. Thus it would be difficult to predict when a warrant would be needed to conduct a search. On the other hand, under a reasonable expectation of privacy test, guidelines could be set forth to delineate situations in which the police would need a search

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[69] United States v. Molkenbur, 430 F.2d 563, 566 (8th Cir. 1970).

[70] *Id.*

[71] United States v. Minker, 312 F.2d 632, 634 (3d Cir. 1962).

[72] United States v. Michaels, 726 F.2d 1307, 1312 (8th Cir. 1984).

[73] Appellant's Opening Brief at 3 (Tanaka).

[74] Appellant's Opening Brief at 3 (Takamiya).

[75] Appellee's Answering Brief at 10 (Kahoohalahala).

warrant.

The California Court of Appeals found a warrantless search of trash might be justified for many of the same reasons as warrantless searches of automobiles have been found to be reasonable. In *People v. Parker*,[76] the court noted that items placed in a trash can are highly portable and that trash is not usually subject to the security precautions that people take with respect to property they intend to keep.[77] Thus the *Parker* court validated a warrantless search of trash in these circumstances where it would be impractical to obtain a warrant.

Although the Hawaii Supreme Court did not analogize the search of trash to automobile searches, it did state that if there are exigent circumstances, a warrant would not be required.[78] This is consistent with previous Hawaii rulings with respect to containers in which the court has recognized the exigent circumstances exception to the warrant requirement.[79]

C. *Reasonable Expectation of Privacy Test*

In determining whether an expectation of privacy is reasonable, there is a basic core of factors which have been considered by various courts. These include the location of the trash, whether the dwelling is a multiple or single unit, and who removed the trash.[80] These factors can be considered on a continuum. Persons may have a reasonable expectation of privacy in trash located close to a single family dwelling—particularly when it is searched by someone other than an authorized trash hauler. On the other hand, there may be little reasonable expectation of privacy in trash located off the premises of a multiple unit dwelling that is searched by the person authorized to remove it.[81]

Some courts have concluded that "the location of the trash is a significant factor in determining whether defendant has abandoned the trash or whether defendant has a 'reasonable expectation of privacy' because any analysis of that expectation is inextricably bound up in the physical location of the trash."[82]

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[76] 44 Cal. App. 3d 222, 118 Cal. Rptr. 523 (1975).

[77] *Id.* The court stated that like an automobile, trash could be searched "upon probable cause and upon a showing that delay would enhance the possibility the articles would be destroyed or placed beyond the reach of the officers." *Id.* at 229, 118 Cal. Rptr. at 529 (quoting *People v. Dumas*, 9 Cal. 3d 871, 883, 512 P.2d 1208, 1216, 109 Cal. Rptr. 304, 312 (1973)).

[78] *Tanaka*, 67 Hawaii at ____, 701 P.2d at 1277.

[79] *See, e.g.*, State v. Rosborough, 62 Hawaii 238, 619 P.2d 108 (1980) (Footlocker could not be searched without a warrant absent exigent circumstances.); State v. Kaluna, 55 Hawaii 361, 520 P.2d 51 (1974) (A packet found on the arrestee's body that could be seized could not be opened without a warrant.).

[80] Smith v. State, 510 P.2d at 797-98.

[81] *Id.* at 798.

[82] State v. Schultz, 338 So. 2d 1326 (Fla. Dist. Ct. App. 1980).

Placing trash in an area of public accessibility with the intention that strangers will take it away indicates a lack of a reasonable expectation of privacy in the trash.[83]

Another indicator of the reasonableness of a defendant's expectation of privacy is whether the dwelling is multiple or single unit. An apartment house tenant who places his trash in a dumpster which is used in common with other tenants has less reason to believe that his trash will remain private than does the home dweller who uses his own trash cans.[84] Because a dumpster is usually located in an area accessible to all of the tenants as well as their guests, and visitors, it is more foreseeable that other people will have access to an apartment dumpster than a person's private trash can. For this reason, a court is likely to find that the defendant does not have an expectation of privacy in trash left in a dumpster.[85]

Although it may not be reasonable for a defendant to expect that the people who collect trash will not look through it, it might be reasonable for a defendant to expect that the police will not search that trash without a warrant.[86] Therefore it might be relevant whether the police or the trash collectors conducted the search.

In *State v. Tanaka*, the Hawaii Supreme Court did not specifically consider the factors mentioned above. Instead the court considered the typical contents of a person's trash bag and decided that society is prepared to recognize as reasonable a person's expectation of privacy with respect to those items.[87] The court also considered the policy behind the Hawaii Constitution search provisions concluding that they were intended to prevent governmental intrusions like the warrantless search of a person's trash.[88] Thus it would appear that the Hawaii Supreme Court is willing to state as a general policy that a defendant has a reasonable expectation of privacy in trash contained in opaque trash bags.[89] This limits police authority to search the contents of a person's trash without a warrant.

V. IMPACT

The fact situations in *Tanaka*[90] show that the court is willing to recognize a

[83] United States v. Michaels, 726 F.2d at 1313.

[84] People v. Gray, 63 Cal. App. 3d 282, 290, 133 Cal. Rptr. 698, 703 (1969) (quoting People v. Stewart, 34 Cal. App. 3d 695, 700, 110 Cal. Rptr. 227, 230 (1973)).

[85] United States v. Michaels, 726 F.2d at 1312.

[86] Smith v. State, 510 P.2d at 798.

[87] 67 Hawaii at ____, 701 P.2d at 1276.

[88] *Id.* at ____, 701 P.2d at 1277.

[89] *Id.* at ____, 701 P.2d at 1274.

[90] *Id.*

defendant's expectation of privacy in trash contained in opaque, closed trash bags as reasonable.[91] It is clear that the Hawaii Supreme Court does not require exclusive access to the trash container in order for a defendant to have a reasonable expectation of privacy.[92] It is uncertain, however, whether the defendant's expectation of privacy would be considered reasonable if there was general access to the dumpster or when the dumpster is shared by many parties. Under these circumstances the defendant should foresee that, because so many people have access to the dumpster, someone might search through the trash. If it is foreseeable that the trash might be searched, it is arguable that the defendant did not have an actual expectation of privacy.

The court considered two factors determinative in establishing the defendants' actual expectation of privacy. First the court looked at the defendants' act of placing the item in an opaque, closed trash bag. The court found that act to be indicative of an expectation of privacy on the part of the defendants. The court then examined the testimony of Tanaka and Takamiya that they had an actual expectation of privacy in their trash.[93]

When the Hawaii Supreme Court decided *State v. Ching*,[94] it held that the act of placing the item in an opaque closed container itself indicated the defendant's actual expectation of privacy.[95] In this case the court treated the closed, opaque trash bag as a container.[96] This raises the question of whether use of a trash can rather than a trash bag indicates any lesser expectation of privacy. Because both trash cans and opaque bags are closed containers, it would seem that the expectation of privacy would be similar.[97]

It is uncertain what the effect on the defendant's expectation of privacy would be if the trash bag was already broken when the police searched it. Is the defendant's expectation of privacy in trash only as strong as the container in which the trash is placed? Arguably, a defendant who places items in plastic trash bags has a lesser expectation that the contents of the bags will not be exposed to public view than the person who places items in an unbreakable trash can.

