

Trademarks and Geographical Indications: A Case of California Champagne

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INTRODUCTION

Legal and cultural clashes occur when international conventions dictate the adoption of new legal constructs into domestic law.¹ This happened recently when the World Trade Organization (WTO) enacted the Trade Related Aspects of Intellectual Property Agreement's (TRIPS) articles 22, 23, and 24.² TRIPS is the dominant international agreement dealing with intellectual property. It requires that members' domestic laws protect geographical indications.³ Some winemakers sell their sparkling

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¹ A prior instance where a legal cultural clash occurred, also involving European Union countries, is copyright protection in the Berne Convention for "moral rights" of the artist that continue after the artwork has been sold. Berne Convention for the Protection of Literary and Artistic Works, *opened for signature* Sept. 9, 1886, 828 U.N.T.S. 221, available at http://www.wipo.int/treaties/en/ip/berne/trtdocs_wo001.html. The provision conflicted with U.S. copyright law's first sale doctrine. See 17 U.S.C. § 109 (2000). Eventually, the U.S. amended its copyright statute on December 1, 1990, to reach a satisfactory compromise. See 17 U.S.C. § 106A (2000). Titled "Rights of Certain Authors to Attribution and Integrity," it gives the author of a visual work the right "to prevent any intentional distortion, mutilation, or other modification of that work which would be prejudicial to his or her honor or reputation."

² The TRIPS agreement was adopted at the Uruguay Round of the General Agreement on Tariffs and Trade (GATT) in 1996. GATT is a large international body that seeks to promote trade and economic growth among all member nations. There are over 100 nations who are members of GATT. At the Uruguay Round, the WTO was created as a governing body. GATT is now the term used to designate the principles of international trade that the WTO promotes. See World Trade Organization [WTO], Understanding the WTO: The Agreements, http://www.wto.org/english/thewto_e/whatis_e/tif_e/agrm7_e.htm (last visited Mar. 6, 2007); Duke University School of Law Library, Research Guides: GATT/WTO, <http://www.law.duke.edu/lib/researchguides/pdf/gatt.pdf> (last visited Mar. 6, 2007). The text of the TRIPS agreement is available on the WTO website at http://www.wto.org/english/tratop_e/trips_e/t_agm0_e.htm (last visited Oct. 6, 2006). Articles 22, 23, and 24 are reproduced in Appendix B for reference.

³ TRIPS uses the term "geographical indication," though the authors prefer the term "geographic indication" to describe the concept. It is also sometimes called "geographic indicator," "geographical indicator," or "geographic designation." Even before TRIPS, France and some other European nations embraced through legislation a similar concept named "appellation of origin." The authors hope that the term chosen is the pre-

white wines under the type designation “champagne.”⁴ The European Union (EU), especially the French government, wants other producers to stop using the term “champagne” for their sparkling white wines.⁵ They argue that “champagne” is an indication of the region in France where certain sparkling wines are made using grapes grown in that region and using a traditional method of processing them. They say that the word is a geographical indication and is not usable by other wine producers outside of the Champagne region of France, even when the producers use the same variety of grapes and the same method of processing.⁶ Non-EU producers of sparkling white wine argue

dominant one being used currently and that it embodies all the concepts described in this article.

A good history of the international law is available in World Intellectual Property Organization [WIPO], Standing Committee on the Law of Trademarks, Industrial Designs and Geographical Indications, Doc. SCT/6/3 (Jan. 25, 2001) (*prepared by the International Bureau*), available at http://www.wipo.int/edocs/mdocs/sct/en/sct_6/sct_6_3.pdf (revised by WIPO, Standing Committee on the Law of Trademarks, Industrial Designs and Geographical Indications, *Document SCT/6/3 Rev. on Geographical Indications: Historical Background, Nature of Rights, Existing Systems for Protection and Obtaining Protection in Other Countries*, Doc. SCT/8/4 (Apr. 2, 2002) (*prepared by the Secretariat*), available at http://www.wipo.int/sct/en/documents/session_8/pdf/sct8_4.pdf; amended by WIPO, Standing Committee on the Law of Trademarks, Industrial Designs and Geographical Indications, *Addendum to Document SCT/6/3 Rev. (Geographical Indications: Historical Background, Nature of Rights, Existing Systems for Protection and Obtaining Protection in Other Countries)*, Doc. SCT/8/5 (Apr. 2, 2002) (*prepared by the Secretariat*), available at http://www.wipo.int/sct/en/documents/session_8/pdf/sct8_5.pdf).

For a general background on geographical indications and how they interact with trademark law, see also Jeffrey Armistead, Note, *Whose Cheese Is It Anyway? Correctly Slicing the European Regulation Concerning Protections for Geographic Indications*, 10 TRANSNAT'L L. & CONTEMP. PROBS. 303 (2000); Stacy D. Goldberg, Comment, *Who Will Raise the White Flag? The Battle Between the United States and the European Union Over the Protection of Geographical Indications*, 22 U. PA. J. INT'L ECON. L. 107 (2001); Alexander V.G. Kraft, Review Essay, *New Wine in Old Bottles*, 12 J. CONTEMP. LEGAL ISSUES 464 (2001); Jacqueline Nanci Land, Note, *Global Intellectual Property Protection as Viewed Through the European Community's Treatment of Geographical Indications: What Lessons Can TRIPS Learn?*, 11 CARDOZO J. INT'L & COMP. L. 1007 (2004); Leigh Ann Lindquist, *Champagne or Champagne? An Examination of U.S. Failure to Comply with the Geographical Provisions of the TRIPS Agreement*, 27 GA. J. INT'L & COMP. L. 309 (1999); Harry N. Niska, *The European Union TRIPS over the U.S. Constitution: Can the First Amendment Save the Bologna that has a First Name?*, 13 MINN. J. GLOBAL TRADE 413 (2004).

4 For example, a company named Cooks sells California Champagne in small bottles that come in a four-pack. Cooks California Champagne is available at Vons grocery store in Fresno, California.

5 See, e.g., *Comité Interprofessionnel du Vin de Champagne v. Wineworths Group Ltd.*, [1990] 2 N.Z.L.R. 432, 452–53 (H.C.) (holding that the word “champagne” is distinctive, not generic, and is not properly used to designate all sparkling white wines, but only those actually originating in the Champagne region of France).

6 *Id.* at 438. The cooperative growers and producers in France have a group, Comité Interprofessionnel du Vin de Champagne (CIVC), that brings suits throughout the world seeking to establish and/or return the term “champagne” to only designate sparkling white wine produced in the approved method with the approved grapes in the Champagne region of France. See *id.* at 434. This may be futile by this point. For example, wedding dresses are not always white. Often, they are “champagne” colored. So the term has broader connotations at this time than could be retracted by the invocation of a law. See

that trademark law should apply. They argue that under trademark law, “champagne” is a generic term for sparkling white wine made in a process akin to that performed in Champagne, France. Generic terms are not protected under the U.S. trademark system.⁷ This article asks whether geographical indication law should be incorporated into the U.S. domestic trademark law.

Trademark law protects business economic interests by encouraging consumers to identify a product by its unique mark.⁸ International law recognizes trademarks and adds protection for geographical indications, naming products for the place where they are produced.⁹ The previous example illustrates a cultural and legal clash.¹⁰ When conflict arises between two legal systems, should one be paramount? Is it possible for them to compromise, co-exist, and complement each other? Some legal scholars argue that the differences are far less controversial than was originally believed.¹¹ This article explains geographical indications and trademarks and advocates a system that respects both the traditional economic theory embodied in the U.S. trademark body of law and the traditional European values of identity of place, method, and aesthetics.¹² Geographical indications are largely consistent with trademark theory.¹³ Trademark law can

WEBSTER'S NEW WORLD DICTIONARY OF THE AMERICAN LANGUAGE 236 (David B. Guralnik ed., 2d coll. ed. 1974) (“1. orig., any of various wines produced in Champagne, France 2. a) now, any effervescent white wine made there or elsewhere; regarded as a symbol of luxurious living b) the typical color of such wine; pale, tawny yellow or greenish yellow”).

⁷ 2 J. THOMAS MCCARTHY, MCCARTHY ON TRADEMARKS AND UNFAIR COMPETITION §§ 12:1–12:4, at 12-4 to 12-15 (4th ed. 2006) [hereinafter MCCARTHY]. See also RESTATEMENT (THIRD) OF UNFAIR COMPETITION § 15, cmt. a (1995) (“Generic designations are not subject to appropriation as trademarks at common law . . .”).

⁸ 1 MCCARTHY, *supra* note 7, § 2.4, at 2-4 to 2-6 (citing reasons for trademark protection, including economic functions and quality encouragement functions).

⁹ Agreement on Trade-Related Aspects of Intellectual Property Rights, Including Trade in Counterfeit Goods, arts. 22–24, Dec. 15, 1993, 33 I.L.M. 81 (1994) [hereinafter TRIPS].

¹⁰ Legal systems are a part of many countries’ respective cultures. For a good summary of the aesthetic difference between the French view and the U.S. economic policy protected by trademark, see generally Jim Chen, *A Sober Second Look at Appellations of Origin: How the United States Will Crash France’s Wine and Cheese Party*, 5 MINN. J. GLOBAL TRADE 29 (1996) and Louis Lorvellec, *You’ve Got to Fight for Your Right to Party: A Response to Professor Jim Chen*, 5 MINN. J. GLOBAL TRADE 65 (1996).

¹¹ See Tunisia L. Staten, *Geographical Indications Protection Under the TRIPS Agreement: Uniformity Not Extension*, 87 J. PAT. & TRADEMARK OFF. SOC’Y 221, 242 (2005); Molly Torsen, *Apples and Oranges (and Wine): Why the International Conversation Regarding Geographic Indications is at a Standstill*, 87 J. PAT. & TRADEMARK OFF. SOC’Y 31, 48–49 (2005). Both Staten and Torsen suggest that the U.S. law on collective marks could provide guidance for geographical indications that would resolve some of the polarization that the two sides of the controversy are espousing.

¹² See Chen, *supra* note 10, at 32 (“[T]his definition comprises both ‘natural factors and human factors.’”); Lorvellec, *supra* note 10, at 77 (“[G]uarantee the future by preserving the countryside and respecting the market.”).

¹³ Geographical indications have long been recognized in both federal and common

be adapted to embrace international economic interests. This will allow the development of a uniform international body of law and economic theory.¹⁴

Part I summarizes relevant trademark law. Part II summarizes the international development of geographical indication law. Part III explores the areas of law where the two diverge and intersect, and considers compromises and possible legislative solutions.¹⁵

I. TRADEMARK

A. International Trademark

In most nations, a trademark is granted to the first person to file or register in the country.¹⁶ But in the U.S., trademarks are granted on a first-to-use basis, in spite of lack of registration.¹⁷ The EU Community Trademark System provides for central filing with the Trademark Office, similar to the U.S. federal trademark system.¹⁸ The rights of trademark holders are then recog-

U.S. trademark law. 2 MCCARTHY, *supra* note 7, § 14:1, at 14-3 (“[I]n the United States and elsewhere, geographic terms can be registered and protected as regional certification marks or collective marks. Geographic terms can also be registered and protected as trademarks and service marks identifying only one commercial source if certain conditions are met.”). A Supreme Court case from as early as 1872 addressed the issue of geographical indications. *Canal Co. v. Clark*, 80 U.S. (13 Wall.) 311 (1872).

¹⁴ Currently there is no clear resolution of the trademark law and geographical indication issues in the U.S. legal system. The issues have been addressed by a variety of agencies and courts, without clear guidance from the legislature. When agencies make rules and fashion agreements with individual nations or private industries, the law becomes fractured and inconsistent. The competing interests delicately balanced in the U.S. system of intellectual property are best protected by a uniform body of law that addresses and embraces legal protection for new or foreign concepts.

¹⁵ Several U.S. agencies regulate the law regarding alcohol and food. For instance, the Bureau of Alcohol, Tobacco, Firearms and Explosives (ATF) had regulatory authority over geographical indications of spirits. The rules dealing with Appellations of Origin are published at 27 C.F.R. § 4.25 (2005). It is preferable for the legislature to pass a coherent statutory scheme, rather than multiple agencies enacting regulations in a piecemeal fashion.

In the body of this article there are references to legal and cultural clashes and varying economic philosophies. The regulation of sparkling white wine in the U.S. versus France is a fine example. In the U.S., it is regulated as a vice along with tobacco and firearms. In France, it is viewed more as a food product like onions and mustard. See Chen, *supra* note 10; Lorvellec, *supra* note 10.

¹⁶ LEE BURGUNDER, *LEGAL ASPECTS OF MANAGING TECHNOLOGY* 463 (4th ed. 2007) [hereinafter BURGUNDER]. “Unlike in the United States, where priority is based on use . . . , in most countries, trademark rights are granted to the first person to file for registration.” *Id.*

¹⁷ 1 MCCARTHY, *supra* note 7, § 2:7, at 2-12.2 (“Common law rights in a symbol used as a trademark are granted by state law. That is, state or federal registration is not needed for trademark protection under state common law. In addition, unregistered marks are protectable under federal law in federal court.”).

¹⁸ 2 MCCARTHY, *supra* note 7, § 14:1.50, at 14-11 to 14-12. The Lisbon Agreement provides the vehicle for registration of geographical indications with the World Intellectual Property Organization (WIPO).

nized throughout the EU. The same is true of federal filing in the U.S.¹⁹

Much of the EU system is analogous to the federal and state dual sovereignty system embraced in the U.S.²⁰ The U.S. has the federal trademark system embodied in the Lanham Act.²¹ The federal system recognizes a co-existing state common law system and state statutory system of unfair competition, which includes trademark law.²² Similarly, the EU has both a “federal” system and each member’s domestic trademark laws.²³ In both situations, the federal and state or international and national laws adjust to address conflicts and inconsistencies.

Trademarks are regional to an extent. For instance, there is a Budweiser trademark in the Czech Republic and in the U.S. Each trademark is valid in its own national market. The regional approach is acceptable unless, as has happened to Budweiser, both companies start exporting their products to the same markets.²⁴ The Czech Republic’s view is that its Budweiser is a geographical indication.²⁵ The EU view may be that geographical indication takes precedence over a conflicting trademark. The U.S. view may be that Anheuser-Busch’s trademark takes precedence over the conflicting geographical indication.

The importance of international agreements in trademark cannot be overstated and some progress is occurring through trade negotiations.²⁶ Business is becoming increasingly global.

¹⁹ Lanham Act, 540 Stat. 427 (codified as amended in scattered sections of 15 U.S.C.).

²⁰ BURGUNDER, *supra* note 16, at 469 (“The Community Trademark System works concurrently with the existing national systems in a way that is analogous to the interplay between the federal and state trademark systems in the United States.”).

²¹ 540 Stat. 427 (codified as amended in scattered sections of 15 U.S.C.).

²² 1 MCCARTHY, *supra* note 7, § 2:7, at 2-12.1 to 2-12.2 (“[T]rademark law is a species of the generic law of unfair competition.”).

²³ The only EU nation that has a common law tradition is England, so most of the EU nations do not have a comparable state trademark law as part of their “common law of unfair competition.” The other EU nations are civil law nations and have codes requiring trademark registration prior to protection. See Michael B. Gunlicks, *A Balance of Interests: The Concordance of Copyright Law and Moral Rights in the Worldwide Economy*, 11 FORDHAM INTELL. PROP. MEDIA & ENT. L.J. 601, 601–02, 628–30 (2001).

²⁴ See Philippe Zylberg, *Geographical Indications v. Trademarks: The Lisbon Agreement: A Violation of TRIPS?*, 11 U. BALT. INTELL. PROP. L.J. 1, 39–57 (2003). The author summarizes the history of the two companies, then summarizes cases that have been brought in various countries including Portugal, the United Kingdom, and Israel.

²⁵ *Id.* at 41 (“Currently, [Anheuser-Busch] and [Budejovicky Budvar] are litigating in more than 20 countries. Most of the litigation focuses on the conflict between trademarks and geographical indications.”).

²⁶ For example, the U.S. and Mexico signed an agreement about tequila on January 17, 2006. Although tequila can only be made in Mexico, bulk shipments of tequila were being shipped to the U.S. where they were bottled. The Mexican Standards Bureau proposed a requirement that tequila be bottled at its source in order to carry the tequila label. If implemented, it would have stopped the flow of tequila to U.S. bottlers. This flow

Countries have to race to keep their regulations apace with the rapid changes in the business world. U.S. businesses want to participate, too.²⁷ The U.S. both conforms to and leads in international development of intellectual property.²⁸

B. United States Trademark Law

U.S. law defines trademark as “any word, name, symbol, or device, or any combination thereof . . . used . . . to identify and distinguish . . . goods, including a unique product, from those manufactured or sold by others and to indicate the source of the goods, even if that source is unknown.”²⁹ Most nations have a similar definition. However, U.S. law differs in two related aspects. First, U.S. law recognizes both common law and statutory trademark protection.³⁰ Most countries use only statutory law to discern the parameters of trademark law within their borders. Countries with a civil law system, rather than a common law system, require statutory creation of protectable trademarks.³¹ Second, the U.S. does not require registration to accord trademark protection.³² Most countries require registration in order to protect a name or mark.³³ The U.S. has refused to become a signatory on some widely adopted international agreements in part because of the U.S. position on common law trademark protection without registration.³⁴

is valued at \$400 million per year. The agreement permits the bulk shipment of tequila to U.S. bottlers to continue. See Press Release, Office of the United States Trade Representative, United States and Mexico Reach Agreement on Tequila (Jan. 17, 2006), available at http://www.ustr.gov/assets/Document_Library/Press_Releases/2006/January/asset_upload_file897_8762.pdf.

²⁷ See generally Mark Silva, Note, *Sour Grapes: The Compr[o]mising Effect of the United States' Failure to Protect Foreign Geographic Indications of Wines*, 28 B.C. INT'L & COMP. L. REV. 197 (2005). Silva believes that the U.S. is essentially being egocentric by not adjusting its laws to respect the EU's laws on geographical indications.

²⁸ The U.S. promoted, and is a signatory of, the Madrid Protocol, which streamlines international trademark recognition. The protocol is now contained in 15 U.S.C.A. §§ 1141–1141n (2006).

²⁹ 15 U.S.C. § 1127 (2000).

³⁰ 1 MCCARTHY, *supra* note 7, § 2:7, at 2-12.1 to 2-12.2.

³¹ See, e.g., Rudolf Rayle, *The Trend Towards Enhancing Trademark Owners' Rights—A Comparative Study of U.S. and German Trademark Law*, 7 J. INTELL. PROP. L. 227, 240–42 (discussing that the basic difference between common law and civil law countries' trademark law is how trademarks originate, namely, Germany's use of registration that has been in effect since the Middle Ages). See also generally 4 MCCARTHY, *supra* note 7, at ch. 29.

³² 1 MCCARTHY, *supra* note 7, § 2:7, at 2-12.1 to 2-12.2.

³³ See BURGUNDER, *supra* note 16, at 463.

³⁴ For example, the U.S. refused to sign the Madrid Agreement. In fact, it refused to sign the Paris Convention for a time. Anne Haring, *Madrid Protocol Basics*, PRACTISING L. INST. NINTH ANNUAL INSTITUTE FOR INTELLECTUAL PROPERTY LAW 1, 1–2 (2003).

1. Lanham Act

a. Registration under the Lanham Act

Federal law embodied in the Lanham Act functions in conjunction with the state common law of trademark.³⁵ Both state common law and federal statutory law govern unfair competition and trademark rights.³⁶ The function of registration under the Lanham Act is to give constructive notice to prospective competitors that the trademark designates another producer's product.³⁷ It promotes market efficiency by providing consumers with a direct way to find the desired product.³⁸ "[R]egistration is prima facie evidence of the validity of the mark, its ownership, and the registrant's exclusive rights to use the mark."³⁹

There are ongoing attempts to create international trademark and geographical indication registries, which would serve the same notice function as registration does in the U.S.⁴⁰ Most nations recognize trademark only when the mark has been registered, so the U.S. practice of maintaining a registry is consistent with international processes for protection of marks. The international agreements contemplate registries for both trademarks and geographical indications.⁴¹

b. Registration and First-to-Use Test

The Lanham Act establishes a "first-to-use" test when there are competing marks.⁴² The Patent and Trademark office must conduct an extensive search of trademarks prior to accepting registration.⁴³ The U.S. has refused to sign some international trademark agreements because of their failure to put a time limit on actual use in order to maintain recognition of the trademark.⁴⁴ Some nations allow registration without conducting a search of

³⁵ See 1 MCCARTHY, *supra* note 7, § 2:7, at 2-12 to 2-13.

³⁶ *Id.* See BURGUNDER, *supra* note 16, at 420 ("Trademark policies coexist at the federal and state levels.").

³⁷ 3 MCCARTHY, *supra* note 7, § 19:145, at 19-426 to 19-427.

³⁸ BURGUNDER, *supra* note 16, at 425.

³⁹ *Id.* at 445 (emphasis omitted).

⁴⁰ TRIPS provides for an international trademark and geographical indication registry. TRIPS, *supra* note 9, at art. 24. It is not yet fully implemented.

⁴¹ See generally TRIPS, *supra* note 9, at arts. 15-24. The U.S. does not necessarily have two registries. 15 U.S.C. § 1054 (2000) provides that collective marks are to receive the same treatment as trademarks. Therefore, they are registered in the same manner as a U.S. trademark.

⁴² Lanham Act, 15 U.S.C. § 1051(d) (2000) ("[T]he applicant shall file in the Patent and Trademark Office . . . a verified statement that the mark is in use in commerce and specifying the date of the applicant's first use of the mark Subject to examination and acceptance of the statement of use, the mark shall be registered").

⁴³ § 1062(a) (stating that the "examiner in charge of the registration of marks . . . shall cause an examination to be made").

⁴⁴ See, for example, the Madrid Agreement, which is discussed *infra*, II.A.2.

prior marks and uses. Other nations that require a search do not always require as extensive a search as U.S. law dictates.⁴⁵

There is a limitation on the Lanham Act's "first to use" criteria. If a foreign business has an international reputation, a U.S. business may not register the same trademark even if the foreign business has not yet registered or has not yet begun to do business in the U.S.⁴⁶ Hence, trademark is regional.⁴⁷ For example, Anheuser-Busch claims that Budweiser is the first national beer brand in the U.S.⁴⁸ Anheuser-Busch registered its U.S. trademark in Budweiser in 1878.⁴⁹ The word was already in use in the Bohemian region of Czechoslovakia to designate beer made there.⁵⁰ But under the Lanham Act, the foreign trademark was not well known in the U.S., so Anheuser-Busch's registration and use of the trademark was permitted.

2. Common Law and Federal Statutory Trademark

Trademark was recognized at common law and is still recognized in state common law. It originated as a branch of unfair competition law.⁵¹ The test for protection was and continues to

⁴⁵ Torsen, *supra* note 11, at 38–39. Torsen indicates that the registry for geographical indications is hotly contested. One side, including the U.S., prefers a voluntary system. The other side, including the EU, prefers a mandatory system that all WTO members must respect when the registration has been in existence for eighteen months. Even the strength of a geographical indication is under debate. It is logical to adopt a system like the U.S. trademark system that already recognizes varying levels of trademark protection depending on the nature of the mark and on the consuming public's understanding of the product. See *Abercrombie & Fitch Co. v. Hunting World, Inc.*, 537 F.2d 4, 8 (2d Cir. 1976) (holding that the term safari is generic, but may have limited secondary meaning for non-safari items sold by plaintiff).

⁴⁶ See Lanham Act, 15 U.S.C. § 1063(a) (2000) (noting that there is a thirty-day period to contest registration). There is a waiting period after submitting an application to allow others to contest a registration. Once the period expires, the trademark is valid.

⁴⁷ BURGUNDER, *supra* note 16, at 420.

⁴⁸ Adolphus Busch pioneered using refrigeration facilities to make Budweiser the first national brand of beer. Linda Raley, BeerHistory.com, Beer History (1998), http://www.beerhistory.com/library/holdings/raley_timetable.shtml.

⁴⁹ Katka Krosnar, *Anheuser-Busch Toasts Budweiser Ruling, American Brewer: Decision Means This 'Bud' Is for Us*, THE PRAGUE POST, Jan. 5–11, 2005, at A1.

⁵⁰ "[T]he Czech brewery had contended that the disputed name was familiar in its home town as far back as the Middle Ages." *December Highlights: Hungarian Tribunal Finds for Anheuser-Busch in Patent Dispute*, 8 INT'L L. UPDATE 188, 188 (2002). The Czech brewery, Budweiser Budvar, has a website located at <http://www.budvar.cz/> (last visited Oct. 9, 2006). It is available in three languages, including English. Its history is located at <http://www.budvar.cz/en/web/Znacka-Budvar/Historie-Budvaru.html> (last visited Oct. 9, 2006).

⁵¹ BURGUNDER, *supra* note 16, at 420–22.

Normally, when courts review business behavior to determine if it amounts to unfair competition, they look for three characteristics:

1. The product or service of the first company employs a symbol or device—a trademark—that consumers use to identify its source;
2. A competitor uses a symbol or device that is so similar that consumers might confuse it with that of the first company; and
3. The competitor adopted that symbol or device having known, or under

be likelihood of confusion among consumers.⁵² Common law's unfair competition construct is universal.⁵³

Trademark is also recognized by statute in the U.S. federal system. It is governed by the Lanham Act,⁵⁴ which protects words, names, symbols, and other marks that distinguish the source of goods and services. The Lanham Act provides for federal registration of a trademark with the Patent Office, but it protects valid trademarks even without registration.⁵⁵ This is a somewhat unique quality of the U.S. trademark system.

The broad identification of trademark in the statute has resulted in both broad protection of marks and in judicial tailoring of the Lanham Act's protections.⁵⁶ The Second Circuit Court of Appeals in *Abercrombie & Fitch Co. v. Hunting World, Inc.*,⁵⁷ identified four categories of trademarks that are entitled to increasing levels of trademark protection.

1. Generic marks cannot be protected.⁵⁸ "Champagne" may be generic. This concept will affect geographical indications under U.S. law. This may be a point of controversy in international law on geographical indication protection.⁵⁹

circumstances that it should have known, about the prior use by the first company.

The third characteristic, knowledge of the original use of the mark, is not required if the mark is registered under the Lanham Act.

⁵² 1 MCCARTHY, *supra* note 7, § 2:8, at 2-15 ("Today, the keystone of that portion of unfair competition law which relates to trademarks is the avoidance of a likelihood of confusion in the minds of the buying public.").

⁵³ TRIPS actually incorporates the definitions of unfair competition as set forth in the Paris Convention. TRIPS, *supra* note 9, at art. 22(2)(b). "In respect of Parts II, III and IV of this Agreement, Members shall comply with Articles 1 through 12, and Article 19, of the Paris Convention (1967)." *Id.* at art. 2(1). Article 1(2) of the Paris Convention provides: "The protection of industrial property has as its object patents, utility models, industrial designs, trademarks, service marks, trade names, indications of source or appellations of origin, and the repression of unfair competition." Paris Convention for the Protection of Industrial Property, art. 1(2), Mar. 20, 1883, 21 U.S.T. 1583, 828 U.N.T.S. 305 [hereinafter Paris Convention].

⁵⁴ Lanham Act, 15 U.S.C. §§ 1051-1141n (2000); *see also* BURGUNDER, *supra* note 16, at 420.

⁵⁵ § 1051(a) ("The owner of a trademark used in commerce may request registration . . ."). *See also* BURGUNDER, *supra* note 16, at 423.

⁵⁶ § 1127 ("The term 'trademark' includes any word, name, symbol, or device, or any combination thereof—(1) used by a person, or (2) which a person has a bona fide intention to use in commerce . . . to identify and distinguish his or her goods . . .").

⁵⁷ 537 F.2d 4, 9 (2d Cir. 1976).

⁵⁸ 2 MCCARTHY, *supra* note 7, § 12:1, at 12-4.

⁵⁹ The EU advocates a clawback action to reclaim geographical indications that have been lost through genericization. *In Brief: Consultations on Geographical Indications Get Underway*, BRIDGES TRADE BIORES, Dec. 20, 2004, at 7, 7 [hereinafter *In Brief*]. U.S. trademark law does not permit clawback of trademarks that have become genericized. *Harley-Davidson, Inc. v. Grottanelli*, 164 F.3d 806, 808 (2d Cir. 1999) (noting that the "word 'hog' had become generic as applied to large motorcycles . . . and that Harley-Davidson's attempt to withdraw this use of the word from the public domain cannot succeed").

2. Descriptive marks can be protected if they obtain a secondary meaning.⁶⁰ Even if protected by trademark, a competitor can use the word as a way to describe the product that both competitors market. This is referred to as fair use.⁶¹ It is a question of fact whether any particular term is descriptive or not.

3. Suggestive marks are entitled to protection without proof of secondary meaning.

4. Fanciful marks are entitled to protection without proof of secondary meaning. They receive the most extensive protection under trademark law.⁶²

The “levels of protection” concept has been widely applied to modern trademark law with its expanded protection for identifiers, such as colors and scents.⁶³

a. Genericide

Generic words and marks are not protected by trademark.⁶⁴ Previously protected names that have become so closely associated with the class of products being marketed that the consumers relate the word with the whole class of products are moved into the public domain and are usable by anyone.⁶⁵ In trademark law this is called genericide.⁶⁶ A famous example of genericide is “aspirin.”⁶⁷ The term was Bayer’s trademarked name for a new type of painkiller. Bayer had few competitors in marketing the painkiller, so the public started calling all similar painkillers “aspirin.” “Aspirin” now refers to all painkillers of the type and

⁶⁰ *Abercrombie & Fitch Co.*, 537 F.2d at 9 (“[T]he Lanham Act makes an important exception with respect to those merely descriptive terms which have acquired secondary meaning”); Lanham Act, 15 U.S.C. § 1052(f) (2000).

⁶¹ 2 MCCARTHY, *supra* note 7, § 14.12, at 14-47.

⁶² BURGUNDER, *supra* note 16, at 430 exhibit 10.3. The issue in *Abercrombie & Fitch Co.*, 537 F.2d at 10–11, concerned the word “safari.” Both companies used the term as a trademark for their competing lines of clothing. The term “safari” is actually a type of expedition commonly performed in Africa and commonly involving hunting wildlife. The term “safari” when applied to clothing is suggestive, descriptive, or generic. Clearly it suggests clothing appropriate for outdoor African environments. The clothing industry as a whole makes clothing commonly thought of as being safari-style. Therefore, it was acceptable, or “fair use,” for competing clothing producers to market safari hats, safari jackets, and safari shirts. Abercrombie & Fitch and Hunting World could not exclude others from using the term as a descriptor. The court recognized a limited trademark protection for items of clothing not necessarily associated with normal safari clothing, such as footwear. Therefore, the term received limited protection as the name of a recognized line of clothing.

⁶³ BURGUNDER, *supra* note 16, at 450 exhibit 10.5. Some recent cases citing *Abercrombie & Fitch* include *Interstellar Starship Servs., Ltd. v. Epix, Inc.*, 304 F.3d 936 (9th Cir. 2002) and *Nartron Corp. v. STMicroelectronics, Inc.*, 305 F.3d 397 (6th Cir. 2002).

⁶⁴ 2 MCCARTHY, *supra* note 7, § 12:1, at 12-4.

⁶⁵ *Id.* § 12:1, at 12-5.

⁶⁶ *Id.* § 12:1, at 12-8.

⁶⁷ *Id.* § 12:4, at 12-15.

Bayer's trademark has been cancelled.⁶⁸

The threat of genericide is greatest for producers who are the first to market a product that becomes quite popular.⁶⁹ Without copyright or patent protection, competitors will begin marketing competing products. If the passage of time between the original introduction of the product and the introduction of competing products is great enough, the consuming public often begins to call all the products by the trademarked name and genericide occurs. Consider the following trademarks or trade names: Kleenex, Band Aid, Xerox, Vaseline, Champagne.⁷⁰ Have they effectively become genericized?

Wine labels named after their place of origin may have become genericized. Champagne was developed over a period of time. In the 17th century, Dom Perignon of the Benedictine Abbey near Epernay, France, developed the innovative technique to make bubbling white wine.⁷¹ It was named after the place where the grapes were grown and processed into wine—Champagne. Naming a product after a place is an acceptable designation for a trademark. That particular name became very well known before there were other sparkling white wines on the market.⁷² When others copied the grapes and the carbonation process, the consuming public called the wines “champagne.” This occurred in the U.S. and in other countries where sparkling white wines are produced. Arguably, champagne may no longer be trademarked due to genericization.⁷³

One can compare the results for aspirin to the results for champagne. As a result of genericide, when competing producers of the same type of painkiller called their product “aspirin,” Bayer lost the exclusive right to the name. Champagne is al-

⁶⁸ In 1921, Judge Learned Hand decided that aspirin had become a generic term for acetyl salicylic acid. The Lanham Act provides for actions to cancel trademarks. *Bayer Co. v. United Drug Co.*, 272 F. 505 (S.D.N.Y. 1921).

⁶⁹ 2 MCCARTHY, *supra* note 7, § 12:1, at 12-8.

⁷⁰ Notice that in all five instances the product was the sole or at least the overly dominant product on the market long enough to allow the public to go to the store to buy the brand name rather than the item name.

⁷¹ Steve Pitcher, *Winemaking Monk Dom Perignon's Fame Continues to Bubble*, S.F. CHRON., Dec. 15, 2005, at F5.

⁷² See 2 MCCARTHY, *supra* note 7, § 12:1, at 12-8. Genericization occurs primarily to very well known products that lack competition in the marketplace.

⁷³ Even if champagne is genericized and can no longer be an identifying trademark, it may still be protected as a geographical indication because there is no genericization concept built into TRIPS' geographical indication law. Article 24 merely defers to trademarks, but makes no mention of trademark doctrines that may or may not apply. See TRIPS, *supra* note 9, at art. 24. A newer concept that is the reverse of genericide is degenericization, where the name or mark is returned to trademark protection after having gone into the public domain. See *In Brief*, *supra* note 59, at 7 (discussing clawback of trademarks). *In Brief* discusses the differing treatment of the process of degenericization and of clawback by the U.S. and by the EU.

ready a generic or descriptive term, such that producers of sparkling white wine might use the term to differentiate their product from a dry red wine. Consumers associate the term with a type of wine purchased for celebrating the New Year and other special events. Absent geographical indication protection, any producer of the same type of wine would be able to designate it “champagne,” since the term designates a type of wine, just as aspirin designates a type of painkiller. Now “champagne” fails to identify a producer of the product, a location for production of the product, or any consumer mindset other than that it is bubbly white wine.⁷⁴ There is even nonalcoholic “champagne” sold for the children celebrating New Year’s.⁷⁵

b. “Likelihood of Confusion” Criteria

Trademark holders who sue for infringement have the burden of proving the infringement.⁷⁶ They must prove likelihood of confusion among consumers regarding products’ sources.⁷⁷ The Lanham Act forbids registration for a mark or trade name if it is likely “to cause confusion, or to cause mistake, or to deceive.”⁷⁸ A trademark owner claiming infringement must show the same likelihood of confusion. So likelihood of confusion is an inquiry at two stages of trademark procedure.

The likelihood of confusion analysis is highly developed in U.S. judicial decisions. The court in *AMF Inc. v. Sleekcraft Boats*⁷⁹ identified eight factors relevant to likelihood of confusion and weighed the facts of the case against all eight factors. This provides a fairly detailed legal construct. The factors are: (1) strength of the mark, (2) proximity of goods, (3) similarity of marks, (4) evidence of actual confusion, (5) marketing channels used, (6) type of goods and care by purchaser, (7) intent, and (8) likelihood of expansion.⁸⁰

⁷⁴ A second class of words that are suspect for trademark protection are descriptive terms. They cannot be trademarked unless they obtain secondary meaning for a particular product. Even then, if a competitor uses the trademarked term to describe its own product, it is not trademark infringement, but fair use. 2 MCCARTHY, *supra* note 7, § 14.12, at 14-47. Only if the descriptive term becomes associated in the consumer’s mind with a certain producer does the word gain trademark protection. Champagne as a geographical descriptor could be such a word if consumers began to associate the term with one producer of a sparkling wine in France. This will not happen. Geographical indication is a national exclusion, not a business exclusion. It is a socialist proposition, not a free enterprise utility.

⁷⁵ The non-alcoholic “champagne” is actually sparkling apple juice. It is not marketed as champagne, but it is called champagne by the children.

⁷⁶ See 15 U.S.C. § 1114 (2000).

⁷⁷ § 1052.

⁷⁸ § 1052(d).

⁷⁹ 599 F.2d 341 (9th Cir. 1979).

⁸⁰ *Id.* at 348–49. These factors could become relevant for considering the validity of a geographical indication under U.S. law. (1) Strength of the mark—arbitrary or fanciful

c. Certification and Collective Marks

Certification and collective marks are recognized in federal trademark law.⁸¹ The Lanham Act provides:

The term “certification mark” means any word, name, symbol, or device, or any combination thereof—

(1) used by a person other than its owner, or

(2) which its owner has a bona fide intention to permit a person other than the owner to use in commerce and files an application to register on the principal register established by this chapter,

to certify regional or other origin, material, mode of manufacture, quality, accuracy, or other characteristics of such person’s goods or services or that the work or labor on the goods or services was performed by members of a union or other organization.

The term “collective mark” means a trademark or service mark—

(1) used by the members of a cooperative, an association, or other collective group or organization, or

(2) which such cooperative, association, or other collective group or organization has a bona fide intention to use in commerce and applies to register on the principal register established by this chapter,

and includes marks indicating membership in a union, an association, or other organization.⁸²

Geographical indications are similar to collective and/or certification marks. A French champagne bottle’s label may contain a wine name, a producer’s name, and a geographical indication like “champagne.”⁸³ All three names may provide information to the wine consumer.⁸⁴ Trademark law developed to provide information to consumers.⁸⁵ Trademark law could provide protec-

marks receive the strongest protection, as opposed to suggestive and descriptive marks which receive minimal protection. *Id.* at 349. (2) Proximity of goods—the more closely the products are related to one another in the marketplace, the more the marks must be differentiated to avoid infringement. *Id.* at 350. (3) Similarity of marks—determined by measuring three levels in the marketplace: sight, sound, and meaning. *Id.* at 351. (4) Evidence of actual confusion—factor weighs heavily when one can show past confusion. *Id.* at 352. (5) Marketing channels used—likelihood of confusion increases where the same marketing channels are used by both businesses. *Id.* at 353. (6) Type of goods and care by purchaser—normal standard is ordinary care unless the market for the products is specialized buyers. *Id.* (7) Intent—did the infringer intend to create confusion among buyers? *Id.* at 354. (8) Likelihood of expansion—if either party will expand and compete more directly with the other, the use is more likely to be found to be infringing. *Id.*

⁸¹ § 1127.

⁸² *Id.*

⁸³ Lorvellec, *supra* note 10, at 67–68.

⁸⁴ U.S. wine bottles include similar information. U.S. wine labels are regulated by the Alcohol and Tobacco Tax and Trade Bureau (TTB). See TTB, Labeling, <http://www.ttb.gov/labeling/index.shtml> (last visited Oct. 13, 2006).

⁸⁵ 1 MCCARTHY, *supra* note 7, § 2.1, at 2-2 to 2-3.

tion for all three marks on the French wine bottle, should such recognition and protection be consistent with sound economic policy.⁸⁶

Two scholars argue that this aspect of the Lanham Act is sufficiently reflective of the geographical indication concept that there is no need to revamp the U.S. intellectual property system to comply with TRIPS.⁸⁷ Certification marks are owned by legal entities other than the users of the mark. They can be used to guarantee that a product was produced in a certain geographical location, that the product meets quality standards, or that the user of the mark is a member of an association.⁸⁸ All three are relevant for French champagne designations. Collective marks are owned and used by members of an association and they indicate membership in that association.⁸⁹ Both types of marks have qualities that are appropriate for producers who wish to take advantage of TRIPS' geographical indication protection. But collective marks require an association to own the mark. The French have the Comité Interprofessionnel du Vin de Champagne (CIVC), which prosecutes its geographical designation in other countries, but it does not claim ownership of a mark.⁹⁰ It is unclear the extent to which the Alcohol and Tobacco Tax and Trade Bureau (TTB), the agency that regulates geographical indications of

⁸⁶ Compare Lorvellec, *supra* note 10, at 68–69, with Chen, *supra* note 10, at 42–43, 59–60.

⁸⁷ Torsen, *supra* note 11, at 47–49; Staten, *supra* note 11, at 242–44.

⁸⁸ Torsen, *supra* note 11, at 48–49.

⁸⁹ *Id.* at 49.

⁹⁰ In contrast to U.S. property law, CIVC does not claim ownership of the name “Champagne.” It does not consider the name to be personal property capable of ownership. Instead, they argue it belongs to the region and the people who grow the grapes and produce the wine there. Telephone Interview with Sam Heitner, Director, Office of Champagne, USA, in Washington, D.C. (Feb. 21, 2006). The office is the U.S. representative of the CIVC. The CIVC protects the name through negotiation and litigation. Office of Champagne, USA, About the Office of Champagne, USA, <http://www.champagne.us/officeofchampagne/index.html> (last visited Oct. 13, 2006). “Trademarks can be sold and delocalised. Not the geographical indication. The trademark is an exclusive individual right. The geographical indication is accessible to any producer of the locality or region concerned.” Press Release, European Commission, WTO Talks: EU Steps Up Bid for Better Protection of Regional Quality Products (Aug. 28, 2003), available at <http://europa.eu/rapid/pressReleasesAction.do?reference=IP/03/1178>. Two examples of the CIVC's litigation are *Comité Interprofessionnel du Vin de Champagne v. Wineworths Group, Ltd.*, [1991] 2 N.Z.L.R. 432 (H.C.), and *Comité Interprofessionnel du Vin de Champagne v. N.L. Burton Pty Ltd.*, (1981) 38 A.L.R. 664 (Austl.). A related problem is that enforcement in the U.S. tends to be through private causes of action, while under TRIPS a Member could provide for enforcement exclusively through government action. TRIPS, *supra* note 9, at pt. III. That is how the GATT was enforced prior to creation of the WTO. The English version of CIVC's website is available at CIVC, http://www.champagne.com/en_indx.html (last visited Oct. 13, 2006); see also CIVC, The Laws Governing Champagne, http://www.champagne.com/en_regles_art.html (last visited Oct. 13, 2006) (“The word ‘Champagne’ is so full of meaning, so desirable that it has always provoked envy. One of the missions of the [CIVC]—the trade association representing all the Champagne Houses and Growers—is to defend and protect the exclusive nature of the Appellation.”).

wines,⁹¹ has embraced the Lanham Act provisions in its regulatory guidelines.⁹²

II. GEOGRAPHICAL INDICATIONS

Since the WTO promulgated TRIPS, geographical indications have become a controversial issue with overtones of cultural value clashes. Geographical indications protect the region's reputation for quality and prevent confusion of consumers. Several EU nations, with France as the strongest one, have recognized and protected "Appellations d'Origine Contrôlée" (AOCs), or appellations of origin, the precursor to the WTO's protection for geographical indications.⁹³ The AOC is a protection of both nature and culture, including the geographical location and the manufacturing process.⁹⁴

Geographical indications protect both producers and consumers from false advertising. Steps have been taken to regulate and register geographical indications. The EU has a registry exclusively for geographical indications.⁹⁵ The U.S. incorporates registration into trademark law.⁹⁶ Regulation protects those with economic interests and deals with the issues of fraud and

⁹¹ The appellation of origin functions formerly performed by the ATF are now performed by the TTB.

On January 24, 2003, the Homeland Security Act of 2002 (the Act) established the Alcohol and Tobacco Tax and [Trade] Bureau (TTB). Rendering the functions of the Bureau of Alcohol, Tobacco and Firearms (ATF) into two new organizations with separate functions, the Act created a new tax and trade bureau within the Department of the Treasury, and shifted certain law enforcement functions of ATF to the Department of Justice. The Act called for the tax collection functions to remain with the Department of the Treasury; and the new organization was called the "Alcohol and Tobacco Tax and Trade Bureau."

TTB, About TTB: History of TTB, <http://www.ttb.gov/about/history.shtml> (last visited Oct. 13, 2006). TTB's mission includes collecting taxes and ensuring "that alcoholic beverages are produced, labeled, advertised and marketed in accordance with Federal law." *Id.* The TTB website attempts to serve as a clearinghouse for appellations of origin, including both approved U.S. viticultural areas and foreign appellations of origin "once the respective foreign government has had the opportunity to verify its information." TTB, Appellations of Origin, <http://www.ttb.gov/appellation/index.shtml> (last visited Oct. 13, 2006). It is limited to appellations of origin for wine.

⁹² There are multiple agencies regulating industries that are affected by TRIPS articles 22, 23, and 24. This may be why the actual U.S. law on geographical indication protection is so unclear. The fact that the TTB regulates wine production, importation, and labeling is probably foreign to the French, who consider wine more of an agricultural product. Likewise, the concept of an agency that taxes and regulates vices and the concept of wine as a vice is probably foreign to the French government and populace.

⁹³ See generally Lorvellec, *supra* note 10 (applying AOC history and reasoning to the goals of the WTO in TRIPS).

⁹⁴ Chen, *supra* note 10, at 31–32.

⁹⁵ See Appendix A.

⁹⁶ The U.S. has incorporated the Madrid Protocol into trademark law. 15 U.S.C.A. §§ 1141–1141n (2006).

genericide.⁹⁷ Efforts are ongoing to create an international registry for both geographical indications and trademarks.⁹⁸

A. Treaties

Treaties dealing with geographical indications generally provide that registration constitutes constructive notice to the public.⁹⁹ The registrant receives priority to use the name. Protection for geographical indications is included in the multilateral agreements that also address trademarks, including the Paris Convention, the Madrid Agreement and Protocol, the Lisbon Agreement, and TRIPS. These agreements provide varying guidelines for trademark and for geographical indication protection.¹⁰⁰ Some are widely adopted and others are less recognized.¹⁰¹ Summaries of each follow.

1. Paris Convention

The Paris Convention for the Protection of Industrial Property (Paris Convention)¹⁰² applies to trademarks and patents. It is widely adopted and has been recognized since 1883, although it has since been amended. It requires members to provide national treatment for trademarks, meaning that foreign trademark applicants and holders are to receive the same treatment as indigenous trademark holders and applicants.¹⁰³ This means

⁹⁷ For example, when a geographical indication has become a common name for a good or has become synonymous with the customary name of a variety of grape within the country, the member country does not need to protect the geographical indication. TRIPS, *supra* note 9.

⁹⁸ *Id.* at art. 23 (providing for the establishment of a multilateral registration system for geographical indications).

⁹⁹ *See id.*

¹⁰⁰ BURGUNDER, *supra* note 16, at 465–68; 2 MCCARTHY, *supra* note 7, § 14:1.501, at 14-10 to 14-11. Many protocols, conventions, treaties, and other international agreements are not automatically part of a nation's domestic law. Many require adoption by the nations who are signatories. The EU is a signatory of TRIPS, but it has also enacted its own directives to make TRIPS part of its "domestic" law. The EU has a legislative system consisting of two types of legislation: directives and regulations. The purpose of the two types of laws is to promote harmonization of national laws with EU laws. Regulations are binding on member nations directly, without the member nations changing their laws to be in compliance. Directives are requirements that member states must meet by adjusting their national laws. There are also judicial decisions, recommendations, and opinions. Judicial decisions are binding on the parties in the suit. Recommendations and opinions are advisory only. *See* RICHARD SCHAFFER ET AL., INTERNATIONAL BUSINESS LAW AND ITS ENVIRONMENT 452–53 (5th ed. 2002).

¹⁰¹ Compare BURGUNDER, *supra* note 16, at 463–74 (summarizing the significant points of the major international agreements), with 2 MCCARTHY, *supra* note 7, § 14:1.50, at 14-10 to 14-11 (same).

¹⁰² Paris Convention, *supra* note 53; *see also* WIPO, Paris Convention for the Protection of Industrial Property, <http://www.wipo.int/treaties/en/ip/paris/index.html> (last visited Oct. 13, 2006) (containing the complete Paris Convention and information about the contracting parties).

¹⁰³ *See* Paris Convention, *supra* note 53, at art. 2. *See* BURGUNDER, *supra* note 16, at

that a U.S. trademark holder who applies for a Portuguese trademark will be granted a Portuguese trademark on the same terms and conditions as a Portuguese company. In short, it prevents discrimination on the basis of nationality.

The Paris Convention is a multilateral agreement embraced by the WTO as the foundation for international standards of intellectual property protection.¹⁰⁴ It puts geographical indications in the context of unfair competition doctrines. This implies that it would not recognize a geographical indication if it creates the likelihood of deception or confusion: This is similar to trademark standards. This is a more limited approach than recent agreements.¹⁰⁵ It adopts the traditional standard of likelihood of confusion among consumers as the test for trademark protection.¹⁰⁶ By implication, the same parameter is applied to geographical indications. The Paris Convention has two other provisions that are consistent with U.S. unfair competition law. First, it requires members to refuse registration and to prohibit use of marks that could be confused with unregistered marks that are already well known in the country.¹⁰⁷ Second, it prohibits false or misleading marks and geographical indications.¹⁰⁸ The U.S. is a signatory to the Paris Convention.

2. Madrid Agreement

The Madrid Agreement Concerning the International Registration of Marks (Madrid Agreement)¹⁰⁹ has only fifty-six nations as signatories as of May 20, 2005. Many, including the U.S. and the United Kingdom, have not signed it.¹¹⁰ The Madrid Agreement permits a single registration for trademarks rather than the current system of filing in each country where the product associated with the trademark might be marketed.¹¹¹ The Ma-

466.

¹⁰⁴ See Paris Convention, *supra* note 53, at art. 1.

¹⁰⁵ See, e.g., 3 MCCARTHY, *supra* note 7, § 14:1.50, at 14-11 (discussing the breadth of the Lisbon Agreement, which is quite broad in its provisions).

¹⁰⁶ Paris Convention, *supra* note 53, at art. 10bis(3)(i) ("The following in particular shall be prohibited: 1. all acts of such a nature as to create confusion by any means whatever with the establishment . . . of a competitor . . .").

¹⁰⁷ See *id.*

¹⁰⁸ *Id.* at art. 10ter. See also Kevin M. Murphy, Comment, *Conflict, Confusion, and Bias under TRIPS Articles 22-24*, 19 AM. U. INT'L L. REV. 1181, 1201-02 (2004).

¹⁰⁹ Madrid Agreement Concerning the International Registration of Marks, arts. 1, 3, Apr. 14, 1891, 828 U.N.T.S. 389 [hereinafter Madrid Agreement].

¹¹⁰ See WIPO, Contracting Parties, http://www.wipo.int/treaties/en/ShowResults.jsp?lang=en&treaty_id=21 (last visited Oct. 12, 2006).

¹¹¹ Madrid Agreement, *supra* note 109, at art. 1(2) ("Nationals of any of the contracting countries may, in all the other countries party to this Agreement, secure protection for their marks applicable to goods or services, registered in the country of origin, by filing the said marks at the International Bureau of Intellectual Property . . ."); see also BURGUNDER, *supra* note 16, at 467. Individual country variations are available at the

Madrid Agreement provides for an international trademark application, which must be completed within two months of receiving national trademark registration. Since national registration is so easy in other countries, the U.S. position is that the prior national registration proviso is unfair.¹¹²

Under the Madrid Agreement, World Intellectual Property Organization (WIPO), a part of the United Nations, can conduct a trademark search and deny trademark applications that are confusingly similar to previously registered trademarks.¹¹³ Some countries do not conduct a search, so it is possible to have registration of very similar trademarks. Trademarks have to be renewed, which can be quite expensive.¹¹⁴

The Madrid Agreement prohibits uses of geographical indications by businesses outside the region even if they are not misleading. Thus, under the Madrid Agreement, one could not legally name one's cheese either Parmesan or Parmesan Style cheese unless it actually comes from Parmigiano. Thus the Madrid Agreement is more far-reaching than the Paris Convention in protecting geographical indications.

The Madrid Protocol amended the Madrid Agreement in 1989 to address concerns of some countries over certain provisions. Sixty-nine countries are signatories at this date, including the United Kingdom and the U.S.¹¹⁵ The Protocol resolves the prior national registration problem and is expected to be widely adopted.¹¹⁶

3. Lisbon Agreement

The Lisbon Agreement for the Protection of Appellations of

Declarations made by Contracting Parties of the Madrid System under the Agreement, the Protocol and the Common Regulations, available at <http://www.wipo.int/madrid/en/notices/pdf/declarations.pdf>.

¹¹² BURGUNDER, *supra* note 16, at 468.

¹¹³ *Id.* at 467.

¹¹⁴ *Id.* at 465.

¹¹⁵ Madrid Agreement, *supra* note 109. The membership status of the Madrid Agreement and the Madrid Protocol is available at the WIPO website. WIPO, Contracting Parties, *supra* note 110. The Madrid Protocol is embodied within the Lanham Act, 540 Stat. 427 (codified as amended in scattered sections of 15 U.S.C.).

¹¹⁶ BURGUNDER, *supra* note 16, at 468. Burgunder correctly predicted that the U.S. would adopt the Madrid Protocol because it addressed both of the U.S.'s concerns with the Madrid Agreement. The actual Guide to the International Registration of Marks under the Madrid Agreement and the Madrid Protocol is available on the WIPO website at <http://www.wipo.int/madrid/en/guide/pdf/index.htm> (last visited Oct. 12, 2006). The Trademark Law Treaty, adopted by WIPO in 1994, streamlines some of the trademark registration procedures used by the trademark offices of the participating nations. As of October 12, 2006, thirty-six countries were parties to the treaty. The U.S. became a party on August 12, 2000. The WIPO website has links to the Trademark Law Treaty and the signatory countries at <http://www.wipo.int/treaties/en/ip/tlt/index.html> (last visited Oct. 12, 2006).

Origin and their International Registration (Lisbon Agreement) was formed in 1958. Until TRIPS, it was the main geographical indication treaty. It is an appendage of the Paris Convention. The Lisbon Agreement provides that WIPO will maintain a registry of geographical indications.¹¹⁷ The Agreement effectively treats geographical indications as superior to trademarks.¹¹⁸ Earlier conflicting trademarks have two years to phase out use of the name.¹¹⁹ Even their status as registered trademarks will not save them from termination. The U.S. is not a signatory, primarily because the U.S. does not subscribe to the supremacy of geographical indications over trademarks: this position is particularly acute with regard to prior recognized trademarks.¹²⁰

4. TRIPS

The most recent international agreement is TRIPS. It is highly influential in the protection of intellectual property, including international treatment of trademark and geographical indications. Because of its influence, it is examined here in more detail.

TRIPS, drafted by the World Trade Organization (WTO), is a comprehensive, multilateral treaty establishing minimum standards for protection of intellectual property.¹²¹ WTO membership includes both developing and industrialized nations.¹²² It is currently the dominant treaty on intellectual property.¹²³ Some of its provisions, particularly those involving geographical indications, are controversial.¹²⁴

TRIPS incorporates the provisions of the Paris Convention,

¹¹⁷ Lisbon Agreement for the Protection of Appellations of Origin and their International Registration, Oct. 31, 1958, 923 U.N.T.S. 205 [Lisbon Agreement]. See also WIPO, Geographical Indications, http://www.wipo.int/about-ip/en/geographical_ind.html (last visited Oct. 12, 2006).

¹¹⁸ 3 MCCARTHY, *supra* note 7, § 14:1.50 n.13, at 14-11 (noting that trademarks found in conflict with a new appellation must be terminated unless objected to within twelve months of registration). McCarthy includes both the Lisbon Agreement and the Paris Convention in his treatise.

¹¹⁹ Lisbon Agreement, *supra* note 117, at art. 5.

¹²⁰ See TRIPS, *supra* note 9, at art. 24(6). TRIPS recognizes the inability to register geographical indications if the word is already either trademarked or in the public domain as being generic.

¹²¹ TRIPS, *supra* note 9, at pmbl.

¹²² The WTO was conceived at the Uruguay Round of General Agreement on Tariffs and Trade (GATT) in 1994, and came into being in 1995; GATT members are WTO members. There are at least 120 WTO members. See BURGUNDER, *supra* note 16, at 41-43.

¹²³ WTO, Overview: the TRIPS Agreement, http://www.wto.org/english/tratop_e/trips_e/intel2_e.htm (last visited Oct. 23, 2006); see also 3 MCCARTHY, *supra* note 7, § 14:22, at 14-66.

¹²⁴ Articles 22, 23, and 24 were achieved through compromise. It has been said that the U.S. has been slow to implement or adopt the TRIPS provisions into its domestic law. See Silva, *supra* note 27, at 198.

giving owners of marks the right to prevent others from using the mark if such use would result in a likelihood of confusion. It permits the co-existence of two systems of protection—the U.S. use-based system, and the registration-based system used by the majority of other nations.¹²⁵ The U.S. has adopted TRIPS. TRIPS adds geographical indication protection not traditionally recognized by the U.S. and other countries.¹²⁶

TRIPS provides two levels of support for geographical indications. The highest level of support is for geographical indications that identify the origin of wine and spirits. All other goods enjoy a lower level of protection.¹²⁷ In TRIPS, geographical indication protection is independent of trademark law and lacks many of the safeguards that both TRIPS and U.S. intellectual property law recognize for trademark, patent, and copyright.¹²⁸

Geographic indicators are a means of identifying the source and denoting the quality and reputation of regionally distinct agricultural goods for purposes of product recognition on the international market.¹²⁹ The wine market, for example, is not primarily a “branded” market, although there are certain examples to the contrary, such as Ernest and Julio Gallo. Instead, wine producers overwhelmingly seek to achieve product recognition using geographic indicators. Better-known examples include “Champagne,” “Claret,” and “Port.” Such marks do more than simply indicate the origin of a good. They denote a guarantee of quality and distinctiveness derived from a combination of unique regional, environmental, and human influences, such as climate, soil, subsoil, plants, and special methods of production [including] traditional, collectively observed farming and processing techniques.¹³⁰ [For protection, TRIPS] itself requires “a given quality, reputation or other characteristics . . . essentially attributable to . . . geographical origin.”¹³¹

Three articles in TRIPS address protection for geographical indications. The EU and some countries support these sections. However, the U.S. and other countries have not embraced the provisions as wholeheartedly as many EU members would like. Each nation has to adjust its domestic laws to comply with the

¹²⁵ See BURGUNDER, *supra* note 16, at 466–67.

¹²⁶ Silva, *supra* note 27, at 198. The U.S. has trademark protection that is similar, but does not have a separate legal doctrine to protect agricultural products and spirits; TRIPS, therefore, provides a new form of protection. However, the U.S. has two agencies that regulate the TRIPS products. The TTB regulates alcohol, and the Department of Agriculture regulates foodstuffs. See TTB, <http://www.ttb.gov> (last visited Oct. 16, 2006); Department of Agriculture, <http://www.usda.gov>; TRIPS, *supra* note 9, at art. 22.

¹²⁷ See TRIPS, *supra* note 9, at art. 22–23.

¹²⁸ See generally TRIPS, *supra* note 9.

¹²⁹ 3 MCCARTHY, *supra* note 7, § 14:1, at 14-3.

¹³⁰ See generally Chen, *supra* note 10.

¹³¹ Murphy, *supra* note 108, at 1184–86 (quoting TRIPS, *supra* note 9, at art. 22).

TRIPS articles.¹³² Foot-dragging by nations, such as the U.S., has caused international trade law tensions. Some scholars divide the ideological economic policy schism along Old and New World lines.¹³³ There is geographical veracity to this viewpoint.¹³⁴

a. Article 22

Article 22 defines and recognizes geographical indications. WTO members (1) must make their domestic laws comply with TRIPS' geographical indications recognition, (2) must prohibit unfair competition, and (3) must prohibit registration of geographical indications as trademarks.¹³⁵ It instructs signatory nations to prohibit use of geographical indications that mislead the public or amount to unfair competition.¹³⁶ Hence, Article 22 incorporates the "likelihood of confusion" concept that is used for both registration and prosecution for infringement. This section provides the universal minimum standards for protection of geographical indications. Wines and spirits have their own heightened level of protection.¹³⁷

b. Article 23

Article 23 provides protections specifically for wines and spirits.¹³⁸ It instructs signatory nations to prohibit use of geographical indications in wines and spirits unless the product is actually from that region.¹³⁹ Likelihood of confusion among con-

¹³² Some treaties are self-activating, but TRIPS is not. It guides member states in how to conform their domestic laws. TRIPS, *supra* note 9.

¹³³ See, e.g., Staten, *supra* note 11, at 222 ("The Article 23 extension dispute is a classic example of an 'Old School' versus 'New School' dispute.").

¹³⁴ See generally Staten, *supra* note 11. Staten's article discusses U.S., New Zealand, and Australian wine producers and wine cases that depart from the EU's proposed treatment of wine geographical indications.

¹³⁵ TRIPS, *supra* note 9, at art. 22(2)–(3) ("In respect of geographical indications, Members shall provide the legal means for interested parties to prevent: (a) the use of any means in the designation . . . of a good that indicates . . . that the good . . . originates in a geographical area other than the true place of origin in a manner which misleads the public as to the geographical origin of the good . . .").

¹³⁶ *Id.*

¹³⁷ TRIPS, *supra* note 9, at art. 23. It is titled "Additional Protection for Geographical Indications for Wines and Spirits." See also Staten, *supra* note 11, at 225.

¹³⁸ TRIPS, *supra* note 9, at art. 23. Some of the wine and spirit situations involving geographical indications are Bacardi, Budweiser, Canadian Whiskey, Kentucky Bourbon, Tennessee Whiskey, Polish Vodka, Scotch, Smirnoff, Tequila, and Zinfandel. See Geographic Indications & International Trade (GIANT), Geographic Indication Case Studies, <http://www.american.edu/ted/giant/casestudies.htm> (last visited Oct. 23, 2006). GIANT is funded by the American Consortium on European Studies and is based at American University. Geographic Indications & International Trade (GIANT), About Us, <http://www.american.edu/ted/giant/aboutus2.html> (last visited Oct. 23, 2006).

¹³⁹ TRIPS, *supra* note 9, at art. 23.

Each Member shall provide the legal means for interested parties to prevent use of a geographical indication identifying wines for wines not originat-

sumers is irrelevant. This section is particularly controversial. "Simply stated, even if the public would not be deceived by the use of a particular geographical indication, a geographical indication may not be used if the wines or spirits do not originate in the place indicated by the geographical indication."¹⁴⁰ Article 23 does not regulate the consuming public, so many people still call sparkling wines "champagne." Were the term champagne protected by U.S. trademark, the law would ask whether the consuming public is likely to be confused, i.e., whether a consumer is likely to believe that all champagnes come only from Champagne, France. With TRIPS' geographical indications, there is no requirement that there be a likelihood of confusion through use of a term that TRIPS would recognize as a geographical indication. Hence, TRIPS is broader in its contemplation of protectable names than U.S. trademark law.

c. Article 24

Article 24 provides exceptions for (1) geographical indications that were already in use as generic terms for products, or (2) when a trademark already existed in the product.¹⁴¹ Exceptions require a factual inquiry and each nation has its own standards based on its domestic law. In the U.S., the Bureau of Alcohol, Tobacco, Firearms and Explosives (ATF) has designated which geographical indications are generic through a two-tiered system.¹⁴²

ing in the place indicated by the geographical indication in question or identifying spirits for spirits not originating in the place indicated by the geographical indication in question, even where the true origin of the goods is indicated or the geographical indication is used in translation or accompanied by expressions such as "kind", "type", "style", "imitation" or the like.

Id.

¹⁴⁰ Staten, *supra* note 11, at 225.

¹⁴¹ TRIPS, *supra* note 9, at art. 24(5).

Where a trademark has been applied for or registered in good faith, or where rights to a trademark have been acquired through use in good faith either: (a) before the date of application of these provisions in that Member as defined in Part VI; or (b) before the geographical indication is protected in its country of origin; measures adopted to implement this Section shall not prejudice eligibility for or the validity of the registration of a trademark, or the right to use a trademark, on the basis that such a trademark is identical with, or similar to, a geographical indication.

Id.; Staten, *supra* note 11, at 226.

¹⁴² 27 C.F.R. § 4.24 (2005). The TTB divides spirits into generic, semi-generic, or non-generic categories. "Examples of generic names, originally having geographic significance . . . are: Vermouth, Sake." *Id.* § 4.24(a)(2). "Examples of semi-generic names which are also type designations for grape wines are Angelica, Burgundy, Claret, Chablis, Champagne, Chianti, Malaga, Marsala, Madeira, Moselle, Port, Rhine Wine (syn. Hock), Sauterne, Haut Sauterne, Sherry, Tokay." *Id.* § 4.24(b)(2). "Examples of nongeneric names which are not distinctive designations of specific grape wines are: American, California, Lake Erie, Napa Valley, New York State, French, Spanish." *Id.* § 4.24(c)(2). "Examples of nongeneric names which are also distinctive designations of specific grape win-

B. European Union Position

Geographical indications, like trademarks, protect both producers and consumers from false advertising. However, geographical indications must be regulated and registered. Regulation protects legitimate interests and addresses issues of fraud, genericide, and inappropriate use. EU Trade Commissioner Pascal Lamy said:

Geographical Indications offer the best protection to quality products which are marketed by relying on their origin and reputation and other special characteristics linked to such an origin. They reward investment in quality by our producers. Abuses in third countries undermine the reputation of EU products and create confusion for consumers. We want this to cease for the most usurped products in the world.¹⁴³

The EU approved a short list of EU geographical indications that it seeks to protect. The list, released in 2003, is attached to this article as Appendix A. According to the EU, names were selected for the list because in many countries outside the EU they are “claimed to be generic terms and/or have been registered as trademarks by [non-EU] producers.”¹⁴⁴ They are also included on the EU’s register of geographical indications.¹⁴⁵ The EU believes that the development of the list will help to advance the negotiations for which names will receive protection.¹⁴⁶ The EU claims that it wants to “recuperate” the names that are being “abused today.”¹⁴⁷ It talks about the “claw-back” of geographical indications. In other words, the EU wants to return from general public use terms like “champagne” for a well-known style of sparkling white wine. If the EU prevails in this endeavor, “champagne” will mean only wine made in Champagne, France, using that region’s grapes and a traditional style of production.¹⁴⁸

es are: Bordeaux Blanc, Bordeaux Rouge, Graves, Medoc” *Id.* § 4.24(c)(3).

¹⁴³ Press Release, European Commission, *supra* note 90. The EU does not presently accept that imitation is the sincerest form of flattery.

¹⁴⁴ *Id.*

¹⁴⁵ *Id.*

¹⁴⁶ *Id.* The list will be negotiated in the agriculture negotiations within the Doha Development Agenda, and in other negotiations that follow.

¹⁴⁷ The EU publications and website often use inflammatory language. *Id.* That is a side issue that the U.S. case of Harley Davidson and Hog rejected. One cannot re-protect a term that has become genericized. See *Harley-Davidson, Inc. v. Grottanelli*, 164 F.3d 806 (2d Cir. 1999).

¹⁴⁸ See Press Release, European Commission, *supra* note 90. “Protecting [geographical indications] is not about protectionism but about free trade. Today, Italian producers have to call their ‘Parma Ham’ as ‘N. 1 Ham’ in Canada and cannot even sell their ham in Mexico. They are losing [sic] an estimated 3.5 million euro per year in these two countries alone.” EUROPA, Intellectual Property: Why Do Geographical Indications Matter To Us?, http://ec.europa.eu/comm/trade/issues/sectoral/intell_property/argu_en.htm (last visited Sept. 30, 2006).

Some nations have already conceded this for "champagne."¹⁴⁹

The EU argues that the current protection for wines and spirits should be extended to other products.¹⁵⁰ Consider that Parmesan cheese originally came from Parmesan, Italy. The EU would take back the name so that it could only mean cheese produced in the Italian region. The geographical indications in cheeses, rice, and teas should obtain the same protection. Producers outside the region could not avoid the protection by noting that the product is in the "style of Parmesan" or "U.S. Parmesan cheese."¹⁵¹ The EU wants to reach full implementation of the WTO standards by each WTO member, but recognizes that a transition period is necessary.¹⁵²

The EU requests WTO members to (1) recognize a selected group of geographical indications, (2) remove prior trademarks that conflict with geographical indications, and (3) protect EU geographical indications that were used in the past or have become generic terms.¹⁵³ The EU contends that these are necessary to obtain access to the market.

The EU advocates a multilateral registry of geographical indications.¹⁵⁴ It conducts negotiations through the WTO. Most registration treaties and statutes provide that registration gives constructive notice to others, so actual knowledge is not necessary for protection to attach.¹⁵⁵ The registrant receives a priority to use the name. Registration also increases certainty that a business's geographical indication will be respected.

The arguments in favor of protecting geographical indications include: (1) protecting the city's or region's reputation for

¹⁴⁹ Australia has agreed to prohibit the use of the champagne designation for all but French wines produced in the Champagne region using the local production methods. See also Laurence P. Harrington, Recent Development, *Tattinger v. Allbev: Has the London High Court Popped Its Cork?*, B.C. INT'L & COMP. L. REV. 139, 140 n.10 ("The French had won 64 previous court battles in England and more than 20 in Spain, Australia, and the U.S. preventing wine makers from using the word 'champagne' on the labels of products not from the Champagne region of France."). However, U.S. wine producers still use the designation "champagne."

¹⁵⁰ See Press Release, European Commission, *supra* note 90.

¹⁵¹ EUROPA, *supra* note 148.

¹⁵² EUROPA, Intellectual Property: Towards Better Recognition of Intellectual Property Rights, http://europa.eu/comm/trade/issues/sectoral/intell_property/index_en.htm (last visited Sept. 30, 2006).

¹⁵³ See generally *Implementation of Article 23.4 of the TRIPS Agreement Relating to the Establishment of a Multilateral System of Notification and Registration of Geographical Indications*, EC Doc. IP/C/W/107/Rev.1, available at http://trade.ec.europa.eu/doclib/docs/2003/july/tradoc_113496.pdf. For more on the EU's proposals regarding geographical indications, see EUROPA, Intellectual Property: Contributions to the WTO, http://europa.eu/comm/trade/issues/sectoral/intell_property/wto_nego/index_en.htm (last visited Sept. 30, 2006).

¹⁵⁴ Press Release, European Commission, *supra* note 90.

¹⁵⁵ See e.g., TRIPS, *supra* note 9, at art. 5; Paris Convention, *supra* note 53, at art. 6.

quality; (2) preventing confusion of consumers;¹⁵⁶ (3) encouraging the development of quality products in association with the name or mark; (4) protecting high quality and regional exports;¹⁵⁷ (5) providing fair treatment; (6) strengthening competitiveness; (7) protecting cultural heritage, traditional methods of production, and natural resources; and (8) rewarding producers' investments in quality.¹⁵⁸

The arguments against protecting geographical indications include: (1) some labels have recently been declared geographical indications, after producers in other regions have used the labels; (2) geographical indications have been trademarked in other countries; (3) geographical indications have become generic terms to describe products; and (4) there is confusion when a geographical indication has become a common name for a good.¹⁵⁹

III. INTERSECTION OF TRADEMARK AND GEOGRAPHICAL INDICATION LAW

A. Trademark Compared to Geographical Indication

The U.S. trademark legal structure is suitable for incorporating geographical indication law. It provides appropriate boundaries that reflect sound economic policy. The U.S. competition model has proved to be effective for businesses and for consumers. The U.S. trademark system can adjust to accept the EU value system, which is indeed economically consistent with trademark policy in the U.S.

Geographical indications have a tie with the locale or territory. Trademarks do not. Geographical indications cannot be sold. Trademarks can be sold. Geographical indications cannot be delocalized. If trademarks are linked to a territory, they can be delocalized. Geographical indications can be used by any producer in the locality or region. Trademarks are exclusive individual rights.¹⁶⁰ Trademark law does, however, provide for certification and collective marks that are quite similar to geographical indications because they are not owned or transfer-

¹⁵⁶ Press Release, European Commission, *supra* note 90.

¹⁵⁷ The claim is essentially that if they are not protected, the value of the product is eroded.

¹⁵⁸ Press Release, European Commission, *supra* note 90.

¹⁵⁹ When a variety of grape within a country has become synonymous with the customary name, is the geographical indication lost? There are also issues about first use. What if a company used the geographical indication before it was declared a geographical indication or before steps were taken to protect the geographical indication? These questions and others remain to be answered by policies yet to be adapted.

¹⁶⁰ 3 MCCARTHY, *supra* note 7, § 14:01, at 14-3 to 14-4 (4th ed. 2006) (explaining that trademarks pinpoint a certain seller, but geographically descriptive marks are not sufficiently specific or distinctive enough to identify a particular seller).

able in the manner of individual trademarks.

“Champagne” is not the name of a specific company that provides sparkling wine; it is the name of a place where several providers produce the type of wine that bears the same name.¹⁶¹ The concept proposed to protect the word “champagne” is similar to the U.S. concept of collective marks. The Lanham Act recognizes and protects collective marks.¹⁶² Geographical indication and trademark scholars have decided that geographical indications fall under the Lanham Act’s recognition of collective marks.¹⁶³ They suggest that the Lanham Act and U.S. trademark law constructs will work well to clarify the geographical indication construct in international law.¹⁶⁴

1. The Geographical Indication Dispute

Scholars divide the geographical indication philosophical dispute into two schools, the old and the new. The lines are roughly drawn along the Old World and New World countries. The Old World countries view trademark as the basic law and geographical indication as a tangential concept that reaches beyond product protection through trademark.¹⁶⁵

Both Bordeaux and Chianti are regions in Europe; Bordeaux is in France and Chianti is in Italy. That their names have come to signify types of red wine is something that Europeans and Americans, in particular, are struggling to regulate, qualify and quantify. It is not necessarily seen as a struggle between developed and developing countries, but rather a friction between the sensibilities of the “Old World” and the new . . . [S]ome jurisdictions favor consumer protection over producer protection.¹⁶⁶

Some nations want to extend the geographical indication protection beyond TRIPS’ Article 22, which is bounded by a requirement of likelihood of confusion among consumers. Article 23 applies to wines and spirits and is an expansion in that it ignores the consumer perspective in favor of protecting producers. It does not focus on information to consumers. Old World na-

¹⁶¹ Under the French law of 22 July 1927, the Champagne area is strictly defined. It accounts for approximately three percent of the total vineyards in France. CIVC, On a Map, http://www.champagne.fr/en_carte.html (last visited Sept. 30, 2006).

¹⁶² 15 U.S.C. § 1054 (2000) (“Subject to the provisions relating to the registration of trademarks, so far as they are applicable, collective and certification marks, including indications of regional origin, shall be registrable under this chapter, in the same manner and with the same effect as are trademarks.”).

¹⁶³ See Staten, *supra* note 11, at 236–41; Torsen, *supra* note 11, at 48–49. Staten and Torsen identify and describe both the Lanham Act’s and the Trademark Act’s provisions for types of collective marks.

¹⁶⁴ Staten, *supra* note 11, at 242.

¹⁶⁵ Torsen, *supra* note 11, at 31–32.

¹⁶⁶ *Id.*

tions, such as France, want Article 22 protection extended to be akin to Article 23 for all products protected by geographical indications.¹⁶⁷ The U.S. opposes extension, as does much of the New World. France has recognized and provided for geographical indication protection for the longest time and has the most developed geographical indication law. Scholars advocate a compromise between the stances of the Old and New Worlds. The model promoted is the U.S. trademark system's treatment of collective and certification marks as the appropriate model for TRIPS geographical indication law.¹⁶⁸

Geographical indications are indeed similar to U.S. trademark law's recognition of collective marks. The U.S. gives limited protection to geographical descriptive terms in a trademark.¹⁶⁹ This is logical since "a product's geographical origin can definitely be a factor in which product a consumer chooses to buy."¹⁷⁰ Perhaps the doctrinal schism between the Old and New Worlds is breaking down.

B. U.S. Geographical Indications

Although the U.S. does not widely protect geographical indications, it should provide some protection. It should develop a clear approach consistent with its trademark law. There are U.S. business entities and groups that want this protection. Some examples include Florida oranges, Idaho potatoes, and Vidalia onions. Napa Valley vintners also appreciate TRIPS' geographical indication protection. One scholar was highly critical of the current U.S. position.¹⁷¹ He feels that if U.S. businesses want protection, the government should provide protection for foreign businesses—in other words, the *quid pro quo* viewpoint.

The authors of a popular international business law textbook¹⁷² have created an exercise that sensitizes business students to the concept of the shoe being on the other foot. They included and discussed *Comité Interprofessionel du Vin de Champagne v.*

¹⁶⁷ Staten, *supra* note 11, at 222–23.

¹⁶⁸ *Id.* at 223. Staten argues that "the United States' system of trademark registration should serve as the uniform model for WTO Members." *See also id.* at 242 ("The United States system of trademark registration . . . is a good model of a system that is efficient, transparent, easy to use, and fair.").

¹⁶⁹ The TTB is the U.S. bureau responsible for determining whether an area should be designated an American viticultural area. "[T]he Director shall receive petitions to establish American viticultural areas and shall use the informal rule-making process, under 5 U.S.C. [§] 533, in establishing viticultural areas in this part." 27 C.F.R. § 9.3(a) (2005).

¹⁷⁰ Torsen, *supra* note 11, at 33 (citing studies that have shown that geographical factors influence consumer choices).

¹⁷¹ Silva, *supra* note 3, at 198–99.

¹⁷² SCHAFFER ET AL., *supra* note 100, at 515–17, 539.

Wineworths Group, Ltd.,¹⁷³ an opinion by the High Court of Wellington where the New Zealand court found that Australian sparkling white wines imported into New Zealand could not properly be designated champagnes. The court determined that the consuming public in New Zealand associated the term “champagne” only with the French product. At the end of the chapter, the authors created an exercise to help students assimilate concepts from the chapter. In one of these problems, the hypothetical Professional Committee of Wilson Barbecue replaced the CIVC from the New Zealand case. Wilson-Style Barbecue replaced champagne as the designation and North Carolina replaced France. The Professional Committee claimed protection for the designation and said it applied to Wilson-bred hogs, using the Wilson method. As the French claim that the uniqueness of the soil, the grapes, and the method contribute to the product, North Carolina claimed the uniqueness of the soil in which the Wilson hogs wallow was pertinent. The claimed infringement occurred in France where a French firm was selling pork barbecue labeled Method Wilson, without a trademark. The humor in the analogy intrigues students and scholars alike.

The New Zealand case stops short of France’s position on the protectability of geographical indications. The court decided that in New Zealand, consumers did indeed tend to think of wine designated “champagne” to be from France. But if the same legal position is adopted by other common law countries such as Canada, Australia, and the U.S., it is unlikely that the consumers in those countries would think that a wine sold as a California champagne would be a French wine. In those countries, the designation “champagne” is merely descriptive and is not likely to confuse consumers as to the source of the product. So the protection for the geographical indication “champagne” would not be recognized in those countries under a similar philosophy. In fact, Australian courts have found no infringement when Australian vintners market their sparkling wines as champagne.¹⁷⁴ However, the international law does not make likelihood of confusion among consumers the cornerstone for geographical indications protection. TRIPS does recognize the issue of confusion for trademarks, but does not make it a prerequisite for protection of geographical indications.¹⁷⁵ The New Zealand case law may be usurped by TRIPS.

¹⁷³ *Id.* at 539. (citing Comité Interprofessionnel du Vin de Champagne v. Wineworths Group, Ltd., [1991] 2 N.Z.L.R. 432 (H.C.)).

¹⁷⁴ Comité Interprofessionnel du Vin de Champagne v. N.L. Burton Pty Ltd. (1981) 38 A.L.R. 664 (Austl.).

¹⁷⁵ TRIPS, *supra* note 9, at arts. 15(1), 16(1).

Some U.S. businesses are asserting geographical indication protection and are receiving it judicially within the U.S. U.S. wine producers have asserted geographical indication protection. The Napa Valley Vintners Association contends that the term burgundy has become genericized but that Napa Valley has not. The Napa Valley Vintners Association¹⁷⁶ has exerted geographical indication protection for the Napa Valley name in at least four instances.¹⁷⁷ First, it fought with Bronco Wine Company, which was using the names “Napa Ridge,” “Napa Creek Winery,” and “Rutherford Vintners.” Under the trade name, Bronco listed the type of wine (grape varietal) and then the appellation of the origin of the grapes. Recently, the Napa Valley Vintners prevailed in a lawsuit against Bronco Wine Company.¹⁷⁸ The court upheld a California statute that required any wine bottle with the word “Napa” on it to actually contain Napa wine.¹⁷⁹

The second instance involves a foreign vintner. Hongye Grape Wine Company in Beijing has applied to register “Napa Valley” (Napa Hegu) as a Chinese trademark for use on its wines. Written in Chinese, the first two characters phonetically spell out “Napa” and the second two characters are the Chinese words for “river valley.”¹⁸⁰ These wines will apparently be made from Chinese grapes and sold in China. The Napa Valley Vintners Association learned of Hongye’s trademark application and filed its opposition in 2003.¹⁸¹ It is not clear whether Napa Hegu is actually on store shelves or whether Hongye has just applied for registration.¹⁸² Winemakers, such as Mondavi and Beringer, use the Napa Hegu characters on their California wines sold in China.

¹⁷⁶ The Napa Valley Vintners, <http://www.napavintners.com> (last visited Oct. 18, 2006). According to its web page, the Napa Valley Vintners “leads in the promotion and protection of the Napa Valley Appellation as one of the finest winegrowing regions in the world. We are committed to the future of Napa Valley through the preservation and enhancement of its land, wine and community.” Napa Valley Vintners, History of the Napa Valley Vintners, <http://www.napavintners.com/region/reghist.asp> (last visited Oct. 18, 2006).

¹⁷⁷ Carol Emert, *Chinese Use of “Napa Valley” on Wine Draws Protests in the U.S.*, S.F. CHRON., Aug. 7, 2003, at D2.

¹⁷⁸ *Bronco Wine Co. v. Jolly*, 95 P.3d 422 (2004), *remanded to* 29 Cal. Rptr. 3d 462 (2005), *cert. denied*, 126 S. Ct. 1169 (2006). See also Press Release, Napa Valley Vintners, CA Supreme Court Issues Decision on Bronco’s Petition for Review: Denied (Aug. 24, 2005), *available at* http://www.napavintners.com/news/release.asp?ID_News=1.

¹⁷⁹ During the course of the case, Bronco argued free speech, interstate commerce, and unconstitutional takings. In earlier litigation, it argued that federal law preempted the area leaving no room for state legislation. Press Release, Napa Valley Vintners, Bronco Loss Considered Consumer Victory (May 26, 2005), *available at* http://www.napavintners.com/news/release.asp?ID_News=3.

¹⁸⁰ Emert, *supra* note 177, at D2. The phrase is transliterated as Napa Hegu. It sounds similar to “nah-pah huuh-goo.” *Id.*

¹⁸¹ In China, it typically takes two years to rule on a trademark. *Id.*

¹⁸² It is possible that other Chinese wines use Napa Hegu on their labels. They may have escaped detection because they did not try to trademark the term. *Id.*

Napa Valley Vintners Association's attorney, Scott Gerien, uses this fact to support his argument that the word is identical and that its use would be deceptive on Chinese wine.

It is ironic that California vintners are now in a similar position to European winemakers who have complained about the use of the words "champagne" and "chablis" by U.S. wineries.¹⁸³ Many decades ago, European immigrants came to the U.S. and borrowed names from the old country for their new world products. One commentator said, "Now China has a fledgling wine industry and we're the old ones compared to them. . . . So we have to go over there and say, 'You can't use this name.'"¹⁸⁴

The third instance involves an Oregon rice wine maker. The Napa Valley Vintners Association is also trying to invalidate the U.S. brand name NapaSaki, a brand of rice wine made in Oregon. They claim the name is deceptive.¹⁸⁵ In the fourth case, the Napa Valley Vintners Association went after an actual Napa sakery, Hakusan Sake Gardens, for calling its premium rice wine Napa Sake. It also labeled a number of its sakes "Napa Valley." The sake is actually brewed in Napa with Napa water, but the rice is grown in the Sacramento Valley. Hakusan's owner, Kohman, Inc., has agreed to stop using "Napa" and "Napa Valley" after being approached by the Napa Valley Vintners Association.¹⁸⁶

C. U.S. Unfair Competition and Trademark Law as a Model for Geographical Indication

Scholars find an analogous protection in U.S. trademark law. The protections of two sections are commonly cited. First, certification and collective marks serve the same purpose as geographical indications. Rather than identifying the producer of the product or service by the mark, these marks identify quality, producer groups, and place of manufacture.¹⁸⁷ Certification marks are distinct from trademark, even though they are identified in the Lanham Act and the Trademark Act.¹⁸⁸ Second, the

¹⁸³ *Id.* Scott Gerien, the attorney who represents the Napa Valley Vintners, uses the old world/new world explanation.

¹⁸⁴ *Id.*

¹⁸⁵ *Id.* NapaSaki is owned by AIG Wine & Spirits Import Co. of New York. John Rannells, AIG's lawyer, contends that NapaSaki is one word, not a geographic term; customers would not confuse it with Napa Valley; and his client had no intention of creating an impression that the product is from Napa Valley. Rannells says that consumers are more likely to confuse NapaSaki with the city Nagasaki than with Napa Valley.

¹⁸⁶ *Id.*

¹⁸⁷ See Torsen, *supra* note 11, at 48–49; Staten, *supra* note 11, at 236–37.

¹⁸⁸ Staten, *supra* note 11, at 236 (citing the Lanham Act, 15 U.S.C. § 1054 (2000) and the Trademark Act, 15 U.S.C. § 1127 (2000)). The Trademark Act defines certification mark as:

any word, name, symbol, or device, or any combination thereof (1) used by a

Lanham Act's "False Designations of Origin, False Descriptions, and Dilution Forbidden" section provides procedures for refuting a mark that misleads consumers: This is similar to the Paris Convention's extension of the same doctrine to geographical indication concepts.¹⁸⁹

Under U.S. trademark law, certification marks, owned by trade associations rather than the individual producers, may be used to designate a geographical origin.¹⁹⁰ So, in effect, it serves as a geographical indication. There are three types of certification marks: those which certify that a product originated in a geographical region; those that certify a minimum standard of quality; and those that certify a producer's membership in an organization.¹⁹¹

1. Genericization

U.S. law does not, however, protect geographical terms that are factually found to be generic.¹⁹² Arguably, neither should the rest of the world. Trademark law does not protect generic marks, and a geographical indication that has become generic should not be protected. It is a factual question how many of the wine designations are genericized at this point. To many individuals in the U.S., it is champagne or chablis no matter where the grapes were grown and the wine was bottled. One scholar proposes using the U.S. trademark registration model as the international

person other than its owner, or (2) which its owner has a bona fide intention to permit a person other than the owner to use in commerce and files an application to register on the principal register established by this chapter, to certify regional or other origin, material, mode of manufacture, quality accuracy, or other characteristics of such person's goods or services or that the work or labor on the goods or services was performed by a union or other organization.

Id. (citing the Trademark Act § 1127). Staten clarifies the statute with the following:

In other words, a certification mark is "protected like a trademark but is still a distinct kind of mark," which indicates to consumers that the goods or services have met certain quality standards or originate from a particular region or were produced [in a particular region]. The owner of the certification mark certifies that the goods or services on which the certification mark is used have those qualities. As a basic rule, the owner of a certification mark does not have the right to use the mark. This principle is known as the "anti-use by owner rule."

Id. at 236–37 (quoting Albrecht Conrad, *The Protection of Geographical Indications in the TRIPS Agreement*, 86 TRADEMARK REP. 11, 21 (1996); and Marcus Hopperger, Introduction to Geographical Indications and Recent Developments in the World Intellectual Property Organization (WIPO), http://www.wipo.int/meetings/2003/geo-ind/en/documents/pdf/wipo_geo_sfo_03_1.pdf (June 12, 2003)) (citations omitted).

¹⁸⁹ Torsen, *supra* note 11, at 48.

¹⁹⁰ Staten, *supra* note 11, at 237 ("[A]n organization such as a trade association, which does not have an economic interest in sales of the products may own a mark used to certify the geographic origin of products of its members.").

¹⁹¹ *Id.* at 237.

¹⁹² *Id.* at 240.

model for geographical indication protection and regulation.¹⁹³ The Old World effectively wants trademark protection for geographical indications,¹⁹⁴ so it should accept the well-developed legal parameters of trademark law. The interests actually being protected are the same in geographical indication and trademark.¹⁹⁵

The scholars indicate that the problem with the proposed extension advanced by the Old World countries is the desire to turn back the clock on genericization and obtain protection for terminology that has indeed lost its valuable meaning in much of the world. The word "champagne" now fails to impress upon the consumer that the name designates a certain quality associated with the place from whence it supposedly came. It no longer even means to consumers that the item came from that place. The designation is merely a sentimental reference to days of yore; it no longer designates anything of value beyond the carbonation and the color. While individual nations may advocate it, well-reasoned law is not prepared to turn back the hands of time.

The *Abercrombie & Fitch* case addressed in Part I.B.2 considered the protectability of generic terms.¹⁹⁶ There, it was the word "safari." The court held that generic terms are not protectable unless they develop a secondary meaning. That means that the term becomes associated in the consumer's mind with a product that is not just related to safaris. A subsequent case, *Murphy Door Bed Co. v. Interior Sleep Systems, Inc.*, held "that 'Murphy bed' is a generic term, having been appropriated by the public to designate generally a type of bed."¹⁹⁷ In short, Murphy Door Bed Co. lost its trademark in its name, just as Bayer lost its trademark in "aspirin." The *Murphy Door Bed Co.* case was relied on in *Harley-Davidson, Inc. v. Grottanelli*,¹⁹⁸ which held that once a term becomes generic, it cannot be "degenericized," and

¹⁹³ *Id.* at 242.

¹⁹⁴ *Id.* at 241.

The Old School views trademarks as intellectual property rights. Their view of geographical indications, however, is irreconcilable since geographical indications and trademarks are fundamentally similar. Trademarks are source indicators. Geographical indications are source indicators. Both trademarks and geographical indications are quality indicators. And like trademarks, geographical indications are business interests. Additionally, extension opponents point out that, "the fact that Articles 22-24 of the TRIPS Agreement create an inextricable link between trademarks and geographical indications bolsters the philosophic perspective of geographical indications as a special form of trademark."

Id. (citations omitted).

¹⁹⁵ Torsen, *supra* note 11, at 51.

¹⁹⁶ 537 F.2d 4 (2d Cir. 1976).

¹⁹⁷ 874 F.2d 95, 97 (2d Cir. 1989), *aff'd in part* 687 F. Supp. 754 (E.D.N.Y. 1988).

¹⁹⁸ 164 F.3d 806 (2d Cir. 1999), *remanded to* 91 F. Supp. 2d 544 (W.D.N.Y. 2000).

thus become protected by trademark law once again. In *Harley-Davidson*, the term was “hog.”¹⁹⁹ The court held that “the word ‘hog’ had become generic as applied to large motorcycles before Harley-Davidson began to make trademark use of ‘HOG’ and that Harley-Davidson’s attempt to withdraw this use of the word from the public domain cannot succeed.”²⁰⁰

Were the same reasoning applied to the wine names, such as “champagne,” no protection as a trademark could be reinstated. If geographical indications are treated consistently with competition law theory in U.S. jurisprudence, judicially developed trademark law will not permit re-protection of the term “champagne.” Thus, the legal system in the U.S. is left with a discrepancy between TRIPS, agreements negotiated to enforce its provisions, and the Office of the United States Trade Representative and TTB regulations on one side, and well-reasoned, consumer-cognizant competition and trademark law on the other. Two dictionary definitions describe “champagne” as either white sparkling wine from the Champagne region of France or any white sparkling wine made in that manner.²⁰¹

The scholars who say it is time for the U.S. to change its law to protect its own wine industry are adhering to practical international marketing logic. But they are inadvertently advocating a rejection of a logical and intricate economic model that has proved to be valuable to the wealth of private enterprises in the U.S. It is wiser to advocate some compromise that will retain the competition model to which U.S. citizens are accustomed, giving recognition of consumer power to name and association, while still respecting the traditions embraced by geographical indication protection.

2. Collective and Certification Marks

The Lanham Act makes collective and certification marks

¹⁹⁹ *Id.* at 808. The court made much of the fact that Harley had previously rejected the term as derogatory for its bikes. Harley sought to dissociate itself from the Hell’s Angels and other rough biker gangs that were associated in the public mind with Harleys. Later, when the term “hog” became trendy to describe the clunky Harleys, the company sought to reclaim the term as its own. *Id.* at 809. It is unknown how much this flip-flop by the company affected the court’s holding and whether it will remain good law. It does appear to be based on fairly sound reasoning.

²⁰⁰ *Id.* at 808.

²⁰¹ See, for example, WEBSTER’S NEW WORLD DICTIONARY OF THE AMERICAN LANGUAGE (David B. Guralnik ed., William Collins + World Publishing Co. 2d coll. ed. 1974), which defines champagne as: “1. any of various wines produced in Champagne, France 2. a) now, any effervescent white wine made there or elsewhere: regarded as a symbol of luxurious living b) the typical color of such wine; pale, tawny yellow or greenish yellow.”

registrable,²⁰² so presumptively they are protectable. They include “indications of regional origin.”²⁰³ Geographical names have been registered as certification marks.²⁰⁴ The common law of unfair competition also recognizes certification marks as protectable under unfair competition doctrines.²⁰⁵ The federal law contemplates the concept of geographical indications as consumer assurances of quality and origin. The U.S. also recognizes geographical indications through its law on collective marks, when those geographical indications are used by a collective group to indicate membership.²⁰⁶ The members of the group own the mark, unlike certification marks. Collective marks are privately enforced through individual member actions.²⁰⁷

Since there is already U.S. law that addresses the subject, incorporating international law concepts into domestic law is wise for two reasons. First, it makes the law consistent and predictable. Second, it makes the law understandable by the courts which apply the law. Trademark law in the EU operates in this fashion; each member has to create and change its domestic law to reflect and be consistent with EU law. As previously mentioned, the U.S. legal system, consisting of both state and federal law, is already accustomed to preventing conflict within its two-tiered structure, and so has already proven that it is capable of achieving the above purposes.

Collective marks are owned and policed by a group, usually the producers themselves.²⁰⁸ Certification marks are owned and policed by a different entity than the users of the mark.²⁰⁹ Trademark law, which deals with both collective and certification

²⁰² 15 U.S.C. § 1054 (2000).

²⁰³ *Id.* (“[C]ollective and certification marks, including indications of regional origin, shall be registrable under this Chapter . . .”).

²⁰⁴ *See, e.g.,* *Community of Roquefort v. William Faehndrich, Inc.*, 303 F.2d 494, 497 (2d Cir. 1962) (“[A] geographical name may be registered as a certification mark even though it is primarily geographically descriptive.”).

²⁰⁵ RESTATEMENT (THIRD) OF UNFAIR COMPETITION § 11 (1995). *See also* 3 MCCARTHY, *supra* note 7, § 19:90, at 19-265 to 19-266. “The Restatement takes the position that certification marks do exist at common law. For example, the Trademark Board held that the term COGNAC was not a generic name for brandy and was a valid common law certification mark certifying that the brandy came from the Cognac region of France.” *Id.* § 19:90, at 19-266; *see also* *Institut National Des Appellations d’Origine v. Brown-Forman Corp.*, 47 U.S.P.Q.2d 1875 (T.T.A.B. 1998).

²⁰⁶ 3 MCCARTHY, *supra* note 7, § 19:99, at 19-290.

²⁰⁷ 3 MCCARTHY, *supra* note 7, §§ 19:98–19:101, at 19-289 to 19-294.3.

²⁰⁸ 15 U.S.C. § 1127 (2000) (“The term ‘collective mark’ means a trademark or service mark—(1) used by the members of a cooperative, an association, or other collective group or organization, or (2) which such cooperative, association, or other collective group or organization has a bona fide intention to use in commerce . . .”); 3 MCCARTHY, *supra* note 7, § 19:98, at 19-289.

²⁰⁹ 3 MCCARTHY, *supra* note 7, § 19:91, at 19-266 (defining “certification mark” as a “mark owned by one person and used by others in connection with their goods or services to certify quality, regional or other origin.”).

marks, lends itself nicely to adoption of TRIPS' geographical indication provisions.

A foodstuff example for certification marks is Roquefort, recognized as a mark certifying that the cheese has been cured in caves in Roquefort, France, from sheep's milk from the region.²¹⁰ As discussed in *Abercrombie & Fitch*,²¹¹ descriptive terms are not highly protected, but may be recognized and protected. If, however, the term is found to have become generic, then the registration application can be denied or the registration can be cancelled.²¹²

CONCLUSION

Geographical indications have long been recognized in Old World countries with fine manufacturing reputations. The concept has now become part of the international law regulating protection of intellectual property. How the newly embraced concept will fit into nations' already developed intellectual property constructs remains to be seen. In the U.S., if geographical indication doctrines become part of trademark law, the carefully crafted logic of trademark law may be unable to sustain the same level of protection for geographical indications as is advocated by some Old World countries.

U.S. trademark law protects a business's economic interests by encouraging consumers to associate a word or mark with the business and its products. Trademark law has well-developed parameters and protects economic interests. The more recent recognition of protection for geographical indications has strained the seams of trademark law. When a conflict arises, which law is paramount? For example, "Champagne" is a place in France and the name for a specific type of wine that was developed there. In the U.S., the word "champagne" cannot be trademarked because among consumers, it is not associated with a certain product of a certain business. However, under international law the word "champagne" is protected as a geographical indication so that other producers of wines like it cannot describe their wines as "champagne."

The U.S. does not broadly protect geographical indications, but it should provide broader protection than currently exists. It should develop a clear approach consistent with its trademark law. This would benefit both international and domestic businesses. The constructs for appropriate levels of protection may

²¹⁰ *Id.* § 19:91, at 19-268.

²¹¹ *Abercrombie & Fitch Co. v. Hunting World, Inc.*, 537 F.2d 4 (2d Cir. 1976).

²¹² 3 MCCARTHY, *supra* note 7, § 19:91, 19-268 to 19-269.

be found in already-drafted Lanham Act language recognizing protection for collective and certification marks.

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A Case of California Champagne

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Appendix A**List of Geographical Indications Claimed by the European Union²¹³****Wines & spirits**

Beaujolais

Bordeaux

Bourgogne

Chablis

Champagne

Chianti

Cognac

Grappa di Barolo, del Piemonte, di Lombardia, del Trentino,
del Friuli, del Veneto, dell'Alto Adige

Graves

Liebfrau(en)milch

Malaga

Marsala

Madeira

Médoc

Moselle

Ouzo

Porto

Rhin

Rioja

Saint-Emilion

Sauternes

Jerez, Xerez

²¹³ Press Release, European Commission, *supra* note 90. This list was created by the EU for negotiation purposes. The EU proposed that these geographic indicators be protected. According to the EU, the list also covers translations, such as "Burgundy," "Champaña," "Coñac," "Port," "Sherry," "Parmesan/o," "Parma ham." Transliterations in other alphabets, such as "КОГНЯК" for Cognac, are also covered. The EU adds to this list when other countries with geographical indications accede to the EU.

Other products

Asiago

Azafrán de la Mancha

Comté

Feta

Fontina

Gorgonzola

Grana Padano

Jijona y Turrón de Alicante

Manchego

Mortadella Bologna

Mozzarella di Bufala Campana

Parmigiano Reggiano

Pecorino Romano

Prosciutto di Parma

Prosciutto di San Daniele

Prosciutto Toscano

Queijo São Jorge

Reblochon

Roquefort

Appendix B**Agreement on Trade-Related Aspects of
Intellectual Property Rights****SECTION 3: GEOGRAPHICAL INDICATIONS*****Article 22******Protection of Geographical Indications***

1. Geographical indications are, for the purposes of this Agreement, indications which identify a good as originating in the territory of a Member, or a region or locality in that territory, where a given quality, reputation or other characteristic of the good is essentially attributable to its geographical origin.

2. In respect of geographical indications, Members shall provide the legal means for interested parties to prevent:

- (a) the use of any means in the designation or presentation of a good that indicates or suggests that the good in question originates in a geographical area other than the true place of origin in a manner which misleads the public as to the geographical origin of the good;
- (b) any use which constitutes an act of unfair competition within the meaning of Article 10*bis* of the Paris Convention (1967).

3. A Member shall, *ex officio* if its legislation so permits or at the request of an interested party, refuse or invalidate the registration of a trademark which contains or consists of a geographical indication with respect to goods not originating in the territory indicated, if use of the indication in the trademark for such goods in that Member is of such a nature as to mislead the public as to the true place of origin.

4. The provisions of the preceding paragraphs of this Article shall apply to a geographical indication which, although literally true as to the territory, region or locality in which the goods originate, falsely represents to the public that the goods originate in another territory.

Article 23***Additional Protection for Geographical Indications
for Wines and Spirits***

1. Each Member shall provide the legal means for interested

parties to prevent use of a geographical indication identifying wines for wines not originating in the place indicated by the geographical indication in question or identifying spirits for spirits not originating in the place indicated by the geographical indication in question, even where the true origin of the goods is indicated or the geographical indication is used in translation or accompanied by expressions such as “kind”, “type”, “style”, “imitation” or the like.²¹⁴

2. The registration of a trademark for wines which contains or consists of a geographical indication identifying wines or for spirits which contains or consists of a geographical indication identifying spirits shall be refused or invalidated, *ex officio* if domestic legislation so permits or at the request of an interested party, with respect to such wines or spirits not having this origin.

3. In the case of homonymous geographical indications for wines, protection shall be accorded to each indication, subject to the provisions of paragraph 4 of Article 22 above. Each Member shall determine the practical conditions under which the homonymous indications in question will be differentiated from each other, taking into account the need to ensure equitable treatment of the producers concerned and that consumers are not misled.

4. In order to facilitate the protection of geographical indications for wines, negotiations shall be undertaken in the Council for Trade-Related Aspects of Intellectual Property Rights concerning the establishment of a multilateral system of notification and registration of geographical indications for wines eligible for protection in those Members participating in the system.

Article 24

International Negotiations; Exceptions

1. Members agree to enter into negotiations aimed at increasing the protection of individual geographical indications under Article 23. The provisions of paragraphs 4–8 below shall not be used by a Member to refuse to conduct negotiations or to conclude bilateral or multilateral agreements. In the context of such negotiations, Members shall be willing to consider the continued applicability of these provisions to individual geographical indications whose use was the subject of such negotiations.

²¹⁴ Notwithstanding the first sentence of Article 42, Members may, with respect to these obligations, instead provide for enforcement by administrative action.

2. The Council for Trade-Related Aspects of Intellectual Property Rights shall keep under review the application of the provisions of this Section; the first such review shall take place within two years of the entry into force of the Agreement Establishing the MTO. Any matter affecting the compliance with the obligations under these provisions may be drawn to the attention of the Council, which, at the request of a Member, shall consult with any Member or Members in respect of such matter in respect of which it has not been possible to find a satisfactory solution through bilateral or plurilateral consultations between the Members concerned. The Council shall take such action as may be agreed to facilitate the operation and further the objectives of this Section.

3. In implementing this Section, a Member shall not diminish the protection of geographical indications that existed in that Member immediately prior to the date of entry into force of the Agreement Establishing the MTO.

4. Nothing in this Section shall require a Member to prevent continued and similar use of a particular geographical indication of another Member identifying wines or spirits in connection with goods or services by any of its nationals or domiciliaries who have used that geographical indication in a continuous manner with regard to the same or related goods or services in the territory of that Member either (a) for at least ten years preceding the date of the Ministerial Meeting concluding the Uruguay Round of Multilateral Trade Negotiations or (b) in good faith preceding that date.

5. Where a trademark has been applied for or registered in good faith, or where rights to a trademark have been acquired through use in good faith either:

- (a) before the date of application of these provisions in that Member as defined in Part VI; or
- (b) before the geographical indication is protected in its country of origin;

measures adopted to implement this Section shall not prejudice eligibility for or the validity of the registration of a trademark, or the right to use a trademark, on the basis that such a trademark is identical with, or similar to, a geographical indication.

6. Nothing in this Section shall require a Member to apply its provisions in respect of a geographical indication of any other

Member with respect to goods or services for which the relevant indication is identical with the term customary in common language as the common name for such goods or services in the territory of that Member. Nothing in this Section shall require a Member to apply its provisions in respect of a geographical indication of any other Member with respect to products of the vine for which the relevant indication is identical with the customary name of a grape variety existing in the territory of that Member as of the date of entry into force of the Agreement Establishing the MTO.

7. A Member may provide that any request made under this Section in connection with the use or registration of a trademark must be presented within five years after the adverse use of the protected indication has become generally known in that Member or after the date of registration of the trademark in that Member provided that the trademark has been published by that date, if such date is earlier than the date on which the adverse use became generally known in that Member, provided that the geographical indication is not used or registered in bad faith.

8. The provisions of this Section shall in no way prejudice the right of any person to use, in the course of trade, his name or the name of his predecessor in business, except where such name is used in such a manner as to mislead the public.

9. There shall be no obligation under this Agreement to protect geographical indications which are not or cease to be protected in their country of origin, or which have fallen into disuse in that country.

Religion, Politics, and the Establishment Clause: Does God Belong in American Public Life?

*L. Scott Smith**

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INTRODUCTION: CULTURE WAR AND RELIGION

There is unquestionably a growing cultural divide in this country, a polarization that resembles nothing so much as a war. Rather than being fought with guns and bayonets, the implements of the fight are ideas or, more precisely, political world-views. The battlefronts span the horizons of intellectual endeavor. Disciplines such as science, ethics, education, law, and journalism are inescapably involved. None of them, however, constitutes the most fundamental fault line of the conflict. That distinction belongs to religion; and why should this fact be surprising? Paul Tillich, and Friedrich Schleiermacher before him, reminded us years ago that there is a symbiotic relationship between religion and culture. Schleiermacher, addressing the "cultured despisers" of religion, described it as "the profoundest depths whence every feeling and conception receives its form."¹ Tillich, in a similar vein, wrote that "religion is the substance of culture, [while] culture is the form of religion."² The roots of the current cultural tug-of-war lie deeply embedded in the participants' respective political assessments of religion, whether orthodox and fundamentalist or liberal and progressive. Hence, when one speaks of such a "culture war," one question becomes relevant—"Does God belong in American public life?"

¹ FRIEDRICH SCHLEIERMACHER, ON RELIGION: SPEECHES TO ITS CULTURED DESPISERS 11 (John Oman trans., Harper Torchbooks 1958) (1799).

² PAUL TILlich, THEOLOGY OF CULTURE 42 (Robert C. Kimball ed., Oxford Univ. Press 1972) (1959).

A. Approach to the Question

The question is a weighty one, and the answers provided by commentators are often characterized by subtle nuance and meticulous qualification. A social pundit may respond negatively to a state Supreme Court Justice who, hearing the appeal of a child custody case, quotes Leviticus 18:22 in condemnation of the lesbianism of the mother.³ But the same pundit may be reserved in his or her criticism when a United States President concludes his inaugural address with the words “God bless America.” Gradations of criticism tend to be part and parcel of any expanded treatment of the above-stated question.

Yet it lies beyond the scope of this article to probe these multifarious distinctions. The goal here is a modest one. I will first consider whether public life in this country was initially intended under the newly proposed Constitution of 1787 to be a secular affair, and I will argue that the answer is far from a definitive “yes.” I will then seek to explain why, in light of the indecisive answers that history gives us, the American public sphere is largely a secular place and what the U.S. Supreme Court’s role has been in that process, from approximately the middle of the twentieth century to the present.

To fulfill this goal, in Parts I and II of this Article, I will set forth and analyze the thesis of Kramnick and Moore that ours is a “Godless Constitution”⁴ intended to comprise the foundation of a secular state. In Parts III and IV, I will describe the tidal wave of secularism that overwhelmed American culture in the nineteenth century and critically analyze the manner in which the Supreme Court rode that cultural wave in its interpretation of the Establishment Clause during the twentieth century. In Parts V and VI, I will dissect the Court’s two recent decisions regarding the public display of the Ten Commandments⁵ and then analyze the opinions advanced by the various Justices. Finally, I will conclude with some of my thoughts concerning how the Supreme Court should interpret the Religion Clauses.

I. HIGHLIGHTS OF KRAMNICK’S AND MOORE’S ARGUMENT

A. The Thesis

Kramnick and Moore argue in favor “of the godless Constitu-

³ See *Chicoine v. Chicoine*, 479 N.W.2d 891, 896 (S.D. 1992) (Henderson, J., concurring in part; dissenting in part).

⁴ ISAAC KRAMNICK & R. LAURENCE MOORE, *THE GODLESS CONSTITUTION: A MORAL DEFENSE OF THE SECULAR STATE* (2005) (1996) [hereinafter *GODLESS CONSTITUTION*].

⁵ *Van Orden v. Perry*, 125 S. Ct. 2854, 2856 (2005) and *McCreary v. ACLU of Kentucky*, 125 S. Ct. 2722, 2727–28 (2005).

tion and of godless politics.”⁶ They insist that the Founders “sought to separate the operations of government from any claim⁷ that human beings can know and follow divine direction in reaching policy decisions.”⁸ The Constitution and the political state to which it gave birth were on an “intentionally secular base.”⁹ Our founding document, they point out, was vehemently denounced by many during the Framers’ own time as a godless one, precisely because it was and is such.¹⁰ Nowhere within its text is there a substantive reference to deity.¹¹

B. Constitution Contrasted with Other American Documents

Consider the radical difference in this respect between the Constitution on the one hand and the Declaration of Independence and the Articles of Confederation of 1776 on the other. The Declaration mentioned “Nature’s God” and the “Creator.” The Articles similarly referred to “the Great Governor of the World.” Yet the Constitution maintains a conspicuous silence in this regard.¹²

C. Exclusion of Religious Tests

The only reference to religion that resulted from the work of the Constitutional Convention was a negative one: “no religious

⁶ GODLESS CONSTITUTION, *supra* note 4, at 12.

⁷ Kramnick and Moore take aim squarely at the Christian Right. *Id.* at 157–61. It is an obtrusive target. One more difficult than that is religion in general, which Kramnick’s and Moore’s thesis is also intended to address. That America was never intended to be a Christian state is spelled out in the Treaty of Tripoli, but that all state and state-supported activity in this country was intended to be divorced from the religious is impossible to prove. See Article II of the Treaty of Tripoli, in THE SEPARATION OF CHURCH AND STATE 121–23 (Forrest Church ed., 2004) [hereinafter SEPARATION OF CHURCH AND STATE]. See also SIDNEY E. MEAD, THE LIVELY EXPERIMENT: THE SHAPING OF CHRISTIANITY IN AMERICA 38–49 (1963) [hereinafter LIVELY EXPERIMENT]; Robert N. Bellah, *Civil Religion in America*, in BEYOND BELIEF: ESSAYS ON RELIGION IN A POST-TRADITIONAL WORLD 168 (University of California Press 1991) (1970) [hereinafter *Civil Religion*].

⁸ GODLESS CONSTITUTION, *supra* note 4, at 12. I do not altogether agree with the following statement by Erez Kalir in review of Kramnick’s and Moore’s book: “The first problem with [the book]—and the genesis of several others—lies in the authors’ failure to define exactly what they mean by the title phrase, and especially by the term ‘godless.’” Erez Kalir, *Book Review: Is the Constitution “Godless” or Just Nondenominational?*, 106 YALE L.J. 917, 919 (1996). It is reasonably clear that Kramnick and Moore have embraced the classical liberal idea that religion, personified by “God,” has no role to play in public policymaking. The authors demonstrate an indifference toward the religious that borders upon hostility.

⁹ GODLESS CONSTITUTION, *supra* note 4, at 14.

¹⁰ *Id.* at 23.

¹¹ In Article VII of the document the date is written as “the Seventeenth Day of September in the Year of our Lord one thousand seven hundred and Eighty seven.” U.S. CONST. art. VII. This reference to “our Lord” is hardly to be interpreted as a resounding expression of religious faith.

¹² GODLESS CONSTITUTION, *supra* note 4, at 28.

Test shall ever be required as a Qualification to any Office or public Trust under the United States.”¹³ Luther Martin, a delegate to the Convention from Maryland, commenting upon the almost unanimous passage of this provision, observed the following:

[T]here were some members *so unfashionable* . . . as to think that a *belief in the existence of a Deity* and of a *state of future rewards and punishments* would be some security for the good conduct of our rulers, and that in a Christian country it would be at *least decent* to hold out some distinction between the professors of Christianity and downright infidelity or paganism.¹⁴

Oliver Ellsworth, a delegate to the Philadelphia Convention from Connecticut, who would later become a United States Senator and the Chief Justice of the Supreme Court, also was critical of the notion of a religious test as a qualification for public office.¹⁵ He argued that, in view of the many diverse religious denominations in the United States, “[a] test in favour of any one denomination of christians would be to the last degree absurd.”¹⁶

The Constitutional Convention’s antipathy to religious tests in the political sphere was paralleled by its refusal even to discuss Benjamin Franklin’s suggestion that each session of the Convention be opened with a prayer.¹⁷

D. Responses to the Absence of Religious Reference

The Convention’s apparent lack of enthusiasm for religion, along with the secular bent of the Constitution itself, did not go unnoticed by the American citizenry. Colonel William Jones, a delegate to Massachusetts’ ratification convention, was outspoken against the document’s exclusion of religious oaths, declaring that “publick men were to be of those who had a good standing in

¹³ U.S. CONST. art. VI.

¹⁴ GODLESS CONSTITUTION, *supra* note 4, at 29 (quoting Luther Martin). Martin’s estimate of this provision is the same as that of the Reverend Daniel Shute, who in the Massachusetts ratification convention spoke in favor of it, when he stated:

Nor is there to me any conceivable advantage, sir, that would result in the *whole* from such a test. Unprincipled and dishonest men will not hesitate to subscribe to *any thing*, that may open the way for their advancement, and put them into a situation the better to execute their base and iniquitous designs. Honest men alone, therefore, however well qualified to serve the publick, would be excluded by it, and their country be deprived of the benefit of their abilities.

The Reverend Daniel Shute and Colonel William Jones on Religious Tests and Christian Belief (Jan. 31, 1788), in *THE DEBATE ON THE CONSTITUTION*, pt. 1, at 919 (Bernard Bailyn ed., Library of America 1993) [hereinafter *THE DEBATE ON THE CONSTITUTION*].

¹⁵ GODLESS CONSTITUTION, *supra* note 4, at 42.

¹⁶ Oliver Ellsworth, “A Landholder” VII, *CONN. COURANT* (Hartford), Dec. 17, 1787, in *THE DEBATE ON THE CONSTITUTION*, *supra* note 14, pt. 1, at 523.

¹⁷ GODLESS CONSTITUTION, *supra* note 4, at 34.

the church” and “that a person could not be a good man without being a good Christian.”¹⁸ Henry Abbot, a North Carolinian, echoed the concern of many that “[t]he exclusion of religious tests is . . . dangerous and impolitic,” and concluded “that if there be no religious test required, Pagans, Deists and Mahometans might obtain offices among us, and that the Senate and Representatives might all be Pagans.”¹⁹ The Reverend David Caldwell, also from North Carolina, took an equally negative view of the religious oath exclusion. For him, it amounted to little more than “an invitation to ‘Jews and pagans of every kind’ to govern us.”²⁰

William Williams, a delegate to the Connecticut ratification convention, was uneasy and troubled by the lack of any acknowledgment in the Constitution of “the being of a God . . . [and] his perfections and his providence.”²¹ He favored editing its Preamble, suggesting that its opening words be the following:

We the people of the United States, in a firm belief of the being and perfections of the one living and true God, the creator and supreme Governour of the world, in his universal providence and the authority of his laws: that he will require of all moral agents an account of their conduct, that all rightful powers among men are ordained of, and mediately derived from God, therefore in a dependence on his blessing and acknowledgment of his efficient protection in establishing our Independence, whereby it is become necessary to agree upon and settle a Constitution of federal government for ourselves ²²

The suggestion failed to find a winning following.

Kramnick and Moore observe that a similar suggestion, made during the height of the Civil War, also went nowhere. In 1863, the National Association for the Amendment of the Constitution, soon renamed the National Reform Association and directed by Presbyterian layman John Alexander, proposed the following alteration of the Preamble:

We, the people of the United States, humbly acknowledging Almighty God as the source of all authority and power in civil government, The Lord Jesus Christ as the Governor among the Nations, and His revealed will as of supreme authority, in order to constitute a

¹⁸ *Id.* at 32. See also *The Reverend Daniel Shute and Colonel William Jones on Religious Tests and Christian Belief*, *supra* note 14, at 920.

¹⁹ *Henry Abbot and James Iredell Debate the Ban on Religious Tests: Could Not the Pope Be President?* (July 30, 1788), in *THE DEBATE ON THE CONSTITUTION*, *supra* note 14, pt. 2, at 902.

²⁰ *GODLESS CONSTITUTION*, *supra* note 4, at 32 (quoting *Rev. David Caldwell and Samuel Spencer Continue the Debate on Religious Toleration*, in *THE DEBATE ON THE CONSTITUTION* (July 30, 1788), *supra* note 14, pt. 2, at 908).

²¹ *William Williams to the Printer* (Feb. 11, 1788), in *THE DEBATE ON THE CONSTITUTION*, *supra* note 14, pt. 2, at 193. See also *GODLESS CONSTITUTION*, *supra* note 4, at 37.

²² *William Williams to the Printer*, *supra* note 21, at 193–94 (emphasis omitted).

Christian government . . . do ordain and establish this Constitution for the United States of America.²³

The proposal was brought to the attention of President Lincoln who, while respectful of and cordial to those who supported it, observed that “the work of amending the Constitution should not be done hastily.”²⁴ The President, in the secular spirit of the Founders, simply allowed the proposal to die its own natural death.

This evidence, according to our authors, demonstrates that the lack of substantive religious reference in the Constitution, as the document emerged from the Philadelphia Convention, was hardly a happenstance, but was intended by its Framers, and later accepted by the states and thoughtful leaders like Lincoln who came along in American history, to convey a strong message in favor of the separation of church and state.²⁵

E. Roger Williams: Religion and Secular Politics

The doctrine of church-state separation was, Kramnick and Moore maintain, solidly embedded in liberal and religious thought, both in America and in England. The roots of the doctrine in this country go back to the religious leader Roger Williams, who pioneered it in his book, *The Bloudy Tenant of Persecution*.²⁶ Religious purity and good government were, for him, two separate and distinct concerns.²⁷ There was, he taught, no necessary correlation between being a good and steadfast governmental official on the one hand and a religious believer on the other.²⁸ Nor would there ever be justifiable cause for the government to support religion, either directly or indirectly, since the Kingdom of God was and is not of this world.²⁹ Williams subscribed to the proposition that religion is fundamentally a private concern of conscience.³⁰ Although he never went so far as to maintain that religious belief is irrelevant to public policy,³¹ believing as he did that elected officials were not immune from religious influence³² and that the state should, in keeping with the Ten Commandments, enjoin murder, thievery, and adultery,³³

²³ GODLESS CONSTITUTION, *supra* note 4, at 146.

²⁴ *Id.* at 146–47.

²⁵ *Id.* at 12, 66.

²⁶ *Id.* at 48; ROGER WILLIAMS, *THE BLOODY TENANT OF PERSECUTION FOR CAUSE OF CONSCIENCE* (Richard Groves ed., Mercer Univ. Press 2001) (1644).

²⁷ GODLESS CONSTITUTION, *supra* note 4, at 52.

²⁸ *See id.* at 53–54.

²⁹ *See id.* at 52.

³⁰ *Id.* at 59–60.

³¹ *Id.* at 53.

³² *Id.* at 61.

³³ *Id.* at 60.

Williams was strongly insistent that religious morality should be distinguished from national pieties and that governmental officials should never claim to act in God's name or under his authority.³⁴

F. The Lockean State and Religious Freedom

Religious freedom, understood through the frame of church-state separation, had been advocated not only by the influentially religious in America, but had also been promoted and defended by the most thoughtfully liberal in England, with John Locke being the foremost example. Kramnick and Moore stress that American personages such as John Adams, John Otis, Samuel Adams, James Madison, Thomas Jefferson, Patrick Henry, and Benjamin Franklin were supremely indebted to Locke's intellectual treasury.³⁵ He believed in a minimal government, the function of which was to preserve life, liberty, and especially property and, aside from that, was to stay out of people's lives.³⁶ One's right to secure property is accorded by God and natural law,³⁷ and government treads upon this right at the expense of violating nature and becoming tyrannous.³⁸ Locke's conception of government is therefore, according to our authors, "purely negative."³⁹ It does little more than to establish the ground rules by which to compete for wealth and property.⁴⁰ By no means should the political state attempt to defend or to promote moral and religious truths or any particular notion of good.⁴¹

Locke's minimalist, or *laissez faire*, view of government allows him to draw a bold line of demarcation between political and religious issues. The government must take care not to encroach upon the latter, which is solely a matter of private provenance.⁴² Religious beliefs do not concern the state; they neither prejudice

³⁴ *Id.* at 61.

³⁵ *Id.* at 72.

³⁶ *Id.* at 73. See also JOHN LOCKE, *The Second Treatise of Government*, in TWO TREATISES OF GOVERNMENT 178 (Mark Goldie ed., Everyman 1993) (1689), in which the author maintains that a person is willing to leave the state of nature and to unite with others "for the mutual preservation of their lives, liberties and estates, which I call by the general name, property." Locke stresses that the protection of one's property is the primary rationale for government. *Id.*

³⁷ LOCKE, *supra* note 36, at 130–31.

³⁸ See *id.* at 217. Locke quotes King James I as saying, "whereas the proud and ambitious tyrant doth think, his kingdom and people are only ordained for satisfaction of his desires . . . the righteous and just king doth by the contrary acknowledge himself to be ordained for the procuring of the wealth and property of his people." *Id.*

³⁹ GODLESS CONSTITUTION, *supra* note 4, at 73.

⁴⁰ *Id.*

⁴¹ *Id.* at 73–74.

⁴² *Id.* at 75. See also JOHN LOCKE, A LETTER CONCERNING TOLERATION 28–29 (Prentice Hall 1950) (1689) [hereinafter TOLERATION], in which he argues that religion is a private, personal matter.

another's property rights nor injure him or her in any way.⁴³ These structural limitations serve to carve out an ample area for the free, unmolested exercise of religion and for the mutual toleration of sectarian differences.⁴⁴ For Locke, civil government is concerned with outward force, while "[a]ll the life and power of true religion consist in the inward and full persuasion of the mind."⁴⁵ The punitive power of the state can never be of assistance in the salvation of souls,⁴⁶ for the church is "a thing absolutely separate and distinct from the commonwealth."⁴⁷

Locke's vision of religious freedom, conceptualized as a private sphere of ritual and belief, to be distinguished and separated from the public domain of the state, deeply imbued itself upon the minds of the Framers and was reflected in the secular character of the Constitution that they proposed.⁴⁸

G. Thomas Jefferson and the "Wall Of Separation"

1. Jefferson and Locke

Thomas Jefferson regarded Locke as one of "the three greatest men that have ever lived, without any exception."⁴⁹ Jefferson was familiar with the latter's *Second Treatise of Government*, and on at least one occasion commended it to a friend as one of a group of excellent and influential works concerning politics.⁵⁰

Locke's minimalist state appealed to Jefferson.⁵¹ Both men

⁴³ GODLESS CONSTITUTION, *supra* note 4, at 78.

⁴⁴ See TOLERATION, *supra* note 42, at 17, in which Locke explains that "[c]ivil interests" consist of "life, liberty, health, and indolency of body; and the possession of outward things, such as money, lands, houses, furniture, and the like," and that the jurisdiction of the state "reaches only to these civil concerns . . . and that it neither can nor ought in any manner to be extended to the salvation of souls."

⁴⁵ *Id.* at 18.

⁴⁶ *Id.* at 19.

⁴⁷ *Id.* at 27.

⁴⁸ GODLESS CONSTITUTION, *supra* note 4, at 77–78.

⁴⁹ See FRANK LAMBERT, *THE FOUNDING FATHERS AND THE PLACE OF RELIGION IN AMERICA* 161 (2003) [hereinafter *THE FOUNDING FATHERS*] (pointing out that Jefferson commissioned John Trumbull as artist to paint portraits of Francis Bacon, Isaac Newton, and John Locke on the same canvas in order that these personages might be given a place of honor at Monticello and "not be confounded at all with the herd of other great men") (quoting THOMAS JEFFERSON, *To John Trumbull*, in *THE PORTABLE THOMAS JEFFERSON* 434, 435 (Merrill D. Peterson ed., Penguin Books 1977) (1975)). Compare NOBLE E. CUNNINGHAM, JR., *IN PURSUIT OF REASON: THE LIFE OF THOMAS JEFFERSON* 129 (Ballantine Books 1988) (1987), where the author relates that Jefferson "asked Trumbull to purchase for him in England [portraits] of Bacon, Locke, and Newton."

⁵⁰ GODLESS CONSTITUTION, *supra* note 4, at 82. Jefferson describes the work as "Locke's little book on government." *Id.*

⁵¹ *Id.* at 70. When describing Jefferson's view of the state, Kramnick and Moore write: "That government was best which governed least, as Jefferson put it." *Id.* It should be noted that there is no evidence that the third President ever wrote or uttered such words. While they are often attributed to him in error, they accurately portray his understanding.

avored and supported a policy of laissez faire not only in politics, but also in religion. Kramnick and Moore observe that “[t]he Declaration of Independence reads like a paraphrase”⁵² of the *Second Treatise*. They also point out that, in his *Notes on the State of Virginia*, Jefferson wrote of religion that “it does me no injury for my neighbor to say there are twenty gods, or no god. It neither picks my pocket nor breaks my leg.”⁵³ The passage brings to mind the words of Locke, who argued that religious matters should not be regulated by the state, “because they are not prejudicial to other men’s rights, nor do they break the public peace of societies.”⁵⁴ Both thinkers, state Kramnick and Moore, were committed to the idea that religion has no place in the public and political sector, but belongs exclusively to the realm of personal and private opinion.⁵⁵

2. A Bill for Establishing Religious Freedom

Jefferson’s understanding of the relationship between church and state was enacted into Virginia law in 1786. Styled “A Bill for Establishing Religious Freedom,” it stated in part

that no man shall be compelled to frequent or support any religious worship, place, or ministry whatsoever, nor shall be enforced, restrained, molested, or burthened in his body or goods, nor shall otherwise suffer, on account of his religious opinions or belief; but that all men shall be free to profess, and by argument to maintain, their opinions in matters of religion, and that the same shall in no wise diminish, enlarge, or affect their civil capacities.⁵⁶

The bill was shepherded through the Virginia Assembly by none other than master strategist James Madison and, in the estimation of Kramnick and Moore, constituted a “comprehensive call for a total separation of church and state.”⁵⁷ The clergy, as might be expected, condemned the measure as indicative of a disregard for public worship and an indifference to religion.⁵⁸

3. Jefferson and the Clergy

Our authors further note that Jefferson had little use for the clergy. Many of them reciprocated the animus and thought that

⁵² *Id.* at 72.

⁵³ THOMAS JEFFERSON, NOTES ON THE STATE OF VIRGINIA, QUERY XVII (1787), reprinted in THOMAS JEFFERSON, WRITINGS 283, 285 (Merrill D. Peterson ed., 1984) [hereinafter WRITINGS].

⁵⁴ TOLERATION, *supra* note 42, at 42; see GODLESS CONSTITUTION, *supra* note 4, at 87.

⁵⁵ GODLESS CONSTITUTION, *supra* note 4, at 96.

⁵⁶ THOMAS JEFFERSON, *A Bill for Establishing Religious Freedom* (1789), reprinted in WRITINGS, *supra* note 53, at 346, 347.

⁵⁷ GODLESS CONSTITUTION, *supra* note 4, at 92.

⁵⁸ *Id.* at 91–92.

his election to the Presidency would jeopardize their place in American life. Jefferson privately responded to their dislike of him in a missive to his friend Benjamin Rush:

They . . . believe that any portion of power confided to me, will be exerted in opposition to their schemes. And they believe rightly: for I have sworn upon the altar of God, eternal hostility against every form of tyranny over the mind of man. But this is all they have to fear from me: and enough too in their opinion.⁵⁹

Interestingly enough, an excerpt from this passage appears in the Jefferson Memorial. Many churchgoing Americans, observe Kramnick and Moore, scarcely realize that the very words memorializing Jefferson are those which comprise an attack upon the Philadelphia clergy.⁶⁰

Yet not all clergy were averse to Jefferson. Some, like Baptist ministers Isaac Backus and John Leland, supported him in his bid to become President. These and other evangelicals resented the fact that state governments were attempting to define religious doctrines and to impose them upon everyone by force of law.⁶¹ Baptists were impressed by the fact that Jefferson had written and inspired the passage of the statute establishing religious freedom in Virginia and stood firmly for the liberty for which they had been struggling.⁶²

4. Jefferson's Correspondence with the Danbury Baptist Association

After Jefferson was elected President, Baptists from the Danbury Baptist Association in Connecticut wrote a letter to him setting forth, in part, their concern that their religious privileges in that state were enjoyed merely as "favours granted" and not as "inalienable rights."⁶³ In his letter of reply, Jefferson underscored a belief they and he shared in common, i.e., "that religion

⁵⁹ *Id.* at 69 (quoting THOMAS JEFFERSON, *Letter to Dr. Benjamin Rush* (Sept. 23, 1800), reprinted in WRITINGS, *supra* note 53, at 1080, 1082, available at <http://www.positiveatheism.org/hist/jeff1080.htm>).

⁶⁰ GODLESS CONSTITUTION, *supra* note 4, at 69.

⁶¹ *Id.* at 110–21. There were churches that separated from the Congregational establishment in New England. Some of these churches became Baptist. *Id.* at 116. Not being part of the protected religious establishment, they were still required either to pay financial support to the established church or to obtain a formal certificate declaring that they were exempt from it. *Id.* at 114–15. Backus and Leland strongly opposed the idea of a Christian commonwealth that employed sanctions of law in this manner. Although they were not disciples of Locke and were not known for being political theorists, they recognized that their view of religious freedom shared an affinity with Jefferson's liberal philosophy. *Id.* at 110–11, 116–17, 119–20.

⁶² *Id.* at 119.

⁶³ *Correspondence with the Danbury Baptist Association, 1801–1802*, in DANIEL L. DREISBACH, THOMAS JEFFERSON AND THE WALL OF SEPARATION BETWEEN CHURCH AND STATE app. 6, at 142, 143 (2002).

is a matter which lies solely between Man & his God, that he owes account to none other for his faith or his worship, [and] that the legitimate powers of government reach actions only, & not opinions.”⁶⁴ The President then stated the following: “I contemplate with sovereign reverence that act of the whole American people which declared that *their* legislature should ‘make no law respecting an establishment of religion, or prohibiting the free exercise thereof,’ thus building a wall of separation between Church & State.”⁶⁵ According to Kramnick and Moore, Baptists “gave qualified support to Jefferson’s wall of separation between church and state,” and they “agreed with [him] that America had not been founded as a Christian nation.”⁶⁶

5. Jefferson’s Respect for Separationism

Jefferson showed respect for the “wall of separation” when he abandoned the practice of his predecessors in proclaiming national days of prayer, fasting, and thanksgiving.⁶⁷ He couched his inaction in terms of the state’s not infringing upon religion rather than in terms of the churches attempting to preempt the powers of state.⁶⁸

H. Undermining the Secular Ideal

1. Religious Holidays and the Appointment of Chaplains

Kramnick and Moore point out that there have been remarkable deviations from the secular ideal of government advanced in the Constitution. Two of them involved none other than James Madison, whose views on church and state are thought to have closely approximated those of his political mentor Thomas Jefferson.⁶⁹ One deviation occurred while Madison was President. During the War of 1812, Congress requested that there be a day “of public humiliation and prayer.”⁷⁰ Under in-

⁶⁴ *Id.* at 148 (citation omitted).

⁶⁵ *Id.* (citation omitted) (quoting U.S. CONST. amend. I). Kramnick and Moore argue that Jefferson’s celebrated metaphor was inspired by James Burgh’s book *Crito*, published in 1767, in which Burgh argued that it was necessary to “build an impenetrable wall of separation between things sacred and civil.” See GODLESS CONSTITUTION, *supra* note 4, at 83 (quoting JAMES BURGH, 2 CRITO, OR ESSAYS ON VARIOUS SUBJECTS 119 (London, 1767)).

⁶⁶ GODLESS CONSTITUTION, *supra* note 4, at 119. The authors do, however, point out that Isaac Backus took issue with Jefferson on numerous points. For example, Backus did not seem to oppose the assertion that the United States was a Christian nation, and he supported a religious test for officeholders that discriminated against Roman Catholics. *Id.* at 119–20.

⁶⁷ *Id.* at 96.

⁶⁸ *Id.* at 96–97.

⁶⁹ SEPARATION OF CHURCH AND STATE, *supra* note 7, at 132.

⁷⁰ GODLESS CONSTITUTION, *supra* note 4, at 105 (quoting James Madison, *A Proclamation* (July 9, 1812), in 24 ANNALS OF CONG. 2223, available at <http://www.wallbuilders.com/resources/search/detail.php?ResourceID=39>).

tense pressure from both politicians and clerics alike, the President acceded to the request, in contravention of his apparently firmly held view that religious matters constituted no part of government polity. Another deviation occurred in 1787, when Madison was a Congressman and voted to support the appointment of chaplains to Congress, which appointment Kramnick and Moore state that he unsuccessfully opposed.⁷¹

2. The Coinage

The authors also observe that the Constitution was undermined when God entered the United States currency in 1863. During the height of the Civil War, Horace Bushnell, the famous Connecticut preacher, decried the influence of Thomas Jefferson's view that government should be a godless endeavor and interpreted the bloody carnage of the War as divine retribution for the country's acceptance of that view. Secretary of the Treasury, Salmon P. Chase, in response to such religious sentiment, decided to recommend a religious motto for one-cent and two-cent coinage. The motto finally approved by Chase and the Congress was "IN GOD WE TRUST."⁷² Thereafter, it became commonplace on United States currency.

3. Sunday Movement and Delivery of the Mail

The authors also describe the bitter conflict between the church and the state, from 1810 to 1912, over the Sunday movement and delivery of the mail.⁷³ In 1810, Congress enacted legislation which provided that the mail would move every day and that post offices would be open for at least an hour each day. By 1815, clergymen and their churches were actively urging the repeal of the legislation, although their attack upon it was ultimately unsuccessful.⁷⁴

⁷¹ GODLESS CONSTITUTION, *supra* note 4, at 105. But compare *Marsh v. Chambers*, 463 U.S. 783, 788, 788 n.8 (1983), in which Chief Justice Burger, speaking for the majority, points out that the House of Representatives elected its first chaplain on May 1, 1789, and that Madison voted for the bill authorizing payment of the chaplains for both the House and the Senate. *Id.* at 788, n.8.

⁷² See United States Department of the Treasury, Fact Sheet on the History of "In God We Trust," <http://www.ustreas.gov/education/fact-sheets/currency/in-god-we-trust.shtml> (last visited Oct. 10, 2006). According to this source, Secretary Chase was moved to the decision by a letter to him from Rev. M.R. Watkinson, from Ridleyville, Pennsylvania. A portion of the letter is as follows: "One fact touching our currency has hitherto been seriously overlooked. I mean the recognition of the Almighty God in some form on our coins." The clergyman asked, "What if our Republic were not shattered beyond reconstruction? Would not the antiquaries of succeeding centuries rightly reason from our past that we were a heathen nation?" Rev. Watkinson's suggestion was a coin with the name of God inscribed upon it. *Id.*

⁷³ See GODLESS CONSTITUTION, *supra* note 4, at ch. 7.

⁷⁴ *Id.* at 133-34.

But in 1828, a second frontal assault was directed by Christians, principally by clergyman Lyman Beecher and evangelical businessman Josiah Bissell, Jr. They urged a strategy of boycott against all companies that operated on Sunday and sent over 900 petitions to Congress demanding repeal of the 1810 legislation.⁷⁵

With the advent of the railroad and the telegraph, the commercial atmosphere in America changed significantly, with the result that seven-day mail service lost its compelling economic rationale. Kramnick and Moore point out that by the 1850s most of the Sunday movement of mail was slowed, if not eliminated, and that, in the aftermath of the Civil War, the trend grew.⁷⁶ By 1912, Congress had closed all post offices that remained open on Sunday.⁷⁷

4. "Under God" in the Pledge of Allegiance

Our authors argue that the entry of God into the Pledge of Allegiance undermined the "godless federal constitutional structure," which the Framers erected.⁷⁸ America was in the midst of the Cold War and was threatened by communism, primarily of the Soviet variety. The Knights of Columbus, the Reverend Billy Graham, President Eisenhower, and the United States Congress all believed that the country's ultimate protection from the threat was to be found "under God."⁷⁹ So in 1954, a half century after Francis Bellamy's Pledge had been adopted, the phrase "under God" was incorporated into it.⁸⁰

Contemplating the next time the Supreme Court will address Michael Newdow's claim that this phrase in the Pledge violates the Establishment Clause, Kramnick and Moore are admittedly troubled by the prospect that the Court may decide "that being religious, i.e., recognizing the existence of a deity"⁸¹ is what it means to be a patriot. They write, "[t]his should be deeply

⁷⁵ *Id.* at 135–36.

⁷⁶ *Id.* at 142.

⁷⁷ *Id.*

⁷⁸ *Id.* at 143.

⁷⁹ *Id.* at 196. See also SUSAN JACOBY, FREETHINKERS: A HISTORY OF AMERICAN SECULARISM 308 (2004). Jacoby underscores the role played by the Knights of Columbus and the Roman Catholic Church in the adoption of the "under God" language, although she makes clear that not only Catholics, but also Protestants and Jews were involved in the venture. She further explains the Roman Catholic hierarchy's leadership of the movement to incorporate the phrase into the Pledge "represented a major tactical change" on their part with regard to public education. Instead of attempting to banish all vestiges of Protestantism from the schools, the Roman Catholic leaders would support religious ideas in public schools that did not violate their own doctrine. *Id.* at 308–09.

⁸⁰ GODLESS CONSTITUTION, *supra* note 4, at 196.

⁸¹ *Id.* at 197. See also L. Scott Smith, *From Typology to Synthesis: Re-Casting the Jurisprudence of Religion*, 34 CAP. U. L. REV. 51, 80–95 (2005) [hereinafter *From Typology to Synthesis*] (analyzing *Elk Grove Unified Sch. Dist. v. Newdow*, 124 S. Ct. 2301 (2004)).

worrisome to all of us, whether one be personally religious or not. The question of whether God exists or not is not a question that should be before our legislative bodies and our courts, whatever a majority might say.”⁸²

Although Kramnick and Moore emphasize that the Constitution created a secular state, they highlight that this secularism “is a precious but confused legacy, one that Americans have fought over since the beginning of the republic.”⁸³ In spite of prominent deviations from the constitutional ideal, the hope is that “the state and religion will not conflict and that each will work in complementary ways to lead us toward the creation of a just society.”⁸⁴ The formula by which the hope will be realized, according to the authors, is that of the separation of church and state, a standard that they freely acknowledge is in trouble.⁸⁵

II. ANALYSIS

A. An Argument from Silence

The fact that the Constitution contains no positive reference to religion and no reference to God whatsoever is not proof that the document was intended to create a secular state. For Kramnick and Moore to rest their thesis, even in part, upon this foundation amounts to an argument from silence. It is like stating that, because no American President has invoked the name of Christ in an inaugural address, it follows that none has professed Christianity. One must remember that, when the Constitution initially emerged from the Philadelphia Convention and was presented to the states for ratification, there was no mention of the freedom of speech, the freedom of assembly, the right to bear arms, or the right against cruel and unusual punishment, to name but a few of the Framers’ most notable silences. If one had lived in that day and had drawn the conclusion from such silence that the Framers were not favorably disposed to such rights and freedoms, he or she certainly would have been mistaken.

1. The Issue of States’ Rights

There are multiple inferences which one may draw concerning why the Constitution contains no reference to deity. Kramnick’s and Moore’s thesis that the Founders desired to create a secular state and a “godless politic” comprises only one such inference, and perhaps the least convincing one at that. It would

⁸² GODLESS CONSTITUTION, *supra* note 4, at 197.

⁸³ *Id.* at 200.

⁸⁴ *Id.*

⁸⁵ *Id.*

certainly be as easy to reason that, under the federalist system of government that the Founders were proposing, they considered religion a matter best reserved to the states and one over which the national government should have no jurisdiction. We are aware, after all, that many of those who were involved in the proposal and adoption of the Constitution were profoundly interested in and sensitive to the issue of states' rights. James Madison continually addressed the fears of those who believed that the national government would swallow up state governments. He wrote that "all those alarms which have been sounded, of a meditated or consequential annihilation of the State Governments, must, on the most favorable interpretation, be ascribed to the chimerical fears of the authors of them."⁸⁶ He highlighted, in the same vein, that "each of the principal branches of the federal Government will owe its existence more or less to the favor of the State Governments, and must consequently feel a dependence, which is much more likely to beget a disposition too obsequious, than too overbearing towards them."⁸⁷

Madison's tone was categorical and his point unmistakable as he tirelessly underscored that the jurisdiction of the proposed federal government "extends to certain enumerated objects only, and leaves to the several States a residuary and inviolable sovereignty over all other objects."⁸⁸ Not only Madison, but also many men of the time, like George Mason,⁸⁹ James Wilson,⁹⁰ and Samuel Bryan,⁹¹ spoke in the most serious and solemn tones about the issue of states' rights. So why is it not plausible to conclude,

⁸⁶ THE FEDERALIST NO. 46 (James Madison), in THE DEBATE ON THE CONSTITUTION, *supra* note 14, pt. 2, at 116.

⁸⁷ THE FEDERALIST NO. 45 (James Madison), in THE DEBATE ON THE CONSTITUTION, *supra* note 14, pt. 2, at 104.

⁸⁸ THE FEDERALIST NO. 39 (James Madison), in THE DEBATE ON THE CONSTITUTION, *supra* note 14, pt. 2, at 31.

⁸⁹ See *George Mason Fears for the Rights of the People*, in THE DEBATE ON THE CONSTITUTION, *supra* note 14, pt. 2, at 605. Mason states that the power of the "General Government" to tax the states directly is "totally subversive of every principle which has hitherto governed us" and "is calculated to annihilate totally the State Governments." *Id.*

⁹⁰ See *James Wilson's Speech at a Public Meeting*, in THE DEBATE ON THE CONSTITUTION, *supra* note 14, pt. 1, at 67. Wilson assures his listeners that "it is evidently absurd to suppose . . . that the annihilation of the State governments will result from their union." *Id.* Later, in the Pennsylvania Ratification Convention, he described the driving principle of federalism as follows: "whatever object was confined in its nature and operation to a particular State, ought to be subject to the separate government of the States, but whatever in its nature and operation extended beyond a particular State, ought to be comprehended within the F[e]deral jurisdiction." *James Wilson's Opening Address*, in THE DEBATE ON THE CONSTITUTION, *supra* note 14, pt. 1, at 796.

⁹¹ See *Reply to Wilson's Speech: "Centinel" [Samuel Bryan] II*, in THE DEBATE ON THE CONSTITUTION, *supra* note 14, pt. 1, at 80. Bryan responds to Wilson's initial speech and asserts that he "has recourse to the most flimsy sophistry in his attempt to refute the charge that the new plan of general government will supersede and render powerless the state governments." *Id.*

in contradistinction to the argument of Kramnick and Moore, that the Founders may have regarded issues of religion as ones which the states, and not the national government, should decide? In such light, would it not make sense that the nation's patriarchs apparently felt no compulsion to cover ground that the state constitutions had already covered?⁹² Kramnick and Moore are curiously silent regarding the towering issue of federalism that occupies, even on occasion monopolizes, the first debates regarding the Constitution.

2. A Reluctance to State the Obvious

Our authors further ignore a second likely and closely related inference. The Framers' failure to reference God in the Constitution may have amounted to little more than an expression of their desire not to address unnecessary issues. Consider the manner in which Noah Webster engaged the argument, made by those who opposed the Constitution, that there was no provision within it against a standing army during times of peace. His words serve to enlighten us about why there is silence on particular subjects. He asks: "Why do not people object that no provision is made against the introduction of a body of Turkish Janizaries; or against making the Alcoran the rule of faith and practice, instead of the Bible?"⁹³ "The answer to such objections," he emphasizes, "is simply this—*no such provision is necessary*."⁹⁴ Webster explains that there is no provision against standing armies because "the principles and habits, as well as the power" of the American people are opposed to them, and that "there is as little necessity to guard against them by positive constitutions, as to prohibit the establishment of the Mahometan religion."⁹⁵ Would taking Webster's point seriously in this instance not readily suggest that the Founders' failure to refer to God in the Constitution could have had to do with their reluctance to state the obvious? This is certainly an inference no less viable than supposing that they intended to secularize American public life. One may wonder that, if the latter had been their object, why they

⁹² The Massachusetts Constitution required the governor and legislators to believe the "Christian religion." The Maryland Constitution similarly required officeholders to declare their "belief in the Christian religion." The New Hampshire Constitution limited senators to those of "the protestant religion." Delaware's oath of office required affirmation of the Trinity and the divine inspiration of the Old and New Testaments. North Carolina required its officeholders to affirm the being of God, to profess the truth of Protestantism, to accept the divine authority of the Old and New Testaments, and not to hold to any religious principle "incompatible with the freedom and safety of the State . . ." See THE FOUNDING FATHERS, *supra* note 49, at 250–51.

⁹³ See Noah Webster, *A Citizen of America*, in THE DEBATE ON THE CONSTITUTION, *supra* note 14, pt. 1, at 150.

⁹⁴ *Id.*

⁹⁵ *Id.* at 151.

proposed a Constitution that left the states free to do about religion what they wished.

3. No Justification for Ineffectual Provisions

Another reasonable inference not in keeping with the secularization thesis deserves mention. Jefferson once wrote that in matters of religion, the effect of coercion was “[t]o make one half the world fools, and the other half hypocrites.”⁹⁶ The point was not lost on the Founders nor on those who debated the adoption of the Constitution. Oliver Ellsworth observed that it is easy for “an unprincipled man”⁹⁷ to take an oath or to declare his belief in a creed and then to justify himself for not comporting himself in accordance with it. Requirements such as religious oaths and tests tend to bind only the person whose virtue binds him anyway; they in no way safeguard the body politic from and screen out the disreputable opportunist who lies and takes the oath or test insincerely. “In short,” Ellsworth maintained, “test-laws are utterly ineffectual.”⁹⁸ James Iredell made the same point when he opined in North Carolina’s ratification convention that religious oaths do not fulfill their purpose.⁹⁹ Why incorporate a well-meaning, albeit ineffectual, requirement into the Constitution? It comprises nothing short of a quantum leap in logic to conclude the failure to do so *ipso facto* suggests that the Founders’ goal was to secularize American public life.

4. The Overarching Point

While the Constitution contains no substantive reference to God and no positive reference to religion, it is prudent to exercise caution when interpreting these facts. They do not in and of themselves demonstrate an antipathy to public expressions of religion, nor do they reveal skepticism regarding the idea of God. One need not conclude that they illustrate the Founders’ desire to create an entirely secular state. Such facts allow a variety of inferences, some of which are incompatible with Kramnick’s and Moore’s thesis, such as those set forth above.

B. Roger Williams and John Locke

1. Roger Williams’s View of Separation

If the separation of church and state is interpreted to mean that the latter is to be a thoroughly secular sphere, then the ap-

⁹⁶ JEFFERSON, *supra* note 53, at 283, 286.

⁹⁷ Ellsworth, *supra* note 16, at 523.

⁹⁸ *Id.* at 524.

⁹⁹ Henry Abbot and James Iredell *Debate the Ban on Religious Tests*, *supra* note 19, at 904.

peal to Roger Williams is in vain. According to one scholar, Williams “had no argument with making God’s will supreme in public as well as in private life.”¹⁰⁰ His dispute was with the manner in which the Puritans in Massachusetts were attempting to do it. He emphasized that civil magistrates should not seek to interpose their will upon church affairs by forcing another under threat of legal penalty to obey commands, which come as a “direct call from God.”¹⁰¹ But he was also insistent that God should not be left out of the affairs of state. He asserted that civil peace arises and is maintained from not only civil laws, but also “true religion.”¹⁰² He declared: “Civil peace cannot stand entire where religion is corrupted.”¹⁰³

Since Williams’s emphasis upon separation was not his way of shielding the state from the influence of the church and of religion, how may his notion of separation be characterized? It was, for him, the means of protecting the individual’s right of conscience, while simultaneously safeguarding the purity of the church and of “true religion.” He was haunted by the specter of a pure and righteous Christian believer, who desired nothing more than to reside within a “garden” fashioned by God that is separated and walled off from the “wilderness” of the world, being molested by civil authorities and forced at the point of sword to confess false beliefs.¹⁰⁴ There are admittedly points of overlap between Williams’s view of separation as a quest for religious purity and Kramnick’s and Moore’s view of it as advocacy for a godless state and politics, but the two visions differ radically from each other in their underlying assumptions, motivation, and ultimate objective. To conflate them is to misunderstand both.

2. John Locke’s View of Separation

Locke, as revealed in his *Letter of Toleration*, did not speak of church and state so much in terms of being separate spheres as of being different ones.¹⁰⁵ Aside from this fact, his view of

¹⁰⁰ JERALD C. BRAUER, *PROTESTANTISM IN AMERICA: A NARRATIVE HISTORY* 33 (1965), available at <http://www.religion-online.org/showchapter.asp?title=1663&C=1656>.

¹⁰¹ *Id.*

¹⁰² WILLIAMS, *supra* note 26, at 153.

¹⁰³ *Id.*

¹⁰⁴ See PHILIP HAMBURGER, *SEPARATION OF CHURCH AND STATE* 38–51 (2002) [hereinafter *SEPARATION*], in which Hamburger argues that Williams adopted “the wall of separation” metaphor as an image of purity which he sought in religion.

¹⁰⁵ See *TOLERATION*, *supra* note 42, at 27, where the author states that church is “a thing absolutely separate and distinct from the commonwealth.” Compare and contrast this statement with the way in which Locke distinguishes the two elsewhere in this work: e.g., civil government is concerned with the outward, while religion the inward, *id.* at 18; civil government is restricted to the things of the temporal world, while religion with those in the world to come, *id.* at 20; civil government is a public matter, whereas religion is a private, personal one, *id.* at 28–31; civil government enforces its precepts with penal-

separation is a narrow one. It rests upon his minimalist conception that the *raison d'être* of the state is the protection of life, liberty, and property. Because the public realm of government is limited, the private and personal realm of religion is expansive. As the tentacles of government now reach deeper into people's lives than they did under Locke's theory, his view of separation is increasingly inapplicable, if not impossible. The advent of the welfare state, in other words, has rendered his notion of separation archaic and hard to square with the present.

So for commentators like Kramnick and Moore to call upon the classical liberalism of Locke in order to defend their regime of secularizing the current welfare state is confused and disingenuous from the start. The essential condition for Locke's view of the separation of church and state is a minimalist state. Without that, the jurisdiction of the state eventually consumes that of the church, rendering it powerless. Assuming that the state is a godless sphere, then godlessness will predominate throughout society as the state increases. Locke's political philosophy does not support such an outcome. He was not by any stretch of the imagination the secularist that Kramnick and Moore are and can hardly be relied upon to support their argument.

Our authors should not regard Locke's view of separation as helpful to their defense of the secular state for other notable reasons. The leading rationale for a secular state is toleration, but Locke's view of separation does not lend itself to the wholehearted promotion of that virtue. In Locke's view, all religious beliefs are not equally deserving of protection. Beliefs that are subversive to the state should never be protected.¹⁰⁶ Nor should those religious beliefs that undermine the foundations of human society.¹⁰⁷ What is more, a church in which communicants owe their allegiance to another prince, (and here some think that he was referring specifically to Roman Catholics although he explains that the reference is to Islam),¹⁰⁸ cannot be tolerated.¹⁰⁹ Atheists likewise have no place in Locke's state.¹¹⁰ The point is that his view of the separation of church and state is quite narrow and is as influenced by religion as it is separated from it. To phrase the observation another way, Locke's is a political point of view that provides freedom *of* religion, but no freedom *from* it.

ties, but religion relies only upon the light of reason and evidence, *id.* at 19; and civil government is concerned with life, liberty, and property, whereas religion is concerned with the salvation of souls, *id.* at 17.

¹⁰⁶ *Id.* at 50.

¹⁰⁷ *Id.*

¹⁰⁸ Patrick Romanell, *Introduction* to TOLERATION, *supra* note 42, at 10.

¹⁰⁹ TOLERATION, *supra* note 42, at 51.

¹¹⁰ *Id.* at 52.

To correlate this position with Kramnick's and Moore's is possible perhaps, but only if one takes a broad leap of abstraction and turns a blind eye to what Locke specifically taught.

3. Summary Observation

Here again, it is imprudent to invoke, as Kramnick and Moore have done, the views of Roger Williams and John Locke in order to defend the secular state. While there are, between these icons and our authors, certain similarities and points of agreement, they are far from conclusive and ultimately convince only those who are already convinced of the secularist position.

C. Thomas Jefferson and the Secular State

1. The Celebrated "Wall"

The most egregious mistake that Kramnick and Moore make is that they, in a less than critical fashion, enlist Jefferson in support of their thesis and interpret his correspondence with the Danbury Baptists as an illustration of his dedication to the notion of the secular state.

One must first remember that the third President was indeed a devoted disciple of Locke. He believed that the best government was a minimal one.¹¹¹ The national government was, for him, properly limited; there were undertakings that were permitted to it, but many others that were not. It was, with respect to religion, distinguishable from state governments and ecclesiastical institutions.¹¹² States were free to engage in religious activities, and Jefferson had no problem with that idea.¹¹³ He had even issued a thanksgiving proclamation while he was governor of Virginia.¹¹⁴ Furthermore, as a member of the Virginia House of Burgesses, he had participated in the drafting and enactment of a resolution calling for a day of fasting, humiliation, and prayer.¹¹⁵ Daniel L. Driesbach perceptively concludes, therefore, that "[t]he 'wall' metaphor was not offered as a general pronouncement on the prudential relationship between religion and all civil government; rather, it was, more specifically, a statement delineating the legitimate constitutional jurisdictions of the federal and state governments on matters pertaining to relig-

¹¹¹ See GODLESS CONSTITUTION, *supra* note 4, at 70.

¹¹² THOMAS JEFFERSON, *Second Inaugural Address* (March 4, 1805) para. 7, reprinted in WRITINGS, *supra* note 53, at 518, 519–20 [hereinafter *Second Inaugural*].

¹¹³ See *id.*

¹¹⁴ DANIEL L. DRIESBACH, THOMAS JEFFERSON AND THE WALL OF SEPARATION BETWEEN CHURCH AND STATE 58–59 (2002) [hereinafter JEFFERSON AND THE WALL].

¹¹⁵ *Id.* at 56.

ion.”¹¹⁶ The letter to the Danbury Baptists, in short, served a political purpose: it was a way by which the President could swipe at John Adams and other Federalists who, during the malicious 1800 presidential campaign, had been suspected of supporting the establishment of a national church.¹¹⁷

2. Jefferson and Public Religion

Kramnick's and Moore's depiction of Jefferson's views border upon caricature. His statements and actions were far more complex than these authors portray. Aside from his conviction that states were free to engage in religious observances, Jefferson nonetheless could bend his own philosophy a bit in the national arena. When the Reverend John Leland, who had been instrumental in disestablishing the Anglican Church in Virginia, came to Washington approximately a year after Jefferson initially took office as President, Leland not only presented the President with a mammoth cheese weighing twelve hundred and thirty-five pounds,¹¹⁸ but also preached in the Hall of the House of Representatives the following Sunday.¹¹⁹ Jefferson, a mere two days after writing his letter to the Danbury Baptists in which he advanced his famous metaphor, appeared in the House to hear Leland preach. Jefferson's listening to Leland's sermon in this context did not represent a sudden break from his usual practice, since he had attended worship services on public property before becoming President.¹²⁰ He would likewise attend public religious services throughout his Presidency.¹²¹ In a similar vein, during his Second Inaugural Address, Jefferson confessed his need for “the favor of that Being in whose hands we are, who led our forefathers, as Israel of old, from their native land, and planted them in a country flowing with all the necessities and comforts of life,”¹²² and he invited his countrymen “to join with me in supplications, that he will so enlighten the minds of your servants, guide their councils, and prosper their measures, that whatsoever they do, shall result in your good, and shall secure to you the peace, friendship, and approbation of all nations.”¹²³ These are all indications that Kramnick and Moore may have painted an oversimplified picture.

¹¹⁶ *Id.* at 60.

¹¹⁷ *Id.* at 57.

¹¹⁸ *Id.* at 10.

¹¹⁹ *Id.* at 21.

¹²⁰ *Id.* at 23.

¹²¹ *Id.*

¹²² *Second Inaugural*, *supra* note 112, at para. 15.

¹²³ *Id.*

3. Jefferson's Bill for Establishing Religious Freedom

There is no question that this statute, which was inspired by Jefferson, disestablished religion in the state of Virginia. It represented a milestone of libertarian accomplishment. No longer would religion be enforced by coercive means. No one would thereafter be compelled to support religious worship or, for that matter, any instrumentality of religion. Yet it cannot go unnoticed that the first protracted sentence of the bill reads, in some respects, like a confession of faith. The sentence refers to "Almighty God," to "his supreme will," and to "the plan of the holy author of our religion, who being lord both of body and mind."¹²⁴ The question that immediately comes to mind is whether the Bill demonstrates a conviction regarding disestablishment or one regarding separation. If the latter, then why the weighty religious references? Would Kramnick and Moore argue that these references are secular? Does the statute really, as they claim, amount to a "comprehensive call for a total separation of church and state,"¹²⁵ or is this characterization simply another indication of their inclination to exaggerate and to accentuate only a part of the evidence?

4. Separation versus Disestablishment

Indeed, when one examines the writings of leading eighteenth century Americans, men like Patrick Henry, Samuel Adams, Isaac Backus, George Mason, John Adams, Caleb Wallace, John Leland, Oliver Ellsworth, and George Washington, who are frequently thought to have subscribed to the secular theory of "separation of church and state," only the most meager evidence surfaces in favor of the theory.¹²⁶ Most of these persons do not so much as even use the word "separation" or any of its derivatives. There is a strong and viable argument one can make that these icons in American history supported disestablishment, which was not for them a notion synonymous with separation.¹²⁷

¹²⁴ 2 THOMAS JEFFERSON, *A Bill for Establishing Religious Freedom*, in THE PAPERS OF THOMAS JEFFERSON 545–46 (Julian P. Boyd ed., 1950), reprinted in ROBERT T. MILLER & RONALD B. FLOWERS, *TOWARD BENEVOLENT NEUTRALITY: CHURCH, STATE, AND THE SUPREME COURT* app. A, at 584–85 (3d ed. 1987).

¹²⁵ GODLESS CONSTITUTION, *supra* note 4, at 92.

¹²⁶ See SEPARATION OF CHURCH AND STATE, *supra* note 7. I would challenge the reader to examine each of the selections in this work and to discover for him or herself the truth of my observation that the founders rarely, if ever, advocate "separation." One discovers in most of these writings an opposition to forced religion or to laws pertaining to worship, along with a commensurate favoring of the view that religious freedom is an inalienable right over which civil authorities have no power. But one does not find these men advocating the notion of separation or of a "godless" public life.

¹²⁷ This observation is generally in agreement with the observation of Hamburger, who describes the doctrine of separation as primarily a phenomenon of the nineteenth century. See SEPARATION, *supra* note 104, at 78, 111. The observation also agrees with

5. Closing Observation about Jefferson

There is significant evidence to suggest that Jefferson did not favor a secular public sphere of the sort that Kramnick and Moore envision and support. My purpose here, however, is not to state whether he did or did not do so, but simply to demonstrate that these authors do not convincingly prove their point about the third President. Appeals to Jefferson's beliefs and practices can militate as easily against a godless state as in favor of one.

6. The Subversion of the Secular Ideal

Madison supported the appointment of congressional chaplains when he served in the House of Representatives.¹²⁸ He also, during his Presidency, proclaimed a national day of public humiliation and prayer.¹²⁹ There is evidence that, after he left office, he came to regard both actions as violations of the Establishment Clause and as deviations from the godless Constitution.¹³⁰ The matter appears finally to boil down to a choice of whether to agree with the public or the private Madison. This choice resembles a leap into darkness, for there are no magical, brightly illuminated guideposts pointing one to the definitive meaning of the Establishment Clause. Yet the burden of proof, it should be remembered, is usually shouldered by the one whose thesis is under consideration. When Kramnick and Moore argue that Madison's religious proclamation was retrogressive and outside the orbit of the Establishment Clause, their assessment is based upon little more than a body of checkered evidence that just as readily lends itself to the opposite point of view.

Furthermore, when these authors describe the introduction of religious beliefs into the national currency, the movement and delivery of the mail, and the national Pledge of Allegiance as un-

the analysis of Daniel Dreisbach, who points out that New England Baptists (like Isaac Backus and John Leland) did not regard "separation" and "nonestablishment" as interchangeable. See *JEFFERSON AND THE WALL*, *supra* note 114, at 51.

¹²⁸ See 1 *ANNALS OF CONG.* 104–05 (Joseph Gales ed., 1834). Compare *GODLESS CONSTITUTION*, *supra* note 4, at 105, where the authors state that Madison "also opposed, unsuccessfully, the appointing of chaplains to Congress." The statement glosses over the fact that Madison did not apparently oppose the action while he was in Congress.

¹²⁹ If the issuance of the proclamation was a mistake as Kramnick and Moore argue, it was one that President Madison continued to make. He issued such proclamations throughout his Presidency. See 1 *JAMES D. RICHARDSON, A COMPILATION OF THE MESSAGES AND PAPERS OF THE PRESIDENTS 1789–1897*, at 513, 532–33, 558, 560–61 (1896).

¹³⁰ See James Madison, *A Detached Memorandum*, in *SEPARATION OF CHURCH AND STATE*, *supra* note 7, at 138, 141. In this writing, Madison stated that the appointment of chaplains for institutions of state "shut the door of worship [against] the members whose creeds and consciences forbid a participation in [the religion] of the majority." *Id.* at 139. He maintained that "[r]eligious proclamations by the Executive recommending thanksgivings & fasts are shoots from the same root . . ." *Id.* at 141.

dermining the godless Constitution and the secular state, one must ask when and by whom such a standard of measurement was ever conclusively established. Kramnick and Moore certainly have not established it. Unless and until godlessness in public life becomes the proven and/or accepted standard, episodes of religious expression in American public life undermine nothing.

If those like Robert Bellah¹³¹ and Sidney Mead¹³² are correct, there has always been a religious dimension in American public life. Whether one refers to this aspect of the country's communal existence as a "civil religion"¹³³ is not really important. What Bellah and Mead suggest is that there is a wellspring of national spirituality, which in turn involves a belief in a deity. Assuming that one agrees with them on this score, as many do,¹³⁴ the very episodes that Kramnick and Moore decry as departures from the standard, other commentators might applaud as reflective of it.

E. Conclusion of Analysis

It appears doubtful whether any historical inquiry into this matter will ever render an uncontested verdict. To expect another outcome would be naïve. Thus, for an answer to the queries of who determined the standard as well as how and when they did so, we must turn our attention elsewhere.

III. SECULARIZATION AND THE SUPREME COURT

A. The Completed Revolution

One may at this juncture wish to ask, "Why, when the historical evidence in favor of a secular state is checkered and far less than conclusive, do we have a secular state, or a public

¹³¹ See ROBERT N. BELLAH, *THE BROKEN COVENANT: AMERICAN CIVIL RELIGION IN TIME OF TRIAL* 12 (1975); and Robert N. Bellah, *Civil Religion in America*, in *BEYOND BELIEF: ESSAYS ON RELIGION IN A POST-TRADITIONALIST WORLD* 168, 168–69 (Univ. of California Press 1991) (1970) [hereinafter *Civil Religion*].

¹³² See SIDNEY E. MEAD, *THE LIVELY EXPERIMENT: THE SHAPING OF CHRISTIANITY IN AMERICA* 38–50 (1963) [hereinafter *LIVELY EXPERIMENT*].

¹³³ See *Civil Religion*, *supra* note 131, at 168. See also JEAN-JACQUES ROUSSEAU, *THE SOCIAL CONTRACT* 176–87 (M. Cranston trans., Penguin Books 1968) (1762), where the author is the first to have used the term.

¹³⁴ See, for example, *THE FOUNDING FATHERS*, *supra* note 49, at 282 (quoting JOHN-JACQUES ROUSSEAU, *ON THE SOCIAL CONTRACT* 131 (Roger D. Masters ed., Judith R. Masters trans., St. Martin's Press 1978) (1762)), in which Lambert writes the following:

Many other Americans professed Christianity but, like Jefferson, embraced a civil religion that excluded or ignored many tenets central to Christian orthodoxy. Jefferson, Adams, Washington, Franklin, and Hamilton all expressed some version of what Rousseau called "civil religion": a belief in "the existence of a powerful, intelligent, beneficent, foresighted, and providential divinity; the afterlife; the happiness of the just; the punishment of the wicked; [and] the sanctity of the social contract."

sphere closely resembling one?"¹³⁵ The answer is that there has already been a successfully executed "secular revolution"¹³⁶ in this country. It was, except for some of its details, completed by the turn of the twentieth century and involved virtually every aspect of American culture, including but not limited to education, the natural sciences, and law.¹³⁷ The insurgents, comprising the nation's intelligentsia, embraced naturalism, materialism, positivism, and the privatization, if not extinction, of religion.¹³⁸ They rebelliously gave birth to a novel social paradigm in this country that embodied their modes of thought and that soon came to dominate American public life.

Current culture skirmishes, which have been recently evidenced, may perhaps be interpreted as little more than a bothersome footnote to the culture war that has already been fought and won. But such skirmishes may also signal a new counter-insurgency, which is uneasy about the direction of American public life under a secular paradigm and ready to mount its overthrow.

1. Education

For more than five hundred years in Western Civilization,

¹³⁵ The observation of Stephen B. Presser is correct. He reviews Kramnick's and Moore's book and states: "There is more than a little that is curious about this book, because its breathlessly-advanced thesis, that ours is a 'Godless Constitution,' now seems to be the well-established view of a majority of members of the United States Supreme Court." Stephen B. Presser, *Some Realism about Atheism: Responses to The Godless Constitution*, 1 TEX. REV. L. & POL. 87, 89-90 (1997) (reviewing ISAAC KRAMNICK AND R. LAURENCE MOORE, *THE GODLESS CONSTITUTION* (1996)). The curiosity really concerns the Court. Why does it tend to favor secularization when an examination of the early history of the Republic on the matter of church-state relations does not lead ineluctably to the conclusion that secularization must be favored?

¹³⁶ See Christian Smith, *Introduction* to *THE SECULAR REVOLUTION*, at 1-4 (Christian Smith ed., Univ. of California Press 2003) [hereinafter *SECULAR REVOLUTION*], in which he uses and defends this term.

¹³⁷ Even Protestantism itself became a secularizing influence. Its Holy Scriptures were interpreted through the lens of the discipline of psychology. See Keith G. Meador, *"My Own Salvation": The Christian Century and Psychology's Secularizing of American Protestantism*, in *SECULAR REVOLUTION*, *supra* note 134, at 269, 296, where the author, describing the first few decades of Protestantism during the twentieth century, states that "parts of American Protestantism were becoming difficult to distinguish from the secular alternative of psychology, and many American Protestants began to forego traditional religious practices entirely in favor of a more direct alleviation of suffering from the psychologists, whom even churches hailed as the true 'physicians of the soul.'" Charles Clayton Morrison, the first editor of the *Christian Century*, wrote retrospectively with regret in 1939 of the breakdown of his religious belief system in the immediate aftermath of the secular revolution: "Its [i.e., any religious phenomenon's] objectivity as something given to me from beyond myself, had been reduced to my own subjective processes." *Id.* at 297 (quoting *How My Mind Has Changed*, *CHRISTIAN CENTURY*, Nov. 8, 1939, at 1370, 1371). Morrison's progressive brand of Christianity had brought him to an ideological place respecting religion the same as or similar to that of scientists, educators, and law professors.

¹³⁸ Christian Smith, *Introduction* to *THE SECULAR REVOLUTION*, *supra* note 136, at 1.

the Christian Church was in charge of education.¹³⁹ Throughout seventeenth-, eighteenth-, and most of nineteenth-century America, the Church's role in education predominated over all others. Harvard, Yale, William & Mary, and Princeton were established as religious institutions, the primary purpose of which was to produce and to train clergy.¹⁴⁰ Most American colleges established during this time were the work of Christian denominations, and so, naturally, their clergy possessed both teaching and administrative responsibilities in these educational institutions.¹⁴¹ By the end of the nineteenth century, clergy involvement in colleges and universities had declined.¹⁴² Higher education was, by then, no longer under the control of the Church.

A large part of this turn of events is explicable in terms of European modes of thought that began flourishing approximately a century earlier. Immanuel Kant propounded his critical philosophy in Germany during the late eighteenth and early nineteenth centuries. He distinguished between empirical knowledge and faith. The former was related to the world of sense perception and had to do with mathematical and physical science. The latter was unbounded by sense and had to do with the movements of the mind. Although Kant correlated the notions of God, freedom, and immortality with morality, it was clear that, for him, these and other moral ideas and maxims possessed a cognitive status fundamentally different from those of science. He limited knowledge, he professed, to make room for faith. It was this dichotomy of knowledge and faith that was of immense significance for the secular revolution.

Auguste Comte and Herbert Spencer, who followed Kant in the nineteenth century, built upon this dichotomy, each in his own way. Comte envisioned a progression in human knowledge, with the mind passing first through a theological stage, followed by a metaphysical one, and then attaining its fullest flower in the ideal of positivism, which he maintained is exemplified by natural science. No longer should one attempt to explain phenomena by resorting to the realm of the supernatural (theology) or to causal forces inherent within phenomena (metaphysics). Science of the kind that occupied Galileo, Kepler, and Newton is concerned with providing explanations, based upon observation, of the relations between observable facts. Positivism, then, for Comte, has to do with real, certain, and exact knowledge, which

¹³⁹ Christian Smith, *Secularizing American Higher Education*, in *SECULAR REVOLUTION*, *supra* note 136, at 97.

¹⁴⁰ *Id.*

¹⁴¹ *Id.* at 97–101.

¹⁴² *Id.* at 101.

embodies mathematics, natural sciences, and sociology.

Spencer accepted the proposition that there is a realm of experience and a realm not experienced. The latter realm is the one properly associated with religious belief, which cannot be tested or quantified empirically. Theism, pantheism, and atheism all fail for the same reason: they cannot be related to or correlated with experience. Agnosticism, according to Spencer, is the only viable option religiously and metaphysically. Spencer also rejected all theological systems and was equally critical of the religious institutions promulgating them.

Christian Smith stresses the heavy impact of Comte and Spencer upon American academicians and higher education. He writes, "Both [thinkers] provided what proved to be key intellectual tools utilized by rising academic elites seeking to displace religious authority in order to make room for themselves as new, secular cultural authorities."¹⁴³

Smith also points out that, during the nineteenth century, over ten thousand American scholars studied at German universities, the most secularized institutions in the world at the time, and brought back to this country German idealism, historicism, and rationalism,¹⁴⁴ each of which was opposed, if not outrightly hostile, to a traditionally religious worldview. Academic faculty members, like John Dewey¹⁴⁵ who had thoroughly immersed himself in Kant's philosophy and Hegelian idealism, resented any parochial or sectarian standard in education and thought of religion as belonging only to one's personal and private life. Such academicians fought for what they perceived as intellectual autonomy, opposing the denominational grip on higher education that was at its tightest during the 1880s and 90s.¹⁴⁶

In addition, institutions like Harvard, Johns Hopkins, and Cornell were under the leadership of Charles Eliot, Daniel Coit Gilman, and Andrew Dickson White, respectively, all of whom were educational reformers who worked assiduously to marginalize religion in the academic curriculum and to further what they were convinced was genuine knowledge.¹⁴⁷

Aside from the above-described ideological shift, the nineteenth century saw the flourishing of capitalism, which fueled secularization. Corporate capitalism was not interested in classi-

¹⁴³ Christian Smith, *Secularizing American Higher Education*, in *SECULAR REVOLUTION*, *supra* note 136, at 97, 101.