Another unanswered question is how far the court will go to protect the contents of a trash bag. In *State v. Ching*[98] the court stated that the owner of property that was lost retained a right to privacy with respect to it because lost

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[91] *Id.*

[92] *Id.*

[93] *Id.* at 1276.

[94] 67 Hawaii 107, 678 P.2d 1088 (1984).

[95] *Id.* at 110, 678 P.2d at 1092.

[96] *Tanaka*, 67 Hawaii at ____, 701 P.2d at 1276.

[97] This assumes the trash can is covered. If it were open so that the contents .ere in plain view, this clearly would be a different issue.

[98] 67 Hawaii 107, 678 P.2d 1088 (1984).

property was not abandoned. An argument can be made that trash is abandoned somewhere between the time the defendant's trash is taken by the trash collectors and its final destruction. Once the trash has been validly removed from the property, it would appear to be no longer within the protection of the Hawaii Constitution.

VI. CONCLUSION

State v. Tanaka upheld an individual's reasonable expectation of privacy in his trash because as a matter of policy the "police [should not be able to] search everyone's trash bags on their property without any reason and thereby learn of their activities, associations, and beliefs."[99] In doing so, the Hawaii Supreme Court has again interpreted the Hawaii Constitution to provide a stronger protection against unreasonable searches and seizures than the protection provided under the United States Constitution.

Lisa M. Tomita

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[99] *Id.*

State v. Moreno: The Admissibility of Hypnosis Enhanced Testimony in Hawaii

I. Introduction

In *State v. Moreno*,[1] the Hawaii Supreme Court addressed the issue of admissibility of a rape victim's testimony that was recalled through hypnosis and set the standard for the admission of such testimony. In reversing the defendant's conviction, the court surveyed the treatment by other jurisdictions of hypnotically enhanced testimony. The court adopted the rule that hypnotically induced recollection is inadmissible[2] but allowed testimony from the victim regarding matters which might be shown to have been remembered before the hypnosis sessions.[3] This recent development will examine the background of the area of hypnotically enhanced testimony and analyze the Hawaii Supreme Court's treatment of testimony recalled through hypnosis.

II. Facts

State v. Moreno is an appeal from motions to suppress evidence and dismiss the indictment and a subsequent conviction for first degree rape. Alvin Moreno was indicted for first degree rape in violation of section 707-730(1)(a)(i) of the Hawaii Revised Statutes.[4] The indictment charged that Moreno had raped the victim on October 19, 1980.[5] On October 28, 1980, the victim gave a state-

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[1] No. 9143 (Hawaii Nov. 8, 1985).

[2] *Id.* slip op. at 5.

[3] *Id.* at 6.

[4] The statute provides that a person commits the offense of rape in the first degree if:

> (a) The person intentionally engages in sexual intercourse, by forcible compulsion, with another person and:
>
> > (i) The other person is not, upon the occasion, his voluntary social companion who had within the previous thirty days permitted him sexual intercourse of the kind involved.

HAWAII REV. STAT. § 707-730(1)(a)(i) (Supp. 1984).

[5] The indictment read: "COUNT II: On or about the 19th day of October, 1980, in the City and County of Honolulu, State of Hawaii, ALVIN DENNIS MORENO did intentionally engage

ment to the police that co-defendant Morgan Bohol had raped her while appellant Alvin Moreno held her down.[6] The victim did not allege that Moreno had sexual intercourse with her.[7]

After the victim gave her statement, a counselor at the Sex Abuse Treatment Center determined that the victim was suffering from partial retrograde amnesia.[8] The victim was treated by a clinical psychologist who conducted hypnotherapy sessions with the victim four times in January and February of 1981.[9] On the day after her last hypnotherapy session the victim gave the police another statement in which she claimed that Moreno raped her and that it was the co-defendant Bohol and not Moreno who had attempted to rape her with a bottle.[10] On April 21, 1981, the victim testified before the grand jury that Moreno had raped her. A two-count indictment was returned against Moreno and Bohol, charging each with first degree rape.[11] On June 4, 1982, Moreno filed motions to suppress evidence and dismiss the indictment on the basis that the victim was not competent to testify about any of the events dealt with in the hypnosis sessions. The trial court denied the motions. Moreno was tried and convicted of first degree rape, and the appeal to the Hawaii Supreme Court followed.[12]

III. Background

While hypnotism is a scientifically accepted medical treatment,[13] courts generally have not admitted statements made while under hypnosis.[14] Most courts

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in sexual intercourse by forcible compulsion with [the victim]. . . ." *Moreno*, slip op. at 1.

[6] The victim's statement read: "Morgan put his penus [sic] into my vagina and kept laughing at me. I kicked him and wacked [sic] his friend. Then his friend Larry got a bottle and tryed [sic] to shove it into my vagina. . . ." *Id.*

[7] The court distinguished sexual intercourse as used in Hawaii Rev. Stat. § 707-730 (1)(a)(i) from deviate sexual intercourse as defined in Hawaii Rev. Stat. § 707-700. *Moreno*, slip op. at 1.

[8] *Moreno*, slip op. at 1. Retrograde amnesia is the phenomenon of loss of memory of events occuring before a given incident. Spector & Foster, *Admissibility of Hypnotic Statements: Is the Law of Evidence Susceptible?*, 38 Ohio St. L.J. 567, 572 (1977).

[9] The court refers to four dates in January and February of *1980*. *Moreno*, slip op. at 2. This date must be a typographical error, intended to mean *1981*.

[10] *Id.*

[11] *Id. See supra* note 5. The prosecution did not press an additional charge against Moreno as Bohol's accomplice. *Moreno*, slip op. at 2 n.1.

[12] *Moreno*, slip op. at 2. Bohol was also convicted of first degree rape but did not appeal.

[13] Diamond, *Inherent Problems in the Use of Pretrial Hypnosis on a Prospective Witness*, 68 Calif. L. Rev. 313, 317 (1980).