¹⁴⁴ *Id.* at 101–02.

¹⁴⁵ *Id.* at 103.

¹⁴⁶ *Id.* at 102–03.

¹⁴⁷ *Id.* at 103.

cally-educated students, but in those who were trained in business, law, engineering, and the material sciences; in those who could, in short, generate capital.¹⁴⁸ As Smith puts it, “[c]apitalism thus undercut the justification for the scholarly task of a college system that privileged religious knowledge in its education, bolstering instead a rationale for a kind of technical, instrumental scholarship that was at the very least indifferent to religious concerns and interests.”¹⁴⁹ Secular research universities soon began to supplant denominational colleges as the dominant institutions of higher education.¹⁵⁰

The marginalization of religion in higher education soon characterized the local public schools as well. During the middle of the nineteenth century, educators like Horace Mann were outspokenly in favor of religious instruction in public schools.¹⁵¹ They believed, like James Pyle Wickersham once did, that “[s]chools in this country should train the young to be religious.”¹⁵² But, by the mid-1870s and 80s, the National Education Association (NEA), which had become membered with those of a secular mindset, went on the attack against teaching religion, i.e., a common Protestant Christianity, in public schools.¹⁵³ Educational elites, consisting of many local school superintendents as well as faculty and administrators of many major universities, joined the NEA and worked to remove religion from public schools.¹⁵⁴ William Torrey Harris, superintendent of schools in St. Louis, Missouri, was one of those who fervently opposed religious teaching in public schools and became a fierce advocate for secular public education.¹⁵⁵

By the beginning of the twentieth century, only hints of the old religious system remained in public schools. It had been a political struggle, Kraig Beyerlein maintains, and “the educational secularizers in the [NEA] had won.”¹⁵⁶

2. Science

Secularization in the sciences unfolded during the nineteenth century as a conflict between positivism and Baconian-

¹⁴⁸ Christian Smith, *Introduction*, in *SECULAR REVOLUTION*, *supra* note 136, at 76.

¹⁴⁹ *Id.*

¹⁵⁰ Kraig Beyerlein, *Educational Elites and the Movement to Secularize Public Education*, in *SECULAR REVOLUTION*, *supra* note 136, at 160, 176.

¹⁵¹ *Id.* at 163.

¹⁵² *Id.* at 165 (emphasis omitted) (quoting NTA Proceedings 606 (1866)).

¹⁵³ *Id.* at 169.

¹⁵⁴ *Id.* at 170.

¹⁵⁵ *Id.* at 174–75.

¹⁵⁶ *Id.* at 193.

ism.¹⁵⁷ The primary goal of the latter was to gather facts through close, honest, and refined observation.¹⁵⁸ The idea of Baconianism was that, as taxonomy grew, it would demonstrate the universal laws of God.¹⁵⁹ Yet just as facts came through observation, they could also be received from God through revelation.¹⁶⁰ According to Baconian science, science and religion were two sides of the very same coin.¹⁶¹ There was a “permeable boundary” between the two.¹⁶²

Men like Herbert Spencer, Charles Darwin, and Thomas Huxley were stalwart representatives of the positivist approach to scientific pursuit.¹⁶³ They flatly rejected Baconian premises. Religion, for them, had nothing to do with science; thus, the clergy had no right to speak with authority regarding scientific questions.

Edward L. Youmans, a personal friend and disciple of Spencer as well as an evolutionist, thought that it was time to disseminate positivist ideas on a popular basis. *Popular Science Monthly* was Youmans’s brainchild. He prevailed upon William Henry Appleton, of publishing fame, to underwrite the publication.¹⁶⁴ It sold at least eleven thousand copies a month and became the leading purveyor of popular scientific ideas during the last part of the nineteenth century.¹⁶⁵

The various authors featured in this periodical, as well as in other periodicals such as *Scientific American*, declared war on biblical literalism.¹⁶⁶ Scripture, they argued, resembled poetry and art more than science,¹⁶⁷ and widespread religious claims demonstrate at best that humans possess spiritual faculties which generate such claims.¹⁶⁸ The result of such arguments against religion resulted in a slow, but devastating erosion of Baconianism’s credibility. The religious texts to which it subscribed came to be viewed by many as nothing more than an artistic accomplishment¹⁶⁹ and certainly not as a source of scientific truth.

¹⁵⁷ Eva Marie Garrouette, *The Positivist Attack on Baconian Science and Religious Knowledge in the 1870s*, in *SECULAR REVOLUTION*, *supra* note 136, at 197.

¹⁵⁸ *Id.* at 198.

¹⁵⁹ *Id.*

¹⁶⁰ *Id.* at 199.

¹⁶¹ *See id.* (commenting on the Baconian view that science (nature) and religion (the biblical text) are “complementary and absolutely noncontradictory,” and that “scientists and theologians could apply the very same scientific method to the study of both”).

¹⁶² *Id.* at 200.

¹⁶³ *Id.*

¹⁶⁴ *Id.*

¹⁶⁵ *Id.* at 201.

¹⁶⁶ *Id.* at 204.

¹⁶⁷ *Id.* at 205.

¹⁶⁸ *Id.* at 206.

¹⁶⁹ *Id.* at 205.

Later, as the subjectivity of language surfaced as a major problem in hermeneutics, criticism rose to a new height when such commentators expressed the idea that perhaps the words of Scripture were more about the thoughts of those who had written, and were presently interpreting, them than about the mind of deity.¹⁷⁰ The upshot of the matter was that positivists urged devotees of religion “to abandon the delusion that they possess facts”¹⁷¹ and to withdraw from scientific discourse, especially when they have their Bibles in hand.

By attacking the religious basis of Baconian science, the positivists had “made themselves the sole inheritors of the right to control the intellectual territory from which they had successfully displaced religious interests.”¹⁷² This accomplishment did not go unnoticed, but “reverberated through most other institutional fields in American society.”¹⁷³ Henceforth, scientific knowledge would be king of the realm, while religious claims would be relegated to virtual irrelevancy.

3. Law

The secularization of law was a drama that unfolded in two major parts. The first pitted the “science of law” movement, represented by men such as Christopher Langdell, Samuel Williston, and Jeremiah Smith, against a jurisprudence in which community and religious notions of justice were creatively incorporated into common law.¹⁷⁴ The science of law protagonists were struggling, as the name of their movement indicates, to define law as “science.”¹⁷⁵ Science, after all, had become the gold standard for knowledge. The champions of this new legal movement were law professors, who desired to view themselves as scientists and purveyors of knowledge. Their laboratories were none other than law schools that were located in or near the universities where they taught.¹⁷⁶

The second part of the drama was cast as a conflict between so-called legal realists,¹⁷⁷ like Oliver Wendell Holmes, John

¹⁷⁰ *Id.* at 207–08.

¹⁷¹ *Id.* at 210.

¹⁷² *Id.* at 213.

¹⁷³ *Id.*

¹⁷⁴ David Sikkink, *From Christian Civilization to Individual Civil Liberties*, in *SECULAR REVOLUTION*, *supra* note 136, at 310.

¹⁷⁵ *Id.* at 314. The author writes that “the classical reformers [those in the science of law movement] pursued a science of law that was meant to parallel botany or other physical sciences.” *Id.*

¹⁷⁶ Those representing the science of law were also convinced that “a university, and a university alone, can furnish every possible facility for teaching and learning” legal science. *Id.* at 315 (internal quotation marks omitted).

¹⁷⁷ See *id.* at 334. See also JURISPRUDENCE: TEXTS AND READINGS ON THE

Chipman Gray, and Roscoe Pound on the one hand, and formalists, like advocates of the science of law such as Langdell¹⁷⁸ on the other. The legal realists insisted that law was an organic phenomenon, the study of which could not be divorced from political and social fact. Law was not, as the formalists believed, about the meticulous gathering and organization of principles from legal reporters, because this approach undermined its nature as a living, breathing reality always shaped in a particular social context.

The winners of the first struggle were those representing the science of law. David Sikkink emphasizes that they succeeded in “delegitimizing the religious basis for legal decision making.”¹⁷⁹ They attacked the jurisprudence of the heart and its appeal to religion, substituting for it the “pure gaze of the scientific law professor.”¹⁸⁰

But these legal reformers were not altogether dismissive of religion. The law, they insisted, must be “discovered.” It therefore possessed a transcendent aspect; it was as if they claimed a “direct line to God’s mind through their knowledge of the principles of legal science.”¹⁸¹ But they were comfortable speaking only of “general religion” or “general Christianity.”¹⁸² Although theirs

PHILOSOPHY OF LAW (George C. Christie ed. 1973). Christie states that “legal realism” possesses the following four characteristics: (1) a desire to separate law from morality in legal analysis, (2) a distrust of legal formalism, i.e., deducing legal conclusions from rules of law, (3) a suspicion of all legal generalizations along with the desire to break them down into smaller units, and (4) a belief in the instrumental work that law can accomplish in society. *Id.* at 641–42. I use the term “legal realism” very broadly to include not only Holmes, Gray, and Pound, but also sociological jurists like Louis Brandeis, Benjamin Cardozo, Karl Llewellyn, Felix Cohen, and Jerome Frank.

¹⁷⁸ Langdell was dean of the Harvard Law School and initiated the “case method” system of instruction. This method, still followed in law schools today,

rested on the concept that the law could be scientized as neatly and efficiently as chemistry or biology. If one could isolate gases, observe their properties, and draw conclusions from which scientific principles could be developed, one ought to be able to bring the same logic to legal precedents, reach back into time for the earliest applicable cases and trace their progress, observe the properties of each, and from them develop constant legal principles

LIVA BAKER, *THE JUSTICE FROM BEACON HILL: THE LIFE AND TIMES OF OLIVER WENDELL HOLMES* 208 (1991). Holmes, convinced that law could not be properly studied divorced from pertinent political and social realities, despised “case method” instruction, thought it largely worthless, and stayed in law school only a year. *Id.* at 208–09. *See also* JEROME FRANK, *COURTS ON TRIAL* 226 (1949), where he quotes Langdell, saying: “What qualifies a person to teach law . . . is not experience in the work of a lawyer’s office, not experience in dealing with men, not experience in the trial or argument of causes, not experience, in short, in using law, but experience in learning law. . . .”

¹⁷⁹ David Sikkink, *From Christian Civilization to Individual Civil Liberties*, in *SECULAR REVOLUTION*, *supra* note 136, at 316.

¹⁸⁰ *Id.*

¹⁸¹ *Id.*

¹⁸² *Id.* at 316–17. In *Church of Holy Trinity v. United States*, 143 U.S. 457 (1892), the Supreme Court referred to this country as “a Christian nation.” But the reference, it

was not “that good old-time religion,” it was nevertheless one that molded character and conformed to the dictates of a general morality.¹⁸³

The winners of the second struggle were the legal realists. They were convinced that judges did not discover law, but were policymakers who create it.¹⁸⁴ Holmes, who was representative of the group, argued that “[t]he ground of [a judicial] decision really comes down to a proposition of [social and political] policy.”¹⁸⁵

He and other realists, like Louis Brandeis and Benjamin Cardozo, were also empiricists to the core. They were more impressed by social and political differences than by unities and similarities. Holmes believed, according to one biographer, that the “truth was only what he couldn’t help thinking on the basis of observation and experience, and his only absolute was an absolute abhorrence of absolutes.”¹⁸⁶ There were, for him, no eternal guideposts in law that imparted to it a transcendent dimension. It was and is located in a sea of relativism and, in the final analysis, is a product of human construction.

Needless to say, Holmes was, in terms of religious faith, an agnostic. There was little room in his judicial philosophy for a belief in God.¹⁸⁷ Law was, in his view, separate and distinct from religion and morality, and simply “embodies the story of a nation’s development through many centuries.”¹⁸⁸

His attack on legal formalism began in the nineteenth century, but rolled onward, gathering momentum with new and powerful voices, through most of the twentieth century. The eventual demise of formalism thoroughly secularized law in America. Religion—general or otherwise—no longer had a protected place in this country’s public life. The autonomy of the in-

should be noted, is couched in general, as opposed to sectarian, terms. David Sikkink, *From Christian Civilization to Individual Civil Liberties*, in *SECULAR REVOLUTION*, *supra* note 136, at 318.

¹⁸³ David Sikkink, *From Christian Civilization to Individual Civil Liberties*, in *SECULAR REVOLUTION*, *supra* note 136, at 320.

¹⁸⁴ *Id.* at 323.

¹⁸⁵ *Id.* at 328 (quoting WILLIAM M. WIECEK, *THE LOST WORLD OF CLASSICAL LEGAL THOUGHT: LAW AND IDEOLOGY IN AMERICA, 1886–1937*, at 180 (1998)).

¹⁸⁶ *Id.* at 327 (quoting LIVA BAKER, *THE JUSTICE FROM BEACON HILL: THE LIFE AND TIMES OF OLIVER WENDELL HOLMES* 11 (1991)).

¹⁸⁷ *Id.* at 324. Holmes was a well-read man, who had studied and been influenced by both Comte and Spencer. *See id.* at 325. In *Lochner v. New York*, he wrote, “The 14th Amendment does not enact Mr. Herbert Spencer’s Social Statics.” 198 U.S. 45, 75 (1905) (Holmes, J., dissenting).

¹⁸⁸ David Sikkink, *From Christian Civilization to Individual Civil Liberties*, in *SECULAR REVOLUTION*, *supra* note 136, at 327 (quoting Oliver Wendell Holmes, *The Path of the Law*, 10 *HARVARD LAW REVIEW* 457–78 (1897)).

dividual, along with the capitalization of individual civil rights, came to the forefront in jurisprudence. One's beliefs regarding religion amounted to a private, individual right. The state's function was to remain religion-neutral, while at the same time protecting those whose religious liberties were infringed.¹⁸⁹

4. Summary Observation

It should not be overlooked that the Court's emphasis upon individual autonomy and state neutrality coincided with the modes of thought of traditional liberalism. Just as the secularization of higher education ultimately owed a profound debt to Kant¹⁹⁰ as one of the primary architects of liberal thought, and the secularization of science built upon the dichotomy in his thought between empirical knowledge and faith, the secularization of law illustrated, first, the attempt to redefine itself as a formalistic science so as to be regarded as a discipline of knowledge that was worthy of the university and, second, after this attempt failed, to cast itself as the means of safeguarding individual autonomy against collectivist forces, such as those of religion, which were thought to militate against the spirit of the individual. The secular revolution was one, in the final analysis, about politics. It represented the triumph of political liberalism.

B. Supreme Court Cases and Establishment Tests

Around the middle of the twentieth century, after the secular revolution was already won and the brightest legal minds in the country had effectively concluded that religion should have at best a marginal role in American public life, the Supreme Court received an opportunity to express its newfound sense of the relationship between religion and the state.¹⁹¹

1. Constitutionalizing the Wall

The question before the Court was whether a township in New Jersey could, without violating the Establishment Clause of the First Amendment,¹⁹² tax its citizens for the costs of transporting children to church schools.¹⁹³ Justice Black, speaking for the majority of the Court, answered the question in the affirmative,

¹⁸⁹ Elsewhere I have described the strong emphasis upon autonomy in the Court's interpretation of the Religion Clauses. See *From Typology to Synthesis*, *supra* note 81.

¹⁹⁰ For a lengthy discussion of Kant's liberalism and its influence upon jurisprudence, see L. Scott Smith, *Religion-Neutral Jurisprudence: An Examination of Its Meanings and End*, 13 WILLIAM & MARY BILL OF RIGHTS JOURNAL 815, 823-39 (2005) [hereinafter "*Religion-Neutral*" *Jurisprudence*].

¹⁹¹ *Everson v. Bd. of Educ.*, 330 U.S. 1 (1947).

¹⁹² U.S. CONST. amend. 1.

¹⁹³ *Everson*, 330 U.S. at 5.

but in the course of doing so spelled out the meaning of the Establishment Clause as follows:

Neither a state nor the Federal Government can set up a church. Neither can pass laws which aid one religion, aid all religions, or prefer one religion over another. Neither can force nor influence a person to go to or to remain away from church against his will or force him to profess a belief or disbelief in any religion. No person can be punished for entertaining or professing religious beliefs or disbeliefs, for church attendance or non-attendance. No tax in any amount, large or small, can be levied to support any religious activities or institutions, whatever they may be called, or whatever form they may adopt to teach or practice religion. Neither a state nor the Federal Government can, openly or secretly, participate in the affairs of any religious organizations or groups and *vice versa*. In the words of Jefferson, the clause against establishment of religion by law was intended to erect “a wall of separation between church and State.”¹⁹⁴

Justice Black emphasized that the individual is free to accept or to reject religious belief and that all governmental entities, whether local, state, or federal, must remain neutral, neither favoring nor disfavoring any religious persuasion.¹⁹⁵ In support of his opinion, Justice Black invoked not only Jefferson’s celebrated metaphor of “a wall of separation,” but also “Virginia’s Bill for Religious Liberty,” authored by the same patriot.

2. The Advent of the *Lemon* Test

In the cases that followed *Everson*, the Court declared unconstitutional a number of attempts by government to interject religion into public life. Based upon such decisions, the Court was able to formulate, almost a quarter of a century after *Everson*, what became known as the “*Lemon* test” for determining Establishment Clause violations. The test mandated that, in order to pass scrutiny (1) a statute have a secular purpose, (2) there be no evidence that the statute’s principal effect is to advance or to inhibit religion, and (3) the statute not foster excessive entanglement between government and religion.¹⁹⁶ The primary goal of this three-pronged test was to ensure that religion and the affairs of state be separate from each other. Religion was relegated to a private sphere of American life separate and distinct from the public one, where issues of state are debated and decided and its business is administered.¹⁹⁷

¹⁹⁴ *Id.* at 15–16.

¹⁹⁵ *Id.* at 18.

¹⁹⁶ *Lemon v. Kurtzman*, 403 U.S. 602, 612–13 (1971).

¹⁹⁷ The following cases are but a few in which the *Lemon* test was applied: *Stone v. Graham*, 449 U.S. 39 (1980), where the posting of the Ten Commandments in public school classrooms was held to violate the Establishment Clause; *Wallace v. Jaffree*, 472 U.S. 38 (1985), where the authorization of a period of silence “for meditation or voluntary

3. The Endorsement Test

Thereafter, Justice O'Connor, in a concurring opinion in *Lynch v. Donnelly*,¹⁹⁸ a case that involved whether a crèche displayed on public property in Pawtucket, Rhode Island during the holiday season violated the Establishment Clause, suggested that the *Lemon* test be modified and recast as an "endorsement test." According to Justice O'Connor, the question to ask, first off, is whether the government intends by a specific practice to convey a message of endorsement or disapproval of religion; secondly, whether the practice has the effect of communicating a message of endorsement or disapproval of religion; and thirdly, whether there is institutional entanglement between religion and the government.¹⁹⁹ This test was subsequently utilized by the Court in *County of Allegheny v. ACLU Greater Pittsburgh*.²⁰⁰ It is not appreciably different from the *Lemon* test in terms of attempting to insulate the state's business from any expression of religion. The goal was, at bottom, to safeguard the secular nature of all state endeavors, which are largely co-extensive with American public life.

4. The Coercion Test

Subsequently, the Court in *Lee v. Weisman*,²⁰¹ a case involving whether a rabbi offering a nonsectarian prayer at a school commencement ceremony violated the Establishment Clause, advanced its "coercion test." The Court explained that a state may not place any student at a school-sponsored event in the position of either participating in or protesting a religious activity. A person cannot, in short, be coerced; he or she cannot be made to feel

prayer" was held to violate the Establishment Clause; *PEARL v. Nyquist*, 413 U.S. 756 (1973), in which New York statutory amendments providing for (1) maintenance and repair of school facilities and equipment to insure the health, welfare and safety of pupils, (2) a tuition grant program, and (3) a tax benefit program for those failing to qualify for tuition reimbursement, and largely for the benefit of Roman Catholic schools and their students were declared violations of the Establishment Clause; *Meek v. Pittenger*, 421 U.S. 349 (1975), where sections of the Pennsylvania Public School Code were stricken down as offenses against the Establishment Clause insofar as they provided instructional material, equipment, and auxiliary services to parochial schools; *Wolman v. Walter*, 433 U.S. 229 (1977), in which an Ohio statute was held to violate the Establishment Clause by providing instructional materials, equipment, and field trip expense to parochial schools; and *Edwards v. Aguillard*, 482 U.S. 578 (1987), in which a Louisiana statute providing that there could be no teaching of the theory of evolution unless it was accompanied by instruction in "creation science" was held a violation of the Establishment Clause.

¹⁹⁸ 465 U.S. 668 (1984).

¹⁹⁹ *Id.* at 689–93 (O'Connor, J., concurring).

²⁰⁰ 492 U.S. 573 (1989) (holding that a crèche displayed by itself on public premises is a violation of the Establishment Clause).

²⁰¹ 505 U.S. 577 (1992). The Court followed *Lee* in *Santa Fe v. Doe*, 530 U.S. 290 (2000), in which the Court struck down a Texas school district's policy of allowing a student chaplain to pray at school football games.

like an outsider in an activity that is sponsored by an instrumentality of the state. The thrust of the coercion test was to defend individual autonomy by protecting the secular character of any activity in which the state is involved.²⁰²

5. The Historical Test

These three tests, whenever the Court desires, have been selectively used and then abandoned by it when considering establishment violations. A state act or practice can, rather mysteriously to some observers, be evaluated in terms of the antiquity of the practice involved. The Court, for example, decided that the Nebraska Legislature's eighteen-year practice of hiring a Protestant clergyman to open each day's legislative session with a prayer was not contrary to the demands of religious freedom or disestablishment.²⁰³ Such decisions left pundits wondering what factors determined which test would be applicable in future contests. Predictability in Establishment Clause cases largely vanished and an apparent case by case approach fast became the predominant rule, if there ever was one.²⁰⁴

Could it be that the Court's wavering approach to the anti-establishment norm indicated a largely subjective jurisprudence that was more concerned, in the spirit of Justice Holmes, with charting political policy than with attempting to measure, according to the rationale of a Christopher Langdell, some supposed Constitutional truth? It is to the political implications of the Court's jurisprudence that we turn next.

IV. ANALYSIS

A. Justice Black and the *Everson* Decision

1. *Everson* and the "Wall of Separation"

The *Everson*²⁰⁵ decision does not demonstrate the slightest attempt to understand Jefferson's correspondence with the Danbury Baptists, nor does the decision acknowledge any possible differences between the meaning that Jefferson imparted to the "wall of separation" and that which the Court gave to it. It appears that Justice Black appropriated the metaphor in a manner that was not only foreign to the third President's meaning and purpose, but to his political philosophy as well.

Critics may hasten to observe that it is hardly remarkable

²⁰² *Lee*, 505 U.S. at 588.

²⁰³ *Marsh v. Chambers*, 463 U.S. 783, 785–86 (1983).

²⁰⁴ *From Typology to Synthesis*, *supra* note 81, at 51–53.

²⁰⁵ *Everson v. Bd. of Educ.*, 330 U.S. 1 (1947).

for the Court, or for a Justice who has served on it, to make creative use of history and legal precedent in order to support or to oppose any given point-of-view. That is correct, but before incorporating a metaphor into the Religion Clauses of the First Amendment, is it too much to expect that a modest exegesis of the metaphor's meaning inform the endeavor?

When Jefferson utilized this phrase, there are numerous reasons to suggest he was attempting to point out that the national government had no power over religious concerns. Baptists, who had been sadly persecuted in New England and elsewhere for their dissident beliefs, desired assurances from the new President that he would support religious freedom and not the establishment of a national church. Might it be that he was attempting to give them this assurance in his now famous letter and, again, in his Second Inaugural Address? In the latter, he stated,

In matters of religion I have considered that its free exercise is placed by the Constitution independent of the powers of the General Government. I have therefore undertaken on no occasion to prescribe the religious exercises suited to it, but have left them, as the Constitution found them, under the direction and discipline of the church or state authorities acknowledged by the several religious societies.²⁰⁶

In view of such evidence, it is at best problematic to advocate that Jefferson meant by the metaphor to propose a thoroughly secular public life. He appeared to believe that the regulation of religion was best left to the individual states and to religious institutions themselves.

I am not dogmatically urging that the meaning of Jefferson's letter to the Baptists is a settled one; it is an open question admitting of diverse historical judgments. One may even allow, for the sake of argument and in accordance with the view of some historians, that Justice Black's appropriation of Jefferson's language is on the correct side of the argument. This allowance notwithstanding, the point is that the Justice's treatment of the issue is far from historically serious. One can only guess how he might have responded to the observation made in this Article, that Jefferson took up the metaphor in an attempt to limit national power, while his (Justice Black's) own purpose was unquestionably to expand it.

2. *Everson* and Politics

This brings one to the crux of the matter: the most salient fact about the majority decision in *Everson* is that it was a politi-

²⁰⁶ *Second Inaugural*, *supra* note 112, at para. 7.

cal one. In its aftermath, the Supreme Court, thanks additionally to the doctrine of incorporation,²⁰⁷ would be emboldened by its new authority to scrutinize all state action regarding religion and, in turn, to outlaw any manifestation of religious devotion that was co-mingled with a state-sponsored activity. The decision brought increased power to the Court by giving it a police function that allowed the Court essentially to redefine appropriate secular standards in the states and to assure that they be met. *Everson*, in short, had everything to do with politics and little, if anything, to do with a critical reading of history.

3. *Everson* and the Secular Revolution

The secular standards that *Everson* concretely laid down were far from new. They were not the product of the Court's ingenuity. They were part and parcel of the secular revolution that had already been accomplished in this country by the turn of the twentieth century and that had transformed Europe a century before that. Immanuel Kant had dichotomized reason, which, he insisted, had two spheres; one contained knowledge (with a sensible content), while the other comprised thinking (without it). The former was a theoretical realm of science and progress, whereas the latter was a practical one of metaphysics, morals, and religion. Science possessed a public character, while religion was relegated to personal and private life. The state, according to Kant, had no right to impose any religious or moral beliefs upon its citizens. It was to honor each person's individual autonomy.

The *Everson* decision constitutionalized not only Jefferson's metaphor, but also imparted to it the thought patterns of the secular revolution. *Everson* dictated that religious concerns and state concerns would forevermore be separate and distinct from each other. The state would not interfere with the autonomy of the individual in religious matters, but would be "a neutral in its relations with groups of religious believers and non-believers."²⁰⁸ What was more, the public square would be free of religion; specifically, of any form of religious expression in schools and school-sponsored events. Nonsectarian prayer and devotional Bible-reading without comment, released time programs for religious instruction, and any religious holiday displays would henceforth be regarded as imposing and coercive, as the illicit importation of private matters of faith into the public square. What the *Everson* decision did not state, even though it was written in large print between the lines, was that the Establishment Clause was to be

²⁰⁷ See *Cantwell v. Connecticut*, 310 U.S. 296, 303 (1940).

²⁰⁸ *Everson*, 330 U.S. at 18.

construed through the lens of the political dogma of liberalism, dating back at least to Kant and provided new twists by Comte and Spencer.

B. The Central Notions of Liberalism

The problem with liberalism has to do with its central notions, such as state neutrality and individual autonomy. Elsewhere I have analyzed these ideas,²⁰⁹ and I will not attempt to recapitulate here my previous discussions concerning them, other than briefly to point out that state neutrality constitutes an impossibility and that individual autonomy, when divorced from moral and religious boundaries, lends itself to anarchy and chaos.

Consider for a moment the situation in a public school classroom, in which there is no school prayer, devotional Bible-reading, singing of Christmas carols, display of the Ten Commandments, or group recitation of “under God” in the Pledge of Allegiance. The silence is unquestionably audible. Can even a distantly observant person think that this atmosphere does not convey a strong impression to a student concerning the significance (or, better yet, the insignificance) of these activities in the life of the community and in his or her life as a public citizen? If, on the other hand, such activities are part and parcel of the school curriculum, would any person dare defend them as “neutral”? State neutrality is a chimerical concept for law professors, philosophers, and Supreme Court justices to ponder and to make sense of, but it is a notion without clothing in the real world where people interact on a daily basis with one another.

Consider too a scene that has become commonplace on the streets of every major city in this country. A homeless drug-addict is offered, but refuses, the assistance of healthcare professionals. He or she “chooses” instead to continue living on a public sidewalk, where all his or her bodily functions are exercised. Does the idea of individual autonomy, unbounded by any and all moral and religious constraint, not inure to the society’s detriment? Is such a notion not tantamount to chaos? A realm of personal, private autonomy free of any such constraint cannot be defined consistent with the goals of freedom.

State neutrality and individual autonomy, as incoherent as both are, nonetheless constitute pillars of the secular ideal. It is this ideal that has inspired the *Lemon*, the endorsement, and the coercion tests. The “godless” state, which supposedly epitomizes

²⁰⁹ See “Religion-Neutral” Jurisprudence, *supra* note 190, and *From Typology to Synthesis*, *supra* note 81.

neutrality, exists to safeguard the individual autonomy of its citizenry by insuring that their decision-making process is untrammelled, however slightly, by the imposition of any moral or religious value that might, by happenstance or otherwise, creep into state-supported activity. Another name for this political regime, according to those who support it, is “the separation of church and state,” and among its many plaudits, is that it purportedly honors the memory of Thomas Jefferson and other American patriots. That is as historically suspect as its central notions are philosophically untenable.

C. The Epistemology of Liberalism

The idea of two spheres, one secular, embodying the naturalistic pursuit of knowledge, and the other religious, encompassing unverifiable belief and ritualistic practice, is not only unworkable, but also rests upon epistemological premises that are thoroughly doubtful, if not altogether incorrect. Kant and the other thinkers who shaped the secular revolution in both Europe and America were convinced that belief in God amounted to thinking and not knowing.²¹⁰ Indeed, for Comte, religious belief of any kind was superstitious and infantile; and, according to Spencer, religious knowledge was impossible because there was no corresponding empirical datum. Without re-tracing arguments made elsewhere, it must suffice to observe that the argument that science is intellectually rigorous and defensible, while religion is not, does not pass muster. The “truths” of science are not eternal. They are not part of a sphere of certitude; hence, they cannot be differentiated from religious claims in that fashion. As Alvin Plantinga reminds us with a hint of humor, John Trowbridge, who was chairman of the department of physics at Harvard University in the 1880s, encouraged students not to major in physics since most discoveries in the field had already been made;²¹¹ after all, there could be but one Newton as there was but one universe. Plantinga also underscores the temporary character of scientific truth, when he writes as follows: “We all know of scientific theories that once enjoyed consensus but are now discarded: caloric theories of heat, effluvial theories of electricity and magnetism, theories based on the existence of phlogiston, vital forces in physiology, theories of spontaneous generation of life, the luminiferous ether, and so on.”²¹²

²¹⁰ See “Religion-Neutral” Jurisprudence, *supra* note 190, at 836–39.

²¹¹ Alvin Plantinga, *Creation and Evolution: A Modest Proposal*, in DARWINISM, DESIGN, AND PUBLIC EDUCATION 519 (John Angus Campbell & Stephen C. Meyer eds., 2003).

²¹² *Id.*

It is most interesting to note that Richard Rorty, one of today's stellar proponents of liberal thought as well as a devout atheist, explains that he is opposed to religion, but not on epistemological grounds. He is quoted as stating the following:

I do not think that Christian theism is irrational. I entirely agree . . . that it is no more irrational than atheism. Irrationality is not the question but rather, desirability. The only reason I can think of for objecting to Christian theism is that a lot of Christians have been bigoted fanatics. But of course, so have a lot of atheists. . . .

. . . .

. . . Atheism is more practical only if you wish to form a pluralistic, democratic society. In that situation, the persistence of the theist who claims to know that this or that is against God's will becomes a problem. So atheists find themselves wishing that these groups would wither away.²¹³

Is Rorty not effectively conceding, then, that it is indefensible to argue that Christian theism should partake of a separate sphere because it is more irrational and more fanatically supported than a godless ideology? His point appears to be simply that atheism is more conducive to the formation of a democratic society. But that is a strange argument, is it not, when most of those within American society describe themselves as "Christian?" Rorty criticizes "the persistence of the theist who claims to know that this or that is against God's will" but he does not disapprove of the atheist who claims to know that it is not.

D. A Political Choice

The truth that pervades Rorty's transparent observation is the same one that rose to the surface in our discussion of the secular revolution and in our consideration of the Court's embrace of the liberal, secular ideal. That truth concerns politics. When phrased in its most elemental fashion, the issue concerns the kind of state in which one desires to live. Does one want to live in a secular state under a "godless Constitution," where each individual is an autonomous end to him- or herself, and where autonomy may often move perilously close to chaos? Or, alternatively, does one wish to live in a state where basic moral and religious values, including the notion of deity, are upheld and promoted, but where such values may create resentment and be experienced as an imposition? There is nothing magical about this choice. It need not, as I have demonstrated, be covered over with layer upon layer of historical investigation, philosophical

²¹³ Stephen Louthan, *On Religion—A Discussion with Richard Rorty*, *Alvin Plantinga*, and *Nicholas Wolterstorff*, 27 *CHRISTIAN SCHOLAR'S REV.* 177, 178, 183 (1996).

analysis, or judicial precedent-weighting. The problem is one that cannot be fully resolved by resorting to any of these modes of thought. Although they may contribute to the illumination of options, this does not alter the reality that the underlying problem involves making an easy to understand, even crudely simple, political choice.

The choice is not a lopsided one, where only one of the combatants comes loaded with historical and empirical evidence and heavy intellectual muscle. Except for the reality that traditional liberalism reigns as undisputed champion throughout most elite cultural institutions, like the academies of higher education, the media, and the Supreme Court, the match is, in most respects, an even contest. One searches in vain for an eternal truth dictating that higher education *must* marginalize the religious impulse, that the pursuit of science *must* be inextricably tied to methodological naturalism,²¹⁴ and that the law *must* be interpreted to mandate the secularization of the public square. Nowhere is it written, except in the political philosophy of liberalism and its cousins, such as naturalism and instrumentalism,²¹⁵ that religious thought has to be relegated to the nethermost regions of the mind and comprise what is ungraciously referred to, in political terms, as personal and private, or merely “sectarian,” belief.

The Supreme Court has not yet admitted what most pundits and political interest groups already know about it; namely, that the issues with which it, as an institution, must grapple boil down to a political struggle, pure and simple, and that the most significant measuring rod of where any Justice stands in the struggle concerns the way in which he or she understands the relation of religious values to the state. By and large, liberalism’s secular ideal still prevails on the Court, but there is reason to suspect that the ideal may no longer have the unconditional appeal it once had. To examine this contention, I now turn to the Court’s most recent decisions regarding the public display of the Ten Commandments.

²¹⁴ See L. Scott Smith, *On Teaching Neo-Darwinism in Public Schools: Avoiding the Pall of Orthodoxy and the Threat of Establishment*, 11 ROGER WILLIAMS U. L. REV. 143, 175–78 (2005). See also Alvin Plantinga, *When Faith and Reason Clash: Evolution and the Bible*, in INTELLIGENT DESIGN CREATIONISM AND ITS CRITICS: PHILOSOPHICAL, THEOLOGICAL, AND SCIENTIFIC PERSPECTIVES 113, 136–39 (Robert T. Pennock ed., MIT Press, 2001).

²¹⁵ For an invigorating, thoughtful, and provocative discussion of the way in which education, science, and law have been conjoined with and defined by the philosophy of naturalism, see generally PHILLIP E. JOHNSON, *REASON IN THE BALANCE: THE CASE AGAINST NATURALISM IN SCIENCE, LAW & EDUCATION* (1995). Naturalistic discourse is one of the byproducts of a public sphere from which religion is excluded.

V. THE PUBLIC DISPLAY OF THE TEN COMMANDMENTS

A. Introduction

The Supreme Court, during the summer of 2005, handed down two decisions concerning the public display of the Ten Commandments and did so with diverse outcomes. In the *Van Orden* decision, the Court held in favor of the display, but in the *McCreary County* decision held against it. A consideration of the various opinions by the Justices will aid one in understanding where each of them stands regarding the relationship between the state and its embodiment of religious values. More significantly, we will also be able to observe how the Justices are engaged in a political dispute, with the proponents of the liberal-secular ideal on the one side and the advocates of a state embodying some moral and religious values on the other.

B. *Van Orden v. Perry*

In *Van Orden*,²¹⁶ the text of the Ten Commandments was displayed on a monument, six feet high and three feet wide, that was located on twenty-two acres surrounding the Texas state capitol and containing a number of other monuments and historical markers.²¹⁷ Van Orden, the petitioner, sought first a declaration that the monument violated the Establishment Clause, and second, an injunction for its removal.²¹⁸ Chief Justice Rehnquist wrote the plurality opinion, in which Justices Scalia, Kennedy, and Thomas joined.

1. Chief Justice Rehnquist's Plurality Opinion

Chief Justice Rehnquist, rejecting Van Orden's claims, explained that the Court's decisions under the Establishment Clause attempt to address two concerns. The first is historical and consists of the positive role of religion and religious traditions throughout the country's history, while the second is philosophical and embodies the principle that state intervention in religious matters can impede religious freedom.²¹⁹ The challenge is to respect both concerns. "Our institutions," he reminded us, "presuppose a Supreme Being, yet these institutions must not press religious observances upon their citizens."²²⁰ There must be a respect for history and for the principle of church-state separation.

²¹⁶ 125 S. Ct. 2854 (2005).

²¹⁷ *Id.* at 2858.

²¹⁸ *Id.*

²¹⁹ *Id.* at 2859.

²²⁰ *Id.*

The Chief Justice, for reasons he failed to explain, does not consider the *Lemon* test “useful in dealing with the sort of passive monument”²²¹ involved in this case. The test that seems to shape his opinion most was the one of *Marsh v. Chambers*²²² that tends to measure, according to the antiquity of a religious practice, whether it has a place in American public life. He recited profusely from President Washington’s Thanksgiving Day Proclamation, in which the President announced an official day of prayer and thanksgiving to observe “with grateful hearts, the many and signal favors of Almighty God.”²²³ The Chief Justice further noted the public place of honor provided to Moses and the Decalogue within the Supreme Court’s own courtroom, as well as in the rotunda area of the Jefferson Building, on the floor of the National Archives, inside the Department of Justice, and in front of the Ronald Reagan Building.²²⁴ He was, of course, equally cognizant of legal precedents, like *McGowan v. Maryland*,²²⁵ in which the Ten Commandments have, at least in part, been upheld in public life. The Legislative and Executive branches, he maintained, have respectfully recognized the role of the Ten Commandments in America’s heritage.²²⁶

The religious character of the Decalogue is openly acknowledged in this opinion, but the Chief Justice stressed that “the Ten Commandments have an undeniable historical meaning.”²²⁷ It is really upon this “historical meaning” that his opinion turns. That the case involved neither primary nor secondary education and that Van Orden walked by the monument for a number of years before bringing his lawsuit were also facts deemed highly relevant to the opinion.²²⁸

2. Justice Thomas’s Concurrence

Justice Thomas, concurring in the Chief Justice’s opinion, argued for returning “to the views of the Framers and adopt[ing] coercion as the touchstone”²²⁹ for interpreting the Establishment Clause. In this context, “coercion” means one is compelled to take a particular action “by force of law and threat of penalty.”²³⁰ In this sense, Van Orden was obviously not coerced, and there is

²²¹ *Id.* at 2861.

²²² 463 U.S. 783 (1983).

²²³ *Van Orden*, 125 S. Ct. at 2861.

²²⁴ *Id.* at 2862.

²²⁵ 366 U.S. 420 (1961).

²²⁶ *Van Orden*, 125 S. Ct. at 2863.

²²⁷ *Id.*

²²⁸ *Id.* at 2863–64.

²²⁹ *Id.* at 2867 (Thomas, J., concurring).

²³⁰ *Id.* at 2865 (quoting *Lee v. Weisman*, 505 U.S. 577, 640 (Scalia, J., dissenting)) (emphasis omitted).

no cognizable establishment violation.²³¹

By recommending that the Court “return to the views of the Framers”²³² and to “the original meaning”²³³ of the Establishment Clause, Justice Thomas supported a particular historical understanding of the Constitution; i.e., the view that it was written sympathetically to religion and was never intended to secularize all activities sponsored by the states. He reminded us of the doubt he expressed in the *Newdow* case concerning whether the Establishment Clause is applicable to the states by reason of its incorporation into the Fourteenth Amendment.²³⁴ He continued to leave the door ajar for the entertainment of this theoretical possibility, by writing: “If the Establishment Clause does not restrain the States, then it has no application here, where only state action is at issue.”²³⁵

Reasons for adopting the method of originalism, he asserted, have to do in part with the inadequacies of the *Lemon* and endorsement tests, which have brought even the most trivial vestiges of the religious to the federal courthouse for litigation.²³⁶ Both tests save religious words and symbols from being stricken down as establishment violations only by “declaring them of little religious significance.”²³⁷ His point is that, to pass constitutional muster, words and symbols, even when admittedly religious, must be justified in secular terms. Such a compromise is unfair to believers and nonbelievers alike and results finally in judicial incoherence and confusion.²³⁸ The unintelligibility of the Court’s body of precedents in this area serves to highlight the eyebrow-raising specter that Establishment Clause cases turn finally on “judicial predilections”²³⁹ or, in other words, on “the personal preferences of judges.”²⁴⁰

3. Justice Breyer’s Concurrence

Concurring in the plurality’s judgment, Justice Breyer asserted that Establishment Clause cases are fact-intensive ones²⁴¹ and that there was and is “no test-related substitute for the exercise of legal judgment.”²⁴² He highlighted the following facts that

²³¹ *Id.*

²³² *Id.* at 2867.

²³³ *Id.* at 2865.

²³⁴ *Id.*

²³⁵ *Id.*

²³⁶ *Id.* at 2865–66.

²³⁷ *Id.* at 2866.

²³⁸ *Id.*

²³⁹ *Id.* at 2867.

²⁴⁰ *Id.*

²⁴¹ *Id.* at 2869 (Breyer, J., concurring in the judgment).

²⁴² *Id.*

were important to him in reaching his decision: specifically, that the monument was donated by the Fraternal Order of Eagles to shape civic morality as a way of combating juvenile delinquency,²⁴³ that its physical setting suggests little or nothing that is religious,²⁴⁴ that for forty years the location of the monument on public property was unchallenged,²⁴⁵ and that the display was not on public school grounds.²⁴⁶

After emphasizing what he regarded as decisive facts of the case, Justice Breyer weighed them against the *Lemon* test. The Texas display, he thought, demonstrated no religious purpose, illustrated that its primary effect was neither to advance nor to inhibit religion, and resulted in no excessive government entanglement with religion. Although his opinion happened to coincide with the three prongs of the *Lemon* test,²⁴⁷ Justice Breyer insisted that the formulation of his opinion rested upon a consideration of the basic purposes of the Religion Clauses, i.e., to “assure the fullest possible scope of religious liberty and tolerance for all,”²⁴⁸ rather than upon the application of any particular test.

4. Justice Stevens’s Dissent

Justice Stevens, with whom Justice Ginsburg joined in dissent, took the position that the state of Texas, by agreeing to the placement of the monument on capitol grounds, endorsed “the divine code of the ‘Judeo-Christian’ God.”²⁴⁹ Justice Stevens passionately opined, “[i]f any fragment of Jefferson’s metaphorical ‘wall of separation between church and State’ is to be preserved—if there remains any meaning to the ‘wholesome “neutrality” of which this Court’s [Establishment Clause] cases speak,”²⁵⁰ then the subject display is unquestionably unconstitutional.

Not only does the display constitute Texas’s endorsement of a divinely-given Code, but the state, argued Justice Stevens, is also unwittingly fueling a sectarian conflict concerning which version of the Code is the proper one, since the display features one version of it to the exclusion of others.²⁵¹ If this were not enough constitutionally to condemn the display, one could likewise consider that it impermissibly prefers religion over irreligi-

²⁴³ *Id.* at 2870.

²⁴⁴ *Id.*

²⁴⁵ *Id.*

²⁴⁶ *Id.* at 2871.

²⁴⁷ *Id.*

²⁴⁸ *Id.* at 2868 (quoting *School Dist. of Abington Twp. v. Schempp*, 374 U.S. 203, 305 (1963)).

²⁴⁹ *Id.* at 2874 (Stevens, J., dissenting).

²⁵⁰ *Id.* (quoting *School Dist. of Abington Twp. v. Schempp*, 374 U.S. 203, 222 (1963)).

²⁵¹ *Id.* at 2879–80.

gion, such that nonbelievers and polytheists are made to feel like outsiders.²⁵²

Justice Stevens reserved his most forceful criticism for those who advocate originalism. First, he stated that the Founders' speeches, some of them with prolific religious allusions, should not be interpreted as a direct reflection of the government's position on the church-state relationship, as would the "permanent placement of a textual religious display on state property."²⁵³ Second, he reminded us that religious statements and proclamations were not espoused at the Constitutional Convention nor enshrined in the text of the founding document.²⁵⁴ Third, he observed that historical investigation renders ambiguous results, noting that Jefferson refused to issue Thanksgiving proclamations and that Madison, in his *Detached Memorandum*,²⁵⁵ later voiced disapproval of his public religious proclamations and of the appointment of Congressional chaplains at state expense.²⁵⁶ Fourth, the Justice noted that many of the Framers understood the word "religion" in the Establishment Clause to include only Christian sects;²⁵⁷ thus, a return to the original meaning of the word would necessitate the exclusion of those in other religions. Fifth, he argued that the Establishment Clause narrowly constricted to the national government and not applicable to state governments through the incorporation doctrine would mean that a state could "constitutionally adorn all of its public spaces with crucifixes or passages from the New Testament . . . [or] would also have full authority to prescribe the teachings of Martin Luther or Joseph Smith as *the* official state religion."²⁵⁸

Justice Stevens, in conclusion, emphasized, "[t]he principle that guides my analysis is neutrality."²⁵⁹ It is a principle, he asserted, rooted in this country's history as well as in the text of the Constitution.²⁶⁰

5. Justice Souter's Dissent

The thrust of Justice Souter's dissent, joined by Justice Ginsburg, was that the Establishment Clause "requires neutral-

²⁵² *Id.* at 2881.

²⁵³ *Id.* at 2883.

²⁵⁴ *Id.*

²⁵⁵ James Madison, *A Detached Memorandum*, in SEPARATION OF CHURCH AND STATE, *supra* note 7, at 138, 141.

²⁵⁶ *Van Orden*, 125 S. Ct. at 2884 (Stevens, J., dissenting).

²⁵⁷ *Id.* at 2885.

²⁵⁸ *Id.* at 2887.

²⁵⁹ *Id.* at 2889.

²⁶⁰ *Id.*

ity as a general rule.”²⁶¹ Relying upon *Stone v. Graham*,²⁶² Justice Souter stated that there is no doubt the Ten Commandments amount to a religious statement.²⁶³ When displayed on public property any such religious text constitutes a violation of the Establishment Clause, unless the circumstances of its display indicate that it is not placed there “with a predominant purpose on the part of government either to adopt the religious message or to urge its acceptance by others.”²⁶⁴ In this instance, “the government of Texas is telling everyone who sees the monument to live up to a moral code because God requires it.”²⁶⁵ Governmental neutrality, stressed the Justice, has been lost in this instance: “any citizen should be able to visit that civic home without having to confront religious expressions clearly meant to convey an official religious position that may be at odds with his own religion, or with rejection of religion.”²⁶⁶

Justice Souter distinguished between Texas’s display of the Decalogue and “any number of perfectly constitutional depictions”²⁶⁷ of it, such as the frieze in the Justices’ own courtroom, on which Moses is secularly depicted as one lawgiver, among many, holding the tablets of the Commandments.²⁶⁸ Although the Texas display is one of numerous ones on the state capitol grounds, Justice Souter doubted the secular purpose of it, since he did not think that it is tied by appearance, history, or aesthetic sense to the other monuments, but stands on its own.²⁶⁹

C. *McCreary County, Kentucky v. ACLU of Kentucky*²⁷⁰

1. Introduction

McCreary and Pulaski Counties, in the state of Kentucky, conspicuously displayed the King James version of the text of the Ten Commandments in their respective courthouses.²⁷¹ After litigation was instituted by the American Civil Liberties Union of Kentucky against the two counties seeking to enjoin the displays, the counties each altered their displays on two separate occasions, first by expanding the display²⁷² and, second, by installing

²⁶¹ *Id.* at 2892 (Souter, J., dissenting).

²⁶² 449 U.S. 39, 42–43 (1980) (holding that the mandatory posting of the Ten Commandments in public classrooms violated the Establishment Clause).

²⁶³ *Van Orden*, 125 S. Ct. at 2892 (Souter, J., dissenting).

²⁶⁴ *Id.*

²⁶⁵ *Id.* at 2893 (citation omitted).

²⁶⁶ *Id.* at 2897.

²⁶⁷ *Id.* at 2894.

²⁶⁸ *Id.* at 2893–94.

²⁶⁹ *Id.* at 2895.

²⁷⁰ 125 S. Ct. 2722 (2005).

²⁷¹ *Id.* at 2728.

²⁷² *Id.* at 2729.

another display that still featured the Commandments.²⁷³ In the second display, the Commandments were central to it, but were present along with eight small-framed documents bearing a religious theme.²⁷⁴ In the third display, set up after the district court had ordered the removal of the second one in each county, nine framed documents of equal size were posted.²⁷⁵ The third display was not set up pursuant to any new county resolution.²⁷⁶

2. Justice Souter's Majority Opinion

Justice Souter, with whom Justices Breyer, Stevens, Ginsburg, and O'Connor joined, emphasized that the counties' actions had no secular purpose and, hence, violated the "central Establishment Clause value of official religious neutrality,"²⁷⁷ still as important "an interpretative guide"²⁷⁸ as it was in *Everson*.²⁷⁹ Reminding the two counties that "the world is not made brand new every morning,"²⁸⁰ the Court, by means of the fictional "objective observer"²⁸¹ of the endorsement test, is free to examine the history of the counties' various displays and to conclude that, when considered together, they demonstrated a definite governmental purpose to advance a form of religion.

Justice Souter criticized the originalism of Justice Scalia, insisting that the latter's reliance upon the Framers is at best inconclusive as there is no compelling evidence of a consensus among them regarding the role of religion in public life. Justice Souter further lambasted his colleague's view that the deity of the Framers "was the God of monotheism"²⁸² and pointed out, *à la* Justice Story, that the purpose of the Establishment Clause was simply "to exclude all rivalry among Christian sects."²⁸³ The original meaning of the clause, in other words, did not give a privileged place to monotheistic conceptions of deity "with Mosaic antecedents."²⁸⁴

3. Justice O'Connor's Concurrence

Justice O'Connor joined the majority's opinion. She main-

²⁷³ *Id.* at 2730.

²⁷⁴ *Id.* at 2729.

²⁷⁵ *Id.* at 2730.

²⁷⁶ *Id.*

²⁷⁷ *Id.* at 2733 (majority opinion).

²⁷⁸ *Id.* at 2742.

²⁷⁹ 330 U.S. 1 (1947).

²⁸⁰ *McCreary*, 125 S. Ct. at 2736.

²⁸¹ *Id.* at 2735.

²⁸² *Id.* at 2744.

²⁸³ *Id.* at 2745 (quoting Justice Story, in R. CORD, SEPARATION OF CHURCH AND STATE: HISTORICAL FACT AND CURRENT FICTION 13 (1988)) (emphasis omitted).

²⁸⁴ *Id.*

tained that the Establishment Clause prohibits government coercion, preference, and endorsement in matters of religion,²⁸⁵ and opined that the counties' display "conveys an unmistakable message of endorsement to the reasonable observer."²⁸⁶

4. Justice Scalia's Dissent

Justice Scalia was joined in his dissent by the Chief Justice, Justice Thomas, and Justice Kennedy in part, and proclaimed his desire to return to the original meaning of the Establishment Clause. To that end, he pointed out that the first actions by all three branches of the national government²⁸⁷ were to foster morality and civil responsibility by encouraging religion.²⁸⁸ He adduced supportive evidence from Presidents Washington, John Adams, Jefferson, and Madison²⁸⁹ and asked, "With all of this reality (and much more) staring it in the face, how can the Court possibly assert that the "the First Amendment mandates governmental neutrality between . . . religion and nonreligion?"²⁹⁰

The principle of religion-neutrality has, he stated, been abandoned by the Court on a number of occasions.²⁹¹ The only "good reason"²⁹² why the Court occasionally ignores it has to do with the desire to save face with the American people who, he insisted, would not stand for an across-the-board application of it.²⁹³ Because Justice Scalia rejects the principle, he found no reason to declare that the counties' displays of the Ten Commandments violated the Establishment Clause. According to his reading of the Clause, it permits the disregard of polytheists as well as of atheists.²⁹⁴

Justice Scalia pointed out that he has adduced in support of his position, in contrast to that of Justice Stevens, primarily official acts and proclamations of the United States, such as the First Congress's commencement of the practice of legislative prayer, its appointment of congressional chaplains, its proposal of a Thanksgiving Proclamation, President Washington's Thanksgiving Proclamation, and the invocation of God at the opening of sessions of the Supreme Court.²⁹⁵ In further reply to

²⁸⁵ *Id.* at 2746 (O'Connor, J., concurring).

²⁸⁶ *Id.* at 2747.

²⁸⁷ *Id.* at 2748–49 (Scalia, J., dissenting).

²⁸⁸ *Id.* at 2749.

²⁸⁹ *Id.* at 2749–50.

²⁹⁰ *Id.* at 2750.

²⁹¹ *Id.* at 2751–52.

²⁹² *Id.* at 2752.

²⁹³ *Id.*

²⁹⁴ *Id.* at 2753.

²⁹⁵ *Id.* at 2753–54.

his colleague, Justice Scalia maintained that, even though the text of the Constitution may fail to elucidate the meaning of the Establishment Clause, such official state actions do.²⁹⁶ In addition, the religious view supported by the Framers was, he opined, broadly monotheistic, since they proclaimed a single beneficent God, but never Jesus Christ.²⁹⁷

Justice Scalia of course took issue with the notion of the “living Constitution.”²⁹⁸ He questioned why, if the Constitution is supposed to change in accordance with “democratic aspirations,”²⁹⁹ the same are always found in the Justices’ own personal views of the Establishment Clause rather than in the current society’s dispositions.³⁰⁰

He likewise denied that his originalist position marginalizes the belief systems of millions of Americans who are not of a monotheistic persuasion. Far from it. Polytheism, he insisted, is completely protected by the Religion Clauses, but it does not follow from that fact that the state’s invocation of God is an establishment.³⁰¹

Justice Scalia believed that the net effect of *McCreary* is to heighten the requirements of *Lemon*, first by justifying inquiry into legislative purpose as a means of ascertaining how governmental action would appear to an objective observer, and second by requiring that a secular purpose predominate over any purpose to advance religion.³⁰² In other words, no longer is the search for a secular purpose, but the search now consists of a rigorous and full-scale review of the facts with the idea that, in order to pass constitutional muster, any religious purpose must be subordinate to the secular one.³⁰³

Justice Scalia concluded his dissent with the observation that the exhibits in question were meant only to focus upon the historic role of religious belief in the country’s communal life. That role, he insisted, is permissible.³⁰⁴ To outlaw them on that basis is to fall prey to what Justice Goldberg once called an “untutored devotion to the concept of neutrality”³⁰⁵ and would, without question, “commit the Court (and the Nation) to a revisionist

²⁹⁶ *Id.* at 2754–55.

²⁹⁷ *Id.* at 2755.

²⁹⁸ *Id.* at 2756.

²⁹⁹ *Id.*

³⁰⁰ *Id.*

³⁰¹ *Id.*

³⁰² *Id.* at 2757.

³⁰³ *Id.* at 2758.

³⁰⁴ *Id.* at 2762–63.

³⁰⁵ *Id.* at 2763 (quoting *School Dist. of Abington Twp. v. Schempp*, 374 U.S. 203, 306 (1963) (Goldberg, J., concurring)).

agenda of secularization.”³⁰⁶

VI. ANALYSIS

A. Any Sure Verdict from History?

The opinions of the Justices concerning governmentally supported religious displays turn, in large part, upon a consideration of the role of religion in the earliest days of the Republic. Justices Scalia and Thomas are convinced that the Framers, including Thomas Jefferson, who was not in attendance at the Constitutional Convention, appreciated public religion and desired to encourage it. Justices Souter and Stevens, on the other hand, entertain doubts about that proposition. Yet they all cull through the pages of history, quick to highlight any evidence to support their respective points-of-view. There is a veritable mountain of evidence on either side of the issue, but these are separated by a canyon, both deep and wide, representing the historically unknown, and perhaps unknowable. The crux of the problem is that the Constitutional Convention did not explicitly and substantively address the role of religion in public. Nowhere within the paragraphs of the country’s founding document is there so much as a reference to God. We are left, ultimately, looking down into an abyss of silence, from and about which we are free to conclude whatever we wish. My contention is not that all historical investigations end in deadlock, but that the search for a consensual view among the Founders concerning the role of religion in public life is an investigation that has managed to disappoint more than it has satisfied hopeful expectation. The search has proven to be an historical dead-end.³⁰⁷

Arguing about that which is irresolvable raises a host of interesting questions, not the least of which is the following: “What do we hope to accomplish by the exercise?” The issues of the de-

³⁰⁶ *Id.*

³⁰⁷ Steven G. Gey, in critical response to Carl H. Esbeck’s historical conclusions from history regarding the church-state relationship throughout the early years of the Republic, is not sanguine about the historical approach to the Religious Clauses. Gey astutely points out, “When all is said and done, the historical account of church and state in the early republic leaves us right where we started . . .” See Steven G. Gey, *More Or Less Bunk: The Establishment Clause Answers That History Doesn’t Provide*, 2004 B.Y.U. L. REV. 1617, 1630 (2004). Gey further argues, “History frames the discussion about constitutional meaning and provides a context in which the various dimensions of constitutional questions can be viewed in sharp relief. History provokes us to ask the right questions, but it will never give us all the right answers.” *Id.* at 1631. With these comments, I generally agree. But then Gey, more than a bit mysteriously, adds, “However, an honest fealty to history will yield an Establishment Clause that no religiously pluralistic modern democracy would want or accept.” *Id.* This statement tends to assume that an “original meaning” is discoverable if the historical investigator is but honest in the pursuit of it. Gey has, whether he knows it or not, stated two positions that are not compatible.

bate may certainly be brought into stark, trenchant focus, but that in and of itself does not issue in a resolution. Perhaps one will be sufficiently impressed by particular strands of evidence that he or she will venture a conclusion and defend it in a two-fisted manner in a learned monograph. Yet others taking an antipodal position will do the same. The question is whether, given the state of the evidence, the kind of historical argument in which the Justices are engaged is not an exercise in futility.

I contend that it is, if the hope is for an answer beyond reasonable dispute. As the Justices' expressions of opinion about establishment matters have grown increasingly animated, the Court has become more deeply divided than ever. That is because the problem posed by the presence of religion in circles of state is not one that will ever be resolved by historical inquiry. Resort to the metaphorical mantra of "a wall of separation" solves nothing; it only triggers the historical reflection that has plunged the Court into its current morass. Historical investigation may certainly enlighten us by charting one or more plausible explanations, but it is farfetched to believe that such investigation will one day conclude the debate.

B. A Discussion of Justice Scalia's Originalism

Justice Scalia's determination to uncover the original meaning of the Establishment Clause purchases a variety of assumptions that are problematic. The first is that "original meaning" lends itself to discovery through meticulous historical investigation. This assumption is false; in fact, the "original meaning" that one derives from an investigation appears to have as much, if not more, to do with the historical investigator as it does the data investigated. How are we, for example, to assess James Madison's *Detached Memorandum*? Is it a group of idle reflections teetering upon irrelevancy by virtue of having been written by the man years after he left office? Or does the *Memorandum* provide us the profoundest kind of insight into Madison's most seasoned thoughts? In the same way, when William Williams of Connecticut, who suggested that the Preamble of the Constitution be modified to include reference to "the one living and true God, the creator and supreme Governour of the world,"³⁰⁸ but nonetheless approved the document without this or any other such reference, what may we conclude by his action? Some may argue he came to accept the notion that the Constitution is an entirely secular document, while others may charge that, since the choice before the state ratifying conventions was either to ac-

³⁰⁸ See William Williams to the Printer, *supra* note 21, at 193.

cept or to reject the newly proposed Constitution, he chose to do the former in the hope that the document would later be amended. On what principled basis do we decide upon the “original meaning”?

Yet let us assume, *arguendo*, that the welter of historical questions that present themselves concerning the Framers’ thoughts, ideas, and intentions regarding the relationship between religion and the state readily lend themselves to original meaning analysis. What precisely are we to do with our conclusions? Are we free, in Pickwickian fashion, to transplant them into our contemporary state and culture, into post-modernity if you will? If so, how do we square original meanings with our radically expanded notion of the state, our changing demographics, and the advent of cultural problems the Framers could scarcely have imagined? Even Justice Scalia is not sufficiently audacious to suggest that original meanings can broadjump into the twenty-first century.

He has instead involved himself, perhaps unwittingly, in an exercise chock-full of assumptions and abstractions. Consider the progression of his argument—he defends public displays of the Decalogue by appealing to the Framers’ monotheistic vision of God, and then moves to a “disregard of polytheists and believers in unconcerned deities.”³⁰⁹ The First Commandment states, “Thou shalt have no other gods before me.” It exemplifies a henotheistic faith, one defined as belief in a single deity without denying the existence of others, rather than a monotheistic faith, which holds to belief in a single god. Justice Scalia’s transition from the Ten Commandments to monotheism is unwarranted. His conclusion that “polytheists and believers in unconcerned deities” can be disregarded on the strength of the Establishment Clause does not follow, since he has not proven that the Commandments, which he believes shaped the Framers’ religious views, are built upon a monotheistic faith.

Even if the transition from the Commandments to the Framers’ view of God were perfectly sound, one still cannot move from Christian monotheism to monotheism in general without engaging a formidable abstraction and being transported a considerable distance from the Framers’ original meaning. Monotheism does not necessarily entail beneficence or grace. One may believe in a single deity who instructs his or her devotees to kill and to plunder their neighbors as infidels. Such a belief, I dare say, is light-years from the notion of deity entertained by any of the Framers. So Justice Scalia’s attempt to capture original meaning

³⁰⁹ *McCreary*, 125 S. Ct. at 2753 (Scalia, J., dissenting).

succeeds mainly in disclosing his own “judicial predilections” and “personal preferences,”³¹⁰ an endeavor that his comrade in arms, Justice Thomas, roundly criticizes.

C. Justices Souter and Stevens on Neutrality

It is to Justice Breyer’s credit that he frankly admits the role of subjective “legal judgment” in Establishment Clause cases.³¹¹ Those with whom he voted in both *Van Orden* and *McCreary*, to be sure, exercised such judgment. Justices Stevens and Souter did so, although they appeared to rest their judicial analysis on the principle of neutrality. Justice Souter declared, “If neutrality in religion means something, any citizen should be able to visit that civic home [the capitol grounds in Texas] without having to confront religious expressions clearly meant to convey an official religious position that may be at odds with his own religion, or with rejection of religion.”³¹² Justice Stevens also insisted, “The principle that guides my analysis is neutrality.”³¹³ What they both mean by “neutrality” is that the state is to be indifferent to religion, relegating it to a private sphere. They mean that the Constitution is a godless document that was intended to create a godless state. If one can walk the capitol grounds in Austin, Texas and not be confronted by religious expressions, that suggests that religious expressions are banned there. “Neutrality,” for these Justices, bristles with hostility to religion. I have elsewhere analyzed the various meanings of this term and concluded, “The net effect of utilizing the concept of neutrality in religion cases amounts to little more than judicial legerdemain and obfuscation.”³¹⁴ What more can one say about judicial action that

³¹⁰ *Van Orden v. Perry*, 125 S. Ct. 2854, 2867 (Thomas, J., concurring).

³¹¹ *Id.* at 2869 (Breyer, J., concurring in the judgment). Gregg Abbott, the Texas Attorney General who defended the constitutionality of the Decalogue display in the *Van Orden* case, comments that Justice Breyer’s “legal judgment” rule may prove fulcrumatic in the future.” Gregg Abbott, *Upholding the Unbroken Tradition: Constitutional Acknowledgment of the Ten Commandments in the Public Square*, 14 WM. & MARY BILL RTS. J. 51, 59 (2005). Is it a “rule” or a judicial decision-making process? It is difficult for one to understand how this “rule” constrains a Justice to any outcome other than the one which he or she desires.

³¹² *Van Orden*, 125 S. Ct. at 2897 (Souter, J., dissenting).

³¹³ *Id.* at 2889 (Stevens, J., dissenting).

³¹⁴ “*Religion-Neutral Jurisprudence*,” *supra* note 190, at 815, 870. It is important to realize that “neutrality” is a term that conveys various meanings, depending upon the underlying political theory driving the interpretation of the Religion Clauses. Their opinions in these two Ten Commandments cases leave no doubt that Justices Souter and Stevens are using the term to mean indifference toward the religious, which for them has no constructive role to play in the public arena. Yet compare their opinions here with the majority opinion in *Zelman v. Simmons-Harris*, 536 U.S. 639 (2002), emphasizing that a school voucher program was religion-neutral, because it conferred educational benefits to a large group of people “without reference to religion.” *Id.* at 653. Needless to say, Justices Souter and Stevens dissented. The latter stated that “the voluntary character of the private choice to prefer a parochial education over an education in the public school sys-

purports to be neutral toward the religious while prohibiting it in all state-sponsored activity and, at the same time, giving the irreligious free reign?

This rhetorical question brings me to a crucial point concerning the secular ideal. The kind of neutrality that Justices Souter and Stevens praise is that of traditional liberalism, which commits one to a secular revisionist agenda. Liberalism dichotomizes our lives into public and private spheres. Religious expression finds a home only in the latter. This means that congressional and legislative chaplains, references to God on the currency or in the Pledge of Allegiance, an isolated public display of the Ten Commandments or of a crèche during the holiday season, prayer and devotional Bible-reading in public schools, and all other references to God in the public sphere are misguided, out-of-place, and coercive. But why must the Establishment Clause of the Constitution be so interpreted? I have argued in Parts II through V of this Article that such a necessity is not real, but only imagined. Neutrality, as understood by Justices Souter and Stevens, is shorthand for the secular ideal of traditional liberalism. That ideal is not dictated by the actual text of the Constitution any more than Justice Scalia's original meanings.

D. Toward a Political Jurisprudence

If we reject traditional liberalism and its secular ideal and reject Justice Scalia's method of original meaning, where does that leave us? It leaves us in precisely the same place where we were following Part V of this Article. We have a political choice to make, either in favor of the godless state or against it.

It is not popular to regard Supreme Court Justices as propounding answers to political questions. Yet that is what they do when they confront Establishment Clause cases. Both "original meaning" and "neutrality" analysis are ways of expressing political positions. Original meaning is an expression of what I have elsewhere called "de facto establishmentarianism,"³¹⁵ and "neutrality" embodies, as I have stated, the philosophy of liberalism.³¹⁶ While neither is found in the actual text of the Constitution, both are typologies that are implied by the Religion Clauses.

tem seems to me quite irrelevant to the question whether the government's choice to pay for religious indoctrination is constitutionally permissible." *Id.* at 685 (Stevens, J., dissenting). Justice Souter, in a similar way, viewed the Ohio voucher program to be in conflict with *Everson*. *Id.* at 688 (Souter, J., dissenting). The meaning of neutrality depends upon the political theory that is in place.

³¹⁵ L. Scott Smith, *Constitutional Meanings of "Religion" Past and Present: Explorations in Definition and Theory*, 14 TEMP. POL. & CIV. RTS. L. REV. 89, 117 tbl (2004).

³¹⁶ *Id.*

The Supreme Court, instead of engaging in what is at best a sophistic debate, where genuine political perspectives are camouflaged and obscured by glib discussions of “neutrality” and “original meaning,” could do much better to admit that the resolution of Establishment Clause cases is not to be found in historical investigation, philosophical analysis, or the examination of legal precedents, although all three may contribute to decisions. The essential, but missing, ingredient from the Court’s discussions is a frank acknowledgment of the importance of political typology.

“Political typology” does not suggest that there be an open, free-for-all discussion of politics in judicial decisions, but of only those political positions that result from combining the Religion Clauses of the First Amendment. What I mean by “combining the Religion Clauses” may be briefly explicated as follows: the Establishment Clause may be understood in terms of “accommodationism” or “separationism,” and the Free Exercise Clause in terms of “narrow” or “expansive” free exercise. The various combinations of these possibilities give rise to four political points-of-view: (1) separationism and narrow free exercise—classical liberalism; (2) separationism and expansive free exercise—communitarianism; (3) accommodationism and expansive free exercise—revised liberalism; and (4) accommodationism and narrow free exercise—de facto establishmentarianism.

These political typologies can contribute to an overarching synthesis, which allows one to recast the jurisprudence of religion in a straightforward and hardheaded political fashion. Elsewhere I have attempted to do this.³¹⁷ The primary advantage of such an effort is that, while it acknowledges that the Religion Clauses lend themselves to various forms of political analysis, it presses forward toward a comprehensive, synthetic approach of adjudication, without allowing any one typological position to be overwhelmed by the others. What is more, because the approach I am defending is balanced, it might well present itself as a helpful compromise for breaking the ideological and political logjam that presently divides the Court and that renders its jurisprudence of religion a “muddle.”³¹⁸

³¹⁷ *From Typology to Synthesis*, *supra* note 81.

³¹⁸ Michael W. McConnell, *The Religion Clauses of the First Amendment: Where Is the Supreme Court Heading?*, in *FIRST AMENDMENT LAW HANDBOOK* 269 (James L. Swanson & Christian L. Castle eds., 1990). One may ask about *Van Orden* and *McCreary*, “Where do these split decisions leave those desiring to post the Decalogue, or wondering if existing postings pass Constitutional muster?” See Sue Ann Mota, *Competing Judicial Philosophies and Differing Outcomes: The U.S. Supreme Court Allows and Disallows the Posting of the Ten Commandments on Public Property in Van Orden v. Perry and McCreary County v. ACLU*, 42 WILLAMETTE L. REV. 99 (2006), in which the author attempts to give the reader guidelines by which to chart constitutionality. *Id.* at 120. Such an effort is largely misspent. The fact is that there is a political tug-of-war occurring on

CONCLUSION

“Does God belong in American public life?” is the question with which we began. The answer is nowhere explicitly set forth in the Constitution, nor is it unambiguously suggested by a study of the Framers’ ideas and actions. Any answer to the question derived from in-depth historical inquiry will, at best, receive only support from, not be necessitated by, that inquiry. Kramnick and Moore, as I have argued, will convince no one of the truth of their thesis who is not already convinced. After examining the historical evidence pertaining to whether the Constitution was intended to create a godless state, a fair-minded investigator, not given to tendentious examination of the sources, will admit that he or she is unsure.

The historical uncertainty that looms over this question compels one to ask another: Why, then, has the Establishment Clause, since *Everson*, been interpreted as if the Constitution were intended to give birth to a secular state? I have argued that this has little to do with the Constitution and most everything to do with the secular revolution that roared like a tsunami over Europe and began flooding into this country during the last half of the nineteenth century. By the end of that century, higher education, the pursuit of the natural sciences, and the study of law had begun functioning in a secular mode. By the middle of the twentieth century, the Supreme Court had interpreted the Establishment Clause as erecting a “wall” by which to protect the state from the slightest vestiges of religion. The Court, by means of the incorporation doctrine and a disregard for the balances of federalism, had essentially proclaimed itself the unconditional guardian of liberty, who meticulously polices the “high and impenetrable wall” separating American public life from religious words and actions. I have suggested, categorically and unabashedly, that the Court’s secularization agenda was an attempt to enhance its own power as well as to walk in step with the intelligentsia’s secular revolution.

One’s answer to the question posed by this Article, I have also maintained, comes down in the final analysis to a political determination. Either one accepts the idea of a secular state or one rejects it. There is no place to look outside politics for a definitive answer.

the Court, and Establishment decisions hang frequently by a mere thread. What is at stake is whether the secular ideal of traditional liberalism, as set forth in *Everson*, will continue to survive. There is little for the practitioner to do than to present the most compelling arguments he or she can on one side or the other, with the realization that the debate is essentially about politics, not interpreting the fine points of legal precedent.

The Supreme Court's recent adjudication of two cases involving the public display of the Ten Commandments demonstrates the inconclusiveness of any historical argument, since the same Justices in both cases adduced evidence to affirm one display and to outlaw the other. The thoroughly transparent arguments in behalf of "original meaning" and "neutrality" serve only to highlight the underlying political nature of the question before the Justices and their political treatment of it.

Finally, I have recommended that the Court break its blockage of discourse and self-consciously adopt a political theory of religion-jurisprudence, one that holds together the strongest points of the political typologies that emerge from a consideration of the Religion Clauses. Since the Court is involved in political policymaking anyway, such a theory would not be an extreme departure from its routine practice. Yet the theory would demand that the Court honestly acknowledge the political nature of the subject matter. The balance in the theory would also comprise a kind of compromise, since using the theory means holding all political perspectives in a synthetic unity without allowing one perspective to be overwhelmed by the rest. The notion of deity, conceived in a broad, but not explicitly Christian manner (de facto establishmentarianism), can and should belong to American public life, along with a respect for the values of individual autonomy (classical liberalism), freedom of association (communitarianism), and freedom of expression (new liberalism).³¹⁹

³¹⁹ See *From Typology to Synthesis*, *supra* note 81.

Evolution, Science, and Ideology: Why the Establishment Clause Requires Neutrality in Science Classes

*Stephen W. Trask**

INTRODUCTION

Public education is often considered to be one of the most benign aspects of state power. Many people question how such a benevolent institution could be labeled as coercive when it rarely even engages in corporal punishment. It is the dominance of this assumption in society that allows compulsory public education to conceal its considerable coercive power. The source of this power is the inherent capacity of public education to shape how students view the world. Both the public education system and the elites who influence it use this power to serve their own ideological ends. One of the best examples of this ideological coercion is the choice of public schools to teach evolutionary theory as the exclusive explanation for the origin of life. Both public schools and federal courts justify the failure to teach alternatives with the claim that evolutionism is the only *scientific* explanation for the origin of life. In reality, alternatives to evolutionary theory are only unscientific to the extent that one relies on a *secular* definition of the scientific method. Relying on a slanted definition of science will inevitably produce a rigged game when one determines whether a theory is scientific.

Although some school districts and legislatures have attempted to solve this problem, the federal courts have used the Establishment Clause to obstruct all attempts at reform. The underlying cause of this situation is both philosophical and legal. Flawed epistemological assumptions have produced flawed legal reasoning. Because the problem has two sources, the solution must also have two aspects. First, people should recognize that the definition of science, which is legitimizing the exclusion of alternatives to evolutionary theory, is ideological. Second, the U.S. Supreme Court should hold that the failure to teach alternatives

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to evolutionary theory in public school science classes is an establishment of religion under the First Amendment. Section I of this paper will analyze the false epistemological assumptions that are legitimizing the indoctrination of students into evolutionary theory. Section II will examine Establishment Clause cases that have dealt with evolutionism. Section III will discuss why the exclusive teaching of evolutionism in public schools violates the Establishment Clause.

I. UNMASKING SECULAR HUMANISM

Nearly all public schools teach evolutionism without incorporating alternatives to evolutionism into the curriculum.¹ In order to address the legal errors that have produced this situation, it is first necessary to address the epistemological errors that are justifying the exclusion of alternatives to evolutionary theory from public school science classes. Some late twentieth-century philosophers examined the role that knowledge can play in justifying the exclusion of non-conforming belief systems. An exploration of the thought of these philosophers will offer some insight into the logic that has legitimized the exclusion of alternatives to evolutionism.

The search for truth is not always an objective inquiry. Michel Foucault has argued:

If we truly wish to know knowledge . . . we must look not to philosophers but to politicians—we need to understand what the relations of struggle and power are. One can understand what knowledge consists of only by examining these relations of struggle and power, the manner in which things and men hate one another, fight one another, and try to dominate one another, to exercise power relations over one another.²

The search for truth is not always an innocent pursuit; it can also be a power struggle. The ability to determine what truth is can place a person or group of people in a position of social dominance. According to Foucault, every society has a politics of truth, which determines what forms of discourse will be accepted

¹ See *McLean v. Ark. Bd. of Educ.*, 529 F. Supp. 1255, 1259 (E.D. Ark. 1982).

The Biological Sciences Curriculum Study (BSCS) . . . developed a series of biology texts which, although emphasizing different aspects of biology, incorporated the theory of evolution as a major theme. The success of the BSCS effort is shown by the fact that fifty percent of American school children currently use BSCS books directly and the curriculum is incorporated indirectly in virtually all biology texts.

Id.

² 3 MICHEL FOUCAULT, *Truth and Juridical Forms*, in *THE ESSENTIAL WORKS OF FOUCAULT 1954–1984: POWER* 1, 12 (Paul Rainbow & James D. Faubion eds., Robert Hurley et al. trans., The New Press 2000) (1994).

as truth.³ This politics of truth includes the methods that people will use to define truth and what people will be responsible for making determinations concerning the nature of truth.⁴ This politics of truth that exists in a society at any given time is not something that the state must enforce, since embedded power relations in culture “permeate the whole fabric of our existence.”⁵ Power is not always bad, but it is always dangerous, and it is important to understand the world through cautious investigation that takes into account the dangers of truth and power.⁶

Logical Positivism, an early twentieth-century philosophical movement, strongly influenced the epistemological methods that exist in the scientific community today.⁷ A.J. Ayer was probably the best-known proponent of Logical Positivism. He argued that in order for a statement to be meaningful, it must be verifiable.⁸ The necessary condition of whether a statement is factually significant is whether some observation could affirm or deny the truth of the statement.⁹

We enquire in every case what observations would lead us to answer the question, one way or the other; and, if none can be discovered, we must conclude that the sentence under consideration does not, as far as we are concerned, express a genuine question, however strongly its grammatical appearance may suggest that it does.¹⁰

Therefore, under Ayer’s definition of science, a statement that refers to the “purposeful complexity of the universe as evidence for the existence of God” would be an incoherent statement since no possible observation could directly affirm or deny the existence of God.¹¹

Jean-François Lyotard has written about the role that the

³ See 3 MICHEL FOUCAULT, Truth and Power, in THE ESSENTIAL WORKS OF FOUCAULT 1954–1984: POWER, *supra* note 2, at 111, 131.

Each society has its regime of truth, its “general politics” of truth—that is, the types of discourse it accepts and makes function as true; the mechanisms and instances that enable one to distinguish true and false statements; the means by which each is sanctioned; the techniques and procedures accorded value in the acquisition of truth; the status of those who are charged with saying what counts as true.

Id.

⁴ *Id.*

⁵ FOUCAULT, *supra* note 2, at 17.

⁶ See Colin Gordon, *Introduction* to 3 THE ESSENTIAL WORKS OF FOUCAULT 1954–1984: POWER, *supra* note 2, at xi, xix.

⁷ See *infra* notes 63–64, 137–144 and accompanying text.

⁸ ALFRED JULES AYER, LANGUAGE, TRUTH & LOGIC 35 (Dover Publications 1952) (1936).

⁹ *Id.*

¹⁰ *Id.*

¹¹ *Id.* at 115 (“For to say that ‘God exists’ is to make a metaphysical utterance which cannot be either true or false. And by the same criterion, no sentence which purports to describe the nature of a transcendent god can possess any literal significance.”).

scientific epistemology can play in legitimizing exclusion. He argues that scientific epistemologies are language games¹² since there are rules or constraints that establish what forms of discourse a person can use in the process of fulfilling the requirements of the game.¹³ The dominant definition of science in the scientific community is such a language game because it establishes the rules or constraints that one must follow to arrive at truth.¹⁴ Science is simply descriptive statements that are limited by two constraints¹⁵: the descriptive statements must be open to explicit observation, and they must be subject to review by scientific experts.¹⁶

Scientific epistemologies, like Logical Positivism, legitimize the exclusion of those who do not understand truth exclusively through empirical verification. "The scientist questions the validity of narrative statements and concludes that they are never subject to argumentation or proof. He classifies them as belonging to a different mentality: savage, primitive, underdeveloped, backward, alienated, composed of opinions, customs, authority, prejudice, ignorance, ideology."¹⁷ The state excludes any theory that has a supernatural element under the assumption that such statements must inevitably rely on subjective faith instead of objective proof.¹⁸ Therefore, those who do not define truth exclu-

¹² See JEAN-FRANÇOIS LYOTARD, *THE POSTMODERN CONDITION: A REPORT ON KNOWLEDGE* 3, 9–11 (Geoff Bennington & Brian Massumi trans., Univ. of Minnesota Press 1984) (1979).

¹³ *Id.* at 10.

Wittgenstein . . . focuses his attention on the effects of different modes of discourse; he calls the various types of utterances he identifies along the way . . . *language games*. . . [E]ach of the various categories of utterance can be defined in terms of rules specifying their properties and the uses to which they can be put—in exactly the same way as the game of chess is defined by a set of rules determining the properties of each of the pieces, in other words, the proper way to move them.

Id. Wittgenstein gave these linguistics the title "language games," and Lyotard developed the idea further, applying it to scientific epistemologies.

¹⁴ *Id.* at 18 (Science is "composed of denotative statements, but imposes two supplementary conditions on their acceptability: the objects to which they refer must be available . . . in explicit conditions of observation; and it must be possible to decide whether or not a given statement pertains to the language judged relevant by the experts."). *Id.* at 24 ("These two rules underlie what nineteenth-century science calls verification and twentieth-century science, falsification.").

¹⁵ *Id.* at 18.

¹⁶ *Id.*

¹⁷ *Id.* at 27.

¹⁸ *Introduction* to CHRISTIAN PERSPECTIVES ON LEGAL THOUGHT, at xx–xxi (Michael W. McConnell et al. eds., 2001) ("A second source of the resistance, we think, is a throw-back to the modern or 'scientific' period of legal thought. . . . Religion is subjective, and science is objective."); Iain T. Benson, *Notes Towards a (Re)Definition of the "Secular"*, 33 U. BRIT. COLUM. L. REV. 519, 520 (2000).

The term 'secular' has come to mean a realm that is neutral or, more precisely, 'religion-free.' Implicit in this religion free neutrality is the notion that the

sively through the process of scientific verification often experience marginalization.

The hegemony of scientific knowledge production becomes even more problematic given that this form of knowledge requires as much faith as belief in the supernatural. Lyotard argues that science is facing a major crisis of legitimation because of epistemological problems that result from its inability to demonstrate the legitimacy of its method.¹⁹ Two problems would result if science attempted to legitimize itself. First, it would rely on circular reasoning, which would violate the very principles that govern rational inquiry in the scientific discipline.²⁰ Second, science cannot prove through the senses alone that all true knowledge must be directly accessible to the senses since, if there were either forms of knowledge or elements of reality that were inaccessible to the senses, the senses, by definition, would be unable to detect those forms of knowledge or elements of reality.²¹ Therefore, since science cannot confer legitimacy upon itself, it is inevitable that science will seek legitimation using narrative knowledge.²² It will seek to tell the epic stories of scientific discoveries in order to confer legitimacy on its method.²³ However, the problem with using narrative as a function of legitimation is that the foundation of science becomes a form of knowledge that science believes is inferior, backward, and worthless.²⁴ The scientific epistemology is slowly collapsing under its own unconditional demands for proof. The positivistic view of the scientific

secular is a realm of facts distinct from the realm of faith. . . . States cannot be neutral towards metaphysical claims. Their very inaction towards certain claims operates as an affirmation of others. . . . The often *anti*-religious stance embodied in *secularism* excludes and banishes religion from any practical place in culture.

Id. The term "faith" refers to a belief that does not rely on proof.

¹⁹ LYOTARD, *supra* note 12, at 27–28.

Before it came to this point (what some call positivism), scientific knowledge sought other solutions. It is remarkable that for a long time it could not help resorting for its solutions to procedures that, overtly or not, belong to narrative knowledge. . . . It is not inconceivable that the recourse to narrative is inevitable, at least to the extent that the language game of science desires its statements to be true but does not have the resources to legitimate their truth on its own.

Id.

²⁰ *Id.* at 29 ("Without such recourse it would be in the position of presupposing its own validity and would be stooping to what it condemns: begging the question, proceeding on prejudice.").

²¹ *See id.* ("It is recognized that the conditions of truth, in other words, the rules of the game of science, are immanent in that game . . .").

²² *Id.* The term "narrative knowledge" refers to a belief that does not rely on proof.

²³ *Id.* at 28.

²⁴ *Id.* at 29 ("Scientific knowledge cannot know and make known that it is the true knowledge without resorting to the other, narrative, kind of knowledge, which from its point of view is no knowledge at all.").

method is a faith-based principle.

Some practical implications for science classes emanate from these philosophical principles. The object of study in science classes should be anything in the universe that a person can study through the five senses. Therefore, revealed texts in which some people find authority are not within the realm of scientific study. This is not because such religious texts are necessarily inferior to scientific study—they are just two different topical areas of study. This does not mean that science classes can exclude any idea relating to the supernatural. There are two possible approaches to the scientific method. One studies reality through the senses in both approaches. The point of tension between the two methods concerns what inferences one can draw from sensory experience. The materialistic approach (Logical Positivism) to the scientific method would not allow a person to infer supernatural explanations from the sensible world. The non-materialistic approach to the scientific method would allow a person to infer supernatural explanations from sensory experience. Science classes should teach students about both of these approaches to the scientific method because neither has a superior claim to proof and both entail faith.²⁵

The current indoctrination in science classes is the result of a failure to teach both approaches.²⁶ Public schools and the courts have argued that the materialistic scientific method is the only scientific method.²⁷ When one operates under this assumption, the exclusion of alternatives to evolutionary theory from the curriculum becomes inevitable since only theories that are exclusively materialistic in their inferences are legitimate scientific theories. Other explanations relating to the origin of life are excluded, by definition, since these theories include supernatural inferences about the material world. As was previously discussed, both of these methods require faith. However, public schools and the courts arbitrarily exclude and indoctrinate people who subscribe to the non-materialistic scientific method.²⁸ Only recognition of the faith-based assumptions inherent in each of

²⁵ See *supra* notes 19–24 and accompanying text.

²⁶ See Benson, *supra* note 18, at 520 (“[A] properly constituted secular government (non-sectarian not non-faith) will see as necessary the due accommodation of religiously informed beliefs from a variety of cultures.”).

²⁷ See, e.g., *McLean v. Ark. Bd. of Educ.*, 529 F. Supp. 1255, 1267–68, 1272 (E.D. Ark. 1982); *Kitzmiller v. Dover Area Sch. Dist.*, 400 F. Supp. 2d 707, 735–38 (M.D. Pa. 2005).

²⁸ See *Edwards v. Aguillard*, 482 U.S. 578, 589 (1987); *McLean*, 529 F. Supp. at 1267–68, 1272; *Freiler v. Tangipahoa Parish Bd. of Educ.*, 185 F.3d 337, 346–48 (5th Cir. 1999); *Kitzmiller*, 400 F. Supp. 2d at 735–38; *Wright v. Houston Indep. Sch. Dist.*, 366 F. Supp. 1208, 1210–11 (S.D. Tex. 1972); *Peloza v. Capistrano Unified Sch. Dist.*, 37 F.3d 517, 521–22 (9th Cir. 1994).

these methodologies will end the ideological exclusion and oppression.²⁹

The ultimate implication of exclusively teaching the materialistic approach to the scientific method is that the state is forcibly indoctrinating students into the religion of secular humanism. According to the Council for Secular Humanism, "Secular humanism . . . is a philosophy and world view which centers upon human concerns and employs rational and scientific methods to address the wide range of issues important to us all."³⁰ Elements of the secular humanist belief system include: use of reason and science to understand the universe and solve problems,³¹ discouraging supernatural understandings of reality,³² protecting the Earth for the good of other species and future generations,³³ skepticism toward untested knowledge,³⁴ belief in common moral decency,³⁵ separation of church and state,³⁶ belief in agnosticism or atheism,³⁷ belief in naturalism (i.e., no supernatural realm),³⁸ belief that evolutionary theory is strongly supported by the evidence,³⁹ and opposition to creationism in science classes.⁴⁰ The beliefs of the religion of secular humanism emerge logically and

²⁹ Benson, *supra* note 18, at 521 ("What can advertise itself as neutral is often anything but Until the necessarily 'implicit faiths' are acknowledged, explicit faiths are at a marked disadvantage in finding any place in the public sphere, including: politics, public education, and law itself.").

³⁰ Council for Secular Humanism, What is Secular Humanism?, <http://www.secularhumanism.org/index.php?section=main&page=what> (last visited Oct. 2, 2006).

³¹ Council for Secular Humanism, The Affirmations of Humanism: A Statement of Principles, <http://www.secularhumanism.org/index.php?section=main&page=affirmations> (last visited Oct. 2, 2006) ("We are committed to the application of reason and science to the understanding of the universe and to the solving of human problems.").

³² *Id.* ("We deplore efforts to denigrate human intelligence, to seek to explain the world in supernatural terms, and to look outside nature for salvation.").

³³ *Id.* ("We want to protect and enhance the earth, to preserve it for future generations, and to avoid inflicting needless suffering on other species.").

³⁴ *Id.* ("We are skeptical of untested claims to knowledge . . .").

³⁵ *Id.* ("We believe in the common moral decencies: altruism, integrity, honesty, truthfulness, responsibility. Humanist ethics is amenable to critical, rational guidance. There are normative standards that we discover together. Moral principles are tested by their consequences.").

³⁶ *Id.* ("We are committed to the principle of the separation of church and state.").

³⁷ Council for Secular Humanism, *supra* note 30 ("Secular humanists are generally nontheists. They typically describe themselves as nonreligious.").

³⁸ *Id.* ("Secular humanists accept a world view or philosophy called naturalism, in which the physical laws of the universe are not superseded by non-material or supernatural entities . . .").

³⁹ PAUL KURTZ, A SECULAR HUMANIST DECLARATION 21 (1980), ("[E]volution of the species is supported so strongly by the weight of evidence that it is difficult to reject it.").

⁴⁰ *Id.* ("[W]e deplore the efforts by fundamentalists (especially in the United States) to invade the science classrooms, requiring that creationist theory be taught to students and requiring that it be included in biology textbooks."). This is particularly interesting since secular humanists apparently want to mix their religious beliefs with politics, and, more specifically, to prohibit the teaching of other religious beliefs that conflict with their religious beliefs.

necessarily from the materialistic scientific method.⁴¹

II. CURRENT ESTABLISHMENT CLAUSE LAW ON EVOLUTION

A. *Epperson v. Arkansas*

In 1968, the Supreme Court heard the case *Epperson v. Arkansas*, which was its first Establishment Clause case dealing with evolutionism.⁴² A 1928 Arkansas statute prohibited Arkansas public schools and universities from teaching the theory that people evolved from other species.⁴³ The Arkansas statute was a product of religious fundamentalist opposition to evolutionism in the 1920s.⁴⁴ The statute modeled the Tennessee law that was the subject of the famous *Scopes* case.⁴⁵ The Court held that the statute violated the “constitutional prohibition of state laws respecting an establishment of religion or prohibiting the free exercise thereof.”⁴⁶ The Arkansas law prohibited one scientific theory out of the entire scientific discipline because the law conflicted with a religious group’s interpretation of Genesis.⁴⁷ “The First Amendment mandates governmental neutrality between religion and religion, and between religion and nonreligion.”⁴⁸ The Arkansas law failed the neutrality standard because it did not prohibit all teaching concerning the origin of life.⁴⁹ Instead, the law targeted a specific theory that conflicted with the Bible.⁵⁰

B. *McLean v. Arkansas Board of Education*

In 1982, the Federal District Court in the Eastern District of Arkansas heard the case *McLean v. Arkansas Board of Education*, which dealt with a recently passed Arkansas act that required public schools to give equal treatment to creation science and evolution science.⁵¹ The major issue in this case was whether the act violated the Establishment Clause,⁵² and the court applied the *Lemon* Test to make this determination.⁵³ The *Lemon* Test has the following three prongs: “First, the statute

⁴¹ A.J. Ayer endorsed the Secular Humanist Declaration that the Council for Secular Humanism issued in 1980. *Id.* at 28. This provides strong evidence for the link between logical positivism and secular humanism.

⁴² 393 U.S. 97 (1968).

⁴³ *Id.* at 98.

⁴⁴ *Id.*

⁴⁵ *Scopes v. State*, 289 S.W. 363 (1927); *Epperson*, 393 U.S. at 98.

⁴⁶ *Epperson*, 393 U.S. at 103.

⁴⁷ *Id.*

⁴⁸ *Id.* at 104.

⁴⁹ *Id.* at 109.

⁵⁰ *Id.*

⁵¹ 529 F. Supp. 1255, 1256 (E.D. Ark. 1982).

⁵² *Id.* at 1257.

⁵³ *Id.* at 1258.

must have a secular legislative purpose; second, its principal or primary effect must be one that neither advances nor inhibits religion; finally, the statute must not foster ‘an excessive government entanglement with religion.’”⁵⁴ If any of these prongs is not satisfied, the law in question is unconstitutional.⁵⁵

The court first held that the act violated the secular purpose prong of the *Lemon* Test.⁵⁶ Deference must be given to the legislative purpose contained within an act, but this situation demanded attention to the historical context in which the act was implemented.⁵⁷ The court looked at the legislative history of the act, including statements of people who supported the legislation, and found that its purpose was sectarian and not educational.⁵⁸ The act was nothing more than an attempt to introduce the Biblical version of creation into the science curriculum.⁵⁹

The court also concluded from the language of the act that its purpose and effect was to advance religion.⁶⁰ The definition of creationism used within the act implicitly referred to Genesis, since it mentioned sudden creation out of nothing and a worldwide flood.⁶¹ The court concluded that the concept of creation out of nothing is necessarily a religious concept,⁶² and the major effect of the act would be to advance religious beliefs because of its correlation with the Genesis account.⁶³

The court next concluded that the act could not have any educational purpose because creation science was not science as accepted by the scientific community.⁶⁴ The court held that “the essential characteristics of science are: (1) It is guided by natural law; (2) It has to be explanatory by reference to natural law; (3) It is testable against the empirical world; (4) Its conclusions are tentative, i.e., are not necessarily the final word; and (5) It is falsifiable.”⁶⁵ The concept of a sudden creation out of nothing fits none of these characteristics of science.⁶⁶ In addition, at the time the case was decided, not one recognized scientific journal had

⁵⁴ *Lemon v. Kurtzman*, 403 U.S. 602, 612–13 (1971) (citations omitted) (quoting *Walz v. Tax Commission of New York*, 397 U.S. 664, 674 (1970)).

⁵⁵ *McLean*, 529 F. Supp. at 1258.

⁵⁶ *Id.* at 1264.

⁵⁷ *Id.*

⁵⁸ *Id.*

⁵⁹ *Id.*

⁶⁰ *Id.*

⁶¹ *Id.*

⁶² *Id.* at 1265–66.

⁶³ *Id.* at 1266.

⁶⁴ *Id.* at 1267.

⁶⁵ *Id.*

⁶⁶ *Id.*

published an article on creation theory.⁶⁷ The court did not believe that “such a loose knit group of independent thinkers in all the varied fields of science could, or would, so effectively censor new scientific thought.”⁶⁸ The act also violated the advancement of religion prong of the *Lemon* Test, since if creation science was not science, the only effect of the act would be to advance religion.⁶⁹

The *McLean* opinion could not be a better example of how the materialistic approach to the scientific method legitimizes the exclusion of alternatives to evolution science, such as creation science, from class curriculum. The court’s appeal to the dominance of the materialistic approach to the scientific method in the scientific community only serves to demonstrate the central thesis of Lyotard⁷⁰:

[T]he conditions of truth, in other words, the rules of the game of science, are immanent in that game, . . . they can only be established within the bonds of a debate that is already scientific in nature, and . . . there is no other proof that the rules are good than the consensus extended to them by the experts.⁷¹

It should be no surprise that no peer-reviewed scientific journal had published an article on scientific creationism at the time that *McLean* was decided.⁷² It is not a scientific conspiracy that produced this result. As Foucault pointed out, it is the “political relations [that] have been established and deeply implanted in our culture”—“the power relations that permeate the whole fabric of our existence.”⁷³ Even though reliance on both the materialistic and the non-materialistic approach entails faith, there is great risk in publishing something that runs so contrary to the norms of the scientific community.

⁶⁷ *Id.* at 1268.

⁶⁸ *Id.*

⁶⁹ *Id.* at 1272.

⁷⁰ See *supra* notes 12–16, 64–68.

⁷¹ LYOTARD, *supra* note 12, at 29.

⁷² Since the time of this opinion, however, some peer-reviewed intelligent design literature has been published.

Although open hostility from those who hold to neo-Darwinism sometimes makes it difficult for design scholars to gain a fair hearing for their ideas, research and articles supporting intelligent design are being published in peer-reviewed publications. Examples of peer-reviewed books supporting design include *The Design Inference* (Cambridge University Press) by William Dembski, and *Darwin’s Black Box* (The Free Press) by Michael Behe

Discovery Institute, *Top Questions*, <http://www.discovery.org/csc/topQuestions.php> (last visited Oct. 8, 2006).

⁷³ FOUCAULT, *supra* note 2, at 17.

C. Edwards v. Aguillard

In 1987, the U.S. Supreme Court heard the case *Edwards v. Aguillard*, and addressed whether the statute in question violated the Establishment Clause.⁷⁴ The State of Louisiana passed the Balanced Treatment for Creation-Science and Evolution-Science in Public School Instruction Act (Creationism Act), which prohibited public schools from teaching evolution science unless accompanied by creation science.⁷⁵ Public schools were not required to teach either evolutionism or creationism, but if a public school wanted to teach one, the act required that it also teach the other.⁷⁶ The Supreme Court cited the *Lemon* Test as the legal standard that it would use to determine the constitutionality of the Creationism Act.⁷⁷

The Court noted that it must consider some distinct issues when applying the Establishment Clause to the unique context of elementary and secondary public schools.⁷⁸ Although the courts should offer considerable deference to the decision-making of local school districts, they still must conform to the requirements of the First Amendment.⁷⁹ Courts must be particularly careful in ensuring compliance with the Establishment Clause in elementary and secondary schools because parents entrust their children to these schools with the assumption that schools will not advance religious views that conflict with the private beliefs of the students and their families.⁸⁰ There is great potential risk because of the compulsory nature of education and the role that teachers play as role models.⁸¹ The Court concluded that in “no activity of the State is it more vital to keep out divisive forces than in its schools.”⁸²

The Court then looked to the first prong of the *Lemon* Test to

⁷⁴ 482 U.S. 578, 580–81 (1987).

⁷⁵ *Id.* at 581.

⁷⁶ *Id.*

⁷⁷ *Id.* at 582–83; *see also supra* note 54 and accompanying text. “The *Lemon* test has been applied in all cases since its adoption in 1971, except in *Marsh v. Chambers* The Court based its conclusion in that case on the historical acceptance of the practice.” *Edwards*, 482 U.S. at 583 n.4.

⁷⁸ *Edwards*, 482 U.S. at 583–84 (“The Court has been particularly vigilant in monitoring compliance with the Establishment Clause in elementary and secondary schools.”).

⁷⁹ *Id.* at 583.

⁸⁰ *Id.* at 583–84 (“Families entrust public schools with the education of their children, but condition their trust on the understanding that the classroom will not purposely be used to advance religious views that may conflict with the private beliefs of the student and his or her family.”).

⁸¹ *Id.* at 584 (“The State exerts great authority and coercive power through mandatory attendance requirements, and because of the students’ emulation of teachers as role models and the children’s susceptibility to peer pressure.”).

⁸² *Id.* (quoting *Illinois ex rel. McCollum v. Bd. of Educ.*, 333 U.S. 203, 231 (1948) (Frankfurter, J., opinion)).

determine whether the actual purpose of the state was secular, and held that the Creationism Act lacked a secular purpose.⁸³ The stated purpose of the law was academic freedom, but it was unclear whether this meant academic freedom for the teachers to express or for the students to hear both sides of the issue.⁸⁴ Regardless of how it was interpreted, the Act did not advance either of these purposes.⁸⁵ The Act did not advance the academic freedom of teachers since teachers had the freedom to teach alternatives to evolutionism prior to the passage of the Act.⁸⁶ It did not advance fairness for students for a number of reasons.⁸⁷ It required development of curriculum guides for creationism but imposed no such requirement for evolutionism.⁸⁸ The Act supplied resource services for creationism that it did not supply for evolutionism.⁸⁹ It prohibited schools from discriminating against anyone who taught creationism, but did not forbid discrimination against anyone who taught evolutionism.⁹⁰ The Court said that the goal was not to expand the science curriculum, but rather to discredit evolutionism by counter-balancing the teaching of evolutionism with creationism at every point.⁹¹

The Court also held that the Creationism Act had a religious purpose because of the historical conflict between evolutionism and the teachings of certain religious groups.⁹² The Court cited the *Epperson v. Arkansas* case as evidence for its holding.⁹³ *Epperson* involved a statute that prohibited the teaching of evolutionism,⁹⁴ and the Court held that it was unconstitutional to target and prohibit a single scientific theory about the origin of life because it conflicts with the Biblical teachings of religious groups.⁹⁵ The *Edwards* Court concluded that the Creationism Act advanced the religious view that a supernatural being created human beings.⁹⁶ The primary purpose of the act was to advance a particular religious belief in violation of the First Amendment.⁹⁷ The Court finished its opinion with the rather open-ended statement that “[w]e do not imply that a legislature

⁸³ *Id.* at 585.

⁸⁴ *Id.* at 586.

⁸⁵ *Id.*

⁸⁶ *Id.* at 587.

⁸⁷ *Id.* at 588.

⁸⁸ *Id.*

⁸⁹ *Id.*

⁹⁰ *Id.*

⁹¹ *Id.* at 589.

⁹² *Id.* at 590.

⁹³ *Id.*; *Epperson v. Arkansas*, 393 U.S. 97 (1968).

⁹⁴ *Epperson*, 393 U.S. at 98.

⁹⁵ *Id.* at 98, 106–07.

⁹⁶ *Edwards*, 482 U.S. at 591–92.

⁹⁷ *Id.* at 593.

could never require that scientific critiques of prevailing scientific theories be taught.”⁹⁸ However, the Court concluded that the Creationism Act did not accomplish this with a secular purpose.⁹⁹

The reasoning of the Court in *Edwards* is paradoxical. The Court began its opinion by discussing the great injustice that would occur if public schools indoctrinated students with beliefs that conflict with their private beliefs.¹⁰⁰ However, the Court then concluded that the purpose of the Creationism Act was a “sham” because the supporters of the Act were religious fundamentalists who opposed the indoctrination of their children with evolutionary theory.¹⁰¹ One might question whether the Court was opposed to the indoctrination of all students, or if, instead, the Court was more concerned about the target of the indoctrination.

The Court did not follow the precedent that it established in *Epperson*. The overriding concern of *Epperson* was one factor—neutrality.¹⁰² The *Epperson* Court held that the Arkansas statute was unconstitutional because it was not neutral toward religion. The Court held:

Arkansas’ law cannot be defended as an act of religious neutrality. Arkansas did not seek to excise from the curricula of its schools and universities all discussion of the origin of man. The law’s effort was confined to an attempt to blot out a particular theory because of its supposed conflict with the Biblical account, literally read.¹⁰³

The problem with the statute in *Epperson* was its lack of neutrality. The government prohibited the teaching of a belief because it conflicted with another belief. The Court explicitly stated that Arkansas could have constitutionally prohibited all teaching about the origin of life in public schools.¹⁰⁴ The Crea-

⁹⁸ *Id.*

⁹⁹ *Id.* at 594.

¹⁰⁰ See *supra* notes 78–82 and accompanying text.

¹⁰¹ *Edwards*, 482 U.S. at 586–90 (“While the Court is normally deferential to a State’s articulation of a secular purpose, it is required that the statement of such purpose be sincere and not a sham.”).

¹⁰² *Epperson v. Arkansas*, 393 U.S. 97, 104 (1968) (“The First Amendment mandates governmental neutrality between religion and religion, and between religion and nonreligion.”).

¹⁰³ *Id.* at 109.

¹⁰⁴ *Id.* (“Arkansas’ law cannot be defended as an act of religious neutrality. Arkansas did not seek to excise from the curricula of its schools and universities all discussion of the origin of man.”). This is particularly interesting in light of the fact that the Court used a statement of the sponsor of the Creationism Act, where he said that he would prefer that schools not teach either creationism or evolutionism, as part of its reasoning for holding that there was no secular purpose. *Edwards*, 482 U.S. at 587 (“Senator Keith stated: ‘My preference would be that neither [creationism nor evolution] be taught.’ Such a ban on teaching does not promote—indeed, it undermines—the provision of a comprehensive sci-

tionism Act at issue in *Edwards* achieved this neutrality since it simply required that schools teach either both or none. The Court's holding in *Edwards* conflicted with the precedent set in *Epperson* since *Edwards* prohibited communities from requiring that science classes teach creationism with evolutionism.¹⁰⁵

The Court also operated on the assumption that the mere inclusion of creationism with evolutionism in the curriculum is an advancement of religion and an attempt to counterbalance and discredit evolutionary theory at every point.¹⁰⁶ Consider this scenario: A philosophy teacher at a public high school will only teach proofs opposing the existence of God in his philosophy class, and he refuses to teach any proofs supporting the existence of God because he believes that the concept of God is religious and not philosophical. Religious fundamentalist parents at the school express their outrage that this teacher is teaching their students an atheistic belief system that is contrary to the Bible. Because of outrage expressed by the religious parents, the school district passes a policy requiring that teachers give equal time to proofs supporting and opposing the existence of God. How could this policy be constitutional under the Supreme Court's analysis in *Edwards*? The teacher, after all, was just teaching the students philosophy, and religious parents do not have a right to counterbalance philosophical theories at every point with their personal religious beliefs.¹⁰⁷ The statute lacks a secular purpose since the school only implemented the statute in reaction to outrage expressed by a specific religious sect,¹⁰⁸ and including the proofs for the existence of God would clearly advance the religious viewpoint that there is a God.¹⁰⁹ It is simply incorrect to believe that presenting both sides of an issue is somehow taking sides. Fairly

entific education.") (citations omitted).

¹⁰⁵ See *Epperson*, 393 U.S. at 97–98, 106–07. The Supreme Court used some language toward the end of the *Edwards* opinion that indicates that the Court is not foreclosing the possibility of teaching alternatives to evolution. See *Edwards*, 482 U.S. at 593. However, this is likely only an attempt by the Court to soften the impact of the opinion by creating an impression of moderation that probably does not exist in practice. The reasoning that leads the Court to its holding in *Edwards* indicates that the exclusion of alternatives containing supernatural explanations is likely to be near absolute. *Id.* at 591–93.

¹⁰⁶ *Edwards*, 482 U.S. at 589 (“[T]he Act . . . has the . . . purpose of discrediting ‘evolution by counterbalancing its teaching at every turn with the teaching of creationism’”) (quoting *Aguillard v. Edwards*, 765 F.2d 1251, 1257 (5th Cir. 1985)); *id.* at 592 (“The legislative history documents that the Act’s primary purpose was to change the science curriculum of public schools in order to provide persuasive advantage to a particular religious doctrine that rejects the factual basis of evolution in its entirety.”); *id.* at 593 (“The legislation therefore sought to alter the science curriculum to reflect endorsement of a religious view that is antagonistic to the theory of evolution.”).

¹⁰⁷ *Id.* at 589.

¹⁰⁸ *Id.* at 590–92.

¹⁰⁹ *Id.* at 592–93.

presenting various perspectives on an issue is the essence of neutrality.

The Court did not even address the argument that it is important to present both sides of an issue. The Court sidestepped this argument and cited other parts of the statute that it thought were unfair.¹¹⁰ However, even if those other parts of the statute were unfair, that still does not address the fairness of the statute's most important provision, which is the requirement that schools teach both or none. The Court's concern about the unfairness of other parts of the statute is also unfounded because those parts of the statute were remedial measures. This statute was addressing a problem, which was the systematic exclusion of creationism from science classes.¹¹¹ The statute required the development of curricula for creationism because there was no such curriculum in existence.¹¹² The statute correctly assumed that a curriculum dealing with evolutionism was already in existence.¹¹³ The statute also attempted to correct the specific problem of discrimination against creationists.¹¹⁴ Even if these remedial measures were unconstitutional, the Court should have merely struck them down instead of using them to justify striking down the more important parts of the statute that the legislature would have wanted left in place.¹¹⁵ These remedial measures were tangential to the overriding purpose of the statute.

¹¹⁰ *Id.* at 588–89.

¹¹¹ *See id.* at 630 (Scalia, J., dissenting) (“The Louisiana legislators had been told repeatedly that creation scientists were scorned by most educators and scientists, who themselves had an almost religious faith in evolution.”).

¹¹² *Id.* at 631.

In light of the unavailability of works on creation science suitable for classroom use . . . and the existence of ample materials on evolution, . . . science teachers . . . would need a curriculum guide on creation science, but not on evolution, and that those charged with developing the guide would need an easily accessible group of creation scientists.

Id. (citation omitted).

¹¹³ *See id.*

¹¹⁴ *Id.* at 630 (“It is hardly surprising, then, that in seeking to achieve a balanced, ‘nonindoctrinating’ curriculum, the legislators protected from discrimination only those teachers whom they thought were *suffering* from discrimination.”).

¹¹⁵ The Supreme Court has held that

a court should refrain from invalidating more of the statute than is necessary. . . . “[W]henver an act of Congress contains unobjectionable provisions separable from those found to be unconstitutional, it is the duty of this court to so declare, and to maintain the act in so far as it is valid.”

Regan v. Time, Inc., 468 U.S. 641, 652 (1984) (quoting *El Paso & Northeastern Ry. v. Gutierrez*, 215 U.S. 87, 96 (1909)). “Whether an unconstitutional provision is severable from the remainder of the statute in which it appears is largely a question of legislative intent, but the presumption is in favor of severability.” *Id.* at 653.

D. *Freiler v. Tangipahoa Parish Board of Education*

In 1999, the U.S. Court of Appeals for the Fifth Circuit heard an Establishment Clause case that dealt with the Tangipahoa Parish Board of Education's requirement that teachers read a disclaimer before the start of any unit that would deal with the topic of evolutionary theory.¹¹⁶ The following statement was the required disclaimer:

It is hereby recognized by the Tangipahoa Board of Education, that the lesson to be presented, regarding the origin of life and matter, is known as the Scientific Theory of Evolution and should be presented to inform students of the scientific concept and not intended to influence or dissuade the Biblical version of Creation or any other concept.

It is further recognized by the Board of Education that it is the basic right and privilege of each student to form his/her own opinion and maintain beliefs taught by parents on this very important matter of the origin of life and matter. Students are urged to exercise critical thinking and gather all information possible and closely examine each alternative toward forming an opinion.¹¹⁷

The sole issue before the court was whether the disclaimer at issue violated the First Amendment.¹¹⁸ The court concluded that it would apply the *Lemon* Test to make this determination because it was the applicable law, even though it had been the subject of substantial criticism.¹¹⁹

The first question was whether the state action at issue had a secular purpose under the first prong of the *Lemon* Test.¹²⁰ The school board offered three purposes for the statute: "(1) to encourage informed freedom of belief, (2) to disclaim any orthodoxy of belief that could be inferred from the exclusive placement of evolution in the curriculum, and (3) to reduce offense to the sen-

¹¹⁶ *Freiler v. Tangipahoa Parish Bd. of Educ.*, 185 F.3d 337, 341 (5th Cir. 1999).

¹¹⁷ *Id.* After the Fifth Circuit issued this opinion, the court acknowledged that it incorrectly quoted the disclaimer but denied a petition for rehearing en banc. *Freiler v. Tangipahoa Parish Bd. of Educ.*, 201 F.3d 602, 603 (5th Cir. 2000). The following was the correct disclaimer: "It is further recognized by the Board of Education that it is the basic right and privilege of each student to form his/her own opinion or maintain beliefs taught by parents on this very important matter of the origin of life and matter." *Id.*

¹¹⁸ *Freiler*, 185 F.3d at 342.

¹¹⁹ *Id.* at 344. The court cited a recent Supreme Court decision, which applied the *Lemon* Test to support its conclusion that the *Lemon* Test remains legally viable:

[T]he Supreme Court laid to rest rumors of the *Lemon* test's demise The Court acknowledged the continued viability of the general *Lemon* principles used to evaluate whether government action violates the Establishment Clause and noted in particular that the nature of the inquiry under *Lemon*'s purpose prong has "remained largely unchanged."

Id. (quoting *Agostini v. Felton*, 521 U.S. 203, 223 (1997)). See also *supra* note 54 and accompanying text.

¹²⁰ *Freiler*, 185 F.3d at 344.

sibilities and sensitivities of any student or parent caused by the teaching of evolution.”¹²¹ The court had to determine whether the disclaimer furthered the stated purposes of the school board.¹²² If the disclaimer furthered one articulated purpose and that purpose was secular, the disclaimer would not violate the secular purpose test.¹²³ The court held that the disclaimer failed to further freedom of belief because the disclaimer told students that evolutionism did not have to affect what they already know, and this violated the principle of critical thinking.¹²⁴ The court concluded that the disclaimer did further the other two stated purposes of disclaiming orthodoxy and decreasing the offense of parents,¹²⁵ and the court held that these were both secular purposes.¹²⁶

The court next had to determine whether the disclaimer conveyed a message of endorsement or approval in violation of the second prong of the *Lemon* Test.¹²⁷ The court held that the disclaimer primarily protected a particular religious belief, which was the Biblical view of creation.¹²⁸ Three factors in the disclaimer led the court to this conclusion:

- (1) the juxtaposition of the disavowal of endorsement of evolution with an urging that students contemplate alternative theories of the origin of life; (2) the reminder that students have the right to maintain beliefs taught by their parents regarding the origin of life; and (3) the “Biblical version of Creation” as the only alternative theory explicitly referenced in the disclaimer.¹²⁹

The court concluded that the disclaimer as a whole encouraged students to meditate upon religion in general and the Biblical narrative specifically.¹³⁰ Although introducing religious concepts in schools would not be *prima facie* unconstitutional, there is a clear difference between comparative religion classes or history classes and the disclaimer at issue,¹³¹ because the disclaimer

¹²¹ *Id.*

¹²² *Id.* (“In undertaking such a ‘sham’ inquiry, we consider whether the disclaimer furthers the particular purposes articulated by the School Board or whether the disclaimer contravenes those avowed purposes.”) (citation omitted).

¹²³ *Id.* (“If the disclaimer furthers just one of its proffered purposes and if that same purpose proves to be secular, then the disclaimer survives scrutiny under *Lemon*’s first prong.”).

¹²⁴ *Id.* at 345.

¹²⁵ *Id.*

¹²⁶ *Id.*

¹²⁷ *Id.* at 346 (“*Lemon*’s second prong asks whether, irrespective of the School Board’s actual purpose, ‘the practice under review in fact conveys a message of endorsement or disapproval.’”) (quoting *Doe v. Santa Fe Indep. Sch. Dist.*, 168 F.3d 806, 817 (5th Cir. 1999)).

¹²⁸ *Id.*

¹²⁹ *Id.*

¹³⁰ *Id.*

¹³¹ *Id.* at 347.

does not provide understanding of different religions.¹³² The court concluded that the disclaimer violated the second prong of the *Lemon* Test and the Endorsement Test because it advanced religion.¹³³

The court in this case reached the correct holding for the wrong reasons. It is acceptable (and in fact necessary) for schools to teach alternatives to evolutionism in science classes because it is important for schools to offer diverse perspectives on issues instead of just imposing one view on students. Teaching different perspectives on the origins of life would not advance religion any more than teaching the pro-life and pro-choice positions on abortion would somehow advance the pro-life position.¹³⁴ If directly teaching so-called religious alternatives in the curriculum would not advance religion, then the infinitely more conservative step of reading a disclaimer would surely not advance religion in the way that the court describes. However, the school district may have been advancing the religion of secular humanism through its failure to teach alternatives as an actual part of the curriculum. If the disclaimer violated the Establishment Clause, it is only because it did not go far enough in presenting actual alternatives to secular humanism in science classes.

E. *Kitzmiller v. Dover Area School District*

In 2005, the U.S. District Court for the Middle District of Pennsylvania heard *Kitzmiller v. Dover Area School District*, which involved a disclaimer about evolutionary theory that the School District required teachers to read to students in ninth-grade biology classes.¹³⁵ The court held that the disclaimer was an unconstitutional violation of the Establishment Clause¹³⁶ as it failed both the Endorsement Test and the *Lemon* Test.¹³⁷

There was one element of the court's reasoning in this case that was particularly significant. Like all of the previous court

¹³² *Id.*

¹³³ *Id.* at 348.

¹³⁴ The court explicitly states in its opinion that teaching comparative religion would be acceptable. *Id.* at 347 (“[I]t might well be said that one’s education is not complete without a study of comparative religion or the history of religion and its relationship to the advancement of civilization.”) (alteration in original) (quoting *Sch. Dist. of Abington v. Schempp*, 374 U.S. 203, 225 (1963)). Teaching evolution and its alternatives is no different from comparative religion, since both compare the religion of secular humanism against others. The failure to recognize that science classes are currently advancing religion legitimizes the exclusion and indoctrination.

¹³⁵ 400 F. Supp. 2d 707, 708 (M.D. Pa. 2005).

¹³⁶ *Id.* at 764–65.

¹³⁷ *Id.* at 765. Most of the court’s analysis centered on the facts of the specific disclaimer in this case, which is not particularly relevant to this article since such disclaimers are a much weaker version of what this article proposes.

decisions that have dealt with evolutionism, the determining issue in this case was whether the alternative theory at issue was a scientific theory.¹³⁸ The court held that intelligent design is not science.¹³⁹ Intelligent design violates the rules of the scientific discipline that have excluded the possibility of supernatural causation since the 16th and 17th centuries.¹⁴⁰ Science intentionally excludes questions relating to the meaning and purpose of the world, and supernatural explanations are not scientific.¹⁴¹ “This self-imposed convention of science, which limits inquiry to testable, natural explanations about the natural world, is referred to by philosophers as ‘methodological naturalism’ and is sometimes known as the scientific method.”¹⁴² The court reasoned that including supernatural explanations is a “science stopper” because “once you attribute a cause to an untestable supernatural force, a proposition that cannot be disproven, there is no reason to continue seeking natural explanations as we have our answer.”¹⁴³ The court pointed out that every major scientific association that has considered the question has concluded that intelligent design is not science.¹⁴⁴ The court, therefore, held that intelligent design

¹³⁸ *Id.* at 738 (“[Intelligent Design’s] failure to meet the ground rules of science is sufficient for the Court to conclude that it is not science . . .”); *id.* at 765 (“[T]he Board’s ID Policy violates the Establishment Clause. In making this determination, we have addressed the seminal question of whether ID is science. We have concluded that it is not, and moreover that ID cannot uncouple itself from its creationist, and thus religious, antecedents.”).

¹³⁹ *Id.* at 735.

¹⁴⁰ *Id.* The court’s conclusion is factually incorrect. The approaches of scientists to the scientific method have been far more diverse than the court describes. Sir Isaac Newton (1642–1727), one of history’s most important scientists, is an excellent example.

[S]cientists and historians are trying to reconcile the Isaac Newton they thought they knew with the Isaac Newton they’re discovering in his private papers.

. . . .

Only recently made available to the public, at the National Library in Jerusalem, these documents are now revealing that for Newton, religion and science were inseparable, two parts of the same life-long quest to understand the universe.

Newton himself wanted to design a universe in which God was absolutely present and absolutely powerful. There’s an enormous irony there. In the 18th century, gangs of interpreters, most of them French, will take the God out of Newton’s world. It’s a very common image of what the Newtonian world was, that it was soulless, that it was mechanical, that it really wasn’t theologically motivated at all.

Now, ironically, that’s very anti-Newtonian, because Newton argued that God had to be present, you couldn’t read him out of the universe.

NOVA: *Newton’s Dark Secrets*, (PBS television broadcast Nov. 15, 2005), available at http://www.pbs.org/wgbh/nova/transcripts/3217_newton.html.

¹⁴¹ See *Kitzmiller*, 400 F. Supp. 2d at 735.

¹⁴² *Id.*

¹⁴³ *Id.* at 736.

¹⁴⁴ *Id.* at 737.

“fails to meet the essential ground rules that limit science to testable, natural explanations.”¹⁴⁵

The court only proves one truth through its reasoning in this case. If one relies on an exclusively materialistic definition of science, one will necessarily classify anything that is supernatural as unscientific. The question is whether there is any basis for the presupposition that science must be exclusively materialistic in its inferences. As has already been discussed, the materialistic conception of the scientific method entails as much faith as the non-materialistic approach to the scientific method.¹⁴⁶ Even if every scientist on the planet endorsed the materialistic approach to the scientific method, it would not become any more verifiable.

The court argued that allowing supernatural explanations would be a “science stopper” since it would destroy the need to search for natural explanations. This is logically untrue. The materialistic approach to the scientific method allows for only natural theories. The non-materialistic approach to the scientific method allows for both natural theories and supernatural theories. Under the non-materialistic approach, people will be just as free to search for natural explanations as they are under the materialistic approach. Both theories have the goal of increasing knowledge about the sensible world. The existence of a supernatural theory will not stop people from searching for other possible natural theories. However, even if this were a risk, there is an equal risk that the materialistic approach to the scientific method could produce absurd theories in a desperate attempt to find a materialistic explanation where no reasonable one exists. Regardless of how one resolves these practical questions, it will not implicate the ultimate position at issue here, which is that belief in either approach to the scientific method requires faith. The fact that a certain method appears to be practical does not necessarily mean that it is true.

III. ESTABLISHMENT OF RELIGION AND SECULAR HUMANISM

The current precedents of the federal courts concerning the teaching of evolutionism in public schools violate the Establishment Clause. The First Amendment to the United States Constitution says, “Congress shall make no law respecting an establishment of religion”¹⁴⁷ The *Lemon* Test is the primary legal standard that the federal courts have applied in recent evolution-

¹⁴⁵ *Id.* at 738.

¹⁴⁶ See *supra* notes 19–24 and accompanying text.

¹⁴⁷ U.S. CONST. amend. I.

ism cases to determine whether state actions violate the Establishment Clause.¹⁴⁸ Therefore, the *Lemon* Test will be applied to determine whether the failure to incorporate alternatives to evolutionary theory in public school science classes violates the Establishment Clause.

The *Lemon* Test requires that: “First, the statute must have a secular legislative purpose; second, its principal or primary effect must be one that neither advances nor inhibits religion; finally, the statute must not foster ‘an excessive government entanglement with religion.’”¹⁴⁹ The failure to include alternatives to evolutionary theory is unconstitutional under the second prong of the *Lemon* Test. The second prong of the *Lemon* Test requires neutrality toward religion. In *Epperson*, the Court held:

Government . . . must be neutral in matters of religious theory, doctrine, and practice. It may not be hostile to any religion or to the advocacy of no-religion; and it may not aid, foster, or promote one religion or religious theory against another or even against the militant opposite. The First Amendment mandates governmental neutrality between religion and religion, and between religion and nonreligion.¹⁵⁰

Therefore, since neutrality is the legal standard, the issue here is whether exclusively teaching evolutionism in science classes is neutral toward religion.

Primary and secondary public education is a special setting for the application of the Establishment Clause.¹⁵¹ When families place their children in the public education system, they expect that the school will not indoctrinate their children with belief systems that conflict with their own beliefs.¹⁵² Additionally, the state exerts substantial coercive power with mandatory attendance requirements.¹⁵³ Many families do not have the resources to seek out alternative educational arrangements for their children. The unique setting of public education demands elevated concern because of the risk of indoctrination that is in-

¹⁴⁸ See, e.g., *Edwards v. Aguillard*, 482 U.S. 578, 582–83 (1987); *McLean v. Ark. Bd. of Educ.*, 529 F. Supp. 1255, 1258 (D. Ark. 1982); *Freiler v. Tangipahoa Parish Bd. of Educ.*, 185 F.3d 337, 344 (5th Cir. 1999); *Kitzmiller*, 400 F. Supp. 2d at 765.

¹⁴⁹ *Lemon v. Kurtzman*, 403 U.S. 602, 612–13 (1971) (citations omitted) (quoting *Walz v. Tax Commission of New York*, 397 U.S. 664, 674 (1970)).

¹⁵⁰ *Epperson v. Arkansas*, 393 U.S. 97, 103–04 (1968); *id.* at 104 (“As early as 1872, this Court said: ‘The law knows no heresy, and is committed to the support of no dogma, the establishment of no sect.’”) (quoting *Watson v. Jones*, 80 U.S. (13 Wall.) 679, 728 (1871)); *Larson v. Valente*, 456 U.S. 228, 244 (1982) (“The clearest command of the Establishment Clause is that one religious denomination cannot be officially preferred over another.”).

¹⁵¹ *Edwards*, 482 U.S. at 583–84.

¹⁵² *Id.*

¹⁵³ *Id.* at 584.

herent in public education.

The Supreme Court has established precedents that help determine when teaching religion in public schools is neutral. In *Zorach v. Clauson*, the Court found that a state violates the principle of religious neutrality if it engages in religious instruction that only represents the views of a particular sect.¹⁵⁴ The Court held in *Epperson* that the state violates the principle of neutrality if it tailors education to the principles or prohibitions of a particular religious group or dogma.¹⁵⁵ On the other hand, in *School District of Abington Township v. Schempp*, the Supreme Court held that an education is incomplete without classes on the history of religion or comparative religion.¹⁵⁶ Public schools can integrate study of the Bible and religion when presented objectively.¹⁵⁷ The key principle for the Court is neutrality. Public schools can educate students about religion, but they cannot side with particular beliefs when educating about religion.

Secular humanism is a religion under the Establishment Clause. The Supreme Court held in *Epperson* that the requirement of neutrality between different religious sects, and between religion and nonreligion, is central to the Court's First Amendment jurisprudence.¹⁵⁸ The necessary implication of this principle is that the state cannot favor secular humanism over theistic religious beliefs. The Supreme Court has held that secularism is a religion in a few cases, including *School District of Abington Township*.¹⁵⁹ "We agree of course that the State may not estab-

¹⁵⁴ 343 U.S. 306, 314 (1952).

Government may not finance religious groups nor undertake religious instruction nor blend secular and sectarian education nor use secular institutions to force one or some religion on any person. . . . The government must be neutral when it comes to competition between sects. It may not thrust any sect on any person. . . . It may not coerce anyone to . . . take religious instruction.

Id.

¹⁵⁵ *Epperson*, 393 U.S. at 106 ("There is and can be no doubt that the First Amendment does not permit the State to require that teaching and learning must be tailored to the principles or prohibitions of any religious sect or dogma."); *id.* at 106-07 ("It forbids alike the preference of a religious doctrine or the prohibition of theory which is deemed antagonistic to a particular dogma.").

¹⁵⁶ 374 U.S. 203, 225 (1963) ("[O]ne's education is not complete without a study of comparative religion or the history of religion and its relationship to the advancement of civilization."). The Court is not indicating here that schools cannot teach religion in science classes; it merely used religion classes as an example. What is important is the underlying principle, which says that it is perfectly fine to incorporate religion in public school curriculum as long as the presentation is neutral.

¹⁵⁷ *Id.* ("Nothing we have said here indicates that such study of the Bible or of religion, when presented objectively as part of a secular program of education, may not be effected consistently with the First Amendment.").

¹⁵⁸ *Epperson*, 393 U.S. at 103-04.

¹⁵⁹ 374 U.S. at 225; *Torcaso v. Watkins*, 367 U.S. 488, 495 n.11 (1961) ("Among religions in this country which do not teach what would generally be considered a belief in the existence of God are Buddhism, Taoism, Ethical Culture, Secular Humanism and oth-

lish a ‘religion of secularism’ in the sense of affirmatively opposing or showing hostility to religion, thus ‘preferring those who believe in no religion over those who do believe.’”¹⁶⁰ Additionally, a long line of Supreme Court and Federal Circuit cases have held that non-theistic beliefs like atheism fall within the definition of religion under the First Amendment.¹⁶¹ Therefore, secular humanism is a religion under the First Amendment.

The exclusive teaching of evolutionary theory in public schools is an advancement of the religion of secular humanism. There is an inherent connection between evolutionary theory and the secular humanist worldview. Secular humanists generally reject knowledge that science cannot test.¹⁶² Since one cannot directly test the supernatural, secular humanists inevitably adopt a naturalistic worldview, which is the belief that there is only a natural realm and no supernatural.¹⁶³ Any secular humanist theory about the origin of life cannot rely on the supernatural because that would be inconsistent with naturalism. Therefore, there is an inherent link between secular humanism and evolutionary theory because evolutionism is an exclusively materialistic theory about the origin of life.¹⁶⁴

Some critics may question why teaching evolutionism would advance secular humanism if some theistic religious groups also believe in evolutionism.¹⁶⁵ There are two answers. First, even if

ers.”). See also *Zorach*, 343 U.S. at 314 (“To hold that it may not would be to find in the Constitution a requirement that the government show a callous indifference to religious groups. That would be preferring those who believe in no religion over those who do believe.”); *id.* (“But we find no constitutional requirement which makes it necessary for government to be hostile to religion and to throw its weight against efforts to widen the effective scope of religious influence.”); *id.* at 315 (“We cannot read into the Bill of Rights such a philosophy of hostility to religion.”).

¹⁶⁰ *Sch. Dist. of Abington Twp.*, 374 U.S. at 225 (quoting *Zorach*, 343 U.S. at 314).

¹⁶¹ *Wallace v. Jaffree*, 472 U.S. 38, 52–53 (1985) (“At one time it was thought that this right merely proscribed the preference of one Christian sect over another, but would not require equal respect for the conscience of the infidel, the atheist, or the adherent of a non-Christian faith such as Islam or Judaism. . . . [T]he Court has unambiguously concluded that the individual freedom of conscience protected by the First Amendment embraces the right to select any religious faith or none at all.”); *Torcaso*, 367 U.S. at 495 (“We repeat and again reaffirm that neither a State nor the Federal Government can constitutionally force a person ‘to profess a belief or disbelief in any religion.’” (quoting *Everson v. Bd. of Educ.*, 33 U.S. 1, 15 (1947))); *Kaufman v. McCaughtry*, 419 F.3d 678, 682 (7th Cir. 2005) (“[T]he Court has adopted a broad definition of ‘religion’ that includes non-theistic and atheistic beliefs, as well as theistic ones.”); *Reed v. Great Lakes Cos.*, 330 F.3d 931, 934 (7th Cir. 2003) (“[R]eligion’ includes antipathy to religion. . . . If we think of religion as taking a position on divinity, then atheism is indeed a form of religion.”).

¹⁶² Council for Secular Humanism, *supra* note 31 (“We are skeptical of untested claims to knowledge . . .”).

¹⁶³ Council for Secular Humanism, *supra* note 30 (“Secular humanists accept a world view or philosophy called naturalism, in which the physical laws of the universe are not superseded by non-material or supernatural entities . . .”).

¹⁶⁴ KURTZ, *supra* note 39, at 28.

¹⁶⁵ See *Kitzmiller v. Dover Area Sch. Dist.*, 400 F. Supp. 2d 707, 765 (M.D. Pa. 2005)

it is possible for evolutionary theory to be consistent with the beliefs of some groups, science classes do not teach this form of evolutionism. Science classes generally teach evolutionism with no supernatural element. Therefore, whether evolutionism can be theoretically reconciled with religion is irrelevant since science classes rarely teach that permutation of evolutionism and religion. Second, even if evolutionism, as taught in science classes, complements the beliefs of some religious groups, there is still a violation of the Establishment Clause, since the exclusive teaching of evolutionism would advance the beliefs of some Christian religious denominations over the beliefs of other Christian religious denominations. The legal standard explicitly requires government neutrality between religious sects.¹⁶⁶ Teaching evolutionary theory exclusively in public school science classes would advance the religious beliefs of Christian religious groups that believe in a non-literal interpretation of Genesis, and it would discriminate against Christian religious groups that believe in a literal interpretation of Genesis.

Some people may wonder why it is necessary to teach alternatives to evolutionism in science classes instead of in religion or social studies classes. There are a few reasons. First, indoctrination in science classes is uniquely dangerous because of how the norms of the scientific discipline mask its religious content. Only directly teaching alternatives in science classes will make students aware of ideological content. Second, even if schools offered religion classes, they would likely not have the same status as science classes since they would probably be electives instead of required courses. Third, science teachers generally present evolutionary theory as uncontested truth. It is unlikely that supernatural religious beliefs would get the same uncontested status if taught in other classes. Fourth, the exclusion of supernatural theories from science classes marginalizes religious belief. It creates the impression that secular humanism is a practical device that allows people to understand the world today, and religion is only an object of historical study concerning some de-

("Both Defendants and many of the leading proponents of ID make a bedrock assumption which is utterly false. Their presupposition is that evolutionary theory is antithetical to a belief in the existence of a supreme being and to religion in general.").

¹⁶⁶ *Epperson v. Arkansas*, 393 U.S. 97, 103-04 (1968); *Larson v. Valente*, 456 U.S. 228, 244 (1982) ("The clearest command of the Establishment Clause is that one religious denomination cannot be officially preferred over another.").

Government may not finance religious groups nor undertake religious instruction nor blend secular and sectarian education nor use secular institutions to force one or some religion on any person. . . . The government must be neutral when it comes to competition between sects. It may not thrust any sect on any person. . . . It may not coerce anyone to . . . take religious instruction.

Zorach v. Clauson, 343 U.S. 306, 314 (1952).

ranged people of the past. It also marginalizes religion by creating the implicit assumption that religion has nothing to say about science. Fifth, would it be objectionable to teach the non-materialistic approach to the scientific method and creation science exclusively in science classes and to teach secular humanism in social studies? If there is truly no marginalization that occurs through just teaching the materialistic scientific method and evolutionism in science classes, then there should be no objection to a reversal of this situation.

A few cases have specifically addressed whether teaching evolutionism exclusively in science classes violates the Establishment Clause, and all of the cases have held that it does not. In 1972, the U.S. District Court for the Southern District of Texas heard *Wright v. Houston Independent School District*.¹⁶⁷ The plaintiff sought an injunction that would prohibit the School District and the State Board of Education from teaching evolutionism without critical analysis and alternative theories.¹⁶⁸ The plaintiffs argued that evolutionary theory was contrary to the Bible, and that the uncritical presentation of evolutionism in science classes was, therefore, a direct attack on their religious beliefs by the state, which violated the Establishment Clause and the Free Exercise Clause.¹⁶⁹ The plaintiffs argued that the state was establishing a secular religion through its uncritical presentation of evolutionism,¹⁷⁰ and that the teaching of evolutionism was directly contrary to the principle of legal neutrality that the Supreme Court established in *Epperson*.¹⁷¹

The court rejected the plaintiffs' claim.¹⁷² Arkansas promoted religion by legislative means in *Epperson*, but there was no official state or school district policy, which required that teachers only teach evolutionism.¹⁷³ The court did not think it was significant that the textbooks had a bias in favor of evolutionism.¹⁷⁴ "This Court has been cited to no case in which so nebulous an intrusion upon the principle of religious neutrality has been condemned by the Supreme Court."¹⁷⁵ There was no evidence that students could not challenge their teacher's presentation of evolutionism, and the law in *Epperson* prohibited dis-

¹⁶⁷ 366 F. Supp. 1208 (S.D. Tex. 1972).

¹⁶⁸ *Id.* at 1208.

¹⁶⁹ *See id.* at 1209.

¹⁷⁰ *Id.*

¹⁷¹ *Id.*

¹⁷² *Id.* at 1210.

¹⁷³ *Id.*

¹⁷⁴ *See id.*

¹⁷⁵ *Id.*

cussion of evolutionism.¹⁷⁶

The court concluded that that there was an insufficient connection between the First Amendment concept of religion and evolutionism.¹⁷⁷ Science and religion deal with similar issues and sometimes have conflicting opinions, but the government cannot prohibit ideas that are contrary to a particular religious belief.¹⁷⁸ Teachers cannot stop discussing every scientific issue where a religion has a conflicting belief.¹⁷⁹ Offering equal time to all theories is not a solution to the problem. Every religion in the world has a belief about the origin of life, and there is no way to decide which theories to teach.¹⁸⁰ The court concluded that the proposed solutions would create more problems than they attempted to solve.¹⁸¹

There are a number of problems with the court's analysis. The court claimed that nothing in *Epperson* indicated that the bias in this case was significant enough to justify holding it unconstitutional, but the Court in *Epperson* stated directly that a "[s]tate may not adopt programs or practices in its public schools or colleges which 'aid or oppose' any religion. *This prohibition is absolute.*"¹⁸² Additionally, it is true that there was a legislative action in *Epperson*, but there is no reason why a legislative action or school district policy is necessary. The quoted statement above indicates that *Epperson* prohibits "practices," and that there could still be an unconstitutional state action even without an official policy. The fact that the actions of the state of Arkansas were worse in *Epperson* than the actions of the Houston School District does not make the actions of the Houston School District constitutional since the prohibition against bias in education is absolute under *Epperson*.

The court argued that science and religion deal with similar topics, and that the government cannot prohibit everything in science that conflicts with religious beliefs.¹⁸³ This statement demonstrates yet again that courts justify the exclusion of alternative perspectives by masking secular humanism with scientific discourse. Furthermore, if one assumes that an issue that comes up in science class is a point of strong ideological disagreement because it conflicts with religious beliefs, it would make sense to

¹⁷⁶ *Id.*

¹⁷⁷ *Id.*

¹⁷⁸ *Id.* at 1211.

¹⁷⁹ *Id.*

¹⁸⁰ *Id.*

¹⁸¹ *Id.*

¹⁸² *Epperson v. Arkansas*, 393 U.S. 97, 106 (1968) (citation omitted) (emphasis added).

¹⁸³ *Wright*, 366 F. Supp. at 1211.

include alternative perspectives on that issue.

The court stated that equal time is not feasible because there are too many theories.¹⁸⁴ Is there any other place in public education where this would be a legitimate excuse? A teacher could not simply state: “We do not have time to teach both the pro-life and pro-choice positions this semester so we are just going to teach you the pro-choice perspective. After all, in the abortion literature alone, there are at least thousands of different viewpoints on the issue.” This clearly does not justify failing to make a good faith effort to include diverse perspectives. Maybe this argument would be more credible if schools taught two perspectives instead of one. It is possible to offer students the big picture on these issues. There are many theories, but there are common themes that schools can teach in a significantly more inclusive manner than singular indoctrination.

In 1980, the D.C. Circuit Court of Appeals heard *Crowley v. Smithsonian Institution*.¹⁸⁵ The appellants in that case filed a civil action against the Smithsonian Institution in the United States District Court for the District of Columbia because the Smithsonian presented two exhibits involving evolutionary theory.¹⁸⁶ “The 1978 exhibit, the ‘Emergence of Man,’ is described in an accompanying pamphlet as ‘the story of how, when and where modern human beings evolved from homonid ancestors who lived millions of years ago.’”¹⁸⁷ The appellants argued that advocating the theory of evolutionism was unconstitutional support for the religion of secular humanism, and they requested an injunction that would either prohibit funding for evolutionism or require equal funding for Biblical creationism.¹⁸⁸

The D.C. Circuit rejected the claim that the exhibits established a religion of secular humanism. Although the exhibits referred to evolutionism, they did not refer to evolutionism as the only credible theory about the origin of life, nor did they mention anything about religion or secular humanism.¹⁸⁹ The exhibits did nothing to disparage any religious belief.¹⁹⁰ Even if evolutionary theory relied on faith instead of scientific proof, as the appellants claimed, that would not by itself prove that the evolutionism exhibits established a religion of secular humanism.¹⁹¹ One cannot infer that anything one believes on faith is a religion simply be-

¹⁸⁴ *Id.*

¹⁸⁵ 636 F.2d 738 (D.C. Cir. 1980).

¹⁸⁶ *Id.* at 740.

¹⁸⁷ *Id.* at 741.

¹⁸⁸ *Id.* at 740.

¹⁸⁹ *Id.* at 741.

¹⁹⁰ *Id.*

¹⁹¹ *Id.* at 742.

cause some religions rely on faith.¹⁹² The involvement of the government in an area of importance to religious believers does not mean that the activity is supporting a religion.¹⁹³ For example, government advocacy supporting or opposing abortion would not establish a religion even though there are religious concerns at stake in the issue.¹⁹⁴ “[I]t does not follow that a statute violates the Establishment Clause because it ‘happens to coincide or harmonize with the tenets of some or all religions.’”¹⁹⁵ The court also pointed to past precedents that support diffusion of scientific knowledge and prohibit any special protection for religious groups from the competition that comes from scientific information.¹⁹⁶ The court affirmed the decision of the district court concluding that the exhibits did not establish a religion of secular humanism.¹⁹⁷

There are a few problems with the court’s reasoning in *Crowley*. The court states that even if evolutionism is unverifiable, that alone does not make it a religious belief.¹⁹⁸ This is true, but evolutionism is a religion because it takes a position on an issue that has always been at the center of religious belief systems, i.e., the origin of life and the universe. It is an advancement of religion when the government adopts a distinctly materialistic belief about the origin of life that directly conflicts with other religious beliefs. The court reasons that evolution is not a religion just because it coincides with the beliefs of secular humanism. However, there is a distinction between regulating morals and supporting doctrine. A state can prohibit murder, but a state cannot coerce people into believing that murder is wrong because God prohibits it. The Seventh Circuit has found that taking a position on divinity, whether affirming or denying, is itself a religious belief.¹⁹⁹ Similarly, taking a position on the origin of life is a religious belief regardless of the position that one takes since this issue is at the heart of religious belief.

The court arbitrarily creates a higher burden of proof in this case for theistic religious belief than for non-theistic religious belief. In some federal cases, the courts have held that a mere ref-

¹⁹² *Id.*

¹⁹³ *Id.*

¹⁹⁴ *Id.*

¹⁹⁵ *Id.* (quoting *McGowan v. Maryland*, 366 U.S. 420, 442 (1961)).

¹⁹⁶ *Id.* at 744.

¹⁹⁷ *Id.*

¹⁹⁸ *Id.* at 742.

¹⁹⁹ See *Kaufman v. McCaughtry*, 419 F.3d 678, 682 (7th Cir. 2005) (“[T]he Court has adopted a broad definition of ‘religion’ that includes non-theistic and atheistic beliefs, as well as theistic ones.”); *Reed v. Great Lakes Cos.*, 330 F.3d 931, 934 (7th Cir. 2003) (“[R]eligion’ includes antipathy to religion. . . . If we think of religion as taking a position on divinity, then atheism is indeed a form of religion.”).

erence “to creation out of nothing” is by itself an advancement of religion, but the federal courts will not infer that a purely materialistic evolutionary process is an advancement of the religion of secular humanism.²⁰⁰ In the context of theistic religion, mere correlation is enough to prove a violation of the Establishment Clause. In the context of non-theistic religion, only explicit endorsement is sufficient for the courts. The federal courts violate the principle of religious neutrality when they require a higher degree of proof to demonstrate an establishment of theistic religion than is required to demonstrate an establishment of secular humanism.

In 1994, the Ninth Circuit Court of Appeals heard *Peloza v. Capistrano Unified School District*.²⁰¹ The plaintiff, a high school biology teacher, sued the school district, arguing that evolutionism is a religion, and that forcing him to teach evolutionism was, among other things, a violation of the Establishment Clause.²⁰² He argued that evolutionism is a religion that relies on chance instead of a creator to explain the origin of life.²⁰³ The court applied the *Lemon* Test to determine whether there was a violation of the Establishment Clause.²⁰⁴ The court held that exclusively teaching evolutionism does not establish a religion because the Supreme Court and the Ninth Circuit have never held that evolutionism or secular humanism are religions under the Establishment Clause, and the weight of the precedent and the dictionary definition are to the contrary.²⁰⁵ The court also stated

²⁰⁰ Compare *Edwards v. Aguillard*, 482 U.S. 578, 591 (1987) (“The preeminent purpose of the Louisiana Legislature was clearly to advance the religious viewpoint that a supernatural being created humankind.”), and *McLean v. Ark. Bd. of Educ.*, 529 F. Supp. 1255, 1265 (E.D. Ark. 1982) (“The argument that creation from nothing in 4(a)(1) does not involve a supernatural deity has no evidentiary or rational support. To the contrary, ‘creation out of nothing’ is a concept unique to Western religions. In traditional Western religious thought, the conception of a creator of the world is a conception of God.”), and *Kitzmiller v. Dover Area Sch. Dist.*, 400 F. Supp. 2d 707, 718 (M.D. Pa. 2005) (“[A]nyone familiar with Western religious thought would immediately make the association that the tactically unnamed designer is God . . .”), with *Peloza v. Capistrano Unified Sch. Dist.*, 37 F.3d 517, 521 (9th Cir. 1994) (“Only if we define ‘evolution’ and ‘evolutionism’ as does *Peloza* as a concept that embraces the belief that the universe came into existence without a Creator might he make out a claim.”), and *Crowley*, 636 F.2d at 741 (“The concept of evolution was referred to in these exhibits. . . . The exhibits did not mention religion in general or Secular Humanism in particular. Neither by their terms nor by implication did the exhibits disparage religion or any religious tenet.”), and *Wright v. Houston Indep. Sch. Dist.*, 366 F. Supp. 1208, 1210 (S.D. Tex. 1972) (“Plaintiffs’ case depends in large measure upon their demonstrating a connection between ‘religion,’ as employed in the first amendment, and Defendants’ approach to the subject of evolution. The Court is convinced that the connection is too tenuous a thread on which to base a first amendment complaint.”).

²⁰¹ 37 F.3d 517 (9th Cir. 1994).

²⁰² *Id.* at 519.

²⁰³ *Id.*

²⁰⁴ *Id.* at 520.

²⁰⁵ *Id.* at 521.

that the U.S. Supreme Court concluded in *Edwards v. Aguillard* that evolutionism is not a religion.²⁰⁶ Finally, the court concluded that evolutionary theory is a scientific theory arrived at through scientific study, and that it is not a religion.²⁰⁷

The court's conclusion that secular humanism is not a religion under the Establishment Clause is problematic. After all, the Supreme Court explicitly stated in two cases that secularism is a religion,²⁰⁸ and held in two cases that atheism is a religion.²⁰⁹ The Ninth Circuit only cited two Federal Circuit cases in support of its position, and neither case supports the court's position. The first case cited by the court was *Smith v. Board of School Commissioners*.²¹⁰ In *Smith*, the court concluded at the outset of the case that it did not need to rule on whether secular humanism was a religion because the facts in that specific case could not prove a violation of the Establishment Clause even if secular humanism were a religion.²¹¹ The holding in *Smith* does not support the conclusion that secular humanism is not a religion.

The court's second citation was to a quotation from Laurence Tribe in *United States v. Allen*, which concluded that courts

²⁰⁶ *Id.*

²⁰⁷ *Id.* at 521–22.

²⁰⁸ *Sch. Dist. of Abington Twp. v. Schempp*, 374 U.S. 203, 225 (1963) (“[T]he State may not establish a ‘religion of secularism’ in the sense of affirmatively opposing or showing hostility to religion, thus ‘preferring those who believe in no religion over those who do believe.’” (quoting *Zorach v. Clauson*, 343 U.S. 306, 314 (1952))); *Torcaso v. Watkins*, 367 U.S. 488, 495 n.11 (1961) (“Among religions in this country which do not teach what would generally be considered a belief in the existence of God are Buddhism, Taoism, Ethical Culture, Secular Humanism and others.”). *See also Zorach*, 343 U.S. 306, at 314 (“To hold that it may not be to find in the Constitution a requirement that the government show a callous indifference to religious groups. That would be preferring those who believe in no religion over those who do believe.”); *id.* (“But we find no constitutional requirement which makes it necessary for government to be hostile to religion and to throw its weight against efforts to widen the effective scope of religious influence.”); *id.* at 315 (“We cannot read into the Bill of Rights such a philosophy of hostility to religion.”).

²⁰⁹ *Wallace v. Jaffree*, 472 U.S. 38, 52–53 (1985) (“At one time it was thought that this right merely proscribed the preference of one Christian sect over another, but would not require equal respect for the conscience of the infidel, the atheist, or the adherent of a non-Christian faith such as Islam or Judaism. . . . [T]he Court has unambiguously concluded that the individual freedom of conscience protected by the First Amendment embraces the right to select any religious faith or none at all.”); *Torcaso*, 367 U.S. at 495 (“We repeat and again reaffirm that neither a State nor the Federal Government can constitutionally force a person ‘to profess a belief or disbelief in any religion.’” (quoting *Everson v. Bd. of Educ.*, 33 U.S. 1, 15 (1947))).

²¹⁰ *Peloza*, 37 F.3d at 521 n.5 (citing *Smith v. Bd. of Sch. Comm’rs*, 827 F.2d 684, 690–95 (11th Cir. 1987)).

²¹¹ *See Smith*, 827 F.2d at 689.

The Supreme Court has never established a comprehensive test for determining the “delicate question” of what constitutes a religious belief for purposes of the first amendment, and we need not attempt to do so in this case, for we find that, even assuming that secular humanism is a religion for purposes of the establishment clause, Appellees have failed to prove a violation

Id.

should consider anything that is arguably non-religious to be not a religion under the Establishment Clause.²¹² The court in *Allen* stated that it did not even fully agree with the quotation from Tribe, but in that case, the court found it helpful since the issue was whether possession of nuclear weapons by the federal government was a religion.²¹³ In light of all of the Supreme Court precedent holding that both secularism and atheism are religions, it is difficult to understand how the Ninth Circuit reached the conclusion that secular humanism is not a religion.

The Ninth Circuit also advanced a dictionary definition that said that religion includes belief in the supernatural.²¹⁴ Supreme Court precedent clearly has more legal authority than Webster's Dictionary on the meaning of the First Amendment.²¹⁵ In addition, if the Ninth Circuit had considered the implication of this definition for situations beyond this single case, the court, without question, would not have advanced this definition. Making belief in the supernatural the definition of religion would exclude atheists and agnostics from the protection of the First Amendment since the First Amendment only protects the free exercise of religion.²¹⁶

The court also pointed to the holding of *Edwards v. Aguillard* to support its conclusion that evolutionism is not a religion under the First Amendment.²¹⁷ However, the court failed to cite a specific page number in *Edwards* that supports this conclusion.²¹⁸ The reason that the court could not cite a particular page is that the Supreme Court never specifically addressed the issue of whether evolution is a religion. However, the Ninth Circuit may have assumed that it was implied in *Edwards*. In any case, it is ultimately irrelevant whether *Edwards* held that evolution-

²¹² *Peloza*, 37 F.3d at 521 n.5 (citing *United States v. Allen*, 760 F.2d 447, 450–51 (2d Cir. 1985)).

²¹³ See *Allen*, 760 F.2d at 450–51 (“Although we need not follow him to that extreme in this opinion—supporting nuclear armaments being a good deal more than ‘arguably’ non-religious—we find his analysis helpful and provocative.”).

²¹⁴ *Peloza*, 37 F.3d at 521 n.4 (“According to Webster’s, religion is the ‘belief in and reverence for a supernatural power accepted as the creator and governor of the universe.’”).

²¹⁵ See *supra* note 161 and accompanying text.

²¹⁶ U.S. CONST. amend. I (“Congress shall make no law respecting an establishment of religion, or prohibiting the free exercise thereof . . .”). Note that the word religion is used only once in the First Amendment, which means that it would be nearly impossible to arrive at different definitions of religion for the Free Exercise and Establishment Clauses. Therefore, the logical implication of the court’s dictionary definition is that it would be constitutional to pass laws prohibiting atheism and agnosticism.

²¹⁷ *Peloza*, 37 F.3d at 521 (“The Supreme Court has held unequivocally that while the belief in a divine creator of the universe is a religious belief, the scientific theory that higher forms of life evolved from lower forms is not.”) (citing *Edwards v. Aguillard*, 482 U.S. 578 (1987)).

²¹⁸ *Id.*

ism is not a religion since the Supreme Court should overturn *Edwards* by holding that failure to teach alternatives to evolutionism violates the Establishment Clause.

CONCLUSION

The public education system and the courts have systematically excluded alternatives to evolutionary theory from public school science classes. The primary rationale for excluding alternatives to evolutionism is the idea that supernatural religious beliefs do not belong in science classes because they are unscientific. This reasoning is nothing more than a façade because the materialistic scientific method that legitimizes the exclusion of alternatives to evolutionary theory is just as unverifiable as belief in the supernatural. The hegemony of the materialistic approach to the scientific method has allowed the religion of secular humanism to flourish in public school science classes under the mask of scientific objectivity. Only recognition of the faith-based assumptions that are inherent in both the materialistic and non-materialistic scientific methods will create the possibility of ending the unjust indoctrination that is plaguing public schools.

Teaching evolutionism without alternative theories in public school science classes advances and establishes the religion of secular humanism. The legal standard is neutrality, and excluding alternatives to evolutionism could not be a more explicit violation of this standard. The state is compelling students to attend science classes that engage in religious instruction. *Epperson* is the only evolutionism case that reached the right holding for the right reason. The Court correctly held that neutrality toward religion was the standard, and a statute that prohibited the teaching of evolutionism was not neutral, which proves that the true constitutional standard is to teach either all or none. Subsequent federal court cases, which have dealt with the issue of evolutionism, violate the principle of neutrality contained in the *Lemon* Test because they have the effect of advancing the religion of secular humanism.

The Importance of Selective Federal Preemption in the U.S. Securities Regulatory Framework: A Lesson from Canada, Our Neighbor to the North

*Cheryl Nichols**

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INTRODUCTION

Selective federal preemption in a country's securities regulatory framework is required to compete successfully in the global securities market. It prevents balkanization of a country's securities regulatory framework. By definition, selective federal preemption includes some preservation of state or local authority in the securities regulatory framework to address local issues, i.e., issues particular to each state. At the local level, state securities regulatory authorities (SSRAs) have the power to bring, at a minimum, fraud actions that the federal regulator does not have the resources to address effectively. SSRAs are the "local cops on the securities beat,"¹ whose mission is to protect the small investor.² Selective federal preemption is needed to "maintain uniformity and certainty' in U.S. securities markets so that they remain ahead of markets 'in London, Frankfurt, Tokyo or Hong Kong.'"³ When signing the National Securities Markets Improvement Act of 1996 (NSMIA), which contained critical selective federal preemption provisions, President Clinton asserted that it was needed to "enhance capital formation and the com-

¹ *The Securities Fraud Deterrence and Investor Restitution Act of 2003: Hearing on H.R. 2179 Before the Subcomm. on Capital Markets, Insurance and Government Sponsored Enterprises of the H. Comm. on House Financial Services*, 108th Cong. 53 (2003) (testimony of Christine A. Bruenn, NASAA President and Maine Securities Administrator).

² The author defines small investors as individuals that invest relatively small amounts of money in the U.S. securities markets.

³ Rachel Witmer, *Litigation Reform: Gramm, Domenici, Dodd Introduce Bill To Federalize Securities Class Actions*, 29 Sec. Reg. & L. Rep. (BNA) 1401, 1402 (1997) [hereinafter Witmer, *Litigation Reform*].

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petitiveness of the American economy”⁴ The Securities Industry Association (SIA) also agreed that NSMIA’s selective federal preemption provisions would “clear away some of the regulatory underbrush that adds to the cost of capital[,] without compromising investor protections.”⁵ Moreover, successful competition in the global securities market means that a country must have a securities regulatory framework that promotes uniformity without stifling systemic risk; uniformity and an appropriate level of systemic risk are necessary components in a securities regulatory framework for successful competition and innovation in the global securities market.⁶

A country’s securities regulatory framework is one of its most important competitive tools in the global securities market. A competitive securities regulatory framework promotes a large investor class, provides large pools of capital to encourage issuers and other market participants to take risk by expanding their businesses, and facilitates increased employment.⁷ Although some balkanization is necessary to combat local securities fraud, some level of federal preemption is required to avoid too much fragmentation in the securities regulatory framework. Too much fragmentation will increase the cost of capital to unacceptable levels, sending issuers in search of less expensive capital in securities markets with more uniformity in their regulatory framework.

A globally competitive securities regulatory framework also requires flexibility. It must be structured to respond quickly to constant change, one of the primary characteristics of the global securities market. Only a regulatory authority at the federal level will have the requisite power to respond effectively in a constantly changing global securities market. A federal regulatory authority would regulate all securities markets in a country, making decisions that bind all securities markets and market participants. In addition, the federal regulatory authority would have the power and the ability to craft a coherent policy for a country’s securities regulatory framework. Coherent policy is more likely to lead to uniformity and lower costs of capital, i.e., the creation of a more competitive securities market in the global

⁴ Statement on Signing the National Securities Markets Improvement Act of 1996, 2 PUB. PAPERS 1812 (Oct. 11, 1996).

⁵ Rachel Witmer, *Legislation: Congress Passes Major Securities Bill; Clinton Expected to Sign It OMB Says*, 28 Sec. Reg. & L. Rep. (BNA) 1211, 1212 (1996).

⁶ International Organization of Securities Commissions [IOSCO], *Objectives and Principles of Securities Regulation*, at 7, IOSCO Pub. Doc. 154 (May 2003), available at <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD154.pdf>.

⁷ See *Clinton Signs Long-Awaited Securities Reform Bill*, ON WALL STREET, Nov. 1, 1996, at 32, 32.

securities market.

The U.S. securities markets,⁸ recognized as the premier securities market in the world, employs selective federal preemption in its securities regulatory framework. The Supremacy Clause of the U.S. Constitution states that the laws of the U.S. federal government shall be the supreme laws of the land.⁹ Accordingly, federal law displaces or preempts state law where it expressly states that state law is preempted, where it creates a comprehensive regulatory scheme which, de facto, preempts state law in the entire area of the law related to a particular subject matter, or where state law conflicts with federal law. Currently, selective federal preemption in the U.S. securities regulatory framework does not preclude state jurisdiction over, among other areas, securities fraud. “Congress has expressly preserved the role of the states in securities regulation’ in such areas as fraud in the sale of securities and investment advisory services.”¹⁰ However, since the enactment of NSMIA, greater levels of federal preemption have been employed in the U.S. securities regulatory framework.

Generally, selective federal preemption is used in the U.S. securities regulatory framework when a securities product or transaction will have a national impact on the U.S. securities markets, i.e., the effect of the product or transaction will not be confined to one state. When a securities product or transaction has a national impact, selective federal preemption is needed to ensure uniformity of regulatory requirements, thus reducing regulatory costs borne by issuers and other market participants. Such uniformity minimizes regulatory fragmentation at the state level. However, states retain power for securities products or transactions that do not have a significant impact in more than one state.¹¹ Generally, this means that state regulatory authori-

⁸ In this article the term “U.S. securities markets” only includes securities markets (and of course the types of securities traded on such markets) regulated by the U.S. Securities and Exchange Commission (Commission). The term does not include markets regulated solely by the Commodities Futures Trading Commission (CFTC). Commission regulated securities markets includes exchanges, the over-the-counter (OTC) markets, electronic communications networks (ECN), and other alternative trading facilities (ATF). The types of securities traded on markets regulated by the Commission include equities, mutual funds, real estate investment trusts (REITS), unit investment trusts (UIT), and equity-based derivatives, options, and futures. See generally U.S. Securities and Exchange Commission [SEC], <http://www.sec.gov/index.htm> (last visited Sept. 11, 2006).

⁹ U.S. Const. art. VI, cl 2.

¹⁰ *Jurisdiction And Procedure: Common Law Fraud Claims Not Preempted By Federal Securities Law, Court Concludes*, 33 Sec. Reg. & L. Rep. (BNA) 1634, 1635 (2001) (quoting *Zuri-Invest AG v. NatWest Finance Inc.*, 177 F. Supp. 2d 189 (S.D.N.Y. 2001)).

¹¹ The author recognizes that the State of New York is an exception to this general rule. See *infra* Section II.A.2 (discussing the impact of actions taken by the State of New York on the U.S. securities regulatory framework).

ties retain jurisdiction over securities fraud within their own jurisdictions.

Failure to implement a securities regulatory framework incorporating selective federal preemption may result in a country losing control of its securities markets—one of the most important components of its economy. Canada is an example of what may happen when a country fails to establish a securities regulatory framework capable of competing in the global securities market, i.e., it fails to include selective federal preemption in its securities regulatory framework. Canada's securities regulatory framework does not include a federal securities regulator authorized to set policy, rules, and regulations for the securities markets in its thirteen provinces and territories. The absence of selective federal preemption means that each province has the ability to thwart any significant efforts to implement changes in Canada's securities regulatory framework, which was designed to ensure that its securities markets remain competitive in the global securities market. Canada's fragmented regulatory framework has allowed the U.S. to assume regulatory authority over portions of Canada's securities markets and market participants. For example, NASDAQ Canada was established in 2000 in the province of Quebec, and primary regulation of NASDAQ Canada was delegated to the U.S. by amending Quebec's Securities Act.¹²

Successful competition in the global securities market is essential because having the premier securities market in the world generally means being the premier economic power in the world. Moreover, successful competition in the global securities markets means greater pools of capital will be available to a country's businesses than would otherwise exist with a less prominent global presence; this leads to economic growth and expansion, which, in turn, leads to increased levels of employment. A securities regulatory framework, which includes selective federal preemption, is more likely to facilitate fair, efficient, and liquid markets and, at the very least, a perceived level playing field for investors. Regulatory balkanization, the regulatory approach taken by Canada, is more likely to produce unfavorable consequences, e.g., migration of market participants and investors to securities markets outside the country's jurisdiction in search of transparent markets and better returns.

This article does not endeavor to identify the appropriate

¹² See The NASDAQ Stock Market, Inc., General Form for Registration of Securities Pursuant to Section 12(b) or 12(g) of the Securities Exchange Act of 1934 (Form 10), Amendment No. 1 (May 14, 2001), available at <http://www.shareholder.com/common/edgar/1120193/950172-01-500184/01-00.pdf>.

level of federal preemption required to compete successfully in the global securities market for each country. It only seeks to point out that selective federal preemption is a necessary component in a securities regulatory framework to compete successfully in the global securities market. Moreover, the author contends that selective federal preemption has been recognized as a necessary component for a globally competitive securities regulatory framework by a consensus of securities regulatory authorities in the global securities market. This consensus is reflected in the *Objectives and Principles of Securities Regulation*, published by the International Organization of Securities Commissions (IOSCO) in May 2003.¹³

This article will first describe the significant characteristics of the global securities market. Next, it will identify significant attributes of a securities regulatory framework that successfully includes selective federal preemption and a corresponding federal regulator, using the IOSCO Standard. It will then compare the characteristics of the regulatory frameworks and corresponding securities regulators in the U.S. and Canada to the IOSCO Standard. Next, it will describe and analyze what happens when a country fails to employ selective federal preemption in its securities regulatory framework, using Canada, our neighbor to the north, as an example.

I. THE GLOBAL SECURITIES MARKET

*The financial crisis of other nations can no longer exist in a vacuum. They affect every other nation as we move closer to a global economy.*¹⁴

The global securities market has arrived. In the twenty-first century, securities markets are inextricably intertwined and advanced technology facilitates the interconnectivity of world securities markets allowing capital and information to move quickly anywhere in the world. "During 1992, 94 foreign issuers accessed the U.S. public markets for the first time. Registered offerings by foreign issuers exceeded \$33 billion . . ." and 172 foreign issuers accessed the U.S. private markets for a cumulative total of \$13 billion.¹⁵ From 1990 through 2002, the number of foreign issuers registered with the Securities and Exchange Commission (the Commission) tripled from 434 to over 1300 from

¹³ IOSCO Pub. Doc. 154, *supra* note 6, at 7. The IOSCO is a key international standard-setting body in the global securities market; its members are securities regulatory authorities for the preeminent securities markets in the world. See Section III of this article.

¹⁴ 144 Cong. Rec. 3, 4401 (1998) (statement of Sen. Grams).

¹⁵ H.R. REP. NO. 103-179, at 12 (1993).

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59 countries.¹⁶ Between 1986 and 1995, trading in foreign stocks in the U.S. increased from \$100.2 billion to approximately \$723.6 billion, and trading by foreign investors in U.S. stocks alone increased from \$277.5 billion to \$877.6 billion.¹⁷ In addition, domestic securities markets increasingly are being integrated into the global securities market leading to “competing, international combinations of stock exchanges” allowing investors “to trade any stock, any time, anywhere in a linked forum.”¹⁸

A. U.S. Recognition of the Global Securities Market

1. The Global Securities Market and the NASDAQ Stock Market, Inc.

In June 2000, NASDAQ conducted a private placement to “allow [NASDAQ among other things] to respond to current and future competitive challenges caused by technological advances and the increasing globalization of financial markets.”¹⁹ The proceeds were used to increase its global preeminence by attempting to extend its trading platform throughout the world.²⁰ The second phase of NASDAQ’s private placement was completed in January 2001 and raised \$180 million; the total amount raised in phases 1 and 2 was \$326 million.²¹ From 2000 until 2001, NASDAQ created stand-alone stock exchanges in Canada,²² Japan,²³ and Europe.²⁴ NASDAQ asserted

¹⁶ See SEC, GOVERNMENT PERFORMANCE AND RESULTS ACT (GPRA) 2004 ANNUAL PERFORMANCE PLAN AND 2002 ANNUAL PERFORMANCE REPORT 6 (2003) [hereinafter GPRA], available at http://www.sec.gov/about/gpra2004_2002.pdf.

¹⁷ *Departments of Commerce, Justice, and State, the Judiciary, and Related Agencies Appropriations for 1997: Hearings Before the Subcomm. on the Departments of Commerce, Justice, and State, the Judiciary, and Related Agencies of the H. Comm. on Appropriations*, 104th Cong. 635 (1996) (Justification of the Budget Estimates, Securities and Exchange Commission).

¹⁸ 3D HAROLD S. BLOOMENTHAL & SAMUEL WOLFF, *SECURITIES AND FEDERAL CORPORATE LAW* § 23:34, at 23-73 (2d ed. 2006).

¹⁹ The NASDAQ Stock Market, Inc., Annual Report (Form 10-K), at F-7 (Mar. 28, 2002).

²⁰ The NASD sold 40% of NASDAQ during the first phase of its private placement that raised \$260 million for NASDAQ and \$74 million for the NASD. Greg Ip, *Nasdaq Looks to Europe: Are Preparations A Prelude to a Bid for London Exchange?* WALL ST. J., Nov. 1, 2000, at C1.

²¹ Press Release, The NASDAQ Stock Market, Inc., NASDAQ Completes Private Offering and Expands Board (Jan. 25, 2001), available at http://www.nasdaq.com/newsroom/news/pr2001/ne_section01_025.html.

²² “In April 2000, [NASDAQ] entered into a cooperative agreement with the Provincial Government of Quebec for the development of a new securities market within Canada called [NASDAQ] Canada.” The NASDAQ Stock Market, Inc., *supra* note 12, at 5.

²³ NASDAQ Japan began operating on June 19, 2000. *Id.*

²⁴ *Id.* at 6.

On March 20, 2001, NASDAQ entered into a non-binding letter of intent and is currently negotiating a definitive agreement with the London International Financial Futures and Options Exchange (LIFFE) to create a new U.S. joint venture company that will list and trade single stock futures. The products of

that the foundation to create a global exchange should be built on a strong regional presence in the dominant capital centers of the world. . . . [T]hose centers are the United States, Europe, and parts of Asia, particularly Japan. By establishing centers for . . . trading in these key regions, the foundation [would] be developed for electronically linking these markets to establish a global platform.²⁵

However, the severe down-turn in the securities markets in 2000, combined with its poor performance through 2002, halted NASDAQ's expansion and ultimately led to retrenchment with the closing of trading markets established in all countries except Canada. By 2003, NASDAQ's strategy for achieving global preeminence changed from creating standalone exchanges in other countries to becoming the premier market in the U.S. and being "a market the world's investors could count on."²⁶

2. The Global Securities Market and the New York Stock Exchange (NYSE)

The NYSE, in order to compete successfully in the global securities market, has changed its business model. On December 6, 2005, NYSE members voted to merge with Archipelago Exchange, an open, fully electronic exchange.²⁷ According to the NYSE's CEO, John A. Thain, the combined entity "will create a strong, dynamic and innovative enterprise capable of meeting the demands of investors and issuers throughout the world in the decades ahead [in order to compete] globally in a high-speed electronically connected world."²⁸ NYSE's CEO determined that the merger was necessary because publicly held exchanges in "London, Frankfurt, Toronto and Sydney are aggressively competing to expand their reach."²⁹ and market share in the global securities market. The SEC shares this view: "If the U.S. mar-

the new joint venture are expected to be traded through the LIFFE CONNECTTM electronic system.

²⁵ *Id.* at 4-5.

²⁶ NASDAQ, Inc., 2003 Annual Report, at 1 (Mar., 2004), *available at* <http://www.nasdaq.com/about/AR2003/2003AR.pdf>. NASDAQ began to implement this strategy by purchasing electronic communications networks (ECN), which provided more routing capacity, connectivity, and increased market share. *Id.* at 6. NASDAQ Japan closed on August 16, 2002 due to insufficient business. *Nasdaq Japan Inc. to Go 'Dormant'; Board Finds No 'Viable Path Forward'*, 34 Sec. Reg. & L. Rep. (BNA) 1382, 1382-83 (2002).

²⁷ 1247 out of 1307 members voted in favor of the merger, i.e., approximately 95.4% of members eligible to vote on the transaction. Press release, New York Stock Exchange, New York Stock Exchange Announces Certified Results of Dec. 6 Member Vote on Merger with Archipelago Holdings, Inc. (Dec. 7, 2005), *available at* <http://www.nyse.com/press/1133956348217.html>.

²⁸ Press Release, New York Stock Exchange, New York Stock Exchange and Archipelago Exchange Agree to Merge—NYSE Group, Inc. Will Become a Publicly Held Company (Apr. 20, 2005), *available at* http://www.nyse.com/pdfs/joint_release.pdf.

²⁹ *Id.*

kets fail to meet investor needs by offering the fairest and most efficient trading mechanisms possible, an increasingly competitive international environment will be sure to offer alternatives for investors.”³⁰

B. Canada’s Recognition of the Global Securities Market

Canada, in a report commissioned to study the need for regulatory change in its securities markets (The Wise Persons’ Committee Report), determined that:

Technological changes have radically increased the mobility of capital. . . .

. . . .

Between 1980 and 2000, private capital flows (including gross bank flows, portfolio flows and foreign direct investment) increased more than six-fold to nearly US\$4 trillion annually worldwide. By 2003, outstanding international debt securities worldwide totaled US\$10.3 trillion, a ten-fold increase from 1987 levels.

Multinational securities firms now conduct business around the world and around the clock. Exchanges and trading systems operate on a cross-border basis.³¹

In particular, cross-border transactions in Canadian equities have increased from 5% of GDP in 1990 to 38% of GDP in 2002. Canadian issuers raised more debt capital internationally than domestically, with a significant number of Canadian issuers inter-listed on foreign stock exchanges, including 78 on the NYSE and 81 on the NASDAQ.³² Moreover, there is a consensus among market participants in Canada’s securities markets that successful competition means competing effectively in an environment characterized by increasing international competition for capital—a clear recognition of the global securities markets.³³ The Ontario Securities Commission (OSC), the largest provincial securities markets regulator in Canada, contends that the existence of the global securities market is

evidenced by a number of trends, including:

- the growth of cross-border securities transactions;

³⁰ Press Release, SEC, NYSE’s Rescission of Rule 390 and Commission’s Request for Comment on Market Fragmentation (Feb. 23, 2000), *available at* <http://www.sec.gov/news/press/2000-14.txt>.

³¹ WISE PERSONS’ COMMITTEE TO REVIEW THE STRUCTURE OF SECURITIES REGULATION IN CANADA, IT’S TIME—WPC FINAL REPORT 2 (2003) [hereinafter WISE PERSONS’ COMMITTEE].

³² *Id.* at 6.

³³ University of Toronto Capital Markets Institute, *White Paper: A Symposium on Canadian Securities Regulation: Harmonization or Nationalization?*, at Executive Summary-i (Oct. 2002) (edited by James Baillie).