[14] C. McCormick, Handbook on the Law of Evidence § 206 (3d ed. 1984). *See also* Mickenberg, *Mesmerising Justice: The Use of Hypnotically-Induced Testimony in Criminal Trials*, 34 Syracuse L. Rev. 927, 929 (1983).

exclude such statements by applying evidentiary rules regarding the competence of the witness rather than on a disbelief in the science of hypnosis.[15] The first case in the United States to deal with the issue of hypnosis of a witness was *People v. Ebanks*.[16] The California Supreme Court, excluding the statements given under hypnosis, ruled that "the law. . .does not recognize hypnotism."[17] Defendants have generally been unsuccessful in attempting to introduce exonerating statements made while under hypnosis.[18] Courts have also not allowed witnesses to testify under hypnosis.[19] Such evidence is excluded because of the undue weight accorded hypnosis by the jury, who may mistakenly believe that hypnotized witnesses do not lie.[20]

IV. Applications in Hawaii: *State v. Moreno*

In *State v. Moreno*,[21] the Hawaii Supreme Court addressed the issue of admissibility of the testimony of a witness whose memory had been enhanced by hypnosis. The court recognized the uses of hypnosis[22] as well as the ongoing debate in the legal community over the admissibility of hypnotically enhanced testimony.[23] The court briefly reviewed the four predominant rules that have been adopted in other jurisdictions, many of which have dealt extensively with

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[15] Mickenberg, *supra* note 14, at 930.

[16] 117 Cal. 652, 49 P. 1049 (1897).

[17] *Id.* at 665, 49 P. at 1053.

[18] *See, e.g.*, People v. Blair, 25 Cal. 3d 640, 602 P.2d 738, 159 Cal. Rptr. 818 (1979); People v. Ebanks, 117 Cal. 652, 49 P. 1049 (1897); Rodriguez v. State, 327 So. 2d 903 (Fla. Dist. Ct. App.), *cert. denied*, 336 So. 2d 1184 (Fla. 1976); State v. Pusch, 77 N.D. 860, 46 N.W.2d 508 (1950); State v. Pierce, 263 S.C. 23, 207 S.E.2d 414 (1974); Greenfield v. Commonwealth, 214 Va. 710, 204 S.E.2d 414 (1974). *See also* Note, *The Admissibility of Testimony Influenced by Hypnosis*, 67 VA. L. REV. 1203 (1981).

[19] Mickenberg, *supra* note 14, at 928. Statements made by witnesses while hypnotized should be distinguished from hypnotically enhanced testimony. In recent years, the law enforcement and legal communities have increased the use of hypnosis in order to refresh and enhance a witness' memory, thus allowing him to testify from present recollection once on the stand. Hypnosis to enhance memory is also used (1) to aid in investigation and criminal factfinding, and (2) as therapy for the victim. Diamond, *supra* note 13, at 313-21.

The *Moreno* court held that the dominant purposes of hypnotizing the victim in that case were to uncover more facts and to enhance her recall for purposes of testimony and not as a theraputic tool to aid the victim in recovering from the crime. *Moreno*, slip op. at 2-3. This recent development will focus on the use of hypnosis for enhancing the recollection of past events. For a more detailed discussion of the history and other uses of hypnotism, see Diamond, *supra* note 13; Mickenberg, *supra* note 14.

[20] *See infra* note 101 and accompanying text.

[21] No. 9143 (Hawaii Nov. 8, 1985).

[22] *See supra* note 19.

[23] *Moreno*, slip op. at 3.

the issue.[24]

Some courts have held that hypnotically induced testimony is admissible, as is any other means of refreshing a witness' recollection. Credibility of testimony enhanced through hypnosis is measured by the trier of facts.[25] At the other extreme is California where testimony of witnesses that is hypnotically induced is excluded per se.[26] The two other approaches avoid blanket rules. New Jersey admits hypnotically enhanced testimony only if the offering party can show that the administration of the hypnosis was accomplished in accordance with strict procedures,[27] while other states have compromised and ruled hypnotic memory inadmissible but allowed a witness to testify to those facts that can be shown to have been remembered before the hypnosis session.[28]

The *Moreno* court acknowledged that hypnotically induced testimony is unreliable, but recognized hypnosis as a useful tool in therapy. The court refused to adopt a bright line rule of exclusion,[29] as such a rule would require the victim of a crime to forego hypnosis for therapy, or risk being ruled incompetent to testify at trial.[30] Without analysis, the court affirmed both the denial of the defendant's motion to dismiss the indictment as well as the motion to rule the victim wholly incompetent to testify. The court then ruled that the victim's testimony that Moreno raped her was a hypnotically induced recollection and therefore inadmissible. Adopting the compromise rule, the court held that witnesses who have undergone hypnotherapy may testify to those matters which can be shown to have been remembered before the hypnosis session.[31]

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[24] The court briefly summarized the rules other jurisdictions have adopted concerning the admissibility of hypnotically enhanced testimony. *Moreno*, slip op. at 3-4. Many of the cases from other jurisdictions are factually similar to *Moreno*. *See, e.g.*, State *ex rel* Collins v. Superior Court, 132 Ariz. 180, 644 P.2d 1266 (1982); People v. Shirley, 31 Cal. 3d 18, 641 P.2d 775, 181 Cal. Rptr. 243, *cert. denied*, 459 U.S. 860 (1982); Harding v. State, 5 Md. App. 230, 246 A.2d 302 (1968) *cert. denied*, 395 U.S. 949 (1969); People v. Hughes, 59 N.Y.2d 523, 453 N.E.2d 484, 466 N.Y.S.2d 255 (1983).

[25] *See infra* notes 45-57 and accompanying text.

[26] *See infra* notes 58-70 and accompanying text.

[27] *See infra* notes 71-95 and accompanying text.

[28] *See infra* notes 96-105 and accompanying text.

[29] *Moreno*, slip op. at 5.

[30] The Hawaii Supreme Court recognized that:

> A criminal trial for rape or assault would present an odd spectacle if the victim was barred from saying anything, including the fact that the crime occured, simply because he or she submitted to hypnosis sometime prior to trial to aid the investigation or obtain needed medical treatment. Even in cases dealing with the frailties of eyewitness identification some allowance must be made for the practicalities.

Moreno, slip op. at 5 (quoting People v. Hughes, 59 N.Y.2d at 545, 453 N.E.2d at 495, 466 N.Y.S.2d at 266).

[31] *Moreno*, slip op. at 5-6.

V. Analysis

The Hawaii Supreme Court in *State v. Moreno* established standards for the admissibility of hypnosis enhanced testimony. While the court did not "enter into a long discussion on the subject of the reliability of hypnotically induced testimony,"[32] it is helpful to outline some of the effects of hypnosis on witnesses. This will be followed by a discussion of the competing lines of authority and an analysis of the rule adopted by the Hawaii Supreme Court.