- an increasing number of additional listings of Canadian companies on foreign exchanges;
- the emergence of multinational securities firms servicing businesses from offices around the world; and
- an increasing number of strategic alliances and other connections between regulated financial markets in different parts of the world.³⁴

The Investment Dealers Association (IDA), Canada's largest national securities self-regulatory organization (SRO) representing all investment dealers, also recognizes the existence of the global securities market. The IDA agrees that "there is . . . only one world securities market."³⁵

The Province of Quebec acknowledges the existence of the global securities market.³⁶ It recommends further harmonization between Canada's provinces with respect to each province's securities laws.³⁷

C. Recognition of the Global Securities Market Beyond North America

Recognition of the global securities market is not confined to the U.S.; The Federation of European Securities Exchanges (FESE)³⁸ also recognizes the global securities market and asserts that it is "driven by advances in technology and telecommunications, is leading to a growing number of companies wishing to raise capital in more than one country [and that] [i]nvestors too are looking at integrated, or interconnected, international markets in order to maximise their return and spread their capital risk."³⁹ In February 2006, the Tokyo Stock Exchange decided to

³⁴ ONTARIO SECURITIES COMMISSION, FIVE YEAR REVIEW COMMITTEE FINAL REPORT ~ REVIEWING THE SECURITIES ACT 42 (2003), *available at* http://www.osc.gov.on.ca/Regulation/FiveYearReview/fyr_20030529_5yr-final-report.pdf [hereinafter FIVE YEAR REVIEW COMMITTEE FINAL REPORT].

³⁵ *Suitability Requirements*, IDA REP. (Investment Dealers Association of Canada), Summer 2000, at 7.

³⁶ *See Harris, supra* note 33, at 90.

³⁷ *Id.* at app., at xiv.

³⁸ Established in 1974, FESE represents the interests of European securities exchanges as regulated markets. FESE has twenty-four full members representing approximately forty securities exchanges and clearing houses from all EU countries, and Iceland, Norway, and Switzerland. Federation of European Securities Exchanges, About Members, <http://www.fese.be/en/?inc=cat&id=4> (last visited Feb. 8, 2007). Members include the Athens Exchange, Italian Exchange, London Stock Exchange, Budapest Stock Exchange, Euronext, Stockholm Stock Exchange, and Irish Stock Exchange. Federation of European Securities Exchanges, Full Members, <http://www.fese.be/en/?inc=page&id=7> (last visited Feb. 8, 2007).

³⁹ Federation of European Securities Exchanges, The Federation, <http://www.fese.be/federation/index.htm> (last visited Aug. 16, 2006); *see also* Reena Aggarwal, *Demutualization and Corporate Governance of Stock Exchanges*, 15 J. APPLIED CORP. FIN. 105-13, (2002).

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invest approximately \$27 million to upgrade its trading systems.⁴⁰ In addition, in 2002, “the Australian Stock Exchange (ASX) ranked 12th in the world in terms of size and 16th in terms of turnover.”⁴¹

D. The Importance of Domestic Stock Markets

Securities markets are one of the most important tools that a country has for raising investment capital and efficiently allocating the country’s investment capital among competing businesses. They enable businesses and governments to raise debt and equity capital from public investors in order to fund operations. Accordingly, securities markets are vital to the growth, development and strength of market economies. They also “support corporate initiatives, finance the exploitation of new ideas[,] facilitate the management of financial risk . . . [and] have become central to individual wealth and retirement planning.”⁴² Moreover, capital markets are among the key factors in promoting a country’s long-term economic growth.⁴³ “Countries that are best able to channel savings into productive investments will register higher rates of growth and more rapid increases in living standards.”⁴⁴

In 1975, the U.S. Congress amended the federal securities laws because it recognized that “[t]he securities markets of the United States are indispensable to the growth and health of this country’s and the world’s economy.”⁴⁵ The 1975 amendments were designed to assist U.S. securities markets in adapting and responding to changing economic and technological conditions domestically and beyond U.S. borders. Without this flexibility, Congress believed that the U.S. might lose its status as an international financial center and that its economic, financial, and

⁴⁰ *Tokyo Stock Exchange Plans \$27 Million in Upgrades, and More*, WALL ST. & TECH., Feb. 23, 2006, <http://www.wallstreetandtech.com/showArticle.jhtml?articleID=180207050>.

⁴¹ Sydney Media, Fact Sheet—Global Sydney, <http://www.sydneymedia.com.au/html/2291-global-sydney.asp> (last visited Oct. 7, 2006).

⁴² IOSCO Pub. Doc. 154, *supra* note 6, at 1.

⁴³ WISE PERSONS’ COMMITTEE, *supra* note 31, at 4.

⁴⁴ *Id.*

⁴⁵ *The Structure of Securities Markets: Hearings on the Emerging Structure of U.S. Securities Markets and the Appropriate Role for Regulation Before the S. Comm. on Banking, Housing, and Urban Affairs*, 106th Cong. 217 (2001) (statement of Arthur Levitt, Chairman, U.S. Securities and Exchange Commission). \$190 million was raised for the NASD. Phases 1 and 2 of NASDAQ’s private placement reduced the NASD’s ownership significantly resulting in ownership by approximately 2,900 investors. NASDAQ investors include NASDAQ-listed companies, dealer firms, and institutional investors. Press Release, NASDAQ, NASDAQ Completes Private Offering and Expands Board (Jan. 25, 2001), [available at http://www.nasdaq.com/newsroom/news/pr2001/ne_section01_025.html](http://www.nasdaq.com/newsroom/news/pr2001/ne_section01_025.html).

commercial interests would suffer.

Like the U.S., Canada understands the importance of its securities markets to the overall health of its economy. Moreover, Canada's securities markets "are especially important in financing emerging companies that have yet to display the financial track record of more established concerns."⁴⁶

E. Regulatory Response to the Global Securities Market

Securities markets are essential to the health of the economy⁴⁷ and successful businesses. They are also a key underlying component to the employment of individuals and their ability to save and invest for retirement, education, and other essential needs. Effective competition means that a country attracts foreign businesses seeking equity capital and maintains its own domestic businesses. A sound, efficient securities regulatory framework is essential to having dynamic and fair capital markets. A regulatory framework that is slow, rigid, complex, and that adapts poorly to the pace of change in the global securities market will not facilitate successful competition.

An appropriate regulatory framework in the global securities market should be designed to compete effectively in a world of changing technology and fluid borders. Accordingly, a competitive securities regulatory framework must include a strong central authority with a dual mission of protection of investors and consistent treatment for capital seekers. "[R]egulators must strike a fine balance between ensuring efficient capital markets for issuers and maintaining adequate protection for investors."⁴⁸ Conversely, poorly regulated markets inhibit capital formation and economic growth. As early as 1993, the Commission realized that it would "need to devote even greater attention and more resources to address issues raised by cross-border offerings and listings, without either disadvantaging U.S. companies vis-a-vis their international rivals or compromising investor protection."⁴⁹ Accordingly, the Commission's "mission is to administer and enforce the federal securities laws in order to protect investors, and to maintain fair, honest, and efficient markets."⁵⁰

⁴⁶ WISE PERSONS' COMMITTEE, *supra* note 31, at 4. "In 2002, capital markets provided 88% of the long-term financing of Canadian firms, compared to only 73% in 1990." *Id.* Canada's economy relies heavily on raw materials (e.g., lumber and ores), not finished products. Only the largest of such companies qualify for listing on U.S. securities markets.

⁴⁷ "A sound and progressive financial system, of which capital markets are a critical component, is a key driver of long-term economic growth." *Id.*

⁴⁸ *Id.* at 3.

⁴⁹ H.R. REP. NO. 103-179, at 12-13 (1993).

⁵⁰ GPRA, *supra* note 16, at 16.

Among the regulators of the world's largest securities markets, there seems to be a loose consensus of the nuts and bolts of an appropriate regulatory framework, i.e., one that is designed to compete effectively in the global securities market. This consensus is reflected in the *Objectives and Principles of Securities Regulation* published by the IOSCO.⁵¹

II. THE INTERNATIONAL ORGANIZATION OF SECURITIES COMMISSIONS

IOSCO is one of the "world's key international standard setting bodies"⁵² in the global securities market. IOSCO's mission is to promote cooperation and provide expertise to set standards for securities regulatory frameworks. Accordingly, its members have agreed to: (1) "cooperate together to promote high standards of regulation in order to maintain just, efficient and sound markets;" (2) "exchange information on their respective experiences in order to promote the development of domestic markets;" (3) "unite their efforts to establish standards and an effective surveillance of international securities transactions;" and (4) "provide mutual assistance to promote the integrity of the markets by a rigorous application of the standards and by effective enforcement against offenses."⁵³

IOSCO members are Securities Regulatory Authorities (SRAs) for the preeminent securities markets in the world, including the United States, Germany, Japan, China, Great Britain, and Canada.⁵⁴ IOSCO has approximately 180 members that regulate more than ninety percent of the world's securities markets.⁵⁵ Members are classified as ordinary,⁵⁶ associate,⁵⁷ and af-

⁵¹ See IOSCO Pub. Doc. 154, *supra* note 6, at 1.

⁵² Securities and Futures Commission, IOSCO, <http://www.sfc.hk/sfc/html/EN/iosco/iosco.html> (last visited Oct. 6, 2006); see also Jane Diplock, Chairman, Executive Committee of IOSCO & Securities Commission, New Zealand, Is Regulation Keeping Up With Or Fettering Cross-Border Developments?, (Feb. 17, 2006) (transcript available at <http://www.sec-com.govt.nz/speeches/jds170206.shtml>). IOSCO began in 1983 to replace its predecessor, the Inter-American Regional Association (IARA). IARA, created in 1974, was composed of Securities Regulatory Authorities from North and South America. IOSCO, Historical Background, <http://www.iosco.org/about/index.cfm?section=history> (last visited Oct. 7, 2006).

⁵³ IOSCO, General Information, <http://www.iosco.org/about/> (last visited Oct. 6, 2006).

⁵⁴ Because there is no single securities regulatory entity authorized to bind the Canadian securities markets, only certain Canadian provincial securities regulators are members of IOSCO—Ontario, Quebec, Alberta, and British Columbia. See IOSCO, Membership and Committees Lists: Active Member Organizations and Contacts, <http://www.iosco.org/lists/> (last visited Oct. 6, 2006).

⁵⁵ See *id.*; IOSCO, Historical Background, <http://www.iosco.org/about/index.cfm?section=history> (last visited Oct. 7, 2006).

⁵⁶ Ordinary members include: Australian Securities and Investments Commission, China Securities Regulatory Commission, France—Autorité des marchés financiers, Ger-

filiate.⁵⁸ Ordinary members are voting members, while associate members are not allowed to vote.⁵⁹ Affiliate members are SROs, have no vote, and are ineligible for membership in the Executive Committee and the Presidents' Committee.⁶⁰ Affiliate members are eligible for membership in the SRO Consultative Committee.

IOSCO is administered by a General Secretariat, but performs its regulatory standard setting responsibilities through committees. IOSCO's committees include a Presidents' Committee, an Executive Committee, a SRO Consultative Committee, and various Regional Committees. The Presidents' Committee consists of all the presidents of member agencies and is authorized to achieve IOSCO's mission. The Executive Committee consists of two sub-committees: The Technical Committee and the Emerging Markets Committee. The Executive Committee has nineteen members, including the chairpersons of its sub-committees and each regional committee,⁶¹ one ordinary member elected by each regional committee, and nine ordinary members elected by the Presidents' Committee. Members of the Technical Committee include the Ontario Securities Commission, Quebec—Autorité des marchés financiers, the Commission, and the U.S. Commodity Futures Trading Commission; essentially, Technical Committee members include SRAs from the world's larger and more developed securities markets.⁶² The SRO Consultative Committee (SROCC) was established to provide information to

many—Bundesanstalt für Finanzdienstleistungsaufsicht, Japan—Financial Services Agency, Canada—Ontario Securities Commission, Canada—Quebec Autorité des marchés financiers, Russia—Federal Service for Financial Markets of Russia, and U.S. Securities and Exchange Commission. IOSCO, Ordinary Members, http://www.iosco.org/lists/display_members.cfm?memID=1&orderBy=none (last visited Oct. 24, 2006).

⁵⁷ Although not eligible to vote or to be elected to the Executive Committee, associate members are members of the Presidents' Committee. IOSCO, Categories of Members, <http://www.iosco.org/about/index.cfm?section=categories> (last visited Oct. 6, 2006). Associate members include the British Columbia Securities Commission (Canada), Alberta Securities Commission (Canada), U.S. Commodity Futures Trading Commission, and the North American Securities Administrators Association, Inc. (NASAA). IOSCO, Associate Members, http://www.iosco.org/lists/display_members_print.cfm?memid=2 (last visited Oct. 6, 2006).

⁵⁸ IOSCO, Membership and Committees Lists: Active Member Organizations and Contacts, <http://www.iosco.org/lists/> (last visited Oct. 6, 2006).

⁵⁹ IOSCO, Categories of Members, <http://www.iosco.org/about/index.cfm?section=categories> (last visited Oct. 9, 2006).

⁶⁰ *Id.*

⁶¹ IOSCO, Structure of the Organization, <http://www.iosco.org/about/index.cfm?section=structure> (last visited Oct. 8, 2006). Regional committees include Asia-Pacific Regional Committee, Inter-American Regional Committee, Africa/Middle-East Regional Committee, and European Committee. *Id.*

⁶² IOSCO, Members of the Technical Committee, http://www.iosco.org/lists/display_committees.cfm?cmtid=3 (last visited Oct. 8, 2006). Other members of the Technical Committee are: Australia, France, Germany, Hong Kong, Italy, Japan, Mexico, The Netherlands, Spain, Switzerland, and The United Kingdom. *Id.*

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assist those considering foreign business operations and investment in the global securities market; specifically, it provides information about the rules and requirements for membership in SROs of IOSCO member countries. SROCC also provides investor education information, including broker-dealer and investment adviser registration status and dispute resolution procedures. SROCC has sixty-one IOSCO affiliate members; SROCC members include the Montreal Exchange in Quebec; the Mutual Fund Dealers Association of Canada; the Market Regulation Services Inc. in Ontario, Canada; and the National Association of Securities Dealers, Inc. (NASD) and the NYSE in the U.S.⁶³ Regional Standing Committees were established to address problems specific to regions in which certain IOSCO members are located. There are four Regional Standing Committees: (1) the Africa/Middle-East Regional Committee,⁶⁴ (2) the Asia-Pacific Regional Committee,⁶⁵ (3) the European Regional Committee,⁶⁶ and (4) the Inter-American Regional Committee.⁶⁷

IOSCO's *Objectives and Principles of Securities Regulation* (OPSR) represents a consensus among SRAs regarding the goals and infrastructure of an effective securities regulatory framework in the global securities market.⁶⁸ IOSCO members are

⁶³ IOSCO, SRO Consultative Committee (SROCC), <http://www.iosco.org/committees/srocc/> (last visited Oct. 8, 2006).

⁶⁴ Africa/Middle-East Regional Committee members include Nigeria, Algeria, Kingdom of Bahrain, Dubai, Egypt, Ghana, Israel, Jordan, Kenya, Malawi, Republic of Mauritius, Morocco, Sultanate of Oman, South Africa, Tanzania, Tunisia, Uganda, United Arab Emirates, West African Monetary Union, and Zambia. IOSCO, Members of Africa/Middle-East Regional Committee, http://www.iosco.org/lists/display_committees.cfm?cmtid=7 (last visited Oct. 8, 2006).

⁶⁵ Asia-Pacific Regional Committee Members include Thailand, Australia, Bangladesh, Brunei, People's Republic of China, Chinese Taipei, Hong Kong, India, Indonesia, Japan, Korea, Kyrgyz Republic, Malaysia, Mongolia, New Zealand, Pakistan, Papua New Guinea, Philippines, Singapore, Sri Lanka, and Vietnam. IOSCO, Members of the Asia-Pacific Regional Committee, http://www.iosco.org/lists/display_committees.cfm?cmtid=6 (last visited Oct. 8, 2006).

⁶⁶ European Regional Committee members include Belgium, Albania, Armenia, Austria, Federation of Bosnia and Herzegovina, Bulgaria, Republic of Croatia, Republic of Cyprus, Czech Republic, Denmark, Estonia, Finland, Former Yugoslav Republic of Macedonia, France, Germany, Gibraltar, Greece, Guernsey, Hungary, Ireland, Isle of Man, Italy, Jersey, Republic of Kazakhstan, Lithuania, Grand Duchy of Luxembourg, Malta, The Netherlands, Norway, Portugal, Romania, Russia, Republic of Serbia, Slovak Republic, Slovenia, Spain, Republic of Srpska, Sweden, Switzerland, Turkey, Ukraine, and United Kingdom. IOSCO, Members of the European Regional Committee, http://www.iosco.org/lists/display_committees.cfm?cmtid=4 (last visited Oct. 8, 2006).

⁶⁷ Inter-American Regional Committee members include Brazil, Argentina, the Bahamas, Barbados, Bermuda, Bolivia, Chile, Colombia, Costa Rica, Dominican Republic, Ecuador, El Salvador, Honduras, Jamaica, Mexico, Ontario, Republic of Panama, Peru, Quebec, Trinidad and Tobago, U.S., Uruguay, and Venezuela. Associate Members (non-voting) include Alberta and British Columbia. IOSCO, Members of the Inter-American Regional Committee, http://www.iosco.org/lists/display_committees.cfm?cmtid=9 (last visited Oct. 8, 2006).

⁶⁸ Initially, the OPSR was adopted in 1998 and updated most recently in May 2003.

committed to the objectives and principles enumerated in the OPSR and “intend to use their best endeavors within their jurisdiction[s] to ensure adherence to [the] principles [stated in the OPSR].”⁶⁹ Although compliance with the regulatory framework set out in the OPSR is not mandatory, it may be used by SRAs to determine whether their domestic regulatory frameworks facilitate fair, efficient, and transparent markets within the global securities market. Such regulatory frameworks are more likely to protect investors and attract issuers and other market participants. “IOSCO recognizes . . . that domestic securities markets are increasingly being integrated into a global market.”⁷⁰ Moreover, a globally competitive securities market requires a flexible regulatory framework which can respond swiftly to a global securities market in a constant state of development. Accordingly, the objectives and principles enumerated in the OPSR are deemed, for the purpose of this article, to facilitate effective, and therefore competitive, regulation in the global securities market.

A. The IOSCO Standard

IOSCO asserts that, in the global securities market, competitive securities markets require a regulatory framework that fosters capital formation and economic growth, with an emphasis on competition.⁷¹ Such a regulatory framework would be based on three objectives implemented by adhering to thirty principles of securities regulation, which have been grouped into eight categories in its OPSR.⁷² The three objectives are: (1) the protection of investors; (2) ensuring that markets are fair, efficient and transparent; and (3) the reduction of systemic risk.⁷³

Under IOSCO’s regulatory framework, effective investor protection requires issuers and other market participants to disclose material information to investors (both retail and institutional investors), prohibits manipulative or fraudulent practices in the securities markets, mandates supervision of market intermediaries or operators of exchanges that provide investment services,

IOSCO Pub. Doc. 154, *supra* note 6.

⁶⁹ *Id.* at 3. IOSCO members intend to seek changes in their jurisdictions to the extent implementation of IOSCO objectives and principles with respect to securities regulation are impeded by a members’ policies or legislation. *Id.*

⁷⁰ *Id.* at 1.

⁷¹ *Id.* at 8.

⁷² The categories are principles relating to the regulator, for self-regulation, for the enforcement of securities regulation, for cooperation in regulation, for issuers, for collective investment schemes (e.g., mutual funds), for market intermediaries (e.g., brokers and dealers), and for the secondary market (e.g., exchanges, alternative trading systems (ATSs), and clearing and settlement systems). *Id.* at i–iii.

⁷³ *Id.* at i.

and prescribes minimum standards for market participants.⁷⁴ IOSCO's regulatory framework also includes the notion that investors must perceive that they have fair access to material information⁷⁵ before and after trading, and during market operation hours. Moreover, the regulatory framework must not favor some investors over others, and must punish effectively any investor who attempts to manipulate securities markets or to engage in other unfair and fraudulent behavior.⁷⁶

Under the IOSCO Standard, investor protection requires, among other things, that investors receive full disclosure of material information to facilitate informed investment decisions. At a minimum, full disclosure of material information includes accurate and complete financial statements.⁷⁷ Under the IOSCO, financial statements are "key components of disclosure requirements . . . [and] accounting and auditing standards . . . should be of high and internationally acceptable quality."⁷⁸ The notion that full and accurate disclosure of all material information about a particular security results in informed investment decisions rests on the basic assumption that investors receiving full disclosure have the knowledge and skill to understand, analyze, and act reasonably based on the information provided. Finally, investor protection also requires consistent enforcement of securities laws as well as an effective, relatively inexpensive, neutral mechanism in which investors can resolve disputes with market participants.⁷⁹

The IOSCO Standard mandates a regulatory framework capable of establishing and maintaining fair, efficient, and transparent securities markets.⁸⁰ This means that the regulatory framework must ensure that all market participants (including brokers, dealers, and exchanges) perceive that they are competing on a level playing field. The regulatory framework must require, at the very least, the imposition of licensing and initial and ongoing minimal capital requirements. Capital requirements should be set at levels designed to ensure that market intermediaries have sufficient capital to meet the requirements of their customers (investors), counterparties, or the dissolution of their

⁷⁴ *Id.* at 6–7, 12.

⁷⁵ *Id.* at 12. Material information is information that a reasonable investor requires to make an informed investment decision. See *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976); *Basic Inc. v. Levinson, Inc.*, 485 U.S. 224 (1988).

⁷⁶ IOSCO Pub. Doc. 154, *supra* note 6, at 6.

⁷⁷ *Id.*

⁷⁸ *Id.* at 5.

⁷⁹ *Id.* at 6.

⁸⁰ *Id.*

business without loss to their customers.⁸¹ The regulatory framework must also include “a comprehensive system of inspection, surveillance and compliance programs.”⁸²

The IOSCO Standard also requires the reduction of systemic risk, i.e., the risk that market intermediaries (e.g., brokers and dealers) will fail or cease to be going concerns and adversely impact securities markets.⁸³ Implementation of this objective requires laws and procedures specifying minimum capital requirements and adequate operational controls. When a market intermediary ceases to be an ongoing concern, the regulatory framework must include rules and procedures to facilitate the orderly winding down of the market intermediary’s business and, most importantly, attempt to confine the effect of its failure so that it does not affect adversely other market intermediaries.⁸⁴ The IOSCO Standard also states that the establishment of efficient and accurate procedures for clearing and settling securities transactions reduces systemic risk.⁸⁵ However, the IOSCO Standard cautions against eliminating systemic risk in the regulatory framework because risk-taking by market intermediaries is essential to success in the global securities market.⁸⁶

The IOSCO Standard also describes the attributes of the entity or entities charged with implementing a country’s securities regulatory framework.⁸⁷ These attributes are of particular importance because the author contends that the securities regulator described in the IOSCO Standard should be established at the federal level and must be authorized to impose some level of federal preemption in order to compete successfully in the global securities market.

1. Regulator Attributes Under the IOSCO Standard

Under the IOSCO Standard, a globally competitive securities regulatory framework requires an independent and accountable regulator with responsibilities and authority enumerated clearly in the applicable law.⁸⁸ However, the IOSCO Standard does not require the establishment of a single regulatory entity; the term

⁸¹ *Id.* at 5.

⁸² *Id.*

⁸³ *Id.* at 6–7.

⁸⁴ *Id.* IOSCO recognizes that such an orderly winding down may include laws other than the regulator’s securities laws. *Id.* at 7. Perhaps the country’s securities regulator might do well to have a department that reviews bankruptcy proceedings to ensure that investors and market intermediaries are treated fairly.

⁸⁵ *Id.*

⁸⁶ *Id.* at 7.

⁸⁷ *Id.* at 9–11.

⁸⁸ *Id.* at 9.

regulator may include sharing the regulator responsibilities and authority with two or more government or quasi-government agencies.⁸⁹ The regulator must be operationally independent to avoid influence from political entities and the securities industry. Moreover, regulator independence requires sufficient and stable funding, i.e., funds to both hire and to retain skilled and qualified staff. Accountability requires public monitoring of the regulator and judicial review of orders issued in connection with its regulatory activities. The regulator must have these attributes along with a steady source of funds to perform its responsibilities.

The regulator must be clear and consistent in the exercise of its authority and in the formulation of policy. Under the IOSCO Standard, this means that in performing its responsibilities, the regulator must be consistent, comprehensive, transparent, fair, and equitable.⁹⁰ In promulgating rules to effect policy, the regulator should use a process that allows for participation and consultation by the public, including market participants and investors, and others affected by regulator rulemaking and underlying policy. Moreover, the IOSCO Standard requires procedural fairness and an analysis of whether specific rules and their underlying policies unnecessarily burden capital formation.⁹¹

The regulator must actively promote the education of investors and market participants. A regulatory framework based on disclosure requires that both investors and market participants possess the financial knowledge and skills to understand and act upon the information disclosed by issuers. Market participants must also receive continuing education regarding securities products and applicable securities laws, rules, and regulations. In essence, the regulator “should . . . play an active role in the education of investors and other participants in capital markets.”⁹²

Under the IOSCO Standard, the regulator uses the assistance of SROs to fulfill its regulatory functions and responsibilities.⁹³ Although not a requirement under the IOSCO Standard, it is recommended that the regulator oversee SROs.⁹⁴ Specifically, an SRO should be required to “meet appropriate standards before . . . exercis[ing] its authority. . . . [and o]versight of the SRO should be ongoing.”⁹⁵ SROs are useful in the regulatory

⁸⁹ *Id.* at 9 n.11.

⁹⁰ *Id.* at 10.

⁹¹ *Id.* at 11.

⁹² *Id.*

⁹³ *Id.* at 12–13.

⁹⁴ *See id.* at 12.

⁹⁵ *Id.* at 19.

framework because they have expertise about market operations and practices and, generally, have a greater ability to respond quickly to changes in the securities markets. Most importantly, SROs are more likely to spot a violation of securities laws before the regulator. In addition, the IOSCO Standard presumes that, with respect to policy and rulemaking, SROs are likely to be in a better position to determine whether a particular rule or regulation will impose too great a burden on the securities industry even though it achieves a laudable goal, such as investor protection.⁹⁶ Finally, the IOSCO Standard presumes that the regulator will delegate duties to the SRO that the SRO has the “incentive[] to perform most efficiently.”⁹⁷ Despite the usefulness of SROs in the regulatory framework, the IOSCO Standard requires that SROs be monitored closely, at all times, by the regulator.⁹⁸ This means that the regulator must approve SRO rules before they are implemented, i.e., before they are required to be followed by the SROs’ members. The regulator must ensure that SRO rules, and the manner in which they are implemented by the SRO, are fair and enforced consistently in accordance with applicable securities laws and regulations.⁹⁹

The IOSCO Standard recognizes that a significant drawback in the delegation of authority by the regulator to an SRO is that there is a *prima facie* conflict of interest when the SRO is responsible for the regulation of its members and the operation and regulation of a securities market¹⁰⁰ simultaneously.¹⁰¹ When the regulation of members and market centers are combined, there may be pressure from the SRO’s members to favor the market center, which is a profit center, over the regulation of member compliance, which is always a cost center. Accordingly, the regulator must monitor the SRO to whom it has delegated regulatory authority closely and must intervene when needed; the regulator must also retain the authority to investigate, inspect, and enforce securities laws in circumstances under which it has delegated such authority to an SRO.¹⁰² Under the IOSCO regulatory

⁹⁶ See *id.* at 12–13.

⁹⁷ *Id.* at 12.

⁹⁸ *Id.* at 12–13.

⁹⁹ *Id.* at 12.

¹⁰⁰ For example, this conflict was recognized and eliminated when the Commission approved NASDAQ’s application to become a registered exchange, thus elevating it to SRO status and relieving the NASD of this responsibility. Press Release, NASDAQ, SEC Approves NASDAQ’s Exchange Registration Application (Jan. 16, 2006), *available at* <http://ir.nasdaq.com/releasedetail.cfm?ReleaseID=184424>. Prior to January 1996, the NASD was also the primary regulator or SRO for NASDAQ and other trading systems that compete with NASDAQ such as electronic communication networks or ECNs.

¹⁰¹ IOSCO Pub. Doc. 154, *supra* note 6, at 13.

¹⁰² *Id.*

model, effective delegation of certain regulatory responsibilities and functions by the regulator to an SRO include drafting rules, which must be approved by the regulator prior to implementation, designed to assure member compliance with applicable securities laws and SRO rules;¹⁰³ assuring fair and consistent treatment of SRO members and prospective members; establishing member conduct standards to promote investor protection;¹⁰⁴ enforcing SRO rules and imposing appropriate sanctions as well as cooperating with regulator-initiated investigations and enforcement actions; and assuring fair representation of the SRO's members on its board of directors.¹⁰⁵

The IOSCO Standard requires a regulator with comprehensive enforcement powers, including inspection, investigation and surveillance powers.¹⁰⁶ At a minimum, the regulator must have sufficient power to obtain data, documents and other records from individuals and/or firms that the regulator determines may have violated applicable securities laws, or that may have relevant information. The regulator's power should include the authority to impose administrative sanctions, and/or to seek orders from courts or tribunals, and, where appropriate, to enter into enforceable settlements and to accept binding undertakings.¹⁰⁷

Effective implementation of a regulator's enforcement powers under the IOSCO Standard requires a regulatory framework that routinely uses inspection and surveillance. For example, the regulator's inspection and surveillance powers should be routine, not in response to a suspicion of violations of applicable securities laws. Acknowledging that regulator resources may be limited, inspections by the regulator should be prioritized beginning with areas "of high risk to investors or which threaten systemic stability."¹⁰⁸ Again, the regulator may delegate its power of inspection to SROs or other third parties under proper supervision.¹⁰⁹

Effective enforcement in the global securities market may require crossing jurisdictional lines.¹¹⁰ Specifically, regulators

¹⁰³ *Id.* This includes avoiding the promulgation of rules that may create uncompetitive situations and prohibiting rules that allow members and/or market participants to gain an unfair competitive advantage over other members and/or market participants.

¹⁰⁴ *Id.* The regulator, along with the SRO, must ensure that the SRO's rules do not conflict with public policy established by the regulator.

¹⁰⁵ *Id.*

¹⁰⁶ *Id.* at 14–15.

¹⁰⁷ *Id.* at 15.

¹⁰⁸ *Id.* at 14–15.

¹⁰⁹ IOSCO recommends that SROs or other third parties conducting inspections on behalf of the regulator should be "subject[ed] to disclosure and confidentiality requirements." *Id.* at 14.

¹¹⁰ IOSCO Standard also recognizes the need for domestic cooperation in an effective

must have the power and the resources to handle cases involving cross-border misconduct. Accordingly,

the regulator [must have] authority to obtain information . . . that may be relevant to investigating and prosecuting potential violations . . . relating to securities transactions, and that such information can be shared directly with other regulators or indirectly through authorities in their jurisdictions for use in investigations and prosecutions of securities violations.¹¹¹

This principle is crucial to effective implementation of the IOSCO Standard, which states that “[d]omestic laws need to remove impediments to international cooperation [between securities regulators]. . . . The inability to provide regulatory assistance can seriously compromise efforts towards effective securities regulation.”¹¹² Regulators must provide regulatory assistance to their regulatory counterparts in other countries.¹¹³ Providing such regulatory assistance requires establishing cooperative arrangements that allow information sharing across country borders. Moreover, regulators must determine whether such information sharing arrangements sufficiently identify systemic threats to the stability of their domestic securities markets. For example, will the financial failure of a market intermediary in the U.S. cause the financial failure of a market intermediary in Canada? Another benefit of cross-border informational sharing arrangements is that “a significant part of an issuer’s commercial activity [may] take place in a country other than the one in which its stock is listed.”¹¹⁴ This is certainly the case in large, well-developed securities markets such as the U.S. “Fraud, market manipulation, insider trading and other illegal conduct that crosses jurisdictional boundaries can and does occur more and more frequently in a global market aided by modern telecommunications.”¹¹⁵ Accordingly, IOSCO recommends that its members

regulatory framework. *Id.* at 15–16.

¹¹¹ *Id.* at 16.

¹¹² *Id.* at 17.

¹¹³ *Id.*

¹¹⁴ *Id.* at 18.

¹¹⁵ *Id.* “It is also common for scheme promoters, managers and custodians to be located in several different jurisdictions and they may not be in the same jurisdiction as investors to whom the scheme is promoted.” In addition, “[s]imilar financial products may be traded on various markets in several countries. . . . [T]here are many derivatives in which the underlying product or reference price is traded, produced or derived on foreign markets.” *Id.* IOSCO lists several examples of violations of securities laws that might necessitate cooperation between international regulators:

[1] shifting the proceeds of crime [from domestic] to foreign jurisdictions; [2] wrongdoers fleeing to a foreign country; [3] routing [fraudulent] transactions through foreign jurisdictions to disguise the identity of parties or the flow of funds; [3] the use of foreign accounts to hide beneficial ownership of shares; and [4] the facilitation of cross-border breaches through the use of international communications media, including the Internet.

memorialize information sharing arrangements in the form of a Memorandum of Understanding (MOU).¹¹⁶ Although the form and content of MOUs will necessarily differ in light of the particular facts and circumstances, IOSCO recommends that MOUs should, at a minimum, identify: (1) the circumstances in which assistance may be requested; (2) the type of information that may be shared; (3) procedures to maintain the confidentiality of information provided; and (4) how the shared information may be used.¹¹⁷

“IOSCO recognizes that sound domestic markets are necessary to the strength of a developed domestic economy and that domestic securities markets are increasingly being integrated into a global [securities] market.”¹¹⁸ Accordingly, successful competition in the global securities market means that the regulatory frameworks of the U.S. and Canadian securities markets must closely resemble the IOSCO Standard.

III. REGULATORY FRAMEWORK OF U.S. SECURITIES MARKETS

A. Background

Prior to 1996, responsibility for regulating the U.S. securities markets was more evenly shared between federal and state regulatory authorities. In fact, state regulation of U.S. securities markets began before federal securities laws were enacted. In 1911, Kansas was the first state to enact securities laws, followed by New York in 1921. State securities regulatory authorities (SSRAs) were considered the local cops on the beat, the front lines in the war against securities fraud in their respective jurisdictions. However, the stock market crash in October 1929 and its fallout was a cataclysm that facilitated acceptance of federal regulation of U.S. securities markets.¹¹⁹ Beginning in 1933, Con-

Id.

¹¹⁶ *Id.* at 19.

¹¹⁷ *Id.* Information may also be required concerning financial and other supervisory information, technical expertise, surveillance and enforcement techniques along with investor education information. *Id.* IOSCO also recommends including a public policy exception to the provision of information in MOUs. *Id.* at 20.

¹¹⁸ *Id.* at 1.

¹¹⁹ Before the stock market crashed in October 1929, there was negligible support for regulation of the U.S. securities markets by the federal government. However, it is estimated that “of the \$50 billion in new securities . . . half became worthless.” SEC, *The Investor’s Advocate: How the SEC Protects Investors, Maintains Market Integrity, and Facilitates Capital Formation*, <http://www.sec.gov/about/whatwedo.shtml> (last visited Sept. 6, 2006) [hereinafter SEC, *Investor’s Advocate*]. Banks also lost significant sums of money during the period, which spurred an economic crisis, subsequently leading to demand for federal regulation of the U.S. securities markets by key market participants. It was believed that the public’s faith in the stock market must be restored in order for the economy to recover. *Id.*

gress passed federal statutes to regulate U.S. securities markets.¹²⁰

1. Federal Regulation in the U.S. Securities Markets

Federal regulation of U.S. securities markets began in 1933 with the passage of the Securities Act of 1933 (the Securities Act) and was quickly followed by the Securities Exchange Act of 1934 (the Exchange Act). The Exchange Act created the Commission, a single federal regulatory authority to regulate U.S. securities markets.¹²¹ The Commission's mandate is to regulate U.S. securities markets by administering and enforcing federal securities laws and by promulgating rules that implement the regulatory framework prescribed in federal securities laws.¹²² At the time of the passage of the Securities Act and the Exchange Act, there was a consensus that the maintenance of fair, efficient, and orderly securities markets facilitates greater investor participation, liquidity, and efficient capital formation in U.S. securities markets.

The federal securities laws consist of the Securities Act of 1933,¹²³ the Securities Exchange Act of 1934,¹²⁴ the Trust Inden-

¹²⁰ Securities Act of 1933, 15 U.S.C. §§ 77a–77bbbb (2000); Securities Exchange Act of 1934, 15 U.S.C. §§ 78a–78lll (2000); Investment Advisers Act of 1940, 15 U.S.C. §§ 80b-1–80b-21 (2000); and Investment Company Act of 1940, 15 U.S.C. §§ 80a-1–80a-64 (2000).

¹²¹ Securities Exchange Act of 1934, 15 U.S.C. §78d (2000). The Commission consists of five commissioners, four Divisions and eighteen Offices. Although headquartered in Washington, D.C., the Commission has eleven regional and district Offices throughout the U.S. Commissioners are appointed by the President with the advice and consent of the Senate. The President also designates one of the Commissioners as Chairperson. Each Commissioner is appointed to a five-year term ending on June 5 of each year. The terms of each Commissioner are staggered so that only one Commissioner's term ends each year on June 4. No more than three Commissioners may belong to the same political party. SEC, *Investor's Advocate*, *supra* note 119.

¹²² The Commission is only authorized to bring civil actions in federal court and administrative proceedings internally. Although criminal actions may be initiated under federal securities laws, only the Office of the U.S. Attorney is authorized to bring such actions. Commissioners meet to conduct activities authorized under federal securities laws. Commission meetings are open to the public unless confidential matters are discussed, for instance whether to issue a formal order of investigation. A formal order of investigation is an order issued by the Commission authorizing its staff to issue subpoenas to compel documents and testimony. Formal orders of investigation and information obtained pursuant to such orders are non-public. SEC, About the Division of Enforcement, <http://www.sec.gov/divisions/enforce/about.htm> (last visited Sept. 20, 2006); SEC, *Investor's Advocate*, *supra* note 119; 17 C.F.R. § 203.5 (2005).

¹²³ 15 U.S.C. §§ 77a–77aa (2000). The Securities Act prohibits fraud in the offer and sale of securities and requires disclosure of material information to investors to facilitate an informed investment decision. See SEC, *Investor's Advocate*, *supra* note 119. When enacted, the Securities Act “specifically preserved the right of each of the states to regulate the offering of securities in that state.” SEC, REPORT ON THE UNIFORMITY OF STATE REGULATORY REQUIREMENTS FOR OFFERINGS OF SECURITIES THAT ARE NOT “COVERED SECURITIES” 1 (1997), *available at* <http://www.sec.gov/news/studies/uniformity.htm> [herein after SEC, REPORT ON UNIFORMITY OF 1997].

¹²⁴ §§ 78a–78nn. The Securities Exchange Act prohibits fraud in the purchase and

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ture Act of 1939,¹²⁵ the Investment Advisers Act of 1940,¹²⁶ and the Investment Company Act of 1940,¹²⁷ and are based on the principle of full disclosure of information required by a reasonable investor to make an informed investment decision. According to the Commission:

The main purposes of [the federal securities laws] can be reduced to two common-sense notions:

Companies publicly offering securities for investment dollars must tell the public the truth about their businesses, the securities they are selling, and the risks involved in investing.

People who sell and trade securities—brokers, dealers, and exchanges—must treat investors fairly and honestly, putting investors' interests first.¹²⁸

The Commission promotes full disclosure in U.S. securities markets by requiring issuers and other market participants to provide comprehensive and accurate information to investors with respect to: 1) the offer, sale, and purchase of securities; 2) the efficient and fair operation of securities exchanges and the over-the-counter market (OTC); and 3) the operations and sales practices of market participants.¹²⁹ Section 5 of the Securities Act prohibits the offer and sale of securities through interstate commerce unless the issuer registers its securities with the Commission.¹³⁰ Registration with the Commission requires the

sale of securities in the secondary market and authorizes the Commission to register, regulate, and oversee market participants, including broker-dealers, securities self-regulatory organizations (SROs), such as the NYSE and the NASD. SEC, *The Laws that Govern the Securities Industry*, <http://www.sec.gov/about/laws.shtml> (last visited Sept. 20, 2006) [hereinafter *The Laws that Govern*].

¹²⁵ §§ 77aaa–77bbbb. The Trust Indenture Act of 1939 prescribes the content of trust indenture agreements between issuers and their respective bondholders. SEC, *The Laws that Govern*, *supra* note 124.

¹²⁶ §§ 80b-1–80b-21. The Investment Advisers Act of 1940 requires registration of investment advisers—firms or individuals compensated for providing investment advice to investors—with assets under management of \$25 million dollars or more in order to protect investors. SEC, *The Laws that Govern*, *supra* note 124.

¹²⁷ §§ 80a-1–80a-64. The Investment Company Act of 1940 regulates the operation and sales practices of investment companies, i.e., companies, including mutual funds, that primarily invest, reinvest, and trade in securities and offer their own securities to investors. The Public Utility Holding Company Act of 1935 is no longer under the jurisdiction of the Commission. SEC, *The Laws that Govern*, *supra* note 124.

¹²⁸ See SEC, *Investor's Advocate*, *supra* note 119.

¹²⁹ This principle of adequate disclosure assumes, of course, that those receiving the disclosure have the ability to comprehend such information and have the investment skills and/or knowledge to use the information to make sound investment decisions. The jury is still out on whether this is actually the case, despite the Commission's efforts towards investor education. The Commission offers educational information on its website including, but not limited to, the EDGAR database, which contains disclosure documents that issuers whose securities are publicly traded must file with Commission. See *generally* SEC, *Filings & Forms (EDGAR)*, <http://www.sec.gov/edgar.shtml> (last visited Sept. 20, 2006).

¹³⁰ 15 U.S.C. § 77e.

issuer to make disclosures of material facts—information required by a reasonable investor to make an informed investment decision.¹³¹ Accordingly, issuers must file a registration statement with the Commission, which contains, among other things, a prospectus.¹³²

An issuer may avoid registration of its securities by qualifying for a specific exemption from the registration requirement under § 5 of the Securities Act. Generally, an exemption is based on the type of security being offered and sold or the type of securities transaction. For example, securities issued by banks, municipal authorities, charitable and/or religious entities, and certain employee benefit plans are exempt from the registration requirements of § 5 of the Securities Act.¹³³ Transactions that are exempt from the registration requirements of § 5 of the Securities Act include secondary market transactions by persons other than the issuer or an affiliate of the issuer, non-public offerings by the issuer, and sales by brokers or dealers.¹³⁴ Section 3(b) of the Securities Act authorizes the Commission to create exemptions from the registration requirements of § 5 of the Securities Act.¹³⁵ For example, a limited offering authority is available for offerings of less than \$5 million¹³⁶ and is expressed in Securities Act Rules 504 (limited to \$1 million or less),¹³⁷ 505,¹³⁸ 701,¹³⁹

¹³¹ See *Basic Inc. v. Levinson*, 485 U.S. 224 (1988) (holding an omitted fact is material if there is a substantial likelihood a reasonable investor would have considered the matter significant).

¹³² A prospectus includes, among other things, a description of the issuer, its organization and financial condition, the terms of the prospective offering, and independently audited financial statements. After the issuer files the appropriate registration statement with the Commission, the appropriate division of the Commission determines whether to review the issuer's registration statement based on non-public criteria. The Commission must promptly tell the issuer whether its registration statement will be reviewed prior to becoming effective. Generally, if the Commission decides to review the issuer's registration statement, it must provide comments to the issuer within thirty days of the date that the issuer filed its registration statement with the Commission. When the Commission completes its review process and the issuer has supplied any additional information requests by the Commission, the issuer requests the Commission to declare its registration statement effective so that it may offer and sell its securities to public investors. See SEC, REPORT ON UNIFORMITY OF 1997, *supra* note 123, at 1–2.

¹³³ 15 U.S.C. § 77c.

¹³⁴ 15 U.S.C. § 77d.

¹³⁵ 15 U.S.C. § 77c(b).

¹³⁶ This exempting authority is granted to the Commission in § 3(b) of the Securities Act, *id.*, and to define the phrase “not involving any public offering” in § 4(2) of the Securities Act. 15 U.S.C. § 77d(2).

¹³⁷ Under Rule 504, 17 C.F.R. § 230.504(b)(2) (2006), exemption is limited to \$1 million or less and does not require specific disclosures or filings except as required under the anti-fraud provisions of the federal securities laws. However, Regulation D of the Securities Act requires issuers using the Rule 504 exemption to file notice with the Commission within fifteen days after the first sale of securities. § 230.503(a).

¹³⁸ Rule 505, 17 C.F.R. § 230.505, provides an exemption from registration for specified purchasers. Rule 505 does not require specific disclosures for sales of securities to “accredited investors,” but certain disclosures must be made to non-accredited investors.

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1001,¹⁴⁰ Regulation A (mini-registration),¹⁴¹ and § 4(2) of the Securities Act, which exempts transactions “not involving a public offering” from the registration requirements of § 5 of the Securities Act. Rule 506 describes transactions that are not considered to involve a public offering of securities, i.e., that are private placements. The type of disclosures, if any, required in private placements depends upon the circumstances of the particular transaction.¹⁴²

The Commission also regulates key market participants in the U.S. securities markets including securities exchanges, OTC markets, brokers, dealers, investment advisers, and investment companies (e.g., mutual funds).¹⁴³ There were approximately 5191 broker-dealers,¹⁴⁴ 15,300 investment companies,¹⁴⁵ and 8302 investment advisers¹⁴⁶ participating in U.S. securities markets in 2004.

a. How the Commission Performs its Regulatory Duties in the U.S. Securities Markets

The Commission performs many of its regulatory responsibilities through its staff. Focusing on selective federal preemption, the primary divisions of the Commission include the Division of Corporation Finance (CorpFin), the Division of Market Regulation (MarketReg), the Division of Investment Manage-

§ 230.502(b). Offerings using the Rule 505 exemption are subject to the anti-fraud provisions of the federal securities laws.

¹³⁹ Rule 701, 17 C.F.R. § 230.701, provides an exemption from § 5, 15 U.S.C. § 77e, which lists registration requirements for employee compensation plans by non-public companies. Although there are no specific disclosure requirements, offerings made pursuant to Rule 701 are subject to the anti-fraud provisions of the federal securities laws.

¹⁴⁰ Rule 1001, 17 C.F.R. § 230.1001, provides an exemption from registration, which is coordinated with the exemption from registration with California.

¹⁴¹ 15 U.S.C. § 77d(2). The Regulation A exemption, 17 C.F.R. §§ 230.251–.263, requires the issuer to file an offering statement containing required disclosures including, but not limited to, unaudited financial statements. Securities may not be sold under this exemption until the Commission has qualified the issuer’s offering statement.

¹⁴² Rule 506, 17 C.F.R. § 230.506. However, the Rule 506 exemption does require the issuer to file a notice with the Commission within fifteen days after the first sale of securities. § 230.503(a).

¹⁴³ SEC, *Investor’s Advocate*, *supra* note 119; SEC, Over-the-Counter Markets, <http://www.sec.gov/divisions/marketreg/mrotc.shtml> (last visited Sept. 20, 2006).

¹⁴⁴ THE NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC., 2004 YEAR IN REVIEW at Our 2004 Performance (2005), *available at* http://www.nasd.com/web/groups/corp_comm/documents/home_page/nasdw_014279.pdf.

¹⁴⁵ INVESTMENT COMPANY INSTITUTE, 2005 INVESTMENT COMPANY FACT BOOK 9 (45th ed. 2005), *available at* http://www.ici.org/factbook/05_fb_sec1.html#fund_sponsors. This number is for the period 2004 and includes mutual funds, closed-end funds, exchange-traded funds, and unit investment trusts.

¹⁴⁶ INVESTMENT ADVISOR ASSOCIATION, EVOLUTION RESOLUTION: A PROFILE OF THE INVESTMENT ADVISORY PROFESSION 3 (2005), *available at* http://www.icaa.org/public/evolution_revolution-2005.pdf This number is for the period 2004; in 2005, investment advisers registered with the Commission totaled 8,614.

ment (IM), the Division of Enforcement (Enforcement), the Office of Administrative Law Judges (ALJ), the Office of the Chief Accountant (Chief Accountant), the Office of Compliance Inspections and Examinations (OCIE), and the Office of International Affairs (OIA).¹⁴⁷ CorpFin reviews disclosure documents required under the federal securities laws in the primary securities market¹⁴⁸ including registration statements filed in connection with new issues and follow-on offerings, annual (10-K) and quarterly (10-Q) filings, proxy materials, tender offers, and mergers and acquisitions. It also prepares administrative interpretations of the Securities Act, the Exchange Act, and the Trust Indenture Act of 1939 (Trust Indenture Act) regarding securities traded in the primary securities market. With respect to rules and regulations promulgated pursuant to federal securities laws, CorpFin drafts and recommends rules and regulations to implement the Securities Act, the Exchange Act and the Trust Indenture Act.¹⁴⁹ In addition, CorpFin, in cooperation with the Chief Accountant, monitors the accounting profession with an emphasis on standards promulgated by the Financial Accounting Standards Board (FASB),¹⁵⁰ one of several entities responsible for developing Generally Accepted Accounting Principles (GAAP).¹⁵¹

MarketReg regulates and establishes standards for key market participants in the U.S. securities markets, including SROs,

¹⁴⁷ See the Commission's website for a listing of all offices and divisions along with a discussion of their responsibilities. SEC, *supra* note 8.

¹⁴⁸ See generally SEC, Division of Corporation Finance, <http://www.sec.gov/divisions/corpfina.shtml> (last visited Oct. 4, 2006). The primary securities market is regulated under the Securities Act, which governs activities related to new issues, including initial public offerings or IPOs.

¹⁴⁹ Administrative interpretations are sometimes issued in the form of no-action letters, which are letters issued in response to public requests of whether a particular course of action or transaction would violate the Securities Act, the Exchange Act, or the Trust Indenture Act. Specifically, the CorpFin staff writes a letter stating whether it would or would not recommend that the Commission take action against the issuer for engaging in the practice and/or transaction. CorpFin also provides informal guidance by giving its interpretation of applicable securities regulations and advice on compliance with applicable disclosure requirements to registrants, prospective registrants and the public. SEC, *Investor's Advocate*, *supra* note 119.

¹⁵⁰ *Id.* FASB was established in 1973 and is a private organization that establishes standards of financial accounting and reporting in the U.S. FASB standards are recognized by the Commission and the American Institute of Certified Public Accountants. FINANCIAL ACCOUNTING STANDARDS BOARD, FACTS ABOUT FASB 1 (2005), available at http://www.fasb.org/facts/facts_about_fasb.pdf.

¹⁵¹ GAAP represents uniform minimum standards of, and guidelines for, financial accounting and reporting. American Institute of Certified Public Accountants, Glossary of Terms, Acronyms, and Abbreviations, <http://www.aicpa.org/members/glossary/g.htm> (last visited Oct. 4, 2006). It is comprised of standards, interpretations, opinions and bulletins used to prepare financial statements for companies whose securities are publicly-traded in U.S. securities markets. Federal Accounting Standards Advisory Board, Generally Accepted Accounting Principles, <http://www.fasab.gov/accepted.html> (last visited Oct. 3, 2006).

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brokers, and dealers. Its duties include reviewing SRO proposed new rules or changes to existing SRO rules submitted to the Commission for approval. MarketReg is also responsible for implementing and monitoring the Commission's financial integrity program for brokers and dealers.¹⁵² Like CorpFin, MarketReg issues no-action letters in response to public requests about whether a particular course of action or transaction would violate federal securities laws. Unlike CorpFin, MarketReg is responsible for surveillance of the actual trading of securities in U.S. securities markets. It also monitors the activities of the Securities Investor Protection Corporation (SIPC), a non-profit, private corporation that insures customer accounts of broker-dealers in the event of insolvency.¹⁵³

IM monitors the activities of entities and individuals regulated under the Investment Advisers Act and the Investment Company Act, including mutual funds, UITs,¹⁵⁴ ETFs,¹⁵⁵ variable insurance products,¹⁵⁶ and federally registered investment advisers.¹⁵⁷ IM regulatory activities include interpreting the laws and

¹⁵² SEC, *Investor's Advocate*, *supra* note 119. The financial integrity program requires broker-dealers to make and keep certain books and records, which allow the Commission to determine, among other things, whether brokers/dealers have sufficient net capital to avoid insolvency. Exchange Act, 17 C.F.R. § 240.17a-3 (2005).

¹⁵³ SEC, No Action Letters, <http://www.sec.gov/answers/noaction.htm> (last visited Oct. 6, 2006); SEC, *Investor's Advocate*, *supra* note 119.

¹⁵⁴ A UIT is:

[a] trust, registered with the SEC under the Investment Company Act of 1940, in which a fixed portfolio of income-producing securities are purchased and held to maturity. This type of investment vehicle is commonly used with municipal bonds. Each unit usually costs \$1,000 and is sold by brokers to investors for an average load of 4% which is included in the per share price.

TIAA-CREF Brokerage Services, Investment Glossary, http://www.tiaa-crefbrokerage.com/invest_glosry_UUnd.htm (last visited Oct. 6, 2006).

¹⁵⁵ ETFs

are open-ended registered investment companies under the Investment Company Act of 1940, which have received certain exemptive relief from the SEC to allow secondary market trading in the ETF shares. ETFs are index-based products, in that each ETF holds a portfolio of securities that is intended to provide investment results that, before fees and expenses, generally correspond to the price and yield performance of the underlying benchmark index.

American Stock Exchange, ETFs Glossary, <http://www.amex.com/etf/Glossary/Gloss.htm>.

¹⁵⁶ For example, variable annuities and variable life insurance—variable annuities are life insurance annuity contracts that consist of an underlying securities portfolio that fluctuates based on the value of the securities. The goal is to provide periodic payments at a specified time (usually retirement). Accordingly, it is important that the value of the annuity is preserved to meet periodic payment requirements. Periodic payments may change based on the market value of the underlying securities portfolio, or may be fixed at some minimum level based on portfolio appreciation. TIAA-CREF Brokerage Services, Investment Glossary, http://www.tiaa-crefbrokerage.com/invest_glosry_V.htm (last visited Oct. 6, 2006).

¹⁵⁷ SEC, Division of Investment Management, <http://www.sec.gov/divisions/investment.shtml> (last visited Oct. 6, 2006). Federal Registration requires that the investment adviser have assets under management in excess of \$25 million. Investment

regulations under the Investment Advisers Act and the Investment Company Act for the public and for divisions within the Commission (e.g., Enforcement). IM is also responsible for drafting new rules and amendments to existing rules on behalf of the Commission pursuant to the Investment Advisers Act and the Investment Company Act. Like CorpFin and MarketReg, IM issues no-action letters in response to requests from regulated individuals, entities, and the public about the Investment Advisers Act and the Investment Company Act.¹⁵⁸ In addition, IM participates in audits of registered individuals and entities and the examination of annual and periodic reports of persons and entities regulated under the Investment Advisers Act and the Investment Company Act, reviews reports such persons and entities must file with the Commission, and proposes new rules and amends existing rules, which it must submit to the Commission for approval.

Enforcement investigates¹⁵⁹ possible violations of federal securities and recommends to the Commission whether those investigated should be prosecuted civilly in federal courts and/or administrative proceedings.¹⁶⁰ Investigatory and prosecutorial activities also include settlement negotiations on behalf of the Commission.¹⁶¹ If those prosecuted are found to have violated federal securities laws, available remedies in the federal courts

Advisers Act of 1940, 15 U.S.C. § 80b-3a (2000).

¹⁵⁸ SEC, *Investor's Advocate*, *supra* note 119; SEC, Division of Investment Management, <http://www.sec.gov/divisions/investment.shtml> (last visited Oct. 6, 2006).

¹⁵⁹ Investigations conducted by Enforcement are private. This means that the Commission is prohibited from disclosing that an investigation has commenced. It is the job of Enforcement to collect sufficient information during an investigation to recommend to the Commission that it initiate a civil action or an administrative proceeding. Enforcement obtains information by, among other things, interviewing witnesses, examining the books and records of regulated entities, and reviewing trading data. Enforcement, acting on behalf of the Commission, may compel regulated individuals and entities to produce information it requires to conduct its investigation. However, the Commission must issue a formal order of investigation to obtain such information from non-regulated individuals, including officers and directors of companies whose securities are publicly traded. SEC, *Investor's Advocate*, *supra* note 119.

¹⁶⁰ Administrative proceedings initiated by the staff on behalf of the Commission begin with the issuance of an Order Instituting Proceedings (OIP) issued by the Secretary of the Commission. 17 C.F.R. § 201.141 (2005). An administrative law judge (ALJ), compensated by, but not appointed by, the Commission presides over the hearing and evaluates evidence presented by Enforcement and respondents. The ALJ issues an initial decision subsequent to the hearing that contains findings of fact, conclusions of law, and recommended sanctions. Both Enforcement and respondents have a right to appeal the ALJ's decision, or a portion thereof, to the full Commission. The Commission's review of the ALJ's decision is *de novo*, and it may affirm, reverse, or remand the ALJ's decision in full or in part. Administrative sanctions include cease and desist orders, suspension or revocation of broker-dealer and investment adviser registrations, censures, bars from association with the securities industry, payment of civil monetary penalties, and disgorgement (return of ill-gotten gains). Both Enforcement and respondent have a right to appeal the Commission's final order to the appropriate U.S. District Court of Appeals. SEC, *Investor's Advocate*, *supra* note 119.

¹⁶¹ SEC, *Investor's Advocate*, *supra* note 119.

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include injunctions, civil penalties, disgorgement of illegal profits, or barring or suspending individuals from acting as corporate officers of companies whose securities are publicly-traded.¹⁶² Available sanctions in administrative proceedings include cease and desist orders, disgorgement of ill-gotten gains,¹⁶³ civil penalties, and the revocation or suspension of the licenses authorizing regulated entities and their employees to participate in the U.S. securities industry.

The Commission determines whether to authorize Enforcement to bring a civil action, an administrative proceeding, or both, based on several factors. These factors include “the seriousness of the wrongdoing, the technical nature of the [case], tactical considerations, and the type of sanction or relief [sought].”¹⁶⁴

For example, only the Commission is authorized to bar regulated entities such as brokerage firms from participating in the securities industry. Accordingly, the Commission might initiate an administrative proceeding to revoke the registration of the brokerage firm, which means the firm can no longer engage in a securities business in the U.S. securities markets.

Although the Commission only has civil enforcement authority, it may, and frequently does, make referrals and provide assistance to the U.S. Attorney’s Office and state securities enforcement authorities that do have criminal enforcement authority under federal and state securities laws, respectively,¹⁶⁵ against those serving as directors and officers for companies whose securities are publicly traded.¹⁶⁶ In 2002, the Commission, through its Enforcement staff, brought 598 enforcement actions.¹⁶⁷

The Chief Accountant advises the Commission about accounting and auditing matters and collaborates with domestic and international accounting and auditing standards-setting private sector entities, e.g., the American Institute of Certified Public Accountants (AICPA). It also cooperates closely with the Pub-

¹⁶² SEC, About the Division of Enforcement, <http://www.sec.gov/divisions/enforce/about.htm> (last visited Oct. 6, 2006).

¹⁶³ When the Commission obtains disgorgement of ill-gotten gains, i.e., money obtained by defendants from their illegal conduct, this does not mean that such funds are automatically returned to individual investors who have been defrauded. “The Commission’s mandate is to protect investors,” not to act on behalf of individual investors. *Id.*

¹⁶⁴ SEC, *Investor’s Advocate*, *supra* note 119.

¹⁶⁵ *Id.*

¹⁶⁶ The Commission may bar a person from acting as an officer or director by filing an action in federal district court. *Id.*

¹⁶⁷ GPRA, *supra* note 16, at 26. Typical actions included insider trading, accounting fraud, and providing false or misleading information about securities and/or securities transactions. SEC, *Investor’s Advocate*, *supra* note 119.

lic Company Accounting Oversight Board.¹⁶⁸ In addition, the Chief Accountant consults with Commission staff (e.g., CorpFin staff), registrants, and others about the application of accounting standards and financial disclosure requirements under federal securities laws. It may also refer matters to Enforcement if it obtains information indicating possible violations of federal securities laws.

OCIE is responsible for the Commission's examination program for registered SROs, broker-dealers, transfer agents, clearing agencies, investment companies, and investment advisers. The Commission's examination program consists of inspections designed to assess compliance with federal securities laws, to detect violations of federal securities laws, and to inform the Commission of new developments, including products and technologies, in the securities industry.¹⁶⁹

OIA's primary purpose is to reach out to members of the global securities market "to promote cooperation and assistance and to encourage the adoption of high regulatory standards worldwide."¹⁷⁰ According to the Commission, OIA's activities are essential to furthering its interests in the global securities market,¹⁷¹ and include negotiating information-sharing protocols in connection with enforcement cases, providing technical assistance concerning the operation and regulation of securities markets to various countries, and participating in international organizations (e.g., IOSCO) and meetings.¹⁷² For example, OIA assists Enforcement in obtaining and evaluating information needed from other countries to prosecute violations of the U.S. securities laws.

As currently staffed and funded, it would be impossible for the Commission to perform its regulatory responsibilities for the U.S. securities markets single-handedly. Accordingly, the Exchange Act authorizes the Commission, as primary regulator, to delegate the performance of certain of its regulatory responsibilities to SROs. SROs must register with the Commission under §§ 6 and 19(a) of the Exchange Act¹⁷³ and are subject to oversight by the Commission. To qualify for registration with the Commis-

¹⁶⁸ SEC, *Investor's Advocate*, *supra* note 119. More detailed information is available at Public Company Accounting Oversight Board (PCAOB), <http://www.pcaob.org> (last visited Oct. 6, 2006).

¹⁶⁹ SEC, *Investor's Advocate*, *supra* note 119.

¹⁷⁰ *Id.*

¹⁷¹ *Id.*

¹⁷² *Id.*

¹⁷³ 15 U.S.C. § 78f(a) (2000). Section 78s(a) authorizes the Commission to effectively shut down an aberrant registered national securities exchange by revoking its registration with the Commission.

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sion, the SRO must evidence that it has the capacity to regulate its members and their associated persons with a view towards ensuring compliance with applicable securities laws and the rules promulgated hereunder, as well as ensuring compliance with its own rules.¹⁷⁴ SROs are statutorily required to police their members by conditioning membership on compliance with applicable securities laws (including state securities laws);¹⁷⁵ SRO policing efforts must include the imposition of sanctions on its members for violations of applicable securities laws (federal and state) and its own rules. The largest and the most active SROs are the NASD and the NYSE.¹⁷⁶ Specifically, the Commission delegates much of its responsibility for performing examinations of market participants' books and records to SROs which have more resources to perform such examinations on a regular basis (once per year). Generally, examinations of books and records are conducted to ensure that market participants are complying with federal securities laws and to protect investors by determining whether market participants have sufficient capital to support their activities in the marketplace. Examinations of the sales practices of market participants facilitates investor protection by determining whether market participants are making misrepresentations of, and/or omitting to state, material facts in connection with the offer, sale, and purchase of securities in U.S. securities markets. However, despite delegation of certain of its regulatory duties to SROs, the Commission remains ultimately responsible for ensuring that market participants comply with federal securities laws.

¹⁷⁴ § 78f(b)(1).

¹⁷⁵ Section 78f(c)(1) provides that only registered broker-dealers and their associated persons may be members of a national securities exchange, such as the NYSE. See § 78f(c)(2) for a description of factors national securities exchanges consider in denying membership to broker-dealers. Institutional investor membership is prohibited.

¹⁷⁶ FITCH RISK MANAGEMENT, REVIEW OF SIPC RISK PROFILE AND PRACTICES: THE MJK CLEARING EVENT, THE SECURITIES LENDING EXPOSURE, RISK MANAGEMENT PRACTICES AND CAPITAL REQUIREMENTS 24 (2003) ("The two most prominent SROs are the National Association of Securities Dealers (NASD) and the New York Stock Exchange (NYSE)."). NASD Member Firms totaled 5111 in 2005. NASD, NASD Statistics, http://www.nasd.com/web/idcplg?IdcService=SS_GET_PAGE&ssDocName=NASDW_010990 (last visited Oct. 6, 2006). NASDAQ and NYSE are exchanges. 15 U.S.C. § 78c(a)(1) (2000), defines an exchange as

[A]ny organization, association, or group of persons, whether incorporated or unincorporated, which constitutes, maintains, or provides a market place or facilities for bringing together purchasers and sellers of securities or for otherwise performing with respect to securities the functions commonly performed by a stock exchange as that term is generally understood, and includes the market place and the market facilities maintained by such exchange.

For a list of securities exchanges currently registered with the Commission, see SEC, Self-Regulatory Organization (SRO) Rulemaking and National Market System (NMS), <http://www.sec.gov/rules/sro.shtml> (last visited Oct. 6, 2006).

2. State Regulation of U.S. Securities Markets

The state regulatory framework, like the federal regulatory framework, is comprised of a state securities regulatory authority (SSRA)¹⁷⁷ that regulates, within its borders, the issuance and trading of securities; the activities of market participants; and, until 1996, the financial integrity (operations and capital requirements) and sales practices of brokers, dealers, investment advisers, and investment companies. SSRAs are responsible for enforcing state securities laws passed by state legislatures. SSRA regulatory activities include licensing investment professionals and securities firms within their respective jurisdictions, examining broker-dealer and investment adviser firms to confirm compliance with state securities laws, reviewing state offerings not subject to federal securities laws, and educating investors.

The state securities registration process differs from the federal securities registration process because a majority of states regulate securities offerings based on merit reviews rather than, or along with, full disclosure; only a minority of states include full disclosure in their securities registration process. Registration based on merit review means that SSRAs must determine the *fairness* of prospective offerings to investors. The definition of fairness varies from state to state. The merit review process is designed to “prevent promotion of fraudulent or inequitable” securities offerings.¹⁷⁸

Like federal securities laws, state securities laws include exemptions from registration requirements based on the type of securities and the securities transaction. Types of securities that are exempt from state registration requirements include securities issued by banks or savings institutions and by certain reli-

¹⁷⁷ Eleven SSRAs are appointed by their respective Secretaries of State, others by their respective Governors, five are under the jurisdiction of their state's Attorney General, and the remaining SSRAs operate under the auspices of their respective state banking or financial institutions, or commerce departments. *The Role of State Securities Regulators in Protecting Investors: Hearing on Efforts to Enforce Securities Laws, Investment Adviser Registration and Licensing, State Investigations into Mutual Fund Industry Abuses, and Investor Education Programs Before the S. Comm. on Banking, Housing, and Urban Affairs*, 108th Cong. 34 (2005) [hereinafter *Role of State Securities Regulators*] (statement of Ralph A. Lambiase, Director, Division of Securities Connecticut Department of Banking; President, NASAA).

¹⁷⁸ In merit reviews, SSRAs determine the fairness of the offering by considering, among other factors, whether the offering: (1) limits sales of stock to insiders and promoters and at a significantly discounted price; (2) Requires repayment of insider loans before the offering is conducted; (3) Ensures that material transactions are from unaffiliated third parties and are ratified by a majority of the issuer's independent board members; (4) Demonstrates that the issuer's net income in the past fiscal year is sufficient to cover fixed charges, preferred stock dividends, and redemption requirements of any preferred stock being offered; and (5) Prohibits unequal voting rights without allowing preferential dividends or liquidation provisions in exchange for accepting unequal voting rights. SEC, REPORT ON UNIFORMITY OF 1997, *supra* note 123, at 7–8.

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gious and charitable organizations. Securities transactions that are exempt from state registration requirements include the offer or sale of a security issued to specified purchasers;¹⁷⁹ any transaction in which there is an offer to not more than ten persons in the state during any twelve month period under certain conditions; and any transaction in which there is an offer to existing security holders of the issuer, if certain conditions are met.¹⁸⁰ Moreover, most states have limited offering exemptions from their registration requirements based on such factors as the number of offerees or purchasers, the dollar amount of the offering, or a combination of the two.¹⁸¹

State securities laws, although closely following the regulatory framework set out in federal securities laws, are tailored to fit the requirements of the local marketplace. State securities laws were, and continue to be, different in each state.¹⁸² To address the issue of uniformity, or lack thereof, in the state registration process, forty-eight states have adopted (with modifications) the Uniform Securities Act of 1956 (Uniform Act)¹⁸³ drafted by the National Conference of Commissioners on Uniform State Laws (NCCUSL).¹⁸⁴ SSRAs have attempted to decrease the cost

¹⁷⁹ Specified purchasers include banks, savings institutions, and institutional buyers. *Id.* at 9.

¹⁸⁰ Required conditions include advance notice to the state securities commission. *Id.* at 9–10.

¹⁸¹ *Id.* at 10.

¹⁸² Prior to 1996, all issuers were required to comply with state securities laws of all states. *Id.* at 1. Inevitably, this process raised the cost of capital unnecessarily.

¹⁸³ New York and California have not adopted the Uniform Act. Uniform Law Commissioners, A Few Facts About the Uniform Securities Act (2002), http://www.nccusl.org/Update/uniformact_factsheets/uniformacts-fs-usa.asp (last visited Feb. 9, 2007). Originally, the Uniform Act was drafted in 1956 and was adopted, with modifications, in 37 jurisdictions. It was revised in 1985 and 2002; the Uniform Act of 2002 does not conflict with current federal securities laws and has been adopted by Hawaii, Idaho, Iowa, Kansas, Maine, Minnesota, Missouri, Oklahoma, South Carolina, South Dakota, Vermont, and the U.S. Virgin Islands; it has been endorsed by NASAA, the Securities Industry Association, the NYSE, the NASD, and the Investment Counsel Association of America, and is approved by the American Bar Association. Uniform Securities Act Organization, <http://www.uniformsecuritiesact.org/usa/DesktopDefault.aspx> (last visited Oct. 11, 2006). Regarding registration, the Uniform Act provides for registration of state offerings by notification, coordination and qualification. Registration by notification requires the issuer to make only a notice filing with the SSRA. UNIFORM SECURITIES ACT § 302, 7C U.L.A. 74 (2006). Registration by coordination enables the issuer's state registration statement to become effective when its federal registration statement is declared effective by the Commission. § 303, 7C U.L.A. 81. Registration by qualification means that the state securities authority will conduct a full review of the issuer's prospective offering within its jurisdiction. Generally, registration by qualification is used when the issuer is exempt from registration under the Securities Act but not under state securities laws. § 304, 7C U.L.A. 84.

¹⁸⁴ Uniform Law Commissioners, Frequently Asked Questions about NCCUSL, <http://www.nccusl.org/nccusl/DesktopDefault.aspx?tabindex=5&tabid=61> (last visited Oct. 11, 2006). The NCCUSL consists of lawyers, judges and law professors, who are appointed by states, the District of Columbia, Puerto Rico, and the U.S. Virgin Islands. It

of capital by adopting the Uniform Act and working together to regulate multi-state offerings under the auspices of the North American Securities Administrators Association.

a. North American Securities Administrators Association (NASAA)

The North American Securities Administrators Association (NASAA) is a *voluntary* umbrella organization representing state and provincial securities regulators in North America. Established in 1919, NASAA consists of the SRAs in the U.S., Canada, and Mexico.¹⁸⁵ NASAA's organizational structure includes a board of directors, standing committees, an executive director, and staff responsible for daily operations.¹⁸⁶ Similar to the Commission, NASAA's standing committees¹⁸⁷ are comprised of five sections—Broker-Dealer,¹⁸⁸ Corporation Finance,¹⁸⁹ Enforcement,¹⁹⁰ Investment Adviser,¹⁹¹ and Investor Education.¹⁹²

drafts uniform and model laws in topical areas of the law which would benefit from uniformity. Uniform Law Commissioners, About NCCUSL, <http://www.nccusl.org/nccusl/DesktopDefault.aspx?tabindex=0&tabid=9> (last visited Oct. 11, 2006).

¹⁸⁵ North American Securities Administrators Association [NASAA], About NASAA, http://www.nasaa.org/About_NASAA/ (last visited Oct. 11, 2006). Canadian membership includes its thirteen provinces and territories of British Columbia, Yukon, Northwest Territories, Nunavut, Quebec, Newfoundland & Labrador, Nova Scotia, New Brunswick, Ontario, Prince Edward Island, Manitoba, Saskatchewan, and Alberta. Canada does not have a federal securities regulator. NASAA, Director of Securities Laws & Regulations, http://www.nasaa.org/industry_regulatory_resources/Directory_of_Securities_Laws_Regulations/ (last visited Oct. 11, 2006).

¹⁸⁶ NASAA is headquartered in Washington, D.C. and its departments include legal, finance, government affairs, communications, investor education, and membership services. See generally NASAA, About NASAA, http://www.nasaa.org/About_NASAA/ (last visited Oct. 11, 2006).

¹⁸⁷ NASAA, Sections & Project Groups, http://www.nasaa.org/About_NASAA_Sections_Project_Groups/ (last visited Oct. 11, 2006).

¹⁸⁸ Project groups of the Broker-Dealer Section include Continuing Education, Exams Advisory, Market and Regulatory Policy and Review, Operations, Arbitration, and Variable Annuities. NASAA, Sections & Project Groups: Broker-Dealer Section, http://www.nasaa.org/about_nasaa/nasaa_sections_project_groups/345.cfm (last visited Oct. 11, 2006).

¹⁸⁹ Project groups in the Corporation Finance section include Corporation Finance Policy, Direct Participation Programs Policy (e.g., limited partnerships), Franchise and Business Opportunities, Shareholder Rights, Small Business/Limited Offerings, Small Business Capital Formation, and Coordinated Interpretations. NASAA, Sections & Project Groups: Corporation Finance Section, http://www.nasaa.org/about_nasaa/nasaa_sections_project_groups/346.cfm (last visited Oct. 11, 2006).

¹⁹⁰ Project groups in the Enforcement section include Attorney/Investigator Training, Enforcement Technology, Enforcement Trends, Litigation Forum, Special Project Development & Coordination, and Viaticals & Life Settlements. NASAA, Securities & Project Groups, Enforcement Section, http://www.nasaa.org/about_nasaa/nasaa_sections_project_groups/347.cfm (last visited Oct. 11, 2006).

¹⁹¹ Project groups in the Investment Adviser section include Operations, Regulatory Policy & Review, Training, and Zones. NASAA, Securities & Project Groups, Investment Adviser Section, http://www.nasaa.org/about_nasaa/nasaa_sections_project_groups/348.cfm (last visited Oct. 11, 2006).

¹⁹² Project groups in the Investor Education section include affinity and ethnic-based

NASAA's Enforcement committee coordinates enforcement efforts for multi-state or multi-jurisdictional frauds by facilitating information sharing and attempting to allocate efficiently the enforcement efforts of its membership. The Enforcement committee serves as a liaison, on behalf of NASAA membership, to federal agencies (particularly the Commission) and SROs. The Enforcement committee also attempts to identify fraud and enforcement trends in the various jurisdictions of its members. For the reporting period 2002–2003, SSRAs “filed a total of 2,964 administrative, civil, and criminal enforcement actions; assessed \$822,315,470 of monetary fines or penalties; collected \$660,109,508 in restitution, rescission, and disgorgement and sentenced criminals to over 717 years of incarceration.”¹⁹³

NASAA has adopted several programs over the years in an attempt to harmonize state securities laws. These efforts include the Uniform Limited Offering Exemption (ULOE) in 1983 to facilitate uniformity regarding registering securities offerings; the Coordinated Equity Review (CER) program; and the Small Company Offering Registration (SCOR) program. However, compliance with such programs is strictly voluntary. ULOE provides a state exemption for offerings that are exempt under Rules 505 and 506 of Regulation D of the Securities Act.¹⁹⁴ SCOR provides a lead state examiner for multi-state offerings required by relatively smaller issuers, such as microbreweries, small banks, and technology startups.¹⁹⁵ CER targets relatively larger multi-state offerings, e.g., securities that trade on the NASDAQ Smallcap market or the OTC Bulletin Board.

Most importantly, NASAA members have additional responsibilities other than securities regulation within their jurisdictions. For example, the responsibility for enforcing the securities laws of the State of New York resides with its State Attorney

outreach, online trading awareness, senior outreach, and youth outreach. NASAA, Securities & Project Groups, Investor Education Section, http://www.nasaa.org/about_nasaa/nasaa_sections__project_groups/349.cfm (last visited Sept. 9, 2006).

¹⁹³ These statistics were compiled by NASAA with over 70 percent of its 52 members responding. *Role of State Securities Regulators*, *supra* note 177, at 40 (prepared statement of Joseph P. Borg, Director, Alabama Securities Commission & Chairman of the Enforcement Section of NASAA).

¹⁹⁴ See ROSA MARIA MOLLER, SECURITIES REGULATIONS AND THEIR EFFECTS ON SMALL BUSINESSES 32 (2000) available at <http://www.library.ca.gov/crb/00/04/00-005.pdf>; NASAA, Statement on Public Offerings, http://www.nasaa.org/Issues__Answers/Legislative_Activity/Testimony/684.cfm (last visited Sept. 9, 2006). Offerings under Regulation D of the Securities Act are limited offerings that are exempt from the registration requirements of § 5 of the Securities Act. Regulation D exemption requirements are contained in Rules 501–08, which contain requirements to qualify for Regulation D's limited offering exemptions from registration. 17 C.F.R. §§ 230.501–230.508 (2006).

¹⁹⁵ See NASAA, Statement on Public Offerings, http://www.nasaa.org/Issues__Answers/Legislative_Activity/Testimony/684.cfm (last visited Sept. 9, 2006).

General (AG). However, the AG is divided into five major divisions with corresponding bureaus. There are four case-specific divisions: Appeals and Opinions,¹⁹⁶ Criminal Prosecutions,¹⁹⁷ State Counsel,¹⁹⁸ and Public Advocacy; plus a separate Regional Offices Division.¹⁹⁹ There is also a Division of Administration that provides budget, personnel, operations, and technology services for the Attorney General.²⁰⁰ The Investor Protection Bureau is responsible for enforcing and administering the State of New York's securities laws and operates under the auspices of the Division of Public Advocacy (Public Advocacy). Public Advocacy was established to defend and protect the public interest in New York courts. Public Advocacy is comprised of ten bureaus, and in addition to enforcing the State of New York's securities laws, it also enforces its health care laws, environmental laws, laws that prevent trade restraint, laws that protect charitable donors and beneficiaries, and laws that prohibit discrimination. Moreover, the AG's recommended budget for the fiscal year 2005–06 of \$214 million must be shared by all divisions and the corresponding bureaus.²⁰¹ Unlike the Commission, SSRAs rarely have the luxury of focusing exclusively on monitoring and enforcing state securities laws.

As a member of IOSCO, NASAA also participates in the global securities market by exchanging views with international criminal law and regulatory sectors focused on combating investment fraud, and by identifying ways of coordinating enforcement efforts when investigating and prosecuting securities fraud that has crossed international borders.²⁰²

Finally, cooperation between the Commission and SSRAs is mandated under § 19(d) of the Exchange Act. Accordingly,

¹⁹⁶ The Division of Appeals and Opinions handles appellate litigation in both the State of New York and Federal courts. In addition, it drafts opinions which interpret State of New York laws for New York State agencies and municipalities. Office of NYS Attorney General Eliot Spitzer, Tour the Attorney General's Office, <http://www.oag.state.ny.us/tour/tour.html> (last visited Sept. 11, 2006).

¹⁹⁷ The Criminal Prosecutions Division investigates and prosecutes criminal cases including, but not limited to, Medicaid fraud, auto insurance fraud, white collar and organized crime occurring in New York State. *Id.*

¹⁹⁸ The Division of State Counsel provides counsel and representation in legal proceedings involving New York State agencies, the Governor, other New York State officials and the New York State Legislature. *Id.*

¹⁹⁹ The Regional Offices program provides mini-satellite offices in New York State to provide access to the programs and services of the AG and to provide cost-effective representation for New York agencies in all New York State and Federal courts. *See id.*

²⁰⁰ NEW YORK STATE DEPARTMENT OF LAW, 2001 ANNUAL REPORT 29 (2002).

²⁰¹ Assemb. B. 550, 2005 Leg., 228th Legis. Sess. (N.Y. 2005), available at <http://www.budget.state.ny.us/archive/fy0506archive/fy0506appropriations/ppgg.pdf>.

²⁰² *Role of State Securities Regulators*, *supra* note 177, at 37 (statement of Ralph A. Lambiase, Director, Division of Securities Connecticut Department of Banking; President, NASAA).

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NASAA and the Commission co-sponsor an annual Conference on Federal-State Securities Regulation (Conference). At the Conference, participants in working groups focus on regulatory topics such as corporation finance, broker-dealer sales practices, investment advisers, investor education, and enforcement.²⁰³

Against this setting, a movement towards federal preemption in the U.S. securities markets began, in earnest, with the passage of the National Securities Markets Improvement Act of 1996 (NSMIA).²⁰⁴

3. Selective Federal Preemption in the Securities Regulatory Framework

This section identifies significant legislative action endorsing selective federal preemption from 1996 to the present. 1996 was chosen because Congress passed legislation that clearly demonstrated its support for selective federal preemption in the securities regulatory framework. The chart below summarizes legislation signifying Congress's intent to use selective federal preemption in the securities regulatory framework.

²⁰³ Press Release, SEC, SEC, NASAA to Co-Sponsor Conference on Federal-State Securities Regulation (Apr. 5, 2004), *available at* <http://www.sec.gov/news/press/2004-46.htm>.

²⁰⁴ Pub. L. No. 104-290, 110 Stat. 3416 (codified as amended in scattered sections of 15 U.S.C.) (1996).

<u>Name</u>	<u>Purpose</u>	<u>Citation</u>
National Securities Markets Improvement Act of 1996 Oct. 11, 1996	To modernize and rationalize the regulatory framework of the U.S. Securities Markets including, but not limited to, the respective responsibilities of Federal and State governmental authorities	Pub. L. No. 104-290, 110 Stat. 3416 (codified as amended in scattered sections of 15 U.S.C.) (1996).
Securities Litigation Uniform Standards Act of 1998 Nov. 3, 1998	To prevent certain state private securities class action lawsuits alleging fraud from being used to frustrate the objectives of the Private Securities Litigation Reform Act of 1995	Pub. L. No. 105-353, § 1, 112 Stat. 3227 (1998).
Sarbanes-Oxley Act of 2002 Jul. 30, 2002	"To protect investors by improving the accuracy and reliability of corporate disclosures made pursuant to the securities laws, and for other purposes."	Pub. L. No. 107-204, 116 Stat. 745 (2002).
The Securities Fraud Deterrence and Investor Restitution Act of 2004	Although never passed, this was an attempt to further curtail state regulatory authority in the U.S. securities markets and was described as a bill "[t]o enhance the authority of the [Commission] to investigate, punish, and deter securities laws violations, and to improve its ability to return funds to defrauded investors, and for other purposes."	H.R. 2179, 108th Cong. (2d Sess. 2004); H.R. REP. NO. 108-475, pt. 1 (2004).

a. The National Securities Markets Improvement Act of 1996

According to President Clinton, the NSMIA represented the most significant overhaul of the regulatory framework for the U.S. securities markets in decades. NSMIA would

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enhance capital formation and the competitiveness of the American economy by eliminating regulatory overlap between the States and the Federal Government. . . . [The] bill achieve[d] the difficult task of improving the efficiency of the financial markets without compromising investor protections. . . . [It] will more efficiently divide responsibility for regulation between the Federal and State governments. The [Commission] will be charged with responsibility for activities in the national markets, such as regulation of securities listed on the national exchanges and mutual funds, as well as large investment advisors.²⁰⁵ States will have responsibility for smaller issues and investment advisors²⁰⁶ with smaller portfolios, while retaining their authority to take enforcement actions against fraudulent conduct in all situations. . . . These changes will all enhance our national capital markets, helping to create and nurture new businesses and new jobs, and enhancing the returns of both businesses and investors.²⁰⁷

NSMIA was designed to facilitate the development of national securities markets and to reduce the costs and burdens of duplicative regulation. NSMIA increased the use of selective federal preemption by

designating the Federal government as the exclusive regulator of national offerings of securities[:]; repealing anti-competitive restrictions on entities from whom brokers may borrow; requiring the consideration of efficiency, competition, and capital formation whenever the [Commission] makes a public interest determination in its rulemaking; providing for streamlining and coordinating of examinations of broker-dealers by [SROs]; significantly reducing regulatory burdens on the mutual fund industry; [and] simplifying and reducing ineffective and anticompetitive restrictions imposed by the Investment Company Act.²⁰⁸

NSMIA also empowered the Commission to exercise wide-ranging, exemptive authority. The Commission's exemptive authority allows it, by rule or regulation, to exempt any person, security, or transaction from any requirement under federal securities laws.²⁰⁹ Congress contended that such exemptive authority was needed to ensure sufficient flexibility to respond quickly to changes in the U.S. securities industry.²¹⁰ However, the Commission's exemptive authority must be exercised to promote effi-

²⁰⁵ Large investment advisers are investment advisers with more than \$25 million in assets under management. SEC, Investment Advisors: What You Need to Know Before Choosing One, <http://sec.gov/investor/pubs/invadvisors.htm> (last visited Sept. 26, 2006).

²⁰⁶ Smaller investment advisers are investment advisers with \$25 million or less under management. *Id.*

²⁰⁷ Statement on Signing the National Securities Markets Improvement Act of 1996, 2 PUB. PAPERS 1812 (Oct. 11, 1996).

²⁰⁸ H.R. REP. NO. 104-622, at 16 (1996).

²⁰⁹ 15 U.S.C. § 77z-3 (2000). The Commission may exercise its exemptive authority conditionally or unconditionally. *See also* H.R. REP. NO. 104-622, at 58 (1996).