A. *The Nature of Hypnosis*

Although the precise nature of hypnosis is difficult to define,[33] it is possible to describe some of its effects. Under hypnosis, subjects lose initiative and lack the desire to make and execute plans. This renders the subject submissive and more willing to follow orders of the hypnotist.[34]

Persons under hypnosis have the ability to be selectively attentive or inattentive. This leads to the subject's ability to focus on past events and block out distractions that possibly interfere with waking memory.[35]

Subjects have the ability to visualize past events to a greater degree than in the waking state. Coupled with the increase in selectivity of attention, this allows the subject, at the suggestion of the hypnotist, to "relive" past happenings and "see" details that may have previously escaped attention. If a subject cannot fully recall the events, the suggestion that he remember all of the details, his desire to satisfy the hypnotist's questions, and the tendency to fantasize will often lead to "filling in" of gaps in memory to accommodate a logical story. This is known as confabulation.[36] Subjects generally do not question memories enhanced by hypnosis and tend to accept without criticism recollections that they otherwise may not have believed.[37]

Hypnosis also increases the suggestibility of the subject, and this is a critical

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[32] *Id.* at 4.

[33] Spector & Foster, *supra* note 8, at 567. The American Medical Society has defined hypnosis as "a condition of altered attention in which the subject manifests alterations in consciousness and memory, increased susceptibility to suggestion, and the production of responses and ideas atypical of those occurring in the usual state of mind." Council on Mental Health, *Medical Use of Hypnosis*, 168 J. A.M.A. 186, 187 (1958). Webster's Dictionary defines hypnosis as a "state that resembles sleep but is induced by a hypnotizer whose suggestions are readily accepted by the subject." WEBSTER'S NEW COLLEGIATE DICTIONARY 563 (rev. ed. 1976).

[34] Diamond, *supra* note 13, at 316; Mickenberg, *supra* note 14, at 937.

[35] Diamond, *supra* note 13, at 316; Mickenberg, *supra* note 14, at 938.

[36] Mickenberg, *supra* note 14, at 938-39.

[37] Diamond, *supra* note 13, at 316; Mickenberg, *supra* note 14, at 939-41.

factor in the accuracy of hypnotically enhanced recall.[38] Purposeful suggestion has proven to be a somewhat effective tool to assist the hypnotist in enhancing the subject's recall of past events. The difficulty lies in the fact that all the suggestions to the subject are not necessarily verbal. The questions posed, and the attitude and demeanor of the hypnotist transmit non-verbal suggestion of what is expected of the subject.[39] The subject often focuses on these suggestions and relates them to the hypnotist in the form of fantasy recall. The inherent danger is that the subject's desire to satisfy the hypnotist's expectations, coupled with confabulation, leads to "memories" of non-existent events. The accuracy of all "memory" recalled by hypnosis is questionable because even an expert hypnotist cannot avoid planting inadvertent suggestions in the mind of the subject.[40]

Distinguishing fact from confabulation in the hypnotized witness' recollection presents difficulties[41] because neither the hypnotic subject nor experts can differentiate between those memories that existed before the session and those "restored" through hypnosis. Not being able to distinguish truth from fantasy or pre-hypnotic from post-hypnotic memory makes the subject confident in the accuracy of his recall of the events. This confidence, however, does not reflect the inaccuracies that may be present in the recollection.[42]

These characteristics of hypnosis are not exhaustive, for the science is still developing. Many commentators argue that while hypnosis is a verifiable scientific phenomenon, it is unclear whether it is effective in enhancing the recall of a witness, or whether a witness so aided should be allowed to testify.[43]

B. *Analysis of* State v. Moreno

The rejection of a blanket rule of admission or exclusion demonstrates an attempt by the court to balance the dangers inherent in the hypnotic process with the recognition that hypnosis has valid medical uses. While initially

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[38] The common element to all the definitions of hypnosis is the hyper-suggestibility of the subject. Mickenberg, *supra* note 14, at 932.

[39] Often, the hypnotist is unaware of non-verbal cues given the subject. Diamond, *supra* note 13, at 333.

[40] *Id.*

[41] The *Moreno* court recognized that "separating the wheat of prior recollection, from the chaff of hypnotically induced recollection, may be a difficult task. . . ." *Moreno*, slip op. at 6 n.3.

[42] The confusion of pre-hypnotic and post-hypnotic memory results from the tendency of subjects not to recall being hypnotized. This tendency can be furthered by the suggestion of the hypnotist that the subject forget the hypnosis session and instead clearly remember the elicited memory. Mickenberg, *supra* note 14, at 940. Some experts have even recommended use of a post-hypnotic suggestion that induces amnesia of the hypnosis session when it involves a victim or a witness. *Id.* at 940 n.73 and authorities cited therein.

[43] Diamond, *supra* note 13, at 320-21.

Moreno seems an appealing response to this problem,[44] closer analysis of the predominant rules suggests that the court's compromise does not remedy the shortcomings in hypnotically enhanced memory.

1. *The admissibility rule*

Some jurisdictions view hypnotic enhancement of recall as one more means of refreshing the recollection of a witness and rule the testimony is admissible.[45] The fact that the witness recalled the testimony through hypnosis is available as an attack on the credibility of the witness, not the admissibility of the testimony. The first case to adopt the admissibility principle was *Harding v. State*.[46] The rule that the testimony was admissible was followed in many other jurisdictions.[47]

Implicit in the *Harding* rule is the assumption that effective cross-examination will expose the shortcomings in the testimony.[48] Because of the subject's

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[44] The New York Court of Appeals, which also adopted the compromise position, recognized that "the law is in a state of flux and there is no rule which will entirely satisfy all the demands of logic, policy and practicality." People v. Hughes, 59 N.Y.2d at 540, 453 N.E.2d at 493, 466 N.Y.S.2d at 264.

[45] Other methods of refreshing a witness' recollection are varied. A common method employed is for counsel to let the witness see a memorandum or photograph in order to refresh the witness' memory sufficiently for the witness to testify from his present "jogged" recollection. C. McCORMICK, *supra* note 14, § 9. The Federal and Hawaii Rules of Evidence allow a "writing" to be used to refresh the memory of the witness. *See* FED. R. EVID. 612; HAWAII R. EVID. 612. The rationale behind this practice is that "[i]t is abundantly clear from everyday observation that the latent memory of an experience may be revived by an image seen, or a statement read or heard." C. McCORMICK, *supra* note 14, § 9, at 17.

[46] 5 Md. App. 230, 246 A.2d 302 (1968). The facts in *Harding* are similar to *Moreno*. Before her hypnosis session the victim could not identify the defendant as the attacker, but after hypnosis positively identified the defendant. *Id.* at 233-35, 246 A.2d at 304-05. The *Harding* court had "no difficulty" in affirming the admission of the rape victim's testimony that was recalled through hypnosis. The fact that the recall was elicited by hypnosis reflected on the witness' credibility and was a question for the trier of facts. *Id.* at 236, 246 A.2d at 306. *Harding* was the leading case on the issue of hypnotically enhanced testimony, but has since been overruled. *See* Collins v. State, 52 Md. App. 186, 447 A.2d 1272 (1982), *aff'd*, 296 Md. 670, 464 A.2d 1028 (1983); Polk v. State, 48 Md. App. 382, 427 A.2d 1041 (1981).