²¹⁰ H.R. REP. NO. 104-622, at 38 (1996).

ciency, competition, and capital formation as well as the public interest and investor protection.²¹¹ Accordingly, the Commission must analyze the potential costs and benefits of a particular proposed rule.²¹²

(1) Increased Use of Selective Federal Preemption in Securities Registration

NSMIA facilitates the creation of national securities markets and the reduction of the cost of regulation by prohibiting state regulation of offerings of “covered securities” or “conditionally covered securities.” Covered securities²¹³ include the following:

1. Securities listed, including securities authorized for listing, on the NYSE, the AMEX, and the NASDAQ-NMS;²¹⁴
2. Securities of the same issuer that are equal in seniority or senior to the security listed on the NYSE, AMEX, or NASDAQ-NMS;²¹⁵
3. Securities issued by investment companies registered with the Commission;²¹⁶
4. Sales of securities in items 1 and 2 to qualified purchasers;²¹⁷

²¹¹ *Id.* Congress also intended that the Commission raise the permissible amount of offering exemptions under § 3(b) of the Securities Act from \$5 million to \$10 million, including, but not limited to, increasing the exemption amount under offerings for certain employee benefit plans, and small public offerings under Regulation A of the Securities Act. *Id.* However, this broad grant of exemptive authority is not valid with respect to § 15C of the Exchange Act and to the definitions listed in § 3(a)(42)–(45) of the Exchange Act, which govern government securities dealers. Section 105(b) of NSMIA allows the Commission to act by issuing an order with respect to the Exchange Act to facilitate individual exemptive requests; the Commission is authorized to establish procedures and circumstances that determine whether it will issue an exemptive order. *Id.*

²¹² In addition, Congress requires a rigorous cost and benefits analysis in connection with its review of major rules promulgated by the Commission under the Small Business Regulatory Enforcement Fairness Act of 1996. *Id.* at 39.

²¹³ The Securities Amendments Act of 1996 generally exempts from state registration requirements those securities listed on major stock exchanges, e.g., NASDAQ (National Market System only) or NYSE. *Id.* at 57–58.

²¹⁴ This includes discretionary authority for the Commission to identify securities listed on other exchanges or trading systems that are similar to the NYSE, AMEX, or NASDAQ-NMS. Congress’s intent is to require the Commission to monitor listing requirements of exchanges on which covered securities are listed to ensure compliance with applicable federal securities laws. *Id.* at 30.

²¹⁵ This provision covers securities other than equities, for example, the issuer’s debt securities. *Id.*

²¹⁶ 15 U.S.C. § 77r(b) (2000). The NASD also conducts examinations of investment companies registered with the Commission that are also its members; this includes approximately ninety percent of investment companies. The NASD’s examination includes, but is not limited to, a review of the sales literature and advertising materials. H.R. REP. NO. 104-622, at 31 (1996).

²¹⁷ § 77r(b)(3). This section contemplates that the Commission will define a “qualified purchaser,” which would include purchasers of mortgaged-backed securities, asset-backed securities, other structured securities, and securities issued in connection with project financings. H.R. REP. NO. 104-622, at 31. Generally, Congress believes that “qualified” purchasers are sophisticated investors, capable of protecting themselves in a manner that renders regulation by State authorities unnecessary.” *Id.* Congress’s intent was that

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5. Secondary market trading transactions that are exempt from the registration requirements under §§ 4(1), 4(3) and 4(4) of the Securities Act;²¹⁸
6. Securities exempt from registration pursuant to § 3(a) of the Securities Act;²¹⁹
7. Securities sold in private transactions pursuant to § 4(2) of the Securities Act, if offered or sold in accordance with a rule or regulation promulgated by the Commission in accordance with § 4(2) of the Securities Act.²²⁰

Conditionally covered securities²²¹ include registered securities offerings by issuers with total assets exceeding \$10 million²²² with two years of audited financial statements ending before the filing of a registration statement with the Commission. However, securities offerings in which a person²²³ has been statutorily disqualified²²⁴ are subject to both federal and state regulation. The effect of NSMIA's increased use of selective federal preemption is to impose one set of rules for securities that are, or will be, traded on a national basis.²²⁵ For example, SSRAs may not perform merit reviews of offerings involving covered or conditionally covered securities.

The states' authority to bring enforcement actions under their securities laws prohibiting fraud and deceit in connection with any securities offering and securities transaction is specifically preserved under NSMIA.²²⁶ Such enforcement actions

these types of structured offerings be regulated exclusively by the Federal government and apply to all offerings, both registered or exempt from registration under the Securities Act. *Id.* at 32.

²¹⁸ § 77r(b)(4). The issuer must be reporting under the Exchange Act, or is exempt from the reporting requirements under the Exchange Act. H.R. REP. NO. 104-622, at 32.

²¹⁹ Section 3(a) exempts securities if they are: a) securities of non-profit and similar entities described in § 3(a)(4); b) intrastate offerings under § 3(a)(11)(i); and c) municipal securities as defined in § 3(a)(2). H.R. REP. NO. 104-622, at 32.

²²⁰ *Id.*

²²¹ A conditionally covered security also includes a security that will be a covered security upon completion of the transaction. Offerings involving securities that have been plagued by high levels of fraud will continue to be regulated by state securities authorities, i.e., regulation of such securities is not preempted under federal securities laws. These securities offerings include securities issued by blank check companies, partnerships, limited liability companies, direct participation investment programs, penny stock companies, and roll-up transactions. *Id.* at 32-33.

²²² Total assets may be measured after the transaction is completed. *Id.* at 32.

²²³ Person includes associated persons of broker-dealers. *Id.* at 33.

²²⁴ A person is statutorily disqualified when she is barred from associating with a broker-dealer and/or an investment adviser or investment company. Such a person is effectively excluded from participating in the U.S. securities industry. Section 39(a)(39) of the Exchange Act authorizes the Commission to exempt statutorily disqualified persons, thus exempting the securities offering from state regulation. *See* H.R. REP. NO. 104-622, at 33.

²²⁵ 15 U.S.C. § 77r(a) (2000).

²²⁶ § 77r(c)(1).

would include cases involving broker-dealer sales practices in which misrepresentations and/or omissions of material facts occur. However, Congress asserted that “[NSMIA] preempts authority that would allow the States to employ the regulatory authority they retain to reconstruct in a different form the regulatory regime for covered securities that Section 18 [of NSMIA] has preempted.”²²⁷ Moreover, NSMIA did not reduce the revenue stream to states by eliminating state registration requirements for securities offerings and transactions involving covered or conditionally covered securities; states may still require notice filings and fees in connection with securities offerings and securities transactions made within their borders.²²⁸ They may suspend securities offerings and securities transactions within their borders if the issuer fails to make a filing and/or pay a fee required under state law.²²⁹

(2) Selective Federal Preemption and Broker-Dealer Financial Responsibility

NSMIA preempts state laws imposing financial responsibility and reporting requirements on broker-dealers and associated persons of broker-dealers. Specifically, selective federal preemption applies to regulation of capital, margin, books and records, bonding, and recordkeeping requirements.²³⁰ However, state securities laws continue to apply to broker-dealer sales practices involving fraud in the offer, sale, and purchase of securities traded within the jurisdiction of each state; accordingly, SSRAs maintain the ability to initiate enforcement actions involving fraud. In addition, broker-dealers and their associated persons must still register and pay filing fees in each state. Again, although some state regulatory powers have been preempted by federal securities laws, states continue to receive revenue from

²²⁷ H.R. REP. NO. 104-622, at 34.

²²⁸ § 77r(c)(2)(B).

²²⁹ § 77r(c)(3). States also have the authority to request any registration documents filed with the Commission in order to compute the required fee. H.R. REP. NO. 104-622, at 35. Offering documents “include any prospectus, notice, circular, advertisement, letter, or communication, written or by radio or television, which offers any security for sale or confirms the sale of any security.” *Id.*

²³⁰ Associated persons may effect transactions for existing customers in states in which they are not registered. This exemption from state registration requires that the associated person “must not be ineligible to register in the [state in which the transaction occurs] for any reason[;] must be registered with the NASD and with at least one [state;] must be associated with a broker-dealer that is registered in the [state] in which the transaction is effected”; permissible transactions are those executed for an “existing customer . . . while that customer is temporarily away from home”; and transactions executed for an existing customer while the associated person is awaiting a response to his/her application for licensing in the state. However, the associated person cannot execute more than ten transactions under this provision in states in which the associated person is not licensed. H.R. REP. NO. 104-622, at 36–37.

state filing and registration fees.

(3) Selective Federal Preemption and the
Regulation of Investment Companies and In-
vestment Advisers

NSMIA imposed selective federal preemption by amending the registration provisions of the Investment Company Act (ICA) with a view towards reducing unnecessary regulatory costs and procedural burdens. Investment companies (e.g., mutual funds) were permitted to register an indefinite number of securities on an annual basis. Regulatory costs were reduced significantly because investment companies were permitted to file one registration per year rather than filing a registration statement for each offering of its securities within a one-year period.²³¹

NSMIA authorized the Commission to require investment companies to make and keep certain books and records in addition to those necessary to prepare their financial statements.²³² This expansion of the Commission's authority was designed to facilitate examinations to determine whether investment companies and related entities were complying with federal securities laws. The Commission's expanded authority does not extend to an investment company adviser, unless it is a majority-owned subsidiary of a registered investment company.²³³ Finally, NSMIA left to the states the job of regulating investment advisers with assets of less than or equal to \$25 million; however, investment advisers with less than or equal to \$25 million under management may continue to register with the Commission if they so choose.

b. The Securities Litigation Uniform Standards
Act of 1998 Increased the Use of Selective
Federal Preemption

Selective federal preemption in the regulatory framework of U.S. securities markets continued with the passage of the Securities Litigation Uniform Standards Act of 1998 (SLUSA).²³⁴ SLUSA established uniform national rules for securities class ac-

²³¹ Fees for such registration statements are based on the aggregate sales price of securities sold during the investment company's fiscal year. Failure to meet the annual filing deadline and to pay the requisite fee subjects the investment company to the payment of interest based on the amount due at a rate established by the Secretary of Treasury under the Debt Collection Act of 1982. *Id.* at 44; *see also* 15 U.S.C. § 80a-24(f).

²³² H.R. REP. NO. 104-622, at 47. Previously, the Commission could only require investment companies to make and keep records necessary to prepare their financial statements. *Id.*

²³³ *Id.*

²³⁴ H.R. REP. NO. 1689, at 4-5 (1997). SLUSA amended § 28(b) of the Exchange Act.

tion lawsuits involving covered securities.²³⁵ Its effect was to require class action lawsuits alleging certain categories of securities fraud²³⁶ and involving covered securities to be filed in federal court under federal securities laws.²³⁷ According to Congress, SLUSA was needed to close a loophole used by the private securities bar to avoid the provisions of the Private Securities Litigation Reform Act of 1995 (PSLRA).²³⁸ PSLRA was passed to eliminate “vexatious litigation that was draining value from the shareholders and employees of public companies.”²³⁹ However, according to a report and statistical analysis of securities class actions lawsuits (Report)²⁴⁰ commissioned by Congress to assess the effectiveness of the implementation of the PSLRA, the private securities bar seemingly avoided the more stringent requirements of securities fraud cases under federal securities laws by filing class actions in state courts under state securities laws. The Report suggested

that the level of class action securities fraud litigation has declined by about a third in federal courts, but that there has been an almost equal increase in the level of state court activity, largely as a result of a “substitution effect” whereby plaintiffs resort to state court to avoid the new, more stringent requirements of federal cases. There has also been an increase in parallel litigation between state and federal courts in an apparent effort to avoid the federal discovery stay or other provisions of [PSLRA]. This increase in state activity has the potential not only to undermine the intent of [PSLRA], but to increase the overall cost of litigation to the extent that [PSLRA] encourages the filing of

²³⁵ H.R. REP. NO. 105-803, at 13 (1998) (Conf. Rep.) (noting class actions relating to a covered security are “defined by section 18(b) of the Securities Act of 1933, which was added” with the passage of NSMIA). Again, selective federal preemption focuses on securities that are traded nationally in the U.S. securities markets.

²³⁶ Specifically, securities fraud consists of misrepresentations, omissions, deception, or manipulation in connection with the purchase or sale of a covered security. *Id.* at 7.

²³⁷ SLUSA amended § 16 of the Securities Act and § 28 of the Exchange Act to limit class actions involving covered securities, i.e., covered class actions. Securities Litigation Uniform Standards Act of 1998, Pub. L. No. 105-353, 112 Stat. 3227, 3227 (1998).

²³⁸ H.R. REP. NO. 105-803, at 13–15 (1998) (Conf. Rep.). *See also, e.g.*, Michael A. Perino, *Fraud and Federalism: Preempting Private State Securities Fraud Causes of Action*, 50 STAN. L. REV. 273, 290–91 (1998). PSLRA was passed despite being vetoed by President Clinton. H.R. REP. NO. 105-640, at 9 (1998).

²³⁹ H.R. REP. NO. 105-640, at 9 (1998); *see also* H.R. REP. NO. 104-369, at 31–32 (1995) (Conf. Rep.). Unfortunately, under the PSLRA, the private securities bar could still determine and select the most favorable state forum in which to file a securities class action. Because the issuer’s security was traded nationally, the plaintiff’s attorney’s selection could result in forcing shareholders and defendants to travel great distances in order to litigate securities class actions. Moreover, different plaintiffs and classes could file competing securities class actions in the same or different states forcing the issuer to litigate more than one securities class action case simultaneously. Most of these issues were resolved under SLUSA.

²⁴⁰ *See* Joseph A. Grundfest & Michael A. Perino, *Securities Litigation Reform: The First Year’s Experience* (John M. Olin Program in Law and Econ., Working Paper No. 140, 1997).

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parallel claims.

....

... [The Commission] called the shift of securities fraud cases from Federal to State court “potentially the most significant development in securities litigation” since passage of [PSLRA].

... [P]laintiffs’ lawyers have sought to circumvent [PSLRA’s] provisions by exploiting differences between Federal and State laws by filing frivolous and speculative lawsuits in State court, where essentially none of [PSLRA’s] procedural or substantive protections against abusive suits are available.²⁴¹

Specifically, SLUSA prohibited securities class actions involving covered or conditionally covered securities (covered class actions) from being filed in state courts by defining covered class actions as:

- any single lawsuit in which damages are sought on behalf of more than fifty persons²⁴² or prospective class members with common questions of law or fact;²⁴³ or
- any single lawsuit brought on behalf of one or more unnamed parties seeking to recover damages on a representative basis on behalf of themselves and other unnamed parties similarly situated; and
- any group of lawsuits filed in or pending in the same court, involving common questions of law or fact, brought on behalf of more than fifty persons, which are joined, consolidated, or otherwise proceed as a single action.²⁴⁴

SLUSA was drafted to include *mass actions*²⁴⁵ and to authorize federal courts “to stay discovery in any state court action if deemed to aid in the federal court’s jurisdiction.”²⁴⁶

²⁴¹ H.R.Rep. No. 105-640, at 10 (1998) (Conf. Rep.) (quoting Grundfest & Perino, *supra* note 240). PSLRA contained a heightened pleading standard, which required plaintiffs’ complaints to state specific grounds for their claims. In addition, all motions had to be resolved before conducting discovery. *Id.* at 45.

²⁴² Corporations, investment companies, pension plans, partnerships, or other entities are treated as one person, if the entity was not organized solely for the purpose of participating in a class action involving covered securities. 9 LOUIS LOSS & JOEL SELIGMAN, *SECURITIES REGULATION* 4169 (3d ed. 2004).

²⁴³ *Id.* at 4168. Common questions of law or fact must predominate over any questions affecting only individual persons or members. However, it is not necessary under SLUSA to prove individual reliance of all class members on the common questions of fact. *See id.*

²⁴⁴ *Id.* at 4168–69. Individual plaintiffs bringing bona fide actions will not be prohibited solely because more than fifty persons commence actions in the same state court against a single defendant or issuer. *Id.* at 4170.

²⁴⁵ Mass actions involve many plaintiffs, have high settlement value, and “may be abused by lawyers who seek to evade [SLUSA].” *Id.*

²⁴⁶ THOMAS LEE HAZEN, *FEDERAL SECURITIES LAW* 85–86 (2d ed. 2003). *See, e.g., In re Bankamerica Corp. Sec. Litig.*, 95 F. Supp. 2d 1044, 1049 (E.D. Mo. 2000) (staying state court class action that “threaten[ed] the orderly conduct of the federal case,” which represented more than twenty-six times the dollar amount in claims than the state court proceeding that was stayed).

SLUSA prohibits securities class actions based on state statutory or common law in any state or federal court, if it alleges misrepresentations and/or omissions of material facts or the use of any manipulative or deceptive device in connection with the offer, sale, or purchase of a covered, or conditionally covered, security. Such securities class actions could not be filed in state court under state or federal securities laws.²⁴⁷ In this case, the use of selective federal preemption means that nationally traded securities can only be subject to federal securities laws, not varying state securities laws; such uniformity facilitates a reduction in the cost of regulation.

c. Sarbanes-Oxley Act of 2002 (SOX) and Selective Federal Preemption

SOX increased the use of selective federal preemption in the regulatory framework of the U.S. securities markets. Areas traditionally regulated by states were now partially regulated under federal securities laws. Specifically, SOX set (1) minimum standards of professional conduct, including non-industry regulation, for accountants performing audits of companies whose securities are publicly traded; and (2) more stringent Commission regulation of the corporate governance of companies whose securities are publicly traded.

(1) Regulation of Accountant Conduct and Selective Federal Preemption

SOX uses selective federal preemption to establish a regulatory framework for accounting firms that conduct audits of companies' required filings with the Commission. Prior to the enactment of SOX, the fragmentation of the regulatory framework governing the accounting profession conducting audits of such companies adversely impacted effective regulation of the accounting profession *and* the usefulness of information obtained from such audits. Accordingly, a reliable regulatory framework for the accounting firms, who are responsible for ensuring that material information provided by such companies is correct, is an essential component of competing successfully in the global securities

²⁴⁷ 15 U.S.C. § 77p(b)–(e). SLUSA excludes certain types of class actions and state court actions. State jurisdiction is preserved with respect to actions brought pursuant to the law of the state where the issuer is incorporated, and actions brought by a state, or on behalf of a state, in which the plaintiffs are named and are authorized by a state to participate in the class action. Essentially, SLUSA preserves SSRA power to continue investigatory and enforcement activities. Shareholder derivative class actions brought on behalf of a corporation or issuer are also excluded under SLUSA. Certain state law fiduciary claims against officers, directors, or control persons primarily based on misrepresentations in connection with tender offers, mergers, and other such transactions are not precluded by SLUSA. *See id.*

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market. In congressional hearings conducted by the Senate Committee on Banking, Housing, and Urban Affairs to consider “the effectiveness of the accounting regulatory oversight system,” it was determined that

The profession’s combination of public oversight and voluntary self-regulation is extensive, Byzantine, and insufficient. The Panel found that the current system of governance lacks sufficient public representation, suffers from divergent views among its members as to the profession’s priorities, implements a disciplinary system that is slow and ineffective, lacks efficient communication among its various entities and with the [Commission], and lacks unified leadership and oversight.²⁴⁸

Under SOX, companies filing with the Commission can only retain accounting firms registered with the Public Company Accounting Oversight Board (PCAOB)²⁴⁹ to conduct audits of their financial statements.²⁵⁰ PCAOB, subject to Commission oversight,²⁵¹ has broad power to establish and adopt standards for auditing, quality control, and ethics for accounting firms conducting audits for companies whose securities are publicly traded.²⁵² PCAOB’s powers include the authority to conduct inspections and investigations and to impose sanctions.²⁵³ All final decisions

²⁴⁸ S. REP. NO. 107-205, at 2, 5 (2002) (quoting testimony of Shaun O’Malley, Chairman, 2000 Public Oversight Board Panel on Audit Effectiveness and former Chairman, Price Waterhouse LLP, before the Committee on Mar. 6, 2002).

²⁴⁹ 15 U.S.C.A. § 7212(a) (2006). PCAOB has authority only with respect to audits of companies whose securities are publicly traded. It has no jurisdiction over the work of accountants auditing other companies, i.e., companies whose securities are *not* publicly traded. § 7211(a).

²⁵⁰ Registered accounting firms must also file a report annually to update all required information. In addition, registration and annual fees are assessed to cover the cost of processing and reviewing applications and annual reports. S. REP. NO. 107-205, at 8. Accounting firms must register with PCAOB in order to be eligible to conduct audits of public companies. Accordingly, suspension or revocation of an accounting firm’s registration means that it can no longer engage in the practice of auditing publicly traded companies. *Id.* at 7.

²⁵¹ See Sarbanes-Oxley Act of 2002 § 107(a), 15 U.S.C.A. § 7217(a) (2006). PCAOB has rulemaking authority, but all rules, auditing standards, and its budget must be submitted to the Commission before becoming effective. § 7217(b). The Commission must also hear appeals of PCAOB’s disciplinary actions and negative inspection reports. § 7217(c).

²⁵² S. REP. NO. 107-205, at 8. However, SOX authorizes PCAOB to rely on professional groups of accountants or one or more advisory groups of practicing accountants or other interested parties as long as such parties meet SOX’s statutory tests. *Id.*

²⁵³ *Id.* at 9–11. PCAOB final inspection reports are sent to the Commission and applicable accountancy boards routinely. They are also made public. Accounting firms are allowed twelve months to correct problems uncovered during PCAOB inspections. Sanctions available for violations of applicable provisions of SOX include revoking or suspending the accounting firm’s registration, barring individuals associated with registered accounting firms from association with their current firm as well as any other accounting firm, imposing civil monetary penalties, mandatory participation in professional education or training programs, and censure. Revoking an accounting firm’s registration with PCAOB or barring an individual from association with a registered accounting firm may only be imposed if the violation was committed intentionally, knowingly, recklessly, or

issued and sanctions imposed by PCAOB may be appealed to the Commission.

Most importantly with respect to the global securities market, PCAOB also has jurisdiction over public accounting firms organized outside of the U.S. that prepare audited financial statements for issuers trading in the U.S. securities markets.²⁵⁴ However, PCAOB has exemptive authority, i.e., it may determine that the role of the foreign accounting firm is sufficiently *de minimis* to avoid SOX's registration requirement.²⁵⁵ Whether this requirement diminishes the competitiveness of the U.S. securities markets in the global securities market remains to be seen.

(2) Corporate Governance and Selective Federal Preemption

SOX, using selective federal preemption, regulates in an area of corporate law traditionally reserved to state incorporation laws—corporate governance. Among other things, SOX places particular emphasis on issuer audit committees. Under SOX, audit committees are directly responsible for the oversight, compensation, and appointment of the accounting firm hired to conduct an audit of the issuer's books, records, and procedures. In addition, auditors are required to report directly to the audit committee.²⁵⁶ SOX was designed to increase the independence of the audit committee, given its importance as the first line of defense for ensuring the accuracy of financial disclosures required under federal securities laws.²⁵⁷ Accordingly, SOX prohibits the payment of consulting fees to audit committee members by the issuer, and prevents audit committee members from being affiliated persons of the issuer or its subsidiaries.²⁵⁸ SOX also re-

peated negligence. PCAOB is authorized to impose sanctions for failure reasonably to supervise a partner or employee. Liability for failure to reasonably supervise a partner or employee is based on similar standards used with respect to broker-dealer under § 15(b)(4) of the Exchange Act. SOX also contains a similar safe harbor, i.e., the accounting firm may avoid liability by showing that it has written internal control procedures designed with a view towards preventing violations of applicable provisions of SOX and that its internal control procedures were implemented and monitored for effectiveness. *Id.*

²⁵⁴ See 15 U.S.C.A. § 7216(a). Congress "believes that there should be no difference in treatment of a public company's auditors under [SOX] simply because of a particular auditor's place of operation. Otherwise, a significant loophole in the protection offered U.S. investors would be built into the statutory system." S. REP. NO. 107-205, at 11.

²⁵⁵ See 15 U.S.C.A. § 7216(c).

²⁵⁶ §§ 78j-1(k)(1), (m)(2).

²⁵⁷ S. REP. NO. 107-205, at 14.

²⁵⁸ 15 U.S.C.A. § 78j-1(m)(3). See also S. REP. NO. 107-205, at 24 ("Former SEC Chairman Arthur Levitt testified that 'as a listing condition, stock exchanges should require at least a majority of company boards to meet a strict definition of independence,' including barring audit committee members from accepting consulting fees from the company.").

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quires the audit committee to establish and implement procedures for protecting whistleblowers, including allowing employees to anonymously report concerns about accounting or auditing matters.²⁵⁹ Finally, the issuer must pay for independent counsel and/or other advisers that audit committee members determine are needed to perform their responsibilities as audit committee members.²⁶⁰

Corporate governance reforms under SOX include additional inroads on state preeminence in matters of corporate governance. Section 302 of SOX requires the Chief Executive Officer (CEO) and the Chief Financial Officer (CFO) to certify that the information contained in annual and quarterly reports filed with the Commission is accurate. Accordingly, the signatures of the CEO and the CFO are required on such reports to evidence certification. Section 303 of SOX prohibits any officer or director from taking any action to fraudulently influence accounting firms engaged in conducting audits of companies required to file with the Commission.²⁶¹ Finally, § 404 of SOX requires that each annual report contain a written assessment of a company's internal controls for ensuring accurate financial reporting.

d. H.R. 2179 and Selective Federal Preemption

The most recent significant attempt to increase selective federal preemption in the U.S. securities markets regulatory framework is The Securities Fraud Deterrence and Investor Restitution Act of 2004 (H.R. 2179).²⁶² H.R. 2179 was designed in part to preempt state laws that interfered with the Commission's ability "to investigate and deter fraud, levy and collect fines and disgorgement [sic] funds, and provide for a significant increase in money available for return to injured investors."²⁶³ Introduced on May 21, 2003, H.R. 2179²⁶⁴ proposed to preempt state securities laws by, among other things,

- Allowing states to place funds obtained from successfully prosecuted fraud cases in an investor restitution fund administered and distributed by the Commission, even if the Commission was not a party to the agreement or settlement which was the source of such

²⁵⁹ 15 U.S.C.A. § 78j-1(m)(4).

²⁶⁰ § 78j-1(m)(5)–(6). *See also* S. REP. NO. 107-205, at 25.

²⁶¹ 15 U.S.C.A. §§ 7241–42. SOX also mandates the adoption of codes of conduct for an issuer's senior officials and disclosure of the terms of such codes of conduct on Form 8K. Any change in, or waiver of, the provisions of such codes must be disclosed to the public immediately. § 7264; *see also* § 7262.

²⁶² H.R. 2179, 108th Cong. (2d Sess. 2004). H.R. 2179 expressly preserves the right of states' securities regulations to bring fraud cases in their respective jurisdictions. H.R. REP. NO. 108-475, pt. 1, at 50 (2004).

²⁶³ H.R. REP. NO. 108-475, pt. 1, at 12.

²⁶⁴ H.R. 2179 was introduced by Representatives Baker, Oxley, Tiberi, Ose and Kelly.

funds.²⁶⁵

- Continuing the Commission's prohibition of state regulation of capital, margin, books and records, disclosure, and disclosure of conflict of interest requirements for brokers, dealers, municipal securities dealers, government securities brokers or government securities dealers.²⁶⁶
- Preempting state or local laws exempting property from foreclosure or forced sale to satisfy judgments obtained by the Commission in connection with its enforcement activities.²⁶⁷ It would preempt state laws that allow properties otherwise covered by state homestead exemptions to be seized by the Commission.
- Establishing that the Central Registration Depository (CRD) and the Investment Adviser Registration Depository (IARD) are operated on behalf of the Commission.²⁶⁸

However, it is clear that H.R. 2179 was not designed to completely eliminate SSRAs in the securities regulatory framework. Its purpose seems to be to increase selective federal preemption in an area Congress deemed to be "weak areas" in the securities regulatory framework. Also, H.R. 2179 requires the Commission to cooperate with NASAA "to produce . . . a joint study on strengthening the working relationship between State and Federal securities regulators."²⁶⁹

²⁶⁵ H.R. REP. NO. 108-475, pt. 1, at 8. The Congressional Committee stresses that states are not required to deposit disgorgement and/or civil penalties in the Commission controlled fund. In addition, this fund would be used only for the purpose of making restitution payments to investors. *Id.* However, such funds are, in many cases, used to cover the costs of state enforcement actions.

²⁶⁶ Proposed Amendment to H.R. 2179, 108th Cong. (2003) (offered by Rep. Baker). However, this section of H.R. 2179 requires the Commission to consult with SSRAs in order to evaluate whether requirements established under this section of H.R. 2179 are adequate. *Id.*

²⁶⁷ H.R. REP. NO. 108-475, pt. 1, at 2. However, Representative Harris offered an amendment that would exempt such property from a judgment or order obtained by the Commission if its aggregate value did not exceed \$125,000 and it was acquired more than 1215 days prior to the Commission's judgment or order. *See* Proposed Amendment to H.R. 2179, 108th Cong. (2003) (offered by Rep. Harris). Subsequently, Representative Harris offered an amendment to her amendment that would require that such property "constitutes or is derived from" proceeds obtained in violation of securities laws and after "payment of debts." Proposed Amendment to the Amendment in the Nature of a Substitute to H.R. 2179, 108th Cong. (2003) (offered by Rep. Harris). Representative Hensarling also offered an amendment that would limit waiver of state homestead exemptions subject to Commission judgments or orders to an aggregate value of \$125,000 after the payment of debts. Amendment to the Amendment in the Nature of a Substitute to H.R. 2179, 108th Cong. (2003) (offered by Rep. Hensarling).

²⁶⁸ *See* H.R. REP. NO. 108-475, pt. 1, at 30. There is an ongoing dispute as to the ownership of the CRD. This section states that such public disclosure programs are under the authority of the Commission, not the states. NASAA, representing the SSRAs, also asserts ownership of the CRD. NASAA, CRD & IARD, http://www.nasaa.org/Industry_Regulatory_Resources/CRD_IARD/ (last visited Oct. 14, 2006).

²⁶⁹ H.R. REP. NO. 108-475, pt. 1, at 28.

IV. CANADIAN REGULATORY FRAMEWORK

A. Overview

Unlike the U.S., Canada does not, nor is it able to, use selective federal preemption in its securities regulatory framework. Canada does not have federal securities laws directly regulating securities markets throughout the country. Moreover, it does not have any entity at the federal level whose sole mission is to ensure a uniform securities regulatory framework, require provincial compliance with such a securities regulatory framework, and represent Canada in the global securities market. Instead, Canada's securities regulatory framework consists of thirteen provincial²⁷⁰ securities regulators and several SROs. Each province has its own SRA, whose jurisdiction does not extend beyond its borders.²⁷¹ Furthermore, although provincial securities laws are based on similar principles and objectives, the implementation of provincial securities laws, inevitably, is inconsistent.²⁷²

The only organization charged with harmonizing the various provincial securities laws and their implementation is the Canadian Securities Administrators (CSA). This is problematic because, like NASAA, the CSA is a voluntary membership organization. Accordingly, provincial compliance with CSA initiatives and policy recommendations is not statutorily mandated. SRAs may choose to follow all, a portion, or none of CSA's harmonization recommendations.

1. Canadian Securities Administrators

The CSA was established in an attempt to bring some uniformity to a very fragmented regulatory framework. Like its counterpart in the U.S.—NASAA—CSA members are the thirteen SRAs responsible for securities regulation in Canada's provinces and territories. The CSA "is an informal body that functions through meetings among its members. . . . [and does not

²⁷⁰ The term province in this article is meant to include Canada's territories, the Yukon Territory, Northwest Territories, and Government of Nunavut.

²⁷¹ The provincial securities regulators are: British Columbia Securities Commission (BCSC); Alberta Securities Commission (ASC); Saskatchewan Financial Services Commission (SFSC); Manitoba Securities Commission (MSC); Ontario Securities Commission (OSC); Commission des Valeurs Mobilières du Québec (CVMQ); New Brunswick Securities Administration Branch (NBSAB); Nova Scotia Securities Commission (NSSC); Prince Edward Island Securities Office (Office of the Attorney General) (PEISO); Securities Commission of Newfoundland and Labrador (SCNL); Registrar of Securities (Community Services), Government of the Yukon Territory (RSYT); Registrar of Securities (Department of Justice), Government of the Northwest Territories (RSNT); and Registrar of Securities (Department of Justice), Government of Nunavut (RSN). WISE PERSONS' COMMITTEE, *supra* note 31, at 15.

²⁷² *Id.*

have] binding authority over the securities regulators regarding policy development or enforcement activities, and is *funded by each of its members on a voluntary basis*.”²⁷³ Although created in 1937, it was not until 2003 that the CSA created a Policy Coordination Committee (PCC) to “oversee the implementation of the CSA’s strategic plan²⁷⁴ and ongoing policy and rule development.”²⁷⁵ Despite its limitations, the CSA has focused on harmonizing the various securities laws of its members. Some of its initiatives include:

- National instruments and national policies—The development and implementation of 25 national instruments and 24 national policies covering key areas such as prospectus requirements, mutual funds regulation, rights offerings, take-over bids, registration issues and marketplace operations.
- Mutual Reliance Review System (MRRS)²⁷⁶—A system in which one securities regulator is designated as the “principal regulator” on which other jurisdictions rely for analysis and review of filings and exemptive relief applications.
- System for Electronic Document Analysis and Retrieval (SEDAR)—A web-based system that facilitates the electronic filing of securities information as required by provincial and territorial regulators and that provides public access to most disclosure documents filed by reporting issuers. [SEDAR was established in 1997.]
- System for Electronic Disclosure by Insiders (SEDI)—A web-based system that facilitates the filing and public viewing of reports on

²⁷³ *Id.* (emphasis added).

²⁷⁴ Canadian Securities Administrators, CSA Structure, http://www.csa-acvm.ca/html_CSA/about.html#structure (last visited Feb. 10, 2007). CSA’s strategic plan includes focusing on three areas to make Canada’s securities regulatory framework globally competitive: “[1.] innovative, responsive and flexible policy-making, focused on significant threats to investors and market integrity; [2.] coordinated and streamlined administrative and regulatory operations; and [3.] strategic, firm and fair enforcement.” CANADIAN SECURITIES ADMINISTRATORS STRATEGIC OBJECTIVES at 2, 4 (2005), available at http://www.csa-acvm.ca/pdfs/CSA_Strategic_Objectives_Feb2005_ENG.pdf.

²⁷⁵ WISE PERSONS’ COMMITTEE, *supra* note 31, at 16. PCC has six members appointed for two-year terms. The first members are the chairs of the BSC, ASC, MSC, OSC, CVMQ and NSSC. The CSA also elects its chair and vice-chair for two-year terms. *Id.*

²⁷⁶ *Id.* at 17.

[I]f an issuer wishes to issue securities by way of a prospectus in more than one jurisdiction in Canada, the MRRS allows the issuer to deal with one principal regulator (usually the regulator in the jurisdiction where the issuer’s head office is located) rather than with each of the regulators in the jurisdictions in which the securities are being offered. Staff of the principal regulator provide comments to the issuer on behalf of all of the commissions and make recommendations. The issuer then receives a single decision document from the principal regulator.

However, because participation in MRRS is voluntary, SRAs are free to withdraw from the system at any time and to deal directly with the issuer. Accordingly, market participants must be prepared to deal with the individual SRA securities acts and regulations at all times and there is no reduction in filing fees nor in fees paid to attorneys, accountants, and investment bankers. *Id.*

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securities trading by insiders of reporting issuers.

- National Registration Database (NRD)—A web-based system that permits dealers and advisers to file registration forms electronically.²⁷⁷
- USL Project—A project with the goal of developing uniform securities legislation and uniform rules for adoption by each jurisdiction in Canada.²⁷⁸

However, it cannot be emphasized too strongly that compliance with CSA initiatives is entirely *voluntary*. There are no federal or provincial securities laws that require SRAs to comply with CSA initiatives. Like Canada's securities regulatory framework, the level of participation in CSA initiatives is quite fragmented. SEDAR, created in 1997, enjoys the highest level of participation by the thirteen SRAs. All Canadian public companies and mutual funds are generally required to file their documents in SEDAR. However, filing requirements differ based on which SRA has primary jurisdiction.²⁷⁹ SEDAR is operated by CDS Limited,²⁸⁰ which is regulated by the SRAs in Ontario and Quebec along with the Bank of Canada. SEDAR maintains working and reporting relationships with Canada's remaining SRAs.²⁸¹

Moreover, Canada's attempts at facilitating a uniform secu-

²⁷⁷ The NRD was launched by the CSA and the Investment Dealers Association of Canada on March 31, 2003. "Generally, an individual or company whose business is trading, underwriting or advising with respect to securities is required to register annually with one or more provincial securities regulators." Currently, all thirteen SRAs participate in NRD. However, Quebec did not participate until January 2005. See generally National Registration Database Information, http://www.nrd-info.ca/home_index.jsp (last visited Oct. 26, 2006).

²⁷⁸ WISE PERSONS' COMMITTEE, *supra* note 31, at 16.

²⁷⁹ *Id.* at 35. System for Electronic Document Analysis and Retrieval, Background on SEDAR, http://www.sedar.com/sedar/background_on_sedar_en.htm. See also National Instrument 13-101 System for Electronic Document Analysis and Retrieval (SEDAR) (2004) (Can.), available at <http://ftp.sfsc.gov.sk.ca/scripts/ssc/files/nat-inst/13-101niamendedasof-mar30-04.pdf>.

²⁸⁰ System for Electronic Document Analysis and Retrieval, Background on SEDAR, http://www.sedar.com/sedar/background_on_sedar_en.htm (last visited Oct. 26, 2006). CDS Limited is owned by certain Canadian chartered banks, the Toronto Exchange, and the Investment Dealers Association of Canada. Canadian Depository for Securities Limited, CDS Is ..., <http://www.cds.ca/cdshome.nsf/Main-E?OpenFrameSet> (last visited Oct. 26, 2006). The IDA regulates its members based on authority delegated by Canada's thirteen provinces and territories.

²⁸¹ The Office of the Superintendent of Financial Institutions (OSFI) is also actively involved in the Canadian regulatory structure. OSFI supervises and regulates all Canadian banks, federally incorporated or registered trust and loan companies, insurance companies, cooperative credit associations, fraternal benefit societies and pension plans. OSFI has offices in Ottawa, Montreal, Toronto and Vancouver. See Treasury Board of Canada Secretariat, Office of the Superintendent of Financial Institutions Canada: DPR 2000-2001 § 2.3 Role, Responsibilities, and Organization, http://www.tbs-sct.gc.ca/rma/dpr/00-01/OSFI00dpr/osfi0001dpr01_e.asp (follow "2.3 Role, Responsibilities, and Organization" hyperlink) (last visited Oct. 14, 2006).

rities regulatory framework may be undermined at any time if an SRA decides that it is no longer in its best interest to participate in the CSA or to comply with CSA initiatives. The CSA is also subject to an interruption of funding since contributions by its members are voluntary and are taken from the individual SRA budgets of its members.

Like the U.S., Canada's securities regulatory framework includes a fund to protect investors in the event that an investment dealer becomes insolvent. The Canadian Investor Protection Fund (CIPF) is sponsored by the Investment Dealers Association, the Montreal Exchange, and the TSX Group of Companies.²⁸² Investment dealers are automatically enrolled in CIPF if they are members of one of CIPF's sponsoring SROs. The CSA and sponsoring SROs supervise the activities of the CIPF with respect to the financial condition of its members.²⁸³ Although the applicable SRO is responsible for conducting examinations of investment dealers operating within its jurisdiction, CIPF is authorized to conduct annual reviews and evaluations of each SRO's examination activities to ensure compliance with CIPF Minimum Standards. Eligible customer accounts are covered up to a maximum of \$1 million for losses of securities, commodity and futures contracts, segregated insurance funds and cash.²⁸⁴

2. Investment Dealers Association of Canada (IDA)

The IDA is Canada's largest SRO and is authorized under the securities acts of all thirteen SRAs to regulate the activities of Canadian investment dealers. The IDA also serves as an industry representative for its members.²⁸⁵ In its representative role, the IDA is responsible for ensuring that its members' perspectives are considered in the formulation of national policies,

²⁸² See Canadian Investor Protection Fund, Welcome to CIPF: About CIPF, http://www.cipf.ca/c_home.htm (last visited Oct. 14, 2006).

²⁸³ CIPF activities include, among other things, establishing and reviewing national standards for capital adequacy and liquidity, financial reporting, accounting records, internal control, segregation of customers' fully and partly paid securities, and insurance. CANADIAN INVESTOR PROTECTION FUND ANNUAL REPORT TO INVESTORS 2 (2003), available at http://www.cipf.ca/look_images/03reportsumm/cipf%20ar03.pdf.

²⁸⁴ *Id.*; Canadian Investor Protection Fund, Explore CIPF Coverage: Coverage Limits and Policies, http://www.cipf.ca/c_explore_coverage.htm (last visited Oct. 14, 2006). The maximum amount of customer loss due to an insolvent member firm is calculated by "taking into account both the delivery of any available securities, commodity and futures contracts, segregated insurance funds and cash to which the customer is entitled and the distribution of any assets of the insolvent Member firm, less any amounts owed by the customer to the Member." Most investors will have two accounts eligible for coverage—a general account and a retirement account; each is eligible for \$1 million coverage. If there is more than one general account, they are combined into one account for coverage purposes. Retirement accounts are treated similarly. See *id.*

²⁸⁵ Investment Dealers Association of Canada, About the IDA: Roles and Responsibilities, http://www.ida.ca/About/Roles_en.asp (last visited Oct. 14, 2006).

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rules, practices and standards governing Canada's securities industry.²⁸⁶ The IDA is overseen or supervised by SRAs and the CIPF.²⁸⁷ SRAs delegate their supervisory responsibilities of the IDA to the CSA. CSA performs its oversight responsibilities through its regulatory oversight group by reviewing and/or approving all rule changes proposed by the IDA and conducting periodic operational reviews. As previously noted, CIPF reviews and evaluates the IDA's regulatory activities to ensure compliance with CIPF Minimum Standards.²⁸⁸

The IDA conducts inspections and audits of its members²⁸⁹ and requires all members to maintain risk adjusted capital greater than zero at all times; if risk adjusted capital falls below zero, the member must notify the IDA's senior vice president of member regulation.²⁹⁰ However, similar to the NASD in the U.S., the IDA requires varying levels of risk adjusted capital above zero based on the type of business activities conducted by the member firm.²⁹¹

Similar to the NASD, the IDA mandates the education of its members' employees, investor education, and cooperation with governments in developing financial legislation in the public interest.²⁹² The education of its members' employees includes administering exams for licensing to demonstrate proficiency requirements to carry on certain types of securities activities. IDA membership requires members (and their employees) to submit to IDA examinations and investigations to ensure compliance with its bylaws, regulations, rulings or policies; any applicable securities laws of provincial and territorial securities commis-

²⁸⁶ *Id.*

²⁸⁷ Investment Dealers Association of Canada, Membership: Member Regulatory Process, http://www.ida.ca/Membership/MembRegProc_en.asp (last visited Oct. 14, 2006). Many member firms are members of more than one SRO and, to prevent duplication, each firm selects one particular SRO for audit purposes. See CANADIAN INVESTOR PROTECTION FUND ANNUAL REPORT TO INVESTORS, *supra* note 283, at 2. The IDA has recently taken over the audit jurisdictions of The Toronto Stock Exchange (TSX) and the Canadian Venture Exchange. Press Release, Investment Dealers Association of Canada & Canadian Venture Exchange, IDA and CDNX Announce Member Regulation Transfer to the IDA (Jan. 4, 2000), available at http://www.ida.ca/Files/Media/MediaRelease/General/MRG200001040_en.pdf.

²⁸⁸ Investment Dealers Association of Canada, Membership: Member Regulatory Process, *supra* note 287. The CIPF review includes receipt of all Monthly Financial Reports, Joint Regulatory Financial Questionnaires, and field examinations.

²⁸⁹ IDA's inspections and audits include, but are not limited to, the financial status of the firm, an annual audit by external auditors, a sales and compliance review, and a credit practices review. *Id.*

²⁹⁰ IDA By-Law 17.1 Minimum Capital, Conduct of Business and Insurance, in IDA RULE BOOK, <http://www.ida.ca> (follow "English" hyperlink; then follow "Rule Book" hyperlink) [hereinafter IDA RULE BOOK].

²⁹¹ *Id.*

²⁹² See, e.g., IDA Policy 6 Proficiency and Education, in IDA RULE BOOK, *supra* note 290.

sions; and the bylaws, rules, regulations and policies of any SRO.²⁹³ Examinations and investigations may be initiated by complaints to the IDA, at the direction of the IDA's board of directors, the request of an SRA, or by any information the IDA receives about a member's and/or its employee's conduct, business, or affairs.²⁹⁴ In addition, the IDA requires its members to disclose their financial condition and other information to their clients²⁹⁵ upon request.²⁹⁶

IDA members, similar to their U.S. NASD counterparts, must participate in or become a member of an arbitration program or organization to resolve disputes between its members and their clients.²⁹⁷ At the request of a client, IDA members must agree to submit the dispute to binding arbitration.²⁹⁸ Moreover, the arbitration program is separate and independent of the securities industry. In addition, each IDA member must participate in an ombudsperson service approved by the IDA's board of directors.²⁹⁹ Upon request by a client, any dispute with an IDA member must be submitted to the ombudsperson service.³⁰⁰ The ombudsperson service determines whether the dispute is eligible for resolution using its services. IDA members are bound by the rules, procedures and standards of the ombudsperson service, but the ombudsperson's recommendations are non-binding on each participant.³⁰¹ Finally, all decisions made by the IDA in performing its regulatory functions may be reviewed, upon request, by any SRA with jurisdiction.³⁰²

3. The Mutual Fund Dealers Association of Canada (MFDA)

The MFDA³⁰³ was established as a not-for-profit federal cor-

²⁹³ *Id.* at By-Law 19.1 Examinations and Investigations.

²⁹⁴ *Id.* at By-Law 19.2 Examinations and Investigations.

²⁹⁵ The term "client" is defined as any person "who has had a transaction with a Member within one year of the day on which a request for a statement of financial condition is made." *Id.* at IDA Regulation 1400.1 Disclosure to Clients of Members' Financial Condition and Other Information.

²⁹⁶ The required disclosure of the member's financial condition generally contains the member's balance sheet and income statement; disclosure of notes to member's financial statements (if applicable) is not required. *Id.*

²⁹⁷ The arbitration program or organization must be approved by the IDA's board of directors. *Id.* at By-Law 37.1 Alternative Dispute Resolution.

²⁹⁸ *Id.*

²⁹⁹ *Id.* at By-Law 37.2 Alternative Dispute Resolution.

³⁰⁰ *Id.*

³⁰¹ *Id.*

³⁰² *Id.* at By-Law 33.1 Review by Securities Commissions.

³⁰³ The MFDA is governed by a board of directors currently with twelve members; the board members are from the public and the industry, such as the IFIC. Mutual Fund Dealers Association of Canada [MFDA], Board of Directors, <http://www.mfda.ca/about/boardOfDirectors.html> (last visited Sept. 8, 2006).

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poration in June 1998 to act as an SRO for the distribution side of Canada's mutual fund industry,³⁰⁴ i.e., it is responsible for regulating all sales of mutual funds by its members. Specifically, MFDA's regulatory activities include monitoring the operations, standards of practice, and business conduct of its members.³⁰⁵ In addition, the MFDA is not responsible for regulating the activities of Canadian mutual fund dealers who are already members of an SRO, e.g., IDA mutual fund dealers will continue to be regulated by the IDA.³⁰⁶ The MFDA is authorized to conduct disciplinary proceedings and to impose fines, suspensions or loss of registration.³⁰⁷ MFDA's rules and bylaws are based on provincial and territorial statutory requirements, recommendations of the MFDA board of directors and industry committees,³⁰⁸ current industry practices, standards of similar SROs, and requirements of SRAs.³⁰⁹ However, MFDA membership is only required in five of Canada's thirteen provinces: Ontario,³¹⁰ British Columbia,³¹¹

³⁰⁴ MFDA, Our Role, <http://www.mfda.ca/> (last visited Sept. 8, 2006). Participants in Canada's mutual fund industry include independent dealers, fund companies, banks/trust companies, and insurance companies. See *Profile of the Mutual Fund Dealer Industry*, MFDA IN TRANSITION (MFDA, Toronto, Ontario), Aug. 1999, at 2.

³⁰⁵ MFDA, About the MFDA, <http://www.mfda.ca/about/aboutMFDA.html> (last visited Sept. 8, 2006). The MFDA regulates the operations, standards of practice and business conduct of its members. *Id.* It has 176 members and over 69,000 mutual fund salespersons. *Id.* It does not regulate mutual funds or mutual fund manufacturers. Brochure from MFDA of Canada, Information for Investors, available at http://www.mfda.ca/investors/brochure/MFDA_brochure.pdf. The term "mutual fund manufacturers" is used to describe the entity that actually creates the mutual fund itself; this entity is separate from an entity involved exclusively in the distribution of mutual funds. Provincial and territorial securities commissions regulate mutual funds and mutual fund manufacturers. Finally, *Some Mutual Fund Investor Protection* [sic], THE FUND OBSERVER (Canadian-FundWatch.com), Nov. 2004, at 3, available at <http://www.canadianfundwatch.com/modules.pdf?noredirect=1&name=News&file=article&sid=88>.

³⁰⁶ *You were asking...*, MFDA IN TRANSITION (MFDA, Toronto, Ontario), Dec. 1998, at 8.

³⁰⁷ *Id.*

³⁰⁸ The five industry committees were comprised of volunteers from the mutual fund industry, the staff of the MFDA, the Investment Funds Institute of Canada (IFIC), the IDA, and the OSC. *MFDA Applies for Recognition as SRO*, MFDA IN TRANSITION (MFDA, Toronto, Ontario), Jan. 2000, at 1.

³⁰⁹ The MFDA performs its regulatory responsibilities through five policy committees: (1) the Distribution Structures Committee; (2) the Sales Compliance and Practices Committee; (3) the Proficiency and Continuing Education Committee; (4) the Capital, Insurance and Investor Protection Fund Committee; and (5) the Books, Records, and Administration Committee. *Id.*

³¹⁰ Ontario recognized the MFDA as an SRO in February, 2001. MFDA, SRO Recognition, <http://www.mfda.ca/about/recognition.html> (last visited Oct. 25, 2006). The OSC did not initiate compliance examinations of mutual fund dealers until 1996. See *Mutual Fund Dealer Compliance Issues: a Regulatory Perspective*, MFDA IN TRANSITION (MFDA, Toronto, Ontario), Apr. 1999, at 2; Canada Department of Finance, Canada's Securities Industry at 9, http://www.fin.gc.ca/toce/2005/cansec05_e.html (follow "Adobe Acrobat Version" hyperlink) (last visited Sept. 8, 2006) [hereinafter Canada Dep't of Fin.].

³¹¹ British Columbia recognized the MFDA as an SRO in February, 2001. Canada Dep't of Fin., *supra* note 310, at 9; MFDA, SRO Recognition, *supra* note 309.

Saskatchewan,³¹² Alberta,³¹³ and Nova Scotia.³¹⁴

4. Market Regulation Services, Inc. (RS)

RS, a joint initiative of the TSX Group³¹⁵ and the IDA, is the independent regulation services provider for Canadian equity markets.³¹⁶ However, it is only recognized in five of Canada's thirteen provinces: Ontario, Quebec, Alberta, Manitoba, and British Columbia. RS monitors real-time trading operations and market-related activities of market participants in Canadian equity markets only in provinces in which SRAs have recognized it as an SRO. Accordingly, RS acts as an SRO only for the following trading systems and exchanges: TSX, TSX Venture Exchange (TSX V), Bloomberg Tradebook Canada Company (Bloomberg), Canadian Trading and Quotation System (CNQ), Liquidnet Canada Inc. (Liquidnet), and Market Securities, Inc. (BlockBook).³¹⁷

As an SRO, RS implements and administers Canada's Universal Market Integrity Rules (UMIR). UMIR and its companion policies were designed to facilitate universal rules for regulating equities trading on exchanges.³¹⁸ They were written by securities

³¹² Saskatchewan recognized the MFDA as an SRO on February 13, 2001. *Id.*

³¹³ Alberta recognized the MFDA as an SRO on April 10, 2001. *Id.*

³¹⁴ Canada Dep't of Fin., *supra* note 310, at 9. Nova Scotia recognized the MFDA as an SRO in November, 2001. *Id.*; MFDA, SRO Recognition, *supra* note 309.

³¹⁵ The TSX Group includes the TSX and the TSX V. The TSX and TSX V outsourced its compliance responsibilities when the TSX demutualized to compete with ATSSs entering the Canadian securities markets. Market Regulation Services Inc., Frequently Asked Questions, <http://www.rs.ca> (follow "About RS" hyperlink; then follow "Frequently Asked Questions" hyperlink) (last visited Sept. 10, 2006).

³¹⁶ *Id.* RS was formed on March 1, 2002, by combining the previous in-house surveillance, trade desk compliance, investigation and enforcement functions of the TSX and the TSX V. Market Regulation Services Inc., Our History, <http://www.rs.ca> (follow "About RS" hyperlink; then follow "Our History" hyperlink) (last visited Sept. 10, 2006). RS recognizes the importance of the global securities market and is a member of the Intermarket Surveillance Group (ISG). ISG is an international committee of representatives from thirty-one exchanges around the world. Market Regulation Services Inc., Special Initiatives, <http://www.rs.ca> (follow "About RS" hyperlink; then follow "Special Initiatives" hyperlink) (last visited Sept. 10, 2006). *See also* Market Regulation Services Inc., Recognition Orders, <http://www.rs.ca> (follow "Market Policy" hyperlink; then follow "Recognition Orders" hyperlink) (last visited Oct. 25, 2006).

³¹⁷ Market Regulation Services Inc., Frequently Asked Questions, *supra* note 315. TSX is Canada's senior equities market and consists of a broad cross-section of Canadian issuers. TSX V is Canada's public venture equity market. CNQ is Canada's small cap market. Bloomberg Tradebook is an ATS that facilitates Canadian institution investors' trading in equity and fixed income securities domestically and internationally. Liquidnet Canada Inc. allows Canadian institutional investors to trade U.S. stocks directly and anonymously with other U.S. and European institutional investors; it bypasses both exchanges and brokers. BlockBook is a block trading network for equities traded in the Canadian securities markets. It also provides anonymous size and value while monitoring trading on the network. Market Regulation Services Inc., The Marketplaces We Regulate, <http://www.rs.ca> (follow "About RS" hyperlink; then follow "The Marketplaces We Regulate" hyperlink) (last visited Sept. 10, 2006).

³¹⁸ Prior to the creation of RS, each exchange regulated equities trading using its own set of trading rules. Generally, each exchange's trading rules were different. RS uses

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industry representatives, legal and compliance officers, exchanges, trade association representatives, and provincial SRAs.³¹⁹

RS is also charged with market surveillance, with a view toward preventing violations of applicable securities laws and SRO rules and regulations. This includes the authority to issue trading halts.³²⁰ RS may initiate preliminary investigations based on its market surveillance activities. If, during a preliminary investigation, RS determines that wrongful conduct has been committed by an entity over which it has no jurisdiction, it may forward information from its preliminary investigation to the appropriate provincial SRA. If RS does have jurisdiction over the prospective wrongdoer, the matter is referred to its Investigations & Enforcement staff for possible enforcement³²¹ action.³²² If RS determines that violations have occurred that warrant disciplinary action, the action may be settled or referred to a hearing panel for a contested hearing.³²³ A Disciplinary Notice is issued and published if the hearing panel determines that a violation has occurred.³²⁴ Final RS decisions may be appealed to the appropriate

UMIR to regulate various trading practices including manipulative or deceptive methods of trading, short selling, front running, best execution obligations, order entry, and order exposure. UMIR “[1] applies equally to each class of marketplace participants[; 2] cannot be circumvented by directing trading activity to another marketplace[; 3] applies to trading of all forms of listed or quoted securities[; and 4] incorporates exceptions to the rules to accommodate the workings of an individual marketplace or ATS.” Market Regulation Services Inc., Universal Market Integrity Rules (UMIR), <http://www.rs.ca> (follow “Market Policy” hyperlink; then follow “Universal Market Integrity Rules” hyperlink) (last visited Sept. 10, 2006).

³¹⁹ UMIR is updated by its Rules Advisory Committee comprised of representatives from the following entities: Barristers and Solicitors, Billy de Lavery; National Bank Financial; RBC Dominion Securities, Inc.; RS; BMO Nesbitt Burns, Inc.; Investors Groups; TSX Group Inc.; Bloomberg Tradebook Canada Company; Canaccord Capital; TD Securities Inc.; and CNQ. Market Regulation Services Inc., Board & Advisory Committees, <http://www.rs.ca> (follow “About RS” hyperlink; then follow “Board & Advisory Committees” hyperlink) (last visited Sept. 10, 2006).

³²⁰ Generally trading halts are issued “in anticipation of a material news announcement by [a particular] company.” Trading halts may also be initiated by a listed company or SRA. Market Regulation Services Inc., Timely Disclosure, <http://www.rs.ca/> (follow “Surveillance” hyperlink; then follow “Timely Disclosure” hyperlink) (last visited Sept. 10, 2006).

³²¹ Enforcement is the process used by RS to determine whether to proceed with disciplinary action against regulated persons. Market Regulation Services Inc., Our Role, <http://www.rs.ca/> (follow “Enforcement” hyperlink) (last visited Sept. 10, 2006).

³²² Market Regulation Services Inc., Trading Analysis, <http://www.rs.ca/> (follow “Surveillance” hyperlink; then follow “Trading Analysis” hyperlink) (last visited Sept. 10, 2006).

³²³ Hearing panels consist of at least one member in good standing of Canada’s national bar association (the Law Society), two members of the securities industry, and a current or former director, officer, or employee of an investment dealer or trading organization. Market Regulation Services Inc., Contested Hearing Decisions, <http://www.rs.ca> (follow “Enforcement” hyperlink; then follow “Contested Hearing Decisions” hyperlink) (last visited Sept. 10, 2006).

³²⁴ The hearing panel’s decision is also made public and such decisions may be re-

SRA.³²⁵

SRAs using RS's services oversee its self-regulatory activities. While some SRAs may perform adequate oversight, others may not have the resources and/or political will to conduct adequate oversight of RS.³²⁶

5. The Canadian Public Accountability Board (CPAB)

Canada's fragmented regulatory framework limits the efficacy of the CPAB, which was established in July 2002 to oversee accounting firms auditing Canadian issuers.³²⁷ CSA Rule 52-108 requires accounting firms that conduct audits of reporting issuers to register with the CPAB.³²⁸ However, compliance with CSA rules is strictly voluntary. Accordingly, the requirement to register with the CPAB in accordance with CSA Rule 52-108 does not apply to accounting firms in Alberta, British Columbia, and Manitoba.³²⁹ In addition, any provincial regulator or regulatory authority may grant an exemption to the requirements of CSA Rule 52-108.³³⁰ Registered firms are subject to the CPAB's inspection, investigation, and disciplinary procedures.³³¹ Lastly, CPAB also has rulemaking authority which is subject to SRA review prior to implementation.³³²

6. Canadian Securities Industry Reorganizes in 1999 to Enhance Global Competitiveness

The Canadian securities markets were reorganized in late 1999 in order to become more competitive in the global securities market. Canada's major exchanges agreed to restructure along

viewed on RS's website. *Id.*

³²⁵ *Id.*

³²⁶ Market Regulation Services Inc., About RS, <http://www.rs.ca> (follow "About RS" hyperlink) (last visited Feb. 10, 2007). Memorandum of Understanding Regarding Oversight of Market Regulations Inc. (Feb. 15, 2002), available at http://www.osc.gov.on.ca/MarketRegulation/SRO/rs/mou/srou-rs_25-OSCB-896.pdf. See also WISE PERSONS' COMMITTEE, *supra* note 31, at 25.

³²⁷ Canadian Public Accountability Board [CPAB], Background, <http://www.cpab-ccrc.ca/> (follow "Who We Are" hyperlink; then follow "Background" hyperlink) (last visited Sept. 10, 2006). The CPAB is organized as a non-profit corporation with an eleven-member board of directors and two member categories—the Council of Governors and the Industry Members. CPAB, Structure, <http://www.cpab-ccrc.ca/> (follow "Who We Are" hyperlink; then follow "Structure" hyperlink) (last visited Sept. 10, 2006).

³²⁸ CPAB, Background, *supra* note 327.

³²⁹ See National Instrument 52-108 Auditor Oversight § 1.2(2) (2004) (Can.), available at <http://www.cpab-ccrc.ca/412b56fd5a8ab.pdf>.

³³⁰ *Id.* § 4.1.

³³¹ *Id.* §§ 1.1, 3.3(1).

³³² CPAB Article 11 Participating Audit Firms § 11.3 Rules, in BY-LAW NO.1—AMENDED AND RESTATED, <http://www.cpab-ccrc.ca> (follow "By-Laws" hyperlink; then follow "CPAB By-Law No. 1" hyperlink) (last visited Sept. 10, 2006).

lines of market specialization.³³³ The reorganization was:

intended to enhance the efficiency of the trading facilities and services of [Canadian] Exchanges, create new opportunities for the Canadian market-place and improve the competitive position of the Canadian securities industry in the context of the globalization of the securities . . . markets and technological developments . . . [and] to eliminate fragmentation of the Canadian market for exchange-traded securities . . . , avoid duplication of services and leverage the strengths of each Exchange through specialization.³³⁴

After the 1999 reorganization, the TSE (now the TSX and part of the TSX Group) became the only exchange for trading senior equities. The CDN, which became the CDNX,³³⁵ was solely responsible for trading junior equities, and was merged into the TSX Group in 2001. It was then renamed the TSX Venture Exchange (TSX V). In 2002, the TSX demutualized and became the first exchange in North America whose shares were publicly traded.³³⁶ The ME took over all Canadian trading in derivatives.³³⁷ The Table below highlights the changes brought about as a result of the reorganization³³⁸:

³³³ At that time, Canada's major exchanges included the Alberta Stock Exchange (ASE), the Montreal Exchange (ME), the Toronto Stock Exchange (TSE), the Canadian Venture Exchange (CDNX), and the Vancouver Stock Exchange (VSE). Canada Dep't of Fin., *supra* note 310, at 1.

³³⁴ Memorandum of Agreement Between the Alberta Stock Exchange, the Montreal Exchange, the Toronto Stock Exchange (both for itself and on behalf of the Canadian Dealing Network Inc.) and Vancouver Stock Exchange §§ 1.2.–1.3. (Mar. 15, 1999), *available at* http://www.m-x.ca/f_publications_en/restructuring.pdf [hereinafter Memorandum of Agreement].

³³⁵ CDNX was created through a merger of the VSE (Vancouver) and ASE (Alberta), and later Winnipeg stock exchanges. Canada Dep't of Fin., *supra* note 310, at 1; *see also* Market Regulation Services Inc., *The Marketplaces We Regulate*, *supra* note 317.

³³⁶ Canada Dep't of Fin., *supra* note 310, at 5.

³³⁷ *Id.* at 1.

³³⁸ Memorandum of Agreement, *supra* note 334.

<u>Exchange</u>	<u>Activities After 1999</u>	<u>Activities Before 1999</u>
Montreal Exchange (ME)	All exchange-traded derivative products, comprising (without limitation) any type of option and futures contracts, including options and futures on index participation units.	Derivatives and equities, including equities inter-listed with the TSX.
Toronto Stock Exchange (TSE) (renamed TSX)	All senior securities, other than exchange-traded derivatives products including (without limitation) stocks, rights, convertible debentures, trust and limited partnership units, warrants, bonds and mutual fund securities and other products commonly traded on the cash market, including index participation units. Senior securities means the securities of all issuers that qualify for listing on the TSX.	Equities, junior and senior, including equities inter-listed with ME.
Alberta Stock Exchange (ASE) and the Vancouver Stock Exchange (VSE)	All junior securities, other than exchange-traded derivatives products, defined as the securities of all other issuers, including (without limitation) stocks, rights, convertible debentures, trust and limited partnership units, warrants, bonds and mutual fund securities and other products commonly traded on the cash market, including junior securities under participation units. For greater clarity, current ME issuers that do not qualify for transfer to the TSX will be transferred to the ASE/VSE (and not Canadian Dealing Network, Inc. (CDN)).	Equities, junior and senior, some inter-listing between the VSE and the ASE.
Transfers	TSX will transfer CDN to the VSE and the ASE; TSX will transfer OM (the Nordic Exchange) to the ME; TSX will transfer to ME the shares held by TSX in Canadian Derivatives Clearing Corporation; ME will transfer to TSX the shares held by ME in the Canadian Depository for Securities Ltd.	

7. Organization of the Canadian Securities Industry After 1999

Currently, Canada's major exchanges are TSX in the province of Ontario, and ME (listing primarily derivatives) in the province of Quebec. TSX, although ranked among the top seven exchanges in the world, measured by market capitalization of domestic issuers, still remains significantly below those exchanges ranked above it.³³⁹ However, many Canadian businesses list on U.S. securities markets.³⁴⁰

Interlistings generally raise the profile of issuers in the global market, and trading volumes for these issuers' shares often increase across all markets. . . . To capture a greater proportion of trading in securities of issuers that are listed on other markets, particularly those in the U.S., the TSX Group recently extended trading in U.S. dollars to 16 securities listed on the Toronto Stock Exchange, with additional securities to be added in the future. [Moreover, t]o address changes brought on by technology and globalization, the [Canadian] securities industry has been taking steps to improve foreign market access for Canadian issuers and investors. A number of Canadian securities firms, particularly those owned by banks, are building a global platform through the acquisition of foreign businesses operating in niche markets such as discount brokerages, wealth management and investment banking.³⁴¹

To increase global competitiveness, Canada's federal government "announced a coordinated national enforcement approach to strengthen the investigation and prosecution of serious corporate fraud and market illegality" in 2003.³⁴² In support of this initiative, the provinces of Ontario and Quebec enhanced enforcement in their securities regulatory frameworks. Each province passed legislation that increased penalties and expanded the investigative powers of their respective SRAs. This coordinated national enforcement approach was designed to develop "a proposed regime that will give investors in the secondary market a simpler procedure to sue companies, directors, officers, underwriters and experts that make misleading or untrue statements, or fail to give full and timely information."³⁴³

³³⁹ Market capitalization of domestic companies at the end of 2003 for the top exchanges in the global securities market are, in billions of U.S. dollars: (1) NYSE \$11,329; (2) Tokyo Stock Exchange \$2,953; (3) The NASDAQ Stock Market \$2,844; (4) London Stock Exchange \$2,460; (5) Euronext \$2,076; (6) Deutsche Börse (German Exchange) \$1,079; and (7) TSX Group \$889. The ME is also a member of the GLOBEX Alliance (GLOBEX). GLOBEX is an international electronic trading network for derivatives products. The ME's membership in GLOBEX "provides Canadian derivatives investors access to international markets." *Id.* at 6–7.

³⁴⁰ In 2003, 184 Canadian issuers were interlisted on U.S. exchanges. *Id.* at 8.

³⁴¹ *Id.*

³⁴² *Id.* at 9.

³⁴³ *Id.*

Other initiatives designed to strengthen Canada's securities regulatory framework include the IDA's new rules to promote the independence of research analysts employed by securities firms.³⁴⁴ In addition, the Canadian securities regulatory framework includes the Canadian Depository for Securities Limited (CDS), which acts as a securities depository, clearing, and settlement mechanism for Canada's securities markets.³⁴⁵ CDS also facilitates access to the global securities market; it settles cross-border transactions with the U.S. securities markets and has custodial relationships with, among others, the Depository Trust Company in the U.S., Japan Securities Settlement & Custody, Inc., and Euroclear France.³⁴⁶ CDS is regulated by the SRAs in Ontario and Quebec along with the Bank of Canada; CDS also works with the CSA and the Office of the Superintendent of Financial Institutions. For example, CDS operates SEDAR on behalf of the CSA.³⁴⁷

8. The Securities Regulatory Framework in Quebec

a. Commission des Valeurs Mobilières du Québec (CVMQ)/Autorité des marchés financiers (AMF)

On February 1, 2004, Quebec reorganized its securities regulatory framework. The purpose of the reorganization was to separate the administrative functions from the quasi-tribunal functions of Quebec's existing SRA.³⁴⁸ Market participants in Quebec's securities industry "complained that the hearings of commissions do not have the appearance of fairness because, from the outside, the commissioners seem to be passing judgment on their own decisions."³⁴⁹ The AMF, the entity emerging after the combination, is authorized to regulate the securities markets in Quebec by, among other activities, ensuring that issuers and other financial sector market participants meet their obligations, protecting investors, regulating the information that issuers must disclose to investors, and supervising the regulation of se-

³⁴⁴ The CSA has proposed corporate governance guidelines and related disclosure requirements designed to replace TSX corporate governance guidelines. *Id.* at 9–10.

³⁴⁵ The Canadian Depository for Securities Limited Homepage, <http://www.cds.ca/> (last visited Sept. 10, 2006).

³⁴⁶ *Id.*

³⁴⁷ *Id.* See also The System for Electronic Documents Analysis and Retrieval Homepage, <http://www.sedar.com> (last visited Sept. 10, 2006).

³⁴⁸ Quebec's existing SRA was combined with certain other financial sectors in Quebec to form a new regulator for Quebec's financial sector, the Autorité des marchés financiers (AMF). Autorité des marchés financiers [AMF], History, <http://www.lautorite.qc.ca/accueil.en.html> (follow "About Us" hyperlink; then follow "History" hyperlink) (last visited Sept. 10, 2006).

³⁴⁹ Jean-Marie Gagnon, *Do We Need a National Regulator?: No: A Single Market Umpire for the Whole Country Would Be More Easily "Captured" by Big Business, Argues Laval University Professor*, GLOBE AND MAIL (Toronto), Jan. 28, 2004, at A13.

curities professionals.³⁵⁰

Quebec's primary SRO is the Bourse de Montréal (the Montreal Exchange, or ME), which regulates derivative trading³⁵¹ and investment dealers in Quebec; it offers clearing services through its wholly-owned corporation, Canadian Derivatives Clearing Corporation (CDCC).³⁵² It also provides educational services about the derivatives market to both institutional and retail investors through its Derivatives Institute.³⁵³ Members of the ME approved demutualization on September 25, 2000, and the ME became a for-profit company.³⁵⁴ It also closed its trading floor and began using only an electronic trading platform, SAM, to trade derivatives.³⁵⁵

(1) Quebec's Approval of NASDAQ Canada Diminishes Canada's Efforts to Compete in the Global Securities Market

Canada's inability to use selective federal preemption in its regulatory framework allowed Quebec to disrupt its attempt to reorganize its securities market to compete in the global securities market. On November 21, 2000, Quebec began trading equity securities by allowing the NASDAQ Stock Market, Inc. (NASDAQ U.S.) to establish NASDAQ Canada.³⁵⁶ NASDAQ Canada provides direct access to all NASDAQ U.S. listed securities, which means that equity trading is no longer confined to the province of Ontario. Moreover, NASDAQ Canada represents a de

³⁵⁰ AMF, Industry Sectors, <http://www.lautorite.qc.ca/accueil.en.html> (follow "About Us" hyperlink; then follow "Industry Sectors" hyperlink) (last visited Sept. 10, 2006).

³⁵¹ As part of the 1999 reorganization of Canada's securities markets, ME, on October 1, 2001, ceased trading junior equity listings. See Montreal Exchange [ME], Our Mission, <http://www.m-x.ca/> (follow "About Us—Mission" hyperlink) (last visited Sept. 10, 2006); Canada Dep't of Fin., *supra* note 310, at 5; ME, Historical Highlights, <http://www.m-x.ca/> (follow "About Us—Historical highlights" hyperlink) (last visited Sept. 10, 2006).

³⁵² ME, Profile Overview, http://www.m-x.ca/profil_bref_en.php (last visited Sept. 16, 2006). The CDCC is the issuer, clearinghouse and guarantor of derivative contracts traded on the ME. It also provides clearing services to other exchanges and partners. CDCC, a for-profit company, has provided these services since 1975. ME, THREE-MONTH CANADIAN BANKERS' ACCEPTANCE FUTURES (2001), available at http://www.m-x.ca/f_publications_en/bax_en.pdf.

³⁵³ Financial Advisors Association of Canada, The Derivatives Institute, <http://www.advocis.ca/content/education/CE-prog/CE-derivatives.html> (last visited Sept. 16, 2006). The Derivatives Institute was established by the ME in April 2001 "to understand and use derivative instruments." ME, About Us, http://www.d-x.ca/a_propos_institut_en.php (last visited Sept. 16, 2006); see also RBC Action Direct Inc., Seminars, <http://www.actiondirect.com/RBC:RCq-SI71A8YAAIkFOU/derivatives-institute.html> (last visited Sept. 16, 2006).

³⁵⁴ ME, Historical Highlights, http://www.m-x.ca/qui_histo_en.php.

³⁵⁵ SAM (Montreal Automated System) is the ME's electronic trading platform. *Id.*

³⁵⁶ Press Release, NASDAQ, NASDAQ Concludes Record Share and Dollar Volume Year Composite Index Finishes Lower (Sept. 16, 2006), available at http://www.nasdaq.com/newsroom/news/pr2001/ne_section01_022.html; see also Canada Dep't of Fin., *supra* note 310, at 6.

facto reorganization of Canada's securities markets by Quebec and the U.S. Recently, Canada's attempts to reorganize its securities markets to compete in the global securities market were further diminished when British Columbia recognized NASDAQ Canada, again establishing equity trading within its borders.

Quebec amended its securities act to establish NASDAQ Canada.³⁵⁷ The amendment recognized NASDAQ Canada as an SRO for purposes of carrying on business in Quebec; it also recognized NASDAQ Canada's parent, NASDAQ U.S., as an SRO in Quebec. This amendment effectively injected the U.S. securities regulatory framework into the Canadian securities regulatory framework because "[t]he rules of NASDAQ Canada are those of NASDAQ [U.S.], and are overseen by the [U.S.] Securities and Exchange Commission . . . NASDAQ [U.S.] is a subsidiary of the NASD, a registered [SRO] in the [U.S.]" securities regulatory framework.³⁵⁸

NASDAQ Canada began with ten securities firms participating in trading securities listed on NASDAQ U.S. (including Canadian companies) from Montreal, Quebec. Moreover, participating investment dealers are the largest investment dealers in Canada's securities industry.³⁵⁹ Participating investment dealers are able to establish affiliated, wholly-owned Delaware corporations whereby the affiliate operates in Montreal in the same building as its parent company and uses NASDAQ U.S. workstations.³⁶⁰ All affiliates are regulated under U.S. securities laws, which require registration with the Commission and membership in the NASD of affiliates as well as some of their personnel. The affiliate is structured as an order entry firm and, under Quebec law, can have only one institutional client, its parent company.³⁶¹ Moreover, the affiliate must have dually-engaged employees, i.e.,

³⁵⁷ *New Regulatory Structure for the Quebec Financial Sector: Recent Developments—A Supplement to the June 2002 Newsletter*, INFO. (Ogilvy Renault, Quebec), Dec. 2002, at 2, available at <http://www.ogilvyrenault.com/WebControls/GetResource.aspx?id=2067>. Quebec also offered NASDAQ U.S. an incentive package, which included a ten year tax holiday. Bertrand Marotte, *Nasdaq Nixes Plans for Separate Canadian Stock Exchange*, GLOBE AND MAIL (Can.), Sept. 20, 2003, at B5.

³⁵⁸ Simon Romano, Notice and Request for Comments: NASDAQ Canada, Inc. Proposal for Improved Access for B.C. Dealers, at 2 (July 24, 2004) (on file with author).

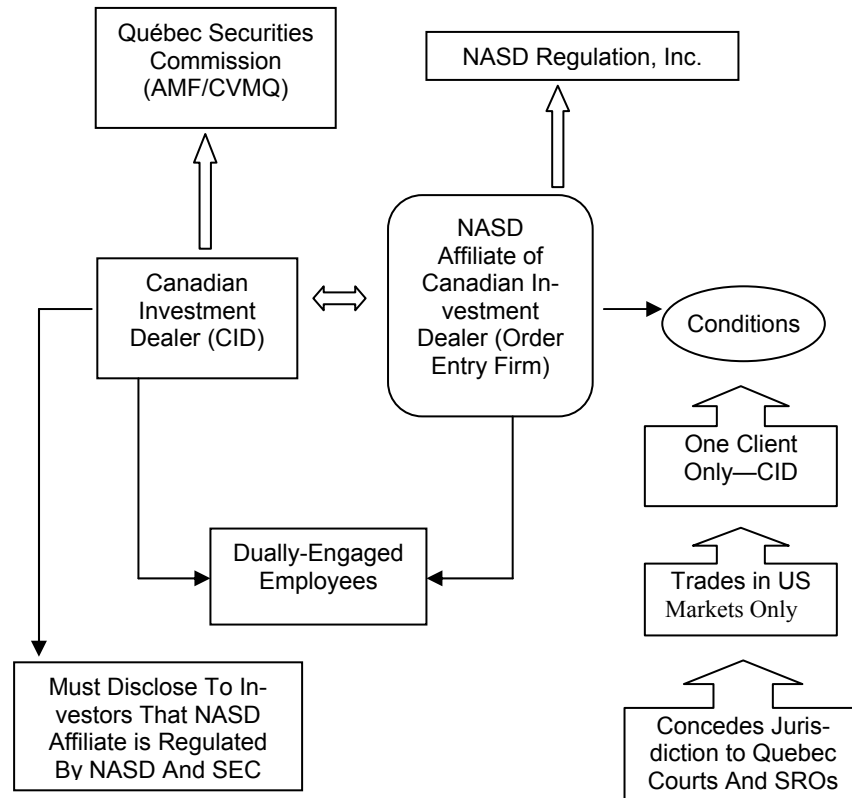
³⁵⁹ The participating investment dealers are BMO Nesbitt Burns, Canaccord, Capital Casgrain & Company, CIBC WorldMarkets Corp., Desjardins, NBC International Inc. (USA), Pictet Overseas, Scotia Capital Markets, TD Securities Inc., Yorkton Capital (USA). Press Release, NASDAQ, Helen Kearns Named President of NASDAQ Canada (May 1, 2001), available at http://www.nasdaq.com/newsroom/news/pr2001/ne_section01_143.html.

³⁶⁰ See *id.* The NASDAQ Workstation II is a computerized trading tool that provides access to all NASDAQ markets for Market Makers (firms that maintain firm bid and offer prices in a given security by standing ready to buy or sell at publicly-quoted prices), brokers, and institutions.

³⁶¹ Romano, *supra* note 358, at 3.

employees who work at the affiliate and the parent company simultaneously.³⁶² This arrangement effectively allows direct regulation under the U.S. securities regulatory framework and indirect regulation by Quebec's securities regulatory framework. Quebec regulates the same employees in connection with their interactions with Canadian investors (institutional and retail) and securities markets.³⁶³

NASDAQ Canada Broker-Dealer Model



³⁶² *Id.* at 10.

³⁶³ Investment dealers and their NASD affiliates must: (1) remain affiliated with a Quebec dealer that is an IDA member in good standing; (2) undertake to the NASD and the Commission that: (i) its NASD affiliate would carry on its business in compliance with applicable NASD requirements; (ii) its NASD affiliate would not have any clients in Quebec (other than its Quebec parent) and would only engage in U.S. transactions; (iii) all trading officers and employees of the NASD affiliate would be dually employed by both the parent investment dealer and its NASD affiliate; and (iv) its NASD affiliate would consent to jurisdiction in any action or proceeding before any court or securities regulatory authority in Quebec, and agree to provide access to and inspection rights to the Commission. *Id.* at 11.

This arrangement benefits Canadian investment dealers

[b]y enabling Canadian dealers to set up U.S. NASD member affiliates on their own premises in Canada, staff them with Canadian employees, utilize existing infrastructure, and supervise them via their existing Canadian compliance operations, etc., the costs of accessing NASDAQ US [sic] should be reduced from those that would apply to either foreign affiliate operations or third party jitney operations.³⁶⁴

At its inception, NASDAQ Canada would be established in three phases. Phase one included opening the NASDAQ Canada office in Montreal, Quebec; launching a NASDAQ Canada website; creating a NASDAQ Canada Index to track the market performance of Canadian issuers listed on NASDAQ U.S.; and trading of all NASDAQ-listed securities in U.S. dollars only. Phases two and three were expected to follow depending on the success of phase one. Phase two included participation by non-NASD member firms in Canada, trading in both U.S. and Canadian dollars, regulatory oversight by NASD and Quebec's SRA, and listing Canadian companies exclusively on NASDAQ Canada. Phase three would include linking NASDAQ Canada with NASDAQ Japan and NASDAQ Europe. According to Frank G. Zarb, the CEO of NASDAQ U.S. in 2000, "Our ultimate goal is linking [NASDAQ] Canada to a global trading platform that will include [NASDAQ] markets in Asia and Europe."³⁶⁵

On September 20, 2003, NASDAQ abandoned its plans to start a new exchange in Canada or to trade Canadian stocks in Canadian dollars, effectively eliminating the possibility of a stand-alone Canadian securities market using NASDAQ U.S.'s trading platform. NASDAQ U.S.'s global expansion strategy was adversely impacted by a downturn in technology stocks and the global economy. According to former NASDAQ Canada president Helen Kearns, "[M]arket conditions have really dictated how quickly [NASDAQ] Canada could roll out and it's been a difficult market."³⁶⁶ These events, among others, resulted in losses for NASDAQ U.S. and the closing of other global ventures including NASDAQ Japan and Europe.³⁶⁷

Phase one of NASDAQ Canada continues to operate in the provinces of Quebec and British Columbia and is NASDAQ U.S.'s

³⁶⁴ *Id.* at 6. Jitney operations include such services as execution, clearing, and settlement of trades performed by U.S. broker-dealers on behalf of Canadian investment dealers.

³⁶⁵ Press Release, NASDAQ, NASDAQ Announces the Launch of NASDAQ Canada (Nov. 21, 2000) (on file with author).

³⁶⁶ Bertrand Marotte, *Canadian Nasdaq on Hold*, GLOBE AND MAIL (Can.), Oct. 28, 2002, at B1; see also Marotte, *supra* note 357, at B5.

³⁶⁷ Marotte, *Canadian Nasdaq on Hold*, *supra* note 366; *Nasdaq Europe to Close*, BBC NEWS, June 26, 2003, <http://news.bbc.co.uk/2/hi/business/3024558.stm>.

only successful global venture using this business model. NASDAQ Canada continues to seek expansion to other Canadian provinces including Ontario.³⁶⁸

9. The Ontario Securities Commission Regulates Canada's Premier Securities Markets

The OSC³⁶⁹ administers and enforces securities laws³⁷⁰ in the province of Ontario. Canada's premier securities markets are housed within Ontario's borders. It is managed by a board of directors comprised of members of the OSC or commissioners.³⁷¹ Commissioners are appointed by the Lieutenant Governor in Council for varying terms of five years or less, but may be reappointed by the Lieutenant Governor in Council.³⁷² The OSC must have at least nine but not more than fourteen commissioners, who may serve on a part-time basis.³⁷³ Full-time commissioners are generally full-time executive managers of the OSC and fill the positions of Chair, CEO, and Vice-Chair. The remaining commissioners are part-time and conduct their responsibilities in a non-executive capacity. A quorum requires only two commissioners.³⁷⁴ All commissioners have statutory responsibility for the administration of Ontario's Securities Act. All bylaws passed by the OSC must be approved by Ontario's Minister of Finance.³⁷⁵

OSC commissioners meet to address regulatory policy matters every two weeks, and at least quarterly to conduct non-regulatory matters. The commissioners conduct non-regulatory

³⁶⁸ Marotte, *supra* note 357, at B5.

³⁶⁹ In 1994, Ontario's Securities Act was amended to change the OSC's status from government agency to a Crown Corporation responsible to the Ontario Legislature through the Minister of Finance. In 1997, the OSC was converted to a self-funded Crown Corporation. Ontario Securities Commission [OSC], Governance & Accountability http://www.osc.gov.on.ca/About/Governance/ga_index.jsp (last visited Sept. 18, 2006). According to the OSC, these changes promoted "greater autonomy and independence from the government." FIVE YEAR REVIEW COMMITTEE FINAL REPORT, *supra* note 34, at 61.

³⁷⁰ The OSC is statutorily mandated to administer Ontario's Securities Act and its Commodity Futures Act in order "to provide protection to investors from unfair, improper or fraudulent practices and to foster fair and efficient capital markets and confidence in their integrity." Memorandum of Understanding Between the Minister of Finance of Ontario and the OSC § 1.1.4.A.3 (May 26, 2003), *available at* <http://www.osc.gov.on.ca/> (follow "Policy & Regulation" hyperlink; then follow "Memoranda of Understanding" hyperlink; then follow June 6, 2003 "Memorandum of Understanding" hyperlink) [hereinafter MOU Minister of Finance & OSC].

³⁷¹ OSC, The Commission, http://www.osc.gov.on.ca/About/Governance/ga_the_commission.jsp (last visited Sept. 18, 2006).

³⁷² *Id.*

³⁷³ *Id.*

³⁷⁴ *Id.*; Securities Act, R.S.O. 1990, Ch. S.5 s. 3(11) (2006) (Can.).

³⁷⁵ Ontario Securities Act § 143.3(3) requires the Minister to approve, reject or return the bylaw to the OSC for further consideration within sixty days of delivery. R.S.O. 1990, Ch. S.5 s. 143.3(3).

matters through meetings of its three standing committees: Audit and Finance, Corporate Governance and Nominating, and Compensation.³⁷⁶ All committee members are part-time, non-executive commissioners;³⁷⁷ however, the OSC chairman is an ex officio, non-voting member of the Governance and Nominating Committee.³⁷⁸

OSC regulatory activities include making policy, conducting investigations, and sitting as an administrative tribunal.³⁷⁹ The OSC obtained rulemaking authority as recently as 1995.³⁸⁰ All OSC rules must be submitted to the Ontario Minister of Finance for review and approval.³⁸¹ The rule becomes effective if the Minister of Finance does not reject or return the rule.

Although non-binding, the OSC is statutorily authorized to make policy. Like the OSC's rulemaking process, proposed policies must be published for public comment.³⁸² Although OSC policies may not be prohibitive or mandatory, they inform market participants about, among other topics, the manner in which the OSC may exercise its discretionary authority, the interpretation of Ontario securities law, and OSC practices for conducting its duties under the Ontario Securities Act.