[47] Currently North Dakota, *see, e.g.*, State v. Brown, 337 N.W.2d 138 (N.D. 1983), Wisconsin, *see, e.g.*, State v. Armstrong, 110 Wis. 2d 555, 329 N.W.2d 386, *cert. denied*, 461 U.S. 946 (1983), and Wyoming, *see, e.g.*, Chapman v. State, 638 P.2d 1280 (Wyo. 1980), are the only states that still follow the admissibility rule. The federal courts also follow this rule. *See, e.g.*, United States v. Awkard, 597 F.2d 667 (9th Cir.), *cert. denied*, 444 U.S. 885 (1979); Kline v. Ford Motor Co., 523 F.2d 1067 (9th Cir. 1975); Wyller v. Fairchild Hiller Corp., 503 F.2d 506 (9th Cir. 1974); Connolly v. Farmer, 484 F.2d 456 (5th Cir. 1973); Jewett v. United States, 15 F.2d 955 (9th Cir. 1926).

[48] Mickenberg, *supra* note 14, at 956. *See, e.g.*, Chapman v. State, 638 P.2d 1280 (Wyo.

increased susceptibility to suggestion[49] this assumption is highly questionable. While the unhypnotized witness may still have doubts about the accuracy of his testimony and may communicate that uncertainty to the jury by his "body language" or demeanor,[50] the witness refreshed through hypnosis will not lack confidence in his recall of the events. Fabrication of events by the witness[51] and the witness' confidence in his recall make it questionable that cross-examination will effectively expose issues of credibility, demeanor, and confidence of the witness.[52]

Impeachment of hypnotically enhanced testimony may also be difficult for other reasons. For example, hypnosis makes the otherwise effective tool of impeachment by prior inconsistent statement essentially unavailable to counsel. Because of the fabrication by the hypnotized witness to fill in the gaps, there may not be inconsistencies in the story. If inconsistencies are uncovered, the witness will have rationalized explanations for them.[53] In addition many times there is no way to check the accuracy of the facts "recalled" by the witness. In many circumstances, witnesses are hypnotized only if there are no other witnesses available. Thus, when the accuracy of the hypnotically enhanced testimony is questioned, there is no way of independently checking its validity.[54] These difficulties, together with the witness' confidence in the truth of his recall, make it difficult to use cross-examination as a means to show inaccuracies in hypnotically enhanced testimony.[55]

Many of the courts that adopt the *Harding* rule attempt to remedy this problem by jury instruction.[56] Other courts allow the defense to call expert witnesses to alert the jury to the unreliability of the hypnotically enhanced testimony. This may not effectively overcome jurors' beliefs in the reliability of the witness'

1980).

[49] *See supra* notes 38-42 and accompanying text.

[50] Dr. Diamond stated:

> Most persons, when aware of the deficiencies of their recall of events, will communicate their awareness by hesitancy, expressions of doubt, and body language indicating lack of self-confidence. The jury relies on these indicators of lack of certainty of recall, and their importance in the determination of the weight of the evidence may be equal to or greater than the bare substance of the testimony.

Diamond, *supra* note 13, at 339.

[51] *See supra* notes 34-37 and accompanying text.

[52] Diamond, *supra* note 13, at 339.

[53] Mickenberg, *supra* note 14, at 957.

[54] *Id.* at 956-57.

[55] Juries tend to place undue weight on hypnotically enhanced testimony, perhaps stemming from a mistaken belief that a person under hypnosis is incapable of lying or that hypnosis enhanced recall is infallible. Mickenberg, *supra* note 14, at 958; Spector & Foster, *supra* note 8, at 594-97.

[56] Mickenberg, *supra* note 14, at 958.

recall, as many jurors place little weight on defense expert testimony that is met with conflicting testimony from a prosecution expert.[57]

2. *The per se exclusionary rule*

California is the only jurisdiction to adopt the rule that testimony enhanced through hypnosis is inadmissible per se.[58] In *People v. Shirley*,[59] the California Supreme Court held that hypnotically induced testimony cannot be separated from actual recall and therefore "is inadmissible in all matters relating to those events, from the time of the hypnotic session forward."[60] The practical effect of this rule is that the witness must either forego hypnosis or be ruled incompetent to testify about even those matters that can be shown to be remembered before any hypnosis.[61]

The California court distinguished hypnotizing a witness to improve memory from other means of refreshing recollection.[62] The court based its rejection of hypnosis testimony on the standard set forth in *Frye v. United States*[63] which condition admission of new scientific methods of proof on a showing that the method has been generally accepted as reliable in the relevant scientific community.[64] Applying *Frye*, the California Supreme Court held that the process of

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[57] *Id.*

[58] Other jurisdictions have held that hypnosis testimony is inadmissible with limited exceptions. *See infra* notes 96-105 and accompanying text.

[59] 31 Cal. 3d 18, 641 P.2d 775, 181 Cal. Rptr. 243 (1982). *See also* People v. Guerra, 37 Cal. 3d 385, 690 P.2d 635, 208 Cal. Rptr. 162 (1984).

[60] 31 Cal. 3d at 66, 641 P.2d at 804, 181 Cal. Rptr. at 273.

[61] The court put limitations on the rule, cautioning that hypnotized witnesses generally are not incompetent to testify on matters that are "wholly unrelated" to the events that were the subject of the hypnosis. *Id.* at 68, 641 P.2d at 807, 181 Cal. Rptr. at 273. The court also approved enhancement of memory of verifiable facts for investigative purposes such as recalling license plate numbers, while reiterating that a person so hypnotized would be rendered incompetent to testify as a witness to the events. *Id.*

[62] The court recognized that hypnosis not only enhances recall of events, but contributes to creation of "pseudomemories, to the witness' abiding belief in their veracity, and to the inability of the witness (or anyone else) to distinguish between the two." *Id.* at 53, 641 P.2d at 795-96, 181 Cal. Rptr. at 264 (citing Polk v. State, 48 Md. App. 382, 394, 427 A.2d 1041, 1048 (1981)).

[63] 293 F. 1013 (D.C. Cir. 1923).

[64] *Id.* at 1014. The rationale is that testimony enhanced or acquired through a scientific method can only be as accurate as the technique that produced it. For a discussion of the *Frye* "general acceptance" test as well as its viability under Rule 703 of the Federal Rules of Evidence, see C. McCormick, *supra* note 15, § 203. *Cf.* Hawaii R. Evid. 703. The Federal and Hawaii rules allow experts to rely on facts or data otherwise not admissible as long as they are of the type "reasonably relied" upon by experts in the field. See Bowman, *The Hawaii Rules of Evidence*, 2 U. Hawaii L. Rev. 431, 462-63 n.195 (1981) for a comparison between the Federal rule and the

enhancing the memory of witnesses by hypnosis has not been accepted as accurate in the scientific community[65] and that the testimony of a witness so hypnotized is "tainted" and inadmissible.[66]

The scientific basis for the per se inadmissibility rule has been approved by a majority of jurisdictions[67] as well as legal commentators.[68] The same dangers

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Hawaii rule.

The California Supreme Court also surveyed the cases from other jurisdictions that have applied the *Frye* test to hypnotism. *See* State v. Mena, 128 Ariz. 226, 624 P.2d 1274 (1981) (excluding the testimony of a witness that has been "tainted" by hypnosis because of the dangers of distortion and the lack of general acceptance in the medical and psychiatric fields); *Rodriguez*, 327 So. 2d 903 (hypnotically induced testimony inadmissible because of the unreliability of hypnosis-induced statements); People v. Hangsleben, 86 Mich. App. 718, 273 N.W.2d 539 (1978) (qualifications of the hypnotist are inadequate to show the reliability of the hypnosis testimony under *Frye*); State v. Mack, 292 N.W.2d 764, 768 (Minn. 1980) ("the best expert testimony indicates that no expert can determine whether memory retrieved by hypnosis, or any part of that memory is truth, falsehood or confabulation"); Jones v. State, 542 P.2d 1316 (Okla. Crim. App. 1975) (excluding testimony enhanced by hypnosis by equating the testimony to that enhanced by "truth serum" or lie detector, neither of which are accepted as accurate).

Arizona has since retreated from the standard and currently allows witnesses to testify to pre-hypnotic recall. *See Collins*, 132 Ariz. 180, 644 P.2d 1266.

There are tests for admission other than *Frye* that admit scientific evidence if the circumstances such as corroborating facts indicate that the testimony is reliable. *See* Manson v. Brathwaite, 432 U.S. 98 (1977); Neil v. Biggers, 409 U.S. 188 (1972). These other standards are inapplicable in the area of hypnotically enhanced testimony because the *Frye* standard requires that the process of hypnosis be accurate and accepted, thus rendering the existence of corroborating facts irrelevant. *See* State v. Mack, 292 N.W.2d 764, 769 (Minn. 1980) (holding that the *Manson* and *Neil* standard did not apply because hypnosis generally erases "the ordinary indicia of reliability"); People v. Hughes, 59 N.Y.2d 523, 453 N.E.2d 484, 466 N.Y.S.2d 255 (1983) (holding that hypnotically enhanced testimony is inadmissible because the determinative factor in the *Frye* test of admission is the reliability of the science of hypnosis rather that the plausibility of the actual testimony).

[65] *Shirley*, 31 Cal. 3d at 66, 641 P.2d at 806, 181 Cal. Rptr. at 272.

[66] *Id.* at 66-67, 641 P.2d at 806, 181 Cal. Rptr. at 273.

[67] The courts that do not accept the *Harding* admissibility rule base their rejection on the grounds that hypnosis enhanced recall is scientifically inaccurate. *See supra* note 65 and accompanying text; *infra* notes 74, 97 and accompanying text.

[68] "The plain fact is that such testimony is not and cannot be reliable. The only sensible approach is to exclude testimony from previously hypnotized witnesses as a matter of law, on the ground that the witness has been rendered incompetent to testify." Diamond, *supra* note 13, at 349. Dr. Diamond, a professor of clinical psychiatry as well as a professor of law, criticizes authors of legal articles because they do not understand the scientific risks involved in the use of enhancing memory through hypnosis and rely too heavily on the use of traditional legal tools such as impeachment and cross-examination to effectively avoid the risks of faulty testimony. *Id.* at 327-32.

In its extensive discussion of the legal and medical history of hypnosis, the California Supreme Court concluded that the scientific community generally opposed the use of hypnosis as a tool for eliciting accurate memory because of its inherent unreliability. The court gave little weight to law

inherent in the *Harding* rule[69] are supportive of the per se inadmissibility rule advocated in *Shirley*. Because of the dangers inherent in hypnotically bolstered recall, the ineffectiveness of the traditional legal practices to expose the inaccuracies, and the scientific community's uneven acceptance of the accuracy of hypnotically induced recall, some courts have opted to exclude the testimony as well as any testimony that is possibly "tainted" by hypnosis.[70]

3. *The procedural "safeguards" rule*

Several jurisdictions including New Jersey,[71] Florida,[72] and New Mexico[73] have adopted rules that admit hypnosis testimony on a limited basis provided certain procedural safeguards are followed. The purpose of the standards is to control the actions of law enforcement personnel and the hypnotist so as to alleviate the possibility of suggestion to the subject.[74] In the leading case of *State v. Hurd*,[75] the New Jersey Supreme Court adopted strict procedural standards and required that a party offering hypnotically enhanced testimony demonstrate compliance with the following standards: (1) a psychiatrist or psychologist, qualified as an expert, must have conducted the session;[76] (2) the conductor of the session must be independent of the parties and not regularly employed by the prosecution or defense;[77] (3) all information supplied to the hypnotist by law enforcement personnel must be recorded;[78] (4) before the hypnosis session, the subject must describe to the hypnotist all the facts as the

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review articles on the subject by authors who are exclusively members of the legal profession. *Shirley*, 31 Cal. 3d at 56 n.34, 641 P.2d at 799-800 n.34, 181 Cal. Rptr. at 266 n.34. *See also Mack*, 292 N.W.2d at 765 n.4 (list of legal articles on the subject).

[69] *See supra* notes 45-57 and accompanying text.

[70] For an analysis of the reasons that pre-hypnotic memory is unreliable, see *infra* notes 96-105 and accompanying text.

[71] *See e.g.*, State v. Hurd, 86 N.J. 525, 432 A.2d 86 (1981).

[72] *See e.g.*, Brown v. State, 426 So. 2d 76 (Fla. Dist. Ct. App. 1983).

[73] *See e.g.*, State v. Beachum, 97 N.M. 682, 643 P.2d 246 (Ct. App. 1981), *cert. dismissed*, 98 N.M. 51, 644 P.2d 1040 (1982).

[74] Mickenberg, *supra* note 14, at 962-64.

[75] 86 N.J. 525, 432 A.2d 86 (1981).

[76] The court recognized that there are other people who are trained in administering hypnosis but required a professional in order to guarantee that the trial court would be able to access information concerning the medical reason for the witness' loss of memory. The court also asserted that the expert would be able to produce the most accurate recall. *Id.* at 545, 432 A.2d at 96.