The OSC regulates marketplaces in Ontario, including exchanges, alternative trading systems (ATSs), quotation and trade reporting systems, and stock exchanges, by specifying the terms

³⁷⁶ OSC, The Commission, *supra* note 371.

³⁷⁷ *Id.* Part-time members meet under the leadership of the Lead Director, who presides as chair over all meetings of part-time members charged with administering the infrastructure of the OSC. The Lead Director may make recommendations but has no decision-making authority. OSC, Lead Director of the Board of Directors Mandate, http://www.osc.gov.on.ca/About/Governance/ga_lead_director.jsp (last visited Sept. 18, 2006).

³⁷⁸ OSC, The Commission, *supra* note 371. The OSC also has an Adjudicative Committee responsible for evaluating and monitoring the OSC's adjudicative procedures and practices. The Adjudicative Committee has no decision-making authority. See OSC, Adjudicative Committee, http://www.osc.gov.on.ca/About/Governance/ga_adjudicative.jsp (last visited Sept. 18, 2006). The Adjudicative Committee is advised by an Independent Adjudicative Counsel about hearings and related matters; it provides legal research and drafting assistance to the Adjudicative Committee. OSC, Independent Adjudicative Counsel, http://www.osc.gov.on.ca/About/Governance/ga_independent-adj-counsel.jsp (last visited Sept. 18, 2006).

³⁷⁹ OSC, ANNUAL REPORT 2004, at 1 (2004), available at <http://www.osc.gov.on.ca/About/AnnualRpt/2004/com.html>. However, the OSC cannot issue any order under the Ontario Securities Act without a hearing. Securities Act, R.S.O.1990 Ch. S.5 s. 127(4) (2006) (Can.).

³⁸⁰ OSC, Rule-Making in Ontario, http://www.osc.gov.on.ca/Regulation/Rulemaking/rrn_backgrounder.jsp (last visited Sept. 18, 2006). The OSC must publish proposed rules for public comment for a period of at least ninety days. Securities Act, R.S.O. 1990 Ch. S.5 s. 143.2(1)-(4) (2006) (Can.).

³⁸¹ R.S.O. Ch. S.5 s. 143.3.

³⁸² R.S.O. Ch. S.5 s. 143.8(2).

and conditions under which they can operate in Ontario.³⁸³ The OSC recognizes the TSX and the Canadian Trading and Quotation System (CNQ). The TSX V and the ME have received exemptions from registration in Ontario. It does not recognize NASDAQ Canada. The OSC also recognizes quotation and trade reporting systems (QTRSs). Such QTRSs operate facilities that distribute quotations for the purchase and sale of securities and report such transactions exclusively to registered dealers.³⁸⁴

The Ontario Ministry of Finance and the Ontario Legislature oversee the OSC. The Minister of Finance appoints a statutorily authorized, independent Five Year Review Committee to review securities regulation in Ontario.³⁸⁵

The need for a single securities regulator was identified by the Five Year Review Committee as “the most pressing securities regulation issue in Ontario and across Canada.” We believe strongly that a single securities regulator for Canada is essential in order to effectively protect investors and foster integrity and confidence in our capital markets in an increasingly global marketplace. A single securities regulator will maximize efficiency, take advantage of scale and scope, ensure a level national playing field, and encourage Canadian competitiveness.³⁸⁶

The Five Year Review Committee also recommended the development of securities transfer legislation modeled on revised Article 8 of the U.S. Uniform Commercial Code.³⁸⁷ The OSC must enter into an MOU with the Ontario Minister of Finance every five years.

The OSC also publishes an annual Statement of Priorities and solicits comments from market participants; the Statement of Priorities also compares OSC’s annual performance against the goals enumerated in the previous year’s Statement of Priori-

³⁸³ Neil Mohindra, *Securities Regulation Market in Canada*, CRITICAL ISSUES BULL. (The Fraser Institute), 2002, at 9; National Instrument 21-101 Marketplace Operation (2004) (Can.), available at <http://ftp.sfcc.gov.sk.ca/scripts/ssc/files/nat-inst/21-101consolidatedmay20-04.pdf>.

³⁸⁴ OSC, Exchanges and Other Marketplaces, http://www.osc.gov.on.ca/MarketRegulation/Marketplaces/mp_index.jsp (last visited Sept. 18, 2006); see also Roel C. Campos, Commissioner, Securities and Exchange Commission, Remarks at New York University Stern: New Challenges in Regulating Financial Markets (Mar. 24, 2006).

³⁸⁵ OSC, *supra* note 379, at 1; OSC, Advisory Committee Legislative Reviews, http://www.osc.gov.on.ca/Regulation/FiveYearReview/fyr_index.jsp (last visited Sept. 18, 2006).

³⁸⁶ David A. Brown, OSC, *Executive Summary, Five Year Review Committee Final Report: Reviewing the Securities Act (Ontario)*, at 1 (Aug. 18, 2004), available at http://www.osc.gov.on.ca/Regulation/FiveYearReview/fyr_20040818_fairness_exec-sum.pdf (last visited Sept. 25, 2006) (citation omitted) (quoting FIVE YEAR REVIEW COMMITTEE FINAL REPORT, *supra* note 34, at 29).

³⁸⁷ *Id.* at 4; see also MOU Minister of Finance & OSC, *supra* note, 370, § 1.1.4.B.10.

ties.³⁸⁸ Market participants are also surveyed to measure the OSC's effectiveness in providing services and meeting obligations to market participants. "The [OSC's] regulatory and adjudicative decisions must be made and be seen by the public to be made in an independent and impartial manner."³⁸⁹

The OSC wants to facilitate "Canadian financial markets that are attractive to domestic and international investors, issuers and intermediaries because they are cost efficient and have integrity."³⁹⁰ It also recognizes that it must address issues in the global regulatory framework to compete successfully domestically as well as internationally; the OSC also asserts that the fragmentation of Canada's securities regulatory framework adversely impacts the competitiveness of Canadian securities markets in the global marketplace:

Financial markets are global. Borders no longer serve as barriers to capital flows. Those seeking to invest and those seeking capital go where they see the opportunity for the best returns for the risks assumed. As capital flows become global, so do the market intermediaries and infrastructure servicing the business. Many of the largest intermediaries are global conglomerates combining banking, insurance and securities services in one entity.³⁹¹

Accordingly, the OSC has determined that it must maintain a globally competitive securities regulatory framework.³⁹² Mostly, the goal is reflected in the OSC's efforts to harmonize its securities laws/regulations with other provinces in Canada as well as internationally, especially with the U.S. securities markets. The OSC has also established an International Affairs Office to ensure that Ontario (through the OSC) is a recognized participant in the shaping of the international securities regulatory framework in an increasingly global securities market.³⁹³

V. ANALYSIS

A. Securities Regulatory Frameworks of the U.S. and Canada: A Comparison with the IOSCO Standard

The securities regulatory frameworks of the U.S. and Canada, to varying degrees, meet the three objectives of the IOSCO

³⁸⁸ See OSC, STATEMENT OF PRIORITIES 2006/2007, at 1-3, 10 (2006), available at http://www.osc.gov.on.ca/About/WhatWeDo/wwd_2006-2007_statement_of_priorities_annual.pdf (last visited Oct. 14, 2006).

³⁸⁹ MOU Minister of Finance & OSC, *supra* note 370, § 1.1.4.B.10.

³⁹⁰ OSC, BUSINESS STRATEGY 2004-2008, at 1, available at http://www.osc.gov.on.ca/About/WhatWeDo/wwd_2004-2008_osc_business_strategy.pdf.

³⁹¹ *Id.* at 2.

³⁹² *Id.*

³⁹³ See OSC, International Affairs, http://www.osc.gov.on.ca/International/int_index.jsp. (last visited Sept. 10, 2006).

Standard: protecting investors; ensuring fair, efficient, and transparent markets; and dealing with systemic risk.³⁹⁴ However, the U.S. has a greater capacity to achieve the IOSCO Standard because its securities regulatory framework incorporates selective federal preemption. Moreover, Canada's failure to use selective federal preemption in its securities regulatory framework will significantly impair its ability to achieve the IOSCO Standard.

Effective investor protection under the IOSCO Standard requires disclosure of material information to both retail and institutional investors, prohibits manipulative or fraudulent practices in the securities markets, mandates supervision of market intermediaries or operators of exchanges that provide investment services, and prescribes minimum standards for market participants.

1. Investor Protection

a. Disclosure of Material Information

The U.S. and Canadian³⁹⁵ securities regulatory frameworks require issuers and other market participants to disclose all material information about the issuer's securities in the primary and secondary markets. Both regulatory frameworks are based on the principle of full disclosure of material information, and the definition of material information is substantially the same under both regulatory frameworks. The U.S. securities regulatory framework defines material information from the perspective of the investor's decision to buy or sell the issuer's securities; information is material if it is required by a reasonable investor to make an informed investment decision.³⁹⁶ The province of On-

³⁹⁴ IOSCO Pub. Doc. 154, *supra* note 6, at i.

³⁹⁵ As noted previously, the term "Canadian securities regulatory framework" refers to the provinces of Ontario and Quebec only, because they are the most active in Canada with respect to trading volume and regulatory activity. Describing and analyzing all thirteen provinces and territories would expand significantly the length and adversely impact the thesis of this article.

³⁹⁶ Accordingly, the disclosure of material information by an issuer accessing the primary market includes a description of the issuer, its organization, the terms of its particular offering, and independently audited financial statements. Securities Act, 15 U.S.C. § 77g(b)(1) (2000). In the secondary market, §§ 12–14 of the Exchange Act require continuous disclosure from an issuer or reporting company required to register under these provisions. §§ 78l–78n. A reporting company includes a company with a class of securities listed on a national securities exchange (§ 78l(b)); a company with assets in excess of \$10 million and equity securities held by at least 500 persons (§ 78l(g) and Rule 12g-1, 17 C.F.R. § 240.12g-1(2006)); and a company with a Securities Act registration statement that has been declared effective by the Commission (§ 78l). Required disclosures in the secondary market include an extensive description of the reporting company's business, audited financial statements for its fiscal year, management's discussion and analysis of the issuer's performance and financial position, and any material events. *See* 15 U.S.C. §§ 78m, 78j-1; 17 C.F.R. § 228.303; *see also* *Basic Inc. v. Levinson*, 485 U.S. 224,

tario's securities regulatory framework defines material information from the perspective of the effect of information on the value or price of the issuer's securities, i.e., information is material if it could reasonably be expected to significantly affect the market price or value of the issuer's securities.³⁹⁷ The province of Quebec's securities regulatory framework, similar to that of the U.S., defines material information from the perspective of the investor; information is material if a reasonable investor's decision of whether to buy, sell, or hold an issuer's securities is likely to be influenced or changed by the information.³⁹⁸ Ontario, Quebec and the U.S. obtain the requisite disclosure, with minor differences, by requiring issuers to submit material information to a designated regulator. In the U.S., material information in the primary market is obtained in the registration process; continuing disclosure in the secondary market is submitted to the Commission and stored in EDGAR.³⁹⁹ In Ontario and Quebec, material information in their primary markets is obtained in their respective registration processes; continuing disclosure in their secondary markets is submitted to provincial SRAs and stored in SEDAR. Information stored in EDGAR and SEDAR is made available to investors, generally, on the regulator-sponsored websites for EDGAR and SEDAR.⁴⁰⁰

Although full disclosure of material information is required in the securities regulatory frameworks of Ontario and Quebec, the consistency and quality of the implementation of full disclosure of material information is somewhat fragmented. There is no federal securities law mandating full disclosure; each province has its own disclosure requirements embodied in its own securities act. The CSA has attempted to bridge this gap by drafting National Instrument 51-102 (NI 51-102) and MRRS.⁴⁰¹ However,

236 (1988).

³⁹⁷ Securities Act, R.S.O. 1990, ch. S.5 s. 1(1) (2006) (Can.).

³⁹⁸ Securities Act, R.S.Q. ch. V-1.1 s. 73 (2006) (Can.).

³⁹⁹ SEC, Important Information About EDGAR, <http://www.sec.gov/edgar/aboutedgar.htm> (last visited Sept. 10, 2006).

⁴⁰⁰ SEC, Filings & Forms (EDGAR), <http://www.sec.gov/edgar.shtml> (last visited Oct. 14, 2006); SEDAR, http://www.sedar.com/homepage_en.htm (Oct. 14, 2006); *see also* National Instrument 13-101 System for Electronic Document Analysis and Retrieval (SEDAR) (2004) (Can.), *available at* <http://ftp.sfscc.gov.sk.ca/scripts/ssc/files/nat-inst/13-101niamendedasof-mar30-04.pdf>. National Instrument 13-101 was adopted by all thirteen provinces, but with one or more changes to the original instrument in certain provinces.

⁴⁰¹ *See*, National Instrument 51-102 Continuous Disclosure Obligations (2004) (Can.), *available at* http://www.osc.gov.on.ca/Regulations/Rulemaking/Current/Part5/rule_51-102-cont-disc-ob.pdf. MRRS designates one principal regulator to review issuer disclosure documents for securities offerings made in more than one province. As previously noted, the provinces do not surrender their jurisdiction or discretion under MRRS and are free at any time to withdraw and deal directly with the issuer. WISE PERSONS' COMMITTEE, *supra* note 31, at 17. Notably, the chief goal of MRRS is not to facilitate uniformity, but to

compliance with NI 51-102 and MRRS is voluntary for all thirteen provinces. Provinces may also adopt portions of NI 51-102 and MRRS. Despite the fact that these measures are designed to facilitate uniformity in the Canadian securities regulatory framework, voluntary compliance, instead of mandating compliance using selective federal preemption, severely undermines this goal. Voluntary compliance means that the issuer must always be prepared to deal with the regulatory framework of each province in which it plans to offer its securities.

b. Prohibition of Manipulative or Fraudulent Practices

Investor protection under the IOSCO Standard also requires the prohibition of manipulative or fraudulent practices in the securities market.⁴⁰² In the U.S., manipulative or fraudulent practices are prohibited under both federal and state securities laws.⁴⁰³ The federal anti-fraud provisions include § 17(a) of the Securities Act, § 10(b) of the Exchange Act, and Rule 10b-5 promulgated thereunder.⁴⁰⁴ Both provisions prohibit fraud or deceit, and manipulative or deceptive devices or contrivances.⁴⁰⁵ Canada's prohibitions against fraud and manipulation are contained in National Instrument 23-101 (NI 23-101).⁴⁰⁶ However, because selective federal preemption is not included in Canada's securities regulatory framework, making compliance with all or a portion of the provisions of NI 23-101 voluntary, the provinces of Alberta, British Columbia, and Saskatchewan have decided to retain their own rules prohibiting manipulative or fraudulent practices.⁴⁰⁷ This ability to opt out adversely impacts the consistency required to compete successfully in the global securities market.

In the primary market, U.S. federal anti-fraud provisions do not prohibit stabilization of stock prices when needed. Regulation M of the Exchange Act provides guidelines with respect to

reduce cost of regulation in multi-jurisdictional offerings in Canada. Memorandum of Understanding Regarding Mutual Reliance Review System Between the OSC and Members of the Canadian Securities Administrators (Oct. 28, 1999), *available at* http://www.albertasecurities.com/dms/2984/7165/7166_1353811_v1_-_MOU-_MRRS_-_in_word.pdf.

⁴⁰² IOSCO Pub. Doc. 154, *supra* note 6, at 5.

⁴⁰³ This is one of the primary areas in the U.S. securities regulatory framework which has not been preempted under NSMIA.

⁴⁰⁴ 15 U.S.C. §§ 77q(a), 78j(b) (2000); 17 C.F.R. § 240.10b-5 (2006). Other anti-fraud provisions under federal securities laws include § 14(e) of the Exchange Act, § 15(c)(1) of the Exchange Act, and § 206 of the Investment Advisers Act of 1940. 15 U.S.C. §§ 78n(e), 78o(c)(1), 80b-6 (2000).

⁴⁰⁵ See 15 U.S.C. §§ 77q, 78j (2000); 17 C.F.R. § 240.10b-5 (2006).

⁴⁰⁶ National Instrument 23-101 Trading Rules § 3.1 (2001) (Can.), *available at* http://www.rs.ca/en/pdf/National_Instrument_23-101.pdf; Companion Policy to National Instrument 23-101 Trading Rules § 3.1 (2004) (Can.), *available at* <http://www.spsc.gov.sk.ca/ssc/files/nat-inst/23-101cp-consolidated-may20-04.pdf>.

⁴⁰⁷ National Instrument 23-101 Trading Rules, § 3.1(2).

when and at what price the broker-dealer may enter a stabilizing bid.⁴⁰⁸ However, federal securities laws do prohibit such manipulative or fraudulent practices as free riding,⁴⁰⁹ insider trading,⁴¹⁰ parking,⁴¹¹ wash sales,⁴¹² false and misleading statements during a distribution of securities resulting in the artificial distortion of the market price for investors,⁴¹³ and issuer repurchases designed to manipulate the issuer's stock price.⁴¹⁴ Canada's fraud and manipulation provisions also allow stabilization of stock prices while expressly prohibiting substantially the same type of fraudulent and manipulative conduct under the U.S. securities regulatory framework.⁴¹⁵

Generally, almost every state (including the District of Columbia and the Commonwealth of Puerto Rico) has broadly-worded anti-fraud provisions that apply to all securities issued and/or traded within its borders. Most states have adopted all or some portion of the anti-fraud provisions of the Uniform Securities Act (USA),⁴¹⁶ but not New York and California.⁴¹⁷ Although

⁴⁰⁸ Regulation M, 17 C.F.R. § 242.104 (2005).

⁴⁰⁹ Illegal free riding occurs any time a purchaser of securities does not have the funds to pay for the purchase but rather intends to take a free ride on the securities purchased. See *A.T. Brod & Co. v. Perlow*, 375 F.2d 393 (2d Cir. 1967) (holding that a customer ordered stock from his broker with the predetermination of paying for it only if the price increased by the settlement date).

⁴¹⁰ SEC, Insider Trading, <http://www.sec.gov/answers/insider.htm> (last visited Oct. 21, 2006).

Illegal insider trading refers generally to buying or selling a security, in breach of a fiduciary duty or other relationship of trust and confidence, while in possession of material, nonpublic information about the security. Insider trading violations may also include "tipping" such information, securities trading by the person "tipped," and securities trading by those who misappropriate such information.

Id.

⁴¹¹ Parking consists of transferring record ownership of a security in order to hide the true identity of the beneficial owner of such security. See *First Montauk Securities Corp.*, Exchange Act Release No. 38,775, 64 SEC Docket 2082 (June 25, 1997).

⁴¹² SEC, Wash Sales, <http://www.sec.gov/answers/wash.htm> (last visited Oct. 21, 2006). Wash sales occur when you buy and sell the same security at the same time or within a short period of time. "Wash sales violate the federal securities laws—Section 9(a)(1)(A) and Rule 10b-5 of the Securities Exchange Act of 1934—if they are done to create the false or misleading appearance of active trading in a security." *Id.*

⁴¹³ 15 U.S.C. § 78i(a) (2000).

⁴¹⁴ *Id.*

⁴¹⁵ Companion Policy to National Instrument 23-101 Trading Rules § 3.1(1)–(4) (2004) (Can.), available at <http://www.sfcc.gov.sk.ca/ssc/files/nat-inst/23-101cp-consolidated-may20-04.pdf>.

⁴¹⁶ They are: Alabama, Alaska, Arkansas, Colorado, Connecticut, Delaware, District of Columbia, Guam, Idaho, Indiana, Iowa, Kansas, Kentucky, Maine, Maryland, Massachusetts, Michigan, Mississippi, Missouri, Montana, Nebraska, Nevada, New Hampshire, New Mexico, North Carolina, Oklahoma, Oregon, Pennsylvania, Puerto Rico, Rhode Island, South Carolina, South Dakota, Tennessee, Utah, Vermont, Washington, West Virginia, and Wyoming. LOUIS LOSS & JOEL SELIGMAN, *SECURITIES REGULATION* 73–74 n.114 (3d ed. 1998).

⁴¹⁷ LOUIS LOSS ET AL., *SECURITIES REGULATION* 162, 174 (4th ed. 2006).

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Hawaii, Minnesota, New Jersey, and Wisconsin have adopted § 101 of the USA, they have also adopted other anti-fraud provisions.⁴¹⁸ Moreover, even though Arizona, Florida, Georgia, Louisiana, Texas, and Ohio have not adopted the USA, they have substantially adopted the anti-fraud provisions contained in § 101 of the USA.⁴¹⁹ The language of state anti-fraud provisions in states that have adopted the USA generally tracks the language of § 10(b) of the Exchange Act.⁴²⁰ Section 101 of the USA states that

[i]t is unlawful for any person, in connection with the offer, sale or purchase of any security, directly or indirectly

(1) to employ any device, scheme, or artifice to defraud,

(2) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading, or

(3) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person.⁴²¹

The USA anti-fraud provisions provide for both civil liabilities and criminal penalties. Under § 410 of the USA, there is civil liability for violations of its anti-fraud provisions. However, civil liability is available only to buyers of securities, not sellers.⁴²² Buyers may sue under § 410 or in equity to recover consideration paid plus interest, costs, and reasonable attorneys' fees minus any income generated by the security.⁴²³ Criminal penalties may be imposed under § 409 for willful violations of the USA anti-fraud provisions.⁴²⁴

The USA,⁴²⁵ a voluntary attempt by various SSRAs to achieve consistency in state securities regulation, has failed even in the one area, anti-fraud, in which state action is expressly permitted under selective federal preemption. Although all

⁴¹⁸ LOSS & SELIGMAN, *supra* note 416, at 74.

⁴¹⁹ *Id.* at 74–75 n.116.

⁴²⁰ *Id.*

⁴²¹ UNIFORM SECURITIES ACT § 101 (1956) (current version at UNIFORM SECURITIES ACT § 501, 7C U.L.A. 150 (2006)).

⁴²² *Id.* § 410 (current version at UNIFORM SECURITIES ACT § 509, 7C U.L.A. 162 (2006)). In the author's opinion, the reason for allowing only civil liability for violation of the anti-fraud provisions of the USA is that in each state, both buyers *and* sellers may sue based on state common law and equitable remedies such as fraud and rescission, respectively. In other words, a statute is not needed.

⁴²³ *Id.* § 410(a) (current version at § 509(b)(1), 7C U.L.A. 163 (2006)).

⁴²⁴ *Id.* § 409 (current version at § 508, 7C U.L.A. 158 (2006)). Willful is defined under the USA as “proof that a person acted intentionally in the sense that the person was aware of what he or she was doing.” § 508 cmt. 2, 7C U.L.A. 158 (2006).

⁴²⁵ This description of the Uniform Securities Act of 1956 includes the Revised Uniform Securities Act of 1985 and the 2005 revision.

SSRAs agree with the principle of uniformity as evidenced by the USA, they refuse to adopt voluntarily the USA as drafted even with respect to its anti-fraud provisions. Voluntary compliance under the auspices of NASAA inevitably leads to fragmentation in the securities regulatory framework and its related problems—different laws in each state, different levels of enforcement, varying quality of employee skills and knowledge of applicable securities laws, and increases in the issuer's cost of capital. The CSA, like NASAA, is attempting to achieve consistency in provincial regulation by promulgating a Canadian Uniform Securities Act (CUSA) along with a Securities Administration Act (SAA);⁴²⁶ the drafting of the CUSA and the SAA is the essence of Canada's Uniform Securities Legislation Project (USL Project). However, the USL Project seems doomed to fail from the start because: (1) the provinces are not required to adopt, in whole or in part, the CUSA at its completion; (2) the CSA has already acquiesced to the notion that Quebec requires special (non-uniform) treatment because of its "civil law regime and particular legislative drafting requirements";⁴²⁷ (3) British Columbia was already in the process of streamlining and simplifying its own securities act; and (4) the USL Project allows each province to draft its own SAA.⁴²⁸

Selective federal preemption prevents de facto policy and rulemaking by a single dominant state or province in the securities regulatory framework. The state of New York houses within its borders, arguably, the premier market within the U.S. securities markets—the NYSE. Selective federal preemption prevents New York's SSRA's (the New York Attorney General, currently Eliot Spitzer)⁴²⁹ regulatory activities from having a disproportionate impact on regulatory framework of the U.S. securities markets. This may represent de facto policy and rulemaking in the U.S. securities markets. Moreover, Spitzer's legal mandate is

⁴²⁶ UNIFORM SECURITIES ACT: A LEGISLATIVE PROPOSAL FOR HARMONIZATION OF SECURITIES LAWS: CONSULTATION DRAFT (2003). SAAs must be promulgated by all thirteen provinces and contain the procedural provisions for implementing the USA in each province. The CSA acknowledges that it would be preferable to have uniform procedures, but states that this is too difficult to accomplish. See CANADIAN SECURITIES ADMINISTRATION, UNIFORM SECURITIES LEGISLATION PROJECT: COMMENTARY ON CONSULTATION DRAFTS 14 (2003).

⁴²⁷ CANADIAN SECURITIES ADMINISTRATION, *supra* note 426, at 13.

⁴²⁸ *Id.* at 14.

⁴²⁹ The New York Attorney General is elected for a term of four years and manages over 500 attorneys and over 1800 employees including forensic accounts and scientists. Office of NYS Attorney General Eliot Spitzer, Tour the Attorney General's Office, <http://www.oag.state.ny.us/tour/tour.html> (last visited Oct. 21, 2006). "The Attorney General shall [p]rosecute and defend all actions and proceedings in which the state is interested, and have charge and control of all the legal business of the departments and bureaus of the state" N.Y. EXEC LAW § 63 (2002).

only to protect securities markets within New York's borders. Selective federal preemption prevents domination of the U.S. securities regulatory framework by a single state whose legal mandate is only to protect securities markets within its borders, even if the NYSE is located within its borders. Without the limits imposed by selective federal preemption in the securities regulatory framework, Spitzer's regulatory activities would dominate policy and rulemaking, just as the OSC's regulatory activities dominate policy and rulemaking in the Canadian securities regulatory framework.

(1) The Spitzer Phenomenon⁴³⁰

Spitzer's recent enforcement activities, although laudable, could have affected adversely the competitiveness of the U.S. securities markets in the global securities market. The competitiveness of the U.S. securities markets is weakened when a single SSRA's enforcement activities result in policies and rules that change the securities regulatory framework created by Congress and implemented and monitored by the Commission. In 2002, Spitzer entered into an agreement with Merrill Lynch (the Spitzer Agreement) to settle charges that its investment advice was tainted by conflicts of interest, i.e., securities analysts at Merrill Lynch were not being truthful and fair in public announcements about companies that were Merrill Lynch's investment banking clients.⁴³¹ The Spitzer Agreement, negotiated solely between Spitzer and Merrill Lynch, produced significant reforms in the way in which Merrill Lynch conducted its investment banking activities. The Spitzer Agreement had a signifi-

⁴³⁰ N.Y. EXEC LAW § 63 (2002) (allowing the Attorney General to prosecute violations of New York state laws, as well as violations of federal laws or regulations). Any conduct which violates state or federal law or regulation is actionable under § 63-12. *Id.* § 63-12; *see also* *People v. World Interactive Gaming Corp.*, 714 N.Y.S.2d 844, 848 (1999); *New York v. Feldman*, 210 F. Supp. 2d 294, 300 (S.D.N.Y. 2002). Executive Law § 63-12 provides:

Whenever any person shall engage in repeated fraudulent or illegal acts or otherwise demonstrate persistent fraud or illegality in the carrying on, conducting or transaction of business, the [A]ttorney [G]eneral may apply, in the name of the people of the state of New York, to the supreme court of the state of New York, on notice of five days, for an order enjoining the continuance of such business activity or of any fraudulent or illegal acts, directing restitution and damages and, in an appropriate case, canceling any certificate filed under and by virtue of the provisions of section four hundred forty of the former penal law or section one hundred thirty of the general business law, and the court may award the relief applied for or so much thereof as it may deem proper.

§ 63-12.

⁴³¹ Press Release, Office of New York State Attorney General Eliot Spitzer, Spitzer, Merrill Lynch Reach Unprecedented Agreement to Reform Investment Practices: Merrill Lynch to Pay \$100 Million Penalty (May 21, 2002), *available at* http://www.oag.state.ny.us/press/2002/may/may21a_02.html.

cant impact on all investment banks in the U.S. because Merrill Lynch is the largest securities brokerage firm in the U.S. securities markets, the state of New York, Spitzer's jurisdiction, has Wall Street⁴³² and the NYSE within its borders. Spitzer recognized that his activities resulted in de facto policy and rulemaking for the U.S. securities markets. He stated that "[t]his agreement [between Merrill Lynch and the New York State Attorney General] changes the way Wall Street will operate [by] severing the compensation link between the research and banking divisions [of Merrill Lynch] that tainted investment advice."⁴³³ In fact, Spitzer's settlement with Merrill Lynch was the catalyst for a Global Settlement addressing research analyst conflicts of interest and related issues with the top ten U.S. securities firms in the U.S. securities markets.⁴³⁴ The Global Settlement, negotiated by the Commission with the assistance of Spitzer, the NASD, NASAA, and the NYSE, resulted in, among other things, the promulgation of new rules for research analysts by the Commission.⁴³⁵ However, the Global Settlement would not have occurred without the Commission's statutory power to negotiate, accept, implement, and monitor the Global Settlement. Essentially, the Commission has the statutory authority to impose the Global Settlement on all securities firms participating in the U.S.

⁴³² Wall Street is the heart of the U.S. Financial District and was the first permanent location of the NYSE. NY.com, Financial District, http://www.ny.com/sights/neighborhoods/financial_district.html (last visited Oct. 22, 2006); NYSE Group, Timeline, http://www.nyse.com/about/history/timeline_events.html (last visited Oct. 22, 2006).

⁴³³ Press Release, Office of New York State Attorney General Eliot Spitzer, *supra* note 431. Among other things, Merrill Lynch agreed to sever the link between compensation for analysts and investment banking, prohibit investment banking input in determining analyst compensation, "[c]reate a new investment review committee responsible for approving all research recommendations with strict standards and independence from investment banking and the analysts themselves," "disclose in Merrill Lynch's research reports whether it has received or is entitled to receive any compensation from a covered company over the past 12 months," "pay a \$100 million penalty," and issue a statement of contrition for its failure to address conflicts of interest. *Id.*

⁴³⁴ Bear, Stearns & Co. Inc.; Credit Suisse First Boston LLC; Goldman, Sachs & Co.; J.P. Morgan Securities Inc.; Lehman Brothers Inc.; Merrill Lynch & Co., Inc.; Morgan Stanley & Co., Inc.; Salomon Smith Barney Inc.; UBS Warburg LLC; and U.S. Bancorp Piper Jaffray Inc. Collectively, these firms paid total penalties of almost \$900 million dollars. Press Release, NASD et al., SEC, NY Attorney General, NASD, NASAA, NYSE and State Regulators Announce Historic Agreement to Reform Investment Practices: \$1.4 Billion Global Settlement Includes Penalties and Funds for Investors (Dec. 20, 2002), *available at* http://www.nasd.com/PressRoom/NewsReleases/2002NewsReleases/NASDW_002864; Press Release, SEC et al., Ten of Nation's Top Investment Firms Settle Enforcement Actions Involving Conflicts of Interest Between Research and Investment Banking (Apr. 28, 2003), *available at* <http://www.sec.gov/news/press/2003-54.htm>.

⁴³⁵ The terms of the Global Settlement included a ban on spinning IPOs, an obligation to provide independent research to clients for five years by paying for independent research firms chosen by an independent consultant appointed by regulators, disclosure of analysts' recommendations, ratings, and price target forecasts to the public, and payment of significant monetary penalties by each securities firm. *See* Press Release, NASD et al., *supra* note 434.

securities markets, while Spitzer's authority as an SSRA is only effective in a single state—New York. Selective federal preemption empowers the Commission to bring all necessary parties to the negotiating table and to impose a consistent solution effective against all participants in the U.S. securities regulatory framework. The IOSCO Standard requires consistency in a country's domestic securities regulatory framework to compete successfully in the global securities market. The Commission's comprehensive statutory authority facilitates consistency in the U.S. securities markets and thus is critical to the competitiveness of the U.S. securities markets in the global securities market.

The Office of the New York Attorney General is similar to the OSC in the Canadian securities regulatory framework. Arguably, Canada's premier securities markets (e.g., the TSX) are located in Ontario and, therefore, are regulated by the OSC. Accordingly, the OSC's policy and rulemaking activities, in effect, set policies and rules for the Canadian securities markets even though the OSC's jurisdiction is confined to the province of Ontario. However, unlike the OSC, the impact of Spitzer's activities on the U.S. securities regulatory framework is checked by selective federal preemption, which statutorily mandates that the Commission, a federal regulator, set policy and ensure fair and efficient markets in the U.S. securities regulatory framework. The activities of the OSC have a greater impact on the Canadian securities regulatory framework because its securities regulatory framework does not use selective federal preemption. Unlike the U.S., there is no statutorily authorized federal regulator empowered to set policy and ensure consistency in Canada's securities regulatory framework.

c. Supervision of Market Intermediaries that Provide Investment Services

Investor protection under the IOSCO Standard also requires supervision of market intermediaries or operators of exchanges that provide investment services. Such supervision must incorporate a comprehensive system of inspection and surveillance along with a compliance program. This means that there must also be a comprehensive requirement for establishing and maintaining appropriate records to facilitate monitoring of compliance. In the U.S. securities regulatory framework this is a shared responsibility between the Commission and securities industry SROs.⁴³⁶ The SROs represent the front line of supervision by ensuring regulatory compliance by their members. Although

⁴³⁶ SEC, *Investor's Advocate*, *supra* note 119.

the Commission has delegated much of its inspection and surveillance activities to SROs, it conducts sufficient inspections and surveillance to ensure that the SROs perform their delegated regulatory responsibilities.⁴³⁷ This system of delegation allows the Commission, a relatively small federal agency with respect to human resources and budget, to regulate the largest securities market in the world. If an SRO fails to perform its responsibilities adequately, the Commission has statutory authority to sanction the SRO; the ultimate sanction, of course, is to revoke the SRO's registration under the Exchange Act.⁴³⁸ Revocation of SRO registration means that securities firms would no longer be required to become members, thus eliminating the SRO's statutory authority to regulate its members.

SROs acting as exchanges or trading systems in the OTC market perform their delegated regulatory responsibilities by establishing and enforcing listing standards that issuers must meet to trade their securities on securities exchanges or in the OTC securities market. Also, they must ensure that their members comply with applicable securities laws. SROs perform these requirements by promulgating rules, performing inspections, investigating possible violations of applicable securities laws and SRO rules, and imposing sanctions against members found to have committed such violations.⁴³⁹ Although there are several exchanges throughout the U.S.,⁴⁴⁰ the NYSE is the largest, in part because of its listing requirements.⁴⁴¹ Prior to August 31, 2006, the NYSE was responsible for all SRO responsibilities for exchanges under the Exchange Act. Subsequently, the NYSE delegated certain SRO regulatory responsibilities to the NASD, including examining and enforcing compliance with federal

⁴³⁷ SEC, *The Laws that Govern*, *supra* note 124. Section 5 of the Exchange Act requires every national securities exchange to register with the Commission. 15 U.S.C. § 78e (2000). Section 6(b) of the Exchange Act requires every exchange to promulgate rules that are designed, among other things, to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and to provide for appropriate discipline of its members for any violations of the exchange's rules and applicable securities laws. § 78f(b).

⁴³⁸ See §§ 78f(b)(6), 78o-3(b)(7), 78s(d)(3).

⁴³⁹ Regulation of Market Information Fees and Revenues, Exchange Act Release No. 42,208, 71 SEC Docket 496, at IV(A) (Dec. 9, 1999), *available at* <http://www.sec.gov/rules/concept/34-42208.htm>.

⁴⁴⁰ There are nine securities exchanges registered with the Commission. They are the American Stock Exchange, Boston Stock Exchange, Chicago Board Options Exchange, Chicago Stock Exchange, International Securities Exchange, National Stock Exchange (formerly the Cincinnati Stock Exchange), New York Stock Exchange, Pacific Exchange, and Philadelphia Stock Exchange. U.S. Dep't of Labor, Additional Guidance for Filing Form LM-30, http://www.dol.gov/esa/regs/compliance/olms/LM30_additional.htm (last visited Oct. 22, 2006).

⁴⁴¹ See generally NYSE Group, NYSE Arca Listings, <http://www.nyse.com/about/listed/1155031724207.html> (last visited Oct. 23, 2006).

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securities laws by common members, and enforcing and overseeing NYSE Rules that are substantially similar to NASD Rules.⁴⁴² NASDAQ, the largest OTC market,⁴⁴³ is regulated by the NASD. Like the NYSE, the NASD performs the regulatory functions for issuers listed on NASDAQ, the operation of NASDAQ, and the activities of NASDAQ member securities firms.⁴⁴⁴

SROs regulate their member securities firms primarily by performing inspections and surveillance. Inspections or examinations require the creation and maintenance of certain records by member securities firms.⁴⁴⁵ SRO rules for member firms require that they submit to inspections by the SRO; such inspections are designed to determine and to ensure that member securities firms are complying with all applicable SRO rules and securities laws.⁴⁴⁶ Without the creation and maintenance of such books and records, it would be impossible for SROs (or the Commission for that matter) to perform regulatory responsibilities delegated by the Commission and authorized by statute. Section 17(a) of the Exchange Act, and rules promulgated thereunder, require securities firms to create and maintain records required for inspections conducted by SROs and the Commission.⁴⁴⁷ These

⁴⁴² Program for Allocation of Regulatory Responsibilities Pursuant to Rule 17d-2, Notice of Filing of the Plan for Allocation of Regulatory Responsibilities Between NYSE Arca, Inc. and the National Association of Securities Dealers, Inc., Exchange Act Release No. 54,224, 71 Fed. Reg. 43,823 (July 27, 2006).

⁴⁴³ NASDAQ, 2005 ANNUAL REPORT at NASDAQ's Business in Brief (2006), available at http://files.shareholder.com/downloads/NDAQ/92898776x0x36919/4926252F-A3F3-446A-85D0-AEA84A42CB82/NASDAQ_2005AnnualReport.pdf.

⁴⁴⁴ See National Association of Securities Dealers, NASD Corporate Description: Building Investor Confidence Every Day, <http://www.nasd.com>. The NASD also supervises other OTC markets, such as the OTC Bulletin Board (OTCBB) and the pink sheets. SEC, Over-the-Counter Markets, <http://www.sec.gov/divisions/marketreg/mrotc.shtml> (last visited Oct. 9, 2006). The OTCBB is an electronic inter-dealer quotation system that displays real-time quotes, last-sale prices, and volume information for many OTC securities not quoted on NASDAQ or listed on a national securities exchange; the OTCBB is not a part of NASDAQ. OTC Bulletin Board, Overview and History of the OTCBB, <http://www.otcbb.com/aboutOTCBB/overview.stm>. The Pink Sheets is an electronic inter-dealer quotation system that displays quotes and last-sale information for many OTC securities and does not have listing requirements; securities listed in the Pink Sheets are generally foreign issuers and small, thinly-traded, closely held companies unable to meet the listing requirements of NASDAQ, OTCBB, or the NYSE. Pink Sheets, About the Pink Sheets, <http://www.pinksheets.com/about/index.jsp> (last visited Oct. 9, 2006); Pink Sheets, Frequently Asked Questions, <http://www.pinksheets.com/faq.jsp> (last visited Oct. 9, 2006).

⁴⁴⁵ IOSCO Pub. Doc. 154, *supra* note 6, at i–ii; SEC, 2002 ANNUAL REPORT, at 68, 74–76 (2002), available at <http://www.sec.gov/pdf/annrep02/ar02full.pdf>.

⁴⁴⁶ See, e.g., *One Broker Gone Bad: Punishing the Criminal, Making Victims Whole: Hearing Before the H. Subcomm. on Oversight and Investigations of the H. Comm. On Financial Services*, 107th Cong. 109–115 (2002) (testimony of Daniel M. Sibears, Senior Vice President, Deputy Member Regulation, NASD, Inc.).

⁴⁴⁷ Exchange Act 17 C.F.R. § 240.17a-1(a) (2006). Rule 17a-4 allows securities firms to maintain records electronically if the electronic storage media meets the conditions described in the rule. § 240.17a-4(f). See also Reporting Requirements for Brokers or Dealers Under the Securities Exchange Act of 1934, Exchange Act Release No. 38,245, 62 Fed.

records include financial statements prepared in accordance with GAAP⁴⁴⁸ and certain financial and operation reports (commonly known as FOCUS Reports) with the Commission.⁴⁴⁹ Section 17 of the Exchange Act also requires registered exchanges (e.g., the NYSE) to create and maintain sufficient records for effective oversight by the Commission.⁴⁵⁰

Dealers are also required to create and maintain certain books and records to facilitate compliance with the OSA and the QSA⁴⁵¹ in the Canadian securities regulatory framework. Such books and records include blotters or other records of original entry and ledgers reflecting all liabilities, income and expenses, and capital accounts.⁴⁵² OSA and QSA regulations also prescribe the content and time limits of such books and records: they must be maintained "in an accurate and intelligible form" so that they are available "to any person lawfully entitled to examine the re-

Reg. 6443, 6470 (Feb. 5, 1997) (codified at 17 C.F.R. § 240.17a-4(f)) (describing amendment to Rule 17a-4 that will allow broker-dealers to use any electronic storage media that satisfies the other requirements of the Rule); TradeWeb LLC, SEC No-Action Letter, 2003 WL 22220706, at *1 (July 22, 2003) (indicating that the SEC will not enforce any regulations against TradeWeb for using electronic trade confirmation in broker deals).

⁴⁴⁸ Exchange Act, 17 C.F.R. §240.17a-5(c)(2) (2006) (noting that portions of a mandatory audited statement must be "prepared in accordance with generally accepted accounting principles"). GAAP is an acronym for generally accepted accounting principles. Annual financial statements must be filed on a calendar or fiscal year basis and must be audited by an independent public accountant within sixty days after the date of the financial statement. § 240.17a-12(b).

⁴⁴⁹ § 240.17a-5(c)(2). Form X-17A-5 is more commonly known as a FOCUS report. Other required books and records include daily blotters; ledgers reflecting all assets and liabilities, income and expense and capital accounts; separate ledgers itemizing each of the securities firm's customer's accounts; ledgers reflecting all long and short positions in each security carried by the securities firm for its own account; a memorandum of each order, whether executed or not; order tickets for each purchase and sale showing price and time (if possible) of execution; copies of confirmations of transactions and notices of other debits and credits sent to the securities firm's customers; trial balances as proof of money balances in all of the securities firm's ledger accounts; questionnaires or applications for employment executed by each associated person of the securities firms with, among other things, a complete disciplinary history in the securities industry and any criminal records; and fingerprinting records of the firms associated persons. § 240.17a-3 (giving a complete list of records required to be made and kept.). All records must be created in the form prescribed by Rule 17a-3. *Id.* Records required in Rule 17a-3 must be kept and retained for the periods prescribed in Rule 17a-4. § 240.17a-4(a)-(e). Exchange Act Rule X-17A-5 requires registered securities firms to file FOCUS reports with the Commission. Exchange Act, 17 C.F.R. § 240.17a-5(a)(2). FOCUS Report is an acronym for Financial and Operational Combined Uniform Single Report. The depth and detail required in FOCUS Reports are determined by the business activities of each securities firm. Documents used to prepare FOCUS Reports must be kept three years, the first two years in an easily accessible place. § 240.17a-4(b)(8). FOCUS Reports and other required records may be created and maintained electronically. *See* Order Approving Proposed Rule Change by NASD Regulation, Inc. Relating to the Submission of Information in Electronic Form, Exchange Act Release No. 38,591, 62 Fed. Reg. 26,735, 26,842 (May 9, 1997).

⁴⁵⁰ 17 C.F.R. § 240.17a-1 (2006).

⁴⁵¹ Securities Act, R.S.Q., ch. V-1.1 s. 220 (2006) (Can.).

⁴⁵² Securities Act, R.R.O. 1990, Reg. 1015, s. 113 (2006) (Can.).

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cords.”⁴⁵³ Securities dealers’ books and records are used by SROs and SRAs to regulate the activities of securities dealers in Ontario and Quebec.

The Ontario Securities Act defines an SRO as an entity that represents registrants and is organized for the purpose of regulating the operations and the standards of practice and business conduct of its members and their representatives with a goal of promoting the protection for investors and the public interest.⁴⁵⁴ The OSC is statutorily authorized to recognize SROs.⁴⁵⁵ This means that recognized SROs operating within Ontario are subject to financial examination by the OSC.⁴⁵⁶ Accordingly, SROs in Ontario must make and keep certain financial records and practice and procedure documents for review by the OSC.⁴⁵⁷ If the OSC determines that there have been violations of the Ontario Securities Act, the SRO may be required to provide or amend required disclosure documents.⁴⁵⁸ All SRO rules are subject to OSC approval prior to implementation. However, the absence of selective federal preemption in Canada’s securities regulatory framework makes SRO oversight somewhat convoluted. For example, all RS rules must be approved by all SRAs that have contracted for its services—Ontario, Quebec, Manitoba, Alberta, and British Columbia.⁴⁵⁹ The OSC is the principal regulator, which means that it is responsible for coordinating the review and approval process of all rules proposed by RS. However, RS must file the proposed rule with all five SRAs at the same time and all RS rules must be approved by all five SRAs by agreement of the other four SRAs.⁴⁶⁰ “The [OSC] may . . . make any decision with respect to any by-law, rule, regulation, policy, procedure, interpretation or practice of a recognized self-regulatory organization.”⁴⁶¹ There are currently three SROs recognized by the OSC: the IDA, the MFDA, and RS. Quebec also recognizes three SROs: the IDA, the ME, and the MFDA.

⁴⁵³ Securities Act, R.R.O. 1990, Reg. 1015, s. 113(2)(b) (2006) (Can.).

⁴⁵⁴ Securities Act, R.S.O. 1990, ch. S.5 s. 21.1 (2006) (Can.).

⁴⁵⁵ *Id.* SROs are defined as Market Participants under the Ontario Securities Act. R.S.O. 1990, ch. S.5 s. 1.

⁴⁵⁶ *Id.* s. 12(1).

⁴⁵⁷ *Id.* ss. 19(1), 19(3), and 127; Securities Act, R.R.O. 1990, Reg. 1015, s. 113 (2006) (Can.).

⁴⁵⁸ Securities Act, R.S.O. 1990, ch. S.5 s. 127 (2006) (Can.).

⁴⁵⁹ Memorandum of Understanding Regarding Oversight of Market Regulation Services Inc. Between: Alberta Securities Commission (the ASC) and British Columbia Securities Commission (the BCSC) and Commission des Valeurs Mobilières du Québec (the CVMQ) and Manitoba Securities Commission (the MSC) and Ontario Securities Commission (the OSC) (also referred to collectively as the Commissions) app. A, 25 OSCB 896, 9 (Feb. 15, 2002).

⁴⁶⁰ *Id.*

⁴⁶¹ Securities Act, R.S.O. 1990, ch. S.5 s. 21.1(4) (2006) (Can.).

SROs will not regulate their members with a view towards detecting and preventing violations of applicable securities laws without statutory oversight from a single federal regulator. In 1996, the Commission was forced to institute administrative proceedings against the NASD, in part because it failed to comply with certain of its own rules and to enforce compliance with federal securities laws by securities firms acting as NASDAQ market makers.⁴⁶² NASDAQ market makers engaged in manipulative practices in certain securities traded on NASDAQ in order to increase profits by artificially widening spreads in such transactions.⁴⁶³ Specifically,

[NASDAQ] market makers observed an anticompetitive pricing convention by which most [NASDAQ] stocks were quoted only in even eighths (i.e., $\$1/4$, $\$1/2$, $\$3/4$, 0). The pricing convention resulted in most [NASDAQ] stocks being quoted with a minimum inside spread of $\$1/4$, thereby increasing the transactions [sic] costs paid by many investors when purchasing or selling those stocks.⁴⁶⁴

This manipulative and anti-competitive pricing convention resulted in wider spreads and was enforced by NASDAQ market makers using harassment.⁴⁶⁵ In addition, the Commission determined that “[t]he NASD was unduly influenced by [NASDAQ] market making firms with respect to rulemaking, the discipli-

⁴⁶² See Report Regarding the NASD and the NASDAQ Market, Exchange Act Release No. 37,542, 62 SEC Docket 1385 (Aug. 8, 1996); Order Instituting Public Proceedings, Making Findings and Imposing Remedial Sanctions Against NASD, Exchange Act Release No. 37,538 (Aug. 8, 1996). The NASD defines a market maker as

[a] firm that maintains a firm bid and offer price in a given security by standing ready to buy or sell at publicly-quoted prices. The [NASDAQ] Stock Market is a decentralized network of competitive Market Makers. Market Makers process orders for their own customers, and for other NASD broker/dealers; all NASD securities are traded through Market Maker firms. Market Makers also will buy securities from issuers for resale to customers or other broker/dealers. About 10 percent of NASD firms are Market Makers; a broker/dealer may become a Market Maker if the firm meets capitalization standards set down by NASD.

NASD, Glossary of Terms: M, http://www.nasd.com/Resources/Glossary/NASDW_011116 (last visited Oct. 9, 2006).

⁴⁶³ See Report Regarding the NASD and the NASDAQ Market, Exchange Act Release No. 37,542, 62 SEC Docket 1385 (Aug. 8, 1996). “Spread” is “[t]he difference between the bid price at which a Market Maker will buy a security, and the ask price at which a Market [M]aker will sell a security.” NASD, Glossary of Terms: S, http://www.nasd.com/Resources/Glossary/NASDW_011153 (last visited Oct. 16, 2006). The “inside spread” is

[t]he difference between the best bid and best ask among all securities is the highest bid and lowest offer being quoted among all of the Market Makers competing in a security. Since the spread is the aggregate of individual Market Maker spreads, it is narrower than an individual dealer spread or quote.

NASD, Glossary of Terms: I, http://www.nasd.com/Resources/Glossary/NASDW_011041 (last visited Oct. 16, 2006).

⁴⁶⁴ See Report Regarding the NASD and the NASDAQ Market, Exchange Act Release No. 37,542, 62 SEC Docket 1385 (Aug. 8, 1996).

⁴⁶⁵ See *id.*

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nary process and the admission of new members.”⁴⁶⁶ The NASD spent more time investigating and bringing disciplinary actions against certain broker-dealers that were “widely disliked” by NASDAQ market makers.⁴⁶⁷

From 1999 through 2003, NYSE specialists engaged in fraudulent and anti-competitive behavior designed to increase their compensation. Specifically, *all* NYSE equity specialist firms engaged in unlawful trading ahead⁴⁶⁸ and interpositioning.⁴⁶⁹

The Commission took swift and decisive action against the abuses uncovered at the NYSE and NASD. It required systemic changes at both the NASD and the NYSE to ensure fair and competitive markets and to eliminate fraudulent practices that adversely impacted the competitiveness, efficiency, and transparency of the U.S. securities markets.⁴⁷⁰ Such comprehensive remedial action was possible because of the existence of the use of selective federal preemption in the securities regulatory framework.

d. Minimum Standards for Market Participants

The IOSCO Standard requires the authorization of market intermediaries to hold themselves out to the public as such. In

⁴⁶⁶ *See id.*

⁴⁶⁷ *See id.*

⁴⁶⁸ NASD Manual Rule 2111(b) (2006).

A member that accepts and holds a market order of its own customer or a customer of another broker-dealer in a [NASDAQ] or exchange-listed security without immediately executing the order is prohibited from trading that security on the same side of the market for its own account, unless it immediately thereafter executes the customer market order up to the size and at the same price at which it traded for its own account or at a better price.

Id.

⁴⁶⁹ Order Instituting Public Administrative Proceedings, Making Findings, Ordering Compliance with Undertakings, and Imposing a Censure and a Cease-and-Desist Order, Exchange Act Release No. 51,524, 85 SEC Docket 517 (Apr. 12, 2005). NASD Manual Rule 2320(b) (2006).

In any transaction for or with a customer, no member or person associated with a member shall interject a third party between the member and the best available market except in cases where the member can demonstrate that to his knowledge at the time of the transaction the total cost or proceeds of the transaction, as confirmed to the member acting for or with the customer, was better than the prevailing inter-dealer market for the security. A member's obligations to his customer are generally not fulfilled when he channels transactions through another broker/dealer or some person in a similar position, unless he can show that by so doing, he reduced the costs of the transactions to the customer.

Id.

⁴⁷⁰ *See* Order Instituting Public Administrative Proceedings, Making Findings, Ordering Compliance with Undertakings, and Imposing a Censure and a Cease-and-Desist Order, Exchange Act Release No. 51,524 (Apr. 12, 2005).

the U.S., this is accomplished primarily through registration of securities firms with the Commission.⁴⁷¹ Registration of securities firms facilitates compliance with applicable securities laws by requiring securities firms to maintain an appropriate level of capital and to abide by a code of business conduct.⁴⁷²

In Canada, the OSC and the CVMQ also monitor the activities of market participants by requiring registration of dealers, underwriters,⁴⁷³ and other market participants. The OSA prohibits trading and otherwise participating in Ontario securities markets unless such person, dealer,⁴⁷⁴ or adviser registers with the OSC as a dealer or an adviser.⁴⁷⁵ Non-trading employees, designated by the Director of the OSC, are not required to register. Unlike the U.S., Ontario allows registration of all advisers seeking to do business within its borders, while the Commission only mandates registration of advisers with greater than \$30 million in assets under management; advisers with less than \$30 million in assets under management must register with the appropriate SSRA.⁴⁷⁶ Similar to Ontario, Quebec requires the registration of dealers and advisers to engage in the securities business within its borders. The definition of dealer, however, is much broader than the OSA or federal securities laws. Section 5(2) of the QSA includes "trading in securities as principal,

⁴⁷¹ Securities Exchange Act of 1934, 15 U.S.C. § 78o (2000). Brokers and dealers doing business in the U.S. securities markets must register with the Commission in a process administered by the NASD. NASD, Glossary of Terms: N, http://www.nasd.com/Resources/Glossary/NASDW_011118 (last visited Oct. 9, 2006).

⁴⁷² Securities Exchange Act of 1934, 15 U.S.C. § 78m (2000). Compliance is facilitated by requiring minimum levels of skill and knowledge, which are monitored by proficiency exams. 15 U.S.C. § 78o (2000).

⁴⁷³ Quebec does not have specific registration requirements for dealers that act as underwriters. *See* Securities Act, R.S.Q., ch. V-1.1 s. 148 (2005) (failing to list underwriters as governed by the statute).

⁴⁷⁴ Dealer registration is divided into ten categories: a broker (trades in the capacity of an agent or principal); a financial intermediary dealer (e.g., a bank, loan corporation, trust corporation, insurance company, credit union); a foreign dealer; an international dealer; an investment dealer (member of the IDA and trades in the capacity of an agent or principal); a limited market dealer; a mutual fund dealer (trades exclusively in shares or units of mutual funds); a scholarship plan dealer (trades exclusively in shares or units of securities of a scholarship or educational plan or trust); a securities dealer; and a security issuer (issuer registering as dealer to distribute its own securities exclusively for its own account. This category is rarely used). *See* Securities Act, R.R.O. 1990, Reg. 1015, s. 98 (2006) (Can.). In addition, SRO membership is required to obtain registration as a broker or investment dealer. *See* SRO Membership—Securities Dealers and Brokers, OSC Rule 31-507 § 1.1 (2006), *available at* http://www.osc.gov.on.ca/Regulation/Rulemaking/Current/Part3/rule_20000818_31-507_fr.jsp.

⁴⁷⁵ Securities Act, R.S.O. 1990, ch. S.5, s.25(1)(a) (2006). This section also requires registration of the dealer, partners, officers, and employees that perform trading activities such as the purchase and sale of securities. This allows personal liability of individuals for violations of the OSA.

⁴⁷⁶ Investment Advisers Act of 1940, 17 C.F.R. § 275.203A-1 (2006).

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whether as his main activity or only as a secondary activity.”⁴⁷⁷ Curiously, persons seeking to register as a dealer or adviser of a mutual fund, a scholarship plan, or an investment contract dealer (and its representative) must register with the AMF in accordance with *An Act Respecting the Distribution of Financial Products and Services (Quebec)* (FP&S Act) instead of the QSA.⁴⁷⁸

Exchange Act Rule 15c3-1 requires securities firms to have specified levels of initial and ongoing capital to meet the current demands of their business activities and to protect customers and creditors from losses in the event of financial failure.⁴⁷⁹ Adequate liquidity must be maintained at all times. Accordingly, minimum net capital requirements vary based on the type of activities engaged in by the securities firms. Minimum net capital is determined by reducing net worth by all assets that cannot be readily converted into cash and by a percentage of the market value of securities and commodities held in the securities firms’ proprietary accounts to reflect market risk.⁴⁸⁰ Certain firm assets are deducted in their entirety from net worth, including real estate, furniture and fixtures, exchange memberships, prepaid rent, insurance and other prepaid expenses, goodwill, and organizational expenses.⁴⁸¹ Unsecured and partly secured receivables and certain insurance claims must also be deducted from the firm’s net worth,⁴⁸² along with undue concentrations of securities.⁴⁸³ Subordinated liabilities, however, may be added back to

⁴⁷⁷ Securities Act, R.S.Q. ch. V-1.1 s. 5(2) (2006) (Can.). In Quebec, there are also categories of dealer registration with a restricted practice instead of an unrestricted practice (standard full-service securities dealers): security issuer (issuers intending to limit their activity to the distribution of their own securities), independent trader (members of recognized stock exchanges trading on their own behalf or on behalf of a dealer), dealer distributing Quebec business investment company (QBIC) shares, debt security dealer (limited to the distribution or sale of debt securities issued by the federal and provincial governments, municipalities and certain other public bodies), and any other category that may be designated by the AMF. See R.S.Q. ch. D-9.2 s. 192.

⁴⁷⁸ An Act Respecting the Distribution of Financial Products and Services, R.S.Q. ch. D-9.2 s. 72 [hereinafter FP&S Act]. However, Quebec did not decide to participate in the web-based National Registration database until January 2005. Press Release, National Registration Database Information, The Autorité des Marchés Financiers (the “AMF”) Has Announced Its Participation in the National Registration Database (NRD) (Sept. 23, 2004), available at <http://www.nrd-info.ca/news/news040923.jsp>.

⁴⁷⁹ Exchange Act, 17 C.F.R. § 240.15c3-1 (2005). The Commission is authorized to ensure that securities firms maintain reserves with respect to customers’ deposits or credit balances and establish minimum financial responsibility requirements for all brokers and dealers. 15 U.S.C. § 78o(c)(3)(A).

⁴⁸⁰ Mid America Fin. Serv., Inc., SEC No-Action Letter, 1982 WL 29920, at *3 (Nov. 8, 1982). These deductions are designated as haircuts. Haircuts are designed to reflect the price volatility, liquidity, and risk inherent in the securities firms’ proprietary accounts. 17 C.F.R. § 240.15c3-1(c)(2)(vi)(A)–(K).

⁴⁸¹ See 17 C.F.R. § 240.15c3-1(c)(2)(iv)(A).

⁴⁸² See 17 C.F.R. § 240.15c3-1(c)(2)(iv)(B)–(E).

⁴⁸³ An undue concentration of a single security means that the securities firm has a relatively large amount of the security in its proprietary account. This circumstance

net worth to determine the firm's minimum net capital requirements.⁴⁸⁴ Financial regulation is also supplemented by the Securities Investor Protection Act of 1970, which established the Securities Investor Protection Corporation (SIPC). SIPC, funded by the securities industry, provides restitution to customers of firms that are no longer financially viable.

The OSC and the CVMQ also require registered dealers to maintain sufficient capital to protect investors in the event of insolvency. The OSC requires dealers to maintain certain capital and insurance requirements.⁴⁸⁵ In Ontario, all dealers (except securities issuers) must maintain minimum capital (designated as free capital). The required amount of free capital is determined by identifying the maximum deductible under any bonding or insurance policy, plus \$25,000⁴⁸⁶ of net free capital⁴⁸⁷ and a varying percentage of adjusted liabilities.⁴⁸⁸ In addition, all dealers (except mutual fund dealers⁴⁸⁹ and security issuers) must have a broker's blanket bond in the amount of \$200,000, or a greater amount if the dealer's directors determine that a greater amount is needed.⁴⁹⁰ The CVMQ requires unrestricted dealers or discount brokers to maintain minimum capital of \$250,000; unrestricted dealers must also have a risk adjusted capital greater than \$0.⁴⁹¹ Introducing brokers must have minimum capital of \$75,000.⁴⁹² Restricted dealers must maintain minimum capital of \$50,000 plus the amount of the deductible under their broker's blanket bond or insurance policy.⁴⁹³ In addition, both unrestricted and restricted dealers must subscribe for insurance or bonding meeting minimum coverage requirements under the QSA and in accordance with applicable SROs.⁴⁹⁴ Mutual fund,

means that the firm's liquidity may be threatened if it has to liquidate a large position quickly because it may not be able to realize the security's full market value.

⁴⁸⁴ See *Mid-America Fin. Serv., Inc.*, 1982 WL 29920, at *3.

⁴⁸⁵ Securities Act, R.R.O. 1990, Reg. 1015 ss. 107-112 (2006) (Can.).

⁴⁸⁶ R.R.O. 1990, Reg. 1015 s. 107.

⁴⁸⁷ Net free capital is defined in Ontario Securities Act R.R.O. 1990, Reg. 1015 s. 96. See also R.R.O. 1990, Reg. 1015 s. 107(1)(a)-(b).

⁴⁸⁸ Adjusted liabilities are defined in R.R.O. 1990, Reg. 1015 s. 96.

⁴⁸⁹ Mutual fund dealers must maintain at least \$50,000 in bonding or insurance for each employee. See R.R.O. 1990, Reg. 1015 s. 108(2)(a), (4).

⁴⁹⁰ However, the OSC Director has discretion to waive or reduce this coverage. See R.R.O. 1990, Reg. 1015 s. 108(1).

⁴⁹¹ Autorité des marchés financiers [AMF] Securities Reg. § 207 (2005). Risk adjusted capital is calculated according to the method prescribed by the ME. In addition, the deductible under the insurance policy (blanket broker's bond), required by AMF Securities Reg. § 213 (2005), must be included in the calculation for risk adjusted capital.

⁴⁹² AMF Securities Reg. § 207.

⁴⁹³ *Id.* §§ 207-208, 213.

⁴⁹⁴ Minimum insurance or bonding coverage requirements for dealers registered in Quebec include: \$500,000 for each category of risks covered for a dealer with an unrestricted practice or for a discount broker; \$200,000 for each category of risks covered by the financial institution bond for an introducing broker; \$100,000, plus \$50,000 for each

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scholarship plan and investment contract dealers must subscribe for professional liability insurance coverage in accordance with the provisions of the FP&S Act; the AMF will not accept a financial institution bond for these categories of dealer.⁴⁹⁵ Finally, like the Commission, compliance by registered dealers and their employees with the applicable securities laws of the OSC and the CVMQ is facilitated by imposing minimum levels of proficiency assessed by examination.⁴⁹⁶

Business conduct rules are enforced and promulgated by SROs, with the approval of the Commission. The NASD's business conduct rules are designed to ensure that securities firms and their employees "observe high standards of commercial honor and just and equitable principles of trade" when dealing with investors and other members of the securities industry.⁴⁹⁷ These rules cover approximately five major categories concerning legal and appropriate business conduct by firms and their employees and associated persons in the securities industry including general standards of commercial honor and principles of trade;⁴⁹⁸ communications with customers and the public;⁴⁹⁹ transactions with customers;⁵⁰⁰ commissions, mark-ups, and charges;⁵⁰¹ special accounts;⁵⁰² securities distributions;⁵⁰³ special products;⁵⁰⁴ responsibilities to other brokers or dealers;⁵⁰⁵ responsibilities relating to associated persons, employees, and others' employees;⁵⁰⁶ and alternative dispute resolution.⁵⁰⁷ The OSC and the CVMQ also require dealers to supervise their registered salespersons, officers, and partners with a view towards ensuring compliance with Ontario and Quebec securities laws and the

employee, for a debt security dealer or a dealer distributing QBIC shares; and \$10,000 for securities advisers. AMF Securities Reg. § 213. Registration requirements for mutual fund, scholarship plan and investment contract dealers are set out in the regulations adopted under the FP&S Act. *See generally* FP&S Act, *supra* note 478.

⁴⁹⁵ AMF Securities Reg. § 213.

⁴⁹⁶ *See* Proficiency Requirements for Registrants, OSC Rule 31-502 § 2.1. These rules detail which industry courses must be completed and the level of previous registration or experience required for each type of registration. The OSC prescribes certain time limits to complete the required exams and courses. OSC Rule 31-502 § 1.2. In addition, professional training requirements for representatives of mutual fund, scholarship plan and investment contract dealers are prescribed in FP&S Act regulations. *See generally* FP&S Act, *supra* note 478.

⁴⁹⁷ NASD Manual Rule 2110 (2006).

⁴⁹⁸ NASD Manual Rule 2100 Series.

⁴⁹⁹ NASD Manual Rule 2200 Series.

⁵⁰⁰ NASD Manual Rule 2300 Series.

⁵⁰¹ NASD Manual Rule 2400 Series.

⁵⁰² NASD Manual Rule 2500 Series.

⁵⁰³ NASD Manual Rule 2700 Series.

⁵⁰⁴ NASD Manual Rule 2800 Series.

⁵⁰⁵ NASD Manual Rule 2900 Series.

⁵⁰⁶ NASD Manual Rule 3000 Series.

⁵⁰⁷ NASD Manual Rule 10300 Series.

terms and conditions imposed by the OSC and the CVMQ for registration in their respective jurisdictions.⁵⁰⁸ Included in the business conduct rules of the NASD is the “Know-Your-Customer” rule.⁵⁰⁹ Although the Know-Your-Customer Rule is not codified in the Exchange Act, it is expressly stated in the OSA and the QSA.⁵¹⁰

Under OSC Rule 31-505, § 1.5 and QSA § 161 a dealer is required to comply with the Know-Your-Client Rule.⁵¹¹ Under this Rule, a dealer is required to ascertain the identity, creditworthiness, and investment needs of its customer before recommending transactions (purchase or sale) in specific securities to the customer.⁵¹² However, this rule is limited because the dealer only has to determine customer creditworthiness if it is financing the customer’s securities transaction. In addition, if the customer has a registered adviser, the dealer is only required to determine the creditworthiness of the registered adviser.⁵¹³ Moreover, there is no obligation to ensure the suitability of the trade if the adviser gives the instruction to execute to the dealer.⁵¹⁴

Selective federal preemption facilitates consistency, and therefore reliability, in the securities regulatory framework. In the U.S., all policy, laws, and rules must be approved by one entity, the Commission. In Canada, although the provinces of Ontario and Quebec dominate Canada’s securities markets, the approval of policy, laws, and rules is a much more arduous process simply because, at least theoretically, all thirteen SRAs must agree. As we have seen, complete agreement is an anomaly.

2. Ensuring that Markets are Fair, Efficient, and Transparent

Under the IOSCO Standard, ensuring fair, efficient, and transparent markets requires regulator approval of exchange and trading system operators and their trading rules. The regu-

⁵⁰⁸ Advisers must also supervise their registered officers and partners in accordance with Ontario and Quebec securities laws and any terms and conditions imposed by the OSC and the CVMQ for registration in their respective jurisdictions. *See In re Dundee Securities Corporation Settlement Agreement*, 26 O.S.C.B. 6070, ¶ 47 (Aug. 8, 2003) (Can.).

⁵⁰⁹ NASD Manual Rule 2310 (2006).

⁵¹⁰ Securities Act, R.S.Q. ch. V-1.1 s. 161 (2006) (Can.).

⁵¹¹ *Id.*; OSC Rule 31-505 § 1.5–1.6 (1998). Section 4.1 of OSC Rule 31-505 permits the OSC Director, in his discretion, to exempt a dealer from complying with the Know-Your-Client Rule. *See In re Fidelity Investments Canada Ltd. and Valspar Inc.*, 25 O.S.C.B. 1069, app. (Feb. 12, 2002) (Can.).

⁵¹² OSC Rule 31-505 §§ 1.5–1.6 (1998).

⁵¹³ However, the dealer must ascertain the creditworthiness of the customer represented by the registered adviser if payment of the account is not guaranteed by the adviser. *See* OSC Rule 31-505 § 1.6(1)–(2) (1998).

⁵¹⁴ *See* OSC Rule 31-505 § 1.7 (1998).

latory structures for exchanges and trading systems in the U.S. and Canada are designed to detect, deter, and penalize market manipulation and other unfair trading practices. Both countries have laws and require SROs to have rules that ensure transparency of trading. Under the IOSCO Standard, transparency is defined “as the degree to which information about trading (both for pre-trade⁵¹⁵ and post-trade⁵¹⁶ information) is made publicly available on a real-time basis.”⁵¹⁷ Also, the IOSCO Standard emphasizes timely access as an integral component of transparency. “Timely access to relevant information about . . . trading allows investors to better look after their own interests and reduces the risk of manipulative or other unfair trading practices.”⁵¹⁸ In the U.S. and Canada, registered national securities exchanges (including ECNs/ATs registered as exchanges) must promulgate rules designed to prevent fraudulent and manipulative acts and practices. Moreover, they must have the capacity to enforce compliance with the rules and regulations of applicable securities laws as well as the exchange’s rules.⁵¹⁹ However, the absence of selective federal preemption in the Canadian securities regulatory framework makes this process less consistent and transparent because there is no national entity with jurisdiction over all thirteen provinces and territories. For example, RS is the SRO responsible for regulating equities trading but is only authorized to regulate equity trading in five of Canada’s thirteen provinces.⁵²⁰ Finally, the admission criteria and procedures for exchanges and trading systems in the U.S. and Canadian securities markets do not unduly favor some market users over others.

3. The Reduction of Systemic Risk

The IOSCO Standard requires merely the reduction of systemic risk because systemic risk is essential to compete successfully in the global securities market. Regulators must manage systemic risk by implementing processes and procedures designed to minimize market disruptions and their impact on the

⁵¹⁵ “Pre-trade information concerns the posting of firm bids and offers [in both quote and order-driven markets] as a means to enable investors to know, with some degree of certainty, whether and at what prices they can deal.” IOSCO Pub. Doc. 154, *supra* note 6, at 6.

⁵¹⁶ “Post-trade information is related to the prices and the volume of all individual transactions actually concluded.” *Id.*

⁵¹⁷ *Id.*

⁵¹⁸ *Id.* at 43.

⁵¹⁹ 15 U.S.C. § 78f(b) (2000); Ontario Securities Act, R.S.O. 1990, ch. S.5 s. 21 (2006); Quebec Securities Act, R.S.Q., ch. V-1.1, s.169 (2006); Alberta Securities Act, R.S.A. 2000, ch. S-4, ss. 62–63 (2006). Transactions on unregistered exchanges are strictly prohibited unless specifically exempted by the Commission upon application of Exchange Act § 5. *See* § 78e.

⁵²⁰ Market Regulation Services Inc., *About RS*, *supra* note 326.

respective securities markets. Such processes and procedures would include decreasing the risk of financial failure of market intermediaries and its impact on the securities markets,⁵²¹ facilitating adequately supervised clearing and settlement procedures that are accurate and efficient,⁵²² and cooperating and sharing information across jurisdictional boundaries in the global securities market.⁵²³

Both the U.S. and Canada include procedures and processes designed to reduce systemic risk. Both regulatory frameworks have systems in place that reduce the impact of financial failures of market intermediaries, supervised clearing and settlement procedures, and have entered into cooperation and information sharing both inside and outside their respective jurisdictions.⁵²⁴ However, the use of selective federal preemption provides greater flexibility and efficiency with respect to decreasing systemic risk in the U.S. securities regulatory framework. The author concedes that the Commission must consult with various stakeholders in the securities markets before implementing rules for administering federal securities laws. However, after the consultative process is complete, the Commission has the authority, indeed the mandate, to promulgate and to enforce the rules nationwide.⁵²⁵ In Canada, the absence of selective federal preemption makes promulgating rules designed to reduce systemic risk slow and unnecessarily complex. The fragmented Canadian securities regulatory framework, at a minimum, would make cooperation and information sharing in the pursuit of stability more difficult. Moreover, systemic stability cannot be protected in a system in which each SRA is autonomous and there is no federal regulatory authority to consistently facilitate systemic stability in Canada's securities markets. Although all of Canada's SRAs are members of the CSA, membership, and more importantly adoption in whole or in part of CSA national instruments designed to reduce systemic risk, is voluntary. Without federal preemption, there is no single federal regulatory author-

⁵²¹ This means establishing systems and procedures that attempt reasonably "to isolate the risk to the failing institution." This would include specifying minimum capital requirements for market intermediaries and establishing and maintaining various programs for market intermediaries designed to reduce systemic risk. IOSCO Pub. Doc. 154, *supra* note 6, at 6-7.

⁵²² The IOSCO Standard defines clearing and settlement systems as "systems providing the process of presenting and exchanging data or documents in order to calculate the obligations of the participants in the system, to allow for the settlement of these obligations, and the process of transferring funds [and/or] securities." *Id.* at 45.

⁵²³ *Id.* at 7.

⁵²⁴ See generally *id.*

⁵²⁵ See SEC, What We Do, <http://www.sec.gov/about/whatwedo.shtml> (last visited Sept. 26, 2006) (noting that the SEC works closely with many other institutions, but remains the primary overseer and regulator of the U.S. securities markets).

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ity empowered to set a coherent policy by mandating that all provinces adhere to national instruments promulgated by the CSA. The CSA is comparable to NASAA, where member participation is voluntary and adoption of the Uniform Securities Act *is not* mandatory.

B. The IOSCO Standard for Securities Regulator: Selective Federal Preemption Requires a Federal Securities Regulator

Selective federal preemption combined with a federal securities regulator is required to meet the IOSCO Standard for securities regulator (IOSCO Standard Regulator) in the global securities market.⁵²⁶ Only a regulator at the federal level will have the requisite power to make decisions that bind all securities markets and market participants. The IOSCO Standard Regulator: (1) is operationally independent because it has sufficient and stable funding; (2) is accountable based on public monitoring and judicial review of orders issued in connection with its regulatory activities; (3) is clear, consistent, transparent, and fair in the exercise of its authority and formulation of policy, and considers whether its regulatory activities unnecessarily burden capital formation; (4) actively promotes investor and other market participant education because it recognizes that its regulatory framework is based on disclosure of material facts; (5) uses the assistance of SROs to meet its regulatory functions and responsibilities; (6) has comprehensive enforcement powers; and (7) has the authority to conduct cross-border activities, e.g., to obtain and provide information to its regulatory counterparts in other countries.⁵²⁷

The securities regulators in the U.S. and Canada (specifically Ontario and Quebec) have many of the attributes enumerated in the IOSCO Standard Regulator. The Commission, the OSC, and the AMF/CVMQ have a stable and sufficient source of funding. The Commission's entire budget is funded from fee collection generated by statutorily required filings by market participants. All fees collected are deposited in the U.S. Treasury except the portion used to fund the Commission's budget. Total fees collected are more than sufficient to fund the Commission's budget. In 2003, total fees collected were \$1.076 billion,⁵²⁸ of

⁵²⁶ However, IOSCO contends that "[t]here need not be a single regulator, [and that] [i]n many jurisdictions, the desirable attributes of the regulator . . . are in fact the shared responsibility of two or more government or quasi-government agencies." IOSCO Pub. Doc. 154, *supra* note 6, at 9 n.11.

⁵²⁷ *Id.* at 9–16.

⁵²⁸ 25% was from securities registrations, 74% was from securities transactions, and 1% was from tender offer, merger, and other filings. SEC, ANNUAL REPORT 2003, at 4 (2003), available at <http://sec.gov/pdf/annrep03/ar03full.pdf>.

which \$716.4 million was used to fund the Commission. The OSC and AMF/CVMQ are also funded from fees paid by market participants. In 2004, fees collected by the OSC totaled \$76.61 million and expenses totaled \$54.97 million, generating a surplus of \$21.64 million.⁵²⁹ In 2004–05, AMF/CVMQ revenues totaled \$94.7 million with a surplus of \$28.7 million.⁵³⁰ The Commission, the OSC, and the AMF/CVMQ are all publicly monitored and orders issued by the three regulators are subject to judicial review. Each of the three regulators also have education programs for the investing public and securities markets participants. In addition, the Commission, the OSC, and the AMF/CVMQ delegate many of their regulatory functions to SROs under their jurisdictions; SROs performing regulatory functions on behalf of the three regulators are overseen by the applicable regulator.

The U.S., but not Canada, substantially incorporates the IOSCO Standard Regulator attributes of clear and consistent exercise of authority, formulation of policy, and comprehensive enforcement. According to the IOSCO Standard for a securities regulator, these attributes in a securities regulator are required to compete successfully in the global securities market.⁵³¹ The U.S. has established a regulator at the federal level using selective federal preemption to consistently exercise authority, formulate policy, and conduct comprehensive enforcement. This federal regulator, the Commission, is legally authorized to represent and make binding decisions for the U.S. securities markets in the global securities market.⁵³² Each of Canada's thirteen regulators is statutorily empowered to exercise authority, formulate policy, and conduct comprehensive enforcement *only within their respective borders*. Only the CSA purports to represent Canada's thirteen SRAs at the national level, but participation, and adherence to CSA decisions, is purely voluntary.

It is impossible to achieve the IOSCO Regulator Standard without using selective federal preemption implemented by a securities regulator at the federal level. Each of the securities regulators in Canada and the U.S. has substantially the same attributes as those enumerated in the IOSCO Standard for a securities regulator. However, Canada does not have a securities regulator at the federal level to ensure consistency in the exercise of authority, policymaking and enforcement in all thirteen prov-

⁵²⁹ OSC, 2004 MANAGEMENT'S DISCUSSION AND ANALYSIS 2 (2004), available at http://www.osc.gov.on.ca/About/AnnualRpt/rpt_index.jsp (follow "Management's Discussion and Analysis in PDF" hyperlink below the heading "2004").

⁵³⁰ AMF RAPPORT ANNUEL 2004–2005, at 36 (2005) (Can.).

⁵³¹ IOSCO Pub. Doc. 154, *supra* note 6, at i–ii.

⁵³² See SEC, What We Do, *supra* note 525.

inces. Successfully competing in the global securities market requires a regulator at the federal level using selective federal preemption to regulate securities markets. The U.S. understands the importance of a securities regulator at the federal level to maintain its competitive position in the global securities market. Therefore, it consolidates regulatory authority in the Commission, its securities regulator at the federal level, with increasing use of selective federal preemption in its securities regulatory framework.

1. The Absence of Selective Federal Preemption and a Federal Securities Regulator Adversely Impacts Canada's Securities Regulatory Framework

The absence of a federal securities regulator and selective federal preemption causes the location of a securities transaction to be unusually significant in the Canadian securities regulatory framework.

This is because each province only has jurisdiction within its own borders. In Ontario, jurisdiction under the OSA is determined by "whether a person has engaged in 'trading' in a security so as to give rise to the dealer registration requirement in s. 25(1)(a)."⁵³³ Section 25(1)(1) of the OSA defines trade as "any act, advertisement, solicitation, conduct or negotiation directly or indirectly in furtherance of" a sale or purchase of a security.⁵³⁴ This definition is problematic because, frequently, all the components of a securities transaction do not occur in a single province. This means that in each case brought by provincial securities regulators, jurisdiction may be raised as a first defense of the party being sued instead of addressing first whether there has been a violation of the OSA. In addition, factors identified in each province to determine the location of a securities transaction (and thus provincial jurisdiction) may vary considerably. This fact alone would cause inconsistency in the exercise of authority and enforcement as well as make it more difficult to attract capital to Canadian securities markets. In a Quebec case, *Gregory & Co. v. Quebec Securities Commission*, the court determined that a promoter, doing business in Quebec was trading in securities in Quebec even though the promoter mailed bulletins to prospective investors in provinces other than Quebec.⁵³⁵ In *R. v. W. McKenzie Securities Ltd.*, a court in the province of Manitoba determined that an Ontario broker-dealer was trading in se-

⁵³³ 1 VICTOR P. ALBOINI, *SECURITIES LAW AND PRACTICE* § 11.1.5 at 11-28 (2d ed. 1984).

⁵³⁴ The definition also includes an offer to sell. *Id.*

⁵³⁵ *Id.* § 11.1.5 at 11-29 (citing [1961] S.C.R. 584).

curities in Manitoba because it mailed literature and made telephone calls to Manitoba residents.⁵³⁶

In *Gregory*, the promoter had three offices in Quebec and its registration as a broker in Quebec had been revoked for refusing to cease publishing his weekly bulletins. Subsequently, the promoter alleged lack of jurisdiction in Quebec even though his activities included: (1) preparing and printing its bulletin in Quebec; (2) soliciting trades in securities listed on the Montreal Exchange from non-Quebec residents; (3) asserting its ability to execute trades through the Montreal Exchange; (4) accepting payment for trades from non-Quebec residents in its offices in Quebec; and (5) maintaining its bank accounts in Quebec.⁵³⁷ In addition, the shares of companies in which the promoter solicited to non-Quebec residents could only be transferred in Quebec. Trading in securities was found by the court based on the fact that the shares were traded on the Montreal Exchange. The court might not have reached the same result if the company's shares were traded on an exchange located outside of the province of Quebec.

In *McKenzie*, the Manitoba court determined that trading occurred within Manitoba's jurisdiction even though the dealer was registered in Ontario because: (1) the dealer made telephone calls and mailed literature to a Manitoba resident for the purpose of soliciting orders to purchase shares in various companies and (2) the Manitoba resident responded to the broker-dealer's solicitations by agreeing to purchase such shares and paying for his purchase with a check from his bank account maintained at a Manitoba bank and mailing the check to the dealer in Toronto.⁵³⁸ The Court determined that the trade took place at least in part in Manitoba and that

[t]he *Securities Act* of Manitoba is not designed to reach out beyond provincial borders and to restrain conduct carried on in other parts of Canada or elsewhere. Its operation is effective within Manitoba, and nowhere else. For a person to become subject to its restraint he must trade in securities in Manitoba. This is not to say that a non-resident of Manitoba can never become subject to the controls of the statute. If the activities of such a non-resident can fairly and properly be construed as constituting trading within the province, then they fall within the purview of the Act.⁵³⁹

⁵³⁶ *Id.* (citing [1972] S.C.R. 409).

⁵³⁷ *Gregory & Co. v. Quebec Sec. Comm'n*, [1961] S.C.R. 584, 586–89.

⁵³⁸ ALBOINI, *supra* note 533, at 11–30.

⁵³⁹ *Id.* See also *Midland Doherty Ltd. v. Zonailo*, [1982] 36 B.C.L.R. 326, 339 (giving supplementary reasons for judgment); *rev'd on other grounds*, [1983] 43 B.C.L.R. 138 (B.C. Ct. App.); *In re a Company*, June 1968 O.S.C.B. 129, 132 (“[F]urnishing the potential purchaser at his request with a prospectus and an order form” constitutes trading be-

Moreover, to add to the lack of consistency and clarity, each province has discretion to provide a waiver to persons with respect to determining location of trade under its securities act and applicable case law. In *In the Matter of a Company*, the OSC decided not to impose sanctions based on equitable reasons despite the fact that precedent indicated violations of the OSA requiring the imposition of sanctions.⁵⁴⁰ In *Company*, the OSC alleged that a company, through its three directors, violated the OSA by trading as an issuer and by way of primary distribution in Ontario without an Ontario prospectus. The company was registered in British Columbia and had a British Columbia prospectus. The company's three directors were residents of British Columbia, but one of the directors was formerly a resident of Ontario and was also "known to a number of people in [Ontario] . . . to have brought a mine to success in each of two former ventures. Without solicitation from the company or its directors these people and their friends . . . wrote to the company in Vancouver [British Columbia] requesting a prospectus."⁵⁴¹ Based on advice from the issuer's lawyer, the issuer sent copies of its British Columbia prospectus and a subscription form to the people residing in Ontario, issued shares to the Ontario residents upon receipt of their checks, and completed subscription forms. The OSC determined that the company and its three directors violated the OSA by distributing and trading the company's securities in Ontario without an Ontario registration and prospectus. The OSC held that

by using the Post Office to place the British Columbia prospectus and the order form in the hands of the prospective purchasers in Ontario . . . [the company and its directors had 'traded' in Ontario and] . . . [t]he fact that there was no act of solicitation and the fact that the final acts of sale and issue of the shares took place in British Columbia and not in Ontario . . . is beside the point; furnishing the potential purchaser at his request with a prospectus and an order form were acts done in furtherance of a sale and done in Ontario. [S]ending from outside Ontario and in response to a spontaneous request a prospectus and an order form to a person in Ontario constitutes sufficient dealing in Ontario with members of the Ontario public to call for their protection by the supervisory devices of registration and prospectus filing exercised by the Ontario Securities Commission in pursuance of the Ontario Act.⁵⁴²

In *Company*, the discretion exercised by the OSC in not imposing sanctions despite recognized violations of the OSA ad-

cause such activities are considered "acts done in furtherance of a sale and done in Ontario.").

⁵⁴⁰ *In re a Company*, June 1968 O.S.C.B. at 133.

⁵⁴¹ *Id.* at 130-32.

⁵⁴² *Id.* at 132-33.

versely impacts Canada's securities regulatory framework. Clarity and consistency in enforcement of securities acts are essential to a globally competitive securities market. Such uneven enforcement of the OSA reduces the consistency and clarity of the Canadian securities regulatory framework. It also makes it more difficult for lawyers to advise their clients when they are unsure of whether a particular regulatory requirement might be waived by one of Canada's thirteen provincial securities regulators. Lack of consistency in enforcement of provincial securities laws leads to increased costs to ensure compliance with applicable requirements in the fragmented Canadian securities regulatory framework.

a. NASDAQ Canada⁵⁴³ and the Renegade Province of Quebec

NASDAQ Canada is an excellent example of why selective federal preemption implemented by a securities regulator at the federal level is necessary to compete successfully in the global securities market. NASDAQ Canada was established in response to Canada's reorganization of its securities markets in order to increase its competitiveness in the global securities market. Initially, Canadian SRAs understood that consolidation was required in order to maintain the viability of Canada's securities markets in the global securities market. However, the agreement brokered in 1999 to consolidate Canada's securities market completely disintegrated when the province of Quebec, and subsequently British Columbia, decided to withdraw from the 1999 agreement and allow NASDAQ U.S. to establish NASDAQ Canada in Montreal, Quebec.⁵⁴⁴ As a consequence, the Canadian securities regulatory framework was essentially invaded by the U.S. securities regulatory framework. The U.S., through NASDAQ Canada, now had regulatory control over a portion of Canada's securities markets, and Quebec again had equity trading within the province.