[77] The court imposed this requirement to guard against potential bias of the expert that may manifest itself in suggestive conduct, leading questions, or unintentional suggestions to the witness. *Id.*

[78] This requirement was imposed to assist the court in determining what information the hypnotist may have passed directly or indirectly to the subject. *Id.* at 546, 432 A.2d at 96.

subject remembers them;[79] (5) all contacts between the subject and the hypnotist must be recorded;[80] and (6) the only people allowed in the sessions are the hypnotist and the subject.[81] The court held that if these procedural safeguards are satisfied, the burden is on the party opposing the admission to show that the hypnotic testimony is unreliable.[82]

Although the *Hurd* requirements guard against the pitfalls of purposeful, overt, or detectable suggestions, they do not aid in the elimination or detection of unintended or subliminal suggestion.[83] Nor do they protect against the dangers of the more common risk that the subject himself may confabulate and fantasize to fill the holes in his recall.[84]

In adopting this approach, the court recognized the general unreliability of hypnotically enhanced recall, but found a per se inadmissibility rule to be unnecessarily broad which would result in the exclusion of probative and relevant evidence that might be no less accurate than other eyewitness testimony.[85] The court asserted that hypnosis need not be a tool for obtaining truthful testimony, only a means of overcoming amnesia and enhancing the memory of a witness.[86] The court held that "the use of hypnosis to refresh memory satisfies the *Frye* standard in certain instances" and that testimony may be admissible if the offering party can show that the hypnosis process is a reasonably reliable method of restoring memory which is as accurate as normal recall.[87]

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[79] The court gave no rationale for this requirement.

[80] The criteria was established to enable a court to determine what information or suggestions the subject may have received through hypnosis, and to determine what recall was enhanced by the session. The court encouraged the use of videotape to record the contacts between the hypnotist and the witness in order to effectively record visual cues. 86 N.J. at 546, 432 A.2d at 97.

[81] The court recognized that it might be easier for persons familiar with the investigation to ask some of the questions, but imposed the requirement to safeguard against the risk of unintentional and undetectable suggestions that are possible from the mere presence of such persons. *Id.*

[82] *Id.* at 548, 432 A.2d at 97-98.

[83] Mickenberg, *supra* note 14, at 964.

[84] Dilloff, *Admissibility of Hypnotically Influenced Testimony*, 4 OHIO NW. L. REV. 1 (1977). Dr. Orne, the scientist who originally proposed the criteria adopted in *Hurd*, stated that the safeguards could not prevent hypnotized subjects from integrating fantasy and actual memory. Note, *Hypnotically Induced Testimony: Should it be Admitted?*, 19 CRIM. L. BULL. 293, 315 (1983).

[85] The court noted that ordinary eyewitness testimony is often subject to the same dangers as hypnosis-enhanced testimony such as unconscious confabulation, filling gaps in memory to create a logical story, and confidence in the accuracy of the recall over time. 86 N.J. at 545, 432 A.2d at 96-97. *See* Note, *Did Your Eyes Deceive You? Expert Psychological Testimony on the Unreliability of Eyewitness Identification*, 29 STAN. L. REV. 969 (1977).

[86] 86 N.J. at 536-37, 432 A.2d at 91-92.

[87] *Id.* at 537-38, 432 A.2d at 92. The New Jersey Supreme Court approved the trial court's interpretation that the *Frye* rule did not require, as a precondition to admissibility, that hypnosis be "generally accepted" as an accurate means of restoring recall. *Id.* at 535, 432 A.2d at 91. *See supra* note 64 and accompanying text. The court held that hypnotically enhanced testimony was

Many commentators[88] and courts[89] have criticized the comparison in *Hurd* of hypnosis with eyewitness testimony. The traditional admission of possibly inaccurate eyewitness testimony is not a valid justification for admitting "testimony that is *known* to have been subject to the inevitable distortions of the hypnotic process."[90] Cross-examination, impeachment, and demeanor may effectively call into question the credibility of the eyewitness in a way which is arguably ineffective with the hypnotically enhanced witness.[91]

The shortcomings of *Hurd* are a result of a basic misapplication of the *Frye* test.[92] The New Jersey Supreme Court required only that the accuracy of hypnosis be similar to that of normal recall. This overlooks the fact that distinguishing actual memory of the hypnotized witness cannot be distinguished from fantasy and confabulation, and that hypnosis is not comparable to other methods of refreshing present recollection.[93] The better approach would be to interpret *Frye* to require that hypnosis be generally accepted by the scientific community as an *accurate* method of enhancing recall before hypnosis is admissible.[94] The procedural safeguards of *Hurd* do not adequately protect against the problems that make hypnotically enhanced testimony inaccurate and unreliable.[95]

4. *The rule allowing pre-hypnotic memory*

The Hawaii Supreme Court has joined New York, Massachussetts and Arizona in holding that hypnotically induced recollection is inadmissible per se, but that testimony based on pre-hypnotic memory is admissible.[96] The court's

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reasonably reliable if the recollections induced by hypnosis were as accurate as those produced by the "ordinary" eyewitness. 86 N.J. at 537-38, 432 A.2d at 94.

[88] *See, e.g.*, Diamond, *supra* note 13; Mickenberg, *supra* note 14; Note, *Hypnotically Induced Testimony*, *supra* note 84.

[89] *See, e.g.*, *Collins*, 132 Ariz. 180, 644 P.2d 1266; People v. Shirley, 31 Cal. 3d 18, 641 P.2d 775, 181 Cal. Rptr. 243 (1982); State v. Palmer, 210 Neb. 206, 313 N.W.2d 648 (1981); Commonwealth v. Nazarovitch, 496 Pa. 97, 436 A.2d 170 (1981). In *Moreno* the Hawaii Supreme Court did not specifically reject the *Hurd* safeguards. The court held that "[o]n a review of the record, it is apparent that the *Hurd* criteria were not met in this case." *Moreno*, slip op. at 4 n.2.

[90] Diamond, *supra* note 13, at 342 (emphasis in the original).

[91] Mickenberg, *supra* note 14, at 965.

[92] *See supra* note 64 and accompanying text.

[93] *See supra* note 45 and accompanying text.

[94] Mickenberg, *supra* note 14, at 965.

[95] *See supra* notes 45-57 and accompanying text.

[96] *Collins*, 132 Ariz. 180, 644 P.2d 1266; Commonwealth v. Kater, 388 Mass. 519, 447 N.E.2d 1190 (1982); People v. Hughes, 59 N.Y.2d 523, 453 N.E.2d 484, 466 N.Y.S.2d 255 (1983).

adoption of this rule represents an attempt to balance the detrimental effects of hypnosis with the practical recognition that hypnosis is helpful both as a tool in investigation as well as a standard medical treatment for amnesia resulting from witnessing a traumatic event.[97]

While this rule is initially an appealing compromise, closer analysis suggests that it does not remedy the deficiencies present in hypnosis of witnesses. The difficulties in exposing inaccuracies in hypnotically enhanced testimony are also inherent in testimony based on pre-hypnotic recall.[98] In addition, defense counsel would run the risk of eliciting otherwise inadmissible recall "contaminated" by hypnosis. The *Moreno* court responded to this argument by noting that the defense, at its peril, could cross-examine the witness on the fact of hypnosis and

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[97] *See supra* note 19. Although the New York court in *Hughes* recognized the theraputic uses of hypnosis, it specifically discouraged the use of hypnosis as a method for preparing testimony. Reviewing the predominant rules in other jurisdictions, the court refused to accept the extreme rules of *Shirley* and *Harding*. Asserting that the "logical purity of the rule is illusory," the New York court rejected the *Shirley* view that a witness who has been hypnotized is "tainted" and is thus rendered incompetent to testify to even pre-hypnotic memories. 59 N.Y.2d at 540, 453 N.E.2d at 492, 466 N.Y.S.2d at 263. The court also rejected *Harding*, recognizing that the possibility of suggestion and other dangers inherent in enhanced testimony made hypnotism unaccepted generally by scientific experts and, therefore, inadmissible under *Frye*. The *Moreno* court refused to adopt the "bright line" rule of *Shirley* which would force the victim to forego hypnosis for theraputic purposes until the trial, or force the prosecution to abandon the use of the victim as a witness. *Moreno*, slip op. at 5.

Other courts also assert that no valid reason exists as to why a witness could not testify to those matters that have no possibility of being influenced by the dangers of hypnotism. *Collins*, 132 Ariz. 180, 644 P.2d 1266. Originally, the *Collins* court reaffirmed the ruling in State v. Mena, 128 Ariz. 226, 624 P.2d 1274 (1981) which held hypnosis evidence per se inadmissible and rendered the witness incompetent to testify. The *Collins* court rejected the idea that procedural safeguards could insure the reliability of post-hypnotic recall and also stressed that juries place unwarranted emphasis on hypnosis testimony due to a belief that hypnosis is extremely credible. 132 Ariz. at 186-87, 644 P.2d at 1272. After a rehearing, the Arizona Supreme Court modified the holding to allow a witness to testify to pre-hypnotic memory. *Id.* at 209, 644 P.2d at 1295 (Supplemental Opinion).

[98] Although a subject may not create new memory, even pre-hypnotic memory is distorted by hypnosis. The process of hypnosis arguably distorts the accuracy of the subject's pre-hypnotic memory. *See supra* text accompanying note 40; *Collins*, 132 Ariz. at 211-13, 644 P.2d at 1297-99 (Gordon, J., dissenting in part) (Supplemental Opinion).

Although the defendant is not necessarily presented with "created" testimony, he is prevented from effective cross-examination of the witness' pre-hypnotic recall. Cross-examination of a prosecution witness would not effectively uncover inaccuracies, for while the witness may have been hesitant or unsure of his recollection before hypnosis, after the session he becomes convinced in his memory's accuracy. Mickenberg, *supra* note 14, at 971. The Arizona Supreme Court recognized the possibility of affecting the witness' confidence through hypnosis but held that the benefit of hypnosis to investigation outweighed the dangers of bolstered confidence. *Collins*, 132 Ariz. at 209, 644 P.2d at 1295.

the resulting altered recollection.[99] Similar justification has been advanced by the other jurisdictions as well, supposedly to alert the jury to the possibility that the state's witness may be unreliable.[100] This approach does not appear to deal adequately with the problem. Educating juries about the adverse effects of hypnosis is an ineffective compensation to the defense for the loss of effective cross-examination.[101]

Diminishing the defendant's effective means of cross-examination may result in infringement of the right of a defendant to confront witnesses as guaranteed by the sixth amendment.[102] Ineffective cross-examination and the inability of the jury to accurately assess the witness' demeanor and credibility may effectively deny a defendant the right of confrontation.[103]

In testifying only to pre-hypnotic recall, the witness may be required to testify to facts that he no longer believes. The rule dictates that he can only relate those facts that he recalled prior to the hypnosis session, even if his recollection is altered through hypnosis. Because the witness becomes convinced of the accuracy of his post-hypnosis recall, he might have to "stick to the script" of his previously recorded recollections.[104] This could lead to ethical questions regarding coaching of witnesses to elicit testimony that witnesses no longer believe.[105]

The prejudicial dangers inherent in hypnotism suggest that the Hawaii Supreme Court did not go far enough in *Moreno* when it failed to exclude testimony about pre-hypnotic memory. The wiser rule, given the nature of hypnotism and the distortion present even in pre-hypnotic recall, might be exclusion of testimony from previously hypnotized witnesses to any matters covered in a hypnosis session.

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[99] *Moreno*, slip op. at 6 n.3.

[100] Mickenberg, *supra* note 14, at 971.

[101] *Id.* at 972. *See also* Spector & Foster, *supra* note 8, at 578. It has been shown that lay persons place undue weight on the credibility of the hypnosis process, and this is a major reason for excluding facts recalled through hypnosis. Arguably no amount of expert testimony on the unreliability of hypnosis could alleviate the effect of a confident witness on the jury. Mickenberg, *supra* note 14, at 990.

[102] The sixth amendment provides:

> In all criminal prosecutions, the accused shall enjoy the right to a speedy and public trial, by an impartial jury of the State and district wherein the crime shall have been committed, which district shall have been previously ascertained by law, and to be informed of the nature and cause of the accusation; to be confronted with the witnesses against him; to have compulsory process for obtaining witnesses in his favor, and to have the Assistance of Counsel for his defence.

U.S. CONST. amend. VI.

[103] *Collins*, 132 Ariz. at 187, 644 P.2d at 1273.

[104] *Id.* at 211, 644 P.2d at 1297 (Gordon, J., dissenting in part) (Supplemental Opinion).

[105] *Id. See* Note, *Hypnotically Induced Testimony*, *supra* note 84, at 320.

VI. Conclusion

In *State v. Moreno*, the Hawaii Supreme Court for the first time addressed the issue of admissibility of hypnotically enhanced testimony. With a brief analysis, the court recognized that hypnotically enhanced recall is not generally recognized in the scientific or legal communities as reliable or accurate, and held that such testimony is inadmissible as a matter of law. Attempting to balance the strict rule of complete exclusion with the practical uses of hypnosis, the court ruled that a witness is not incompetent to testify about those matters that can be shown to have been remembered prior to the hypnosis.

The modified rule that admits pre-hypnosis memory is an appealing approach but due to the inherent problems with the hypnosis process and the proven inaccuracies that result from hypnotically restoring recollection, it may be unwise. Until science can determine the complete effects of hypnosis on recall, and can assure the accuracy of the process, the better course may be total exclusion of pre-hypnotic as well as post-hypnotic recall.

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