Quebec amended its laws to allow the creation of NASDAQ Canada and provide primary regulatory control of NASDAQ Canada to the U.S. "[NASDAQ] Canada is a recognized [SRO] under Quebec law for purposes of carrying on business in Que-

⁵⁴³ NASDAQ Canada was initially established to become a "standalone Canadian [securities] market on the [NASDAQ] trading platform Phase 2 of [NASDAQ] Canada[] was to have been an ambitious attempt to create an electronic market competing directly with the Toronto Stock Exchange and nascent alternative trading systems." It was going to be "a new exchange in Canada . . . trad[ing] Canadian stocks in Canadian dollars." Marotte, *supra* note 357, at B5.

⁵⁴⁴ NASDAQ Canada's incentive package included a 10-year tax holiday. Marotte, *supra* note 543.

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bec. NASDAQ Canada's parent, [NASDAQ U.S.], is similarly recognized as an SRO under Quebec law for purposes of carrying on business in Quebec."⁵⁴⁵ Moreover, "[t]he rules of NASDAQ Canada are those of NASDAQ [U.S.] and are overseen by the [U.S.] Securities and Exchange Commission"⁵⁴⁶ NASDAQ Canada allows the Canadian dealer to have an NASD affiliate incorporated in the U.S. but co-located within the Canadian dealer's office in Quebec. Dually-engaged employees are also permitted, "thus reducing costs and enabling better compliance and regulatory controls."⁵⁴⁷ The Canadian dealer's NASD affiliate must be registered with the Commission and must be a member of the NASD. Accordingly, the Canadian dealer's NASD affiliate is not required to become registered in Quebec nor to become a member of the IDA.⁵⁴⁸ However, the Canadian dealer of the NASD affiliate must remain an IDA member in good standing.⁵⁴⁹ Quebec also attempts indirect regulation of the NASD affiliate by requiring the Canadian dealer to: (a) have dually-engaged employees with its NASD affiliate; (b) require its NASD affiliate to comply with NASD rules and, therefore, with U.S. securities laws, rules, and regulations; (c) require its NASD affiliate to have only exempt clients and to only engage in U.S. transactions; and (d) require its NASD affiliate to consent to the jurisdiction, in any action or proceedings, of any provincial or provincially-recognized SRA in the province.⁵⁵⁰ Apparently, Quebec believes that it has maintained regulatory control by sharing regulatory authority with the U.S. However, this patchwork regulatory framework probably makes the Canadian securities regulatory framework even more difficult to navigate and it may have an anticompetitive effect in the global securities market.

Supporters of NASDAQ Canada contend that the primary benefit of NASDAQ Canada is to allow small to medium broker-

⁵⁴⁵ Romano, *supra* note 358, at 1. NASDAQ Canada was recognized similarly by the province of British Columbia. In both provinces, registered dealers establish affiliates (incorporated in the U.S. but headquartered in the province), as well as the facilities, of the applicable Canadian dealer. As previously discussed, this allowed such affiliates to trade directly through NASDAQ U.S.'s facilities. *Id.* at 3.

⁵⁴⁶ *Id.* at 2. According to Mr. Romano, prior to the establishment of NASDAQ Canada, many Canadian dealers transmitted orders to NASDAQ U.S. indirectly using ECNs, their U.S. broker/dealer affiliates or other U.S. broker-dealers, who then transmitted such orders directly to [NASDAQ] U.S. However, such indirect access methods were "administratively cumbersome." Direct access would "reduce costs, enhance market visibility and transparency for Canadian dealers, . . . reduce customer risk, and [benefit] Canadian capital markets generally." *Id.*

⁵⁴⁷ *Id.* at 3.

⁵⁴⁸ Provided that the NASD affiliate only has clients classified as accredited investors and other clients who do not require Canadian registration (i.e., non-exempt clients) and only execute U.S. transactions. *Id.*

⁵⁴⁹ *Id.*

⁵⁵⁰ *Id.* at 3-4.

dealers to directly, and therefore less expensively, access U.S. capital markets.⁵⁵¹ Unfortunately (or fortunately, according to one's perspective), the Canadian securities marketplace operates next to the largest securities marketplace in the world, therefore making it vulnerable to being gobbled up by the U.S. securities markets, or at least becoming a "branch investment banking" securities market for the U.S. securities markets.

NASDAQ Canada may be the first step in diminishing the relevance of the Canadian securities markets in the global securities market. This diminution of importance would lead to Canada taking a "back seat" on the bus of meaningful participation in shaping the regulatory structure of the global securities market.

C. Selective Federal Preemption Implemented by a Federal Securities Regulator—Lesson Learned

The U.S. and Canada are quite similar in their approaches to the framework for securities regulation; the primary difference is that the U.S. has a single federal regulatory authority, the Commission, to guide policy and to ensure consistency both domestically and in the global securities marketplace. The U.S.'s understanding of the importance of a single federal regulatory authority is reflected in the steady increase in federal preemption in its securities regulatory framework. Given the experiences of our neighbor to the north, increasing federal preemption in the U.S. securities regulatory framework is the better strategy for at least maintaining the competitiveness of securities markets in the global securities marketplace; regulatory power selectively consolidated in a federal regulator, the Commission, enables the U.S. to speak with one voice in the global securities marketplace, craft a coherent policy, and provide consistent enforcement of its securities regulatory framework. This is important from a global perspective because regulatory authorities in the global securities market only need to negotiate with one entity when dealing with the U.S. securities markets. In Canada, they must negotiate with thirteen provinces if they wish to access all Canadian securities markets. This is the primary reason that the Commission reacted so strongly to the actions of New York Attorney General Spitzer. Given the importance of the NYSE, domiciled in Spitzer's jurisdiction, in the overall U.S. securities regulatory framework, actions taken in the state of New York have policy implications for all U.S. securities markets. Although Spitzer is to be applauded for his excellent work, it is not in the best inter-

⁵⁵¹ *Id.* at 3.

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ests of U.S. securities markets to allow one state—New York—to set policies for all U.S. securities markets.⁵⁵² Moreover, market participants, especially issuers, should not be held to a higher standard in one state despite its preeminence in the U.S. securities markets. A domestically and globally competitive securities market must treat substantially similar conduct equally. This means that Spitzer, and any other SSRA, must consult with the Commission to ensure that the U.S. securities markets continue to “speak with one voice” and therefore remain competitive in the global securities market.

Lest I offend my brethren to the north, they, too, realize the importance of selective federal preemption implemented by a federal securities regulator. The Canadian federal government (Ottawa), along with market participants and issuers, recognizes the need for a single federal regulator to compete successfully in the global securities market. Ottawa realizes that Canada’s fragmented securities regulatory framework causes significant transaction delays and the imposition of onerous costs because market participants must deal with thirteen SRAs. Moreover, a senior securities counsel in Canada asserted that “[a]ll other problems pale in comparison to the lack of harmonization” between Canada’s thirteen provinces.⁵⁵³ Moreover,

at the end of the day, [Canada] will still have 13 securities regulators instead of one. International investors, and indeed Canadians, will still be drawn to the clarity of the U.S. regime, over the relative complexity of [Canada’s]. And Canadian public companies will continue to overwhelmingly call for more dramatic reform, to no avail. Only in Canada.⁵⁵⁴

“[I]t is simply not credible to argue that the involvement of multiple regulators that exists [sic] within the CSA can achieve the efficiency of a national securities regulator.”⁵⁵⁵ Under Canada’s securities regulatory framework, “it is not entirely clear who, if anyone, speaks for Canada.”⁵⁵⁶ Moreover, Barbara Stymiest, the CEO of the TSX, echoing the sentiments of the Ontario’s Minister

⁵⁵² Note that New York, like Ontario, houses the largest and most powerful securities markets and exchanges in the nation’s securities markets. See NYC.com, Financial District (Lower Manhattan), http://www.nyc.com/visitor_guide/Financial_District_Lower_Manhattan.75852/editorial.aspx (last visited Oct. 23, 2006) (noting that New York “houses some great economic powerhouses, including the headquarters of major banks, the New York Stock Exchange, [and] the World Financial Center”).

⁵⁵³ REGULATORY BURDEN TASK FORCE, REPORT TO THE ONTARIO SECURITIES COMMISSION 10 (2003), available at http://www.osc.gov.on.ca/About/Governance/Accountability/ga_20031212_rbtfrpt.pdf.

⁵⁵⁴ Michael Den Tandt, *Charest Won’t Want Single Regulator*, GLOBE AND MAIL (Can.), Apr. 17, 2003, at B2.

⁵⁵⁵ FIVE YEAR REVIEW COMMITTEE FINAL REPORT, *supra* note 34, at 37 (quoting comment letter on the Issues List of Torys LLP).

⁵⁵⁶ *Id.*

of Finance, stated that

the current system, fractured as it is, burdens companies with duplicative costs and impairs Canada's stature on the world stage. . . .

. . . .

[Moreover,] Canada must "get its act together" and begin speaking with a unified voice. The U.K. securities watchdog, for instance, refuses to open up trading on its exchanges to Canadian brokerages on a province-by-province basis, while China's regulator has expressed its displeasure at having to negotiate a recent deal with four separate provinces ⁵⁵⁷

The author of this article would extend this sentiment one step further. Most likely, Canadian companies would also bypass Canadian capital markets given the proximity of the U.S. securities markets if their securities could be traded in both Canadian and U.S. dollars. In fact, Level II of NASDAQ Canada included allowing users to trade in Canadian companies listed on NASDAQ Canada from either the U.S. or Canada *simultaneously* in either Canadian or U.S. dollars.⁵⁵⁸ If this were to occur, Canadian issuers would probably be sorely tempted to bypass Canadian capital markets altogether.

CONCLUSION

*Federal preemption should be crafted to "clear away some of the regulatory underbrush that adds to the cost of capital[,] without compromising investor protections."*⁵⁵⁹

Selective federal preemption administered by a federal securities regulator is the better regulatory model for competing successfully in the global securities market. Congress apparently understands this, based on the trend of increasing selective federal preemption in the securities regulatory framework of the U.S. securities markets. State authority to bring securities fraud cases should be preserved in the delicate balance of selective federal preemption because state securities regulators have a strong interest in putting away "the bad guys" within their jurisdictions. "Bringing suit for common law fraud in no way interferes with the regulatory mandates of the [federal government] [T]he purpose underlying state common law fraud actions—to deter fraudulent practices—is consistent with federal securities

⁵⁵⁷ Sinclair Stewart & Heather Scofield, *Ottawa to "Act Quickly" to Pave Way for National Securities Watchdog*, GLOBE AND MAIL (Can.), Mar. 24, 2004, at B12.

⁵⁵⁸ Press Release, NASDAQ, Helen Kearns Named President of NASDAQ Canada (May 1, 2001), available at http://www.nasdaq.com/newsroom/news/pr2001/ne_section01_143.html.

⁵⁵⁹ Rachel Witmer, *Legislation: Congress Passes Major Securities Bill; Clinton Expected to Sign It* OMB Says, 28 Sec. Reg. & L. Rep. (BNA) 1211, 1212 (1996).

law . . . as both seek to deter fraud.”⁵⁶⁰ Federal preemption must be carefully used to “‘maintain uniformity and certainty’ in U.S. securities markets so that they may remain ahead of markets ‘in London, Frankfurt, Tokyo or Hong Kong.’”⁵⁶¹ Moreover, allowing the Commission to operate exclusively in certain areas in which it previously shared regulatory authority with state SRAs led to a reduction in cost, complexity, and redundancy.

Federal preemption also supports the flexibility required to compete successfully in the global securities marketplace. Enron, Worldcom, Adelphia, and their ilk dealt a severe blow to investor confidence and the perceived transparency and fairness of U.S. securities markets. Without a regulatory framework incorporating selective federal preemption and a federal securities regulator, the necessarily rapid regulatory response to shore up investor confidence and the perceived fairness and transparency of U.S. securities markets would likely not have occurred. A swift response was necessary to ensure that U.S. securities markets remain the premier markets in the world. A tarnished U.S. securities marketplace could result in foreign investors less likely to invest in U.S. issuers, depriving issuers of an important source of capital. In turn, investors would have less investment opportunities because issuers would be less willing to access capital markets perceived as lacking fairness and transparency.

It is obvious that the principle of cooperation or harmonization of securities laws between state or provincial securities regulators is not feasible. The primary problem is that none of the members of the CSA or NASAA are required to adopt uniform securities laws and regulations that have not been adopted by their legislators. Also, wholesale adoption of the provisions of uniform laws is simply not the norm.

The consequence of not “speaking with one voice” is, at best, becoming irrelevant in setting policy in the regulatory framework for the global securities market.

⁵⁶⁰ *Common Law Fraud Claims Not Preempted By Federal Securities Law*, *Court Concludes*, 33 Sec. Reg. & L. Rep. (BNA) 1634, 1635 (2001).

⁵⁶¹ Witmer, *Litigation Reform*, *supra* note 3, at 1402.

The Supreme Court and the President: Toward a Balancing Test with Bite

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INTRODUCTION

With President Reagan’s formal apology and reparation payments in 1988 to Japanese-Americans who were interned during World War II,¹ many felt that a troublesome chapter in

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¹ Civil Liberties Act of 1988, 50 U.S.C. app. § 1989b-4 (2000).

United States history had closed. After Pearl Harbor was attacked on December 7, 1941, approximately 120,000 American citizens and aliens of Japanese ancestry were evacuated from their homes on the West Coast.² They were gathered at assembly centers and relocated to internment camps throughout the country.³ The internment of Japanese-Americans was immediately condemned by legal scholars as “the worst blow our liberties have sustained in many years.”⁴ Although internment was a drastic measure, many believed that it was an anomalous response to a catastrophic attack that could not happen again.

The events of September 11, 2001 shattered the sense of security that Americans had enjoyed for several decades. For the first time since Pearl Harbor was invaded sixty years earlier, there was an attack on American soil that cost thousands of lives. President Bush and Congress reacted to the attacks with swift military action⁵ and new domestic security laws.⁶ In the ensuing years, several lawsuits challenged the constitutionality of those measures before the Supreme Court.⁷

Historically, the Supreme Court has responded to the President’s wartime actions in two ways. At times, the Court has used a deferential balancing model to weigh the President’s assertion of wartime necessity against the protection of civil liberties.⁸ Under this model, the Court interprets constitutional principles broadly to allow presidential actions during wartime that it would find unconstitutional in peacetime.⁹ The Court limits the role of judicial review by refusing to examine the reasonableness of the President’s actions.¹⁰ Advocates of the deferential balancing model argue that the Court should not interfere with the President’s protection of national security during temporary wartime periods.¹¹ However, critics of the model assert that the

² TETSUDEN KASHIMA, JUDGMENT WITHOUT TRIAL: JAPANESE AMERICAN IMPRISONMENT DURING WORLD WAR II, at 4 (2003).

³ *Id.*

⁴ Eugene V. Rostow, *The Japanese American Cases—A Disaster*, 54 YALE L.J. 489, 490 (1945).

⁵ See Authorization for Use of Military Force, Pub. L. No. 107-40, 115 Stat. 224 (2001).

⁶ See Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism (USA PATRIOT) Act, Pub. L. No. 107-56, 115 Stat. 272 (2001).

⁷ See, e.g., *Hamdi v. Rumsfeld*, 124 S. Ct. 2633, 2650 (2004).

⁸ See, e.g., *Korematsu v. United States*, 323 U.S. 214, 219 (1944).

⁹ Oren Gross, *Chaos and Rules: Should Responses to Violent Crises Always Be Constitutional?*, 112 YALE L.J. 1011, 1059 (2003). Gross calls this model “interpretive accommodation.”

¹⁰ *Korematsu*, 323 U.S. at 235 (Murphy, J., dissenting) (“In adjudging the military action taken . . . it is necessary only that the action have some reasonable relation to the removal of the dangers of invasion, sabotage and espionage.”).

¹¹ Eric A. Posner & Adrian Vermeule, *Accommodating Emergencies*, 56 STAN. L. REV.

Court's failure to scrutinize presidential policies has allowed policies based on animosity toward unpopular groups to be justified as national security measures.¹²

At other times, the Court has responded to the President's wartime actions by invoking justiciability doctrines to avoid addressing the merits of a particular issue until the emergency has subsided.¹³ Under the justiciability doctrines model, the Court applies procedural grounds like the political question doctrine and standing to avoid establishing a precedent that would condone constitutional violations.¹⁴ Supporters of the justiciability doctrines model argue that the Court should not demand that military policies conform to constitutional principles when they are needed to protect the country.¹⁵ Some measures essential to winning a war may be unconstitutional.¹⁶ Those supporters be-

605, 627 (2003).

¹² Rostow, *supra* note 4, at 491. Rostow states that in *Korematsu*, the Court "upheld an act of military power without a factual record in which the justification for the act was analyzed." *Id.* See also *Korematsu*, 323 U.S. at 239–40 (Murphy, J., dissenting) ("A military judgment based upon such racial and sociological considerations is not entitled to the great weight ordinarily given the judgments based upon strictly military considerations.").

¹³ See, e.g., *Hirabayashi v. United States*, 320 U.S. 81 (1943).

¹⁴ Posner & Vermeule, *supra* note 11, at 606 n.1.

¹⁵ *Korematsu*, 323 U.S. at 244–45 (Jackson, J., dissenting). Justice Jackson explains the justification for the justiciability doctrines model as follows:

It would be impracticable and dangerous idealism to expect or insist that each specific military command in an area of probable operations will conform to conventional tests of constitutionality. When an area is so beset that it must be put under military control at all, the paramount consideration is that its measures be successful, rather than legal. The armed services must protect a society, not merely its Constitution. . . . No court can require such a commander in such circumstances to act as a reasonable man; he may be unreasonably cautious and exacting. . . .

. . . .

In the very nature of things, military decisions are not susceptible of intelligent judicial appraisal. They do not pretend to rest on evidence, but are made on information that often would not be admissible and on assumptions that could not be proved. . . . Hence courts can never have any real alternative to accepting the mere declaration of the authority that issued the order that it was reasonably necessary from a military viewpoint.

Id.

¹⁶ *Id.* at 245–46. Jackson argues that the internment of Japanese-Americans is a violation of civil liberties. However, the Court's decision upholding the internment under the Constitution was much worse than the internment order itself:

Much is said of the danger to liberty from the Army program for deporting and detaining these citizens of Japanese extraction. But a judicial construction of the due process clause that will sustain this order is a far more subtle blow to liberty than the promulgation of the order itself. A military order, however unconstitutional, is not apt to last longer than the military emergency. . . . But once a judicial opinion rationalizes such an order to show that it conforms to the Constitution, or rather rationalizes the Constitution to show that the Constitution sanctions such an order, the Court for all time has validated the principle of racial discrimination in criminal procedure and of transplanting

lieve that the Court should not exercise judicial review to validate a policy that is necessary, but clearly unconstitutional.¹⁷ However, critics of the justiciability doctrines model argue that by failing to hear cases during wartime, the Court avoids its constitutionally-mandated duty to protect citizens' rights.¹⁸

The major problem with both models, however, is that they are inconsistent with the Founding Fathers' beliefs.¹⁹ The Framers passionately believed that the President and Congress could not ignore constitutional principles.²⁰ They established a Supreme Court with a constitutionally-mandated duty to prevent oppressive government actions passed in times of war and hysteria.²¹ The Founders believed that a plea of military necessity should not be used to violate fundamental constitutional rights.²²

Counterbalancing the Founders' strict adherence to protecting constitutional rights was their belief that national security was extremely important.²³ The Court has often failed to take this into account by inflexibly interpreting the Constitution.²⁴ The Founding Fathers believed that the President should have sufficient power to protect the nation against foreign attacks,²⁵ but the Court's unduly restrictive interpretation can prevent the President from defending against sudden attacks.²⁶ During im-

American citizens. The principle then lies about like a loaded weapon ready for the hand of any authority that can bring forward a plausible claim of an urgent need.

Id.

¹⁷ *Id.* at 244–46.

¹⁸ See, e.g., THE FEDERALIST NO. 78, at 469 (Alexander Hamilton) (Clinton Rossiter ed., 1961) (“[T]he courts of justice are to be considered as the bulwarks of a limited Constitution against legislative encroachments . . .”).

¹⁹ *Id.* at 470 (“Until the people have, by some solemn and authoritative act, annulled or changed the established form, [the Constitution] is binding upon themselves collectively, as well as individually; and no presumption, or even knowledge of their sentiments, can warrant their representatives in a departure from it prior to such an act.”).

²⁰ *Id.*

²¹ See *id.* (“[I]t is easy to see that it would require an uncommon portion of fortitude in the judges to do their duty as faithful guardians of the Constitution, where legislative invasions of it had been instigated by the major voice of the community.”).

²² See *id.*; THE FEDERALIST NO. 8 (Alexander Hamilton), *supra* note 18, at 69–70.

²³ THE FEDERALIST NO. 41 (James Madison), *supra* note 18, at 256 (“Security against foreign danger is one of the primitive objects of civil society. It is an avowed and essential object of the American Union.”).

²⁴ See, e.g., *Ex parte Merryman*, 17 F. Cas. 144, 148–50 (C.C.D. Md. 1861) (No. 9487) (holding that even in times of war, the President does not have the power to suspend the writ of habeas corpus).

²⁵ THE FEDERALIST NO. 70 (Alexander Hamilton), *supra* note 18, at 423 (“Energy in the executive is a leading character in the definition of good government. It is essential to the protection of the community against foreign attacks.”).

²⁶ See, e.g., *Merryman*, 17 F. Cas. at 149. Justice Taney inflexibly interprets the Constitution during the Civil War. In response to imminent danger that Confederate forces would invade Washington, D.C., President Lincoln ordered General Cadwalader to suspend the writ of habeas corpus. He did not get permission from Congress before doing so. In *Merryman*, Justice Taney harshly criticized President Lincoln for unilaterally sus-

minent threats to national security, constitutional principles must be tempered by the President's need to protect the nation.

This comment advocates the balancing test with bite model, which the Court adopted in *Hamdi v. Rumsfeld*.²⁷ This model is most consistent with the Founding Fathers' views because it provides all three branches with important roles during wartime.²⁸ The Court in *Hamdi* exercised its constitutionally-mandated duty to judicially review the President's wartime actions.²⁹ It also demanded evidence to support a citizen's detention,³⁰ while accommodating the military's needs by lowering its evidentiary burden.³¹ At the same time, however, the Court balanced its protection of citizens' rights with the President's interest in conducting the war by reaffirming the holding in *Ex parte Quirin*, which allows the President to detain even American citizens designated as enemy combatants.³²

Part I of this comment explores how the Supreme Court historically has responded to the President's wartime actions. Part II explains the Founding Fathers' belief in constitutional absolutism and the Supreme Court's duty to protect citizens' rights. Part III argues that the Court has applied constitutional absolutism inconsistently with the Founders' wishes by unduly burdening the President's power to protect national security during wartime. Part IV advocates the balancing test with bite model and shows that it is most effective at simultaneously defending national security and protecting constitutional rights.

pending the writ of habeas corpus:

With such provisions in the constitution, expressed in language too clear to be misunderstood by any one, I can see no ground whatever for supposing that the president, in any emergency, or in any state of things, can authorize the suspension of the privileges of the writ of habeas corpus, or the arrest of a citizen, except in aid of the judicial power.

Id.

²⁷ *Hamdi v. Rumsfeld*, 124 S. Ct. 2633, 2647–48 (2004) (holding that an individual detainee's interest in due process must be balanced against the government's interest in protecting national security).

²⁸ *Id.* at 2650 (“Whatever power the United States Constitution envisions for the Executive in its exchanges with other nations or with enemy organizations in times of conflict, it most assuredly envisions a role for all three branches when individual liberties are at stake.”).

²⁹ *Id.* (“We have long since made clear that a state of war is not a blank check for the President when it comes to the rights of the Nation's citizens.”).

³⁰ *Id.* at 2651 (“Any process in which the Executive's factual assertions go wholly unchallenged or are simply presumed correct without any opportunity for the alleged combatant to demonstrate otherwise falls constitutionally short.”).

³¹ *Id.* at 2649 (“[E]nemy combatant proceedings may be tailored to alleviate their uncommon potential to burden the Executive at a time of ongoing military conflict.”).

³² *Ex parte Quirin*, 317 U.S. 1, 37 (1942).

I. THE SUPREME COURT'S WARTIME RESPONSES TO PRESIDENTIAL ACTIONS

Historically, the Supreme Court has responded to the President's wartime actions by following one of two models: the deferential balancing model³³ or the justiciability doctrines model.³⁴ Under the deferential balancing model, the Court examines the reasonableness of the President's actions in a highly deferential manner, allowing infringement of citizens' rights.³⁵ Likewise, under the justiciability doctrines model, the Court avoids reviewing presidential actions so that a harmful judicial precedent is not established.³⁶ Both models severely restrict the wartime role of judicial review in protecting citizens' constitutional rights.³⁷

A. The Deferential Balancing Model

Under the deferential balancing model, the Supreme Court defers to the President's determination that his policies strike the proper balance between defending national security and protecting civil liberties during wartime.³⁸ Constitutional rights normally provided during peacetime are outweighed by the President's need to conduct the war effort.³⁹ Scholars who defend the deferential balancing model argue that the Court's defense of constitutional rights during wartime will unduly burden the

³³ See, e.g., *Korematsu v. United States*, 323 U.S. 214, 218 (1944) ("[W]e cannot reject as unfounded the judgment of the military authorities and of Congress that there were disloyal members of that population, whose number and strength could not be precisely and quickly ascertained." (quoting *Hirabayashi v. United States*, 320 U.S. 81, 99 (1943))).

³⁴ See, e.g., *Hirabayashi v. United States*, 320 U.S. 81, 85 (1943) ("Since the sentences of three months each imposed by the district court on the two counts were ordered to run concurrently, it will be unnecessary to consider questions raised with respect to the first count if we find that the conviction on the second count, for violation of the curfew order, must be sustained.").

³⁵ *Korematsu*, 323 U.S. at 235 (Murphy, J., dissenting) ("[N]o reasonable relation to an 'immediate, imminent, and impending' public danger is evident to support this racial restriction which is one of the most sweeping and complete deprivations of constitutional rights in the history of this nation" (quoting *United States v. Russell*, 80 U.S. (13 Wall.) 623, 628 (1872))).

³⁶ *Hirabayashi*, 320 U.S. at 85.

³⁷ This is particularly problematic because an independent judiciary was specifically intended to protect the constitutional rights of individuals without being swayed by popular opinion. See THE FEDERALIST NO. 78 (Alexander Hamilton), *supra* note 18, at 469 ("This independence of the judges is equally requisite to guard the Constitution and the rights of individuals from the effects of those ill humors which the arts of designing men, or the influence of particular conjunctures, sometimes disseminate among the people themselves, and which, though they speedily give place to better information, and more deliberate reflection, have a tendency, in the meantime, to occasion dangerous innovations in the government, and serious oppressions of the minor party in the community.").

³⁸ See, e.g., *Korematsu*, 323 U.S. at 218.

³⁹ Gross, *supra* note 9, at 1034 ("Judges . . . are sensitive to the criticism that they impede the war effort. Thus, in states of emergency, national courts assume a highly deferential attitude when called upon to review governmental actions and decisions.").

President's protection of national security.⁴⁰ However, critics of the model argue that the Court should review the reasonableness of the President's actions without such deference to determine whether the cost of infringing citizens' rights outweighs national security objectives.⁴¹

The Court adopted the deferential balancing model in *Korematsu v. United States*⁴² in response to President Roosevelt's Executive Order 9066, which authorized General J.L. DeWitt to intern Japanese-Americans during World War II.⁴³ After President Roosevelt signed Executive Order 9066, General DeWitt issued Public Proclamation No. 1, which designated security areas from which Japanese residents should be removed.⁴⁴ In *Korematsu*, the Court upheld the internment order, reasoning that "we cannot reject as unfounded the judgment of the military authorities and of Congress that there were disloyal members of that population, whose number and strength could not be precisely and quickly ascertained."⁴⁵ Although no Japanese resident was ever charged with espionage,⁴⁶ the Court refused to examine the reasons behind General DeWitt's internment order.⁴⁷ The Court determined that the President's national security measures outweighed citizens' due process rights.⁴⁸

Scholars who defend the deferential balancing model argue that vigorous judicial review during wartime unduly burdens the President's defense of national security.⁴⁹ They observe that "[t]he characteristics of judicial review—deliberation, openness, independence, distance, slowness—may be minor costs, and sometimes virtues, during normal times; but during emergencies

⁴⁰ Posner & Vermeule, *supra* note 11, at 627 ("The characteristics of judicial review—deliberation, openness, independence, distance, slowness—may be minor costs, and sometimes virtues, during normal times; but during emergencies they can be intolerable.").

⁴¹ See, e.g., *Korematsu*, 323 U.S. at 235 (Murphy, J., dissenting). Justice Murphy applies no such deference in his dissent, stating, "In adjudging the military action . . . it is necessary only that the action have some reasonable relation to the removal of the dangers of invasion, sabotage and espionage. But the exclusion . . . of all persons with Japanese blood . . . has no such reasonable relation." *Id.*

⁴² *Id.* at 217–19.

⁴³ Exec. Order No. 9066, 3 C.F.R. 1092–93 (1942).

⁴⁴ *Hirabayashi v. United States*, 320 U.S. 81, 86 (1943).

⁴⁵ *Korematsu*, 323 U.S. at 218 (quoting *Hirabayashi v. United States*, 323 U.S. 81, 99 (1943)).

⁴⁶ Sharon Boswell & Lorraine McConaghy, *Abundant Dreams Diverted*, SEATTLE DAILY TIMES, June 23, 1996, at B2.

⁴⁷ See *Korematsu*, 323 U.S. at 235 (Murphy, J., dissenting) (arguing that no reasonable relation existed between the exclusion order and the removal of danger).

⁴⁸ *Id.* at 219–20 (majority opinion) ("Compulsory exclusion of large groups of citizens from their homes . . . is inconsistent with our basic governmental institutions. But when . . . our shores are threatened by hostile forces, the power to protect must be commensurate with the threatened danger.").

⁴⁹ See, e.g., Posner & Vermeule, *supra* note 11, at 627.

they can be intolerable.”⁵⁰ The Court’s examination of wartime actions can interfere with military operations in foreign countries by requiring soldiers to gather evidence about detainees.⁵¹ Furthermore, the openness of court proceedings may allow national security secrets that could harm the military to be released.⁵² Military officials should be given wide latitude to protect national security during wartime without judicial intervention.⁵³

Advocates of the deferential balancing model also argue that the temporary hardships of war justify policies that should not be permitted during peacetime.⁵⁴ As Justice Frankfurter observed in his concurring opinion in *Korematsu*, “action is not to be stigmatized as lawless because like action in times of peace would be lawless.”⁵⁵ Constitutional principles should be somewhat relaxed during a temporary wartime emergency.⁵⁶ Scholars have noted that “[a]lthough deference also permits the executive to violate rights, violations that are intolerable during normal times become tolerable when the stakes are higher.”⁵⁷ The President’s protection against imminent attacks may be unduly restricted by a court that rigidly interprets the Constitution without regard to legitimate national security concerns.⁵⁸

Critics of the deferential balancing model respond that by refusing to examine the President’s policies, the Court allows citizens’ constitutional rights to be violated for reasons unrelated to national security.⁵⁹ In *Korematsu*, for example, the Court ig-

⁵⁰ *Id.*

⁵¹ *Hamdi v. Rumsfeld*, 316 F.3d 450, 470 (2003) (“The military has been charged by Congress and the executive with winning a war, not prevailing in a possible court case.”), *vacated*, 542 U.S. 507.

⁵² John C. Yoo, *Judicial Review and the War on Terrorism*, 72 GEO. WASH. L. REV. 427, 448 (2003) (“A habeas proceeding could become the forum for recalling commanders and intelligence operatives from the field into open court; disrupting overt and covert operations; revealing successful military tactics and methods; and forcing the military to shape its activities to the demands of the judicial process.”).

⁵³ *Hamdi*, 316 F.3d at 474 (“Article III courts are ill-positioned to police the military’s distinction between those in the arena of combat who should be detained and those who should not.”).

⁵⁴ *Korematsu v. United States*, 323 U.S. 214, 224 (1944) (Frankfurter, J., concurring).

⁵⁵ *Id.*

⁵⁶ Gross, *supra* note 9, at 1059 (“[T]he need for additional powers to fend off a dangerous threat is accommodated by an expansive, emergency-minded interpretive spin on existing norms through which various components of the ordinary legal system are transformed into counter-emergency facilitating norms.”).

⁵⁷ Posner & Vermeule, *supra* note 11, at 609.

⁵⁸ Gross, *supra* note 9, at 1044 (“When faced with serious threats to the life of the nation, government will take whatever measures it deems necessary to abate the crisis.”).

⁵⁹ *See, e.g., Korematsu*, 323 U.S. at 235 (Murphy, J., dissenting) (“[N]o reasonable relation to an ‘immediate, imminent, and impending’ public danger is evident to support this racial restriction which is one of the most sweeping and complete deprivations of constitutional rights in the history of this nation” (quoting *United States v. Russell*, 80 U.S. (13 Wall.) 623, 628 (1872))).

nored the fact that General DeWitt, the military commander who ordered the internment of Japanese residents from the West Coast, had animosity toward the Japanese.⁶⁰ As Justice Murphy observed in his dissenting opinion in *Korematsu*, General DeWitt testified before Congress that “I don’t want any of them [persons of Japanese ancestry] here. . . . It makes no difference whether he is an American citizen, he is still a Japanese. . . . [W]e must worry about the Japanese all the time until he is wiped off the map.”⁶¹

The Court’s failure to consider General DeWitt’s reasons for the internment order allowed a policy motivated by hostility toward a racial group to be disguised as a national security measure.⁶² As Justice Murphy observed, “A military judgment based upon such racial and sociological considerations is not entitled to the great weight ordinarily given the judgments based upon strictly military considerations.”⁶³ During wartime, where a racial or politically unpopular group is often targeted, the Court should be especially vigilant in protecting civil liberties.⁶⁴

B. The Justiciability Doctrines Model

Under the justiciability doctrines model, the Court prevents the establishment of a judicial precedent sanctioning constitutional violations by failing to address the merits of a case or an issue.⁶⁵ The Court uses the doctrines of standing and political question to avoid reviewing the constitutionality of the President’s policies.⁶⁶ By refusing to hear a case, the Court does not interfere with the military’s prosecution of a war and does not constitutionally challenge the President’s policies.⁶⁷

⁶⁰ *Id.* at 236 n.2.

⁶¹ *Id.*

⁶² CLINTON ROSSITER, *THE SUPREME COURT AND THE COMMANDER IN CHIEF* 50 (expanded ed. 1976) (Justice Murphy “had apparently bothered to read the military and congressional reports on the evacuation, and had been shocked by the evidences of naked prejudice that ran like angry veins of poison through its entire history.”).

⁶³ *Korematsu*, 323 U.S. at 239–40 (Murphy, J., dissenting).

⁶⁴ ERWIN CHEMERINSKY, *CONSTITUTIONAL LAW: PRINCIPLES AND POLICIES* 672 (2d ed. 2002) (“[T]he Constitution and the Court’s role are most important precisely in such times when pressure and even hysteria to violate rights and discriminate will be most likely to occur.”).

⁶⁵ *See, e.g., Korematsu*, 323 U.S. at 246 (Jackson, J., dissenting) (“A military commander may overstep the bounds of constitutionality, and it is an incident. But if we review and approve, that passing incident becomes the doctrine of the Constitution.”).

⁶⁶ Posner & Vermeule, *supra* note 11, at 606 n.1 (“[T]he expansion of executive power is accepted but not explicitly acknowledged, and courts . . . do and should exercise deference surreptitiously, by ducking legal challenges with the help of the copious procedural mechanisms at their disposal—standing doctrine, denial of certiorari, delay, and so forth.”).

⁶⁷ *Id.*

The Court applied the justiciability doctrines model in *Hirabayashi v. United States*, a case challenging both the curfew and internment orders against Japanese-Americans during World War II.⁶⁸ Gordon Hirabayashi was charged with violating the internment order and failing to comply with the curfew order.⁶⁹ The district court ordered him to serve a concurrent sentence of three months for both counts.⁷⁰ The Court used the concurrent sentence doctrine to avoid deciding the constitutionality of the internment order.⁷¹ Under this doctrine, if an appellate court can affirm a conviction on one count, it does not need to hear a challenge to a second count if the second count's sentence is equal to or less than the first count.⁷² The Supreme Court upheld the curfew order and avoided addressing the internment order:

Since the sentences of three months each imposed by the district court on the two counts were ordered to run concurrently, it will be unnecessary to consider questions raised with respect to the first count if we find that the conviction on the second count, for violation of the curfew order, must be sustained.⁷³

The Court easily upheld the curfew order, as Hirabayashi himself admitted that it was a reasonable wartime measure.⁷⁴ The Court reasoned that "it is enough that circumstances within the knowledge of those charged with the responsibility for maintaining the national defense afforded a rational basis for the decision which they made."⁷⁵ As Chief Justice Rehnquist observed in his book on the subject:

In *Hirabayashi* . . . the Court could have decided the validity of both the relocation requirement and the curfew requirement. The "concurrent sentence" doctrine under which the Court declined to do so is not mandatory but discretionary. But counseling against any broader decision was the well-established rule that the Court should avoid deciding constitutional questions if it is possible to do so.⁷⁶

By using the concurrent sentence doctrine, the Court in *Hirabayashi* avoided review of the controversial internment order.⁷⁷

⁶⁸ *Hirabayashi v. United States*, 320 U.S. 81, 85 (1943).

⁶⁹ *Id.* at 83.

⁷⁰ *Id.* at 85.

⁷¹ See WILLIAM H. REHNQUIST, *ALL THE LAWS BUT ONE: CIVIL LIBERTIES IN WARTIME* 205 (1998).

⁷² BLACK'S LAW DICTIONARY 310 (8th ed. 2004).

⁷³ *Hirabayashi*, 320 U.S. at 85.

⁷⁴ *Id.* at 99.

⁷⁵ *Id.* at 102.

⁷⁶ REHNQUIST, *supra* note 71, at 205.

⁷⁷ *Hirabayashi*, 320 U.S. at 85 ("Since the sentences of three months each imposed by the district court on the two counts were ordered to run concurrently, it will be unnecessary to consider questions raised with respect to the first count if we find that the conviction on the second count, for violation of the curfew order, must be sustained.").

The curfew order requiring citizens to remain in their homes after 8:00 p.m. was a much lighter restriction on civil rights than the internment order forcing citizens to be removed from their homes, sell their personal belongings, and relocate to internment camps.⁷⁸ The Court avoided establishing a legal precedent that validated the internment order until a year and a half later in *Korematsu*.⁷⁹

In *Korematsu*, Justice Jackson defended the justiciability doctrines model in his dissenting opinion.⁸⁰ Although Jackson observed that the internment order singling out Japanese residents was both over-inclusive and under-inclusive, he reluctantly noted that it is more important that military measures be successful than legal.⁸¹ He then presented the rationale for the justiciability doctrines model:

[C]ourts can never have any real alternative to accepting the mere declaration of the authority that issued the order that it was reasonably necessary from a military viewpoint. . . . A military commander may overstep the bounds of constitutionality, and it is an incident. But if we review and approve, that passing incident becomes the doctrine of the Constitution.⁸²

Justice Jackson argued that military decisions should not be subject to judicial standards that might sacrifice the war effort.⁸³ The military emergency of the time may warrant drastic, legally questionable actions by the President.⁸⁴ A judicial precedent approving such policies, however, could be used in times that do not warrant such action.⁸⁵ Thus, the Court should refuse to hear challenges to the President's policies to prevent the establishment of a harmful judicial precedent.⁸⁶

Scholars have asserted two major critiques of the justiciabil-

⁷⁸ *Korematsu v. United States*, 323 U.S. 214, 225–26 (1944) (Roberts, J., dissenting) (“This is not a case of keeping people off the streets at night as was *Hirabayashi* . . . it is [a] case of convicting a citizen as a punishment for not submitting to imprisonment in a concentration camp.”).

⁷⁹ *Id.* at 219.

⁸⁰ *Id.* at 242 (Jackson, J., dissenting).

⁸¹ *Id.* at 244.

⁸² *Id.* at 245–46.

⁸³ *Id.* at 244 (“No court can require such a commander in such circumstances to act as a reasonable man; he may be unreasonably cautious and exacting.”).

⁸⁴ *Id.* at 246 (“A military order, however unconstitutional, is not apt to last longer than the military emergency.”).

⁸⁵ *Id.* (“But once a judicial opinion rationalizes such an order to show that it conforms to the Constitution, or rather rationalizes the Constitution to show that the Constitution sanctions such an order, the Court for all time has validated the principle of racial discrimination in criminal procedure and of transplanting American citizens. The principle then lies about like a loaded weapon ready for the hand of any authority that can bring forward a plausible claim of an urgent need.”).

⁸⁶ *Id.*

ity doctrines model. First, critics have challenged Justice Jackson's argument that wartime precedents will be used to sanction abuses during normal times.⁸⁷ They assert:

Why must the precedent both (1) spill over into ordinary law and (2) remain entrenched 'for all time,' as Jackson puts it? As for the first condition, the precedent will itself have a built-in limitation to emergency circumstances. . . .

. . . .

As for the second condition, . . . [s]tare decisis will be either strong or weak. If it is weak, then past precedents granting emergency powers can be overruled . . .⁸⁸

According to these critics, Justice Jackson incorrectly assumes that wartime measures validated by the Court will be used during normal times.⁸⁹ The Court can restrict the precedent's application to similar wartime emergencies.⁹⁰ The Court can also refuse to extend a precedent to a situation that does not warrant similar deference.⁹¹

A second criticism of the justiciability doctrines model is the normative argument that the Supreme Court has an affirmative duty to prevent constitutional violations.⁹² As Chief Justice Marshall observed in *Marbury v. Madison*, "the very essence of civil liberty certainly consists in the right of every individual to claim the protection of the laws."⁹³ With lifetime tenure and guaranteed salaries, federal judges are in a unique position to vindicate the constitutional rights of racially and politically unpopular groups during times of hysteria.⁹⁴ The Court's use of justiciability doctrines effectively ignores constitutional violations.

II. THE FOUNDING FATHERS' BELIEFS

The primary reason that the Court should avoid applying the deferential balancing model and the justiciability doctrines model is that both models are inconsistent with the Founding Fathers'

⁸⁷ See, e.g., Posner & Vermeule, *supra* note 11, at 615–16.

⁸⁸ *Id.*

⁸⁹ *Id.*

⁹⁰ *Id.* at 615 ("[L]ater judges may either distend the precedent to accommodate government power or else contract the precedent to constrain it.").

⁹¹ *Id.*

⁹² THE FEDERALIST NO. 78 (Alexander Hamilton), *supra* note 18, at 469.

⁹³ 5 U.S. (1 Cranch) 137, 163 (1803).

⁹⁴ See THE FEDERALIST NO. 78 (Alexander Hamilton), *supra* note 18, at 469.

If, then, the courts of justice are to be considered as the bulwarks of a limited Constitution against legislative encroachments, this consideration will afford a strong argument for the permanent tenure of judicial offices, since nothing will contribute so much as this to that independent spirit in the judges which must be essential to the faithful performance of so arduous a duty.

Id.

beliefs.⁹⁵ The Framers adopted a written Constitution to establish certain fundamental rights that are immune from actions by the President and Congress.⁹⁶ They believed that the role of the Supreme Court is to protect citizens' fundamental civil rights during both wartime and peacetime.⁹⁷ The President and military officials cannot use a plea of military necessity to violate fundamental constitutional rights.⁹⁸

A. The Constitution's Supremacy over Ordinary Acts

By creating the Constitution, the Founders intended to establish certain fundamental rights that a political majority could not easily change.⁹⁹ Unless it is amended, the Constitution's provisions are superior to all contrary presidential and congressional acts.¹⁰⁰ Alexander Hamilton declared in *The Federalist* No. 78, "Until the people have, by some solemn and authoritative act, annulled or changed the established form, it is binding upon themselves collectively, as well as individually; and no presumption, or even knowledge of their sentiments, can warrant their representatives in a departure from it prior to such an act."¹⁰¹ The Founding Fathers worried that a tyrannical majority would unite to deprive other citizens of their rights.¹⁰² Thus, they pro-

⁹⁵ *Id.* at 470 (The Constitution "is binding upon themselves collectively, as well as individually; and no presumption, or even knowledge of their sentiments, can warrant their representatives in a departure from it.").

⁹⁶ *Id.*

⁹⁷ See *Ex parte* Milligan, 71 U.S. 2, 120–21 (1866). The Court in *Milligan* embraced constitutional absolutism:

Those great and good men [Founding Fathers] foresaw that troublous times would arise, when rules and people would become restive under restraint, and seek by sharp and decisive measures to accomplish ends deemed just and proper; and that the principles of constitutional liberty would be in peril, unless established by irrepealable law. . . . The Constitution of the United States is a law for rulers and people, equally in war and in peace, and covers with the shield of its protection all classes of men, at all times, and under all circumstances. No doctrine, involving more pernicious consequences, was ever invented by the wit of man than that any of its provisions can be suspended during any of the great exigencies of government. Such a doctrine leads directly to anarchy or despotism, but the theory of necessity on which it is based is false; for the government, within the Constitution, has all the powers granted to it, which are necessary to preserve its existence

Id.

⁹⁸ *Id.* at 121, 123.

⁹⁹ THE FEDERALIST NO. 78 (Alexander Hamilton), *supra* note 18, at 467 ("No legislative act, therefore, contrary to the Constitution, can be valid.").

¹⁰⁰ U.S. CONST. art. VI, cl. 2 ("This Constitution, and the Laws of the United States which shall be made in Pursuance thereof . . . shall be the supreme Law of the Land . . .").

¹⁰¹ THE FEDERALIST NO. 78 (Alexander Hamilton), *supra* note 18, at 470.

¹⁰² THE FEDERALIST NO. 10 (James Madison), *supra* note 18, at 80 ("When a majority is included in a faction, the form of popular government . . . enables it to sacrifice to its ruling passion or interest both the public good and the rights of other citizens.").

posed and ratified a written Constitution to grant all citizens basic protections that cannot be denied by the political branches of government.¹⁰³

Justice Marshall reaffirmed the Constitution's supremacy over acts of the President and Congress in *Marbury v. Madison*.¹⁰⁴ There, Justice Marshall argued that the theory behind written constitutions is to establish certain fundamental, unalterable principles:

The [C]onstitution is either a superior, paramount law, unchangeable by ordinary means, or it is on a level with ordinary legislative acts, and like other acts, is alterable when the legislature shall please to alter it. . . .

. . . .

[I]f the latter part be true, then *written constitutions are absurd attempts*, on the part of the people, to limit a power, in its own nature illimitable. . . .

. . . .

[I]t thus *reduces to nothing* what we have deemed the greatest improvement on political institutions—a written constitution.¹⁰⁵

Justice Marshall argued that measures passed by Congress and the President cannot be given the same weight as constitutional provisions.¹⁰⁶ The Constitution's fundamental principles must remain superior to the temporary decisions of political majorities.¹⁰⁷

The Founders feared that leaders could use the fear of foreign attacks to deprive citizens of their constitutional rights.¹⁰⁸ In *The Federalist No. 8*, Alexander Hamilton contrasts countries forced to maintain standing armies to defend against frequent invasions with those that have small militaries.¹⁰⁹ He warns of

¹⁰³ THE FEDERALIST NO. 78 (Alexander Hamilton), *supra* note 18, at 469 (“[Y]et it is not to be inferred from this principle [that the Constitution can be amended] that the representatives of the people, whenever a momentary inclination happens to lay hold of a majority of their constituents incompatible with the provisions in the existing Constitution would, on that account, be justifiable in a violation of those provisions.”).

¹⁰⁴ 5 U.S. (1 Cranch) 137, 180 (1803) (observing that the Constitution is the “supreme law of the land,” and that only the laws of the United States “made in pursuance of the [C]onstitution” are valid).

¹⁰⁵ *Id.* at 177–78 (emphasis added).

¹⁰⁶ *Id.* at 176–77 (“The distinction, between a government with limited and unlimited powers, is abolished, if those limits do not confine the persons on whom they are imposed, and if acts prohibited and acts allowed, are of equal obligation.”).

¹⁰⁷ *Id.* at 177 (“[A]n act of the legislature, repugnant to the [C]onstitution, is void.”).

¹⁰⁸ See THE FEDERALIST NO. 8 (Alexander Hamilton), *supra* note 18, at 68–69 (noting that “[i]t is of the nature of war to increase the executive at the expense of the legislative authority,” and that “in a country seldom exposed . . . to internal invasions, . . . the people are in no danger of being broken to military subordination. The laws are not accustomed to relaxation in favor of military exigencies . . .”).

¹⁰⁹ *Id.* at 69.

the consequences of a society where people constantly need military protection:

The continual necessity for [the military's] services enhances the importance of the soldier, and proportionably degrades the condition of the citizen. . . . The inhabitants of territories, often the theater of war, are unavoidably subject to frequent infringements on their rights, which serve to weaken their sense of those rights; and by degrees the people are brought to consider the soldiery not only as their protectors but as their superiors.¹¹⁰

Hamilton urged Americans to avoid the constant wars that plagued Europe and made the military state superior to the civil state.¹¹¹ The Founders realized that the government could use wartime hysteria as a pretext to violate citizens' rights.¹¹² By drafting a written Constitution, the Founding Fathers sought to prevent leaders from using wars to aggregate their own power at the expense of constitutional rights.¹¹³

B. The Duty of Judges to Protect Constitutional Rights

The Founding Fathers left the protection of the Constitution to federal judges, who have the duty to defend citizens' rights despite political pressure.¹¹⁴ The Founders understood that in times of hysteria, politically accountable legislators and executive officials cannot protect unpopular constitutional principles.¹¹⁵ Hamilton argued that "it is easy to see that it would require an uncommon portion of fortitude in the judges to do their duty as faithful guardians of the Constitution, where legislative invasions of it had been instigated by the major voice of the community."¹¹⁶ Federal judges were given lifetime tenure so that they could protect citizens' rights against oppressive legislation without fearing political pressure.¹¹⁷

The Founders also envisioned that the Court would challenge policies that restricted citizens' rights during times of hys-

¹¹⁰ *Id.* at 70.

¹¹¹ THE FEDERALIST NO. 6 (Alexander Hamilton), *supra* note 18, at 56.

¹¹² THE FEDERALIST NO. 8 (Alexander Hamilton), *supra* note 18, at 67 ("The violent destruction of life and property incident to war . . . will compel nations the most attached to liberty to resort for repose and security to institutions which have a tendency to destroy their civil and political rights.").

¹¹³ THE FEDERALIST NO. 8 (John Jay), *supra* note 18, at 69 ("[I]n a country seldom exposed . . . to internal invasions, . . . the people are in no danger of being broken to military subordination. The laws are not accustomed to relaxation in favor of military exigencies . . .").

¹¹⁴ THE FEDERALIST NO. 78 (Alexander Hamilton), *supra* note 18, at 469.

¹¹⁵ *Id.*

¹¹⁶ *Id.* at 470.

¹¹⁷ *Id.* at 469.

teria.¹¹⁸ They predicted situations where powerful interest groups would deceive legislators into passing oppressive measures:

This independence of the judges is equally requisite to guard the Constitution and the rights of individuals from the effects of those ill humors which the arts of designing men, or the influence of particular conjunctures, sometimes disseminate among the people themselves, and which, though they speedily give place to better information, and more deliberate reflection, have a tendency, in the meantime, to occasion dangerous innovations in the government, and serious oppressions of the minor party in the community.¹¹⁹

The scenario Hamilton describes is strikingly similar to Japanese-American internment during World War II, where farmers competing with the Japanese fiercely lobbied Congress to support the internment order.¹²⁰ As Justice Murphy observed in his *Korematsu* dissent, competing farmers had admitted that “[i]f all the Japs were removed tomorrow, we’d never miss them in two weeks, because the white farmers can take over and produce everything the Jap grows.”¹²¹ The Founding Fathers realized that politically accountable legislators and the President could not defend unpopular groups’ constitutional rights against intense political pressure.¹²² They trusted independent, lifetime-tenured judges to protect all citizens’ constitutional rights.¹²³

III. THE IMPRACTICALITY OF RIGIDLY INTERPRETING THE CONSTITUTION

Although the Founding Fathers believed that constitutional rights should not be violated during wartime, they also wanted the President to have sufficient power to protect national security.¹²⁴ The Court can interpret the Constitution flexibly without violating it to give the President sufficient power to defend the country. By refusing to accommodate civil liberties to wartime necessities, the Court does not give the President sufficient power to defend the country. The Founding Fathers believed

¹¹⁸ *Id.*

¹¹⁹ *Id.* at 469.

¹²⁰ *Korematsu v. United States*, 323 U.S. 214, 239 n.12 (1944) (Murphy, J., dissenting).

¹²¹ *Id.* at 239 n.12 (internal quotation marks omitted).

¹²² THE FEDERALIST NO. 78 (Alexander Hamilton), *supra* note 18, at 469–70.

¹²³ *Id.* at 470–71 (“That inflexible and uniform adherence to the rights of the Constitution, and of individuals, which we perceive to be indispensable in the courts of justice, can certainly not be expected from judges who hold their offices by a temporary commission.”).

¹²⁴ THE FEDERALIST NO. 70 (Alexander Hamilton), *supra* note 18, at 423 (“Energy in the executive is a leading character in the definition of good government. It is essential to the protection of the community against foreign attacks . . .”).

that an important government objective was defending the nation against military attacks.¹²⁵ While protecting constitutional rights, the Court can still allow the President enough power to defend national security.¹²⁶

The Founding Fathers believed that the President should have sufficient power to protect the country against foreign attacks.¹²⁷ The Founders worried that a weak President would be ineffective at quickly responding to national security dangers.¹²⁸ As Hamilton observed, “[e]nergy in the executive is a leading character in the definition of good government. . . . [and] is essential to the protection of the community against foreign attacks.”¹²⁹ During wars, the President should not be unduly restricted from acting decisively in conducting military operations.¹³⁰

Contrary to the Founders’ belief in presidential strength during wartime, the Court has sometimes rigidly interpreted the Constitution in a manner that frustrates important military measures. During the Civil War, for example, Justice Taney in *Ex parte Merryman* refused to accommodate the President’s war effort by compromising constitutional principles.¹³¹ John Merryman, a citizen residing in Baltimore, Maryland, was arrested for aiding the Confederacy during the Civil War.¹³² He petitioned for a writ of habeas corpus, but the military commander refused to honor it, arguing that he was authorized to suspend the writ by President Lincoln.¹³³ In *Merryman*, Justice Taney rejected President Lincoln’s authority to suspend the writ of habeas corpus without congressional approval:

With such provisions in the constitution, expressed in language too clear to be misunderstood by any one, I can see no ground what-

¹²⁵ THE FEDERALIST NO. 3 (John Jay), *supra* note 18, at 42.

Among the many objects to which a wise and free people find it necessary to direct their attention, that of providing for their *safety* seems to be the first. . . .

At present I mean only to consider [safety] as it respects security for the preservation of peace and tranquility, as well as against dangers from *foreign arms and influence*.

Id. See also THE FEDERALIST NO. 70 (Alexander Hamilton), *supra* note 18, at 423.

¹²⁶ See, e.g., *Hamdi v. Rumsfeld*, 124 S. Ct. 2633, 2649–50 (2004) (“[I]t does not infringe on the core role of the military for the courts to exercise their own time-honored and constitutionally mandated roles of reviewing and resolving claims like those presented here.”).

¹²⁷ THE FEDERALIST NO. 70 (Alexander Hamilton), *supra* note 18, at 423.

¹²⁸ *Id.*

¹²⁹ *Id.*

¹³⁰ *Id.*

¹³¹ See, e.g., *Ex parte Merryman*, 17 F. Cas. 144 (C.C.D. Md. 1861) (No. 9487).

¹³² ROSSITER, *supra* note 62, at 20–21.

¹³³ *Merryman*, 17 F. Cas. at 148.

ever for supposing that the [P]resident, in any emergency, or in any state of things, can authorize the suspension of the privileges of the writ of habeas corpus, or the arrest of a citizen, except in aid of the judicial power.¹³⁴

Justice Taney argued that only Congress can suspend the writ of habeas corpus because the power to suspend it is found in Article I of the Constitution, which lists Congress's powers.¹³⁵ He also cited Chief Justice Marshall's opinion in *Ex parte Bollman* that "[i]f at any time, the public safety should require the suspension of the . . . [writ of habeas corpus], it is for the legislature to say so."¹³⁶ Justice Taney believed that the President could not suspend the writ of habeas corpus under any circumstances.¹³⁷

Contrary to Justice Taney's uncompromising opinion in *Merryman*, some scholars argue that the President has the constitutional power to suspend the writ of habeas corpus to defend against a sudden attack.¹³⁸ If Congress is not in session, the President may need to act quickly to challenge an imminent national security danger. As Professor William F. Duker has observed, "Taney's analysis was faulty in failing to acknowledge a presidential power to suspend where essential to repel sudden invasion."¹³⁹ Other scholars argue that during the Civil War, it was debatable whether the President or Congress should suspend the writ of habeas corpus in emergencies.¹⁴⁰ They contend that President Lincoln should not be criticized for suspending the writ of habeas corpus and for failing to honor John Merryman's habeas petition because Lincoln's constitutional duty as Commander in Chief to protect the nation from an imminent invasion outweighed the debatable procedural rule that only Congress could suspend the writ of habeas corpus.¹⁴¹

¹³⁴ *Id.* at 149.

¹³⁵ *Id.* at 148 ("The clause of the constitution, which authorizes the suspension of the privilege of the writ of habeas corpus, is in the 9th section of the first article. This comment is devoted to the legislative department of the United States, and has not the slightest reference to the executive department.").

¹³⁶ *Id.* at 152 (quoting *Ex parte Bollman*, 8 U.S. (4 Cranch) 75, 101 (1807)).

¹³⁷ *Id.* at 149 ("I can see no ground whatever for supposing that the president, in any emergency, or in any state of things, can authorize the suspension of the privileges of the writ of habeas corpus . . .").

¹³⁸ WILLIAM F. DUKER, A CONSTITUTIONAL HISTORY OF HABEAS CORPUS 147-48 (1980).

¹³⁹ *Id.*

¹⁴⁰ ROSSITER, *supra* note 62, at 25 ("It would seem equally futile to argue over the present location of this power, for it is a question on which fact and theory cannot be expected to concur.").

¹⁴¹ Eli Palomares, *Illegal Confinement: Presidential Authority to Suspend the Privilege of the Writ of Habeas Corpus During Times of Emergency*, 12 S. CAL. INTERDISC. L.J. 101, 119. The author writes: "An argument can be made that Lincoln's first suspension of the writ was legally justified under the President's implied power to repel sudden attacks." *Id.* at 118.

Justice Taney unrealistically believed that the Constitution's provisions should not be interpreted flexibly during hardships faced by the nation.¹⁴² As noted by Clinton Rossiter, Taney "considered himself the last barricade between the Constitution and despotism."¹⁴³ After stating that he was sending a sealed copy of his opinion to President Lincoln, Justice Taney then solemnly observed, "It will then remain for that high officer, in fulfillment of his constitutional obligation to 'take care that the laws be faithfully executed,' to determine what measures he will take to cause the civil process of the United States to be respected and enforced."¹⁴⁴

President Lincoln responded to Justice Taney by admitting that he had an oath to act constitutionally, but argued that the military danger justified his actions.¹⁴⁵ In a speech before Congress on July 4, 1861, President Lincoln agreed with Taney that "the attention of the country has been called to the proposition that one who is sworn to take care that the laws be faithfully executed should not himself violate them."¹⁴⁶ However, he defended his actions as essential to protecting the Union at a time of threatened invasion: "[A]re all the laws *but one* to go unexecuted, and the Government itself to go to pieces, lest that one be violated?"¹⁴⁷ President Lincoln felt that he was required to suspend the writ of habeas corpus without waiting for Congress because an imminent invasion by Confederate forces threatened the nation, and he had a constitutional duty to protect the country.¹⁴⁸

¹⁴² *Merryman*, 17 F. Cas. at 149.

Nor can any argument be drawn from the nature of sovereignty, or the necessity of government, for self-defence in times of tumult and danger. The government of the United States is one of delegated and limited powers; it derives its existence and authority altogether from the constitution, and neither of its branches, executive, legislative or judicial, can exercise any of the powers of government beyond those specified and granted

Id.

¹⁴³ ROSSITER, *supra* note 62, at 22.

¹⁴⁴ *Merryman*, 17 F. Cas. at 153.

¹⁴⁵ ROSSITER, *supra* note 62, at 24.

¹⁴⁶ *Id.* (internal quotation marks omitted).

¹⁴⁷ Gross, *supra* note 9, at 1015 (alteration in original).

¹⁴⁸ ROSSITER, *supra* note 62, at 25 ("The law of the Constitution, as it actually exists, must be considered to read that in a condition of martial necessity the President has the power to suspend the privilege of the writ of habeas corpus."). See also *Ex parte Vallandigham*, 68 U.S. (1 Wall.) 243 (1864). After President Lincoln refused to comply with Justice Taney's ruling in *Ex parte Merryman*, the Court was unsuccessful in protecting even basic civil liberties during the Civil War. In *Ex parte Vallandigham*, Clement L. Vallandigham was arrested for announcing to a crowd that he believed "that the present war was a wicked, cruel, and unnecessary war, one not waged for the preservation of the Union, but for the purposes of crushing out liberty and to erect a despotism . . ." *Id.* at 244. He was arrested, charged with sympathizing with the Confederacy, and sentenced to confinement for the duration of the war. The Supreme Court refused to hear the merits of

IV. THE BALANCING TEST WITH BITE MODEL

This comment advocates the balancing test with bite model, which the Court adopted in *Hamdi v. Rumsfeld*.¹⁴⁹ The balancing test with bite model is most consistent with the Founding Fathers' wishes because it secures essential roles for all three branches of government during wartime.¹⁵⁰ Unlike the deferential balancing model and the justiciability doctrines model, which deferred to the President's decisions with little scrutiny, the Court in *Hamdi* recognized its constitutionally-mandated duty to review presidential actions that threaten to deprive citizens of their rights.¹⁵¹ The Court rejected the argument that exercising judicial review will necessarily interfere with the military's war effort.¹⁵² Further, the Court demanded concrete evidence from the President to support his detention of United States citizens,¹⁵³ but accommodated the military's wartime needs by lowering its evidentiary burden.¹⁵⁴ However, in addition to protecting civil rights as mentioned above, the Court also validated the holding in *Ex parte Quirin*, which gave the President extensive power to conduct the war by detaining even American citizens designated as enemy combatants.¹⁵⁵ In doing so, it achieved a critical balance between civil rights and presidential war powers.

A. The Court's Recognition of Its Duty to Protect Rights

By recognizing its duty to protect constitutional rights, the Court in *Hamdi v. Rumsfeld* complied with the Founders' demand that all three branches of government have active roles at all times.¹⁵⁶ The Supreme Court refused to defer to the military commanders' designation of enemy combatant status without in-

Vallandigham's case, explaining that it lacked jurisdiction under the Judiciary Act of 1789 to originate a writ of certiorari to review the proceedings of a military commission. *Id.* at 251–52.

¹⁴⁹ 124 S. Ct. 2633, 2647 (2004).

¹⁵⁰ *Id.* at 2650 (“Whatever power the United States Constitution envisions for the Executive in its exchanges with other nations or with enemy organizations in times of conflict, it most assuredly envisions a role for all three branches when individual liberties are at stake.”).

¹⁵¹ *Id.* (“We have long since made clear that a state of war is not a blank check for the President when it comes to the rights of the Nation's citizens.”).

¹⁵² *Id.* at 2649 (“[I]t does not infringe on the core role of the military for the courts to exercise their own time-honored and constitutionally mandated roles of reviewing and resolving claims like those presented here.”).

¹⁵³ *Id.* at 2651 (“Any process in which the Executive's factual assertions go wholly unchallenged or are simply presumed correct without any opportunity for the alleged combatant to demonstrate otherwise falls constitutionally short.”).

¹⁵⁴ *Id.* at 2649 (“[E]nemy combatant proceedings may be tailored to alleviate their uncommon potential to burden the Executive at a time of ongoing military conflict.”).

¹⁵⁵ *Ex parte Quirin*, 317 U.S. 1, 37 (1942).

¹⁵⁶ *Hamdi v. Rumsfeld*, 124 S. Ct. 2633, 2650 (2004).

specting its reasonableness.¹⁵⁷ The Court observed that a true balancing test must preserve a role for the Court's protection of civil liberties: "Whatever power the United States Constitution envisions for the Executive in its exchanges with other nations or with enemy organizations in times of conflict, it most assuredly envisions a role for all three branches when individual liberties are at stake."¹⁵⁸

Like the Founding Fathers, who believed that judges should protect constitutional rights against government infringements in times of war and hysteria, the Court recognized its duty to review the constitutionality of wartime policies.¹⁵⁹

The Court rejected the reasoning in *Hirabayashi v. United States* that challenging military decisions would compromise the war effort.¹⁶⁰ In *Hirabayashi*, the Court observed:

Where, as they did here, the conditions call for the exercise of judgment and discretion and for the choice of means by those branches of the Government on which the Constitution has placed the responsibility of war-making, it is not for any court to sit in review of the wisdom of their action or substitute its judgment for theirs.¹⁶¹

The Court in *Hirabayashi* assumed that providing hearings for 70,000 Japanese-American citizens to prove their loyalty would be unduly time-consuming and administratively burdensome.¹⁶² However, England showed that administering due process proceedings for residents was not too difficult.¹⁶³ As Clinton Rossiter observes, "the English in 1940 had examined 74,000 enemy aliens individually . . . [while] Americans in 1942 had declined to make any attempt to separate the loyal from the disloyal in the Japanese-American population."¹⁶⁴ Mere administrative inconvenience is not a valid reason for the government to violate citizens' fundamental constitutional rights.¹⁶⁵

The Fourth Circuit Court of Appeals' decision in *Hamdi v. Rumsfeld* shows that courts still fear that their exercise of judicial review will harm the military's efforts.¹⁶⁶ Arguing that

¹⁵⁷ *Id.*

¹⁵⁸ *Id.*

¹⁵⁹ *Id.*

¹⁶⁰ *Hirabayashi v. United States*, 320 U.S. 81, 93 (1943).

¹⁶¹ *Id.*

¹⁶² *Id.* at 99 ("[W]e cannot reject as unfounded the judgment of the military authorities and of Congress that there were disloyal members of that population, whose number and strength could not be precisely and quickly ascertained.")

¹⁶³ ROSSITER, *supra* note 62, at 50–51.

¹⁶⁴ *Id.*

¹⁶⁵ *Korematsu v. United States*, 323 U.S. 214, 242 (1944) (Murphy, J., dissenting) ("Any inconvenience that may have accompanied an attempt to conform to procedural due process cannot be said to justify violations of constitutional rights of individuals.")

¹⁶⁶ [*Hamdi I*], 316 F.3d 450, 471 (4th Cir. 2003).

Hamdi's detention should be upheld under a "some evidence" standard, the government presented an affidavit from Michael Mobbs, the Special Advisor to the Under Secretary of Defense for Policy, as evidence of Hamdi's affiliation with the Taliban.¹⁶⁷ The district court "criticized the generic and hearsay nature of the affidavit, calling it 'little more than the government's "say-so."'"¹⁶⁸ However, the Fourth Circuit accepted the Mobbs declaration as sufficient evidence. The Fourth Circuit stated: "For the judicial branch to trespass upon the exercise of the warmaking powers would be an infringement of the right to self-determination and self-governance at a time when the care of the common defense is most critical."¹⁶⁹

The Fourth Circuit reasoned that reviewing the government's allegations would unduly burden the military.¹⁷⁰ The court argued that the military would compromise its wartime objectives by having to collect evidence to prove enemy combatant status.¹⁷¹ Furthermore, it argued that courts would have difficulty judging the accuracy of military procedures in distant battle zones.¹⁷²

B. The Court's Modification of Evidentiary Requirements

In addition to recognizing its duty to protect constitutional rights, the Court in *Hamdi* demanded concrete evidence to support the government's detention of American citizens, but lowered its evidentiary standards.¹⁷³ The Supreme Court required that a prisoner have an opportunity to rebut the government's allegations: "Any process in which the Executive's factual assertions go wholly unchallenged or are simply presumed correct without any opportunity for the alleged combatant to demonstrate otherwise falls constitutionally short."¹⁷⁴

The Court ruled that the Due Process Clause requires that detained citizens have an opportunity to present evidence chal-

¹⁶⁷ *Hamdi v. Rumsfeld* [*Hamdi II*], 124 S. Ct. 2633, 2636–37 (2004).

¹⁶⁸ *Id.* at 2637.

¹⁶⁹ *Hamdi I*, 316 F.3d at 463.

¹⁷⁰ *Id.* at 473–74.

¹⁷¹ *Id.* at 470 ("[L]itigation cannot be the driving force in effectuating and recording wartime detentions. The military has been charged . . . with winning a war, not prevailing in a possible court case.").

¹⁷² *Id.* at 474 ("Article III courts are ill-positioned to police the military's distinction between those in the arena of combat who should be detained and those who should not.").

¹⁷³ *Hamdi II*, 124 S. Ct. at 2648, 2649 ("[A] citizen-detainee seeking to challenge his classification as an enemy combatant must receive notice of the factual basis for his classification, and a fair opportunity to rebut the Government's factual assertions before a neutral decisionmaker.").

¹⁷⁴ *Id.* at 2651.

lenging the government's accusation of disloyalty.¹⁷⁵ It refused to defer to the government's evidence without reviewing its reasonableness.¹⁷⁶

Although the Court required the government to provide evidence to support citizen detentions, it also gave the government significant power to prosecute the war by lowering evidentiary standards.¹⁷⁷ The Court observed that a citizen's due process rights must be weighed against the government's interests in protecting national security secrets and preventing prisoners from returning to the battlefield.¹⁷⁸ The Court ruled that lowered evidentiary requirements in court proceedings are constitutional:

Hearsay, for example, may need to be accepted as the most reliable available evidence from the Government in such a proceeding. Likewise, the Constitution would not be offended by a presumption in favor of the Government's evidence, so long as that presumption remained a rebuttable one and fair opportunity for rebuttal were provided.¹⁷⁹

Furthermore, a prisoner can be tried by a military tribunal, as long as proper due process protections are implemented.¹⁸⁰ The Court also trusted lower federal courts to balance citizens' constitutional rights with the military's need to protect national security secrets.¹⁸¹ Despite its presumption in favor of the government's evidence, the Court protected the foundation of due process: a person's right to be heard by a neutral decision-maker and to rebut allegations made against him.¹⁸²

As the Court explained in *Hamdi*, a federal district court can implement procedures that protect both constitutional rights and

¹⁷⁵ *Id.* at 2649. "It is equally fundamental that the right to notice and an opportunity to be heard 'must be granted at a meaningful time and in a meaningful manner.' These essential constitutional promises may not be eroded." *Id.* (quoting *Fuentes v. Shevin*, 407 U.S. 67 (1972)).

¹⁷⁶ *Hamdi II*, 124 S. Ct. at 2650 ("[W]e necessarily reject the Government's assertion that separation of powers principles mandate a heavily circumscribed role for the courts in such circumstances.").

¹⁷⁷ *Id.* at 2649.

¹⁷⁸ *Id.* at 2647 ("We reaffirm today . . . a citizen's right to be free from involuntary confinement . . . and we weigh the opposing governmental interests . . . in ensuring that those who have in fact fought with the enemy during a war do not return to battle against the United States.").

¹⁷⁹ *Id.* at 2649.

¹⁸⁰ *Id.* at 2651.

¹⁸¹ *Id.* at 2652 ("We have no reason to doubt that courts faced with these sensitive matters will pay proper heed both to the matters of national security that might arise in an individual case and to the constitutional limitations safeguarding essential liberties that remain vibrant even in times of security concerns.").

¹⁸² *Id.* at 2648. *See also Mathews v. Eldridge*, 424 U.S. 319, 333 (1976) ("The fundamental requirement of due process is the opportunity to be heard 'at a meaningful time and in a meaningful manner.'").

national security secrets.¹⁸³ The Court reasoned that “arguments that military officers ought not have to wage war under the threat of litigation lose much of their steam when factual disputes at enemy-combatant hearings are limited to the alleged combatant’s acts.”¹⁸⁴

As Professor John Yoo has observed, like surveillance courts, federal courts can modify judicial procedures to accommodate national security concerns.¹⁸⁵ In 1978, Congress enacted the Foreign Intelligence Surveillance Act (FISA), which established Foreign Intelligence Surveillance Courts (FISC) composed of federal district court judges who can issue search warrants upon probable cause that the government is targeting a foreign power.¹⁸⁶ Yoo explains that “FISA proceedings are held *ex parte*, with only the government represented, in a closed hearing so that classified information can be discussed with the judges while protecting intelligence sources and methods.”¹⁸⁷ Like FISA proceedings, federal habeas courts can ensure that citizens’ due process rights are protected by a neutral decision-maker while also protecting national security secrets during wartime.¹⁸⁸

C. The Court’s Respect for the President’s Power

Although the Supreme Court protected constitutional rights in *Hamdi v. Rumsfeld*, it also recognized the President’s power to defend national security.¹⁸⁹ The Court reaffirmed the holding in *Ex parte Quirin*, which allows the President to detain enemy combatants during a war, even if the enemy combatant is an American citizen.¹⁹⁰ In *Ex parte Quirin*, decided by the Court in 1942 during World War II, eight Germans used submarines to reach the United States.¹⁹¹ They carried explosives and planned to destroy war facilities in the U.S. for the German government.¹⁹² After they were captured, President Roosevelt signed a

¹⁸³ *Hamdi II*, 124 S. Ct. at 2652 (“We have no reason to doubt that courts faced with these sensitive matters will pay proper heed both to the matters of national security that might arise in an individual case and to the constitutional limitations safeguarding essential liberties that remain vibrant even in times of security concerns.”).

¹⁸⁴ *Id.* at 2649.

¹⁸⁵ Yoo, *supra* note 52, at 442.

¹⁸⁶ *Id.*

¹⁸⁷ *Id.*

¹⁸⁸ *Hamdi II*, 124 S. Ct. at 2652.

¹⁸⁹ *Id.* at 2647 (“[O]ur Constitution recognizes that core strategic matters of warmaking belong in the hands of those who are best positioned and most politically accountable for making them.”).

¹⁹⁰ 317 U.S. 1, 37 (1942) (“Citizenship in the United States of an enemy belligerent does not relieve him from the consequences of a belligerency which is unlawful because in violation of the law of war.”).

¹⁹¹ *Id.* at 21.

¹⁹² *Id.*

proclamation declaring that anybody attempting to enter the United States to commit war acts would be “subject to the law of war and to the jurisdiction of military tribunals.”¹⁹³ The captured individuals, one of whom claimed to be an American citizen, challenged the President’s authority to establish military tribunals and argued that they had to be tried in civil courts by juries.¹⁹⁴

The Court in *Quirin* distinguished between lawful combatants and unlawful combatants under the law of war.¹⁹⁵ The main distinction between a lawful combatant and an unlawful combatant is that the latter does not wear a uniform.¹⁹⁶ Spies and terrorists are commonly classified as unlawful combatants, i.e., “those who during time of war pass surreptitiously from enemy territory into our own, discarding their uniforms upon entry, for the commission of hostile acts involving destruction of life or property.”¹⁹⁷

The Court ruled that captured individuals who do not wear a uniform while aiding enemy forces are subject to military tribunals, not civil courts.¹⁹⁸ Furthermore, the Court declared that the citizenship of one of the prisoners did not entitle him to a civil trial by jury.¹⁹⁹ It observed, “Citizenship in the United States of an enemy belligerent does not relieve him from the consequences of a belligerency which is unlawful because in violation of the law of war.”²⁰⁰ The Court ruled that the President’s power to detain enemy combatants so that they do not return to the battlefield is an essential war power.²⁰¹

The Court’s opinion in *Quirin* modified but did not overturn the ruling in *Ex parte Milligan* that “[m]artial rule can never exist where the courts are open, and in the proper and unobstructed exercise of their jurisdiction.”²⁰² In *Hamdi*, the Court distinguished *Quirin* from *Milligan* by observing that in the latter case, the Court reasoned that Milligan was arrested at home as a resident of Indiana, not as a prisoner of war:

¹⁹³ *Id.* at 22–23 (quoting Proclamation No. 2561, 7 Fed. Reg. 5101 (July 7, 1942)).

¹⁹⁴ *Id.* at 24.

¹⁹⁵ *Id.* at 30–31.

¹⁹⁶ *Id.* at 31.

¹⁹⁷ *Id.* at 35.

¹⁹⁸ *Id.* at 31.

¹⁹⁹ *Id.* at 31, 37.

²⁰⁰ *Id.* at 37.

²⁰¹ *Id.* at 28–29 (“An important incident to the conduct of war is the adoption of measures by the military command not only to repel and defeat the enemy, but to seize and subject to disciplinary measures those enemies who in their attempt to thwart or impede our military effort have violated the law of war.”).

²⁰² See *Ex parte Milligan*, 71 U.S. 2, 127 (1866).

Had Milligan been captured while he was assisting Confederate soldiers by carrying a rifle against Union troops on a Confederate battlefield, the holding of the Court might well have been different. The Court's repeated explanations that Milligan was not a prisoner of war suggest that had these different circumstances been present he could have been detained under military authority for the duration of the conflict, whether or not he was a citizen.²⁰³

The Court in *Hamdi* showed that judicial review and military operations can function together.²⁰⁴ Once a captured prisoner is found to be an American citizen, he must be provided with the due process rights detailed in *Hamdi* before a neutral decision-maker.²⁰⁵ However, if the tribunal confirms that the citizen is indeed an enemy combatant, he may be detained for the duration of the war.²⁰⁶ The Court in *Hamdi* provided strong protection both for constitutional rights and for national security, proving that they are not mutually exclusive objectives.²⁰⁷

CONCLUSION

As evidenced by the World War II cases of *Korematsu v. United States*²⁰⁸ and *Hirabayashi v. United States*,²⁰⁹ the Supreme Court has historically refrained from challenging the President's wartime actions.²¹⁰ Using the deferential balancing model, the Court in *Korematsu* deferred to the President's constitutional interpretation to allow presidential actions that it would normally find unconstitutional.²¹¹ Similarly, in *Hirabayashi*, the

²⁰³ *Hamdi v. Rumsfeld*, 124 S. Ct. 2633, 2642 (2004).

²⁰⁴ *Id.* at 2649–50.

²⁰⁵ *Id.* at 2648.

²⁰⁶ *Id.* at 2641, 2642.

²⁰⁷ *Id.* at 2647 (“We reaffirm today the fundamental nature of a citizen’s right to be free from involuntary confinement by his own government without due process of law, and we weigh the opposing governmental interests against the curtailment of liberty that such confinement entails.”).

²⁰⁸ 323 U.S. 214 (1944).

²⁰⁹ 320 U.S. 81 (1943).

²¹⁰ *Korematsu*, 323 U.S. at 218 (“[W]e cannot reject as unfounded the judgment of the military authorities and of Congress that there were disloyal members of that population, whose number and strength could not be precisely and quickly ascertained.”).

Where, as they did here, the conditions call for the exercise of judgment and discretion and for the choice of means by those branches of the Government on which the Constitution has placed the responsibility of war-making, it is not for any court to sit in review of the wisdom of their action or substitute its judgment for theirs.

Hirabayashi, 320 U.S. at 93.

²¹¹ *Korematsu*, 323 U.S. at 219–20.

Compulsory exclusion of large groups of citizens from their homes, except under circumstances of direst emergency and peril, is inconsistent with our basic governmental institutions. But when under conditions of modern warfare our

Court did not challenge the internment order against Japanese-Americans.²¹² Instead, the Court used the justiciability doctrines model to avoid hearing the merits of the internment order entirely.²¹³

The Supreme Court should reject both the deferential balancing model and the justiciability doctrines model because they are inconsistent with the Founding Fathers' belief in constitutional absolutism.²¹⁴ The Founders felt that the President and Congress could not alter the Constitution's provisions even during wartime.²¹⁵ They expected the Supreme Court to recognize its constitutionally-mandated duty to protect citizens' constitutional rights from oppressive governmental actions.²¹⁶ Although the constitutional absolutism model is most consistent with the Founders' wishes, the Court has applied the model in ways contrary to their beliefs by overly restricting presidential power during wartime,²¹⁷ instead of ensuring that the President had sufficient power to defend the country against foreign attacks.²¹⁸

The balancing test with bite model advocated in this comment is most consistent with the Founding Fathers' views because it provides all three branches with important wartime roles.²¹⁹ In applying the balancing test with bite model, the

shores are threatened by hostile forces, the power to protect must be commensurate with the threatened danger.

Id.

²¹² *Hirabayashi*, 320 U.S. at 85.

Since the sentences of three months each imposed by the district court on the two counts were ordered to run concurrently, it will be unnecessary to consider questions raised with respect to the first count [for violating the internment order] if we find that the conviction on the second count, for violation of the curfew order, must be sustained.

Id.

²¹³ *Id.*

²¹⁴ THE FEDERALIST NO. 78 (Alexander Hamilton), *supra* note 18, at 470 ("Until the people have, by some solemn and authoritative act, annulled or changed the established form, it is binding upon themselves collectively, as well as individually; and no presumption, or even knowledge of their sentiments, can warrant their representatives in a departure from it prior to such an act.").

²¹⁵ *Id.* at 469.

[Y]et it is not to be inferred . . . that the representatives of the people, whenever a momentary inclination happens to lay hold of a majority of their constituents incompatible with the provisions in the existing Constitution would, on that account, be justifiable in a violation of those provisions . . .

Id.

²¹⁶ *Id.* at 469 ("[T]he courts of justice are to be considered as the bulwarks of a limited Constitution against legislative encroachments . . .").

²¹⁷ See, e.g., *Ex parte Merryman*, 17 F. Cas. 144, 151 (1861).

²¹⁸ THE FEDERALIST NO. 70 (Alexander Hamilton), *supra* note 18, at 423 ("Energy in the executive is a leading character in the definition of good government. It is essential to the protection of the community against foreign attacks . . .").

²¹⁹ *Hamdi v. Rumsfeld*, 542 U.S. 507, 536 (2004) ("Whatever power the United States Constitution envisions for the Executive in its exchanges with other nations or with en-

Court in *Hamdi v. Rumsfeld* recognized its duty to determine whether the President's actions are constitutional.²²⁰ The Court also required the President to provide concrete evidence to support a citizen's detention,²²¹ but lowered the military's evidentiary standard during wartime.²²² Finally, the Court granted the President extensive wartime power by reaffirming the holding in *Ex parte Quirin*, which allows the President to detain even American citizens designated as enemy combatants.²²³

The Court in *Hamdi* showed that courts can have vigorous roles in protecting citizens' rights during wartime.²²⁴ It seems that the Court learned from the World War II cases that failing to review presidential wartime actions can lead to tragic abuses of citizens' constitutional rights.²²⁵ During wars, the Court must delicately balance the competing interests of protecting constitutional rights and allowing the President sufficient power to protect national security.²²⁶ However, it is essential to the system of

emy organizations in times of conflict, it most assuredly envisions a role for all three branches when individual liberties are at stake.”).

²²⁰ *Id.* (“We have long since made clear that a state of war is not a blank check for the President when it comes to the rights of the Nation’s citizens.”).

²²¹ *See id.* at 537 (“Any process in which the Executive’s factual assertions go wholly unchallenged or are simply presumed correct without any opportunity for the alleged combatant to demonstrate otherwise falls constitutionally short.”).

²²² *Id.* at 533 (“[E]nemy-combatant proceedings may be tailored to alleviate their uncommon potential to burden the Executive at a time of ongoing military conflict.”).

²²³ *Ex parte Quirin*, 317 U.S. 1, 37 (1942) (“Citizenship in the United States of an enemy belligerent does not relieve him from the consequences of a belligerency which is unlawful because in violation of the law of war.”).

²²⁴ *Hamdi*, 542 U.S. at 535 (“[I]t does not infringe on the core role of the military for the courts to exercise their own time-honored and constitutionally mandated roles of reviewing and resolving claims like those presented here.”).

²²⁵ The Court cites Justice Murphy’s dissenting opinion in *Korematsu v. United States*, where he argued that the Court should examine the reasonableness of military policies that impact citizens’ constitutional rights. *Id.* *See also* Mark Tushnet, *Defending Korematsu?: Reflections on Civil Liberties in Wartime*, 2003 WIS. L. REV. 273 (2003). Tushnet argues that courts, along with the rest of society, undergo a process of social learning. Tushnet explains the process as follows:

The government takes some action that its officials—and, frequently, the courts—justify by invoking national security. In retrospect, once the wartime emergency has passed, the actions, and their endorsement by the courts, come to be seen as unjustified in fact (that is, by the facts as they actually existed when the actions were taken). . . . The social learning is this: Knowing that government officials in the past have in fact exaggerated threats to national security or have taken actions that were ineffective with respect to the threats that actually were present, we have become increasingly skeptical about contemporary claims regarding those threats, with the effect that the scope of proposed government responses to threats has decreased.

Id. at 283–84.

²²⁶ *See, e.g., Hamdi*, 542 U.S. at 533.

[A] citizen-detainee seeking to challenge his classification as an enemy combatant must receive notice of the factual basis for his classification, and a fair opportunity to rebut the Government’s factual assertions before a neutral decisionmaker. . . . At the same time, the exigencies of the circumstances may

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checks and balances underlying the American government that the Court take a significant role in protecting citizens' rights.

demand that, aside from these core elements, enemy-combatant proceedings may be tailored to alleviate their uncommon potential to burden the Executive at a time of ongoing military conflict.

Id.